

Fort St. John – Technical Notes on Financial Structures

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Fort St. John – Technical Note on Financial Structure

Purpose:

This note will outline the structure of the Fort St. John (FSJ) financing between ISL Health and Northern Health (NH). Changes will be required for future transactions.

Affordability

FSJ had an Affordability Ceiling of \$203 million. This is the net present cost of the annual service payments discounted at a rate of 7.32%. ISL submitted a proposal in response to the RFP with committed bank financing that was unable to meet the Affordability Ceiling. In order to meet the Affordability Ceiling, lower cost financing was required.

Deal Structure

Overview

ISL will insert \$35 million in equity and the remainder of the funding required to complete construction will be supplied by the Regional Hospital District (RHD) and by NH. NH will obtain the necessary funding via a capital grant from the Province. There is no bank debt. During the operating period the ASP will be reduced by an amount that corresponds to the funding provided by NH during construction.

The equity contribution is back end loaded and is secured by a letter of credit from a major Canadian Chartered Bank.

The lifecycle payments are sculpted.

There are two financial models required to fully describe the financing arrangement.

1. Affordability Model
2. Wide Equity Model

Affordability Model

To determine if the Project meets the Affordability Ceiling, PBC requested ISL to model the NH funding during construction as a loan at the Province's long term cost of funds 5.05%. The debt has a two year tail and the profile of the equity distribution is the same as in ISL's RFP submission with committed financing. This model does confirm that ISL meets the Affordability Ceiling. The pre-tax equity return is $5.17, 21$ and the after tax return is $5.17, 21$.

The sources and uses of funds during construction are summarized in Figure 1

Figure 1 Sources and Uses of Funds During Construction Affordability Model (all figures in 1000s)

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SOURCES AND USES OF FUNDS DURING CONSTRUCTION			29-Feb-12
Sources		Uses	
Senior Debt Financing	134,039	Construction and Equipment costs	
Equity	11,500	Development costs	
Sub Debt	23,000	Interest and fees paid	
RHD Funding	94,896	Working Capital	
		Change in Law Reserve Prefunding	
		Insurance/working capital reserve prefunding	
		MRA prefunding	
Total Sources	263,435	Total Uses	263,435

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21

Figure 2 First Full Year ASP (all figures in 1000s)

FM Services (nominal)	Life Cycle Capital (nominal)	SPV Costs (nominal)	First Cost Capital (nominal)	Total ASP (nominal)
				17,587

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Wide Equity Model

The Affordability Model is necessary to demonstrate to Treasury Board that the Affordability Ceiling has been met, however it does not reflect the deal structure that will be in the Project Agreement. To avoid negative accounting impacts, the "loan" from NH modeled in the Affordability Model will in the Wide Equity Model be presented as a contribution during construction by NH. NH will obtain the funding via a capital grant from the Ministry of Health. The wide equity model causes taxable entities to pay additional income tax as there.

The sources and uses of funds during construction are summarized in Figure 3.

Figure 3 Sources and Uses of Funds During Construction Wide Equity Model (all figures in 1000s)

SOURCES AND USES OF FUNDS DURING CONSTRUCTION			29-Feb-12
Sources		Uses	
Equity	11,500	Construction and Equipment costs	
Sub Debt	23,000	Development costs	
Revenue during construction		Interest and fees paid	
- NH	122,120	Working Capital	
- RHD Funding	94,896	Change in Law Reserve Prefunding	
		Insurance/working capital reserve prefunding	
		MRA prefunding	
Total Sources	251,515	Total Uses	251,515

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Figure 4 First Full Year ASP (all figures in 1000s)

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FM Services (nominal)	Life Cycle Capital (nominal)	SPV Costs (nominal)	Equity Payment (nominal)	Total ASP (nominal)
				8,709

5,17,21

Project Agreement

In general there will be few changes to the Project Agreement. Those provisions relating to lenders (e.g. step in rights) will remain in the agreement, but while there are no lenders these provisions will remain silent.

One item that will be added is liquidated damages. ISL will be required to pay NH liquidated damages equal to the outstanding loan in the Affordability Model at a rate of 5.05%. ISL in turn will be collecting these liquidated damages from the Design Builder.

We are not requiring ISL to implement a change in law reserve account or MRA. They are responsible for these risks and are allowed to choose their risk mitigation strategy.

Funding Agreement

The NH funding during construction will be formalized in a separate funding agreement which is based on credit agreement.

[In this section I will outline the main concepts of the funding agreement – I estimate half a page]

The Funding Agreement will cease to exist once Service Commencement is achieved.

Security

The ISL consortium involves a DB joint venture between Acciona and Stuart Olson. By way of security the DB JV is providing

- X
- Y
- Z

[Insert Comment on O&M L/C]

Due Diligence

As ISL's RFP submission included committed financing, extensive due diligence by the banks had been undertaken by the time ISL made their RFP submission.

