Overview of the Airport Redevelopment Transaction for Members of Parliament

Purpose

The purpose of this memorandum is to provide Parliament with a summary of the key elements of the proposed transaction, including key provisions of the Agreement. The Agreement has been drafted in a manner that enables the Government to comply with all requirements of the entrustment letter issued by the U.K. Foreign & Commonwealth Office on July 17, 2015. In particular, the cost of design and construction will be fully borne by the Project Partner and no debt related to the Project will appear on the Government's balance sheet.

Background

Over the past 18 months the Government of Bermuda ("the Government") has engaged in a Public Private Partnership (P3) with the Canadian Commercial Corporation ("CCC") and affiliates of Aecon Group Inc. (collectively, "Aecon", and together with CCC, the "Project Partner" or "Concessionaire") to redevelop the L.F. Wade International Airport (the "Airport") through an incremental contract development process for the redevelopment of the airport (the Airport Development Project or "Project"). That process began when the parties entered into a Memorandum of Understanding (November 10, 2014), which then led to the execution of a series of Letters of Agreement. A further interim agreement, called the Airport Development Agreement ("ADA"), was entered into on August 31, 2015 and agreed to by Cabinet, which set out and described the scope, principles and high level terms ("Heads of Agreement") of the Project's final and definitive agreements. Since then, efforts have focused on developing the detailed design and plans of the Project, and negotiating the definitive core project agreements.

Process

Cabinet established the Project Board chaired by the Minister of Finance with representation from other key ministries including the Attorney General's Chambers, Ministry of Economic Development, Ministry of Public Works and Ministry of Tourism Development & Transport, to provide oversight and decision making for the Project and to guide the negotiations and drafting of the definitive agreements. Day-to-day work on project development and agreement negotiations was directed by two co-directors: Financial Secretary and Airport General Manager, supported by Government advisors from legal, financial, technical, and project management disciplines.

As of October 2016, the Government and the Project Partner have reached agreement on all material aspects of the Project and a set of definitive core project agreements and associated schedules (collectively referred to as "the Agreement") has been prepared. The Agreement was developed through extensive collaboration between the Government and the Project Partner, supported by expert advisors from both sides.

In parallel with the drafting of the Agreement, under the direction of the Project Board, various activities have been undertaken in preparation for executing the transaction to achieve Financial Close. These activities include drafting of enabling legislation and setting up of a Quango to administer the Agreement and provide Retained Government Services.

What commitments are the Government of Bermuda making?

By approving the Agreement the Government agrees to move forward with Phase Three of the Project with the Project Partner which will be focused on achieving Financial Close and securing financing for the Project. Financial close will include the following for Bermuda: i) enacting all enabling legislation, ii) approval of the airport lease, (incorporated in the Quango Legislation), iii) transfer of airport operations and all airport assets, other than those required for the provision of Retained Government Services, to Project Co and transfer of airport assets required for the provision of Retained Government Services to the Quango, and iv) creation and staffing of a Quango to administer the Agreement and provide Retained Government Services.

At this point in the process, (i.e. before signing of the Agreement), since all the non-punitive potential off-ramp options are no longer available, the Government would be liable for 120% of all costs incurred by the Project Partner if the Government elects to terminate the Project or defaults in the performance of its obligations under the Airport Development Agreement. As a result, at this time, in the event the Government chooses to not move forward with the Agreement, it would be liable for approximately BD$18 million to the Project Partner.

The Agreement, having now being approved by Cabinet, provides that the Government will be liable for 120% of all costs incurred by the Project Partner plus other third party costs, plus a BD$5 million breakage fee, if the Project is terminated by the Government or by the Project Partner as a result of a default by the Government, including a failure to enact required enabling legislation. The resulting liability would be, at a minimum, BD$ 23 million.

What is the scope of the project?

The Agreement stipulates that the Government will enter into a 30-year concession agreement with a Special Purpose Entity ("Project Co") to be created. Project Co will be owned by Aecon, holding at least 35% of the equity, and other third party shareholders. The Agreement will include both construction of the new airport as well as operations and maintenance of the Airport for the concession term, except for operations that Bermuda will retain, being air traffic control operations, meteorological services, airport fire & rescue services and ground electronics ("the Retained Government Services").

The Government will lease existing airport land and facilities to Project Co for the 30-year term of the Agreement. The Government will retain ownership of the airport. From a timing perspective, the Agreement will provide that the lease will commence and the transfer the airport assets (e.g., equipment and furniture), will occur at Financial Close. Concurrently, labour force and responsibility for airport operations will also be transferred to Project Co at Financial Close. Project Co will be responsible for operating and maintaining the airport until the end of the concession term and the Quango will be responsible for providing Retained Government Services. The Agreement does not have any extension options, which means that at the end of the term, the operation of the airport, and all airport assets, will transfer back to the Government, subject to the Agreement's handback standards.

