The New Romford Hospital PFI Project

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The Barking, Havering and Redbridge Hospitals NHS Trust achieved financial close on its £216 million (US$394 million) PFI deal on 15 January 2004 – one month after the official signing of the legal contracts for the project. The new hospital will be part of one of the largest non-teaching acute hospital Trusts in England and will be a key facilitator in delivering the Trust's new graduated model of clinical care.

Barking, Havering and Redbridge Hospital chief executive Mark Rees said at the closing of the deal: 'This latest landmark in the process of building the hospital is fantastic news and brings us another step closer to the long awaited reality of a brand new health care facility for our staff and for local people.'

The commissioning of this facility will enable the Trust to deliver modernised acute services from two main centres, King George Hospital in Redbridge and the new hospital at Romford. The new hospital will replace the services currently provided on the Oldchurch and Harold Wood sites.The new hospital at Romford will be a modern facility that has been designed with close consultation between architects and doctors, nurses and therapists. The hospital has been designed around the needs of the patient. The design reflects special attention to the process flow of the patients through the hospital.

The project

The project involves the reconfiguration of the acute hospital from two existing operational sites to a single brownfield site in Romford and has a capital cost of £200 million (US$365 million). The deal comprises:

design and construction of the new 860-bed hospital lifecycle maintenance, renewal and replacement of structural elements over the 33 year operating period outsourcing of the hard facilities management services including planned and responsive maintenance, estate services and ground maintenance outsourcing of the soft facilities management services including cleaning, catering, laundry, portering, security, ward housekeeping etc provision and maintenance of new clinical and telephony equipment and the maintenance of elements of the existing clinical equipment deriving of third party income from managing the car-park and retail units

The contract

The contract was won by Catalyst Healthcare Management, a consortium of Bovis Lend Lease, Sodexho and HBOS. The deal was funded with a £100 million (US$180 million) bond issued by the European Investment Bank and a £118.4 million (US$216 million) public bond arranged by Deutsche Bank, launched at an investor spread of 94 basis points with committed variations bonds of £10 million (US$18 million).

A mezzanine loan of £13.9 million (US$25 million) was provided by HBOS and £14.5 million (US$26.5 million) of equity was provided in the form of junior subordinated loan stock and ordinary shares.

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October 2006.

The scheme had to deal with a number of issues including being a pilot for the Retention of Employment Model for soft FM services and being one of the first projects to use Standard Form 3, the new contract for NHS PFI deals.

Ernst & Young acted as financial advisor to the Trust, advised on this project from the OBC stage to financial close, with advice ranging from healthcare financial advice, project finance and PFI advice to negotiation strategy and support to provision of specialist accounting, tax and VAT advice.

Payment to Catalyst Healthcare is linked to stringent availability and performance criteria and targets include reducing energy (electricity and gas) consumption. The rating agencies gave the project an investment grade shadow rating of BBB/BAA3.

The procurement

The procurement was more complex than other bank-funded health PFI deals due to a number of challenges, both health industry specific as well as project specific, that the project has had to face. These include:

Retention of Employment (RoE) – the NHS introduced the RoE model for soft FM services staff – catering, domestic, portering and security – whereby the staff have the option not to transfer to Sodexho under TUPE but are seconded to Sodexho instead. The New Romford Hospital project was selected to be one of the three pilots for the RoE model when it was on the verge of appointing a preferred bidder. This requirement necessitated a further round of bidding from which Catalyst Healthcare emerged as the preferred bidder Standard Form 3 (SF3) – the NHS issued the new Standard Form 3 Project Agreement in mid-2003, months before the project was due to achieve contract close. The project was required to adopt SF3 (in effect making the project a pilot again) which required further negotiations with the SPV Funding providers – the number and different types of funding providers created a number of different issues and made negotiations more complex. For example the inclusion of the EIB as senior debt provider enabled the cost of finance to be lower than would otherwise have been possible. However, one of the terms of the EIB was the requirement for the SPV to take the risk of a downgrade of the monoline insurer which led to discussions as to who was best placed to take this risk Composite trade tax treatment – this innovative tax treatment was introduced to this project at a time when no guidance was issued to NHS Trusts on this topic. In most cases this tax structure allows a significantly lower tax change – and hence enables reductions in the unitary payment – as nearly 100 per cent of the capital expenditure is allowable for tax purposes, as compared to typically 40 per cent under the fixed asset/capital allowances regime. This tax structure has now become standard practice on most NHS PFI deals Permitted Borrowings – this issue had been the subject of extensive discussions between the funding market and HM Treasury during 2003. It was decided that this project would be used to reach a definitive position on this issue, which resulted in extensive negotiations, partly due to the number and types of funding providers involved Index-linked bonds – the project was partly funded by EIB-issued, index-linked bonds and partly through public-issue, index-linked bonds at a time when appetite for index-linked bonds was low due to a previous government announcement on pensions – as demonstrated by the South Derby PFI project which had to be delayed in order to switch the financing from index-linked to fixed-rate bonds. However the New Romford project was backed by the FSA which was a factor in enabling the index-linked bonds to be launched as the market was at that time saturated with bond paper issued by the other monoline insurers, MBIA in particular Bond process – the process to issue bond debt requires more activity and time than bank debt. These activities include: liaison with rating agencies to obtain the shadow rating for the project (Monoline Insurers will not insure projects that have non-investment grade), issuing an offering circular and undertaking a roadshow (presentations and one-on-one meetings) to introduce the project to potential investors, and pricing discussions to build up the order book.

Legal

UK law firm Berwin Leighton Paisner (BLP) advised Barking, Havering and Redbridge Hospitals NHS Trust on legal aspects. This included advising on procurement, RoE, payment mechanism and negotiating with Catalyst Healthcare, Sodexho and all the funders. Clifford Chance advised Catalyst Healthcare, Shadbolts & Co advised Sodexho with Linklaters and

McGrigors advising the funders.

BLP partner Jim Buchanan says: ‘The project presented a number of challenges. In addition to these, the advent of Foundation Trusts required new legal documentation. If the Trust becomes a Foundation Trust then the protection given to creditors under the NHS (Residual Liabilities) Act will not apply. Therefore, a Deed of Safeguard was negotiated whereby the Secretary of State would perform the payment obligations of the Trust under, amongst other things, the Project Agreement and the Funders Direct Agreement.

‘The project also involved a Managed Equipment Service (MES) which included provisions for the financing, supply, maintenance and renewal of medical equipment. Detailed negotiations were undertaken regarding equipment selection and procurement. This was to ensure that the Trust had appropriate involvement in the selection of equipment in order to meet the Trust’s clinical requirements while, at the same time, permitting the MES provider, Siemens, to manage the risk associated with the MES. Given the sensitivity of funders generally to technology-based services, the impact of service failure in MES was isolated from the larger deal.

‘The legal challenges presented were many and varied and undoubtedly the position reached will provide a precedent for similar transactions in the future.’

Conclusion

The new facility has enabled the trust to deliver modernised acute services from two main centres – King George Hospital in Redbridge and the new hospital at Romford – and replace the services currently provided on the Oldchurch and Harold Wood sites using PFI to transfer the risk and offer a substantial contract to the private sector.

It is important that the knowledge and experience gained in developing the New Romford Hospital project is transferred to other projects, both by the Trust team and its external advisors. To this end, Duane Passman, project director has taken on the position of head of the capital investment unit for the London Strategic Health Authorities and Paul Curran, project manager, has joined the Department of Health’s private finance unit.

Written in association with Chandrika Screen of the Ernst & Young projects department