

Northern Ireland's Alpha water PPP

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After a fitful start, Northern Irish PPP has finally started to boom. For years the region's unstable political environment and the mixed results of devolution obstructed development

But with a rash of PPPs on the drawing board and energetic backing from the Strategic Investment Board, opposition to PPP from local politicians and unions the sector looks unlikely to diminish a growing momentum in the sector, which now looks set for sustained growth (see *IJ Opinion*, 24 March).

PPP deals in Northern Ireland, particularly small ones, have gained a reputation for excessive complexity and lengthy wrangling.

If future developers can emulate Alpha - the first drinking water PPP in the United Kingdom - which closed on schedule only eight months after preferred bidder status was awarded, this perception will need adjustment.

Alpha involves upgrading and expansion works on 5 existing Water Treatment Works - Ballinrees, Castor Bay, Dunore Point, Forked Bridge and Moyola - as well as operation and maintenance.

The project will also involve design and construction of the new Londonderry and Ballymoney Link Mains. It aims both to improve the quality of Northern Ireland's drinking water - of which Alpha will supply around a half - and to ensure compliance with European Union standards.

Alpha will increase treatment capacity from 295 to 423 million litres per day and provide drinking water to 781,000 customers.

Financing

Development consortium Dalriada - Kelda Water Services (45 per cent), Earth Tech Engineering (45 per cent) and Northstone (10 per cent) provided £15 million (US\$28 million) in equity.

RBC and ING jointly arranged a £118 million (US\$220 million) debt facility, half of which was provided by the European Investment Bank. The other half was divided equally between the two banks.

The commercial tranche has a tenor of 24 years, with a margins of 85-100bp and a cover ratios of 1.2 - standard for UK availability-based PFI.

Allen & Overy advised the lenders. Denton Wilde Sapte advised the consortium, with Carson McDowell and Arthur Cox advising on Northern Irish law.

PricewaterhouseCoopers and Dundas & Wilson advised the government, which received technical advice from Mott MacDonald.

The EIB is also funding a parallel project, Omega Wastewater, for which financing will be arranged by the Royal Bank of Scotland.

Project risks

Alpha is in itself no great coup for the financiers, given the sums involved. Yet with Northern Irish PPP so robust, it is no surprise that banks are keen to stake a claim in the market.

With profits already constrained by the size of the project, EIB involvement did little to edify the banks. Development banks are not always popular with their commercial cousins, having, in the words of one banker, a habit of 'muscling in on deals offering cheap money.'

This was not enough to deter the lenders, however, who put in a bid considerably lower than rivals, making no 'best and final offer' necessary and saving time on the deal. Water PPPs can be tricky beasts, with complexities in design and construction often resulting in delays, and any time saved is a bonus.

Drinking water PPPs entail a slightly greater of risk than more straightforward construction projects, bringing with them the added concern of continued quality of supply. As they usually involve laying pipelines beneath private property, making permissions and consents a frequent problem.

Alpha was no exception. Well towards financial close, permissions and consents provoked enough discussion to cause some to doubt whether a deal would be struck at all.

At issue were the statutory powers available to the Northern Ireland Water Service; and the extent to which these would be made available to the consortium.

Dalriada had negotiated privately some of the rights it needed to run pipelines across private land but had been unable to secure rights for a vital link main.

Risk resolution

From the authority's viewpoint, the bid had presumed a greater reliance on statutory powers than it had planned to sanction. In the event, the authority was obliged to wield its powers more widely than it had planned in order to keep the process on track - not a wholly bad thing, considering these powers were instrumental in keeping the deal on schedule.

Disagreement over statutory powers was connected not so much with the legal issues that surround them but with their application.

'A strict reading of the legal provisions is perhaps less important than their practical use,' says Conrad Andersen of Allen & Overy. 'The Water Service has a great deal of experience in applying statutory powers.'

Nor were the developers new to resolving statutory issues.

'There were problems over statutory rights but these were more of a problem of perception than anything else,' says Earth Tech's Bill Stead, 'Northern Ireland has some strange legislation which can make things complicated [Northern Irish laws requiring planning approval from two authorities, as opposed to one in the rest of the UK].'

'But Farrans [Earth Tech's local partner] have laid lots of pipelines all over Northern Ireland,' Stead adds, 'Statutory powers did become a big issue, especially towards the end. But the project was never in jeopardy and strong leadership from the water service ensured the problems were resolved.'

Another salient aspect of the deal was terrorism risk. With all of the project's water drawn originally from a single source - Loch Neagh - the risk of sabotage - or indeed accidental spillage - corrupting supply was one the banks were unwilling to

embrace.

Northern Ireland is not covered by the Pool Re scheme, which provides statutory terrorism cover in the mainland UK. Instead, a new framework was devised, combining commercial insurance with contractual protection.

Project risk was further reduced by a power pass-through agreement - the Water Service is Northern Ireland's largest consumer of power and must guard against price fluctuations to keep costs under control. The agreement ensures any rise in electricity tariffs is passed on to the consumer and not the operators.

Lastly, the deal overlapped with the restructuring and corporatisation of Northern Ireland's water authority. This raised the possibility that the nature of the government entity could change during the process, as happened for example, with the London underground.

Any change would be effected through primary legislation, overriding contract law. This, however, is a risk inherent in all PFI deals and did not lead to higher than normal pricing for Alpha debt, an insider told *IJ* - rather, the risk was thrown into sharper relief by current political developments in Northern Ireland.

Conclusion

Alpha's swift conclusion is an auspicious sign for the until recently frustratingly adolescent Northern Irish PPP market. Conditions are not yet perfect, however. Ambiguities over statutory rights persist, while bureaucratic processes remain ponderous.

PPP/PFI also continues to stir up political and trades union opposition, which could be inflamed by the current corporatisation process. Yet this seems - for now at least - to be insufficient to restrict growth. Revival of the suspended regional parliament would give more play to PPPs detractors; but a wholesale return to procurement is unlikely.

Concluding the Alpha deal at rates standard for PFI across the UK seems to show that problems particular to Northern Ireland can be resolved by consensus without affecting pricing or increasing risk.

The project at a glance

Project Name	Alpha Water PPP
Location	Northern Ireland
Description	First UK drinking water PPP
Sponsors	Northern Ireland Water Service
Operator	Dalriada (Kelda 45%, Earth Tech 45%, Northstone 10% per cent)
Project Duration (Including construction)	2 years - completion in 2008
Total Project Value	£137m
Total equity	£15m (US\$28m)
Total senior debt	£118m (US\$220m)
Senior debt breakdown	EIB £59m, RBC/ING £59m
Tenor	24 years
Senior debt pricing	85 - 100bp
Debt:equity ratio	87:13
Political risk guarantees	Separate terrorism insurance
Mandated lead arrangers	ING, RBC
Legal Adviser to consortium	Denton Wilde Sapte
Financial Adviser to consortium	RBC
Legal adviser to banks	Allen & Overy
Legal adviser to government	Dundas & Wilson
Financial adviser to government	PricewaterhouseCoopers
Technical adviser to government	Mott MacDonald

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