

Value for Money and Project Report

Biosolids Project

City of Greater Sudbury



June 2013



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Section 1: Executive Summary

1.1 Overview

The City of Greater Sudbury (the “City”) is entering into a long term Design Build Finance Operate Maintain (“DBFOM”) contract, also known as a public-private partnership (“P3”), with a private sector consortium¹ led by N-Viro Systems Canada LP (“N-Viro”) for the Biosolids Project (the “Project”). Under the terms of the DBFOM contract, N-Viro will construct a new biosolids facility and upgrade certain existing infrastructure at the Sudbury Wastewater Treatment Plant (“SWWTP”). The City of Greater Sudbury will own the facilities but will license N-Viro to operate and maintain the biosolids facility for a 20-year period, including the repair and lifecycle replacement of the equipment and facilities.

The Project will allow the City to meet its future wastewater disposal needs under an environmentally responsible and sustainable method. Not only is the Project expected to provide value to the City and its taxpayers through the use of a P3 delivery model, it is also expected to significantly reduce odour issues that have been experienced in the community and consequently improve the living conditions of its residents.

The Project is eligible to receive funding support from the Government of Canada through PPP Canada and the P3 Canada Fund in the amount of \$11 million, provided that the City can demonstrate that the Project generates Value for Money (“VfM”) for taxpayers. The remaining Project funding will be provided by the City through debt financing.

An extensive procurement process was undertaken to select the private sector consortium that would partner with the City to deliver the Project. Ultimately, the N-Viro consortium was selected because it provided the lowest price submission, while also complying with the technical requirements of the Project. As this is the first P3 project being implemented by the City, it has been supported throughout the procurement process by a team of external experts in the P3 sector from the following firms: KPMG LLP (transaction and financial), Blake, Cassells & Graydon LLP (legal), RV Anderson Associates Ltd. (technical) and Knowles Consulting (fairness).

The construction price for the Project is \$63.1 million and it will be financed 100% by N-Viro during the construction period. Upon substantial completion of the Project, the City will make a payment to N-Viro for 75% of the construction price (or \$47.3 million). The remaining balance of the construction price will be financed by N-Viro over the 20 year operating term of the Project, with N-Viro receiving annual capital payments of \$1,374,000 from the City. In addition, N-Viro will receive annual operating payments based on the amount of sludge processed by the biosolids facility.

A VfM analysis has been prepared by KPMG. Delivering the Project under a DBFOM model is estimated to generate cost savings of \$11.1 million (or 6.9%) in net present value terms in comparison to a traditional delivery approach. Accordingly, P3 delivery is expected to provide VfM for taxpayers.

¹ The N-Viro consortium consists of the following key members: N-Viro Systems Canada LP, Tribury Matheson Group, and Cole Engineering Group.

The report that follows is intended to provide a summary description of the Biosolids Project, the procurement process leading to the DBFOM contract, key features of the DBFOM contract, and the VfM analysis.



Section 2: Project Overview

2.1 Project Background

The City currently operates nine secondary wastewater treatment plants. Waste activated sludge from the City's wastewater treatment facilities (in addition to the Espanola Waste Water Treatment Plant, Vale Copper Cliff Waste Water Treatment Plant, and the McFarlane Lake Provincial Facility) is collected by truck and hauled to the City's sludge transfer station where it is pumped to Vale's R1 and R3 Tailings Ponds near Lively. The practice has been in place for the past 30 years.

Due to concerns regarding odour, and indications from the Ministry of the Environment and Vale that the City would no longer be able to use the tailing ponds, the City undertook a Biosolids Master Plan and Environmental Assessment in 2008/09. The City's Biosolids Master Plan was presented to Council on February 18, 2009. As part of the Master Plan's development, the City undertook an extensive public consultation process. As a result, the City decided to construct a new biosolids facility that will treat the sludge to produce a beneficial end use product and the facility will be located on the site of the SWWTP.

The Project is expected to deliver a host of benefits to the City and its residents including meeting the City's future wastewater disposal needs based on an environmentally responsible system (e.g., cease disposition of sludge in the tailings ponds, stabilize sludge and produce a beneficial end use product) and addressing the odour issues that have been raised by residents.

