

FINANCING ISSUES – BACKGROUND NOTE

The purpose of this note is to provide background to Proponents on several key financing issues, in order to facilitate discussion and comment on financing-related items in the RFP and Project Agreement. This note is current as of November 25, 2011 and references the draft Project Agreement dated October 27, 2011, as modified by Addendum #1 issued November 25, 2011. This note is for informational purposes only and in the event of any discrepancy between this note and the terms of the Project Agreement and/or Request for Proposals, the Project Agreement and/or Request for Proposals shall govern.

1. Milestone Payments

The Milestone Payments are intended to provide Proponents with an opportunity to source public funding during construction in order to reduce private financing requirements. Milestone Payments are performance based payments which must be triggered by the achievement of significant, verifiable construction milestones (“Eligible Milestone Events”, as set out in the RFP). Proponents must include at least one Milestone Payment in their Proposal (2017 Readiness Milestone), and may include up to five total Milestone Payments, at their discretion.

The City wishes to be non-prescriptive in relation to Milestones and recognizes that construction schedules and approaches will differ between Proponents. Therefore, Proponents may select the Eligible Milestone Events which trigger payment of Milestone Payments, from the list provided in Appendix B to Schedule 3-2 of the RFP. The Eligible Milestone Events are only defined at a high level in the RFP, the intent being to provide Proponents with sufficient detail to pinpoint where in their schedule the Eligible Milestone Event will occur and develop the Financial Model accordingly. Following selection of Preferred Proponent, a more detailed description of each selected Eligible Milestone Event will be developed in partnership with the Preferred Proponent, to a level of detail that will enable objective certification by an independent certifier.

The City also recognizes that financing approaches may differ between Proponents. Therefore, Proponents have flexibility to choose to receive anywhere from one (1) to five (5) Milestone Payments. It is not mandatory that Proponents choose to receive all five (5) possible Milestone Payments. It is, however, mandatory that Proponents include one (1) Milestone Payment which is triggered by the 2017 Readiness Milestone. Therefore, a Proponent may include anywhere one (1) and five (5) Milestone Payments in its Financial Model.

The City may consider adding additional Eligible Milestone Events to the list in Appendix B to Schedule 3-2, enabling Proponents to define additional potential triggering events for Milestone Payments. Proponents may bring forward suggestions as to additional Eligible Milestone Events through the RFI and CCM process. Any additional Eligible Milestone Events should be significant construction milestones that correspond to completion of performance of a discrete phase of work, and are amenable to objective verification by an independent certifier.

2. Key Constraints on Milestone Payments

Milestone Payments must fit within the constraints set out in s. 2.17 of Schedule 3-2 to the RFP. This note provides background on certain selected key Milestone Payment constraints:

a. Minimum of \$300 Million Private Capital Invested

Milestone Payments must be sized such that: (i) At the time of drawing the first Milestone Payment, there is at least \$300 Million of Private Capital Invested¹ in the Project; and (ii) at all times following the draw of the first Milestone Payment until the Revenue Service Commencement Date, there is at least \$300 Million of Private Capital Invested in the Project.

¹ The term “Private Capital Invested” is defined in s. 2.16 of Schedule 3-2 to the RFP as the total amount of financing advanced (Senior Debt, Junior Debt and equity capital) and utilized in the Project to fund Project costs.

b. Milestone Payments must be at least \$50 Million

Any Milestone Payment paid by the City must be a minimum of \$50 Million, excluding HST.

c. Cumulative Milestone Payments must not exceed 65% of the cumulative Cost of Work

This constraint puts an upper limit on the size of Milestone Payments relative to the Cost of Work.² The examples below illustrate the operation of this constraint.

Example 1: Proponent selects five Eligible Milestone Events and models five Milestone Payments. At all times, the cumulative total of Milestone Payments must be no greater than 65% of cumulative Cost of Work. The example below complies with this constraint.

Month	A Cost of Work	B Cost of Work (Cumulative)	C Milestone Payment	D Milestone Payments (Cumulative)	D/B MSP (Cumulative) / Cost of Work (Cumulative)
1	\$45,000,000	\$45,000,000	\$0	\$0	0.00%
2	\$45,000,000	\$90,000,000	\$0	\$0	0.00%
3	\$45,000,000	\$135,000,000	\$0	\$0	0.00%
4	\$45,000,000	\$180,000,000	\$0	\$0	0.00%
5	\$45,000,000	\$225,000,000	\$0	\$0	0.00%
6	\$60,000,000	\$285,000,000	\$0	\$0	0.00%
7	\$60,000,000	\$345,000,000	\$224,000,000	\$224,000,000	64.93%
8	\$60,000,000	\$405,000,000	\$0	\$224,000,000	55.31%
9	\$60,000,000	\$465,000,000	\$0	\$224,000,000	48.17%
10	\$60,000,000	\$525,000,000	\$115,000,000	\$339,000,000	64.57%
11	\$80,000,000	\$605,000,000	\$0	\$339,000,000	56.03%
12	\$85,000,000	\$690,000,000	\$0	\$339,000,000	49.13%
13	\$85,000,000	\$775,000,000	\$0	\$339,000,000	43.74%
14	\$85,000,000	\$860,000,000	\$200,000,000	\$539,000,000	62.67%
15	\$60,000,000	\$920,000,000	\$0	\$539,000,000	58.59%
16	\$60,000,000	\$980,000,000	\$0	\$539,000,000	55.00%
17	\$60,000,000	\$1,040,000,000	\$0	\$539,000,000	51.83%
18	\$60,000,000	\$1,100,000,000	\$175,000,000	\$714,000,000	64.91%
19	\$60,000,000	\$1,160,000,000	\$0	\$714,000,000	61.55%
20	\$60,000,000	\$1,220,000,000	\$0	\$714,000,000	58.52%
21	\$45,000,000	\$1,265,000,000	\$0	\$714,000,000	56.44%
22	\$45,000,000	\$1,310,000,000	\$135,000,000	\$849,000,000	64.81%
23	\$45,000,000	\$1,355,000,000	\$0	\$849,000,000	62.66%
24	\$45,000,000	\$1,400,000,000	\$0	\$849,000,000	60.64%
Total	\$1,400,000,000		\$849,000,000		

65% constraint is complied with throughout construction period.

