

I3 Bond

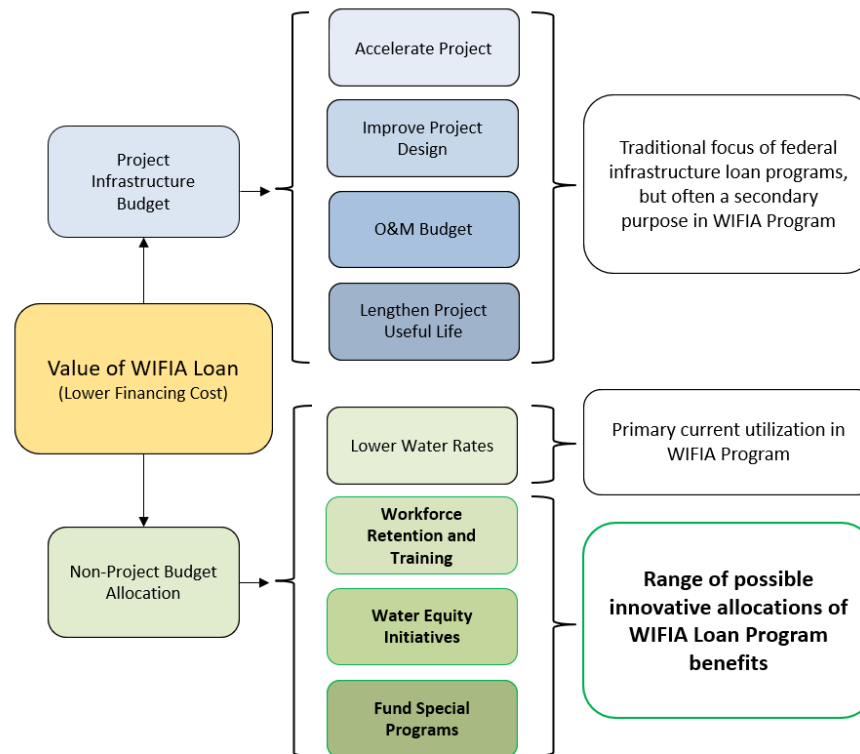
Financing Innovative Infrastructure-Related Initiatives
with WIFIA Loan Program Benefits

Concept Outline 2.0

January 2021

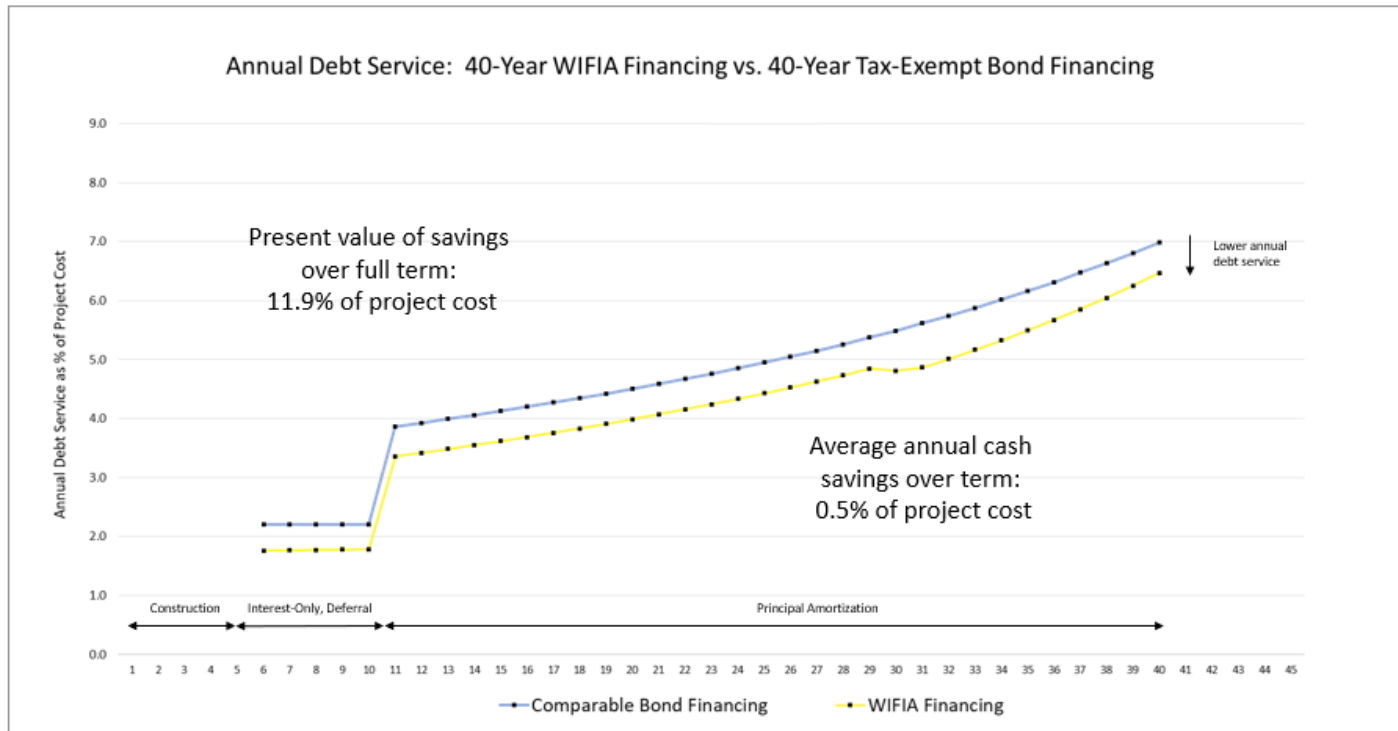
1. Innovative Allocation of WIFIA Loan Benefits