Further, by implementing the Project under a P3 model, the City is able to realize additional benefits of the Project such as leveraging the experience of the private sector in operating a biosolids facility and distributing the end use product. The City does not have biosolids experience internally and due to the proprietary nature of the technology involved in the Project, it would be costly for the City to train and retain individuals with the requisite skill set. Additionally, the City can leverage the distribution network and potential clients that the private sector partner already has to distribute the end product.

To help realize the benefits discussed above, the City has identified several important objectives for the Project, including:

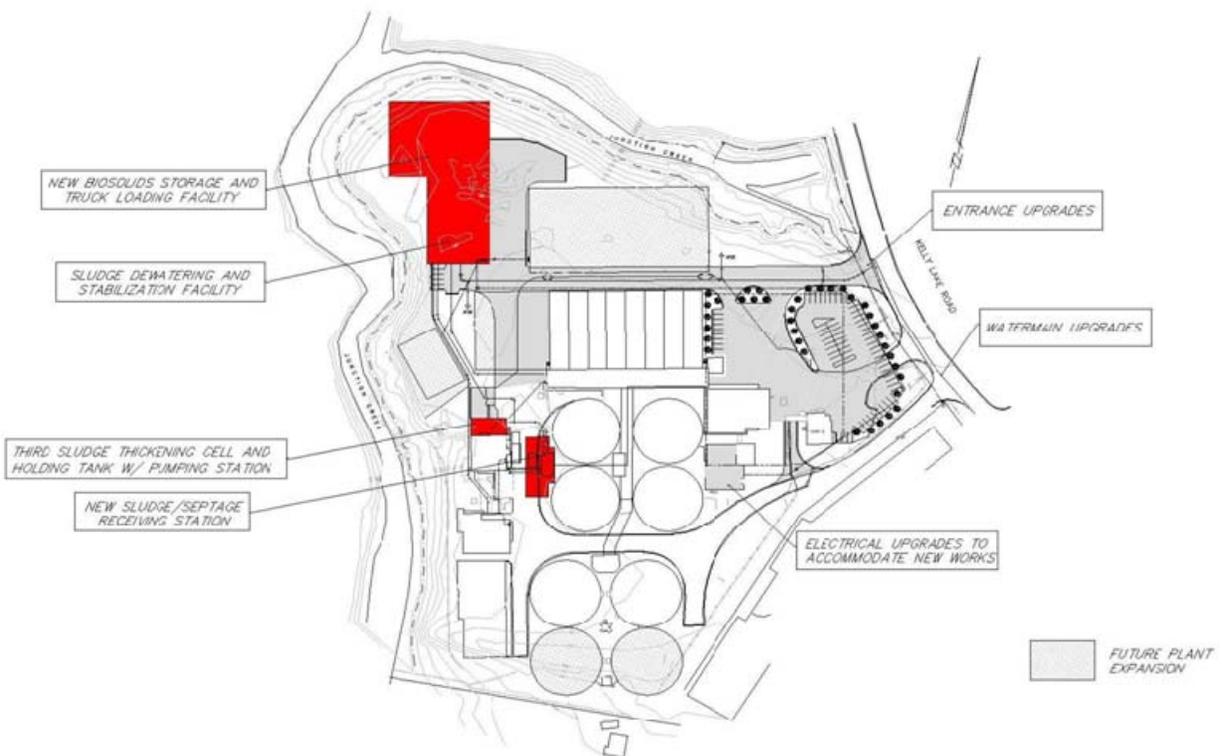
- a) Providing services that are environmentally sustainable and in keeping with industry best practices;
- b) Ensuring the Biosolids Facility and improvements to the existing infrastructure at the SWWTP provide VfM for the City and transfer appropriate risks to the Contractor;
- c) Ensuring the continual provision of quality waste disposal services during redevelopment of the SWWTP;
- d) Ensuring that safe construction and operation practices are followed during the redevelopment of the SWWTP; and
- e) Meeting the City's requirements to reduce odour complaints.

2.2 Scope of the Project

The main components of the Project include:

- general site works such as upgrades to electrical substation, utility services, site access and parking, and fire detection and suppression systems;
- sludge / septage receiving facility;
- sludge thickening facility; and
- biosolids facility including thickened sludge pumping station and sludge dewatering, stabilization and storage facility.
-

The following is a site map showing the location of the main project components.



A rendering of the proposed new biosolids facility is provided below.



