

**LOWER CHURCHILL PROJECT COMPANIES
COMBINED FINANCIAL STATEMENTS
December 31, 2017**

Independent Auditor's Report

To the Directors of Nalcor Energy

We have audited the accompanying combined financial statements of the Lower Churchill Project Companies, which comprise the combined statement of financial position as at December 31, 2017 and the combined statements of loss and comprehensive loss, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information. The combined financial statements have been prepared by management of the Lower Churchill Project Companies based on the financial reporting provisions of the Government of Newfoundland and Labrador Muskrat Falls Oversight Committee.

Management's Responsibility for the Combined Financial Statements

Management is responsible for the preparation and fair presentation of these combined financial statements in accordance with the financial reporting provisions of the Government of Newfoundland and Labrador Muskrat Falls Oversight Committee and for such internal control as management determines is necessary to enable the preparation of combined financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these combined financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the combined financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the combined financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the combined financial statements present fairly, in all material respects, the financial position of the Lower Churchill Project Companies as at December 31, 2017 and its financial performance and its cash flows for the year then ended in accordance with the financial reporting provisions of the Government of Newfoundland and Labrador Muskrat Falls Oversight Committee.

Basis of Accounting and Restriction on Use

Without modifying our opinion, we draw attention to Note 2 to the combined financial statements, which describes the basis of accounting. The combined financial statements are prepared to assist Nalcor Energy to comply with the financial reporting provisions of the Government of Newfoundland and Labrador Muskrat Falls Oversight Committee. As a result, the combined financial statements may not be suitable for another purpose. Our report is intended solely for Nalcor Energy and the Government of Newfoundland and Labrador Muskrat Falls Oversight Committee and should not be used by parties other than Nalcor Energy and the Government of Newfoundland and Labrador Muskrat Falls Oversight Committee.

Deloitte LLP

Chartered Professional Accountants
March 5, 2018

**LOWER CHURCHILL PROJECT COMPANIES
COMBINED STATEMENT OF FINANCIAL POSITION**

<i>As at December 31 (thousands of Canadian dollars)</i>	Notes	2017	2016 (Note 24)
ASSETS			
Current assets			
Cash		4,031	29,342
Restricted cash		1,036,521	1,378,002
Current portion of long-term investments	8	1,037,684	90,569
Trade and other receivables	5	105,057	85,440
Current portion of advances	9	77,583	38,240
Prepayments		4,022	7,683
Total current assets		2,264,898	1,629,276
Non-current assets			
Property, plant and equipment	6	8,939,334	6,665,856
Intangible assets	7	33,537	30,372
Long-term investments	8	297,830	-
Advances	9	-	26,883
Long-term prepayments		574	3,335
Total assets		11,536,173	8,355,722
LIABILITIES AND EQUITY			
Current liabilities			
Trade and other payables	10	357,831	929,224
Non-current liabilities			
Long-term debt	11	7,904,168	5,001,084
Deferred revenue	13	24,900	16,100
Class B limited partnership units	14	491,298	399,086
Contributions		10	10
Total liabilities		8,778,207	6,345,504
Shareholder's equity			
Share capital	15	4	4
Shareholder contributions	15	2,839,620	2,026,207
Reserves	12	(73,895)	(9,807)
Deficit		(7,763)	(6,186)
Total equity		2,757,966	2,010,218
Total liabilities and equity		11,536,173	8,355,722

Commitments and contingencies (Note 21)

See accompanying notes

On behalf of the Board:

DIRECTOR

DIRECTOR

**LOWER CHURCHILL PROJECT COMPANIES
COMBINED STATEMENT OF LOSS AND COMPREHENSIVE LOSS**

<i>For the year ended December 31 (thousands of Canadian dollars)</i>	Notes	2017	2016
			(Note 24)
Other revenue	20	420	391
Net finance income	16	2,072	1,930
Revenue		2,492	2,321
Operating costs		3,223	1,362
Other expense	17	836	327
Expenses		4,059	1,689
(Loss) profit for the year		(1,567)	632
Distribution of income	18	(10)	(10)
Other comprehensive (loss) income for the year			
Cash flow hedges			
Net fair value losses on cash flow hedges	12	(65,840)	-
Reclassification adjustments for amounts recognized in profit or loss	12	1,752	839
Total items that may or have been reclassified to profit or loss		(64,088)	839
Total comprehensive (loss) income for the year		(65,665)	1,461

See accompanying notes

**LOWER CHURCHILL PROJECT COMPANIES
COMBINED STATEMENT OF CHANGES IN EQUITY**

<i>(thousands of Canadian dollars)</i>	Notes	Share Capital	Shareholder Contributions	Reserves	Deficit	Total
Balance at January 1, 2017		4	2,026,207	(9,807)	(6,186)	2,010,218
Loss for the year		-	-	-	(1,567)	(1,567)
Distribution of income		-	-	-	(10)	(10)
Net change in fair value of cash flow hedges	12	-	-	(64,088)	-	(64,088)
Total comprehensive loss for the year		-	-	(64,088)	(1,577)	(65,665)
Shareholder contributions	15	-	813,413	-	-	813,413
Balance at December 31, 2017		4	2,839,620	(73,895)	(7,763)	2,757,966
Balance at January 1, 2016		4	1,546,361	(10,646)	(6,808)	1,528,911
Profit for the year		-	-	-	632	632
Distribution of income		-	-	-	(10)	(10)
Net change in fair value of cash flow hedges	12	-	-	839	-	839
Total comprehensive income for the year		-	-	839	622	1,461
Shareholder contributions	15	-	479,846	-	-	479,846
Balance at December 31, 2016		4	2,026,207	(9,807)	(6,186)	2,010,218

See accompanying notes

LOWER CHURCHILL PROJECT COMPANIES COMBINED STATEMENT OF CASH FLOWS

<i>For the year ended December 31 (thousands of Canadian dollars)</i>	Notes	2017	2016 (Note 24)
Operating activities			
(Loss) profit for the year		(1,567)	632
Adjustments for the following non-cash items:			
Amortization of long-term prepayments		2,761	5,842
Accretion of long-term debt	11	(131)	(51)
Reserves amortized to profit or loss	12	1,752	839
Change in long-term payables		-	(124)
Changes in non-cash working capital balances	23	(1,817)	1,785
Net cash provided from operating activities		998	8,923
Investing activities			
Additions to property, plant and equipment	6	(2,235,481)	(2,265,430)
Additions to intangible assets	7	(3,929)	(16,046)
Change in advances	9	(12,460)	26,943
Change in investments	8	(1,244,945)	1,025,174
Changes in non-cash working capital balances	23	(585,532)	116,237
Net cash used in investing activities		(4,082,347)	(1,113,122)
Financing activities			
Proceeds from long-term debt	11	2,903,215	-
Change in restricted cash		341,481	458,316
Increase in Class B limited partnership units	14	54,979	168,132
Change in deferred revenue	13	8,800	6,600
Increase in shareholder contributions	15	813,413	479,846
Settlement of cash flow hedges	12	(65,840)	-
Distribution of income	18	(10)	(10)
Net cash provided from financing activities		4,056,038	1,112,884
Net (decrease) increase in cash		(25,311)	8,685
Cash, beginning of year		29,342	20,657
Cash, end of year		4,031	29,342
Interest received		26,492	23,139
Interest paid		225,873	190,484

See accompanying notes

LOWER CHURCHILL PROJECT COMPANIES

NOTES TO COMBINED FINANCIAL STATEMENTS

1. NATURE AND DESCRIPTION OF THE PROJECT

These audited combined financial statements include the financial information of the consolidated Labrador-Island Link Holding Corporation (LIL Holdco), Muskrat Falls Corporation (Muskrat Falls), Labrador Transmission Corporation (Labrador Transco) and the Lower Churchill Management Corporation (LCMC). Collectively, the financial information from these combined companies is referred to as the Lower Churchill Project Companies (the Project).

