Aspire Defence's Allenby Connaught MoD PFI

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Aspire Defence - a joint venture between Mowlem, Kellogg Brown Root (KBR) and HSBC Infrastructure - has closed the long-awaited Allenby Connaught ministry of defence (MoD) accommodation project, bringing together two monolines in a groundbreaking financing structure

The scheme has taken longer than originally anticipated to come around, having been awarded preferred bidder status for the 35-year contract in mid-2003. In that time, the project has faced more than its fair share of problems, not the least of which was the struggling Mowlem being taken over by Carillion in February 2006.

The project entails a PFI contract with the MoD for the provision of accommodation facilities and services on a number of garrisons located across the Salisbury Plain Area (Allenby) and at the Aldershot garrison (Connaught) that will benefit 18,000 military and civilian staff.

The origins of Project Allenby Connaught can be traced back as far as 1999 when as part of the MoD's *Strategic Defence Review* some 2,500 soldiers were going to be brought back from Germany and housed in the Aldershot area. This was when the MoD realised it was not ready for this relocation.

'We didn't have any spare accommodation and the existing facilities were in an appalling state' says Mike Cooper, project director from the MoD.

'We conduct surveys on soldiers when they leave over their reasons for quitting and found out that 30 per cent of army personnel said that one of the top five reasons was poor accommodation' adds the MoD's Cooper.

In Salisbury works will be carried out in the garrisons of Tidworth, Bulford, Perham Down, Ludgershall and Netheravon (together known as TidNBul), Larkhill and Warminster.

About 7,000 new en-suite bedrooms will be built and a further 4,100 refurbished to accommodate army personnel.

'Fort the first time 11,000 soldiers will be getting their own rooms, internet enabled, en-suite shower rooms, laundry facilities, kitchenette and communal centres' says Aspire Defence's chief executive Peter Smart.

Other new facilities include:

- offices
- sports centres
- garaging
- dining centres
- theatres
- messes

- roads
- utilities

In total, there will be six major construction sites where more than 200 buildings will be under construction or refurbishment. The project company or its sub-contractors will also provide more than 20 different hard and soft facilities management (FM) services to the garrisons.

'Although this has taken sometime to reach financial close, a lot of work has already been done' says Smart from Aspire Defence. 'We built a 36-man demonstration block where soldiers have been living since January 2005 and we got a lot of feedback from that and used it for the re-design.'

The contracts

The 35-year project agreement is between Aspire Defence and the MoD. Aspire Defence Capital Works is a 50:50 joint venture between Carillion and KBR, with them carrying out the £1.25bn construction programme.

The majority of works involve low-rise and technically simple construction projects costing between £500,000 and £10 million.

Works will be completed progressively within a period of 10 years (Transition Period), with about 97 per cent of works completed in the first eight years.

Aspire Defence Capital Works has entered into sub-contract agreements with various companies including MUJV (EDF Energy and Thames Water), Corus and Rollalong.

A second 50:50 JV between Carillion and KBR, Aspire Defence Services, will provide the garrisons with a wide range of hard and soft FM services. The soft services includes:

- mess and catering services
- housekeeping
- office services
- cleaning
- transport (white fleet management)
- stores management
- grounds maintenance
- 24/7 helpdesk

Hard FM services include repairs and maintenance (including backlog maintenance for the existing estates), asset management and utility infrastructure.

Services sub-contractors include MUJV, Sodexho and Lex Transfleet.

Certain soft FM services will be benchmarked and/or market tested at year 10 and every seven years thereafter.

Sources of funding and financing flows

The sponsors and their financial adviser Citigroup launched a special purpose vehicle (SPV) Aspire Defence Finance to issue bonds to fund the project.

In March 2004, Citigroup and HSBC won the financing mandate and ultimately became the lead arrangers and underwriters of the largest bond issue ever completed by a private contractor under the MoD PFI programme.

The £1.46bn bond issue was split into two equal tranches and benefit from financial guarantee policies provided by Ambac for Series A and MBIA for Series B.

The spread over gilts was at 56bp to give a fixed coupon of 4.674 per cent, with legal maturities of 34 years and average lives of 24.9 years.

'The huge interest generated during the roadshows - where we did 26 one-to-one meetings - and ultimately the level of oversubscription enabled us to squeeze the spreads,' says Smart from Aspire Defence.

At 56bp, the market view is that despite the complexity of the project, the risks associated with it are akin to PFI deals in health and education.

For example on the same day that Aspire's bonds were priced, RBC Capital Markets launched a £100.4m bond issue for Alpha Schools (Highlands) priced at 1bp less than Aspire over gilts with a 30-year legal maturity (IJ News, 31 March 2006).

Prior to the issue of the securities, HSBC undertook a gilt settlement programme (GSP), which involved the purchase and sale of gilts in order to reduce the risk of the gilt market being distorted as a result of the launch and pricing of the bonds.