2.3 Project Funding

The City has applied for funding support from the Government of Canada through PPP Canada and the P3 Canada Fund. The P3 Canada Fund was established by the federal government in 2009 with the intention of inciting public sector sponsors to consider P3s for infrastructure procurements. It is the first infrastructure funding program in Canada that directly targets P3 projects and its stated purpose is to “improve the delivery of public infrastructure and provide better value, timeliness and accountability by increasing the effective use of P3.”²

The Project has received funding approval from PPP Canada for 25% of the total eligible costs of the Project up to a maximum amount of \$11 million. As a prerequisite for this funding, the City must demonstrate to PPP Canada that the Project generates VfM for taxpayers.

The remaining funding will be provided by the City mainly through debt financing.

² <http://www.p3canada.ca/p3-canada-fund-overview.php>



Section 3: Procurement Process

3.1 RFP Process

In 2010, the City completed a Request for Statement of Interest and Expression of Interest (“EOI”). The evaluation of the EOI resulted in four consortia being qualified and approved to participate in the Request for Proposal (“RFP”) process:

- Graham Design Builders; Lystek™
- Kenaidan Contracting Ltd/CH2M Hill; Bioset™
- Maple Reinders/Veolia Water Solutions and Technologies; Biocon™
- N-Viro Systems Canada LP; N-Viro™

In January 2011, Council adopted a DBFOM project delivery model, whereby the selected consortium would finance the entire project cost during construction and provide a portion of the long-term (20 year) project financing. The Project represents the first P3 Biosolids management project in Canada and one of the early P3 projects in the Canadian municipal sector.

On March 14, 2011, a RFP for the City of Greater Sudbury Biosolids Facility was issued to the four consortia listed above. Oversight of the process was provided by a Fairness Monitor from Knowles Consulting who issued a fairness opinion of the RFP process. Proposals were received on January 27, 2012 from two of the four proponents: N-Viro and Veolia (with Plenary Group). Both proponents submitted strong technical proposals; however, due to submission compliance issues the City decided to continue the process using a negotiated protocol that was agreed to by both proponents.

3.2 Negotiation Protocol Process

In order to maximize the time and effort spent on the RFP and prior processes, Council directed staff to enter into negotiations with both private sector parties to arrive at the best solution for the City. The objectives of the negotiation process were to review the scope of the Project, to resolve contract terms and conditions and to reduce the capital and operating costs for the Project.

The negotiation process was conducted under a set of Negotiation Protocol that was communicated to both private sector parties. The negotiation process was overseen by a fairness monitor from Knowles Consulting who issued a fairness opinion of the negotiation process.

Submission requirements and evaluation criteria were developed to assess and evaluate the final submissions under the Negotiations Protocol. The criteria were divided into three categories: technical, financial and risk allocation. Each of these categories was further broken down into detailed evaluation criteria. The weighting assigned to the criteria was heavily weighted towards price because both parties had demonstrated strong technical abilities to meet the City’s requirements for the Project.

The following table summarizes the evaluation criteria and total points allocated. The goal of the evaluation process was to have the lowest cost technically compliant submission be successful.

Criteria	Maximum Points
Technical solution and adherence to Output Specifications and Operating & Maintenance requirements	800
Acceptance of risk sharing as specified in the Project Agreement	300
Financial Plan	400
Financial Offer (Based on Net Present Value)	2,500
Total Score	4,000

During the negotiation period, some minor scope adjustments were made to the project requirements and the DBFOM contract to achieve reductions in both the capital and operating costs from the original RFP and to optimize risk sharing. The two private sector parties were requested to respond to the same project requirements and DBFOM contract.

On October 9, 2012, final submissions were received from N-Viro and Veolia/Plenary Group. The submissions included the full technical solution proposed, an updated financing plan and a revised financial offer to reflect the amended DBFOM contract.

Based on the evaluation criteria above, N-Viro was the highest scoring consortium. N-Viro submitted a strong technical proposal that effectively met the City's requirements and was also the lowest price; however, it did not provide fully committed financing and was scored accordingly. Although the City indicated its preference for fully committed financing in its submission requirements, it was not a mandatory requirement of the Negotiations Protocol. Committed financing means that the lenders and equity financiers have conducted engineering and financial due diligence, as well as a review of the terms and conditions of the draft Project Agreement and have entered into term sheets to finance the project. This work still needed to be completed by the lenders who were not yet committed to N-Viro.

