

Highland closure - the region's second schools PFI

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Scotland's second Highland Schools PFI project - a deal that stands out as the largest Scottish school-building programme and the biggest UK bond-financed education PPP to date - has closed

Eleven new schools - including a Gaelic primary - will be constructed over the next three years at a cost of £134m with the Alpha Schools (Highland) consortium starting work next month on the first three schools.

The work will be funded under the area's second Highland Education Public Private Partnership (PPP) and sees an experienced team of council officials work on the deal.

New secondary schools - will include a swimming pool, community library and learning centre - being built include:

- Dingwall Academy
- Kinlochleven High School (not far from Fort William)
- Millburn Academy in Inverness
- Portree High School (Skye)

There will also be a new school for pupils with additional support needs in Inverness, a new primary school at Inshes in Inverness, and the region's first purpose-built school for Gaelic medium pupils in Inverness.

There will also be new primary schools at:

- Kinlochleven
- Resolis
- Culbokie
- Cawdor

As Highland Council convener Alison Magee says: 'This is the most significant investment this council has or is likely to make and demonstrates our commitment to Highland communities.'

The project

Alpha Schools carry out the work on the 11 schools, providing new facilities for three secondary schools, five primaries, one combined primary and secondary, and a special educational needs school.

Eight of the schools are located around Inverness, and one each at Portree (Skye) and Kinlochleven. The schools will provide replacement facilities for 15 per cent of the Highland Council's estate - by pupil numbers - as well as facilities for new catchment areas.

The consortium was appointed preferred bidder early last year with the SPV, Alpha Schools, jointly owned by Morrison subsidiary Morrison Education (Highland) and Northern Infrastructure Investments (a co-investment vehicle of Noble Fund Managers and 3i). Noble is understood to have a minimal stake in the SPV with 3i taking the lion's share of more than £7 million. Morrison and Northern split the equity 50:50.

The schools will be built by Morrison Construction Services (MCSL), which is now part of Galliford Try and was taken over during the negotiation of this Highland Schools project.

Construction will be managed by MCSL with work carried out by its regional Highland and Central operations and Inverness-based Tulloch Construction. Facilities services will be provided by Morrison over the next 30 years.

Galliford Try centres its PFI business out of Edinburgh for projects in the north of England and Scotland. The close of the Highland Schools PFI follows closely behind its £192 million Northamptonshire Schools PFI which reached financial close in December.

3i partner Dougie Sutherland says: 'Our £7.65m investment demonstrates 3i's commitment to the infrastructure market and Scotland in particular. The UK PFI market is a key element of our infrastructure business and we are delighted to be investing in a project that will bring significant educational benefits to the Highland Region.'

While 3i's Cressida Hogg says: 'It was a great result to get there with Morrisons and we are thrilled to be back in the primary market.'

Financing

Ambac wrapped the entire financing which included a little more than £100 million in bonds. Of that sum a public bond issue made up £81.4 million, as well as £19 million worth of variation bonds (due 2036). Added to that sum, there was a £60 million fixed-interest loan from EIB (due 2035). The EIB debt and the bonds are all wrapped by the monoline.

RBC Capital Markets acted as lead manager for the bond issue. Ambac provides a guarantee on the scheduled payments of principal and interest under the bonds and the EIB loan.

The project priced at 55bp over the reference gilt which is quite an achievement as it priced on the same day as Allenby Connaught which went for 56bp. This, of course, means that two lots of Ambac paper come to the market at the same time and it stands as testament to market liquidity that it was soaked up without comment. The all-in pricing was 4.792.

As Louise Minford, head of UK PFI at the monoline, says: 'For the two [Highland Schools and Allenby Connaught] to get away at the same time is fantastic news for us.'

She adds: 'It took a long time to close and the whole team slotted together well. The fact it was able to absorb the conditional sale of Morrisons to Galliford Try at a late stage in the proceedings is evidence that the team worked pretty well.'

Henrietta Podd, managing director of infrastructure finance at RBC Capital Markets, says: 'The schools sector is still relatively new to the bond market. We did the [North Lanarkshire](#) deal in early summer last year which was limited price index linked.

'Highland Schools was a conventional fixed-rate bond, so that meant we were able to show it to a slightly different group of investors and the general reaction was that they liked this new form of asset class.'

