Options for Fort St. John

Felix Amerasinghe, Corporate and Project Finance – Draft – Confidential

Undated

Options for Fort St John

**Proponent's Capital Structure**

| | Amount | % of facility | % of debt | Rate | Spread | Base Rate | WACC |
|---|---|---|---|---|---|---|---|
| Senior Debt | | | | | | | |
| Sub Debt | | | | | | | |
| Equity | | | | | | | |
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| | Amount | % of facility | % of debt | Rate | Spread | Base Rate | WACC |
|---|---|---|---|---|---|---|---|
| Senior Debt | | | | | | | |
| Equity (blended) | | | | | | | |
| | | | | | | | |

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**Option 1: PBC Proposal**

**Description:** Co-Invest pari pasu with Senior Lenders; Province lends at its cost of funds 130 bps + GOC

PBC

| | Amount | % of facility | % of debt | Rate | Spread | Base Rate | WACC |
|---|---|---|---|---|---|---|---|
| Senior Debt | | | | | | | |
| Province Debt | 101,000 | 53.31% | 60.43% | 5.13% | 1.30% | 3.83% | 2.73% |
| Equity | | | | | | | |
| | 189,452 | 100.00% | | | | | 7.32% |

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a) Achieves 7.32% "Affordability" mark based on the WACC
b) Province will receive lower economics for taking the same risk as the Senior Lenders.
c) Provincial funding will have a longer average life than Senior Lenders – so at any point during the structure province will be taking more risk, and be compensated less than Senior Lenders. (reverse risk transfer – risk transferred back to the province)
d) Province takes between 25 – 30 million of risk without being paid for it.
e) If Province is taking 25 – 30 million of risk, then affordability cost should be reduced from 243 million to 190 million to adjust for the reverse risk transfer, transfer risk back to the province.
f) Provincial contribution is 53.31% of the total facility, which will likely result in the SPV being classified as a Variable Interest Entity.
    a. As a result, the SPV will be fully consolidated both in the income statement and balance sheet.
    b. Province's financial statements will be impacted by the P&L impact that is reflected in the SPV (Normally this is only a concern for the Proponent), if classified as a VIE, then it will be the province's concern as well.
    c. The minority interest will be backed out.
g) Province as Senior Lender will likely need to waive its voting rights and access to information on an equal basis with Senior Lenders;
    a. the Province as a senior lender will have a natural conflict of interest. Province is the owner and lender to the project and the Province has a majority share of the facility.
h) Province would have provided the largest amount of funds, province would be receiving a sub-market return, and will likely have diminished or no voting rights.
i) Provincial contribution is priced at sub market levels. Province will not be able to sell its position to a third party at par; will need to take a deep loss on any sale.

**Option 2: Province takes either senior pari-pasu position with super senior trigger, or takes a senior position making the Private Sector Lenders take a subordinate position.**
**Description:** Co-Invest with Senior Lenders at a pari-pasu level subject to the project operating in good standing. However, if the project has various defaults, for example, if DSCR is less than 1.25x, then Province's allocation assumes a Super Senior position and a substantial portion of ASPs are directed to the Provincial debt repayment to justify providing a lower rate at onset.

Note minimum ADSCR is 1.20x before Equity Lock Up and 1.10x before it is an event of default. With the Province lending, Proponent will need to ensure that ADSCR is above 1.25x (for example), before an equity lock up is triggered.

Option 2

| | Amount | % of facility | % of debt | Rate | Spread | Base Rate | WACC |
|---|---|---|---|---|---|---|---|
| Prov. Sper Senior Debt | 101,000 | 53.31% | 60.43% | 5.38% | 1.55% | 3.83% | 2.87% |
| Senior Debt | 66,140 | 34.91% | 39.57% | | | | |
| Sub Debt | 14,875 | 7.85% | N/A | | | | |
| Equity | 7,437 | 3.93% | N/A | | N/A | N/A | |
| | 189,452 | 100.00% | 100.00% | | | | 7.32% |

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a) Similar framework to Option 1 but Super Senior status, subordinating Banks could be a justification for lower cost of funds.
b) Cost of funds for the province is increased fractionally by 25 bps to optimize contribution.
c) Will still likely be classified as a VIE
d) Voting rights and access to information may prove to be difficult to resolve.
e) Banks may require substantial increase in their existing financing rates, which may make this approach unaffordable.
f) May be able to get improved third party sale of stake, though final terms of pricing of provincial share will be a key driver.

