BERMUDA AIRPORT PRIVATE PLACEMENT TAKES OFF

THE GOVERNMENT OF BERMUDA, THE BERMUDA AIRPORT AUTHORITY, CANADIAN COMMERCIAL CORPORATION, AECON CONCESSIONS AND SKYPORT CORPORATION LTD HAVE REACHED FINANCIAL CLOSE ON THE REDEVELOPMENT OF BERMUDA'S LF WADE INTERNATIONAL AIRPORT. BY DOUGLAS A DOETSCH, PARTNER AND DANIEL P WHITMORE, COUNSEL, MAYER BROWN LLP.

After numerous storms and numerous repairs, the Government of Bermuda (GoB) recognised that the only airport on the island was on borrowed time and in need of major renovations. Built by the US military in 1940 as a joint US/RAF air base, the GoB assumed control of the airport in 1995. Since the existing terminal is only a few metres above sea level, the ageing infrastructure is subject to high rains, flooding and hurricanes. The airport is a strategic asset for Bermuda but with the asset ageing and vulnerable, Bermuda has been cut off and isolated in times of severe weather.

In 2014, the GoB signed a non-binding memorandum of understanding with Canadian Commercial Corporation (CCC) to participate in discussions on the development of an airport-related infrastructure project deemed to be of mutual interest. CCC is a Crown corporation of the Government of Canada that supports exports through government-to-government contracts to assist other purchasing governments obtain products and services from Canada.

Each contract signed by CCC with a foreign government buyer includes an inherent guarantee, backed by the Government of Canada, that the terms and conditions of the contract will be satisfied. In 2015, CCC and the GoB executed an airport development agreement. Under that agreement, CCC identified Aecon International Constructors, a division of Aecon Construction Group, as its proposed subcontractor to perform construction services and Aecon Construction Group, as represented by Aecon Concessions, as an equity provider for a special purpose concessionaire (Project Co) to deliver the balance of the project deliverables.

The procurement

Bermuda, as a British Overseas Territory, remains under the jurisdiction and sovereignty of the United Kingdom. To enter into a contract with CCC, the UK's Foreign & Commonwealth Office delivered an entrustment letter to the Governor of Bermuda to provide the necessary constitutional authorisation and delegation to Bermuda to contract with CCC.

The UK Government, under Her Majesty's Treasury and its Green Book, has provided guidance to other public sector bodies on how to appraise proposals before significant funds are committed. This required Bermuda to demonstrate that the project would deliver "value for money".

To determine whether a given project structure would deliver value for money, the GoB considered several options. The GoB's traditional procurement method was tendering the design and construction of a project with the GoB remaining on the hook for costs and expenses. The capital expenditure for the new terminal under this option was estimated at US$575m.

However, Bermuda's debt in 2017 of approximately US$2.3bn and its recent history of running budget deficits made this a less attractive option. The substantial increase in the GoB's sovereign debt might result in a downgrade of the GoB's credit rating (A2/A+). Additionally, with an annual passenger traffic forecast of less than 1m, the risks associated with a failed procurement were considered to be high.

The best value for money solution was a flexible public-private partnership structure in which the GoB contracted directly with CCC in the concession agreement. With the government-to-government approach, the capital expenditure was much lower at slightly over US$300m. Under the traditional tender option, the GoB would retain the risk of cost overruns and delays. In the government-to-government P3 approach, the GoB transfers the design, building, financing, operating and maintenance (DBFOM) risk to third parties. This DBFOM structure is consistent with airport P3s globally and in the Caribbean.

Transaction overview

The documentation architecture was a unique aspect of the transaction. At financial closing on March 15 2017, the GoB and CCC entered into a 30-year project agreement (the concession). Immediately thereafter, (i) the GoB novated and assigned its rights and obligations under the project agreement to the newly created Bermuda Airport Authority and (ii) CCC novated and assigned its rights and obligations under the project agreement to Bermuda Skyport Corporation Ltd or Project Co. Bermuda Airport Authority and Project Co then entered into an amended and restated project agreement pursuant to which Project Co is responsible for the design and building of the airport redevelopment as well as the ongoing operations and maintenance of the airport.

The construction of the new airport terminal is expected to take 40 months. During the construction period, Project Co will operate the airport with the existing terminal. The project will have the advantage of aeronautical revenues during the construction phase, which will mitigate the adverse effects of any construction delays or cost overruns. After completion, Project Co will decommission most of the existing terminal and the remainder will be renovated for administrative offices.