Podd adds: 'We were slightly concerned over its size when we discovered that we were going out on the same day as Aspire. But because it was so different and people wanted to investigate by investing into the schools sector, we had very good interest.

'We were keen to price before Aspire as it would not be unreasonable for investors to see the bigger issue and use that as the benchmark. We did not know where Aspire was going to be, but we knew it would be better to be before it than

after!'

The bonds were oversubscribed by life companies, pension funds and European banks with 44 per cent going to the mainland European market, 9 per cent to Scotland and 47 per cent in England.

EIB vice-president Peter Sedgwick says: 'This loan confirms the EIB's commitment to support operations in which the public and private sectors work together to the benefit of local communities. The EIB aims to be involved in investment that favours innovation and helps develop the Highland Region.'

This deal sees the project adopt a traditional funding structure with a debt:equity ratio of 92:8.

Grant Thornton acted as financial adviser to the consortium and partner Nathan Goode says: 'Because this was a single bidder project, the funding solution assumed a much higher importance than normal in demonstrating overall value for money for the public sector.'

'The launch of the bond deal came about through a highly transparent process and a genuine partnership between the public and private sector teams.'

Legal

Pinsent Masons acted for the sponsor, McGrigors advised the funders, while the local authority was represented by MacRoberts on this deal - the second bond-financed schools project to date in the UK and the second education PPP project for Highland Council.

Michael Watson, head of projects at McGrigors, says: 'This is the second bond-financed education project in the UK and we are reckoning on doing a few more of them this year. This project follows on nicely from the first one - North Lanarkshire - where we advised the funder as well.'

Watson adds: 'The Highlands is a very large region and the geographical spread of the schools make the construction phase challenging. It was a difficult one for the council as they only had the one serious bidder which meant there was a long period of benchmarking where the price was carefully checked.'

Andy Normington at Pinsents says: 'It was interesting to be working on a deal with EIB financing and public bonds issue bonds - all wrapped by a monoline.'

Conclusion

As the second schools PPP project in the Highland region of Scotland, this was well-trodden ground for the consortium to follow, and the teams benefited greatly from a regional authority that has a good grasp of the financing structure.

It is the largest school-building project to have got off the ground in Scotland to date as well as being the biggest bond-financed UK education PPP to have closed.

It was a challenging project with only Alpha Schools stepping up as the only serious contender from the construction sector and a vast expanse to be covered during the building phase. The long period of benchmarking where the price was carefully checked was made none the easier by Galliford Try moving in on Morrisons and taking it over during a crucial stage of the developments.

The wider application of bond financing for education projects will be interesting to see develop as the Building Schools for the Future programme gathers pace in England and Wales. There are a number of potential projects in the BSF programme that would suit wrappers and it will be interesting to see how the monolines compete with banks for the business.

The future looks good for coming school projects in the country with the Scottish Executive having done a good job of getting the standard form contract working well and a healthy deal flow coming through.

The project at a glance

Project Name	Highland Schools
Location	Highlands and Islands, northern Scotland
Description	The construction and 31-year operation of 11 new schools, effectively re-schooling 15 per cent of the school-age children in the Highlands
Sponsors	Alpha Schools The consortium is jointly owned by Morrison subsidiary Morrison Education (Highland) and Northern Infrastructure Investments (a co-investment vehicle of Noble Fund Managers and 3i) with 50:50 each
Operator	Morrison
Public partner	Highland Council
Construction timetable	3.4 years
Project Duration (Including construction)	30 years
Total Project Value	£142 million
Total equity	£15 million
EIB contribution	£60 million (due 2035)
Bonds breakdown	A bond issue of little more than £100 million (due 2036) £81.4 million in public bond issue £19 million variation bonds
Total construction cost	£134 million
Equity breakdown	50:50
Bond arranger	RBC Capital Markets
Bond pricing	Spread of 55bp giving a coupon of 4.792
Monoline provider	Ambac
Legal Adviser to sponsor	Pinsent Masons
Financial Adviser to sponsor	Grant Thornton
Legal adviser to banks	McGrigors
Legal adviser to council	MacRoberts
Financial adviser to council	Caledonian Consulting
Date of financial close	6 April 2006
Date of bond launch	30 March 2006

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