University of Sheffield accommodation project

Marc Roca

14/06/2006

The University of Sheffield's Student Accommodation DBFO - a uniquely structured project to refurbish and expand Sheffield university's student living quarters - is one of the largest UK higher education PFIs to close on the debt capital markets

Catalyst - a consortium of Bovis Lend Lease and HSBC Infrastructure Fund - launched a £156.8m (US$294m) wrapped bond issue to finance the project, which marks the return of PFI-style university accommodation after a while and in a particularly prolific moment for bond issues.

The consortium closed the deal after an RPI-linked bond issue which priced on 19 May 2006 and was settled on 26 May 2006. It opted for the bond route after it was awarded the project in March 2005, with RBC Capital Markets as sole bookrunner.

The funds will be used to design, build, and maintain student accommodation for up to 4,200 students over a 40-year contract period.

Procured by the University of Sheffield (UoS) in 2004, the project involves the construction of 38 new residential apartment buildings and a refurbishment programme of existing dwellings to create a new student village in south-west Sheffield - northern England.

As other universities had done before, UoS relied on the private sector to rationalise its accommodation portfolio. It opted for a public-private collaboration competition to resolve the issues of increasingly-dated properties and student accommodation scattered throughout the city's residential neighbourhoods.

E & Y's Will Elggod summarises: 'This deal is not particularly based on a specific precedent. Ultimately, the aim of the project was to procure new accommodation for the university at a competitive price and structured such that a significant amount of risk was transferred from the university to the partner.'

While not strictly a PFI project, the 40-year DBFO concession is similar to one. S & P's Liesl Saldanha says: 'This is the first transaction of its type and although it is not strictly a PFI, it shares many of the features of traditional PFIs'.

'Project revenues are a combination of a payment for availability and additional revenues that are subject to volume and market risk.' she adds.

According to Royal Bank of Canada Capital Markets (RBC CM): 'The project is structured to utilise many PFI techniques but with a strong emphasis on partnership between Catalyst and the University, which retains responsibility for marketing and allocating rooms and setting rents.'

RBC's vice president Jessica Castle adds: 'The deal is more of a risk-sharing partnership than other similar projects to-date.'

The project

Working on the model of corporate buyers, universities look at these alternatives for their major capital projects and to maintain manageable levels of debt.

Sheffield University devised a Student Residences Strategy to build and maintain a new student village in the Endcliffe and Ranmoor districts in south-west of Sheffield. The project's capital value is around £160m (US$296m).

By creating the village, the University aimed to return many residential properties to private family use, generate new private homes by redevelopment of existing university sites and preserve historic buildings in the area.

The original tender was advertised in the OJEU on 15 June 2004 and the shortlisted bidders were Bovis Lend Lease/HSBC Infrastructure Funds, Opal Property Group and University Partnerships Programme (UPP).

A combination of new and refurbished accommodation, the village is being built by Bovis Lend Lease and will be maintained over a 40-year contract period by Lend Lease Facilities and Estates Management.

The project company is responsible for life cycle and hard FM on the accommodation element while the University retains soft services.

'The scale of the project is unprecedented, providing almost 4,000 rooms to student for the next 40 years.' says E & Y's Will Elgood. 'The project was also the first to take place post-announcement of the introduction of tuition fees.'

The scheme will comprise the construction of 3,550 new bed spaces, 384 refurbished bed spaces, and 257 transferred bed spaces. It will also encompass the construction of a Hub building with retail and public space for students, as well as the demolition of three large residence halls.

In addition, Catalyst will assume ongoing maintenance responsibility for 250 rooms within the current accommodation portfolio and build two new central 'hub' buildings - one on the Endcliffe site and one on the Ranmoor site. These will be operated by the University and will include a full range of catering, retail, recreational and welfare facilities for students.

Elgood says: 'The student village sits within a conservation area, so specific and stringent criteria had to be met as regards to architecturals.'

Sheffield City Council granted planning permission in May 2005 and building work started in early 2006 with phased completion expected over three years.

Financing

The deal closed in May 2006 after the successful placement of bonds worth £156.8m (US$294m) - including £15m (US$27.75m) in variation bonds.

RBC Capital Markets, which was already financial adviser to the consortium, acted as bond underwriter and letter of credit provider - for both equity contribution and construction contract.

The bonds were wrapped by monoline insurer Financial Security Assurance UK (FSA).

'The bond route made economic sense because it is easier to secure for this length of time - 40 years - than debt finance.' says E & Y's Will Elggod. 'In addition, because the project achieved an investment grade rating from Moody's and S & P, it could be wrapped and thus dramatically reduce the coupon associated with the bond.'

'We chose the bond route for economic reasons.' adds RBC's Jessica Castle. 'The bond offered very long tenor, direct access to RPI linked funding without using derivatives and low initial debt service. With the Triple A wrap, this made it the most efficient source of funding.'

