In the city

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2002-3 MIA for Healthcare Development

Walsgrave

One of the more significant deals in UK PFI in recent years the Walsgrave Hospitals project reached financial close on 28 November 2002. Walsgrave marks three important milestones in the health sector: it is the first deal to be done with two National Health Service (NHS) Trusts, the first to deal with the thorny question of retention of employment (ROE) contracts, and the first to include provisions for the resupply of medical equipment.

The concession awarders are University Hospitals Coventry (UHC) and Warwickshire NHS Trust and Coventry Primary Care Trust (CPCT). The project has three principal facilities: the first being a main, 1,212-bed acute hospital, the second being a research and training facility and the third being a 130-bed mental health unit. The acute hospital and training facilities fall under UHC, while the construction and servicing of the mental health unit falls under CPCT.

The two sponsors are Innisfree (75%) and Skanska BOT (25%). With neither having an extensive soft facilities management capability this has been subcontracted to ISS Mediclean. This detail is important because at the time political and managerial pressure had led to pressure on the UK government to clarify the status of non-clinical hospital employees managed by private consortia - Walsgrave was a pilot hospital for the Retention of Employment (RoE) model.

This was also the single biggest delay to closing financing. In this instance, affected staff stay within nominal NHS employment, with strict provisions for pension rights and working practices. The final innovative solution is a contract with GE Medical Systems to provide technical refresh - the replenishment of some of the larger ticket items required for clinical care. The rationale behind this is an effort to cut procurement costs, so that in this respect, as with RoE, the market and government closely monitor the results.

The holders of the 40-year concession have other opportunities to maximise their revenue. These include the ability

to build a separate private clinic, to be leased to BMI Healthcare Limited, staff accommodation, and a retail facility to be operated in conjunction with Gentian limited.

On the financing side, having two trusts necessitated careful treatment of the bonds, which produced additional complexity in relation to the workings of the payment mechanism and various compensation regimes. Each trust has a separate termination threshold working within one project agreement.

Financing was structured as a £407 million Index linked bond issue, guaranteed by MBIA, and run by BNP Paribas. The notes carried a 37.5-year maturity, and priced at an attractive 90bp over the relevant benchmark. The financing included £35 million in variation bonds, and its co-bookrunner was Barclays Capital.

2002-3 MIA for Environmental Development

St Petersburg Water

The Eu190 million international PPP style deal to build the St Petersburg Southwest Wastewater Treatment Plant, closed on 20 March 2003. The project structure is unique - a public-private partnership (PPP) enterprise based on cooperation between European financial institutions, Nordic contractors, international donors, and local authorities in Russia.

The plant is being built by Nordvod, a consortium comprising YIT, Skanska and NCC on the construction side, and Nordic Environment Finance Corporation (NEFCO) and the state-owned water company Vodokanal of St. Petersburg. Once built, Vodokanal will buy back the rest of the plant from the other sponsors and lenders over 12 years with payments flowing through the Nordvod special purpose vehicle.

Mandated in 2000, Nordic Investment Bank (NIB) lead arranged the deal and put up Eu45 million, to which the EBRD added Eu35 million. Swedfund and FINNFUND also particpated with subloans and 10% equity. White & Case and Allen & Overy acted as legal counsel.

The project also benefited from Nordic bilateral assistance, mainly from Finland and Sweden (SIDA); as well as EU assistance channelled through TACIS and a grant from the NDEP fund.

Once the plant is built it will be operated by a separate operating vehicle with the same ownership structure as Nordvod. The plant's construction - actually started in 1980 and then mothballed - is to be completed within three years.

The project is an element in the Northern Dimension Environmental Partnership investment programme and will greatly reduce the effluent load of untreated and contaminated wastewater discharged into the Gulf of Finland and the Baltic Sea. At present, unprocessed sewage from a population of nearly one million people is being discharged into the Gulf of Finland. Most importantly, emissions of oxygen-consuming substances (BOD5), nitrogen and phosphorus will be substantially reduced when the treatment plant becomes operational.

Once commissioned, the new plant will meet the HELCOM and EU efficiency requirements. In addition to the actual treatment plant, the project also includes a sludge combustion facility.

The project, for which the Russian Federation and the City of St. Petersburg have expressed strong political support, is a good illustration of how coordination of Nordic and international financial resources together with local partners can facilitate the achievement of concrete and significant results for environmental improvement in the Baltic Sea.

2002-3 MIA for Water Development

EMASESA

In November 2002 EMASESA (a water utility wholly owned by the City of Seville) closed a Eu96.15 million non-recourse forward receivables deal - the first of its kind for a Spanish municipal.

Arranged by Dexia SBL and Ahorro Corporación Financiera, the deal involves the sale/securitisation by EMASESA of improvement fees (canon de mejora). The canon are usage-based water surcharges established under a decree by the regional government of Andalucia that EMASESA adds to its retail and commercial invoices to fund upgrades to water and sanitation infrastructure both in Seville and its environs.

The innovation in the transaction is that the financing is structured as a purchase of EMASESA's rights to charge improvement fees - not the fees themselves. As a sale of rights, the deal is non-recourse and consequently has no balance sheet impact on the level of indebtedness of the municipality - an aspect that is certain to make the template very popular with other cash-strapped municipals.

Having purchased the rights on those proceeds, the banks pay EMASESA an amount equal to the NPV of the future income from the canon. The purchase amount is paid in installments between the deal closing date and the forecast end of the investment period (July 2004), in order to match disbursements to be made by EMASESA.

