Treasury and Exchequer Ministerial Decision Report

Government of JERSEY

BUSINESS DISRUPTION LOAN GUARANTEE SCHEME - EXTENSION

1. Purpose of Report

The Business Disruption Loan Guarantee Scheme provides banks with government backed guarantees to ensure that they can lend to businesses which they consider to be viable, but cannot lend to in accordance with their usual commercial terms. This in turn creates £50 million of new lending capacity in the Jersey economy, ensuring that credit is available to businesses which could not otherwise have obtained bank lending.

This report outlines the current status of the scheme, and proposes the extension of the Business Disruption Loan Guarantee Scheme until 31 December 2020.

2. Background

Legal position:

P.28/2020 Draft Public Finances (Amendment of Law) (Jersey) Regulations 202-, approved by the States Assembly on 24th March 2020, agreed a number of temporary modifications to the Public Finances (Jersey) Law 2019. The added modifications included an increase to the limit on guarantees and indemnities that the Minister may provide in a financial year from £3 million to £100 million and the limit on the total outstanding guarantees from £20 million to £100 million.

The amendment to P.28/2020, brought by the Corporate Services Scrutiny Panel and adopted by the Assembly, clarified that:

- the amended powers expire on 30th September 2020; and
- where the Minister has obtained financing, lent money or provided guarantees or indemnities under Articles 26 to 28 while Article 24(8) applied, the financing, lending or provision of guarantees or indemnities remain valid and are not included in any monetary limits set out in Articles 26 to 28 as those Articles apply after the expiry of the modifications.

This in effect increased the limit on guarantees and indemnities that the Minister may provide in a financial year from £3 million to £100 million, and the limit on the total outstanding guarantees from £20 million to £100 million.

The Minister brought these amended powers into effect through MD-TR-2020-0029 by deciding that she considered there exists an immediate threat to the health or safety of any of the inhabitants of Jersey and to the stability of the economy in Jersey.

MD-TR-2020-0030 established the Business Disruption Loan Guarantee Scheme and delegated management to the Treasurer. As part of this, the Minister approved “associated guarantees to Jersey banks of up to £40 million”.[1]

[1] MD-TR-2020-0054 expanded the scheme to make it available to all Jersey businesses, regardless of turnover and the sector in which they operate.

Following this decision, Government allocated blocks of the guarantee to each bank, defined in the contract as the “Guarantee Portfolio Cap”. For four banks this was £5m, representing £4m of guarantees, and for one bank £0 was allocated, it being agreed that loans would be agreed bilaterally.

The contract expires at 30 September 2020, in line with the amendment to P.28/2020. Accordingly, in the absence of any further decision, the scheme will expire at that date.

Performance of the scheme:

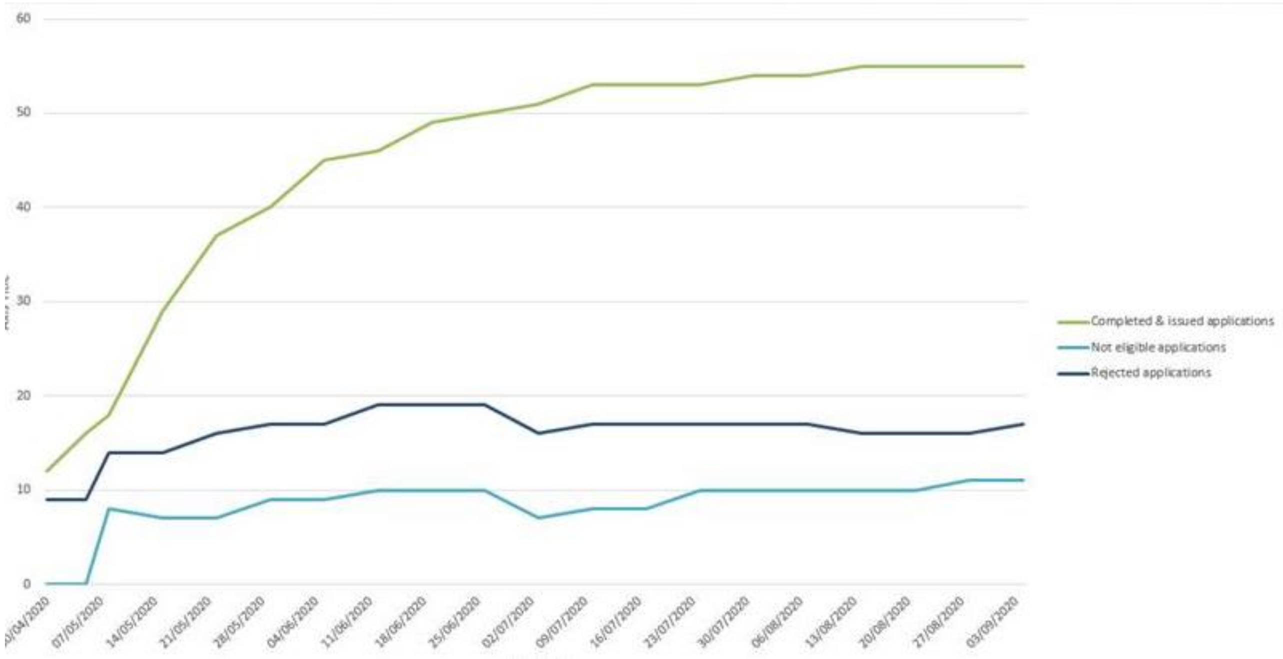
When the scheme was introduced there was concern that bank credit risk appetites could contract sharply, as happened during the 2008 financial crisis. This could have resulted in businesses struggling to borrow when credit was most needed to bridge a period of reduced income due to being unable, or severely restricted in their ability, to operate due to public health measures. Whilst this risk has crystallised to a limited degree, bank credit has remained robust, and the appetite for borrowing has been more limited than the maximum exposure cap under the scheme had provided for.