Who are the parties Involved in the agreement?

Through a series of transactions on Financial Close, the Government will first enter into a Project Agreement with CCC, an agency of the Government of Canada. That Agreement will then be assigned by the Government to the Quango and by CCC to Project Co, respectively. Project Co will enter into a construction contract with CCC to act as design-build contractor to develop and construct a new airport terminal on the existing L.F. Wade International Airport site under a construction contract ("the Construction Contract"). CCC will subcontract the design and construction work to Aecon Construction, a corporation related to Aecon, for 100% of the design and construction of the new airport terminal.

Project Co will be at least 35% owned by Aecon Concessions (a division of Aecon Construction). The balance will be owned by institutional investors. Aecon

Concessions and Construction are both businesses owned and controlled by Aecon Group Inc., a Toronto Stock Exchange listed company with 2015 revenues of C$2.9 billion.

Project Co will commit to the Quango that the new terminal will be designed and constructed on-time, on-spec and on-budget and CCC will commit to Project Co that the new terminal will be designed and constructed on-time, on-spec and on-budget. Aecon Construction will commit to CCC that the new terminal will be designed and constructed on-time, on-spec and on-budget. The Government and Project Co's lenders will have step-in rights under the Construction Contract to ensure that they can enforce the Construction Contract against CCC, thus safeguarding the Government from construction quality, cost and schedule risk.

In addition to committing to the design and construction of the new terminal in accordance with the Construction Contract, CCC is liable for up to 45% of the construction price in addition to the performance of the Construction Contract. If the new terminal is not completed by the agreed upon completion date, CCC must pay delay liquidated damages to Project Co and Project Co must pay delay liquidated damages to the Quango in the amount of a maximum of US$15,000 per day, but no lower than US$5,000 per day for each day the new terminal completion is delayed.

The Quango, CCC and Project Co will also enter into a CCC Direct and Construction Collateral Agreement which is intended to facilitate and support the Government's direct access rights in the future to CCC as the construction prime contractor to Project Co, where CCC thereby stands as the counterparty to assure the "on time, on budget and on specification" delivery of the new terminal.

Once the new terminal is operational, CCC's involvement in the Project will end and Project Co will oversee the operations and maintenance of the Airport until the end of the concession term. Project Co will have a board of directors representing its owners. In terms of management, the DAO General Manager will assume the top position of President and all other staff will consist of former local DAO staff except for two management positions designated by the Board.

During the concession term, Project Co will receive all revenues generated from the airport operations and will be responsible for the majority of airport-related operating expenses including employee remuneration, debt service and maintenance costs. At the end of the concession term, the airport terminal lease will expire and all accompanying assets will be transferred back to the

Government in good working condition and the Government will resume responsibility for all airport operations.

How will the project impact local employment?

Project Co will commit to ensuring that the development of the new terminal and operations of the airport will give priority to employing local Bermuda labour and businesses. Key aspects of the Agreement that encourage local employment are:

- All Department of Airport Operations employees have received Project Co employment offers. Project Co is obligated to provide employment offers, which on the whole, are no less favourable than current employment terms. If employees fail to accept Project Co or Quango employment offers then the Government will retain these employees and the associated employment cost.
- Airport operations employment across Project Co and the Quango is expected to increase 50% over current staffing levels at the Department of Airport Operations.
- Aecon Construction is required to maximize the use of Bermuda-based companies and labour in the construction of the new airport terminal, with approximately 60% of the 400 plus construction jobs expected to be filled by Bermudian labour.

  Aecon will invest in an internship program to provide six month internships for seven Bermudian construction profession graduates (e.g., engineers and architects) with the opportunity for employment during the Construction Phase following successful completion of the internship.

Aecon's labour internship program has been reviewed in detail by the Department of Workforce Development.

What will the new airport terminal cost?

Based on initial cost estimates developed by Aecon, Project construction costs are expected to be $267 million (inflated) and Demolition/Renovation Costs (inflated) $16 million. This represents a significant decrease from the BD$514 million cost estimate that HNTB put forward in the 2008 Airport Master Plan and reflects a revised architectural design and reduced infrastructure redevelopment proposed by Aecon. The construction of the new airport terminal is estimated to take approximately 40 months. Notwithstanding the more affordable cost, the airport design will continue to emphasize Bermuda's premier brand of "First Tier, First Class, First World."

How are the airport lands being allocated between the parties?