Project Co's construction obligations were dropped down to CCC pursuant to a lump-sum turnkey construction contract and CCC's construction obligations were then subcontracted to Aecon International Constructors. Even though CCC's design and building obligations are subcontracted to Aecon, CCC is not relieved or excused from any of its obligations or liabilities under the construction contract, and CCC remains the prime contractor for delivery of the project's construction capital programme to Bermuda on time and on budget. The construction contract is for a fixed price with a 45% construction price cost overrun protection for CCC[1].

To finance the project, Project Co issued US$285m of senior secured notes through a private placement to US investors. Additionally, equity contributions and ongoing revenues would be used during the construction phase. The notes were priced at 5.9% and have a term of 25 years with a five-year tail between the maturity date and the end of the concession term.

Airport revenues

Although geographically not part of the Caribbean, Bermuda is often compared with the Caribbean with respect to different economic and trade factors. With a population about 62,000, its per capita GDP was over US$84,000 in 2014, making it the fourth highest in the world that year and well above the average GDP for the Caribbean. Bermuda competes with the Caribbean for in-bound tourism and recently has been losing market share to Caribbean destinations. This has resulted in a decline in airport traffic: after a peak in 2007, commercial and general aviation traffic declined by 23% from 988,000 in 2007 passengers to 760,000 in 2015. Since an airport's revenue is directly tied to its traffic count, the investors in the private placement assessed the risk related to air traffic and how it could be mitigated.

To address this risk, the GoB delivered a minimum revenue guarantee. The parties agreed to a minimum regulated revenue for a term of 25 years, the term of the notes. The GoB, through the Bermuda Airport Authority, will contribute the difference between the actual regulated revenues and the minimum regulated revenues to the extent that project cashflows are insufficient to pay the noteholders. Payments under the guarantee are reserved for debt service and may not be used to pay equity holders. This form of guarantee is not uncommon in transactions with either no traffic history or declining traffic history. The minimum revenue guarantee bolstered the credit profile of the project and was a factor in enabling the project to achieve an investment grade rating, which in turn reduced the cost of the financing[2].

In addition to the minimum revenue guarantee, the GoB is mounting a strong tourism marketing campaign designed to reverse the declining trend in passenger traffic. In 2017, the America's Cup yacht competition will be held in Bermuda, which should result in a robust increase in in-bound tourism in the near term.

Political risk

In 2007, the government in power, the Progressive Labor Party (PLP), renamed the airport the "LF Wade International Airport" in honour of L Frederick Wade, a leader of the PLP. The opposition party at the time criticised the renaming of the airport, saying the choice was politically-motivated and undemocratic. The politics of the renaming, ten years before the financial closing in 2017, was to prove a harbinger of a greater political battle surrounding the airport's renovation.

In Bermuda's general election in 2012, the One Bermuda Alliance (OBA) party defeated the PLP and has been in power since then. As noted above, the UK Government's procurement guidelines required the GoB to demonstrate that the CCC/Aecon P3 model, rather than a public tender process, demonstrated value for money.

The Ministry of Finance and the Ministry of Tourism, Transport & Municipalities of the GoB prepared an "Overall Business Case – Entrustment Report" that endorsed the P3 structure. A third-party consultant, Steer Davies Gleave, was engaged and provided a "Value for Money Assessment" that came to the same conclusion. Lastly, a blue ribbon panel was formed of local professionals to review the issues, and it also concluded that the CCC/Aecon transaction was the preferred approach. The PLP remained unconvinced.

One of the conditions precedent to financial close was the enactment of certain Enabling Legislation by Bermuda's legislature. The Enabling Legislation was required to establish the new Bermuda Airport Authority and to provide for certain tax concessions for the project.

The legislation was scheduled to be enacted on December 9, 2016. The OBA held a slim majority in both the lower and upper houses. As the date approached, the opposition's efforts ramped up.

The leader of the PLP demanded that, prior to putting the bill up for a vote, the deal be submitted to the Auditor-General for an independent assessment of the cost to taxpayers and he warned against privatisation of the airport.

On the morning the lower house was scheduled to debate the Enabling Legislation, pro-PLP protesters gathered in opposition to the airport redevelopment plans. Matters deteriorated, the police responded with pepper spray, and the Enabling Legislation was postponed until February of 2017.

In February, the authorities were braced for a repeat of the December demonstrations but the protests were largely uneventful and the Enabling Legislation was enacted. Financial close followed in March.

The use of the government-to-government contract, together with the P3 model, provided a bespoke and affordable solution to the GoB's airport redevelopment needs. ■

Footnotes

1 Blue Ribbon Panel Report to the Minister of Finance, LF Wade International Airport Redevelopment Proposal, February 2017 (Blue Ribbon Panel Report), page 16 - available on the GoB's website.

2 Blue Ribbon Panel Report, page 18.