Example 2: Proponent selects three Eligible Milestone Events and models three Milestone Payments. At all times, the cumulative total of Milestone Payments received must be no greater than 65% of cumulative Cost of Work. The example below complies with this constraint.

² The term Cost of Work is defined in s. 2.17 of Schedule 3-2 to the RFP.

Month	A Cost of Work	B Cost of Work (Cumulative)	C Milestone Payment	D Milestone Payments (Cumulative)	D/B MSP (Cumulative) / Cost of Work (Cumulative)
1	\$45,000,000	\$45,000,000	\$0	\$0	0.00%
2	\$45,000,000	\$90,000,000	\$0	\$0	0.00%
3	\$45,000,000	\$135,000,000	\$0	\$0	0.00%
4	\$45,000,000	\$180,000,000	\$0	\$0	0.00%
5	\$45,000,000	\$225,000,000	\$0	\$0	0.00%
6	\$60,000,000	\$285,000,000	\$0	\$0	0.00%
7	\$60,000,000	\$345,000,000	\$0	\$0	0.00%
8	\$60,000,000	\$405,000,000	\$0	\$0	0.00%
9	\$60,000,000	\$465,000,000	\$0	\$0	0.00%
10	\$60,000,000	\$525,000,000	\$50,000,000	\$50,000,000	9.52%
11	\$80,000,000	\$605,000,000	\$0	\$50,000,000	8.26%
12	\$85,000,000	\$690,000,000	\$0	\$50,000,000	7.25%
13	\$85,000,000	\$775,000,000	\$0	\$50,000,000	6.45%
14	\$85,000,000	\$860,000,000	\$0	\$50,000,000	5.81%
15	\$60,000,000	\$920,000,000	\$0	\$50,000,000	5.43%
16	\$60,000,000	\$980,000,000	\$0	\$50,000,000	5.10%
17	\$60,000,000	\$1,040,000,000	\$0	\$50,000,000	4.81%
18	\$60,000,000	\$1,100,000,000	\$50,000,000	\$100,000,000	9.09%
19	\$60,000,000	\$1,160,000,000	\$0	\$100,000,000	8.62%
20	\$60,000,000	\$1,220,000,000	\$0	\$100,000,000	8.20%
21	\$45,000,000	\$1,265,000,000	\$0	\$100,000,000	7.91%
22	\$45,000,000	\$1,310,000,000	\$750,000,000	\$850,000,000	64.89%
23	\$45,000,000	\$1,355,000,000	\$0	\$850,000,000	62.73%
24	\$45,000,000	\$1,400,000,000	\$0	\$850,000,000	60.71%
Total	\$1,400,000,000		\$850,000,000		

65% constraint is complied with throughout construction period.

3. Revenue Service Availability Payment

The Revenue Service Availability Payment (“RSAP”) is intended to be a “take-out” payment similar to a Substantial Completion Payment on other Infrastructure Ontario transactions. The RSAP is payable following the Revenue Service Availability Date, in accordance with the payment terms in the Project Agreement.

The RSAP is intended to “take out” construction period financing and leave a **maximum** of \$400 Million in long term financing to be repaid over the Maintenance Term with revenues from the Annual Service Payment. The amount of the Revenue Service Availability Payment may be expressed by the following equation:

$$Private\ Capital\ Invested_{RSAD} - RSAP = \$400\ Million$$

Where:

Private Capital Invested_{RSAD} Means Private Capital Invested immediately prior to the Revenue Service Availability Date

In the event that Private Capital Invested immediately prior to the Revenue Service Availability Date is less than \$400 Million, then the RSAP shall be \$0.

The City expects that the amount of the RSAP will vary between Proponents based on each Proponent's costs as well as size of Milestone Payments (amount of capital costs already paid down).

4. Affordability

The City's Mandatory Affordability Criteria requires that the Proponent's Capital Cost shall not exceed \$1.718 Billion. This criteria is necessary in order to comply with the City's budgetary commitments to City Council.

For the purposes of the Mandatory Affordability Criteria, the Proponent's Capital Cost is defined as the sum of: (i) all Milestone Payments; (ii) the Revenue Service Availability Payment; and (iii) Private Capital Invested following the payment of the Revenue Service Availability Payment, i.e. the outstanding principal amount of long-term private capital.

The examples below demonstrate calculation of the Capital Cost for purpose of the Mandatory Affordability Criteria. In each case, the Capital Cost is compliant with the maximum of \$1.718 Billion.

* All costs below in nominal terms, \$MM.

	<u>Scenario 1</u>	<u>Scenario 2</u>
Milestone Payment 1	\$365	\$50
Milestone Payment 2	\$166	
Milestone Payment 3	\$314	
Milestone Payment 4	\$138	
Milestone Payment 5	\$38	
Revenue Service Availability Payment	\$279	\$1,260
Private Capital Invested (Post-RSAP)	\$400	\$400
Capital Cost	\$1,700	\$1,710