The current airport property includes a significant parcel of undeveloped land which may be used by the Government for alternative purposes. As part of the Agreement, all undeveloped land which is not required for the purposes of airport operations will not be leased to Project Co and will be retained by the Government ("Authority Controlled Lands"). Specifically, the majority of the land area known as the 'Finger' will be retained by the Government. Current activities which are conducted on the Finger such as airport parking for hazardous cargo as well as fire and rescue and bus driver training will need to be relocated.

The Agreement stipulates that the Government can pursue any activities on the Authority Controlled Lands which do not directly compete with the operations of the airport. The intention is to develop a Photovoltaic solar power project ("PV Project") on this property, with revenues used to help off-set the cost of the Government's obligations to the airport (further described below).

As noted above, the Government will enter into a lease agreement with Project Co with regard to the non-Authority Controlled Lands and all accompanying airport facilities. The lease agreement will incur no cost to Project Co for the term of the concession.

How will airport operations be overseen by the Government?

Airport operations will be overseen by the Quango that will administer the Agreement and thereby supervise Project Co's performance of its obligations. The Quango will supervise the key performance indicators, quality standards, and other performance obligations of Project Co, as well as all other matters pertaining to airport operations including the approval of regulated fees. Additionally, the Quango will be responsible for the provision of the Retained Government Services and for generating additional revenues generating opportunities (for example associated with potential air traffic control).

The Quango will be an autonomous agency of the Government of Bermuda which will be responsible for establishing and appropriately staffing the Airport Quango and establishing the Board. Additionally, the Government will be responsible for funding any costs associated with the Quango. The current estimates put forward by the Department Airport Operations ("DAO") suggest that the annual costs of operating Quango will be approximately ~BD$3.5 million. Government is working to reduce that estimate.

The Board for the Quango would include members from the Ministries of Finance and Transport to represent the Government's interests, including budget setting, access to international airport expertise, and identifying revenue generating opportunities.

How will the project impact airport passengers?

Airport passengers will benefit by traveling through a new, modern terminal offering a significantly enhanced travel experience, and with all the modern amenities found in other world class airport terminals consistent with Bermuda's "First Tier, First Class, First World" brand promise. This enhanced travel experience will be paid for in part through passenger fees set at a level consistent with international standards.

The Agreement specifies that passenger-related airport fees will be increased from current levels, which are now well below international benchmarks, in order to support the development and associated financing costs of the Project. Specifically, we estimate that passenger-related airport fees will be increased by approximately BD$20 per passenger from current levels upon introduction of a new Airport Improvement Charge. Based on analysis of comparable airports in the Caribbean region, Bermuda passenger-related airport fees would come more in line with destinations such as Jamaica and the Bahamas.

Commercial Passenger Fees (BD$ per passenger)

Airport Fee	Today (2016)	Proposed (2017)
Departure Tax	$50.00	$51.00
Aviation Security Fee – U.S.	$8.25	$13.00
Aviation Security Fee – Int'l	$7.25	$13.00
Passenger Facility Charge – U.S.	$4.00	$4.24
Passenger Facility Charge – Int'l	$3.00	$3.18
Airport Improvement Fee	$16.00	-
Airport Infrastructure Charge	-	$32.81
Common User Terminal Equipment ("CUTE") Fee	-	$1.86
Terminal Fees (in-transit/arriving)	$0.75-$1.20	$0.80-$1.27
Total – U.S. Passengers	**$79.00-$79.45**	**$101.85-102.32**
Total – Int'l Passengers	**$77.00-$77.45**	**$100.79-101.26**

Once implemented, the Agreement stipulates that these fees will increase automatically by the average annual rate of inflation rates of Bermuda and USA. Any further increases in airport fees beyond annual inflation, if required to finance additional capital improvements beyond the current scope or to offset the cost of new regulations that are outside the normal course of business, will require specific approval from the Quango.

Will the project impact the Government's sovereign credit rating?

The Agreement notes that the Project will be partially financed with the issuance of Project debt that will be structured so that lenders will have recourse only to the Airport's cash flows but not to the general revenues of the Government. As a result, the Project debt will not be recorded on the Government's balance sheet, which is consistent with the requirements of the Entrustment Letter.

The proposed transaction structure involves the creation of Project Co as a special purpose vehicle ("SPV"), which will raise the debt and equity capital required to finance the development of the Project and receive all cash flows generated by the Airport during the concession term. SPVs are widely used and accepted legal structures for infrastructure concession transactions globally. For reference, an SPV is a separate legal entity formed for a single, well-defined and narrow purpose which in this case is the redevelopment and operations of the L.F. Wade International Airport for the 30-year concession term.

