REPLY BY THE PRESIDENT OF THE STATES' TRADING SUPERVISORY BOARD TO QUESTIONS ASKED PURSUANT TO RULE 14 OF THE RULES OF PROCEDURE BY DEPUTY N. R. INDER

The cost for a Future Guernsey Dairy Project as per the Policy Letter of June 2020 was in the order of £25m and no site had been formally identified. In June 2020, the States of Guernsey voted to progress the Future Guernsey Dairy Project. In 2022, the Future Guernsey Dairy Project was held 'in abeyance' as part of the Government Work Plan.

Question 1

The original Policy Letter described the 'Preferred way forward' as a new dairy on a 'new site'.

(a) *Is this still the Board's preferred option?*

(b) *What States of Guernsey land has been identified for a 'new site'*

(c) *What was the selection criteria for a new site?*

(d) *Can the Board confirm whether Best's Brickfield is the preferred and/or identified site?*

Answer

As outlined in the 2020 policy letter, following its inclusion in the previous Capital Portfolio programme, the current phase of the Future Guernsey Dairy Project ("the Project") has involved working towards the development of the Outline Business Case (OBC). That has included reassessment of the options identified in the original Strategic Outline Case, which identified a new dairy on a new site as the preferred way forward. That conclusion was supported by the regulator, the Office of Environmental Health & Pollution Regulation, which noted: "a long-term solution is required to address the disrepair and extensive ongoing maintenance within the Dairy…. carrying out extensive improvement to the current facility while remaining operational is likely to be extremely challenging in terms of hygienic food production."

The further detail evaluation of options has concluded that a new dairy on a new site remains the optimum solution. Whilst a substantial refurbishment of the existing Dairy may be technically feasible, it would not realise the same production efficiency savings as a new build, and estimated capital costs are greater, due the increased complexity and continuity and safety risks associated with continued production on-site throughout the duration of the works.

The site selection process identified 16 potential sites, of which 10 are States-owned. These were:

- Pitronnerie Road Key Industrial Expansion Area (KIEA)
- Longue Hougue KIEA
- Fontaine Vinery
- Bellegreve Vinery
- Griffiths Yard KIEA
- King Edward VII Hospital
- Home Farm (two sites)
- The existing Guernsey Dairy site
- Land adjacent to Brickfield House

The evaluation process assessed all 16 sites against the following criteria:-

- ownership (with States-owned land preferred)
- access to services (water, electricity, drainage)
- ease of development
- operational efficiency
- vehicle accessibility
- ease of delivery (i.e. current zoning/planning policy)
- environmental impact assessment requirements
- available land area.

The scoring was independently reviewed and validated by a leading local firm of architects, and found to be robust. The initial assessment resulted in a shortlist of six sites, and a financial appraisal of potential development costs was carried out for each site. Four were subsequently discounted as they were not in States ownership, which may impact on the likelihood and cost of delivery.

The remaining two sites are the Pitronnerie Road KIEA and Brickfield House, of which the latter is currently the preferred site.

Question 2

*The original Policy Letter had a figure of around **£22-£26m** for design, analysis, construction and fit out. There have been two substantial office developments recently, one at Admiral Park (hotel, offices, restaurant and carpark) one in St James Street (office space and underground car park); the former in the order of **£30-£35m** the latter between **£11-£13m**.*

(a) Would the Board agree that the figure of £22-£26m is somewhat out of kilter with private sector developments?

*(b) **June 2020 Policy Letter**: Please provide a broad breakdown of costs for the development of a new dairy from consultancy through to build and fit out? To include*

i. Land cost

ii. Consultancy

iii. Building Cost

iv. Dairy/Milk processing equipment costs

(c) April 2022: Has the current Board managed to improve on that figure? If so, please provide

i. Land cost

ii. Consultancy

iii. Building Cost

iv. Dairy/Milk processing equipment costs

Answer

The States' Trading Supervisory Board cannot comment on the accuracy or otherwise of the figures provided for the two recent commercial developments that you mention. They do however serve to illustrate the difficulty of attempting a like for like comparison on different construction projects, the cost of which will clearly depend on the nature of the project and the numerous factors that apply to each one individually.

The Admiral Park development (quoted £30-35 million) includes a 30,000 sq ft office block and a 100 bedroom hotel (estimated 40,000 sq ft), giving total space of 70,000+ sq ft, ignoring the inclusion of a restaurant and purpose built multi-storey parking. The St James Street building is much smaller, providing c18,000 sq ft of office accommodation. So on the most basic comparison one might expect it to cost around a quarter of the Admiral Park development (i.e. £7½-8¾ million), yet the figures provided suggest the actual cost was around 50% higher. That is ignoring the absence of a multi-storey car park and restaurant.

