Birmingham Acute and Adult Psychiatric Hospitals PFI

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The project to build a new 1,213 bed hospital and mental health centre to serve the UK's second largest city reached close this week becoming the tightest-margined healthcare deal to close this year

But the smoothness of the £343.68m bond launch belies a deal that had several complex legal and financial challenges to overcome in the 29 months since preferred bidder was awarded.

In that time the Consort consortium faced the transformation of the hospital NHS Trust into a Foundation Trust clouding legal rules and the controversial departure of the first monoline partner.

In addition, the hospital was locked in the same Department of Health review which froze fellow projects Barts and St Helens.

A final challenge was to sell the deal to the market in the wake of those two deals - stretching the appetite of the banking market for yet another index-linked fixed rate issue.

The transaction - A firm Foundation?

In January 2004 Consort - a consortium of Balfour Beatty, RBS, HSBC Infrastructure Fund and initially AWG - won preferred bidder status to deliver a 1,200-plus bed hospital and new psychiatric facility on the site of the existing Queen Elizabeth Hospital site in Edgbaston as well as a new 32 bed-mental health unit at Showell Green Lane.

The consortium initially planned to reach financial close through a monoline-wrapped bond transaction within 15 months. But matters swiftly became more complicated.

In June 2004 the University Hospital Birmingham NHS Trust won Foundation Trust status, granting it more financial autonomy from central government.

Under the Foundation system the Trust's finances would fall under the scrutiny of an independent regulator - called Monitor - which would set its prudential borrowing limits.

However doubts soon emerged as to whether the transaction would be considered off balance sheet by both the Trust's auditors and, in a worse-case-scenario - a court of law.

While Foundation Trust deals had been signed on a bank debt basis with this ambiguity outstanding - a monoline had not yet called on to bear this much risk.

In October 2005 the mandated monoline MBIA - taking advice from Clifford Chance - pulled out of the deal.

With the deal already under scrutiny from the Department of Health, another monoline competition was swiftly called - in which FGIC outbid its UK rivals.

Glenn Fox, director of FGIC says, 'When FGIC was asked to look at the deal, we were well aware of the issues, having already been mandated on Peterborough, the other Foundation Trust deal in the market. So we were well placed to assess the risks and take a view.'

In April 2006, the deal survived the Department of Health review with minor cuts.

Financing

Financing for the project came primarily from a £343.68 million bond sale lead arranged by RBS and issued by Consort Healthcare (Birmingham) Funding Plc.

'The concern from a marketing perspective was being third in line after Barts and St Helens going into the market before us and we were left with a small window to market and bookbuild and still meet the required closing date for Consort and the Trust' says James Miller of RBS.

The bonds were priced at 51.4bp over the 2030 indexed-linked Gilts, lower than St Helens' 52.7bp and tighter than the 53 to 55bp indicative pricing, signaling strong demand.

Millers says that the securities were marketed to both pension funds - traditional index-linked buyers - and banks but during the book-building process it became clear that the banks would dominate the book.

'The whole issue went to a small number of banks who were looking to asset swap it' adds Miller. 'These guys are looking at it not as a spread over Gilts but on a LIBOR plus basis'.

The deal also featured an additional £55 million in variation bonds that may be sold form time to time to provide extra funds to the issuer and a £250 million EIB loan also guaranteed by FGIC.

The financing will fund an estimated construction cost of £484m at the University hospital and £57 million for the mental health facility. The unitary charge is initially £67m per year.

Conclusion

The reaction of the bank market to the Birmingham bond issue demonstates the clear appetite of banks for index-linked securities to trade in the swap market.

The deal also reflected the importance of monolines in financing large deals at the current stage of the market cycle.

Glenn Fox of FGIC states, 'The monoline competitive position over the last twelve month has been strengthened by bank investors who are prepared to buy very large amounts of wrapped paper and that has led to compression of spreads.'

With AirTanker on the horizon - and taking advice from fellow monoline AMBAC - the monolines may even be called upon to guarantee even bigger chunks of project risk.

Finally the deal raised questions both about the independence of the government's much lauded Foundation Trust hospitals as financial entities and their compatibility with PFI.

It would be easy to understand the frustration of project financiers finding that a supposedly 'independent' Foundation hospital was subject to delay from the same governmental review as for their conventional counterparts.

On the other hand the government has clearly wiped its hands of removing the ambiguity surrounding Foundation Trust's borrowing status in PFI deals.

With further Foundation Trust hospitals including Peterborough soon to close, watch this space.

The project at a glance

Project Name	Birmingham Acute and Adult Psychiatric Hospitals PFI
Location	Birmingham, central England
Description	1,213 bed new build hospital
Sponsors	Balfour Beatty, HSBC, RBS
Operator	Balfour Beatty
FM provider	Haden Young (Balfour Beatty)
Project Duration (Including construction)	40 years Construction period: 2006-2010/2012 (Acute hospital) 2006- ealy 2008 mental health facility
Total Project Value	£618.7 million (US$1,144.3m) excluding variation bonds
Total equity	£50 million (US$92.5m)
Equity Breakdown	• Balfour Beatty Infrastructure Investments - £20 million (US$37.1m) • HSBC Infrastructure Fund - £15 million (US$27.7m) • Royal Bank Project Investments - £15 million (US$27.7m)
Total senior debt	£568.7 million (US$1051.9m) including: • £343.7 million (US$635.7m) index-linked bonds issued by Consort Healthcare Birmingham due 2044 wrapped by FGIC • £225 million (US$ 416.2m) index-linked EIB loan due 2039 and excluding: • £55 million (US$101.7m) variation bonds wrapped by FGIC • £25 million (US$46.6m) EIB variation facility
bond pricing	51.4bp over Gilts
Debt:equity ratio	92:8
Lead manager	RBS
Monoline provider	FGIC
Legal Adviser to sponsor	Tods Murray
Financial Adviser to sponsor	RBS
Legal adviser to banks and monoline	Allen & Overy
Legal adviser to NHS trusts	Pinsent Masons
Financial adviser to NHS trusts	KPMG
Auditor to NHS Trusts	PwC
Date of financial close	14 June 2006