On November 20, 2012, Council passed the following resolution:

That the City of Greater Sudbury authorize the General Manager of Infrastructure Services to enter into an agreement with N-VIRO SYSTEMS CANADA LP ("N-Viro") or a corporate entity owned or controlled by N-Viro for the Design, Build, Finance, Operation and Maintenance ("DBFOM") for the Biosolids Management Facility; such authority being subject to the following conditions which are to be met to the satisfaction of the City and within appropriate timelines as set by the City:

- 1) N-Viro providing evidence of fully committed financing and an updated financing plan for the project; and,*
- 2) N-Viro executing the Project Agreement in substantially the same form as currently finalized and for the amounts submitted.*

N-Viro has satisfied the conditions of Council's resolution. On June 13, 2013 financial close for all financing was achieved by N-Viro with its lenders and the Project Agreement ("PA") was executed between the City and N-Viro.

3.3 Project Team and External Advisors

The Project sponsors who oversaw the procurement process for this Project were the City’s Chief Administrative Officer, Chief Financial Officer / Treasurer and the General Manager of Infrastructure Services.

The City’s Biosolids Project Team was comprised of individuals with the requisite technical, financial and legal knowledge and included a Water/Wastewater Project Engineer from Infrastructure Services, an Assistant City Solicitor and the Manager of Accounting.

The City’s project team was supported by industry experts from the following firms:

External Advisory Team	
Transaction and Financial Advisor	KPMG LLP
Legal Advisor	Blake, Cassells & Graydon LLP
Technical Advisor	RV Anderson Associates Ltd.
Fairness Advisor	Knowles Consultancy Services Inc.



Section 4: Highlights of the Transaction

4.1 Information on N-Viro

N-Viro is a Canadian owned company that has designed, constructed and/or operated biosolids processing facilities in Sarnia, Leamington and Niagara Region in Ontario; as well as in Halifax, Nova Scotia, Summerside, Prince Edward Island and Banff, Alberta. N-Viro has a proven biosolids management technology that produces a beneficial end use product.

To undertake this project, N-Viro has put together the following team:

- N-Viro Systems Canada LP is the lead company coordinating the Project and the technology provider for the Biosolids Facility.
- PMX Inc. is responsible for overall project management.
- A joint venture of Tribury Matheson Group and W.S. Nichols will be the constructor of the Biosolids Facility and the upgrades to existing facilities.
- Cole Engineering Group is the engineering firm for the Project with assistance from RWDI Air Inc. to complete the air and noise project requirements.