Each of the entities was separately formed under the laws of the Province of Newfoundland and Labrador. LIL Holdco was formed on July 31, 2012. Muskrat Falls, Labrador Transco and LCMC were formed on November 13, 2013.

The Project was established to carry on the business of designing, engineering, constructing, commissioning, owning, financing, operating and maintaining the assets and property constituting the Labrador-Island Link (LIL), the Labrador Transmission Assets (LTA) and the Muskrat Falls (MF) hydroelectric plant.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Statement of Compliance and Basis of Measurement

These annual audited combined financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), with the exception of the fact that these statements are combined as described in Note 1. The Project has adopted accounting policies which are based on the IFRS applicable as at December 31, 2017, and includes individual IFRS, International Accounting Standards (IAS), and interpretations made by the IFRS Interpretations Committee and the Standing Interpretations Committee.

These annual audited combined financial statements have been prepared on a historical cost basis. The annual audited combined financial statements are presented in Canadian Dollars (CAD) and all values rounded to the nearest thousand, except when otherwise noted. The annual audited combined financial statements reflect the financial position and financial performance of the Project and do not include other assets, liabilities, revenues, and expenses of the partners of the Labrador-Island Link Limited Partnership (LIL LP or the Partnership). These annual audited combined financial statements were approved by Nalcor Energy's (Nalcor) Board of Directors on March 2, 2018.

2.2 Basis of Consolidation

The Project includes the financial statements of investees (including structured entities) only when it has control as defined in IFRS 10 – Consolidated Financial Statements. In accordance with IFRS 10, control is achieved when the Project:

- has power over the relevant activities of the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect those variable returns.

Based on the criteria outlined in IFRS 10, the Project has determined that LIL Holdco controls the LIL LP and LIL LP controls the LIL Construction Project Trust (Project Trust or the IT) for financial reporting purposes. The IT is a structured entity created for the purpose of obtaining financing and lending the proceeds to LIL LP. LIL LP used judgment in assessing many factors to determine control of the IT, including its exposure to variability in the IT's investments and its role in the formation of the IT. The Project has determined that Muskrat Falls and Labrador Transco are not the primary beneficiaries of the Muskrat Falls/Labrador Transmission Assets Funding Trust (MF/LTA Funding Trust) and that the LIL LP does not control the Labrador-Island Link Funding Trust (LIL Funding Trust) and has not included the results of the funding trusts in these audited combined financial statements.

LOWER CHURCHILL PROJECT COMPANIES

NOTES TO COMBINED FINANCIAL STATEMENTS

2.3 Cash and Cash Equivalents

Cash and cash equivalents consist of amounts on deposit with a Schedule 1 Canadian Chartered Bank, as well as highly liquid investments with maturities of three months or less. Cash and cash equivalents are measured at cost which approximates fair value.

2.4 Restricted Cash

Restricted cash consists of cash held on deposit with Schedule 1 Canadian Chartered Banks and administered by the Collateral Agent for the sole purpose of funding construction costs related to the LIL, LTA and MF hydroelectric plant, including pre-funded equity amounts required under the LIL Project Finance Agreement (LIL PFA) and MF/LTA Project Finance Agreement (MF/LTA PFA). The Project draws funds from these accounts in accordance with procedures set out in the LIL PFA and the MF/LTA PFA. Restricted cash also includes accounts administered by the Trustees of the IT. Restricted cash is measured at cost which approximates fair value.

2.5 Property, Plant and Equipment

Items of property, plant and equipment are recognized using the cost model and thus are recorded at cost less accumulated depreciation and accumulated impairment losses. Cost includes materials, labour, contracted services, professional fees and, for qualifying assets, borrowing costs capitalized in accordance with the Project's accounting policy outlined in Note 2.7. Costs capitalized with the related asset include all costs directly attributable to bringing the asset into operation.

Property, plant and equipment are not revalued for financial reporting purposes. Depreciation of these assets commences when the assets are ready for their intended use.

Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Project support assets 4 - 7 years

As use of the project support assets is directly attributable to the construction of the LIL, LTA, and MF hydroelectric plant, related depreciation costs are capitalized as incurred, until such time as the assets are substantially ready for their intended use or sale.

2.6 Intangible Assets

Intangible assets that are expected to generate future economic benefit and are measurable, including computer software costs and assets under development, are capitalized as intangible assets in accordance with IAS 38.

Intangible assets with finite useful lives are carried at cost less accumulated amortization and accumulated impairment losses. Amortization is recognized on a straight-line basis over their estimated useful lives. As use of the intangible assets is directly attributable to the construction of the LIL, LTA and MF hydroelectric plant, related amortization costs are capitalized as incurred. The estimated useful life and amortization method are reviewed at the end of each reporting year, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives are carried at cost less accumulated impairment losses.

2.7 Borrowing Costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalization. All other borrowing costs are recognized in the Combined Statement of Loss and Comprehensive Loss in the period in which they are incurred.

2.8 Impairment of Non-Financial Assets

At the end of each reporting period, the Project reviews the carrying amounts of its non-financial assets to determine whether there is any indication that those assets may be impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any.

LOWER CHURCHILL PROJECT COMPANIES

NOTES TO COMBINED FINANCIAL STATEMENTS

Where it is not possible to estimate the recoverable amount of an individual asset, the Project estimates the recoverable amount of the cash generating unit (CGU) to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual CGUs, or otherwise they are allocated to the smallest group of CGUs for which a reasonable and consistent allocation basis can be identified. The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. Value in use is generally computed by reference to the present value of future cash flows expected to be derived from non-financial assets.

If the recoverable amount of an asset or CGU is estimated to be less than its carrying amount, the carrying amount of the asset or CGU is reduced to its recoverable amount. An impairment loss is recognized immediately in the Combined Statement of Loss and Comprehensive Loss.

2.9 Provisions

A provision is a liability of uncertain timing or amount. A provision is recognized if the Project has a present legal obligation or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognized for future operating losses. The provision is measured at the present value of the best estimate of the expenditures expected to be required to settle the obligation using a discount rate that reflects the current market assessments of the time value of money and the risks specific to the obligation. Provisions are re-measured at each Combined Statement of Financial Position date using the current discount rate.

2.10 Revenue Recognition

Revenue is recognized on an accrual basis as earned, when recovery is probable and the amount of revenue can be reliably measured.

2.11 Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Lessor accounting

Amounts due from lessees under finance leases are recognized as receivables at the amount of the Project's net investment in the leases. Finance lease income is allocated to accounting periods so as to reflect a constant periodic rate of return on the Project's net investment outstanding in respect of the leases.

Rental income from operating leases is recognized on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognized on a straight-line basis over the lease term.

Lessee accounting

Assets held under finance leases are initially recognized as assets of the Project at their fair value at the inception of the lease or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the Combined Statement of Financial Position as a finance lease obligation.

Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance expenses are recognized immediately in profit or loss, unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with the Project's general policy on borrowing costs (Note 2.7). Contingent rental costs are recognized as operating costs in the periods in which they are incurred.

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased

LOWER CHURCHILL PROJECT COMPANIES

NOTES TO COMBINED FINANCIAL STATEMENTS

asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are incurred.

