

LABRADOR - ISLAND LINK OPERATING CORPORATION
FINANCIAL STATEMENTS
December 31, 2016

Independent Auditor's Report

To the Shareholder of Labrador-Island Link Operating Corporation

We have audited the accompanying financial statements of Labrador-Island Link Operating Corporation which comprise the statement of financial position as at December 31, 2016 and the statements of profit and comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of 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 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 financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 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 financial statements present fairly, in all material respects, the financial position of Labrador-Island Link Operating Corporation as at December 31, 2016 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Deloitte LLP

Chartered Professional Accountants
March 7, 2017

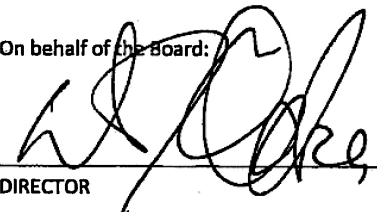
LABRADOR - ISLAND LINK OPERATING CORPORATION
STATEMENT OF FINANCIAL POSITION

<i>As at December 31 (thousands of Canadian dollars)</i>	Notes	2016	2015
ASSETS			
Current assets			
Short-term investments		-	10
Other receivables	5	990	196
Total current assets		990	206
Non-current assets			
Prepaid rent	6	16,100	9,500
Long-term investments		10	-
Total assets		17,100	9,706
LIABILITIES AND EQUITY			
Non-current liabilities			
Long-term payables	7	79	103
Total liabilities		79	103
Shareholder's equity			
Share capital	8	1	1
Shareholder contributions	8	17,081	9,688
Deficit		(61)	(86)
Total equity		17,021	9,603
Total liabilities and equity		17,100	9,706

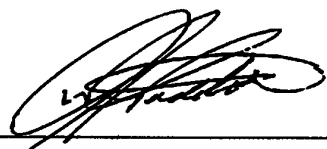
Commitments and contingencies (Note 11)

See accompanying notes

On behalf of the Board:



 DIRECTOR



 DIRECTOR

LABRADOR - ISLAND LINK OPERATING CORPORATION
STATEMENT OF PROFIT AND COMPREHENSIVE INCOME

For the year ended December 31 (thousands of Canadian dollars)

2016 2015

Operating (recoveries) costs	(24)	16
Net finance (income) expense	(1)	(9)
Total comprehensive income (loss) for the year	25	(7)

LABRADOR - ISLAND LINK OPERATING CORPORATION
STATEMENT OF CHANGES IN EQUITY

<i>(thousands of Canadian dollars)</i>	Notes	Share Capital	Shareholder Contributions	Deficit	Total
Balance at January 1, 2016		1	9,688	(86)	9,603
Total comprehensive income for the year		-	-	25	25
Shareholder contributions	8	-	7,393	-	7,393
Balance at December 31, 2016		1	17,081	(61)	17,021
Balance at January 1, 2015		1	9,050	(79)	8,972
Total comprehensive loss for the year		-	-	(7)	(7)
Shareholder contributions	8	-	638	-	638
Balance at December 31, 2015		1	9,688	(86)	9,603

See accompanying notes

LABRADOR - ISLAND LINK OPERATING CORPORATION
STATEMENT OF CASH FLOWS

<i>For the year ended December 31 (thousands of Canadian dollars)</i>	Notes	2016	2015
Cash provided from (used in)			
Operating activities			
Profit (loss) for the year		25	(7)
Adjusted for items not involving a cash flow:			
(Decrease) increase in long-term payables		(24)	16
Changes in non-cash working capital balances			
Increase in other receivables		(794)	(195)
Net cash used in operating activities		(793)	(186)
Investing activity			
Increase in prepaid rent	6	(6,600)	(1,500)
Net cash used in investing activity		(6,600)	(1,500)
Financing activities			
Decrease in restricted cash		-	1,048
Increase in shareholder contributions	8	7,393	638
Net cash provided from financing activities		7,393	1,686
Net increase (decrease) in cash and cash equivalents		-	-
Cash and cash equivalents, beginning of year		-	-
Cash and cash equivalents, end of year		-	-
Interest received		2	8

See accompanying notes

LABRADOR - ISLAND LINK OPERATING CORPORATION

NOTES TO FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS

Labrador-Island Link Operating Corporation (LIL Opco or the Company), was incorporated on November 13, 2013 under the laws of Newfoundland and Labrador. LIL Opco is a 100% owned subsidiary of Nalcor Energy (Nalcor). LIL Opco's head office is located at 500 Columbus Drive, St. John's, Newfoundland and Labrador, A1B 0M5, Canada.