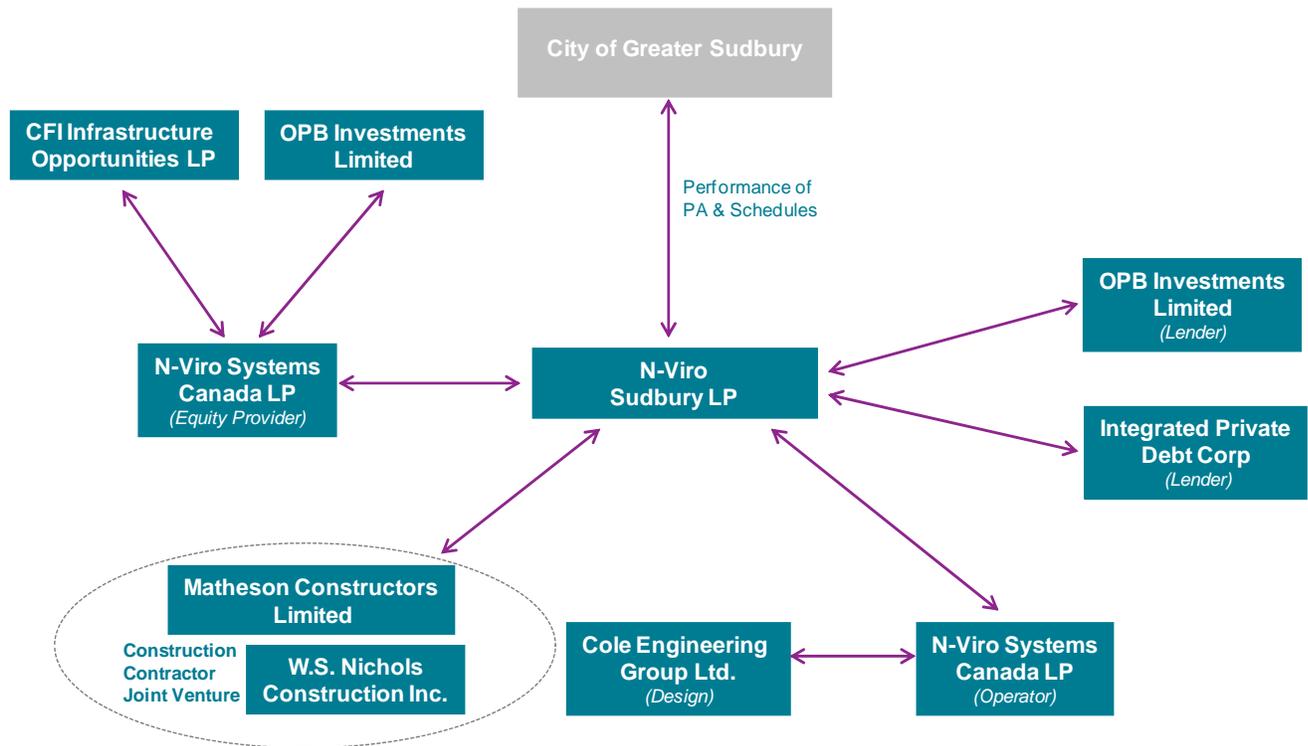
4.2 Project Structure and Financing

N-Viro has incorporated N-Viro Sudbury LP to execute the Project for the City. N-Viro Sudbury LP will have contracts with members of the N-Viro consortium for the design, construction, financing, maintenance and operations of the Project.

The construction price for the Project is \$63.1 million. N-Viro Sudbury LP will finance 100% of the construction price until substantial completion. The City will then pay 75% of the construction price or \$47.3 million to N-Viro Sudbury LP. Of the \$47.3 million to be paid by the City at substantial completion, \$11 million will come from PPP Canada and the City will incur debt to make the remainder of this payment. The balance of the construction price or \$15.8 million will be financed by N-Viro Sudbury LP over the 20 year operating term of the Project. Repayment of the balance will be \$1,374,000 annually for 20 years.

N-Viro will operate and maintain the biosolids facility and receive operating payments from the City. The operating costs to the City in year 1 of the contract is projected to be \$2,802,000 (the actual payment will be based on the amount of sludge processed) and each year thereafter will be adjusted for inflation and the actual quantity of sludge processed in accordance with the Project Agreement.

The project organization and financing structure is depicted in the following chart:



4.3 Risk Transfer and Payment Mechanism under the Project Agreement

Historically, the public sector has used a traditional delivery approach (see Section 5.2 for a description) for service and infrastructure delivery, while taking on full responsibilities and risks for the design, construction, financing, maintenance and operations of a facility. An important element in P3 delivery approaches is the transfer of risks to the private sector. The general principle in risk allocation is that risks should be assigned to the party that is best able to manage the risk.

For the Project, the City and its private sector partner have entered into a DBFOM contract (or Project Agreement) that sets out the responsibilities of all parties during the construction period and for the 20 year operating term of the Project. Important parts of this Project Agreement are the terms that provide for an acceptable allocation of risks between the City and N-Viro. Some of the key risks that have been transferred to the private sector include:

- **Construction Cost Overruns.** The Contractor bears the risk of any construction costs above the price agreed to in the Project Agreement.
- **Project Financing.** The Contractor does not receive any payment until completion of construction and commissioning has been achieved. At that point, the Contractor receives 75% of the construction price identified in its submission and the remaining 25% is repaid over 20 years. Should the Contractor default during the operating period the City will retain 25% of the net present value of the remaining capital outstanding. Hence, capital is at risk by the Contractor throughout the term of the Project Agreement.