In the event that lease incentives are received to enter into operating leases, such incentives are recognized as a liability. The aggregate benefit of incentives is recognized as a reduction of rental expense on a straight-line basis, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

2.12 Net Finance (Income) Expense

For all financial instruments measured at amortized cost and interest bearing financial assets classified as available-for-sale (AFS), interest income or expense is recorded using the effective interest rate, which is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability.

2.13 Foreign Currencies

Transactions in currencies other than the Project's functional currency (foreign currencies) are recognized using the exchange rate in effect at the date of transaction, approximated by the prior month end close rate. At the end of each reporting period, monetary items denominated in foreign currencies are translated at the rates of exchange in effect at the period end date. Foreign exchange gains and losses are included in the Combined Statement of Loss and Comprehensive Loss as other (income) expense.

2.14 Income Taxes

Provision has not been made in LIL LP's annual audited consolidated financial statements for Canadian federal, provincial, or local taxes since any such liabilities are the responsibility of the individual partners. LCMC, Muskrat Falls, Labrador Transco and LIL Holdco are exempt from paying income taxes under section 149(1) (d.2) of the Income Tax Act.

2.15 Financial Instruments

Financial assets and financial liabilities are recognized in the Combined Statement of Financial Position when the Project becomes a party to the contractual provisions of the instrument and are initially measured at fair value. Subsequent measurement is based on classification. Financial instruments are classified into the following specified categories: financial assets at fair value through profit or loss (FVTPL), AFS financial assets, loans and receivables, held-to-maturity investments, financial liabilities at FVTPL, financial instruments used for hedging and other financial liabilities. The classification depends on the nature and purpose of the financial instruments and is determined at the time of initial recognition.

Classification of Financial Instruments

The Project has classified each of its financial instruments into the following categories:

<u>Financial instrument</u>	<u>Category</u>
Cash	Loans and receivables
Restricted cash	Loans and receivables
Trade and other receivables	Loans and receivables
Investments	Held-to-maturity investments
Advances	Loans and receivables
Trade and other payables	Other financial liabilities
Long-term debt	Other financial liabilities
Partnership unit liabilities	Other financial liabilities

LOWER CHURCHILL PROJECT COMPANIES

NOTES TO COMBINED FINANCIAL STATEMENTS

(i) Effective Interest Method

The effective interest method is a method of calculating the amortized cost of a financial instrument and allocating interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial instrument, or, where appropriate, a shorter period to the net carrying amount on initial recognition.

Income or expense is recognized on an effective interest basis for financial instruments other than those financial assets and liabilities classified as at FVTPL.

Financial Assets

(ii) Loans and Receivables

Trade receivables, loans and other receivables with fixed or determinable payments that are not quoted in an active market are classified as loans and receivables. Loans and receivables are measured at amortized cost using the effective interest method, less any impairment. Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

(iii) Held-to-Maturity Investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Project has the positive intent and ability to hold to maturity are classified as held-to-maturity investments. Held-to-maturity investments are measured at amortized cost using the effective interest method less any impairment, with revenue recognized on an effective yield basis.

Financial Liabilities and Equity Instruments

(iv) Other Financial Liabilities

Other financial liabilities, including borrowings, are initially measured at fair value, net of transaction costs. Other financial liabilities are subsequently measured at amortized cost using the effective interest method, with interest expense recognized on an effective yield basis.

(v) Derivative Instruments and Financial Instruments Used for Hedging

Derivative instruments are utilized by the Project to manage risk. The Project's policy is not to utilize derivative instruments for speculative purposes. Derivatives are initially measured at fair value at the date the derivative contracts are entered into and are subsequently measured at their fair value at the end of each reporting period. The resulting gain or loss is recognized in profit or loss immediately unless the derivative is designated and effective as a hedging relationship.

The Project may choose to designate derivative instruments as hedges and apply hedge accounting if there is a high degree of correlation between the price movements in the derivative instruments and the hedged items. The Project formally documents all hedges and the related risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

Hedges which meet the strict criteria for hedge accounting are accounted for as follows:

Cash Flow Hedges

The effective portion of the gain or loss on the hedging instrument is recognized directly in other comprehensive income, while any ineffective portion is recognized immediately in the Combined Statement of Loss and Comprehensive Loss for the period. Amounts recognized as other comprehensive income are capitalized as Construction in Progress, until the LTA and MF hydroelectric facility are ready for their intended use.

LOWER CHURCHILL PROJECT COMPANIES

NOTES TO COMBINED FINANCIAL STATEMENTS

2.16 Derecognition of Financial Instruments

The Project derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Project neither transfers nor retains substantially all the risks and rewards of ownership and continues to control the transferred asset, its retained interest in the asset and any associated liability for amounts it may have to pay is recognized. If the Project retains substantially all the risks and rewards of ownership of a transferred financial asset, it continues to recognize the financial asset and also recognizes the collateralized borrowing for the proceeds received. The Project derecognizes financial liabilities when, and only when, its obligations are discharged, cancelled or they expire.

2.17 Impairment of Financial Assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

Evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- the borrower, more probable than not, entering into bankruptcy or financial re-organization.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Project's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, as well as observable changes in national or local economic conditions that correlate with defaults on receivables.

For financial assets carried at amortized cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited to the allowance account. Changes in the carrying amount of the allowance account are recognized in profit or loss.

When an AFS financial asset is considered to be impaired, cumulative gains or losses previously recognized in other comprehensive income are reclassified to profit or loss in the period.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

3. SIGNIFICANT ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of the annual audited combined financial statements in conformity with IFRS requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses including, but not limited to, allocations of costs among entities. Actual results may differ materially from these estimates. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognized in the period in which the estimate is reviewed if the revision affects only that period or future periods.

LOWER CHURCHILL PROJECT COMPANIES

NOTES TO COMBINED FINANCIAL STATEMENTS

3.1 Use of Judgment

(i) Functional Currency

Functional currency was determined by evaluating the primary economic environment in which the Project operates. As the Project enters into transactions in multiple currencies, judgment is used in determining the functional currency. Management considered factors regarding currency of sales, costs incurred, and operating and financing activities and determined the functional currency to be CAD.

(ii) Consolidation

Management applies its judgment when determining whether to consolidate structured entities in accordance with the criteria outlined in IFRS 10. Management has determined that LIL Holdco should consolidate the Partnership and the IT but should not consolidate the LIL Funding Trust and that Muskrat Falls and Labrador Transco should not consolidate the MF/LTA Funding Trust.

3.2 Use of Estimates

(i) Property, Plant and Equipment

Amounts recorded for depreciation are based on the useful lives of the Project's assets. The useful lives of property, plant and equipment are determined by Management's best estimate of the service lives of these assets and are reviewed on an annual basis. Changes to these lives could materially affect the amount of depreciation recorded.

(ii) Intangible Assets

Amounts recorded for amortization are based on the useful lives of the Project's assets. These useful lives are Management's best estimate of the service lives of these assets and are reviewed on an annual basis. Changes to these lives could materially affect the amount of amortization recorded.

(iii) Class B Limited Partnership Units

The Project determines the fair value of the Class B limited partnership units at each financial reporting date. These units represent Emera Newfoundland and Labrador Island Link Inc.'s (Emera NL) ownership interest in the LIL. Due to the nature of the liability and lack of comparable market data, the fair value of the Class B limited partnership unit liability is determined using the present value of future cash flows. Significant assumptions used in the determination of fair value include estimates of the amount and timing of future cash flows and the discount rate.

