JERSEY COMPETITION REGULATORY AUTHORITY

POJ1395J - Ports of Jersey Long-Term Pricing Framework – Assumptions: Call for Information

Response from the States of Jersey

This paper sets out the response of the States of Jersey ("SoJ") to the Jersey Competition and Regulatory Authority call for information on the Ports of Jersey long-term pricing framework assumptions. SoJ is the sole shareholder of the Ports of Jersey ("PoJ") which was incorporated on 1st October 2015 through the Air and Sea Ports (Incorporation) (Jersey) Law 2015.

This was a law to establish Ports of Jersey Limited and to make provision about it; to make new provision relating to port operations and the management of passenger and freight services into and out of Jersey; to enable staff, assets and liabilities to be transferred to one or more companies; to enable the Jersey Competition Regulatory Authority to license any such companies, and to license the operation of lifeline services; to make further related and consequential provision about the operation and management of Jersey's airport and sea ports and harbours, and about air and maritime safety and security; and for connected purposes.

Question 1

The relevant legislation governing PoJ is the Air and Sea Ports (Incorporation) (Jersey) Law 2015 and the Air and Sea Ports Incorporation (Transfer) (Jersey) Regulations 2015.

The States Assembly debated the Incorporation of Ports of Jersey as P.70/2012 which included a financial model based on a number of assumptions and indications of financial performance. These would be the most appropriate starting point for the assumptions to be used although we would expect Po Jot have taken account of changes in external factors in the 3 years since this legislation was passed.

Question 2

In their Annual Report (October 2018) the Fiscal Policy Panel confirm that "trend" inflation will be 3.3% and as such we believe that 3% is an appropriate assumption for the PoJ model.

Question 3

The latest CAA forecast for aviation demand at UK airports was published at the end of last year (2017). Looking at their long-term forecast under the 'capacity constrained' scenario – which is the most appropriate as assuming a third runway at London Heathrow anytime soon is highly optimistic, they estimate that passenger demand will grow at an annual rate of between 1.2% and 1.5% between 2016 and 2050. Therefore a central forecast of 1.35% pa is actually significantly higher than the 0.8% projection by PoJ and their facilities are not currently capacity constrained.

However, given the recent declines in sea passenger volumes (-14.6% between 2015 and 2017) a flat growth assumption appears to be (overly) optimistic.

Question 4

In the most recent update to the Strategic Business Plan 2018-2022 (as presented to the shareholder in December 2017) the total sums allocated for infrastructure investment between the airport and the harbours are £40million and £20million respectively.

Within these amounts specific reference is made to a phase 1 investment of £24.5million as part of the Airport Masterplan with completion in 2022. As at the time of writing the Harbour Masterplan along with the anticipated level of capital investment has not been formally presented to the Shareholder.

Question 5

Prior to the incorporation of PoJ a report was commissioned from Capita Symonds requesting validation of the Jersey Airport and Harbours proposed capital investment plan for the period 2014-38. The report concluded that the combined capital programme costs were £276 million versus the Airport and Harbours projection of £272 million.

It would therefore seem reasonable to conclude that £276 million (uninflated) is the most appropriate figure, although we note that some adjustments have been made for the current position.

However, we note that only £124 million of the capital investment takes place over the period of the requested price control (10 years) and it may, therefore, be more useful to ensure that all assumptions that are presented cover the same period.

Question 6

The Commercial Project Pipeline – 2018 contained within the Strategic Business Plan update as presented to the shareholder indicates annual revenues of £2.6m on completed commercial projects and £12.8m for projects which are being developed or are 'live', however it is unclear over what timeframe these revenues relate and SoJ is not sighted beyond 2022 in relation to projected revenues or cash flows.

Question 7

We have no comment to make on this question.

Question 8

We have no comment to make on this question.

Question 9

We have no comment to make on this question.

Question 10

We feel it would be useful if the OPEX efficiency target of 0.2% was compared with best practice in other jurisdictions to demonstrate if it is an appropriate figure.

Question 11

Asset valuation for the purposes of determining regulated prices needs to be based on a number of other factors and not just the relevant financial accounting standards. For example, funding requirements, affordability and historic policy. It would not be appropriate to make a decision based purely on the relevant accounting standards as this may affect the incentives introduced by the regulatory regime.

Question 12

The Public Service Obligations (PSO) of PoJ are defined within the Air and Sea Ports (Incorporation) (Jersey) Law 2015 and any change to these would require a decision of the States Assembly. For the purposes of this response it is unlikely that these PSO will change in the medium term.

We would expect the cost of providing these PSO to be reviewed on a regular basis by PoJ in order to identify any efficiency savings that can be achieved through, for example, improvements in technology. Similarly, we would expect PoJ to take all reasonable measures to ensure the consistency of revenue from the Channel Islands Control Area, e.g. through hedging the foreign risk.

We also feel that PoJ should make it clear whether the provision of these PSO are subject to the same efficiency savings target as detailed in Question 10. In addition it would be helpful to understand the annual amounts PoJ are attributing to the key island events referred to in their submission: the Boat Show and Air Display.

Question 13

Given the public ownership model of PoJ, SoJ would expect the company to participate in activities which provide social and/or environmental and/or economic benefits to the Island. However, the specific level of support is not defined by the shareholder, we would normally expect this to be reflected in Key Performance Indicators that are set for the Executive by the Board.

It is acknowledged that some community investment is already provided by PoJ through the maintenance of Jersey's historic harbours as defined in Article 2 of the Air and Sea Ports (Incorporation)(Jersey) Law 2015.

Question 14

The financial model contained within the Incorporation of Ports of Jersey (P.70/2012) assumed dividends of 12.5% of Profit before Tax being paid following incorporation, although "a dividend policy was to be formally agreed with the shareholder in due course". There will be an expectation for a dividend to be paid from a future date and the dividend is likely to be calculated as a percentage of Profit before Tax.

Question 15

We would expect the Board of PoJ to determine the most appropriate methods of funding capital investments but SoJ considers a combination of cash reserves and borrowing as the most relevant current sources of finance. Whilst PoJ infer that lenders will take some comfort from SoJ being the sole shareholder, SOJ is unlikely to want to provide a formal guarantee for any borrowing undertaken by PoJ.

Question 16

We have no comment to make on this question.

Question 17

We have no comment to make on this question.

Question 18

The incorporation of PoJ provides the mechanism to ensure sustainable services to the Island and creates the ability to plan expenditure on capital and infrastructure over the long term, together with considering carefully the appropriate sources of funding for major projects. In order for the long-term sustainability of the businesses to be achieved, there needs to be adequate income generated from PoJ operations to support continued investment.

The States of Jersey acknowledges that the capital investment programme is defined over a 25 year period but accepts that setting a price mechanism for this length of time is neither desirable nor feasible. Given the long-term business planning required the States accepts that a 10-year pricing mechanism is appropriate, although SoJ acknowledges that in many UK regulated sectors a 5-year price control (without reviews) is the standard term.

If a 10-year price control is agreed it should include the ability to undertake regular reviews during that 10-year period. It would be useful for PoJ to elaborate on the circumstances under which they would expect such reviews to take place and the regularity of these reviews.

Question 19

We have no comment to make on this question at this stage.

Question 20

We have no further comments to make at this stage.