McGill hospital: Game changer

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The McGill University Health Centre bond issue has broken the Canadian PPP market wide open. The C$764.1 million ($740 million) senior series A amortising bonds reached financial close on 9 July, reportedly attracting 51 participants the most ever for a PPP bond and setting a new benchmark for investor participation in Canadian PPP deals.

Mays Centre de Recherche (CR) at the Centre Hospitalier de lUniversite de Montreal (CHUM) PPP C$452 million issuance only had 18 participants and, according to an underwriter source close to the McGill financing, there were only six institutions that regularly participated in indexed private infrastructure financing in the country as little as a year ago.

All the previous PPP bonds in Canada did their part to desensitise investors to the market, added the source. McGill was different. It was the first PPP that was structured like a corporate bond issuance, the first with a real road show and the first with a lot of one-on-one meetings. It changed the game.

The request for qualifications for the new McGill healthcare facility was released in June 2007 to considerable market scepticism. The government of Quebec faced challenges about whether a PPP was the appropriate method to finance construction of the McGill and CR-CHUM projects. After some delay, the request for proposals was released to the two interested teams, Groupe immobilier santé McGill led by SNC-Lavalin/Innisfree and Partnerariat CUSM led by John Laing/ OHL, in October 2008 and formal bids were submitted in November 2009.

However, the two bidders were forced to resubmit their technical and financial proposals because, at more than C$1.6 billion, they were deemed too expensive. The two consortiums submitted final bids below the provinces C$1.343 billion construction budget cap this March and the grantor, McGill University Health Centre, awarded SNC-Lavalin/Innisfree the 34.3-year design, construction, financing and maintenance concession in June.

The sponsors initially planned to raise C$754.8 million with long-term amortizing bonds when underwriters Scotia Bank, Casgrain and Dexia launched the deal in June. But they ended up raising C$764 million by the time it closed, allowing the sponsors to reduce their equity contribution to C$191.8 million, split between pure equity (5%) and deeply subordinated debt (95%).

Other sources of financing include C$105 million in milestone payments, a C$245.3 million contribution from the grantor, towards the concessionaire building a parking facility from which the grantor receives revenues, and a $392.5 short-term bank loan that will be repaid entirely from a C$706.5 million substantial completion payment at the end of construction. Lenders on the bank debt were BNP Paribas, CIBC, Credit Agricole, Dexia, Royal Bank of Scotland, Scotia Bank and Sumitomo Mitsui Banking Corporation. According to DBRS, lifetime debt service coverage ratio (DSCR) for the deal is projected to be 1.38x and gearing is 86%. However, if the sponsors decide to issue another C$61 million in debt after operations commence, DBRS said the DSCR would decrease to 1.27x.

The project company began construction last month on the 217,500 square metre hospital. SNC-Lavalin Services, a joint venture led by SNC-Lavalin Construction with Pomerleau and Verreault, is responsible for construction under a fixed-price date-certain contract. SNC is providing a guarantee of 55% of the C$1.57 billion contract price backed by a letter of credit for 10% of this. Contractor liability is capped at 55%, including 10.9% for liquidated damages.

The facility, located at McGills Glen Campus roughly 5km west of downtown Montreal, is scheduled to open in September 2014 and includes 500 patient beds, 20 operating rooms, 3,000 square metres of retail space and a 2,735-space parking garage (not included in the PPP concession). SNC-Lavalin Operations and Maintenance is responsible for routine O&M and Johnson Controls for lifecycle maintenance of technical elements of the facilities. Operational revenues will be covered by availability payments (97.5%) from the province of Quebec and MUHC, with retail and interest revenue covering the remainder.

The C$764 million in bonds were the largest debt financing for an infrastructure concession in Canada to date, and surpassed CR-CHUMs issuance by C$312 million. The fixed-rate McGill bonds priced at 290bp over the equivalent government of Canada bond for a yield of 6.632%, and mature on 30 June 2044. Standard & Poors gave the bonds an A- and DBRS an A low rating. According to a source following the PPP market in Canada, after the deal closed institutions were able to sell the McGill bonds on the secondary market at yields closer to 250bp over the equivalent, indicating that some buyers, at least, would have been happy with lower pricing.

The banker at the underwriters points to the projects fundamentals, investors familiarity with the sponsors SNC-Lavalin is a well known, rated engineering and construction company in Canada as possible factors in getting the bonds out. I believe the widely distributed bond model will work and continue to garner interest from institutional investors in Canada, the source said, but noted that the PPP market remains in its infancy.

Regardless of what worked for McGill, other Canadian PPPs in the pipeline stand to benefit. McGill proves that privately-financed projects, with proper financial and contractual structuring, can attract broad debt market interest. Quebecs other large hospital project, for cross-town rival lUniversité de Montréal, is set to come to market in 2011, while Ontario, in particular, still has some large deals in its pipeline that will benefit from a broader bond market.

SNC-Lavalin Innisfree McGill Finance Inc.
Status: Closed 9 July 2010
Size: C$1.57 billion ($1.5 billion)
Location: Montreal, Canada
Description: 34.3-year design, build, finance and maintain PPP concession for a new 217,500 square metre hospital
Awarding authority: McGill University Health Centre
Sponsors: SNC-Lavalin (60%) and Innisfree (40%)
Equity: C$191.8 million
Long-term debt: C$764.1 million
Short-term bank financing: C$392.5 million
Bond underwriters: Scotia Bank (lead), Dexia and Casgrain
Loan arrangers: BNP Paribas, CIBC, Credit Agricole, Dexia, Royal Bank of Scotland, Scotia Bank and Sumitomo Mitsui Banking Corporation
Contractor: SNC-Lavalin Services
Facilities management: SNC-Lavalin O&M
Technical maintenance: Johnson Controls
Financial adviser: Investec
Legal advisers: McCarthy Tetrault (sponsors) and Ogilvy Renault (government)
Technical adviser: Mott MacDonald