The process of valuing a financial liability for which no published market price exists is based on inherent uncertainties and the resulting values may differ from values that would have been used had a ready market existed for the liability. These differences could be material to the fair value of the financial liability.

4. CURRENT AND FUTURE CHANGES IN ACCOUNTING POLICIES

The following new and revised standards became effective for the accounting period commencing on January 1, 2017 and did not have a material impact on the Project's annual audited combined financial statements.

- IAS 7 – Disclosure Initiative
- IAS 12 – Recognition of Deferred Tax Assets for Unrealized Losses

The following is a list of standards that have been issued and are effective for accounting periods commencing on January 1, 2018 or January 1, 2019, as specified.

- IFRS 9 - Financial Instruments¹
- IFRS 15 - Revenue from Contracts with Customers¹
- IFRS 16 - Leases²

LOWER CHURCHILL PROJECT COMPANIES

NOTES TO COMBINED FINANCIAL STATEMENTS

- IFRIC 22 - Foreign Currency Transactions and Advance Consideration¹

¹Effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

²Effective for annual periods beginning on or after January 1, 2019, with earlier application permitted.

4.1 IFRS 9 - Financial Instruments

In July 2014, the IASB finalized the reform of financial instruments accounting and issued IFRS 9 (as revised in 2014), which contains the requirements for a) the classification and measurement of financial assets and financial liabilities, b) impairment methodology, and c) general hedge accounting. IFRS 9 (as revised in 2014) will supersede IAS 39 - Financial Instruments: Recognition and Measurement upon its effective date.

Phase 1: Classification and measurement of financial assets and financial liabilities

With respect to the classification and measurement, the number of categories of financial assets under IFRS 9 has been reduced; all recognized financial assets that are currently within the scope of IAS 39 will be subsequently measured at either amortized cost or fair value under IFRS 9.

IFRS 9 also contains requirements for the classification and measurement of financial liabilities and derecognition requirements. One major change from IAS 39 relates to the presentation of changes in the fair value of a financial liability designated as at FVTPL attributable to changes in the credit risk of that liability. Under IFRS 9, such changes are presented in other comprehensive income, unless the presentation of the effect of the change in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss.

Phase 2: Impairment of financial assets

The impairment model under IFRS 9 reflects expected credit losses, as opposed to incurred credit losses under IAS 39. Under the impairment approach in IFRS 9, it is no longer necessary for a credit event to have occurred before credit losses are recognized. Instead, an entity always accounts for expected credit losses and changes in those expected credit losses. The amount of expected credit losses should be updated at each reporting date to reflect changes in credit risk since initial recognition.

Phase 3: Hedge accounting

The general hedge accounting requirements of IFRS 9 retain the three types of hedge accounting mechanisms in IAS 39. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is no longer required. Far more disclosure requirements about an entity's risk management activities have been introduced.

Transitional provisions

IFRS 9 (as revised in 2014) is effective for annual periods beginning on or after January 1, 2018 with earlier application permitted. Management has elected to adopt the standard as of the effective date, and although the classifications of existing financial instruments and related disclosures will change, there will be no material adjustments to the amounts reported in the Project's annual audited combined financial statements.

4.2 IFRS 15 Revenue from Contracts with Customers

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. It will supersede the following revenue standards and interpretations upon its effective date:

- IAS 18 Revenue;
- IAS 11 Construction Contracts;
- IFRIC 13 Customer Loyalty Programs;
- IFRIC 15 Agreements for the Construction of Real Estate;
- IFRIC 18 Transfers of Assets from Customers; and
- SIC 31 Revenue-Barter Transactions Involving Advertising Services

As suggested by the title of the new revenue standard, IFRS 15 will only cover revenue arising from contracts with customers. Under IFRS 15, a customer of an entity is a party that has contracted with the entity to obtain goods or

LOWER CHURCHILL PROJECT COMPANIES

NOTES TO COMBINED FINANCIAL STATEMENTS

services that are an output of the entity's ordinary activities in exchange for consideration. Unlike the scope of IAS 18, the recognition and measurement of interest income and dividend income from debt and equity investments are no longer within the scope of IFRS 15. Instead, they are within the scope of IAS 39 (or IFRS 9 if it is early adopted).

As mentioned above, the new standard has a single model to deal with revenue from contracts with customers. Its core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

Specifically, the standard introduces a five-step approach to revenue recognition:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Extensive disclosures are also required by the new standard.

IFRS 15, together with clarifications thereto issued in April 2016, is effective for reporting periods beginning on or after January 1, 2018 with earlier application permitted. Management has elected to adopt the standard as of the effective date and although the related disclosures will change, there will be no material adjustments to the amounts reported in the Project's annual audited combined financial statements.

4.3 IFRS 16 – Leases

IFRS 16 provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements of both lessees and lessors. It will supersede the following lease standard and interpretations upon its effective date:

- IAS 17 Leases;
- IFRIC 4 Determining Whether an Arrangement contains a Lease;
- SIC-15 Operating Leases – Incentives; and
- SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease.

IFRS 16 applies a control model to the identification of leases, distinguishing between leases and service contracts on the basis of whether there is an identified asset controlled by the customer.

The standard introduces significant changes to lessee accounting: it removes the distinction between operating and finance leases under IAS 17 and requires a lessee to recognize a right-of-use asset and a lease liability at lease commencement for all leases, except for short-term leases and leases of low value assets.

In contrast to lessee accounting, the IFRS 16 lessor accounting requirements remain largely unchanged from IAS 17, which continue to require a lessor to classify a lease as either an operating lease or a finance lease.

IFRS 16 is effective for reporting periods beginning on or after January 1, 2019 with early application permitted for entities that apply IFRS 15 at or before the date of initial application of IFRS 16. A lessee can apply IFRS 16 either by a full retrospective approach or a modified retrospective approach. If the latter approach is selected, an entity is not required to restate the comparative information and the cumulative effect of initially applying IFRS 16 must be presented as an adjustment to opening retained earnings. Management anticipates that the application of IFRS 16 in the future may have a material impact on the amounts reported and disclosures made in the Project's annual audited combined financial statements. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 16 until Management performs a detailed review.

LOWER CHURCHILL PROJECT COMPANIES
NOTES TO COMBINED FINANCIAL STATEMENTS

4.4 IFRIC 22 Foreign Currency Transactions and Advance Consideration

IFRIC 22 addresses how to determine the 'date of transaction' for the purpose of determining the exchange rate to use on initial recognition of an asset, expense or income, when consideration for that item has been paid or received in advance in a foreign currency which resulted in the recognition of a non-monetary asset or non-monetary liability (for example, a non-refundable deposit or deferred revenue).

The Interpretation is effective for annual periods beginning on or after January 1, 2018 with earlier application permitted. Entities can apply the Interpretation either retrospectively or prospectively. Specific transition provisions apply to prospective application. The application of these amendments to IFRIC 22 will not have a material impact on the Project's annual audited combined financial statements.

