Bristol Southmead: No bond age

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Sponsors Carillion and Lloyds surprised much of the market at the end of February with financial close on £625 million ($931 million) of bank debt for the Bristol Southmead Hospital PPP – debt that comes with a 30-year tenor.

The project developers, with HSBC as financial adviser, sounded out the debt market during the height of the financial crisis and had three possible funding routes in place: Long-term bank debt; a mini-perm with an average life of 10 years, should the appetite for long-term debt not be strong enough to make it viable; and a bond.

The bond option was explored against the backdrop of the collapse of the monoline industry. The financial advisers sounded out the market on a package that rated the hypothetical unwrapped paper at either A or BBB, each rating dependent on more or less strength in the construction surety package and enhanced debt service coverage ratios.

Though the process did not go as far as seeking ratings from the agencies, the advisers found some demand for the hypothetical paper, notably from pension funds. The main reason the sponsors decided not to issue a bond was the price difference. On the basis of the underlying reference rate, the long-term unwrapped A or BBB paper would have cost the project 25bp-30bp more than long-term banks swaps.

The sponsors chose the bank debt option at the end of October 2009 because they wanted to get the deal funded before the UK general election, which is set for 6 May. There was strong appetite from the banks, and the sponsors were able to choose those that would agree to long-term money and, just as importantly, those that could go through credit-committee and delivery promptly.

The bond might have taken too long to close. For example, how voting rights would work when multiple groups holding unwrapped bonds are involved is a question the market has no answer for at the moment. If the monolines were still available to wrap to AAA, consent for changes in project terms could be handled directly with them. There is talk in the market of some of the monolines working on ways of taking coordinating creditor roles without actually wrapping paper. The discussions are at early stages, but could receive an enthusiastic market response.

The final bank debt package comprises a £375 million commercial tranche and a £250 million EIB tranche. The commercial debt, led by Lloyds and RBS, is split between a £264 million senior term loan with a 30-year tenor, a £98 million equity bridge with a 5.5-year tenor and a £13 million change-in-law facility. Lloyds took £150 million, RBS took £75 million and £150 million came in from Credit Agricole, National Australia Bank and Societe Generale.

Pricing on the commercial debt is 237.5bp over Libor during construction, dropping to 225bp during operation and rising to 260bp towards the end of the loan. The debt to equity ratio was 85:15, and minimum DSCR was 1.25x.

Some bankers speculate that Lloyds' particularly large ticket on the commercial piece is an indication of the bank's aggressive drive for UK market share, driven by pressure from the UK government on part-nationalised UK banks to reach lending quotas. It is true that, as a result of its being bailed out by the UK Government, Lloyds was given a target (reset to $44 billion for 2010-11 in the March budget) for lending to SMEs and that the funding of UK PFIs of this size counted as part of that arrangement. But Lloyds maintains that its large take on the deal was influenced by a growing confidence in the secondary market for such credits, and that it is looking at sell-down options now.

Lloyds' decision to take a 50% equity position in the project was based on the fact that it is looking into fundraising routes for a second infrastructure fund. The fund, Lloyds European Infrastructure Partners, will have an initial target of £500 million, and will focus on social infrastructure deals.

The Bristol Southmead project involves building a new hospital to house the main services of the current Southmead and Frenchay hospitals. It will include 800 acute beds, a community hospital, a helipad, a piazza and a 2,700-space multi-storey car park. Linklaters was legal adviser to Carillion, and Allen & Overy advised the lenders.

Bristol Southmead
Status: Financial close 25 February 2010
Description: £625 million financing of an 800-bed hospital complex
Awarding authority: North Bristol NHS Trust
Financial adviser to the North Bristol NHS Trust: Royal Bank of Canada
Sponsors: Carillion, Lloyds
Financial adviser to the sponsor: HSBC
Mandated lead arrangers: Lloyds, RBS, Credit Agricole, National Australia Bank, Societe Generale
Multilateral lender: European Investment Bank
Legal adviser to the NHS Trust: Bevan Britten
Legal adviser to the sponsors: Linklaters
Legal adviser to the lenders: Allen & Overy