Airport Redevelopment Procurement Options

EXECUTIVE SUMMARY

This paper summarizes the broad options available to the Government of Bermuda, their pros and cons, and why it has made the decision to move forward with the G2G, Bilateral Government to Government option. Further details on these various options can be found on the Government portal at

https://www.gov.bm/airport-redevelopment-project-arp

What are the broad options facing Bermuda with respect to the airport terminal?

The options available to Bermuda are as follows:

1. **EBA** **Maintain existing terminal (the Expensive Band Aid approach)**
2. **BD** **Borrow the money and put out to tender to Design & Build**
3. **DBFOM** **Put out to tender to Design, Build, Finance, Operate & Maintain.**
4. **G2G** **Bilateral Government to Government approach.**

EBA - Expensive Band Aids

Some observers think there is a "do nothing" option. There is not. We have to do **something** or else the facility will become inoperable and we will be cut off from the world. EBA, or Expensive Band Aids, represents the current practice at the airport where the existing terminal is kept in operation b y spending as little money as possible on maintenance and capital investment. Ongoing maintenance costs will escalate beyond the estimates provided here, and would merely delay the inevitable outcome where the airport will need to be replaced. The risks associated with continuing to operate the existing terminal are exceedingly large and cannot be accurately quantified.

There are up-front costs required to make urgent near-term repairs to the existing terminal as well as some improvements to the facility that are necessary to continue operations. These were estimated by GOB's technical advisor to be $62.3 million in repairs and $104.8 million in improvements in a 2013 report. In addition ongoing maintenance costs need to be also included.

DB – Design Build

This is the traditional tender procurement method of the GOB. In 2008 a new terminal was estimated to cost $514 million. This option would involve GOB borrowing all of the funds to finance the development substantially increasing its sovereign debt.

With inflation adjustments and engineering refinements we assume that GOB would need to borrow $575 million to finance the construction of the new terminal in this scenario.

This substantial increase in sovereign debt would weaken GOB's credit profile and would likely result in a credit rating downgrade by the rating agencies. The net impact result would lead to an eventual increase in borrowing costs on all of Bermuda's sovereign debt (currently BD$2.4 billion). Furthermore, GOB would also incur the interest and principal costs associated with the debt for this financing. The net increase in financing costs to GOB significantly outweighs any benefits associated with this option, - i.e. retaining the net cash flows generated by the airport.

DBFOM - Competitive Tender

This option would involve issuing a competitive tender for a DBFOM concession: i.e. – design, build, finance, operate and maintain.

It is important to note that in the DBFOM and G2G scenarios, where the airport is financed completely off GOB's balance sheet, (i.e., GOB is not liable for repayment of the debt), it is required that the facility is operated by the private sector partner for at least the term of the debt, and usually for a nominal tail period beyond that (assumed to be 25 year term plus 5 year tail in this analysis). This ensures that the investors who are responsible for repaying the project debt are protected. This is in contrast to the new Acute Care Wing of the KEMH, which has no operating component because the Government of Bermuda is fully liable for debt service.

Under a competitive tender process, the market would be aware of the construction price put forward by the third party engineering firm in 2008, and so this price would effectively anchor the competitive bids submitted. We also assume bids 15% - 20% lower or BD$460 million to BD$489 million. At this price the prevailing traffic levels cannot support a standalone financing structure, while maintaining competitive passenger fees. It is important to keep in mind that Bermuda has a 30 year history of declining air traffic levels. GOB would therefore be required to make significant financial contributions to the Project, likely in the form of a Substantial Completion Payment, to cover any difference in Project costs that could not be met with Project debt and equity.

This option was not considered to be viable as GOB would likely need to provide capital in the form of a Substantial Completion Payment to ensure a financially viable project and successful competitive tender. This combined with onerous guarantees would also likely impair GOB's sovereign credit rating and, therefore, its cost of borrowing.

Internationally, over the last 30 years, there has not been any successful DBFOM tenders for airports with traffic less than 1 million passengers – like Bermuda's.