5. TRADE AND OTHER RECEIVABLES

<i>As at December 31 (thousands of Canadian dollars)</i>	2017	2016
Receivable due from related parties	140	35
HST receivable	89,324	84,522
Insurance receivable	14,625	-
Interest receivable	968	883
	105,057	85,440

6. PROPERTY, PLANT AND EQUIPMENT

<i>(thousands of Canadian dollars)</i>	Project Support Assets	Construction in Progress	Total
Cost			
Balance at January 1, 2016	198,760	4,259,411	4,458,171
Additions	45	2,333,125	2,333,170
Other adjustments	(1,647)	-	(1,647)
Balance at December 31, 2016	197,158	6,592,536	6,789,694
Additions	19,659	2,281,349	2,301,008
Other adjustments	(196)	-	(196)
Balance at December 31, 2017	216,621	8,873,885	9,090,506
Depreciation			
Balance at January 1, 2016	81,963	-	81,963
Depreciation	41,875	-	41,875
Balance at December 31, 2016	123,838	-	123,838
Depreciation	27,334	-	27,334
Balance at December 31, 2017	151,172	-	151,172
Carrying value			
Balance at January 1, 2016	116,797	4,259,411	4,376,208
Balance at December 31, 2016	73,320	6,592,536	6,665,856
Balance at December 31, 2017	65,449	8,873,885	8,939,334

Capitalized Borrowing Costs

The construction of the LIL, LTA and MF hydroelectric facility is being financed through the issuance of long-term debt and contributed capital. For the year ended December 31, 2017, \$219.2 million (2016 - \$169.4 million) of borrowing costs were capitalized. The Project also capitalized borrowing costs associated with the Limited B units of \$37.2 million (2016 - \$23.6 million) as non-cash additions to property, plant and equipment.

LOWER CHURCHILL PROJECT COMPANIES
NOTES TO COMBINED FINANCIAL STATEMENTS

7. INTANGIBLE ASSETS

<i>(thousands of Canadian dollars)</i>	Computer Software	Assets Under Development	Total
Cost			
Balance at January 1, 2016	3,747	14,658	18,405
Additions	743	15,303	16,046
Balance at December 31, 2016	4,490	29,961	34,451
Additions	708	3,221	3,929
Balance at December 31, 2017	5,198	33,182	38,380
Amortization			
Balance at January 1, 2016	3,419	-	3,419
Amortization	660	-	660
Balance at December 31, 2016	4,079	-	4,079
Amortization	764	-	764
Balance at December 31, 2017	4,843	-	4,843
Carrying value			
Balance at January 1, 2016	328	14,658	14,986
Balance at December 31, 2016	411	29,961	30,372
Balance at December 31, 2017	355	33,182	33,537

Intangible assets consist of computer software costs and assets under development which represent LIL LP and Labrador Transco's right to collect the costs incurred related to these assets through the LIL Lease Agreement, the Transmission Funding Agreement (TFA), the Generator Interconnection Agreement (the GIA) and the Power Purchase Agreement (PPA) with Labrador-Island Link Operating Corporation (LIL Opco), Newfoundland and Labrador Hydro (Hydro) and Muskrat Falls.

Computer software is amortized on a straight-line basis over their finite useful lives of one year. Amortization of assets under development will commence once LIL LP and Labrador Transco begin recovering costs for these assets over the term of the TFA and GIA/PPA.

LOWER CHURCHILL PROJECT COMPANIES
NOTES TO COMBINED FINANCIAL STATEMENTS

8. INVESTMENTS

In December 2013 the Project purchased six structured deposit notes using the proceeds from the issue of long-term debt. These investments were fully drawn down in 2017. In July 2017, the Project purchased six additional structured deposit notes using the proceeds from the additional issue of long-term debt. The investments are restricted in nature and subject to the provisions contained within the MF/LTA PFA and LIL PFA. Muskrat Falls and Labrador Transco recognizes its ratable share of these investments, which is based on its cumulative portion of actual debt drawn for the construction of the MF hydroelectric facility and LTA. As of December 31, 2017, Muskrat Falls' portion was 81% (2016 - 79%) and Labrador Transco's portion was 19% (2016 - 21%).

<i>As at December 31 (thousands of Canadian dollars)</i>	Year of Maturity	2017	2016
Two \$75.0 million Floating Rate Deposit Notes, with interest paid at the one-month Canadian Dollar Offered Rate (CDOR) plus 0.38%.	2017	-	90,569
Two \$75.0 million Floating Rate Deposit Notes, with interest paid at the one-month CDOR plus 0.20%.	2019	150,000	-
\$182.9 million Amortizing Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.20%.	2019	90,833	-
\$483.8 million Amortizing Floating Rate Deposit Note, with interest paid at the one-month CDOR plus 0.20%.	2019	328,872	-
\$548.6 million Amortizing Fixed Rate Deposit Note, with interest paid at a rate of 1.644% per annum	2019	272,501	-
\$725.7 million Amortizing Fixed Rate Deposit Note, with interest paid at a rate of 1.679% per annum.	2019	493,308	-
Long-term investments, end of year		1,335,514	90,569
Less: redemptions to be received within one year		1,037,684	90,569
		297,830	-

9. ADVANCES

Advances consist of deposits paid to contractors on long-term construction contracts in relation to the MF hydroelectric facility and the LIL. Advances are secured by a letter of credit from a Canadian Schedule 1 Chartered Bank or a vendor performance bond. The bond is underwritten by three sureties with Standard and Poor's ratings of A or better.

<i>As at December 31 (thousands of Canadian dollars)</i>	2017	2016
Total advances	77,583	65,123
Less: current portion	77,583	38,240
Total long-term advances	-	26,883

LOWER CHURCHILL PROJECT COMPANIES
NOTES TO COMBINED FINANCIAL STATEMENTS

10. TRADE AND OTHER PAYABLES

<i>As at December 31 (thousands of Canadian dollars)</i>	2017	2016
Trade payables	308,610	897,911
Payables due to related parties	12,800	10,614
Accrued interest	30,532	15,873
Other payables	5,889	4,826
	357,831	929,224

As at December 31, 2017, trade and other payables included balances of €10.5 million EUR (2016 - €31.7 million EUR) and \$nil USD (2016 - \$1.4 million USD).

11. LONG-TERM DEBT

The following table represents the value of long-term debt measured at amortized cost as at December 31:

<i>(thousands of Canadian dollars)</i>	Face Value	Coupon Rate %	Year of Issue	Year of Maturity	2017	2016
LIL LP						
Tranche A	725,000	3.76	2013	2033	725,241	725,257
Tranche B	600,000	3.86	2013	2045	600,100	600,103
Tranche C	1,075,000	3.85	2013	2053	1,075,203	1,075,209
Tranche 1-10	105,000	1.14-1.75	2017	2020-2025	105,025	-
Tranche 11-20	105,000	1.84-2.37	2017	2025-2030	105,032	-
Tranche 21-30	105,000	2.41-2.64	2017	2030-2035	105,057	-
Tranche 31-40	105,000	2.66-2.80	2017	2035-2040	105,112	-
Tranche 41-50	105,000	2.81-2.86	2017	2040-2045	105,115	-
Tranche 51-60	105,000	2.84-2.86	2017	2045-2050	105,144	-
Tranche 61-70	105,000	2.85	2017	2050-2055	105,208	-
Tranche 71-74	315,000	2.85	2017	2055-2057	315,666	-
Muskrat Falls/Labrador Transco						
Tranche A	650,000	3.63	2013	2029	650,173	650,188
Tranche B	675,000	3.83	2013	2037	675,089	675,094
Tranche C	1,275,000	3.86	2013	2048	1,275,227	1,275,233
Tranche 1-10	204,763	1.14-1.75	2017	2020-2025	204,811	-
Tranche 11-20	224,283	1.84-2.37	2017	2025-2030	224,351	-
Tranche 21-30	252,595	2.41-2.64	2017	2030-2035	252,730	-
Tranche 31-40	288,185	2.66-2.80	2017	2035-2040	288,495	-
Tranche 41-50	331,037	2.81-2.86	2017	2040-2045	331,398	-
Tranche 51-60	381,084	2.84-2.86	2017	2045-2050	381,613	-
Tranche 61-64	168,053	2.85	2017	2050-2052	168,378	-
Total debentures	7,900,000				7,904,168	5,001,084

On November 29, 2013, the IT entered into the IT Project Finance Agreement (IT PFA) with the LIL Funding Trust. Under the terms and conditions of the IT PFA, the LIL Funding Trust agreed to provide a non-revolving credit facility in the amount of \$2.4 billion available in three tranches (Tranches A, B and C) to the IT, which itself proceeded to on-lend this amount to LIL LP under the terms of the LIL PFA. On December 13, 2013, all three tranches of the construction facility were drawn down by way of a single advance to the IT of \$2.4 billion to an account administered by the Collateral Agent.