- **Project Schedule.** The Contractor agrees to have the Biosolids Facility and related improvements to the existing infrastructure available within 24 months following execution of the Project Agreement. Should the Contractor fail to meet this requirement, then the Contractor will be responsible for the disposal of sludge from that date and receive reduced payments. The Contractor has to manage the construction schedule to meet this date.
- **Permitting and Approvals.** The Contractor is responsible for obtaining and complying with the Environmental Compliance Approval (Sewage / Air & Noise) for the Biosolids Facility.
- **Operating Cost OVERRUNS.** The Contractor is paid monthly for the operation of the Biosolids Facility based on a pre-defined payment rate for the quantity of sludge processed, therefore the Contractor absorbs any increased operating and maintenance costs above the contract price.
- **Biosolids Production.** The Contractor is responsible for producing Class A Biosolids and will receive reduced payments if not achieved as a result of their processes.
- **Odour Limits.** The Contractor is responsible for maintaining pre-defined odour limits from the Biosolids Facility and will receive reduced payments if these limits are not achieved.
- **Long-Term Asset Maintenance.** The Contractor is responsible during the term of the contract to maintain the facility and equipment in accordance with industry standards. The Contractor is required to submit to the City an annual Maintenance and Asset Management Plan as well as monthly and annual Operations and Maintenance Reports. The Project Agreement has provisions to withhold payments if the Contractor does not maintain the facility and building in accordance with these plans and industry standards.
- **Handback Requirements.** The Project Agreement has provisions for the Contractor to provide a Handover Holdback to the City four years prior to end of the contract. The Handover Holdback will provide any funds that might be necessary to bring the facility and equipment to the expected standard when the City takes over the facility at the end of the 20 year operating period.



Section 5: Value for Money Analysis

5.1 What is Value for Money

Value for Money analysis is a tool commonly used by public sector project sponsors to assess the value to the public of delivering an infrastructure project through a P3 model.

VfM analysis compares the total risk-adjusted cost to the City under two different delivery models - the DBFOM model and the traditional delivery (“TD”) model. If it is found that the DBFOM method costs less than the traditional delivery model, then a P3 approach is considered to deliver VfM. To arrive at risk adjusted costs, it is standard practice to develop a risk matrix and to quantify risks through a risk workshop (as described further in the following section).

5.2 Risk Quantification

An important element in P3 delivery approaches is the transfer of risks to the private sector. The general principle being risks should be assigned to the party that is best able to manage the risk. As part of the project planning stage, a risk matrix was developed through review of precedent industry documents and discussions among project team members. The objective of the risk matrix was to identify project risks that could occur during the design, construction, and operations and maintenance phases and to facilitate the quantification of project risks.

On October 28, 2010 a risk workshop was conducted with representatives from the project team including City staff, RV Anderson, KPMG as well as members from PPP Canada. The purpose of the workshop was to come to consensus on the contents of the risk matrix to be used in the VfM analysis. The risk matrix was finalized in December 2010 prior to the release of the RFP.

Risks were identified and considered for each stage of the Project:

- **Planning and procurement stage** – risks involving availability of funding from the City, market and capacity risk, risks involving land acquisition, and financial risk (e.g., due to changes in capital markets prior to start of the Project);
- **Design stage** – risks related to design errors and specifications;
- **Construction stage** – risks related to geotechnical and environment risks, construction delays, permitting approval risks, cost overruns, latent defects and scope changes, and contractor failure or default;
- **Operations stage** – risks related to building operations and maintenance, building rehabilitation, coordination among parties (facility operators, maintenance contractors and City staff), and operator performance; and

For each identified risk, the probability and cost impact of risk occurrence were assessed for both the TD model and the DBFOM model. Aggregate values of risks retained by the City were estimated under both TD and DBFOM models.

The risk matrix and risk quantification were refreshed at key points of the procurement process and at financial close to reflect the risk allocation of the PA and N-Viro's final financial proposal.

5.3 Description of Delivery Models

A brief overview of each of the two delivery models is provided below:

5.3.1 *Traditional Delivery*

The Traditional Delivery model represents the procurement method by which public sector organizations have historically procured infrastructure projects. Key features of this model as applied to the Project include:

- The Biosolids Facility is procured using a Design-Bid-Build (“DBB”) contract structure, in which the City contracts with a design architect / engineering firm to design the facility, and then puts the construction work out to tender to the lowest qualified bidder. It is assumed that a stipulated sum contract will be used.
- Funding for construction costs comes entirely from the City, which makes regular payments during the construction period to the construction contractor as the facility is built.
- Once built, the City will be responsible for running the facility, including operating the facility and capital maintenance related to the building and equipment. The City may tender with contractors for these services or perform the services using in-house staff. The assumption that the City will perform the operations and maintenance activities in-house in this VfM analysis allows for a more meaningful comparison between Traditional Delivery and the DBFOM model in which the private sector will be responsible for facility operations and capital maintenance.