A key feature of the decree is a provision for revising the canon rates to compensate should certain economic assumptions of the base case scenario - water consumption, interest rates - result in a shortfall under the bank repayment schedule. And lenders get even more comfort from contractual provisions that allow for the resale of the rights to EMASESA (and therefore a recouping of the purchase price) should there be material changes to the legal environment of the transaction threatening the existence of the canon, its scope, or its applicability.

Although commercially bankable, of the total Eu96.15 million funding the European Investment Bank (EIB) put up Eu60 million (60%) with a tenor of 14.25 years. The loan is channelled through the commercial banks - the EIB cannot directly buy the rights. The EIB loan also comes with a wrap from monoline FSA.

On the commercial tranche, Dexia SBL has a take of Eu18.08 million with three Spanish savings banks - El Monte, Unicaja and Caja San Fernando - holding Eu6.03 million each for a tenor of eight years. The canon fees are sized to cover all interest and principal payments to the lenders by December 2010 for the commercial tranche and December 2016 for the EIB.

2002-3 MIA for Social Housing

Glasgow Housing Association Finance

The UK social housing sector reached another level of funding sophistication with the financial close of GHA Finance - the biggest housing stock transfer in Europe. A hybrid/corporate project for the newly established Glasgow Housing Association comprises £725 million ($1.1 billion) of 30-year term loans from the commercial banking sector and the EIB. Ultimately the deal will see over £4 billion invested into the housing stock owned by GHA.

The deal involves the transfer and refurbishment of 81,336 homes from Glasgow Council to Glasgow Housing Association (GHA) at a purchase of price of £25 million (assuming no VAT for the first 10 years of capital expenditure) with over £1 billion of historic debt being written off by Glasgow Council.

But it is not simply the scale of the transaction that puts it in another league from smaller stock transfers. The project comes with a number of 'bells and whistles' that are firsts for the sector - notably the incorporation of second stage transfers to smaller housing associations and the participation of the EIB as an equal and direct lender.

Lead arranged by Royal Bank of Scotland (RBS) and Halifax Bank of Scotland (HBOS), the deal is split almost 50/50 between the £575 million of commercial plus £150 million EIB debt, and £700 million in funding from the Scottish Executive. The EIB debt is something of a departure for the multilateral in that it is a clean loan (not a guarantee) for the full 30-year term with very few drawdown conditions.

From the banking perspective the deal looks complicated but tidy. GHA has industrial and provident society status and is a not-for profit entity with an obligation to sell down to smaller housing associations - the first second stage transfer will be in two years. The transfers add another potential 10 years to the 30-year term through extensions.

The project is further complicated through inter-creditor issues spawned by the different grant income streams and timings that have been included in the structuring. There is a central heating grant of £20.6 million over the first five years as part of the Scottish Executive's warm deal programme and a repayable grant from the Scottish Executive of £302.5 million over the first 10 years of GHA existence. In addition, the project benefits from a £12.5 million annual efficiencies fund grant in years 3-10 and a demolition grant of £114 million over seven years. There is also a £113 million re-provisioning grant over seven years towards the cost of building 2800 new homes and owner-occupier grants of £100 million during the investment programme from years 1-10.

Lenders take further comfort form the fact that rentals are paid direct to GHA and housing benefit accounts for around 75% of rental income across the portfolio. A service level agreement has also been put in place with the Council to ensure that delays in payment, and their potential impact on cashflow, are minimised.

2002-3 MIA for Transport Development

City of Dusseldorf/Rheinbahn

In one of the biggest bids ever to maximize returns on its existing assets, in September 2002 the City of Dusseldorf and local transport operator Rheinbahn signed a $1.67 billion US lease-to-service contract. It was the first deal arranged for an entire city rail network and created a NPV benefit of $62 million for the city's infrastructure development coffers.

Both Rheinbahn and Dusseldorf had benefited from leasing structures in the past. Rheinbahn has closed transactions on rolling stock and maintenance facilities, while the city has been involved in wastewater transactions. But the rail infrastructure deal is by far the largest deal for both lessees and at the time was the largest of its kind in Germany.

East Merchant was mandated as lead arranger in April 2002, and was joined as co-arranger by Capstar Partners. Debt was arranged by East Merchant, and placed in the German market. Commerzbank provided the A loan, which accounts for 90% of the debt, with Landesbank Sachsen and KfW providing the remaining 10%. Deutsche Bank guaranteed the A loan with a payment undertaking agreement, with Landesbank Baden-Württemberg covering the B loan. US equity was provided by John Hancock.

Under the terms of the transaction, both lessees are jointly and separately liable in the event of a default. This added complexity to the deal and demanded considerable attention at the stage of due diligence.

The Dusseldorf deal was particularly attractive to the lessees, which are both reliant on public funding. A single transaction limits administrative and legal costs, even though the assets could well have been split into a series of separate deals. Rolling stock and rail infrastructure such as stations, which have a much longer depreciation schedule, are often the subject of different mandates. Assets in this transaction included track, tunnels, stations and retail space.

The Dusseldorf deal did include a relatively small qualified technological equipment (QTE) lease tranche, which finances signalling equipment, control rooms and software with a value of around $35 million. But the transaction closed with a single equity investor, as the amount of equipment that qualified under QTE rules was too small to justify a dedicated lease. And the addition of a stand-alone QTE would also have made the deal unnecessarily complex, since the sole equity investor was satisfied with the scale and structure of the deal.

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