Further due diligence will be required in advance of financial close. As a condition precedent to close an independent third party, the Technical Advisor, will have to review and find acceptable a number of different items. The draft scope of the Technical Advisor Scope of Work is outlined in Appendix 1.

The Independent Certifier will remain as originally intended.

Appendix 1 Technical Advisor Scope of Work

The Technical Advisor Scope of Work, with a 100% duty of care to the Province/Health Authority, as distinct from the Independent Certifier role is described below. This scope reflects obligations of Project Co to the Province/Health Authority documented in the Funding Agreement. Capitalized terms are defined in the Funding Agreement.

1. In advance of financial close and as a condition precedent to financial close, prepare a report confirming:
 - a. Review of the Planning and Design Documents, Construction Budget, ~~Annual Operating Budget, Operating Build Agreement, Hard FM Services Agreement~~ and the Soft FM Services Agreement to determine if:
 - i. these documents are in a form and substance that is satisfactory;
 - ii. that completion of the Design and Construction with these documents is reasonably achievable; and
 - iii. that the Design and Construction is capable of complying with all Applicable Permits.
 - b. The Construction Budget is sufficient to achieve completion of the Design and Construction of the Project in accordance with the Planning and Design Documents and requirements under the Project Agreement and to pay all Project Costs.
 - c. The Design and Construction of the Project is capable of being completed on or prior to the Target Service Commencement Date for the amount set forth in the Construction Budget.
 - d. The milestones identified in the Construction Budget are reasonably achievable and the description of milestones is adequate for the purposes of measuring and certifying payments.
2. Following financial close, supplement monthly Independent Certifier certificates with:
 - a. An opinion on whether the Service Commencement date is achievable;
 - b. Confirmation that amounts being applied for are all in respect of Project Costs;
 - c. Verifying the relevant construction milestones as set out in the Construction Budget have been met; and
 - d. Certification of the accuracy of the following information provided by Project Co in support of the draw:
 - i. Project Costs incurred to the date of the progress draw broken down by major expense category consistent with the Construction Budget;
 - ii. Details of any variances from the Construction Budget including a breakdown of all Cost Overruns;
 - iii. The estimated date of Service Commencement;

Comment [m1] I would prefer
could limit to use the constructio
period and leave the rest for equity.

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- iv. That the remaining Project Costs to be incurred but not yet paid for do not exceed Available Construction Funds;
- v. That the aggregate amount of all Term Loan Advances under this Agreement do not exceed the corresponding amount set out in the Advance Schedule;
- vi. Project Co's compliance with the applicable provisions of the Builders Lien Act (British Columbia) including the making of all required holdbacks; and
- vii. The \$5,000,000 cash retention for defeciencies at the month of Service Commencement.

Term

The term will match that of the Independent Certifier but will not extend beyond the term of the Funding Agreement, if this is different than the term of the Independent Certifier.

Payment

Fees of the Technical Advisor scope will be paid 100% by the Authority and will be added to the 50% attribution related to the Independent Certifier services. Fees will be paid monthly in accordance with the terms of the Independent Certifier Agreement.

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Appendix 2 Role of the Independent Certifier (excerpt from IC Agreement)

SCHEDULE 1
FUNCTIONS

The Independent Certifier will, subject to the provisions of the Project Agreement, provide the services as set out below. In the event of a conflict between any provision of this Agreement, including this Schedule 1, and a provision of the Project Agreement, the Project Agreement will prevail.

[NTD: review this scope as against the final Project Agreement, particularly Schedule 2, for consistency]

- (a) The Independent Certifier will:
- (i) consult with the Design-Builder and others involved in the Design; and
 - (ii) conduct inspections of the Construction,

as the Independent Certifier determines is required to be satisfied that the Design and Construction are proceeding in accordance with the requirements of the Project Agreement, and will no later than the 10th calendar day of a calendar month prepare and deliver to the Authority and Project Co a monthly written report reporting on:
 - (iii) a description of the Design and Construction completed in the previous calendar month;
 - (iv) the progress of the Design and Construction relative to the Approved Project Schedule, with an explanation and analysis of any variances;
 - (v) a description of any elements of the Facility that for any reason vary from the requirements of the Project Agreement, with particular reference to Schedule 2 [Design and Construction Protocols] and Schedule 3 [Design and Construction Specifications] of the Project Agreement;
 - (vi) any matter required for payment certification pursuant to Section 3.4 of Schedule 2 [Design and Construction Protocols]; and
 - (vii) will comply with its obligations in Section 12 of Schedule 2;
- (b) The Independent Certifier will carry out the functions and comply with the obligations set out in Sections 3.4, 3.5 and 13.1 of Schedule 2 [Design and Construction Protocols] of the Project Agreement, including in respect of an application by Project Co for a Certificate of Service Commencement.