This model is referred to as the “DBB” or “TD” model. The key element of this delivery model is that the risks and responsibilities related to design, construction, and operations and capital maintenance of the facility are retained by the City.

5.3.2 *Design-Build-Finance-Operate-Maintain*

The Design-Build-Finance-Operate-Maintain, or DBFOM, delivery model incorporates design and construction of the Project along with operating the facility and performing capital maintenance over the long term into a single integrated contract. The City has developed detailed output specifications for the Biosolids facility and existing infrastructure improvements at the SWWTP that N-Viro will have to adhere to as part of its contractual arrangement with the City. N-Viro will be responsible for the following:

- Designing the Biosolids Facility based on the specifications and requirements set out in the Project Agreement;
- Constructing the Biosolids Facility and improvements to the SWWTP;
- Financing the construction costs through a mixture of debt and equity;
- Performing operations and routine maintenance of the Biosolids Facility over the term of the contract; and
- Performing capital maintenance of the Biosolids Facility over the term of the contract.

The term of the DBFOM contract will include the design/construction period and 20 years of facility operations. In addition to the activities noted above, N-Viro will also be responsible for the marketing, distribution and disposal of the Final Product. The City will share in the revenues generated from the sale of the Final Product.

In principle, the intent of the DBFOM model is to leverage efficiencies by combining the design and construction phases of the project and also bring in strong project due diligence and discipline associated with private sector financing. In addition, the DBFOM model allows for the transfer of responsibilities and risks associated with facility operations and capital maintenance to the private sector who may be better able to manage those risks.

As mentioned previously, payments from the City to N-Viro will include two streams:

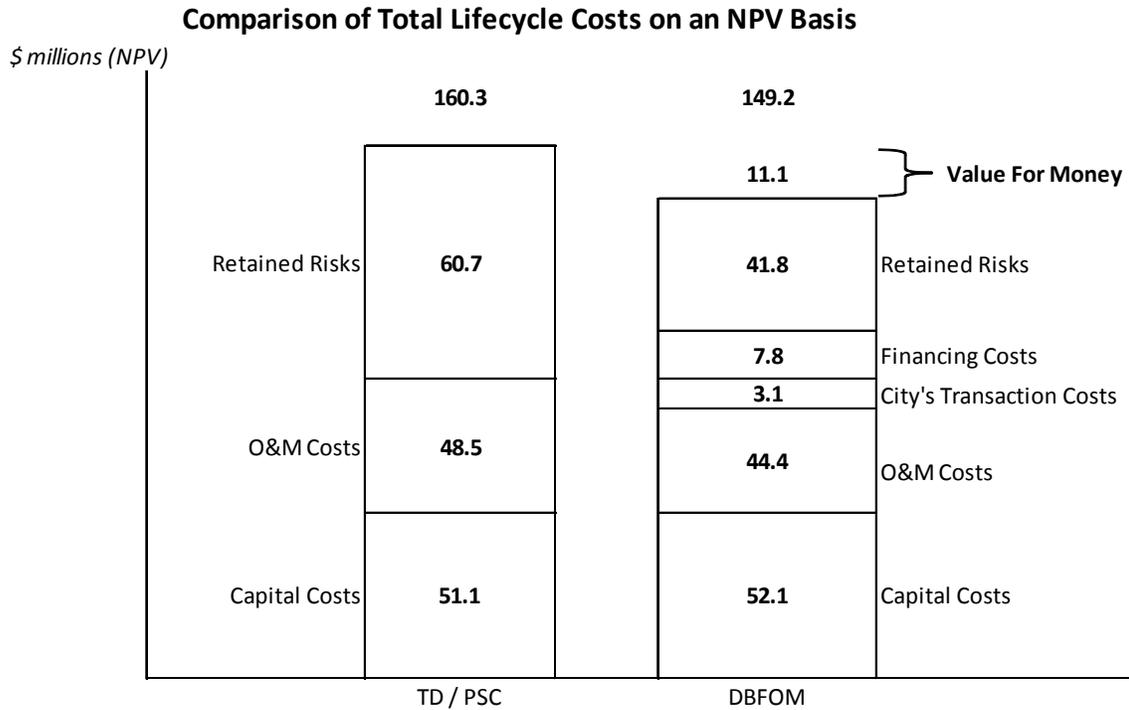
- A Completion Payment in the amount of 75% of total Project costs made payable upon commissioning of the facility.
- Monthly payments during the operations phase of the Project, which comprise of a Capital Payment component and an Operating Payment component. The Capital Payment is repayment of the loan and related interest costs for the 25% balance of the Completion Payment that is to be paid over the 20 year operating term of the contract to N-Viro. The Operating Payment component is a fixed price (adjusted annually) for each dry tonne of Biosolids produced.