Although the Government has agreed to assume certain liabilities related to the Project, including retaining certain operational responsibilities, providing an energy subsidy, and providing a minimum regulated revenue guarantee, the Government will not be providing any financial guarantees to Project Co, Aecon, lenders, or any other person associated with the Project. Project Co is effectively "ring-fenced" and debt holders will only have recourse to the cash flows generated by Project Co, or more specifically the net cash flows generated by the Airport. In the event the net cash flows generated by the airport are insufficient to fund principal and interest payments, debt holders will have no other means to seek repayment of amounts owing. As the Government is not liable for the debt incurred by Project Co, the Government will not be required to record the debt on its balance sheet and there would be no impact on its sovereign debt profile.

What commitments are Aecon and the CCC making to the project?

As described above, each of Aecon and CCC are committing to develop **and construct** a new airport terminal on-**spec, on-**time and on-budget according to the terminal design specifications as agreed to by the Government. In addition, CCC will be liable for up to 45% of the construction contract price in addition to its performance obligation through a limitation of liability ("LOL"). CCC will be fully liable to Project Co for any cost overruns. This provides an additional buffer of approximately BD$125 million above the current construction price to safeguard Bermuda from any construction risk. From an operating perspective, Project Co is providing a commitment to meet various key performance indicators and to provide International Air Transport Association ("IATA") Level of Service "Optimum" during the term of the concession. IATA Level of Service standards are the standard international benchmark for airport service levels.

In addition to operating the airport, Project Co is committing to finance required maintenance capital expenditures relating to the terminal buildings, runways, taxis, and aprons during the life of the concession. Overall, Project Co is committing to invest over BD$630 million in the airport over the term of the concession.

What commitments are the Government making to the project?

The Government will make several commitments to the Project in order to ensure its financial viability. Where possible, those commitments will be off-set by new revenue streams (e.g., developed by the Quango and the development of a PV Project on the finger lands) to ensure such Project related obligations are affordable. Most notably, the Government will avoid the capital costs associated with the Expensive Band Aids approach that will surely apply if the "do nothing" or "delay indefinitely" option is adopted. Such an approach will cost the Government hundreds of millions of dollars with little to show.

The Agreement outlines the following commitments to be made by the Government:

- ***Retained Government Services:*** Bermuda will continue to be responsible for several expenses related to airport operations, as well as the associated capital expenditures associated with those obligations during the concession term. Services retained by the Government include air traffic control operations, meteorological services, airport fire and rescue services and ground electronics. Currently, annual operating expenses (excluding capital expenditures to periodically replace aging equipment) amount to BD$8.8 million per year (air traffic control – BD$1.1 million, meteorological services – BD$2.5 million, airport fire & rescue – BD$3.2 million, ground electronics - BD$2.0 million).

- ***Energy Subsidy:*** Bermuda has agreed to provide a financial subsidy for the electricity that will be required by the airport during the concession term. That subsidy will insulate the Project from Bermuda's high and volatile energy prices, and will in turn lower the cost of financing the Project. Bermuda will have the right to implement new energy generation sources, at its own cost, in order to offset Bermuda's energy liability if the implementation does not materially interfere with airport operations. With respect to the design of the new airport terminal, Bermuda's advisors have worked with Aecon to incorporate certain energy-efficient features to reduce the energy consumption of the new airport terminal.

  The Government will not subsidize electricity consumed by operators of the airport's retail concessions in the new terminal.

  In order to help offset the expense associated with the airport energy subsidy, the Government is developing a PV Project on the "Finger."

- ***Regulated Revenue Guarantee:*** To ensure the Project is financeable, the Government is providing a minimum guarantee on Regulated Revenues to Project Co**.** Further details are discussed in the next section.

- ***Tax Concessions:*** In accordance with normative Bermuda practices to stimulate foreign investment, Aecon and its Affiliates and all subcontractors will be exempt from paying both the employer's share of payroll taxes, customs duty on goods imported for construction, as well as certain other specified taxes during the term of the concession (e.g. land-related and stamp duties).

What is the Government's exposure if revenues are low?

As noted above, the Government will commit to a Regulated Revenue Guarantee for the Project in order to ensure its financial viability. A viable business case to enable Financial Close will require that the airport achieves an investment grade credit rating, which will allow a higher level of debt financing at a cheaper interest rate and over a longer term. Achieving this rating requires the Government to mitigate historical declines in passenger traffic by providing a minimum revenue guarantee driven by passenger traffic volumes.