A dairy is a specialised food processing facility, requiring specialist production and control equipment, capable of maintaining a controlled environment requiring heat treatment, refrigeration, pressurised stainless steel pipework and vessels, residue treatment, and continual conformance with stringent hygiene requirements. While some construction elements might be similar, to compare it with an office development is oversimplistic, and the States' Trading Supervisory Board does not consider it a valid comparison.

The estimate of £22-26 million of capital funding requirement included in the 2020 policy letter was based on a number of assumptions, which is necessary at the early stage of a project. With regard to a broad breakdown of cost, the estimate provided in 2020 comprised approximately:

i. Land cost – 5%
ii. Consultancy/technical advice – 5%
iii. Building cost – 45%
iv. Dairy/milk production equipment – 30%
v. Risk contingency/Optimism bias – 15%

The subsequent analysis and design phase has enabled greater understanding of the requirements and more in-depth financial assessment. Broadly speaking, that general breakdown of overall project costs remains largely the same, with the most significant changes being a reduction in the estimated land costs (2%) and an increase in the anticipated requirement for additional project management, engineering and design costs. Together with the other 'consultancy/technical advice', that now accounts for around 10% of the overall pre-tender estimate.

The final cost will only be known once the preferred option is chosen (post-OBC), detailed design is completed, and the main tendering for the works has been completed, followed by value engineering. In line with other States' capital projects that may be subject to future procurement, we prefer not to publish estimates prior to competitive tendering. To do so is not in the financial interest of the States of Guernsey.

Nevertheless I can confirm that following the further analysis and design work the current estimated cost of the project has not at this point improved on the £22-26 million quoted in the 2020 policy letter. In part, this is a result of the greater level of definition around the project requirements, as it has progressed. However, as with other construction projects, the current estimates have also been impacted by significant inflation in the price of construction materials and equipment due to external factors, not least the effects of Brexit and Covid-19 and the subsequent disruption to supply chains and markets.

Question 3

The Future Dairy Project is 'in abeyance';

(a) Is it fair to assume that the Board has deployed options 3A/3B (do Minimum i/ii)?

(b) What have the plant replacement costs been since June 2020?

(c) *What does the current equipment replacement programme look like in terms of annual expenditure; figures from 2021 through to however long the ERP's life.*

Answer

While the business case for a long-term solution is being progressed, essential maintenance and equipment replacement continues to be carried out at the existing Dairy, to maintain production. However that is not the "Do minimum" Options 3A & 3B referred to in the 2020 Policy Letter, which would entail extensive refurbishment and redevelopment on the current site. As with the current preferred option (i.e. a new dairy on a new site), Options 3A & 3B would be subject to completion and approval of a Full Business Case (FBC) and inclusion within the States Capital Portfolio delivery category.

Between 1 June 2020 and 31 March 2022, £362k has been spent on capital items and a further £554k on repairs and maintenance. The latter was lower than anticipated due to the limited access to the facility because of Covid-19, and the resulting mandatory travel restrictions preventing UK specialists from carrying out work. It is anticipated that repair and maintenance costs will increase in 2022, with a budget allocation for this year of £450k, with annual spend at a similar level until a full refurbishment or new dairy is completed.

In terms of further replacement costs, it is a challenge to forecast the requirements long term as much of the existing equipment has reached the end of its expected useful service life. Estimates have however been made for 2022 and 2023 on a critical need basis. It is anticipated that around £470k will need to be spent this year on replacing dairy equipment, and a further £150k on buildings and general plant. Next year, we anticipate spending around £400k on equipment replacement and a further £333k on other critical systems replacement.

All planned spending is considered essential to meet legal and regulatory requirements[1]. The health, safety and welfare of staff and the operational efficacy of the Dairy are also critically important. All expenditure is reviewed in the context of the Project to ensure that any equipment purchased is suitable to be transferred to a new facility or incorporated into a refurbished facility.

Question 4

In the debate of June 2022, Members gave examples of how, once the Dairy had moved, the La Brigade site could be used for other PEH related facilities, medical or housing.

(a) *If the Dairy evacuated the La Brigade site, has the STSB identified the site for any other of its mandated uses?*

(b) *What is the land area size of the La Brigade site?*

(c) *If required by HSC would the Board resist any approaches to use the land for staff housing or other medical facilities?*

(d) *What conversations have been had with HSC, in this term, as to whether the re location of the Dairy would allow the site to be released for accommodation/medical facility use?*

Answer

The current site is approximately 4,590 sq metres, or 4½ vergees. The States' Trading Supervisory Board has not identified the site as needed for any other of its mandated activities, so will work with relevant States Committees and services to identify the best use for it. The Board has not had any discussion with other Committees in this regard.

