The Aggregator, UK

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In the three years since its launch, the UK's Private Finance 2 (PF2) procurement model has faced considerable scepticism and, until recently, produced few results.

PF2 now has a chance to change market perceptions with the March 2015 closings for three discrete batches of schools that, despite different sponsors, rely on a single financing vehicle - the aggregator. Two more batches are expected to close as soon as July 2015.

The aggregator special purpose vehicle pools debt commitments and then disburses funding for the five batches' 46 schools. The 46 schools are expected to cost a combined £700 million (£1.1 billion), of which the aggregator will finance between £600 million and £630 million.

Private competition for the aggregator and the batches was fierce, even though the aggregator has been almost two years in development, and required serious scrutiny from potential participants. Perhaps because of that attention, the financings for the first three batches closed without any hitches.

But the aggregator will not open the floodgates for PF2. Only one follow-up is in procurement, which only attracted one final bid - from Carillion - with its third-party equity competition scheduled to open this month.

Pilot PF2

The aggregator is a slightly unusual concept, and came out at the same time as the untested PF2. PF2 is a reworking of the established UK procurement model, the Private Finance Initiative (PFI).

PF2 allows government to hold competitions for third-party equity, but also gives the UK Treasury the right to own up to 20% of a project's equity. These features are designed to combat the common perception that private sector equity returns from PFI projects were too high. Scotland's non-profit distributing (NPD) model, which substitutes subordinated debt for private sector equity, is another way of addressing those concerns.

The £2.4 billion Priority School Building Programme (PSBP) involves building 261 schools, 46 of which will be privately financed in five batches.

The aggregator was designed to simplify due diligence by using standardised documentation, and to improve the programme's chances of attracting non-bank debt. The UK Education Funding Agency (EFA) began crafting the aggregator structure in 2011, when bank debt was scarce, expensive and short-dated. Each batch of schools on its own may have been too small to interest an institutional investor or the European Investment Bank (EIB).

The EFA shortlisted three to capitalise the aggregator, and ultimately selected an Amber-led consortium. The agency and Amber reached commercial close on the aggregator in November 2014 – long after the health of the UK's debt markets had improved. Critics, one of whom dubbed the vehicle the aggravator, asked whether there was a need any longer for the structure.

Aggregator model

Amber’s listed equity fund, INPP, has committed mezzanine debt equivalent to 10% of the aggregator's total capital. The EIB and Aviva Investors are each providing 45% of the debt, as a direct loan and as fixed-rate notes, respectively. The aggregator will draw on these facilities when each batch closes.

The aggregator lends on the proceeds of that financing to the project company for each batch. The aggregator is providing £102 million for the North East batch, £136 million for Hertfordshire, Luton & Reading and £110 million for North West.

The single senior fixed-rate loan for each batch funds in staggered draws during construction, and its pricing reflects interest expense, the aggregator's costs and fees.

For the first three batches, Amber and EFA fixed the aggregator's interest rates at financial close with reference to the EIB’s long-term debt costs, and the benchmark Gilt on the day of close, and each batch will price at the same margin above these benchmarks. The senior debt will amortise over between 25 and 26 years – closely matching the concessions’ 25-year operational periods.

The batches were required to obtain a rating of at least BBB- from Standard & Poor’s (S&P), but all reached A-.

Giles Frost, the chief executive of Amber in London, notes that the aggregator boosted the first three batches’ credit ratings by two notches each. “The resulting interest cost savings are benefiting the government,” he says, because the EFA, an agency of the UK Department for Education, pays lower unitary charges, and can demonstrate better value-for-money.

PF2 funding competitions

Under PF2, preferred bidders can hold third-party equity competitions after their selection. Some batch concessionaires opted for this approach.

But for Kajima and Interserve’s Hertfordshire, Luton and Reading PSBP batch, the consortium committed to provide 100% of the batch's equity requirement before submitting its final bid.

The UK government has so far taken a 10% equity stake in the first three batches, through Treasury unit Infrastructure UK (IUK). This stake is run on an arms-length commercial basis, gives IUK the right to one director and no special voting rights.

IUK said it would take 10% stakes in the batches within two months of financial close. “It was plenty of time,” says Kirk Taylor, head of development at Kajima in London, adding that the process was smooth and no further sponsor due diligence was required.

“If there was no way forward for PF2 without the aggregator we would be fine with that, though we prefer using our relationships. The second time would be cleaner,” Taylor says. “Ultimately, we’re glad that those projects came forward, as at that time I think [without the aggregator] they probably would not have.”

Taylor says that Kajima finds that the prospect of earning surplus returns makes PF2 more attractive than Scotland's NPD model. Despite lukewarm sponsor enthusiasm the NPD model is winning converts in government, and is likely to make its debut in Wales soon. Even Ireland is likely to offer more PPP opportunities than England.

A PF2 slowdown

Only one other PF2 project is in procurement - Birmingham’s Midland Metropolitan acute hospital.

The tender for the £353 million Midland Metropolitan launched in July 2014, but just two bidders – Carillion and a Laing O'Rourke-Interserve consortium – stayed on until the competitive dialogue phase, and only Carillion submitted a final draft bid.

The Sandwell & West Birmingham Hospitals NHS Trust, which is procuring Midland Metropolitan, confirmed to *IJGlobal* that it is evaluating Carillion's bid. But neither the trust nor Laing O'Rourke wanted to discuss the other bidder's exit.

The equity competition for a 40% stake in the project company for the 670-bed facility is expected to begin this month, and the winning shareholder would be selected after the hospital's preferred bidder stage. IUK is due to take a 10% stake, and Carillion 50%. Debt would account for 90% of the concession's capital structure.

The County Durham and Darlington NHS Foundation Trust is considering a PF2 in its business case analysis for the University Hospital of North Durham's new accident & emergency unit. Given the amount of blame that PFI payments have attracted for damaging trusts' financial position, only the bravest or healthiest trusts will pick PF2 with confidence.

The Department for Education decided in May 2014 that it would procure a second round of PSBP hospitals directly.

Advisers

For the aggregator, HSBC and Ashurst advised the EFA, whilst Lloyds and Berwin Leighton Paisner advised the Amber consortium. Allen & Overy was legal adviser to the EIB. Amber Infrastructure is loan administration agent and corporate services provider.