LIL Opco was formed to operate and maintain the Labrador-Island Link (LIL). The LIL consists of equipment and facilities constructed between the Labrador Transmission Assets (LTA) and the Newfoundland and Labrador Island Interconnected System.

LIL Opco has entered into the LIL Lease Agreement with the Labrador-Island Link Limited Partnership (LIL LP) and the Transmission Funding Agreement (TFA) with Newfoundland and Labrador Hydro (Hydro). As a result of these agreements, LIL Opco will be the transmission owner for purposes of offering transmission service to Hydro over the LIL during the term of the TFA.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 Statement of Compliance and Basis of Measurement

These annual audited financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). LIL Opco has adopted accounting policies which are based on the IFRS applicable as at December 31, 2016, and includes individual IFRS, International Accounting Standards (IAS), and interpretations made by the IFRS Interpretations Committee and the Standing Interpretations Committee.

These annual audited financial statements have been prepared on a historical cost basis, except for available-for-sale (AFS) financial assets which have been measured at fair value. The annual audited financial statements are presented in Canadian Dollars (CAD) and all values rounded to the nearest thousand, except when otherwise noted. The annual audited financial statements were approved by LIL Opco's Board of Directors on February 24, 2017.

2.2 Restricted Cash

Cash held in accounts administered by the Collateral Agent, under the terms of the LIL Collateral Agency Agreement and Blocked Account Agreement, is classified as restricted cash. Restricted cash is measured at cost which approximates fair value.

2.3 Short-term and Long-term Investments

Investments with maturities greater than three months and less than twelve months are classified as short-term investments. Short-term investments as at December 31, 2015 consisted of an investment with an effective interest rate of 1.05% per annum. At December 31, 2016 the investment, with an effective interest rate of 1.24%, was set to mature February 28, 2018, thereby moving the investment from short-term to long-term. The investment is measured at amortized cost which approximates fair value.

2.4 Other Receivables

Other receivables are classified as loans and receivables and are measured at amortized cost using the effective interest method.

2.5 Provisions

A provision is a liability of uncertain timing or amount. A provision is recognized if the Company 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 Statement of Financial Position date using the current discount rate.

LABRADOR - ISLAND LINK OPERATING CORPORATION
NOTES TO FINANCIAL STATEMENTS

2.6 Revenue Recognition

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

2.7 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 Company'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 Company'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 Company 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 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 Company's general policy on borrowing costs. 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 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.

2.8 Net Finance (Income) Expense

For all financial instruments measured at amortized cost and interest bearing financial assets classified as 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.

2.9 Income Taxes

The Company is exempt from paying income taxes under Section 149(1) (d.2) of the Income Tax Act.

LABRADOR - ISLAND LINK OPERATING CORPORATION
NOTES TO FINANCIAL STATEMENTS

2.10 Financial Instruments

Financial assets and financial liabilities are recognized in the Statement of Financial Position when the Company 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

LIL Opco has classified each of its financial instruments into the following categories: loans and receivables; AFS financial assets and other financial liabilities.

<u>Financial instrument</u>	<u>Category</u>
Short-term investments	AFS financial assets
Other receivables	Loans and receivables
Long-term investments	AFS financial assets
Long-term payables	Other financial liabilities

(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 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) AFS Financial Assets

AFS financial assets are non-derivative financial assets that are designated as available for sale or are not classified in any of the previous categories. Gains and losses arising from changes in fair value are recognized in other comprehensive income and accumulated in the fair value reserve with the exception of impairment losses, interest calculated using the effective interest method, and foreign exchange gains and losses on monetary assets, which are recognized in profit or loss. Where the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the fair value reserve is reclassified to profit or loss.

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.

LABRADOR - ISLAND LINK OPERATING CORPORATION

NOTES TO FINANCIAL STATEMENTS

2.11 Derecognition of Financial Instruments

The Company 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 Company 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 Company 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 Company derecognizes financial liabilities when, and only when, its obligations are discharged, cancelled or they expire.