LOWER CHURCHILL PROJECT COMPANIES

NOTES TO COMBINED FINANCIAL STATEMENTS

On May 10, 2017, the IT, the LIL Funding Trust, LIL LP and the Collateral Agent executed second amendments to the IT PFA and the LIL PFA. Under the terms and conditions of the second amended IT PFA, the LIL Funding Trust agreed to provide an additional non-revolving credit facility in the amount of \$1.05 billion to the IT. These facilities, available in a series of 74 bonds with maturities of every six months beginning in December 2020, were fully drawn down by the IT on May 25, 2017 by way of a single advance to an account administered by a Collateral Agent. LIL LP draws funds from this account on a monthly basis in accordance with procedures set out in the LIL PFA. As at December 31, 2017, the \$2.4 billion construction facility was fully utilized by LIL LP (2016 - \$1.8 billion) and \$0.5 billion of the second construction facility was utilized by LIL LP (2016 - \$nil).

The purpose of the LIL Funding Trust is to issue long-term debentures to the public and to on-lend the proceeds to the IT, which in turn on-lends funds to LIL LP. The financing of the LIL Funding Trust benefits from a direct, absolute, unconditional and irrevocable guarantee from the Government of Canada, and thereby carries its full faith and credit (AAA rating or equivalent). Included in the terms of the guarantee, LIL LP agreed to pay an annual fee starting in May 2018 equal to 0.5% of the average balance outstanding on Tranches 1 through 74 for the prior twelve months.

On November 29, 2013, Muskrat Falls and Labrador Transco entered into the MF/LTA PFA with the MF/LTA Funding Trust. Under the terms and conditions of the MF/LTA PFA, the MF/LTA Funding Trust agreed to provide a non-revolving credit facility in the amount of \$2.6 billion available in three tranches (Tranches A, B and C). On December 13, 2013, all three tranches of the construction facility were drawn down by way of a single advance to an account administered by a Collateral Agent.

On May 10, 2017, Muskrat Falls, Labrador Transco, the MF/LTA Funding Trust and the Collateral Agent executed a second amendment to the MF/LTA PFA. Under the terms and conditions of the second amended MF/LTA PFA, the MF/LTA Funding Trust agreed to provide an additional non-revolving credit facility in the amount of \$1.85 billion available in 64 series bonds with maturities of every six months beginning in December 2020. On May 25, 2017, the second construction facility was fully drawn down by way of a single advance to an account administered by a Collateral Agent. Muskrat Falls and Labrador Transco draw funds from this account on a monthly basis in accordance with procedures set out in the MF/LTA PFA. As of December 31, 2017, the \$2.6 billion construction facility was fully utilized by Muskrat Falls and Labrador Transco (2016 - \$2.5 billion) and \$0.9 billion of the second construction facility was utilized by Muskrat Falls and Labrador Transco (2016 - \$nil).

The purpose of the MF/LTA Funding Trust is to issue long-term debentures to the public and to on-lend the proceeds to Muskrat Falls and Labrador Transco. Muskrat Falls and Labrador Transco are both jointly and severally liable for the full amount of the credit facility. Muskrat Falls' portion of the ratable share is based on its cumulative portion of actual debt drawn for the construction of the MF hydroelectric facility. As of December 31, 2017, Muskrat Falls' cumulative portion of actual debt drawn was 81% (2016 - 79%) and Labrador Transco's cumulative portion of actual debt drawn was 19% (2016 - 21%). Cumulative adjustments were made in the current year to reflect Muskrat Falls' and Labrador Transco's ratable share of the actual debt drawn.

The financing of the MF/LTA Funding Trust benefits from a direct, absolute, unconditional and irrevocable guarantee from the Government of Canada, and thereby carries its full faith and credit (AAA rating or equivalent). Included in the terms of the guarantee, Muskrat Falls and Labrador Transco agreed to pay an annual fee starting in May 2018 equal to its ratable share of 0.5% of the average balance outstanding on Tranches 1 through 64 for the prior twelve months.

The role of the Collateral Agent is to act on behalf of the lending parties, including the LIL Funding Trust, the MF/LTA Funding Trust and the Government of Canada. The Collateral Agent oversees the lending and security arrangements, the various project accounts and the compliance with covenants.

As security for these debt obligations, LIL LP, Muskrat Falls and Labrador Transco have granted to the Collateral Agent first ranking liens on all present and future assets. Sinking funds are required to be set up for the Tranche A, B and C debentures and are to be held in a sinking fund account under the control of the Collateral Agent.

LOWER CHURCHILL PROJECT COMPANIES
NOTES TO COMBINED FINANCIAL STATEMENTS

Sinking fund instalments due for the next five years are as follows:

<i>(thousands of Canadian dollars)</i>	2018	2019	2020	2021	2022
Sinking fund instalments	-	-	63,996	127,991	127,991

12. ACCUMULATED OTHER COMPREHENSIVE INCOME

The components of, and changes in, accumulated other comprehensive loss is as follows:

<i>(thousands of Canadian dollars)</i>	2017	2016
Cash flow hedges		
Balance at January 1	(9,807)	(10,646)
Net fair value losses on cash flow hedges	(65,840)	-
Reclassification adjustments for amounts recognized in profit or loss	1,752	839
Balance at December 31	(73,895)	(9,807)

13. DEFERRED REVENUE

LIL Opco has the option to prepay rent in accordance with the LIL Lease Agreement. For the year ended December 31, 2017, LIL Opco had a prepayment balance of \$24.9 million (2016 - \$16.1 million) to the Partnership. The Partnership has recognized these prepayments as deferred revenue which will be amortized to income once the LIL is in-service.

14. LIMITED PARTNERSHIP UNITS

Debt and equity instruments issued by LIL Holdco are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

14.1. Description of Class B Limited Partnership Units

The Class B limited partnership units represent Emera NL's ownership interest in the LIL LP. As described in the LIL Limited Partnership Agreement, these units have certain rights and obligations, including mandatory distributions, that indicate that the substance of the units represent a financial liability and are measured at amortized cost using the effective interest method. The return on the units is classified as a finance expense. All finance expenses associated with the units have been capitalized.

14.2 Class B Limited Partnership Units

<i>As at December 31 (thousands of Canadian dollars)</i>	Units	2017	Units	2016
Class B limited partnership units, beginning of year	25	399,086	25	207,396
Contributions	-	54,979	-	168,132
Accrued interest	-	37,233	-	23,558
Class B limited partnership units, end of year	25	491,298	25	399,086

LOWER CHURCHILL PROJECT COMPANIES
NOTES TO COMBINED FINANCIAL STATEMENTS

15. SHAREHOLDER'S EQUITY

15.1 Share Capital

<i>As at December 31 (thousands of Canadian dollars)</i>	2017	2016
Common shares without nominal or par value		
Authorized – unlimited		
Issued - fully paid and outstanding - 400	4	4

15.2 Shareholder Contributions

<i>As at December 31 (thousands of Canadian dollars)</i>	2017	2016
Total shareholder contributions	2,839,620	2,026,207

During 2017, Nalcor contributed cash in the amount of \$813.4 million (2016 - \$479.8 million).