Without the minimum revenue guarantee, the project would not be able to raise the necessary funds to finance the redevelopment of the airport and the Government would be required to make a large upfront grant, which is not allowed under the entrustment. The minimum revenue guarantee significantly enhances the credit profile of the Project. Current forecasts, even under an extreme downside scenario, will not result in the guarantee being triggered.

The detailed form of the guarantee in the Agreement has been designed to minimize the impact on the Government's finances. If regulated revenues fall below the annual worst case scenario threshold, the Government would be required to subsidize those revenues by contributing any difference between the level obtained in that year and that threshold into a trust account. Project Co would only be able to access the funds from the trust account to pay lenders if Project Co cash flows were insufficient to service the debt. In the event that Project cash flows are indeed sufficient to service the debt, Project Co will not be entitled to draw from the trust account. In this way, guarantee payments cannot be used to bolster returns to Aecon and its partners.

Additionally, in the event the trust account balance is equal to or greater than the next year's debt service, Bermuda will not be required to contribute to the trust account, regardless if regulated revenues are below the threshold in the project agreement. Finally, it is important to note that this minimum regulated revenue guarantee will only be in effect during the term of the senior debt. Once the senior debt matures, all funds in the trust account will be returned to Bermuda.

Because of the nature of this limited guarantee and it not being an outright guarantee of the debt, it should not impact Bermuda's credit rating nor result in consolidation of project debt on Bermuda's balance sheet. Government and Aecon have already worked closely with the credit agencies in crafting this form of debt support.

How does the Government benefit if the airport is very profitable?

Because the Government is providing substantial benefits to the Project, the Government will also have the right to participate in excess airport profits, when the regulated revenue exceeds a level sufficient to provide Project Co with a reasonable market level of return. This mechanism serves as a significant financial incentive while at the same time minimizing any potential for excessive returns for Project Co and its shareholders. Specifically, once Aecon and the other Project Co shareholders have recovered their initial capital investment, the Government will be eligible to receive a portion of the Project's regulated passenger revenues, on an annual basis, whenever the forecasted regulated revenue target is exceeded. Specifically, the Government will receive 50% of all regulated revenues in excess of the forecast target revenues. The upside sharing mechanism is in effect for the entire term of the concession and there is no maximum cap which limits the amount of upside sharing for Bermuda.

What other key provisions are in the agreement?

A summary of the other key contractual provisions are as follows:

§ ***Exclusivity:*** Project Co will have the exclusive rights to operate a fixed-wing commercial airport in Bermuda during the concession term and exclusive rights to exploit commercial opportunities on the Airport including duty free shopping, food and beverage, advertising, taxis and car rentals;

§ ***Import Duties:*** Imported materials for the development of the airport terminal (e.g. steel, glass, etc.) will be free of import duties;

§ ***Restriction on Sale:*** Aecon and the other Project Co shareholders will not be permitted to dispose of their interest in Project Co without written consent of the Government and only after the new terminal has been completed;

§ ***Environmental***: The Government will retain its liability for pre-existing environmental contamination. Project co will be liable for any new contamination and for any mishandling of pre-existing contamination.

§ ***Revenue:*** All sources of revenue generated from the operations of the airport will be allocated to the Project during the concession; and

- **_Changes in Law:_** the Government shall be responsible for loss or damages resulting from:

    - Any discriminatory changes in law enacted by the Government which have an adverse effect on the rights or interests of Project Co with respect to airport operations;
    - Any change in law that impacts the tax concessions granted to Project Co under the Agreement;
    - Any change in law that is targeted or has detrimental impact on the ability of Project Co to operate the airport;
    - Any change in law that negatively impacts the construction costs associated with the airport terminal development.

Other changes to the laws of Bermuda as well as required changes in airport operations required by international airline or airport organizations that have a detrimental impact on the airport's operations will be the subject of change management negotiations pursuant to the definitive Project agreements with the aim of mitigating such adverse effects.

Annual Commitments of the Bermuda Government

Government Annual Commitments	**Future Cost (2017)** *(BD$ millions)*
Retained Services (Air Traffic Control, Meteorological Services, Ground Electronics, Airport Fire & Rescue)	$8.8
Energy Subsidy	$2.6

Government Annual Commitments	Future Cost (2017) *(BD$ millions)*
Airport Quango Operating Costs	$3.5
Total Government Annual Commitments	**$14.9**
Foregone Airport Cash Flows	**$3.4**[1]
Net Financial Impact to Bermuda	**$18.3***
***Avoided Capital Costs (First 2 years alone)**	**$186**

[1] ***Based on airport operating cash flow in 2015/16, excluding $2.2 million Airport Improvement Fee reserved for capital improvement only.***