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Provincial Treasury Funding

- Structured as a synthetic loan but the Province will not be a lender to Concessionaire
- Funding Agreement developed with terms typically found in senior lender's credit agreement
- Funding Agreement likely to be structured between MoT entity and Concessionaire
- Synthetic loan is deemed to be extinguished upon Service Commencement
- Annual Service Payments will not have a debt repayment component and reduced accordingly

Provincial Funding Agreement

- Minimize changes to Concession Agreement
 - Maintenance reserve account arrangements
 - Liquidated Damages if delayed Service Commencement
- Majority of changes encapsulated in Funding Agreement
 - Protection and security arrangements
 - Requirements for drawdown reports and certificates prior to making a monthly grant to the Concessionaire

Committed Equity

- Minimum required equity commitment
- Equity contributed during construction:
 - Pro rata [confirm]; or
 - Back end of construction if supported by a letter of credit for the full amount or the equity
- Equity Distributions:
 - Limited by the parameters specified in Volume 1 of RFP
- Equity has the primary responsibility for due diligence
- Equity will have to satisfy the Province that appropriate due diligence has been done

Proposed Modified Procurement Process

- Technical Submission and Evaluation unchanged
- Financial Submission:
 - Proposals based on Wide Equity structure
 - Committed equity
 - Bid to Funding Agreement
 - Reliance on equity due diligence
- Financial Proposals evaluated for:
 - Affordability
 - Most scope provided at lowest price basis
- After select Preferred Proponent:

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- Reserve the right to conduct a funding competition or use other Credit Measures

Financial Submission Requirements

- Confirmation that the Proposal meets the terms of the Funding Agreement
- Confirmation of Equity commitment
- Financial information to confirm quality of:
 - Equity providers
 - Principal Contractors
- Heads of terms of agreements with Principal Contractors
- Price proposal submitted in two models
 1. Affordability Model
 2. Wide Equity Model

Financial Models

1. Affordability Model
 - Used to evaluate affordability and price proposal
 - Similar to model expected in a traditional financial proposal
 - Senior debt replaced with synthetic loan made by Provincial Treasury with assumptions bid to the Funding Agreement
 - Parameters specified in Volume 1 of RFP
 - Equity must be $\geq 20\%$ of Eligible Costs (Phase 2 capital costs that remain after federal funding)
1. Wide Equity Model
 - Strips out the synthetic loan of the Affordability Model
 - Identical construction contributions, equity distributions and OMR payments as the Affordability Model
 - Return on Equity different from Affordability model as result of tax implications

Constraints to financial proposal

- Specified in Volume 1 of RFP:
 - Equity greater than or equal to [20%] of Eligible Costs
 - Equity tail specified [1 year]
 - Allowable escalation on lifecycle costs
 - Uniform lifecycle payments
 - DSCR
 - [Andrew to complete]

Security Package

- During Construction
 - Province has similar rights as a typical senior lender
 - Specify minimum security package in DB contract
 - Security could be L/C; or
 - Construction completion and labour and materials bonding

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- Liquidated damages in DB contract sufficient to cover:
 - interest on synthetic loan
 - compensation for equity
 - O&M provider costs
- L/C from SPV to cover amount of LD for interest portion
- L/C from SPV in amount termination payment? [needed in addition to Equity L/C]
- L/C for equity if back-end loaded equity contribution
- During Operations
 - L/C to cover annual O&M costs

Notes from Stephen Todd

Specify the following on the ghost tranche

- Tail on the debt
- Average life and amortization requirements
- Debt Service Reserve Account and any other reserve accounts
- Base Case Coverage Ratios
- Gearing constraints and any restrictions with respect to the timing of contributions relative to equity
- Eligible Project Costs that can be funded
- Cash waterfall priority
- Any restrictions with respect distributions after Service Commencement including timing of distributions
- Due diligence requirements including the need for a lender's technical advisor
- Conditions precedent to financial close and drawdowns including any information (reporting) requirements
- Key Representations and warranties and covenants
- Key definitions particularly with respect to the calculation of any financial ratios
- Minimum security package requirements from the Design Builder and Hard FM subcontractors (if any)

Need to address Due Diligence

We suggest that there would be merit in requiring each bidder to include as part of its financial submission¹ an outline technical report, whose scope would be limited to an assessment of the following:

- The proposed payment arrangements for the design and build contractor, including the methodology and the actual payment S-curve, assessed in light of the proposed construction schedule

¹ To include as part of the technical submission would not be practical; this is essentially funder due diligence that necessarily lags behind the development of the bidder's technical solution

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- How these are complemented by the proposed security package
- A review of the agreed design and build contract heads of terms, including consideration of any impact these may have on the adequateness of the proposed funding arrangements for the project company

We suggest that such report should be prepared for the benefit of the Province, having regard to its position as a funder of the construction activities, and that the technical consultant would be required at the preferred proponent stage to provide additional commentary, as may be required by the Province, but focussed still on these aspects of the bid which would not naturally be the focus of BCCA.

We suggest that bidders should provide heads of terms in their bids, as well as risk allocation schedules, to help communicate why they consider their proposals to be robust.

Need to describe payment drawdown mechanism

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