2.12 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 Company'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 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. Actual results may materially differ 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.

4. FUTURE CHANGES IN ACCOUNTING POLICIES

Amendments to IAS 1 – Disclosure Initiatives that became effective for annual periods beginning on or after January 1, 2016 did not have a material impact on LIL Opco’s annual audited financial statements.

LIL Opco has not applied the following new and revised IFRS that have been issued but are not yet effective:

Amendments to IAS 7 - Disclosure Initiative¹
IFRS 9 - Financial Instruments²
IFRS 15 - Revenue from Contracts with Customers²
IFRS 16 - Leases³

¹Effective for annual periods beginning on or after January 1, 2017, with earlier application permitted.

²Effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

³Effective for annual periods beginning on or after January 1, 2019, with earlier application permitted.

4.1 Amendments to IAS 7 Disclosure Initiative

The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes. The amendments do not prescribe a specific format to disclose financing activities; however, an entity may fulfil the disclosure objective by providing a reconciliation between the opening and closing balances in the Statement of Financial Position for liabilities arising from financing activities.

The amendments apply prospectively. Entities are not required to present comparative information for earlier periods.

Management does not anticipate that the application of these amendments to IAS 7 will have a material impact on LIL Opco’s annual audited financial statement disclosures.

4.2 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, Management does not anticipate material adjustments to LIL Opco's annual audited financial statements upon transition.

4.3 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 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.

Management does not anticipate that the application of IFRS 15 in the future will have a material impact on the amounts reported and disclosures made in LIL Opco's annual audited financial statements.

4.4 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;

LABRADOR - ISLAND LINK OPERATING CORPORATION
NOTES TO FINANCIAL STATEMENTS

- SIC-15 Operating Leases – Incentives; and
- SIC-27 Evaluation of 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.

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 LIL Opco's annual audited financial statements. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 16 until Management performs a detailed review.

5. OTHER RECEIVABLES

<i>As at December 31 (thousands of Canadian dollars)</i>	2016	2015
Accrued interest	-	1
HST receivable	990	195
	990	196

6. PREPAID RENT

Under the terms and conditions of the LIL Lease Agreement, LIL Opco shall have, at its sole discretion and option, the right to prepay all or a portion of the rent due and payable for a future year(s) to LIL LP. The amount of prepaid rent as of December 31, 2016 was \$16.1 million (2015 - \$9.5 million). The prepaid rent will be applied to rent following in-service of the LIL.

7. LONG-TERM PAYABLES

<i>As at December 31 (thousands of Canadian dollars)</i>	2016	2015
Accrued liabilities	4	59
Payables due to related parties	75	44
	79	103

8. SHAREHOLDER'S EQUITY

8.1 Share Capital

<i>As at December 31 (thousands of Canadian dollars)</i>	2016	2015
Common shares without nominal or par value		
Authorized - unlimited		
Issued - fully paid and outstanding - 100	1	1

LABRADOR - ISLAND LINK OPERATING CORPORATION
NOTES TO FINANCIAL STATEMENTS

8.2 Shareholder Contributions

<i>As at December 31 (thousands of Canadian dollars)</i>	2016	2015
Total shareholder contributions	17,081	9,688

During 2016, Nalcor provided shareholder contributions of \$7.4 million (2015 - \$0.6 million).

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

9.1 Fair Value

The estimated fair values of financial instruments as at December 31, 2016 and 2015 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 LIL Opco might receive or incur in actual market transactions.

As a significant number of LIL Opco'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 LIL Opco 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 Company 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, 2016 and 2015.

As at December 31, 2016 and 2015, the Company did not have any Level 2 or Level 3 instruments. The fair values of short-term investments and other receivables approximate their carrying values due to their short-term maturity. The fair value of long-term payables approximates its carrying value due to the underlying nature of the balances with its intercompany counterparties.

9.2 Risk Management

The Company 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 Company's expected future cash flows.

LABRADOR - ISLAND LINK OPERATING CORPORATION
NOTES TO FINANCIAL STATEMENTS

Credit Risk

LIL Opco's expected future cash flows are exposed to credit risk through financing activities, based on the risk of non-performance by counterparties to its financial instruments. Credit risk on investments is minimal, as LIL Opco's deposits are held by a Canadian Schedule 1 Chartered Bank with a rating of AA- (Standard and Poor's). The degree of exposure to credit risk on other receivables is determined by the financial capacity and stability of the counterparties. The maximum exposure to credit risk on these financial instruments is represented by their carrying value on the Statement of Financial Position at the reporting date.