When established it was also unclear how much demand there would be for the scheme given the unprecedented economic shock and impact of public health measures associated with Covid 19. Banks are only able to use the scheme when they cannot lead on usual commercial terms, so the usage of the scheme is dependent on banks’ credit risk appetites, and demand for borrowing.

At 30 August 2020, 55 loans had been approved under the scheme, amounting to £3,158,704. Whilst much lower than the £50m initially approved, there has been limited feedback from the businesses and banking community that the scheme has deficiencies. As the availability of bank credit to businesses has not materially contracted, the scheme has acted as an extension to this, allowing viable local businesses to obtain funding even when they do not fit in to the particular credit risk appetite of local banks. This outcome is in line with the scheme’s objectives.

Only 16 businesses have been rejected under the scheme, the vast majority having applied in the first month of the scheme. This is in line with expectations, and it accords that those who sought to borrow immediately as the crisis hit were less likely to be considered as viable in the long term (and so not eligible for the scheme) given the implied lack of reserves and shareholder support that immediate borrowing suggests. This, as well as the reduced rate of lending under the scheme after May, is illustrated below[2]:

[2] The reduction in not eligible and rejected applications (e.g. 2 July) is due to Government clarifying definitions, leading to banks resubmitting reports.



In addition, even since the expansion of the scheme in May 2020, the vast majority of applicants and approved loans have been within sectors of the economy which were originally included, having been modelled as those sectors most likely to be affected by Covid 19 disruption.

Whilst an audit of banks' compliance with the scheme has not been initiated given the relatively low allocation of the guarantee which has been assigned, feedback received has been positive, and implies that banks are complying with the spirit of the scheme. This is based on feedback from the business community and government monitoring of the scheme through discussions with banks and statistical lending and exposure reports submitted by banks. Whilst the maximum interest rate of a loan under the scheme is 450 basis points above the UK base rate, which for the life of the scheme has been 0.1%, the mean interest rate applied has been less than 4%. The primary negative feedback from the business community has been that the scheme is not notably different to bank's normal lending processes, but this is a proactive decision and contractual obligation on banks, ensuring that banks' credit expertise it utilised and taxpayer money is only directed to viable businesses.

Economic outlook:

In August 2020 the Fiscal Policy Panel updated their economic assumptions[3], including:

- employment to fall by around 1.6 per cent this year, on an annual average basis; and
- Profits in the non-finance sectors are forecast to see considerable falls this year with firms unable to recover revenues lost during the period of restrictions, but without being able to reduce their costs to the same extent. Profitability is expected to recover slowly as demand remains weak.

Options for extension of the scheme:

Having not seen a substantial contraction in bank credit appetites it is pertinent to assess the continued relevance of the scheme objectives. The scheme appears to be functioning smoothly, and there is limited feedback from businesses and banks that the contract, and by extension scheme terms, require material amendment. It is however important that public money is not used

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3 https://www.gov.je/SiteCollectionDocuments/Government%20and%20administration/ID%20Fiscal%20Policy%20Panel%20economic%20assumptions%20August%202020%2020200805%20CB.pdf

simply to allow banks to lend where the rigidity of the bank's lending policies would not normally allow it.

1. Do nothing

It would not be unreasonable to suggest that the scheme has run its life. There is very limited appetite for new borrowing under the scheme, and it has provided credit to those 55 businesses who have borrowed. The mean loan size is around £57,000, which is well within the limits the scheme allows.

This option allows the expiry of the scheme and no renewal. It could assume that disruption is over, or more convincingly that the borrowing appetite in the economy is sufficiently catered for by commercial options, i.e. the lending market is performing well. Whilst the limited uptake of the scheme suggests that this has some weight, it must however be considered that:

- The Fiscal Policy Panel forecasts a deterioration in economic conditions, and worsening conditions for business;
- The hospitality sector and visitor economy, which is a primary beneficiary of the scheme, is less profitable during winter months, which may intensify the need for borrowing (noting that additional grant schemes for this sector are being considered);
- Worsening economic conditions in the UK may lead to a contraction in banks' credit risk appetites;
- In recent months demand on the scheme has been very limited, and manageable within the States budget; and
- There is a risk of further government imposed restrictions on economic activity due to increases in Covid-19 prevalence, for example resulting from regional border restrictions being imposed, and increased rates of Covid-19 and associated lockdowns in Jersey's neighbour jurisdictions, in particular France and the UK.