The above payments will be guaranteed by the City but may be subject to deductions for poor performance of the DBFOM Contractor.

5.4 Value for Money Results

VfM assessment involves the comparison of the risk adjusted cost under traditional delivery, often referred to as the Public Sector Comparator (“PSC”), and the cost of the project under P3 delivery according to the proposal from the successful private sector proponent.

The total lifecycle costs of the Project to the City under the two delivery models are summarized in the chart below.



* Net Present Values are calculated as at the Financial Close Date (June 13, 2013) using a discount rate of 4.5% which represents the long term average borrowing cost of the City

As shown above, the total cost to the City over the 20-year life of the Project under the DBFOM approach will be \$149.2 million (net present value). This compares to \$160.3 million (net present value) under the traditional delivery approach. The City is expected to achieve VfM of \$11.1 million, or 6.9% of total costs.

The cost categories in the chart are described in more detail below.

5.4.1 Traditional Delivery (PSC)

- **Capital Costs** – Estimated costs for construction, equipment, and other costs such as design fees and contract management for delivery of the Biosolids Facility and upgrade to existing infrastructure under a traditional design-bid-build approach.
- **Operating & Maintenance (“O&M”) Costs** - Estimated total operating costs (e.g., labour, chemicals) and maintenance costs (e.g., equipment and building repairs and maintenance) for the Biosolids Facility over the 20-year operating period.
- **Retained Risks** – Estimated value of project risks retained by the City under a traditional delivery approach. Project risks arise from adverse events that may increase a project’s costs. Key project risks retained by the City under the traditional approach include construction delays, deficiencies in works, commissioning delays, change orders, unscheduled maintenance, unanticipated operating costs, and asset condition in 20 years.

5.4.2 *DBFOM Delivery*

- **Capital Costs and O&M Costs** – Have the same meaning as provided for the Traditional Delivery model in Section 5.3.1 above.
- **City's Transaction Costs** – Incremental costs incurred by the City related to the transaction process.
- **Financing Costs** – This represents the incremental costs of private sector financing over public sector financing in NPV terms.
- **Retained Risks** – Estimated value of project risks retained by the City under the DBFOM delivery approach. Retained risks under the DBFOM approach are lower than under traditional delivery as risks have been transferred to the private sector.

The VfM analysis was performed by KPMG. KPMG's VfM letter is included as Appendix A.



Appendix A: KPMG VfM Letter



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Re: Value for Money Assessment – City of greater Sudbury Biosolids Project

Dear Ms. Hayes:

KPMG LLP (“KPMG”) has prepared the Value for Money (“VfM”) assessment for the Sudbury Biosolids Project (“Project”) at the financial close stage, in accordance with Canadian best practices for Value for Money assessment methodologies.

The VfM assessment is based on a comparison of the total project costs at the Financial Close Date for the Project under:

- The traditional delivery approach, as reflected in the Public Sector Comparator (“PSC”) model; and
- The Design Build Finance Operate Maintain (“DBFOM”) delivery approach, incorporating the Recommended Negotiations Party’s proposal.

The VfM assessment was calculated using the following information (collectively the “Information”):

- A risk matrix developed in accordance with Canadian best practices and adapted to reflect project specific risks in consultation with the City and the City’s technical advisor; and
- Cost and other input assumptions for the PSC developed in consultation with the City’s technical advisor and cost information extracted from the financial proposal of the Recommended Negotiations Party.

The VfM assessment demonstrates that the DBFOM approach provides estimated cost savings of \$11.1 million (or 6.9%) in Net Present Value terms in comparison to a traditional delivery approach. Accordingly, the DBFOM approach is expected to deliver VfM to the City.

Yours very truly,

KPMG LLP

Paul Lan
Partner
Toronto, Ontario
June 18, 2013