**Option 3: Province takes a subordinate position.**
**Description:** Province sub-ordinates its investment in the SPV. Province requires the Equity release some of its high cost equity, and reduces the senior debt to create a new junior debt tranche. The Province receives a market based return (a return that is higher than the Senior Lenders).

Option 3

| | Amount | % of facility | % of debt | Rate | Spread | Base Rate | WACC |
|---|---|---|---|---|---|---|---|
| Senior Debt | 156,230 | 82.46% | 90.50% | | | | |
| Prov junior debt | 16,400 | 8.66% | 9.50% | 7.68% | 3.85% | 3.83% | 0.66% |
| Sub Debt | 13,785 | 7.28% | N/A | | | | |
| Equity | 3,037 | 1.60% | N/A | | | | |
| | 189,452 | 100.00% | 100.00% | | | | 7.32% |

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a) Senior Lenders reduce their spread, because they will have substantially more deemed equity in the financing, lower risk to the Senior Lenders, and the reduction in high cost equity, allows the financing to meet affordability mark.
b) A subordinate position avoids conflicts of interests and issues regarding voting rights.
c) A Portion of high cost equity removed and supplemented with lower cost sub-debt can be equated to the risk discounted by Option 1 and 2 above.
   a. Except with this framework, Province is taking risk and is being compensated on a commercial basis for the risk.
d) More commercial based financing than in Option 1 or 2, can be traded in the secondary market.
e) The Mezzanine contribution (subordinated or junior debt) is less than or equal to the **25 – 30 million** of subsidy that would have been foregone in Option 1 and partially in Option 2. So Province would be monetizing a subsidy, getting paid for a subsidy at a market basis, while reducing the overall WACC.
f) Provides province is a better position on both refinancing and restructuring.
g) Should avoid VIE issues as provincial contribution is a true minority position (need to verify with accountants after creating specific structure)

**Option 4: Province Lends 100% of debt**

**Description:** Province removes all senior lenders, lends to project at cost of funds that meets affordability threshold for 5-7 years, Equity is maintained at the current levels and terms.

| Option 4 | Amount | % of facility | Rate | Spread | Base Rate | WACC |
|---|---|---|---|---|---|---|
| Senior Debt (100% Prov) | 167,140 | 88.2% | 6.05% | 2.22% | 3.83% | 5.34% |
| Sub Debt | | | | | | |
| Equity | | | | | | |
| | 189,452 | 100.0% | | | | 7.32% |

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a) Province provides funding with a spread that meets the "Affordability" mark.
b) There is no discrepancy with risk and return trade-off between private banks and province (as there are no banks in the structure).
c) Less issues regarding voting rights, though this could still be an issue with the Equity party
d) As soon as project is built, province can structure debt with terms that are similar to the proposals put forward by mini-perm lenders, for periodic equity cram-downs (i.e., increase in interest rate of provincial debt, if equity holder does not take-out the Province) with a re-financing.
e) Will most likely be classified as a VIE.

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**Note:** Proponent's equity IRR of , is ridiculous for an availability transaction. For example, PPP projects with Revenue risk, the Equity IRR is in the high teens for pure equity, should ask proponent to dramatically reduce their equity IRR.

- There is no revenue risk in a hospital PPP project
- Counter-party risk is the province, so as long as the proponent manages the project, minimal equity risk.
- Only political risk, which is relatively low.