This was a requirement from the MoD, which bore all losses and expenses related to the GSP.

In addition, £115 million and £37.5 million in Series A Authority and Rescue Variation bonds respectively were issued, with the same amounts for Series B.

The variation bonds were retained by the issuer and will be sold from time to time in the future to provide additional finance.

The equity portion on the deal was £120 million and was in proportion to the shareholder structure with Carillion (50 per cent) investing £60 million, KBR (45 per cent) £54 million and HSBC Infrastructure (5 per cent) £6 million.

Sponsors will recoup their investments from a revenue stream coming from a single monthly payment by the MoD, commencing three months after the bond's issue date (6 April 2006).

Payments will be based on availability and performance measurements of construction and services and will be sufficient to meet the project costs, minimum debt service cover ratios, tax obligations and sponsor returns.

According to Carillion, the contract is worth around £12bn and £8bn in nominal and real terms respectively over the concession period, while its share of the project's revenues will be about £6bn.

If one includes Carillion's share of the building and service contracts, it almost doubles the value of the company's order book. The project is estimated to generate about £9.5bn of returns for Carillion Group.

Identical twins - which will prevail?

As well as being the largest PFI bond issued in the London market to date, the twin series structure also represent the first credit-wrapped bonds to be ranked pari passu.

The Ambac-wrapped securities were 2.2 times oversubscribed, while the MBIA bond was 1.76, giving an early signal of market preference for Ambac-backed securities mainly due to MBIA's exposure to Eurotunnel's re-structuring.

However, a banker close to the deal said that 'the securities will trade fairly closely in the aftermarket, while price divergence will depend a lot on how well the two monolines manage their financial PR.'

Around 94 per cent of the bonds were placed domestically and the rest in Europe. The investor base breakdown was as follows:

- 60 per cent insurance companies
- 35 per cent asset managers
- 2.5 per cent banks

- 2.5 per cent hedge funds

Aspire Defence bonds seem to be heralding a new type of financing for large PFI deals in the UK market.

A similar transaction featuring two identical bond tranches one wrapped by Ambac and the other by FSA will be launched for the £1 billion Barts & Royal London Hospital PFI deal which is due to close within days. The two deals will differ in that the hospital deal will feature index-linked notes.

Advisory roles and fees

Citigroup acted as the financial adviser to the SPV, while CMS Cameron McKenna provided legal advice.

Aspire Defence paid £3.493m in combined advisory and underwriting fees or 0.2387 per cent of the bonds' nominal amount.

PwC and Freshfields were the MoD's financial and legal advisers respectively, while Clifford Chance advised the underwriters and monoline insurers.

Pinsent Masons advised the construction and services joint ventures Aspire Defence Capital Works and Aspire Defence Services.

Conclusion

At the core of Project Allenby Connaught lies the objective of providing a mass accommodation solution for the British army, furnishing soldiers of all ranks with single rooms for the first time. This is a step change from traditional army barracks to an environment that will be akin to a campus village with the aim of attracting soldiers in a competitive market place.

Despite a long time in gestation, the contractors and the costumer used this time to work on risk reduction and to build a 36-man demonstration block.

This pilot accommodation facility enabled the MoD to test how the chain of command handles soldiers living in single rooms before giving the final green-light to the project.

Allenby Connaught stands out as the largest MoD PFI contract to date and its financing was also outstanding as it saw the largest PFI bond issued in the London market. Aspire Defence has also broken new ground by putting the two-tranche bond pari passu.

It is too early to predict how these two series, one wrapped by Ambac and the other by MBIA, will perform in the secondary market but as far as the structure of the deal is concern this is certainly a benchmark issue.

The project at a glance

Project Name	Allenby Connaught
Location	Southern England, UK
Description	MoD PFI contract for the provision of accommodation facilities and services on a number of garrisons
Sponsors	Carillion KBR HSBC Infrastructure
Operator	Carillion KBR
EPC Contractor	Carillion KBR
EPC Sub Contract 1	EDF Energy Thames Water

EPC Sub Contract 2	Corus
EPC Sub Contract 3	Rollalong
Project Duration (Including construction)	35 years including a 10-year construction period
Total Project Value	£12bn and £8bn in nominal and real terms respectively
Total equity	£120 million
Equity Breakdown	Carillion £60 million KBR £54 million HSBC Infrastructure £6 million
Total senior debt	£1.463 billion
Senior debt breakdown	Two equal tranches of £731.5 million.
Senior debt pricing	Gilts + 56bp
Debt:equity ratio	92:8
Mandated lead arrangers	Citigroup HSBC
Legal Adviser to sponsor	CMS Cameron McKenna
Financial Adviser to sponsor	Citigroup
Legal adviser to banks	Clifford Chance
Legal adviser to government	Freshfields
Financial adviser to government	PwC
Date of financial close	6 April 2006