

# Walsgrave Hospitals: Serving two masters

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One of the more significant deals in UK PFI this year reached financial close on 28 November 2002. The Walsgrave Hospitals project was funded with a secured single tranche of £407 million MBIA-wrapped, index-linked bonds due 2040, underwritten and run by BNP Paribas and co-led by Barclays Capital. They were issued at 90bp and the financing included £35 million of variation bonds. This is thought to be the largest capital markets issue raised for a health sector PFI, and the largest index-linked project bond yet.

Innisfree Nominees Ltd (75%) and Skanska BOT UK Ltd (25%) own Walsgrave's project company, Coventry and Rugby Hospital Company. They have injected significant equity capital into the project, and although the actual sum is undisclosed, it is believed to be in the region of £38 million. The Skanska-Innisfree contract is worth £4.2 million per year. The deal breaks new ground by transacting with two NHS trusts in a single project agreement, by integrating a contract for full-term equipment procurement and maintenance that has been rarely seen in previous NHS projects and by acting as a testing ground for the NHS standard form for PFI projects.

The two NHS trust clients are Warwickshire NHS Trust (UHC) and Coventry Primary Care Trust (CPCT). Bond debt was chosen over bank debt as it is better for a long-term view. Says Peter Morawitz, from bookrunners BNP Paribas, "the bond market is a very efficient source for long dated inflation linked debt as investors can take a long term view of inflation. In the bank market, the long term inflation risk would need to be mitigated using an inflation or RPI swap in order to swap the inflation linked income stream to a fixed stream." Using a bond financing enabled the tenor to reach 37.5 years, giving the trust affordability benefits.

One of the most innovative aspects of the project is the full-term provision of equipment and maintenance of equipment: this includes a clause for technical refresh obligations within the design, build, maintain and operate contract. Equipment provision, maintenance and refresh carries slight complications as medical equipment is specialised and therefore fairly high-maintenance. Technical refresh obligations demand that when equipment is scheduled for replacement it must be replaced with the new technological equivalent. Equipment refresh clauses are rarely included in hospital PFI packages for these reasons. GE Medical Systems is guaranteeing the equipment element of the project. Caroline Botwood of Investec European Capital, financial adviser for the transaction, says: "Ultimately, there was an element of risk sharing with the trust. But only after significant real price increases."

In line with the NHS standard form PFI contract, managers adopted the Retention of Employment (RoE) model. Staff who are in the trust's employ remain there - this preserves their pension rights, among other things, with the NHS - but are managed by the private sector.

The concession runs for 40 years, which includes a five-year construction period, fairly typical for a PFI newbuild. The concession has a series of completion dates for various phases of the project. Currently it is operating within the interim services period, which will step up during construction until all services come online.

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. Botwood says: "Having two trusts did

require 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."

The project incorporates responsibility for all non-clinical services. An SPV called Health Care Projects Ltd (HCP), which was set up by Skanska and Innisfree, will manage the project. HCP director Ray Pett believes that the deal was executed in the most time- and cost-efficient way under PFI. He says: "We have never been in any doubt that PFI provides the best solution. This has been done in the most cost effective way and working on a greenfield site meant our risks were less complicated."

The hospital is due to open in 2006, and along with the aforementioned three facilities will include a retail area provided by Gentian, a private patients unit to be leased by BMI Healthcare Ltd and staff residential accommodation. Skanska Rashleigh Weatherfoil will provide hard FM such as building services and IT infrastructure with ISS Mediclean providing soft FM. Walsgrave PFI is somewhat similar to the Birmingham Hospital PFI currently in the market. It is still in the early stages, with PwC providing financial advice. Market players say it will be of similar size, and rendered - like Walsgrave - by two NHS trusts. It will also feature a similar split in scope between acute services and mental health services.

### **Walsgrave Hospitals**

Status: closed 28 November 2002

Size: £407 million bond debt

Location: Coventry, UK

Description: PFI bond financing of NHS health services

Sponsors: Skanska and Innisfree

Bookrunner: BNP Paribas

Maturity: June 2040

Coupon: 3.25%

Legal advisory to sponsors: CMS Cameron McKenna and Clifford Chance

Financial advisory: Investec European Capital

Technical advisory: Faithfull & Gould

Equipment provision/underwriting: GE Medical Systems

Architect: Nightingale Associates

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