16. NET FINANCE INCOME

<i>For the year ended December 31 (thousands of Canadian dollars)</i>	2017	2016
Finance income		
Interest on investments	12,248	8,309
Bank interest	105	46
Other interest income	14,353	14,616
	26,706	22,971
Finance expense		
Interest and fees on long-term debt	243,768	190,478
Interest on Class B limited partnership units	37,233	23,558
Bank charges	28	32
	281,029	214,068
Interest capitalized during construction	(256,395)	(193,027)
	24,634	21,041
Net finance income	2,072	1,930

17. OTHER EXPENSE

<i>For the year ended December 31 (thousands of Canadian dollars)</i>	2017	2016
Cash flow hedge ineffectiveness	1,096	-
Realized foreign exchange (gain) loss	(391)	520
Unrealized foreign exchange loss (gain)	131	(193)
Other expense	836	327

18. DISTRIBUTION OF INCOME

In accordance with the LIL Declaration of Trust, the Project Trust elects to make an annual distribution of income to the beneficiaries of the Trust, which is designated as a registered charity in Nova Scotia.

LOWER CHURCHILL PROJECT COMPANIES
NOTES TO COMBINED FINANCIAL STATEMENTS

19. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

19.1 Fair Value

The estimated fair values of financial instruments as at December 31, 2017 and 2016 are based on relevant market prices and information available at the time. Fair value estimates are based on valuation techniques which are significantly affected by the assumptions used including the amount and timing of future cash flows and discount rates reflecting various degrees of risk. As such, the fair value estimates below are not necessarily indicative of the amounts that the Project might receive or incur in actual market transactions.

As a significant number of the Project's assets and liabilities do not meet the definition of a financial instrument, the fair value estimates below do not reflect the fair value of the Project as a whole.

Establishing Fair Value

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the nature of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value. For assets and liabilities that are recognized at fair value on a recurring basis, the Project determines whether transfers have occurred between levels in the hierarchy by reassessing categorization (based on the lowest level input that is significant to the fair value measurement as a whole) at the end of each reporting period. There were no transfers between Level 1, 2 and 3 fair value measurements during the years ended December 31, 2017 and 2016.

	Level	Category	Carrying Value	Fair Value	Carrying Value	Fair Value
			2017		2016	
<i>As at December 31 (thousands of Canadian dollars)</i>						
Financial assets						
Investments	2	HTM ¹	1,335,514	1,334,842	90,569	90,549
Financial liabilities						
Long-term debt	2	OFL ²	7,904,168	8,651,466	5,001,084	5,631,128
Class B limited partnership units	3	OFL ²	491,298	491,298	399,086	399,086

¹Held-to-maturity investments

²Other financial liabilities

The fair values of cash, restricted cash, trade and other receivables, advances and trade and other payables approximate their carrying values due to their short-term maturity.

The fair values of Level 2 financial instruments are determined using quoted prices in active markets, which in some cases are adjusted for factors specific to the asset or liability. Level 2 fair values of other risk management assets and liabilities and long-term debt are determined using observable inputs other than unadjusted quoted prices, such as interest rate yield curves.

The Class B limited partnership units are carried at amortized cost, calculated using the effective interest method,

LOWER CHURCHILL PROJECT COMPANIES
NOTES TO COMBINED FINANCIAL STATEMENTS

which approximates fair value. The effective interest rate of 8.5% (2016 – 8.8%) is defined in the Newfoundland and Labrador Development Agreement as Emera NL's rate of return on equity, and is equal to the rate approved by the Newfoundland and Labrador Board of Commissioners of Public Utilities for privately-owned regulated electrical utilities. Due to the unobservable nature of the effective interest rate and resulting discounted cash flows associated with the units, the instruments have been classified as Level 3.

The table below sets forth a summary of changes in fair value of the Project's Level 3 financial liabilities given a one percent change in the discount rate while holding other variables constant:

<i>(thousands of Canadian dollars)</i>	1% increase in discount rate	1% decrease in discount rate
Class B limited partnership units	(10,509)	10,300

19.2 Risk Management

The Project is exposed to certain credit, liquidity and market price risks through its operating, financing and investing activities. Financial risk is managed in accordance with a Board-approved policy, which outlines the objectives and strategies for the management of financial risk, including the use of derivative contracts. Permitted financial risk management strategies are aimed at minimizing the volatility of the Project's expected future cash flows.

Credit Risk

The Project's expected future cash flows are exposed to credit risk through financing activities, primarily due to the potential for non-performance by counterparties to its financial instruments. Credit risk on cash, restricted cash and investments is minimal, as the Project's deposits are held by Canadian Schedule 1 Chartered Banks with ratings of A, A+ and AA- (Standard and Poor's). The degree of exposure to credit risk on trade and other receivables and advances is determined by the financial capacity and stability of the counterparties whereby the maximum risk is represented by their carrying value on the Combined Statement of Financial Position at the reporting date.

Liquidity Risk

The Project is exposed to liquidity risk with respect to its contractual obligations and financial liabilities, including derivative liabilities relating to hedging activities. Liquidity risk management activities are directed at ensuring cash is available to meet those obligations as they become due. Short-term liquidity is provided through cash, restricted cash on hand and partnership and shareholder contributions. Muskrat Falls, Labrador Transco and LIL LP can access the funds drawn down from the Muskrat/LTA and LIL construction facilities, partnership contributions and shareholder contributions for the payment of construction costs as well as interest payments.

The following are the contractual maturities of the Project's financial liabilities, including principal, sinking funds and interest as at December 31, 2017:

<i>(thousands of Canadian dollars)</i>	< 1 Year	1-3 Years	3-5 Years	> 5 Years	Total
Trade and other payables	357,831	-	-	-	357,831
Long-term debt (including interest and sinking fund)	264,870	624,117	906,408	12,753,363	14,548,758
Unit B partnership units	-	-	162,438	2,665,634	2,828,072
	622,701	624,117	1,068,846	15,418,997	17,734,661

Market Risk

In the course of carrying out its operating, financing and investing activities, the Project is exposed to possible market price movements that could impact expected future cash flow and the carrying value of certain financial assets and liabilities.

Interest Rates

Changes in prevailing interest rates will impact the fair value of financial assets and liabilities. Expected future cash flows from these assets and liabilities are also impacted in certain circumstances.

LOWER CHURCHILL PROJECT COMPANIES
NOTES TO COMBINED FINANCIAL STATEMENTS

Foreign Currency and Commodity Exposure

The Project does not hold any financial instruments whose value would vary due to changes in a commodity price or whose value would materially vary due to fluctuations in foreign currency exchange rates. Cash flow exposure to foreign exchange risk arises primarily through investing activities, most notably US dollar and Euro denominated capital expenditures, and regular procurement activities. Exposure arising from capital expenditures is evaluated on a case by case basis. Where possible, contracts are denominated in CAD.