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[1] The EC (Food and Feed Controls) (Guernsey) Ordinance, 2016 (as amended) and The EC (Food and Feed Controls) (Guernsey, Alderney and Sark) Regulations 2019

Question 5

(a) *What did the Board spend on external costs to get to the June 2020 Policy Letter*

(b) *What has the Board spent on the 'preferred way forward' since June 2020?*

In total, around £39k of external costs were incurred up to June 2020 (and £62k on internal staff costs). Since then, a further £377k has been spent in progressing the work towards the OBC, of which £252k was external cost and £125k internal staff costs.

Questions on the Milk Market

Question 6

Proposition 1 of the June 2020 Policy Letter was as follows:

> *"To reaffirm the States' policy on the dairy industry as set out in the resolutions of the 25th September, 2014 on Article IX of Billet d'État No. XX of 2014, to maintain a States owned Dairy and to confirm that the States remains of the opinion that the unique Guernsey breed of cow must be preserved and protected and that the local dairy farming industry is inextricably linked to sustaining Guernsey's rural environment and agricultural economy."*

(a) *Is the current Board still of the opinion that the States should remain 'owner' of a future Dairy?*

(b) *What is the direct link between the State ownership of the Dairy and the preservation and protection of the Guernsey breed?*

(c) *What is the 'inextricable' link between the dairy herd(s) and Guernsey's agricultural economy?*

(d) *Of the agricultural land in use in Guernsey, what percentage is set aside for Dairy herds?*

Answer

The States' Trading Supervisory Board (STSB) has operational responsibility for the Dairy, including ensuring it operates as efficiently as possible in the best long-term interests of islanders. However matters relating to agricultural policy sit within the mandate of the Committee *for the* Environment & Infrastructure. Therefore while the individual members of the Board may have a view on whether the States should remain owner of a future dairy, the Board itself does not.

However as the question states, in 2020 the States reaffirmed the current policy, previously endorsed in 2014 following a comprehensive review of the local dairy industry. That is the extant States policy, which is to maintain a States-owned dairy, therefore that is the policy that the Board will look to deliver.

"Continuing commitment to the Guernsey breed" and "an independent, but still States-owned, Dairy" were two elements of the overall policy framework set out in the 2014 review, and subsequently endorsed by the States. Other elements include "effective statutory control over the importation of milk", "support for farm business development", and "protection of agricultural land". Rather than there necessarily being a direct link between any two specific elements, the overall ten-point plan represented a comprehensive, coherent vision and policy for the local dairy industry. Nevertheless, maintaining States' control over the financial mechanism that funds the local dairy farming industry, through maintenance of a States-owned dairy, does afford the States a degree of direct control over land management, farming practices and animal welfare.

There is however an inextricable link between the local dairy industry and Guernsey's agricultural economy. Milk production remains the most important farm enterprise in Guernsey, with the sale of milk to the Dairy the major revenue stream for local dairy farmers.

The 2014 dairy industry review found that of the 15,250 vergees of agricultural land, more than 8,000 vergees were currently in use for dairy farming. However it worth noting that the 2014 reviews refers also to only around 10,000 vergees of land being "used each year in productive agriculture", suggesting that a much higher proportion of land 'in use' is dedicated to dairy farming.

The direct economic benefit to the island of this industry has been calculated (in 2020) to be around £2.4 million a year.

Question 7

From the June 2020 Policy Letter:

> *"The Guernsey dairy industry cannot be expected to compete with the economies of scale of the UK dairy farming industry.* ***However, the market cannot be expected to meet price rises beyond what is considered 'affordable' to consumers.*** *In the future, the whole dairy industry will need to continue to address the requirement to supply sufficient milk year round for islanders and to control the costs of producing milk. The financial model for the Guernsey Dairy going forwards, needs to ensure that both the retail price the consumer pays is affordable and that the dairy farming business remains financially sustainable. That also requires the States Guernsey Dairy and the dairy farming industry as a whole, to be as efficient as they can be. Whilst retailers set the retail price, this price is influenced by the Guernsey Dairy gate price and the milk distributors' charges."*

(a) What is the price point of a litre of milk where the Board considers the product unaffordable?

(b) How will the Board ensure that the price point isn't breached and will that include taxpayer subsidies to hold that price?

(c) In Policy terms or direction what has the Board done to ensure the industry is 'address the requirement to supply sufficient milk year round for islanders and to control the costs of producing milk'

Answer

The wider point that was being made in the extract of the 2020 policy letter was that the Dairy itself was unable to fund the capital investment required in a new or refurbished facility, which would effectively have to be recovered through the sale of liquid milk (and to a lesser extent other milk products). That is notwithstanding the efficiency savings that may be realised through a new or refurbished facility.