It highly uncertain if the economic disruption the scheme intends to mitigate is over, and that the need for an extension of credit in the economy has ceased. Accordingly, this option could risk the scheme expiring only to be needed again in the future, which may take substantial time to renegotiate with banks in the absence of the time pressures under which the original contract was negotiated.

2. Extend the scheme until the end of 2020

Noting the uncertainty regarding the necessity of the scheme given the feedback that borrowing appetite in the economy can be met through commercial lending, it may not be appropriate to extend the scheme for a substantial period of time. It may however be considered appropriate to extend for an additional 3 months, and take stock of the scheme at that point in time.

Such an approach would allow more considered assessment of the prevailing economic conditions during the winter period when the sectors of the economy most benefitting from the scheme may suffer a deterioration in reserves. This is relevant given the seasonality of many sectors which have benefited from the scheme, and the risk or further economic restrictions based on public health advice during winter months.

Dependent on the prevailing conditions during the winter months of 2020 and economic advice, the scheme could be adjusted to a different scheme to provide credit into the local economy. A scheme partnering with banks would continue to utilise banks' expertise, controls, risk management and regulation, rather than the government acting as lender and building a lending book from scratch.

Such schemes are not currently envisaged. However, the need for further credit reaching small businesses cannot be discounted given the significant economic disruption forecast. Whilst the Business Disruption Loan Guarantee Scheme contract was negotiated with banks in less than 3 weeks, it is very unlikely that this could be replicated in such a timeframe during less pressurised conditions, even drawing on the recent experience of the scheme.

Further, the limited uptake of the scheme considered against the amount allocated suggests it is unlikely that significant further drawdown would emerge between 30 September and 31 December 2020. This can be controlled by limiting the Guarantee Portfolio Cap allocated to each bank. More immediately the scheme continues to meet the objective of extending credit into the Jersey economy, and provide credit to viable businesses who otherwise would not be able to borrow.

This option would however require an extension of the contract with banks, and a new Guarantee Portfolio Cap. Further, the legal opinion provided to banks outlining the legal basis of the scheme relies on the emergency measures provided through the amendments to the Public Finances (Jersey) Law 2019. As these amendments would not apply at 1 October 2020, banks may request further assurance of the legal validity of the guarantee, which would not be based on emergency powers.

In the absence of the States Assembly approving further guarantees the scheme would need to rely on the Minister's powers to approve up to £3m of guarantees under normal powers. This would constitute £3.75m of new lending, as the scheme only guarantees 80% of the loan (£3m being 80% of £3.75m). This is likely to be sufficient, and can be controlled by the allocation of the Guarantee Portfolio Cap, subject to banks' agreement. Should demand for the scheme exceed the £3m limit a proposition would be required to extend the Minister's powers, should the Minister wish to do so.

3. Recommendation

Given the limited exposure under the scheme, feedback suggesting that it has worked well, and its continuing ability to ensure that credit can reach businesses who have been adversely impacted by Covid 19 related disruption, it is proposed to extend the scheme to the end of 2020. This relies on the Minister's ability to issue up to £3 million of guarantees, so would reduce the original £50 million which was intended to be available under the scheme.

The considerations are outlined in the body of the paper. This approach:

- Ensures that additional credit is available to those businesses which are considered viable but cannot be lent to on bank commercial terms;
- Limits the exposure under the scheme to a further £3 million, constituting £3.75 million of new lending;
- Allows a further extension of the scheme to consider any prevailing public health restrictions as we enter the winter period;
- Allows further consideration of the prevailing economic conditions, noting the Fiscal Policy Panel's advice that the economic outlook may deteriorate; and
- Allows further consideration of whether the scheme can be adjusted to assist in Jersey's economic recovery.

This would be subject to review in November 2020.

4. Reason for Decision

The extension allows the scheme to be used until the end of 2020, allowing businesses to borrow from banks participating in the scheme for an additional 3 months.

Article 28 of the Public Finances (Jersey) Law 2019 provides that:

28 Guarantees and indemnities

(1) The Minister may, in the name of the States, provide guarantees or indemnities.

(2) The total amount of all guarantees and indemnities under paragraph (1) that may be provided during a financial year must not exceed £3 million.

(3) The total outstanding amount of all guarantees and indemnities under paragraph (1) at any given time must not exceed £20 million.

The maximum value of guarantees that can be given by the Minister to the end of 2020 is therefore £3 million. No other guarantees have been given under Article 28(1) in 2020. The total amount outstanding under Article 28(3) is less than £17 million.

5. Resource Implications

The approach does not allocate further funding to the scheme, but relies on the Minister's ability to issue guarantees under the Public Finances (Jersey) Law 2019 without the emergency powers introduced by p.28/2020. Accordingly, the extension of the scheme in this manner restricts the ability of the Minister to issue guarantees for separate purposes.

Government employees have been engaged in monitoring the scheme since its launch at the beginning of April 2020. This will continue regardless of whether the scheme is extended due to the need to monitor existing exposures, so the staffing impact is negligible. Law Officer time is required to draft an amendment to the agreement with banks, which is expected to be limited and manageable within normal business resource.

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