19.3 Hedge Accounting

In May 2017, Muskrat Falls and Labrador Transco entered into six bond forward contracts, to hedge the interest rate risk on the forecasted issue of the additional long-term debt. These contracts were designated as part of a cash flow hedging relationship and the resulting change in fair value of \$65.9 million was recorded in other comprehensive income (loss) with the ineffective portion of \$1.1 million recognized immediately in other (income) expense. The amortization of the other comprehensive loss related to the effective portion of the cash flow hedge is capitalized in line with treatment of the interest expense related to the long-term debt that it is hedging, until the MF hydroelectric facility and LTA are ready for their intended use. At that point, amortization on the remainder of the effective portion will be recognized in profit or loss over the same period as the related debt instruments mature. The total amount amortized as at December 31, 2017 including the previous cash flow hedge initiated in December 2013 was \$1.8 million (2016 - \$0.8 million).

20. RELATED PARTY TRANSACTIONS

The Project enters into various transactions with its parent and other affiliates. These transactions occur in the normal course of operations and are measured at the exchange amount, which is the amount of consideration agreed to by the related parties. Related parties with which the Project transacts are as follows:

Related Party	Relationship
Nalcor	100% shareholder of LIL Holdco, Labrador Transco, LCMC, LIL Opco, Labrador-Island Link General Partner and Muskrat Falls
Emera NL	Limited Partner holding 25 Class B limited partnership units of LIL LP
Labrador-Island Link General Partner	General partner of LIL LP, wholly-owned subsidiary of Nalcor
Labrador-Island Link Operating Corporation	Wholly-owned subsidiary of Nalcor
Hydro	Wholly-owned subsidiary of Nalcor
LIL Funding Trust	Party to the IT PFA
MF/LTA Funding Trust	Party to the MF/LTA PFA

Routine operating transactions with related parties are settled at prevailing market prices under normal trade terms.

- (a) As at December 31, 2017, the Project has related party payables totaling \$12.8 million (2016 - \$10.6 million) with Hydro and Nalcor. These payables consist of various intercompany operating and construction costs.
- (b) The Project has a \$50.0 million (2016 - \$50.0 million) unsecured revolving credit facility with Nalcor. As at December 31, 2017, there was no balance outstanding (2016 - \$nil) on this credit facility.
- (c) For the year ended December 31, 2017, LIL LP had incurred costs of \$2.7 million (2016 - \$15.3 million) related to assets under development which LIL LP controls the right to collect costs through the LIL Lease Agreement and TFA with LIL Opco and Hydro.
- (d) For the year ended December 31, 2017, Labrador Transco had incurred costs of \$0.5 million (2016 - \$nil) related to assets under development which Labrador Transco controls the right to collect costs through the GIA and PPA with Muskrat Falls and Hydro.
- (e) For the year ended December 31, 2017, the Project has received contributions from Nalcor totaling \$813.4 million (2016 - \$479.8 million).

LOWER CHURCHILL PROJECT COMPANIES
NOTES TO COMBINED FINANCIAL STATEMENTS

- (f) For the year ended December 31, 2017, LIL Opco prepaid rent to the Partnership in the amount of \$8.8 million (2016 - \$6.6 million).
- (g) For the year ended December 31, 2017, LCMC had revenue of \$0.4 million (2016 - \$0.4 million) for providing project development and management functions for Muskrat Falls, Labrador Transco and LIL.
- (h) For the year ended December 31, 2017, LCMC was charged \$25.1 million (2016 - \$23.8 million) by Nalcor and Hydro related to intercompany salary costs, administrative services and power purchases for the Lower Churchill Project. LCMC subsequently passes on these costs to Muskrat Falls, Labrador Transco, and LIL LP as part of the project development and management functions LCMC provides to these companies.

21. COMMITMENTS AND CONTINGENCIES

- (a) As part of the LIL PFA, LIL LP has pledged its current and future assets as security to the Collateral Agent. Under the terms and conditions of the IT PFA, LIL LP has also provided a guarantee of the IT's payment obligations to the Collateral Agent for the benefit of the LIL Funding Trust. LIL Holdco has pledged the escrow account, where pre-funded equity contributions have been deposited, as security to the Collateral Agent.
- (b) Under the terms and conditions of the Partnership Agreement, LIL Holdco had committed to fund its share of the capital expenditures of the LIL.
- (c) Labrador Transco and Muskrat Falls have entered into the GIA and PPA with Hydro, whereby Labrador Transco and Muskrat Falls have committed to design, construct, operate and maintain the LTA and the MF hydroelectric facility and provide such other services as agreed to ensure safe and reliable transmission of electricity.
- (d) LIL LP has entered into the LIL Lease Agreement and the TFA with LIL Opco and Hydro, whereby LIL LP has committed to design and construct the LIL and LIL Opco will operate and maintain the LIL at commissioning and provide such other services as agreed to ensure safe and reliable transmission of electricity.
- (e) In July 2012, Nalcor entered into the Energy and Capacity Agreement with Emera NL providing for the sale and delivery of the Nova Scotia Block, being 0.986 TWh of energy annually for a term of 35 years and Supplemental Energy over the initial five years of the term. In October 2015, Nalcor assigned this agreement to Muskrat Falls. As a result of this assignment, Nalcor and Muskrat Falls are jointly liable for the delivery of the Nova Scotia Block to Emera.
- (f) As part of the MF/LTA PFA, Labrador Transco and Muskrat Falls have pledged their present and future assets as security to the Collateral Agent.
- (g) The Project is subject to legal proceedings in the normal course of business. Although the outcome of such actions cannot be predicted with certainty, Management currently believes the Project's exposure to such claims and litigation, to the extent not covered by insurance policies or otherwise provided for will not materially affect its financial position.
- (h) Outstanding commitments for capital projects total approximately \$942.8 million as at December 31, 2017 (2016 - \$1,918.8 million). Pre-funded equity requirements associated with the Project Finance Agreements total approximately \$1,011.0 million (2016 - \$2,834.8 million). Pre-funded equity is used to fund capital and borrowing costs.

LOWER CHURCHILL PROJECT COMPANIES
NOTES TO COMBINED FINANCIAL STATEMENTS

22. CAPITAL MANAGEMENT

Long-term capital includes partner capital, share capital, shareholder contributions, net deficit and long-term debt. The Project's objectives for managing capital are to maintain its ability to continue as a going concern and to ensure timely payment of its contractual obligations as they relate to the construction of the LIL, the LTA and the MF hydroelectric facility. The Project's future requirements for capital are expected to increase commensurate with progress on construction. During this time, it is expected that proceeds from the construction facilities and shareholder contributions will be sufficient to fund the development of the assets. The Province of Newfoundland and Labrador has provided guarantees of equity support in relation to the construction of the Project. These guarantees, together with the proceeds from long-term debt, will ensure sufficient funds are available to finance construction.

23. SUPPLEMENTARY CASH FLOW INFORMATION

<i>For the year ended December 31 (thousands of Canadian dollars)</i>	2017	2016
Trade and other receivables	(19,617)	(38,664)
Prepayments	3,661	(1,841)
Trade and other payables	(571,393)	158,527
Changes in non-cash working capital balances	(587,349)	118,022
Related to:		
Operating activities	(1,817)	1,785
Investing activities	(585,532)	116,237
	(587,349)	118,022

24. COMPARATIVE FIGURES

Certain comparative figures have been adjusted or reclassified to conform to the basis of presentation adopted during the current reporting period. The changes have been summarized as follows:

<i>(thousands of Canadian dollars)</i>	Previously Reported	Reclassification	Reclassified balance at December 31, 2016
Statement of financial position			
Trade and other payables	929,219	5	929,224
Other long-term payables	5	(5)	-
Statement of profit and comprehensive income			
Operating costs	1,372	(10)	1,362
Distribution of income	-	10	10
Statement of cash flows			
Profit for the year	622	10	632
Distribution of income	-	(10)	(10)