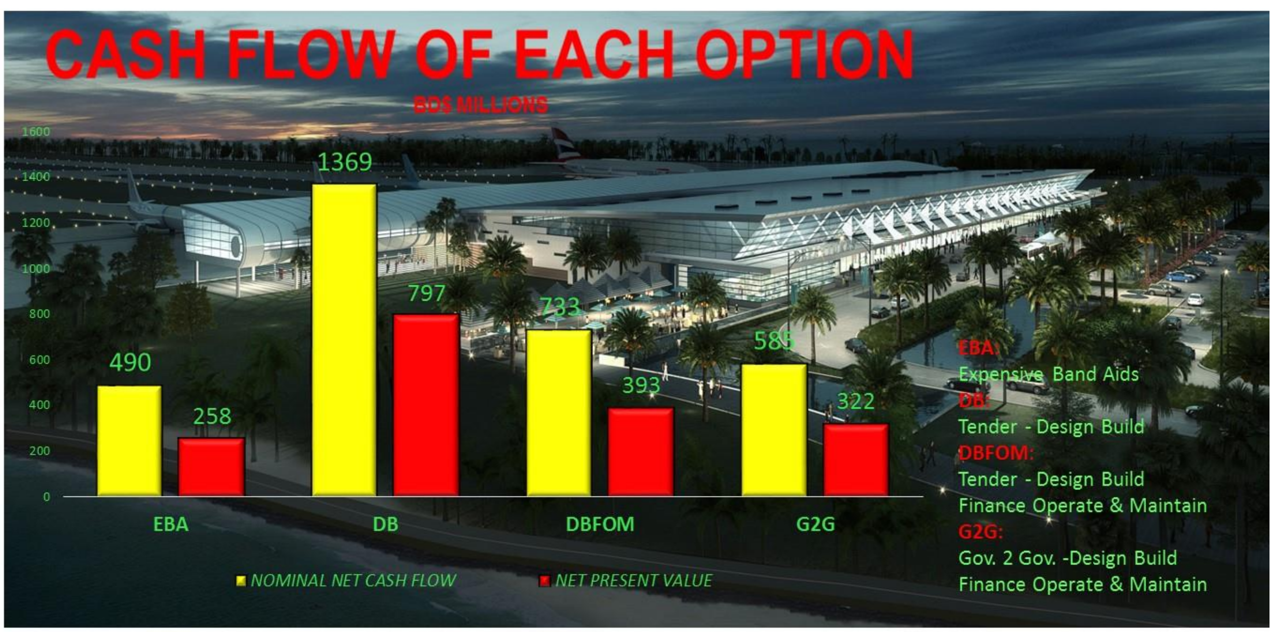
G2G – Bilateral Government to Government

Customized Solution: The G2G approach is a type of DBFOM option. A key difference between the tendered DBFOM and the G2G approach is the degree of customization which can be achieved with G2G. Under the tendered approach, parties would simply bid on the specifications as put forward in the RFP developed by GOB which would then select the best option. The value of customization cannot be easily valued but is considered to be substantial.

Construction Price: Aecon recognized from the outset that costs outlined by HNTB in 2008 were not financially viable and has proposed a minimum cost solution that would meet the needs of Bermuda. As a result, the G2G approach has brought a greatly reduced construction price, slashing the required financial contributions by Bermuda.

Contractor Creditworthiness: The G2G approach provides the Project with the full faith and credit of the Canadian Government (AAA+) backing the fixed-price, turnkey construction contract. This substantially reduces the risk of non-performance by the contractor and insulates GOB from the credit risk of the contractor. This is unique to the G2G option. This also results in lower debt financing costs for the Project as lenders will have greater comfort in CCC relative to another contractor and will require a less restrictive security package.

Bermuda Credit Rating: The bilateral negotiations have led to significantly more attractive terms for GOB than were contemplated at the start of negotiations with CCC and Aecon, or that would have been achievable in a tendered DBFOM model. This has resulted in lower costs for GOB and thus not impairing Bermuda's credit worthiness.



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IN CONCLUSION

The comparative cash flows are shown in the graph, whereby the G2G option is the least expensive building option. The Expensive Band Aids option is somewhat less expensive than G2G but infinitely more risky.

The first three options, including Expensive Band Aids, would require the GOB to either increase the national debt or guarantee the finance costs – both of which would impair Bermuda's credit worthiness and increase its cost of debt.

The Bilateral G2G strategy not only avoids the impairment of government's creditworthiness but it shifts construction risks to the other partner.

GOB has selected this, the BEST OPTION.