

# Manchester super hospital

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21/03/2005

The Central Manchester and Manchester Children's hospitals PFI is an innovative and complex project that could give the industry a much-needed good news story, writes Simon Ellis.

Both PFI contractors and the councils and NHS Trusts they work with have come under renewed flak of late as a mix of early teething problems and brewing scandals have come to the attention of the national media.

With the refinancing profits row over the Darent Valley hospital, the Skye Bridge imbroglio and the collapse of Jarvis dominating the headlines, the UK press has redoubled its efforts to paint PFI firms as grasping, stubborn and financially unsound.

But occasionally a project emerges that gives the lie to the image, where both sides show flexibility and innovation to overcome substantial hurdles.

## The project- Outline

At the end of the last century, acute healthcare in the city of Manchester was beset with a number of pressing problems.

The Manchester Children's and Central Hospital NHS Trusts faced the unsustainable logistical challenge, as well as the £2.5m (US\$4.5m) per year maintenance bill, of managing a dilapidated stock of adult and children's hospitals scattered widely around the city.

According to project commissioning manager, Sandra McGreavy: 'The existing adult and children's buildings had one thing in common. They were inappropriate to provide a 21st century model of care.'

In 1999, the Trust set out to tender a ambitious solution that would relocate the city's Pendlebury and Booth Hall children's hospitals onto a single city centre campus, which they would share with rebuilt facilities for the Manchester Royal Infirmary, St Mary's Women and Children's hospital and the Manchester Royal Eye Hospital.

According to McGreavy, the project developer would be charged with keeping the identities of the five new facilities separate and maintaining the broad-ranging specialist training and research remits at each of the hospitals.

The centrepiece of the campus would be the new central children's hospital, which with 388 permanent beds over three storeys would be the largest paediatric hospital in the UK.

Elsewhere on the campus, the plans included the modernisation of the Royal Manchester Infirmary into a five-storey 758-bed hospital, the transformation of St Mary's into a 167-bed specialist women's hospital, the refurbishment of the 60-bed eye hospital and the provision of a new 97-bed mental health unit.

In spite of the complexity of the project, private sector interest in the 1470-bed hospital complex was strong – sweetened by a £175m (US\$338m) development loan already pledged to the project from the European Investment Bank (EIB).

In February 2001 the new combined Central Manchester and Manchester Children's University Hospitals NHS Trust (CMMC) shortlisted three developers: Mowlem Health, Taylor Woodrow-led New Hospitals and Catalyst – a consortium of Bovis Lend Lease, HSBC and Sodexo.

After a long deliberation process, CMMC cut Mowlem Health from its second shortlist and finally in September 2002 awarded the project to Catalyst.

## The project - Negotiations

Under the terms of the contract, Bovis Lend Lease will build the facility and manage life cycle maintenance over the term of the 37-year contract. Sodexo will provide catering, portering, laundry, security and hard maintenance services.

The consortium partners' interest was split between Bovis Lend Lease, HSBC and Sodexo on a 50:25:25 basis.

Catalyst chief executive Mike Davis said: 'The project involves the redevelopment of the existing site while the Manchester Royal infirmary, St Mary's and the Eye hospital all have to be kept going so there are enormously complex logistics.

There are 18 phases of construction, demolition, decanting and commissioning. It is the most complex site logistically that we have worked on.'

The project will also involve, in July 2005, the transfer of 100,000 square metres of NHS Trust estate to the Catalyst – one of the largest to date under any health PFI.

According to Davis, 'Negotiating the risk profile for taking on responsibility for the retained estate was a major part of the transaction.'

In September 2003, the project received a setback when an independent Grant Thornton review commissioned by Manchester Strategic Health Authority found Greater Manchester health economy was heading to a £12m (US\$21m) budget deficit by the end of the year.

The review brought NHS projects to a standstill and had serious implications for the Central Manchester project.

Davis says, 'When the dreaded letter came we were in the process of getting to a commercial agreement. Overall the review set us back by about 12 months in total.'

With the CMMC's financing in limbo and the ambitious construction timeline slipping, Catalyst resolved to start on site even at the cost of taking on the construction costs itself.

The deal reached commercial close under an early works agreement in June 2004 and Bovis Lend Lease started the first phase of the project July 2004.

Despite the consortium's apparent desire to move the project forward, a meeting in August 2004 the CMMC voiced concerns that FM provider Sodexo was 'dragging its feet' over financial close. The two parties agreed to push for close before the end of the year.

The negotiations were rejoined with renewed vigour and the project scraped to financial close on 16 December 2004.

Commenting on the time taken to reach financial close, Catalyst project manager Mike Fry said: 'Projects of this scope and scale don't happen too frequently so it takes a lot of work to bring them to this stage. The Manchester scheme brings adult, women's, children's, eye and mental health services together, each in distinct hospital but all on a single site.'

Bovis anticipates the first part of the hospital – a new mental health unit and a 1,700-space multi-storey car park will open in early 2006 with the rest of the hospital opening in phases up to late 2009.

#### The financing

Catalyst faced an interesting challenge in financing the project both in accommodating the project cuts and the EIB loan.

Catalyst decided to commit a substantial equity and debt stake from its own partner companies and raise the balance from a bond issue.

In January 2004, Catalyst tasked the Royal Bank of Canada (RBC) with putting together a bespoke financing structure for the project.

RBC acted as joint lead arranger with Deutsche Bank to raise a £218m (US\$421m) index-linked bond which included £38m (US\$73m) of undrawn variation bond facility.

The RBC-Deutsche bonds carry a semi-annual coupon and principal fixed at 82 basis points over the index-linked gilt. The bonds have a 36-year tenor and have a sculpted repayment profile.

The £175m (US\$338m) EIB loan was index-linked and has a tenor of 32.5 years. The loan - only the organisation's fourth to a UK PFI project - was backed through a back-to-back index linked bond issue.

Monoline insurers Ambac Assurance provided a guarantee on the scheduled payments of principal and interest under the Index-Linked Bonds and the EIB Loan.

The £43m (US\$83m) balance of the funding was raised from the consortium in the form of £21m (US\$39m) of subordinated debt provided by HSBC, £21m (US\$39m) in Catalyst shareholder loan stock and the remainder in the form of a £100,000 pinpoint equity stake.

Giles Tucker, head of Infrastructure Finance at RBC, said, 'We aimed to structure a financing package which won support from the UK

institutional client base - generally pension funds wishing to match their RPI linked pension liabilities - thus driving down the cost of funding to the public sector.'

#### Conclusion

According to Mike Davis, the effort expended by Catalyst on the project was worthwhile.

'The project was Catalyst's most challenging yet. In terms of the project being a redevelopment of a congested city site including this very large retained estate, the early handover of the estate and services, and the fact that it was financed by both the EIB and a bond, it was a very complex transaction.'

'In spite of the setbacks, in the end everyone pulled together to get it sorted including the SHA and the NHS trust.'

Making predictions about PFI is rarely a safe occupation, but on current evidence the central Manchester project will not much trouble the pages of the national press.

After all, despite the vast technical and financing challenges involved, the project is set to meet its 2009 construction deadline.

The financing too has a solid pedigree - sourced from a bond issue targeted largely at pension fund investors and a loan secured from a financing institution of the European Union.

Finally, Catalyst, which had to contribute substantially from its own pocket while the RBC bond issue was delayed, is distinctively difficult to cast in the miserly role much of the media has reserved for PFI contractors.

It may not grab many column inches just yet, but the project designed to provide suitable facilities for sick children in Manchester has the opportunity to become the poster boy that the industry badly needs.

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