FINANCIAL STATEGY & Private Finance Initiative

Refinancing: Altcourse Prison

NARRATOR:
Bruce White negotiated the contracts on the Altcourse deal.

BRUCE WHITE:
One of the component elements of the cost of debt in a syndicated London bank debt transaction is the margin, i.e. what the bank charges, of London inter-bank rates and in those days when the transaction was done back in '95 the margins that the banks charged are higher than the margins that are being charged in today's market, partly because that's the way the market was in those days and partly because this was the first of its kind and so banks being slightly more cautious, priced accordingly.

MARCUS DAVISON:
And they said to the funding consortium, something like this: we have demonstrated our ability to manage that risk because we've finished the building within time and within budget. So the amount of risk has now been disproportionately reduced because the 10% of the total time represented by building and commissioning represented far more than 10% of total risk.

And also you must now make a more optimistic, a more positive assessment of our ability as a consortium to handle risk, so on two separate grounds we think you should be prepared to refinance the capital for this prison at a much lower rate.

BRUCE WHITE:
And the banks agreed for the payment of a fee a lower margin. The net result of that is the unitary charge for the 25 years is still predicated with the old margin but the project company's only being charged the new and reduced margin, the difference being upside, i.e. profit.

MARCUS DAVISON:
Now what this meant in hard cash was that the consortium, which consisted of Tarmac who were in charge of building and Group 4 who were in charge of operating. Their original assessment of the overall return to them as shareholders, the present value if you like, of all future returns was going to be about 17 million pounds. They'd earned an extra three million from the early completion, and they estimated that by refinancing the prison they could reap additional returns for the shareholders equivalent to about another 10 to 11 million pounds. The two things together, increasing from 17 to 30 million was an increase of about 60-70% in the total return.

NARRATOR:
Refinancing enhanced the consortium's profits by redistributing returns away from the debt providers and back to the shareholders. Because the cost of debt was reduced, the company's shares rose in value as its future profitability increased.

MARCUS DAVISON:
Now the prison services were not very happy about this. They said if there's to be any gain to be made from refinancing, we think we should get a portion of it.

Complicated sums were done and the prison services got a million pounds as compensation.

NARRATOR:
The experience of Altcourse started the ball rolling for other PFI schemes.

BRUCE WHITE:
Refinancing has now become much more high profile by virtue of the size of some of the gains.

The most acute or high profile would be Norfolk and Norwich hospital where the refinancing gain was close to £100,000,000 which is the cost of a new hospital completely.