Logically there is a limit to how high the price of milk can rise and remain affordable, but the Board does not currently have a view on what specifically that level is. There has been some reduction in sales of liquid milk in recent years, coinciding with price increases, but research tends to suggest that is as much a result of lifestyle changes as it is to do with cost. That would suggest that the level has not yet been reached, but the relatively high price - for what is a premium product, without the economies of scale available elsewhere - is still a concern for the Board. As the extract of the policy letter sets out, the efficient operation of the Dairy and the dairy farming industry is paramount.

In 2014, the States made the decision to reduce the level of subsidy provided to the farming industry. This has reduced, in real terms, from around £3.3 million per year (allowing for inflation) to the current £1 million. A significant proportion of the subsequent increases in the retail price of milk can be attributed to this reduction in direct government support.

In agreeing to the inclusion of the Project in the previous Capital Portfolio programme, the States effectively agreed to further central funding to support the dairy industry. Any further industry subsidy is a policy issue for the Committee *for the* Environment & Infrastructure and the Policy & Resources Committee. The Board is instead focussed on the effective and efficient operation of the Dairy to retain the lowest milk price possible.

Matching supply to demand is not an exact science. Although milk consumption, and therefore sales, are fairly consistent throughout the year, the amount of milk that cows produce does vary – peaking in the spring. An element of oversupply will therefore always be required to satisfy demand over a 12-month period. The application of farm supply contracts and differential gate prices paid to farmers (linked to their supply contracts) is how the Dairy currently looks to manage supply.

Question 8

From the June 2020 Policy Letter:

> *"There are currently 14 farms on the Island with approximately 1,400 milking cows. The cows produce in the region of 8 million litres of liquid milk per annum. Under the current legislative framework, the Guernsey Dairy is required to buy all the milk produced, whether it needs it or not. Guernsey Dairy requires approximately 7 million litres to meet existing demand."*
>
> *"The Guernsey Dairy has experienced a declining trend in milk sales, particularly in the last few years - with 2018 sales down by -2.8% by volume on the previous year and 2019 sales to date showing a further decline of -2.7%. The recent decline is thought to be driven by a combination of customers ordering less, due to a reduction in doorstep deliveries and the longer shelf life of milk, as well as the trend towards plant based alternatives to milk products."*

(a) How many farms and milking cows are on the Island as of April 2022?

(b) How many litres of milk did the cows produce in 2020 and 2021 respectively?

(c) How many litres of milk are required to meet 'existing demand'?

(d) As consumers move away from dairy products, what is the projected downturn in milk consumption over the next 5 years?

(e) The excerpt from the Policy Letter suggests that there is 1 million litres of over capacity in production and, under the law, the Dairy is under obligation to buy all milk from farmers.

i. What is the cost to the Dairy of purchasing unrequired milk?

ii. Is the Dairy buying in over capacity and tipping it down the drain? If not, what happens to the unrequired milk?

Answer

There are currently 12 local dairy farms with approximately 1,360 milking cows. Their total milk production was 7.9 million litres in 2020 and 7.6 million litres in 2021.

It is estimated that around 7.2 million litres of raw milk are required annually to meet existing demand. However that would only be sufficient if raw milk intake at the dairy is maintained at a consistent level over a rolling 12-month period, which as noted already is generally not the case. The limitations of the existing site and the variation in raw milk volumes between spring and autumn keep the current requirement at around 7.6 million litres, but this could be reduced with a new facility.

The increased availability of milk alternatives in recent years has impacted sales of Guernsey Dairy milk. Research suggests that there remains considerable 'brand loyalty' among islanders, who particularly recognise the link between the local dairy industry and its contribution to the upkeep of the island's agricultural land and rural character. Guernsey Dairy has also increased marketing activity, to better promote local milk, assisted by product development – a recent example being the launch of lactose free milk. Overall sales of milk by volume increased by about 1% last year, and these efforts will continue.

However some further reduction in sales is planned for, with lifestyle changes being a primary driver. The financial modelling for the Project has assumed ongoing reductions in sales of around 1.5% per year.

As evidenced above, the million litres of overcapacity referred to in the extract from the 2020 policy letter has been reduced significantly. Surplus milk received last year was around 400k litres, which in very simple terms equates to a cost of approximately £230k. The Dairy has a robust pricing structure in place agreed with farmers that encourages production within set thresholds over a rolling 12-month period, noting however that raw milk production cannot be precisely controlled due primarily to environmental factors outside of farmers' control.

The Dairy does however make use of all milk it is obliged to accept. Any surplus is processed as 'residual milk', with the cream extracted through the skimming process and used to make butter. Only the remaining liquid - effectively white water - is discarded as currently there is currently no resale value, but investigations are continuing to find a use for it.

Date of Receipt of the Question: 22nd April 2022

Date of Reply: 5th May 2022