**Option 5: Province backed Covered Bond Option**

**Description:** Outlined below are funding rates over the equivalent GOC for various companies as of March 16, 2009. This table is descriptive of the cost of funds for various types of entities. The Province will lend to the Banks, at its cost of funds plus a small spread (depends on the credit rating of the institutions as counter-parties) for the base funding amount, thereby providing the institutions access to low cost funding, achieving risk transfer, maintaining essence of PPPs, and affordability mark.

Option 5

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| GOC Yield | | 1.18% | 1.22% | 1.86% | 1.90% | 2.68% | 3.60% |
| Firms | S&P | 2yr | 3yr | 5yr | 7yr | 10yr | 30yr |
| Caisse Centrale Desjardins | AA- | 250 | 270 | 300 | 305 | 315 | 330 |
| CDP Financial | AAA | 290 | 295 | 295 | 305 | 320 | 335 |
| Great West Life Co | A+ | 440 | 465 | 485 | 495 | 505 | 515 |
| HSBC Finance | AA- | 500 | 505 | 515 | 520 | 530 | N/A |
| Banks (Second Tier) | A+ | 370 | 370 | 375 | 375 | 385 | 405 |
| Province of BC | AAA | 90 | 92 | 120 | 155 | 163 | 125 |

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|---|---|
| If Bank's cost of funds is 1.90% plus 3.75%= | 5.65% |
| If PPP Project Debt Cost = | 7.08% |
| **Project Credit Spread =** | 1.43% |
| If Prov cost of funds is 1.90% plus 1.55%= | 3.45% |
| Bank's Cost of funds = | 5.65% |
| Difference = | 2.20% |
| If Province lends to banks at Prov cost of funds plus credit spread for Bank risk | 1.15% |
| Banks saving | 1.05% |
| Reduce Project Credit Spread by | 1.05% |

| | Amount | % of facility | % of debt | Rate | Spread | Base Rate | WACC |
|---|---|---|---|---|---|---|---|
| **Senior Debt** | 167,140 | 88.2% | 100.0% | 6.03% | 2.20% | 3.83% | 5.32% |
| **Sub Debt** | 14,875 | | | | | | |
| Equity | 7,437 | | | | | | |
| | 189,452 | 100.0% | | | | | 7.28% |

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a) Province lends to Banks at its cost of funds plus a spread.
b) Province's counter-party is the Bank and not the SPV (SPE), so the Province is exposed to the counter-party risk of Bank (Second Tier) for example.
c) Province lends an amount needed for funding the SPE, the bank portion.
d) If the Province's cost of funds is 155 bps for 7 years and Bank (Second Tier) cost for the same period is 375 bps, then it is possible that by lending to Bank (Second Tier) at say 115 bps over the 7 yr Province's cost of funds, the Province has saved Bank (Second Tier) 105 bps to fund their obligations.
e) Bank (Second Tier) can fund the entire Ft St. John financing at (325 – 105) or 220 bps.
f) This structure would avoid the VIE and Voting rights issue
g) The amount that the Province is able to Fund third parties will depend on their cost of funds, the benchmark they are using, etc....will need to be negotiated.
h) Province may provide this sort of funding for 7 yrs subject to the third party maintaining a minimum A+ or A rating for example. Details need to be further examined and modelled.

Comparative table

| Principles/Criteria | PPP | Option 1 | Option 2 | Option 3 | Option 4 | Option 5 |
|---|---|---|---|---|---|---|
| Value for Money | 3 | 1 | 2 | 4 | 2 | 4 |
| Mkt Oversight | 5 | 3 | 5 | 4 | 3 | 5 |
| Commercial/Mkt Terms | 5 | 0 | 3 | 4 | 3 | 5 |
| Marketable/transferable debt | n/a | 1 | 3 | 4 | 3 | n/a |
| Risk Transfer | 4 | 2 | 3 | 3 | 2 | 4 |
| Accounting Impact (Prov) | 3 | 1 | 1 | 5 | 1 | 5 |

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|---|---|
| High value | 5 |
| medium- high value | 4 |
| medium value | 3 |
| medium - low value | 2 |
| low value | 1 |
| none | 0 |