Liquidity Risk

LIL Opco is exposed to liquidity risk with respect to its contractual obligations and financial liabilities. 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 equity contributions. Long-term liquidity risk is considered minimal as LIL Opco's obligations are to the LIL LP and are funded entirely by Hydro under the terms of the TFA.

The following are the contractual maturities of LIL Opco's financial liabilities, including principal and interest, as at December 31, 2016:

<i>(thousands of Canadian dollars)</i>	< 1 Year	1-3 Years	3-5 Years	> 5 Years	Total
Long-term payables	-	79	-	-	79

Market Risk

LIL Opco may be 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

During 2016, LIL Opco did not hold any material financial assets or liabilities that were subject to interest rate risk.

Foreign Currency and Commodity Exposure

LIL Opco does not hold any financial instruments whose value would vary due to changes in a commodity price or fluctuations in foreign currency exchange rates.

10. RELATED PARTY TRANSACTIONS

LIL Opco enters into various transactions with its parent and other affiliates. These transactions occur within 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 LIL Opco transacts are as follows:

Related Party	Relationship
Nalcor	100% shareholder of LIL Opco
Hydro	Wholly-owned subsidiary of Nalcor
Lower Churchill Management Corporation	Wholly-owned subsidiary of Nalcor
LIL LP	Limited partnership between LIL Holdco and Emera Newfoundland and Labrador Island Link Inc.
LIL Construction Project Trust	Party to the LIL Project Finance Agreement (LIL PFA) and the IT Project Finance Agreement (IT PFA)
Labrador-Island Link Funding Trust	Party to the IT PFA

Outstanding balances due to or from related parties are non-interest bearing with no set terms of repayment, unless otherwise stated.

- (a) For the year ended December 31, 2016, LIL Opco has prepaid \$6.6 million (2015 - \$1.5 million) in rent for future services of the LIL. Under the terms and conditions of the LIL Lease Agreement, LIL Opco shall have, at its sole discretion and option, the right to prepay all or a portion of the rent due and payable for a future year(s) to LIL

LABRADOR - ISLAND LINK OPERATING CORPORATION
NOTES TO FINANCIAL STATEMENTS

LP. The prepaid rent will be applied to rent following in-service of the LIL.

11. COMMITMENTS AND CONTINGENCIES

- (a) On November 30, 2013, LIL Opco entered into the LIL Lease Agreement to lease the LIL assets from LIL LP until January 1, 2075. Under the terms of the lease, LIL Opco assumes the responsibility for operating and maintaining the LIL and will make rent payments to LIL LP as consideration for the LIL LP leasing, sub-leasing, assigning or licensing as applicable, all assets and rights associated with the LIL. The rent payments will be sufficient to recover all costs associated with the LIL over the term of its service life. LIL Opco's obligation to make rent payments to LIL LP is absolute, unconditional and irrevocable until the initial financing obtained by LIL LP has been paid in full.
- (b) In conjunction with the LIL Lease, LIL Opco also entered into the TFA with Hydro. The TFA payments will be sufficient for LIL Opco to recover all costs associated with rent payments under the LIL Lease, all costs associated with operating and maintenance incurred by LIL Opco and an administrative fee of \$30,000 per year. The purpose of the TFA is to ensure LIL Opco can meet its obligations under the LIL Lease. Hydro's obligation to make payments under the TFA is absolute, unconditional and irrevocable once the LIL is commissioned.
- (c) LIL Opco has irrevocably, absolutely and unconditionally guaranteed the due and timely payment of all obligations of LIL LP in accordance with the LIL PFA, dated November 30, 2013. This guarantee is that of payment and not merely a guarantee of collection. LIL Opco has also granted first ranking liens on all its respective present and future assets other than excluded deposits and contributed surplus.

12. CAPITAL MANAGEMENT

Long-term capital includes share capital, shareholder contributions and retained earnings. LIL Opco's objectives when managing capital are to maintain its ability to continue as a going concern and ensure timely payment of its contractual obligations as it relates to the operations and maintenance of the LIL.