Newcastle hospital

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In the spring of 2003 an Equion-led consortium won preferred bidder status on one of the biggest and most ambitious PFI hospital schemes to come to market so far - writes Alex Black.

Almost exactly one year later, the Northumberland and Tyne and Wear strategic health authority signed the deal that allowed the consortia to start work on a £300m (US$562m) project that will see the closure of Newcastle General Hospital and the development of the Royal Victoria Infirmary (RVI) and Freeman Hospital.

The rationale

Newcastle-upon-Tyne Hospitals NHS Trust is one of the largest NHS Trusts in the UK with a turnover of more than £500m (US$936m) and a catchment area of 500,000 patients.

It also provides specialist tertiary services to 3m people as well as national and international commitments.

The Freeman hospital – which has more than one million patient engagements per year – has a specialist renal services, cancer care and cardio-thoracic units, and was voted the leading NHS hospital in the Sunday Times Survey (2004) and boasts a 3 star status.

The process started when the Newcastle-upon-Tyne Hospitals NHS Trust conducted a review into its estate with the strategic health authority. The review concluded the trust not only needed new facilities, but would also benefit from re-jigging its estate by taking the three hospitals and turning them into two.

After looking at funding options the trust decided to proceed down the PFI financing route.

The parties

The private sector consortium includes Equion, Laing O'Rourke Construction, the Commonwealth Bank of Australia (CBA) and Interserve FM.

Ownership of the Healthcare Support (Newcastle) SPV is split 80:20 between Equion Health (Newcastle) and Interserve.

Equion Health (Newcastle) is joint-owned by Laing-owned Equion and Newcastle Investment Company, which in turn is owned by the CBA.

The construction contractor is Laing O'Rourke Northern (LOR), who will also be design contractor. Interserve FM will provide hard FM.

The health authority's legal advisor is Dickinson Dees, its financial advisor is PwC and its technical advisor is Mott MacDonald.

Macquarie provided financial advice to the sponsor with legal advice coming from Denton Wilde Sapte. CMS Cameron McKenna acted for the banks.

The project

At the Freeman Hospital, a new renal services centre of mroe than 4,000 square metres in size will be designed and built by the project company. The Freeman will also get a new four-storey cancer centre called the Northern Centre for Cancer Treatment.

The RVI site will benefit from a new accident and emergency (A&E) department – with all the clinical support services such as neurosciences, infectious diseases, traumatic orthopaedics and critical care – that entails. Children's services will be integrated into a purpose-built facility adjoining the main development.

In total, an area of 76,300 square metres will be new-build and 6,700 square metres will be refurbishment.

The Freeman phase of the project is almost entirely new build, with some limited refurbishment work at the RVI.

FM services at the new facilities will be handled by the project company, with the trust maintaining the much smaller refurbishment section of the scheme.

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The total capital expenditure required for the construction work was just over £300m and the SPV struck a deal with builder LOR for a fixed-price, turnkey DB contract.

LOR will be expected to absorb any cost over-runs unless a fundamental change in the scope is requested by the trust.

The work

Although construction is taking place on two sites, project co-ordinator Steven Reed says the scheme was being treated as one project and the total construction phase is expected to be around eight years.

It is expected that the new cancer and kidney centres at the Freeman Hospital will open in 2008 and that the new facilities at the RVI will be phased in over four years from 2008. The operational phase of the scheme will then be 30 years.

The financing

The project is being funded by a combination of a 36.5-year index-linked bond worth £201m (US$346m) to be launched by the Royal Bank of Canada, and a 33-year £115m (US$219m) senior secured EIB loan, with XL Capital Assurance guaranteeing the loan.

SPV Healthcare Support (Newcastle) will be owned 80:20 by Equion and Interserve, and the shareholders will invest £25m (US$48m) of subordinated debt (at the end of year five) and one half of a construction liquidity facility of £17m (US$32m). Equion Health (Newcastle), which is joint-owned by Equion and the CBA, owns Equion's share. The debt:equity ratio is 92:8.

Gary Lucas, commercial director for Equion, says the financing package was determined at a relatively early stage in the project when the trust indicated it wanted to involve the EIB and the attractive borrowing rates it would offer.

'This was something we were made aware of even before the preferred bidder stage,' says Lucas. 'The EIB had capped the amount it was prepared to lend based on the original works estimate.

'However, this increased as the scope of the project developed, and it wasn't prepared to loan more. We had a funding competition between debt providers and the bond solution after we were made preferred bidder and made a decision to go with the index-linked bond soon after.'

The hurdles

According to Lucas, the procurement ran fairly smoothly in the context of a major hospital project.

'The technical problems we encountered included getting the phasing down to ensure minimum disruption and decants, something we think we've done pretty well,' he explains.

The trust already has an existing PFI for energy supply and the possibility of integrating the two contracts was investigated, but in the end it was decided to keep the two as separate contracts.

However, a source who worked on project and preferred not to be named said one of the crucial lessons learned was that the ratings agencies should be involved at an earlier stage.

'The contract only contains a hard FM aspect which, as it's a low services content, is a low proportion of the tariff. This affected the rating agencies' view of risk and led to them viewing the deal primarily as a construction project and weighting the risks accordingly. This was a bit of a surprise to us,' the source says.

'If we had to do the deal again, we'd want to see ratings agencies engaged sooner to avoid the situation where the project was defined as a construction project. That would hopefully mean we'd avoid the scenario of having to arrange a construction liquidity facility as we did in this case.

'Helping them to get their understanding of the deal in line with ours at an earlier stage would have been a big benefit.

The conclusion

The trust is not only a teaching trust, but its range of facilities means it also provides a vital service to patients from well beyond its immediate catchment area.

With the NHS introducing national tariffs for acute services, and therefore effectively demanding greater efficiencies, the trust needs to know

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that it can sustain a high standard of patient care without breaking a financial regime that saw it return a £10m (US$18m) surplus last year.

By distilling its acute hospital estate down from three to two, the trust now believes it has its facilities concentrated in a way that will enable it to provide acute services to patients for the foreseeable future.

Project table

Project	Newcastle hospital
Market	PPP
Sector	Health
Country	UK
County	Northumberland
Date of financial close	26 April 2005
Sponsors	Equion Interserve
Project company	Healthcare Support (Newcastle) Finance
Ownership of SPV	80:20 between Equion Health (Newcastle) and Interserve
Total project value	£300m (US$562m)
index-linked bond	£201m (US$346m)
Bond launched by	Royal Bank of Canada
Bond tenor	36.5 years
Senior loan	£115m (US$219m)
Loan supplied by	EIB
Loan tenor	33 years
Subordianted debt	£25m (US$48m)

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Insurer	XL Capital Assurance
Construction liquidity facility	£17m (US$32m)
debt:equity ratio	92:8
Private sector parties	Equion, Laing O'Rourke Construction, the Commonwealth Bank of Australia (CBA) and Interserve
Construction contractor	Laing O'Rourke Northern (LOR)
FM provider	Interserve FM
Health authority's legal advisor	Dickinson Dees
Health authority's financial advisor	PwC
Health authority's financial advisor	Mott MacDonald
Sponsor's financial advisor	Macquarie
Sponsor's legal advisor	Denton Wilde Sapte
Bank's legal advisor	CMS Cameron McKenna

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