Bexley oncology wing, St. James's University hospital, UK

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Aberdeen Infrastructure Partners and a fund managed by Dalmore Capital reached financial close at the end of March on a refinancing of the Bexley oncology wing of the St. James's University hospital in Leeds in the UK.

The original financing for the deal, which closed in October 2004, featured a credit guarantee finance (CGF) structure, which was introduced by then Treasury Project Finance Unit chief Geoffrey Spence in 2003 and at the time was hailed as revolutionary method for financing projects.

Under CGF, the Treasury funded the transaction and then passed the costs on to a syndicate of banks, in this case led by Lloyds Bank, to be wrapped in much the same way as a monoline insurer would do.

In this way, the project would benefit from the low cost of finance achieved by the government, while the government remained shielded from project risk.

Ultimately, the oncology wing of the St. James's University hospital was one of two project to be signed under the CGF scheme. Leeds came first, and it was followed by Portsmouth Hospital. However, after that no other deals were concluded under the system as it was impossible to consider the projects as being off the government's balance sheet.

The sponsors for the oncology wing project are Aberdeen Infrastructure Partners (50%); and Civis PFI/PPP Infrastructure Fund (50%), which is managed by Dalmore Capital and in which the majority investor is the Netherlands' PGGM.

The oncology wing is home to Leeds Cancer Centre and a national specialist transplantation centre and can accommodate 350 inpatients. It is part of Leeds Teaching Hospitals NHS Trust, which serves a population of 850,000 in Leeds and 4.5 million across Yorkshire and the Humber region.

Refinancing

Last month's refinancing used a different structure to the original deal. Bonds and notes were issued for £261 million in three separate tranches with a wrap provided by monoline insurer Assured Guaranty.

One tranche was an £173 million private placement note issuance directed at US private placement investors, another was a £57 million listed fixed-rate tranche, and the last part worth £38 million was listed and linked to the UK's Retail Price Index inflation measure.

In addition to the £261 million value of the issue, the deal also included a £10 million variation bond of cash available to the NHS Trust to spend on improvements, £3 million of which was drawn at close.

The debt was structured in three tranches to maximise investor appetite, matching demand for each type of note or bond, which resulted in the issue being substantially oversubscribed, sources close to the matter explained. “The index-linked market is active, but it is composed of a very finite number of investors, whereas once you go to fixed rate you can tap US private placement players as was done in this case, so you get a much wider investor base,” said Dominic Nathan, managing director at Assured Guaranty. Meanwhile, “index-linked investors are very Sterling focused, UK-based life assurance companies who are matching their liabilities,” he explained.

However, there was demand for some listed and index-linked notes. “We initially went down the route of unlisted private placement notes, but some investors said they preferred listed securities. The RPI-linked issue provided a natural hedge for the borrower,” said Keval Shah, head of bond syndication at Lloyds Bank, which was bond arranger and swap provider for the refinancing deal.

The private placement is thought to have been made to two investors, including Barings. Other investors are thought to include Canada Life, M&G Investments, Standard Life, MetLife, and Royal London Asset Management.

Swap and pricing

And index-linked debt plays an important role. After all, with the NHS trust’s revenue index-linked, it was necessary for all the debt to be synthetically index-linked. So, while it was more economic to raise the majority of the debt on a fixed-rate basis because of a wider market to tap it was also necessary to swap the £230 million fixed-rate debt for index-linked debt.

The 20-year bonds and notes were issued at a spread of 140bp over the relevant spot gilt rate. However, with yields on index-linked gilts negative, they were sold at a premium of 106% to par to avoid a negative coupon.

The Assured Guaranty wrap meant that the issue was rated AA by S&P Global Ratings, while the underlying project is rated BBB. “The wrap means that instead of buying the risk of the project, investors buy Assured Guaranty’s risk,” said S&P’s senior director of infrastructure ratings, Michela Bariletti.

Before the [2008-2009] crisis, most UK PPPs and PFIs benefited from a monoline guarantee, and there wasn’t much thought going into the underlying projects, she said. However, since then “investors no longer buy blindly into the AA guarantee. They also look at the underlying rating and make an effort to understand what it would mean if they were exposed to the project’s risk,” she explained.

Gain to the NHS Trust

The refinancing resulted in a £51.6 million gain to the NHS Trust, £10 million of which was taken upfront, with the rest spread out as a £2 million saving per year.

And £3 million of the gain will be used to build a specialist clinical trial centre.

“Refinancing could be one solution to reduce deficits in the NHS, and I would hope to see other trusts following the lead set by the trust here,” said Barry Millsom, fund manager of Civis PFI/PPP infrastructure fund at Dalmore Capital, commenting on the gain.