The sterling-denominated secured bonds issued by Catalyst Higher Education (Sheffield) are index-linked to the Retail Price Index (RPI) - which also guides rental prices. They are due on 31 July 2045.

The spread is 0.54 per cent over Gilts - listed as UKTi 4.125 per cent 2030 - and the coupon amounts to 1.8415 per cent.

The consortium provided £50,000 (US$92,500) in pinpoint equity and loan stock worth £16,547,000 (US$30,573,000m), of which £8.3m (US$15.3m) was provided by Bovis Lend Lease Holdings. The resulting debt/equity ratio was around the standard 90:10.

An unusual feature was the upfront capital contribution from the University, which amounted to £13.25m (US$24.5m).

According to RBC, this is the first public wrapped RPI-linked project bond for 18 months which was largely placed with institutional investors. It was placed at the lower end of price guidance 'despite extreme volatility in both the gilt and swap market.'

The latter meant that many of the financial and proprietary players were unable to bid aggressively, and over half the bonds were placed with traditional UK investors and the balance with European banks who want to hold the bonds long term on a LIBOR basis.

The debt will be repaid from rent received from the accommodation units over the 40 years, with the University of Sheffield guaranteeing part of the project income through the minimum rental payment (MRP).

Stable debt service coverage ratios above 1.10x are expected, as the project also benefits from some upside when occupancy and rentals are above the guaranteed amounts.

RBC's Jessica Castle says: 'While the project is similar to PFIs, it differs because of its volume element: occupancy level is a factor.'

'The main difference with PFI/PPPs is this occupancy element, which provides the opportunity for some upside.' she adds. 'When rooms over the base case assumption - which covers debt - are occupied, additional revenues are generated.'

S & P's Liesl Saldanha adds: 'Although the University of Sheffield (UoS) guarantees rental levels that meet senior debt service payments, failure to meet availability and performance standards can lead to payment deductions below the UoS guaranteed level.'

Above the UoS guarantee level the project is subject to volume risk, which Standard & Poor's assesses to be quite minimal up to the expected modeled rental level. Furthermore, unlike most PFIs, there is potential to set rents at levels above the projected level.

Castle says: 'Other similarities with PPP/PFI include the fixed-payment and long-term contract, as well as the allocation of some of the life cycle and maintenance risks to the project company.' As a public-private collaboration, risks are allocated to who can better bear them.

Conclusion

Sheffield's wrapped bond issue came to market sandwiched between a spate of bond-financed health PFI deals.

It was released between the issues for Barts - priced at 51.5bp over Gilts - and FSA-wrapped St Helens, which was the next index-linked bond to close and came in below Sheffield at 52.7bp.

The variety represented by Sheffield's pseudo-PFI deal was welcomed by investors, particularly institutional ones. Jessica Castle says: 'Investors were pleased to have a different kind of risk given the recent heavy supply of PFI hospital backed paper.'

As universities seek private collaboration to rationalize their large accommodation portfolios, similar deals are expected to follow and provide more variety to the health-dominated PFI market - only this year four publicly-rated hospital bond sales have already been sold in the UK.

The deal is, though, no pathfinder. A couple of accommodation bond issues have already taken place, one of the last ones also wrapped by FSA. The monoline wrapped £60 (US$111m) worth of index-linked bonds in 2002 for a student campus development project for the University of Hertfordshire, issued by Ellenbrook under the PFI and sold by Royal Bank of Scotland (RBS).

More PFI bond variety is expected this month with the UK's third - and largest - schools deal to-date at South Lanarkshire, as the PPP/PFI bond frenzy seems to go on - albeit in a context of tight pricings prompted by ever more global investor appetite.

The project at a glance

Project Name	University of Sheffield accommodation project
Location	Sheffield, Northern England
Description	The construction and 40-year operation of a new student village in Sheffield involving around 3,900 new or refurbished rooms
Sponsors	Catalyst Higher Education - a 50:50 JV between Bovis Lend Lease and HSBC Infrastructure Funds
Operator	Lend Lease Facilities and Estates Management
EPC Contractor	Bovis Lend Lease
Project Duration (Including construction)	43 years
Construction Stage	3 years
Total Project Value	£160 million
Total equity	£16.6 million
Equity Breakdown	50:50
University capital contribution	£13,250,000
Bonds breakdown	A bond issue of £156.8 million (due 31 July 2045) £141.8 million in public bond issue £15 million variation bonds
Bond arranger	RBC Capital Markets
Bond pricing	Spread of 54bp over Gilts giving a coupon of 1.8415%
Monoline provider	FSA
Legal Adviser to sponsor	Eversheds
Financial Adviser to sponsor	RBC Capital Markets
Legal adviser to banks	Linklaters
Legal adviser to council	Ashurst
Financial adviser to government	Ernst & Young
Date of bond launch	19 May 2006
Date of financial close	26 May 2006