The Water Infrastructure Financing and Innovative Act (WIFIA) Loan Program provides a lower cost of financing for qualifying water infrastructure projects. While Program loan *proceeds* must be spent on the project itself, loan *benefits* may be allocated to non-infrastructure purposes within the water system's service community. There is significant need and scope for innovation in this area, especially in connection with COVID-19 recovery.



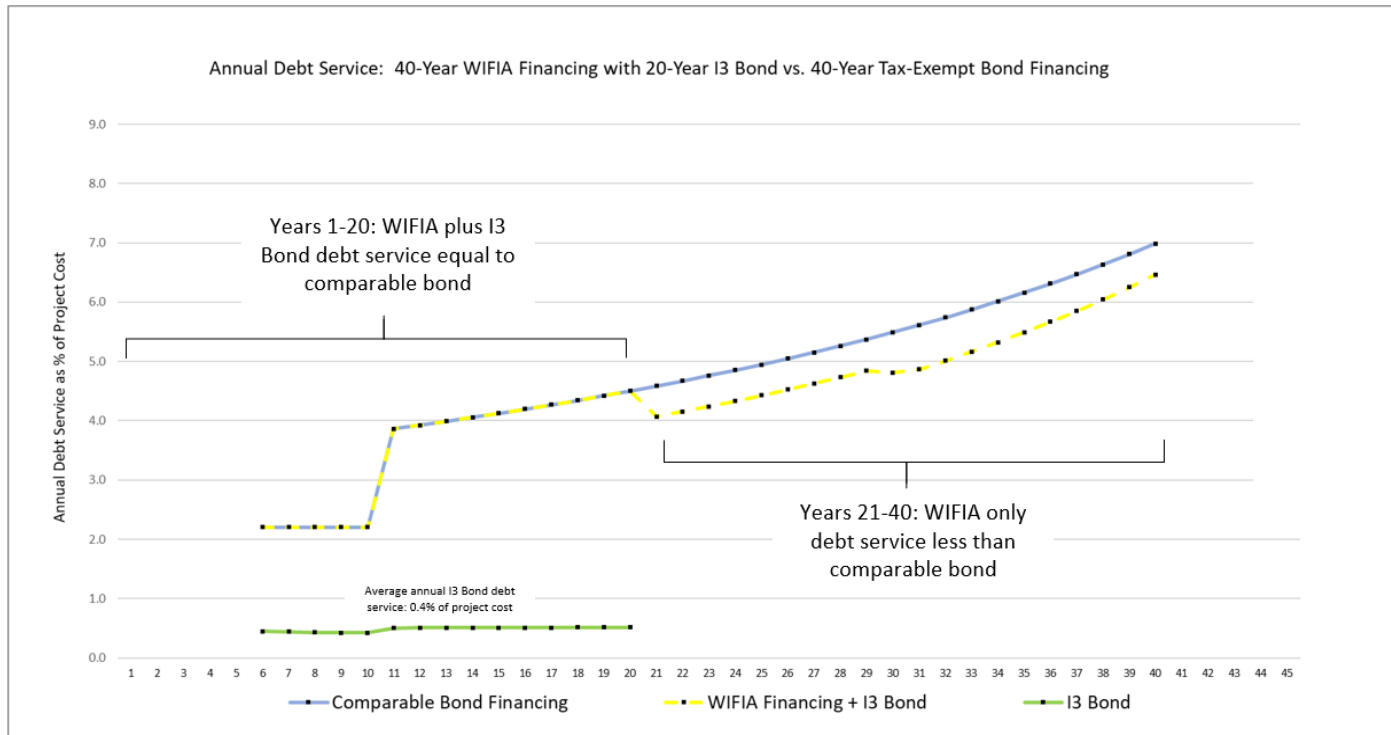
2. WIFIA Loan Benefits: Significant But Spread Over Long Periods

The primary benefit of a WIFIA loan is lower cost of debt service over the full term of the infrastructure project's financing. While this is significant on a present value basis (currently about 10% of project cost or about \$14 million for the average WIFIA project), it is spread out over a typical term of 35 years after a 5-year construction period. This cash flow profile is suitable for a long-lived infrastructure project or basic non-infrastructure purposes like lowering water rates. But a small annual increase in cash available over a multi-decade period may not be useful for more immediate social and environmental purposes.



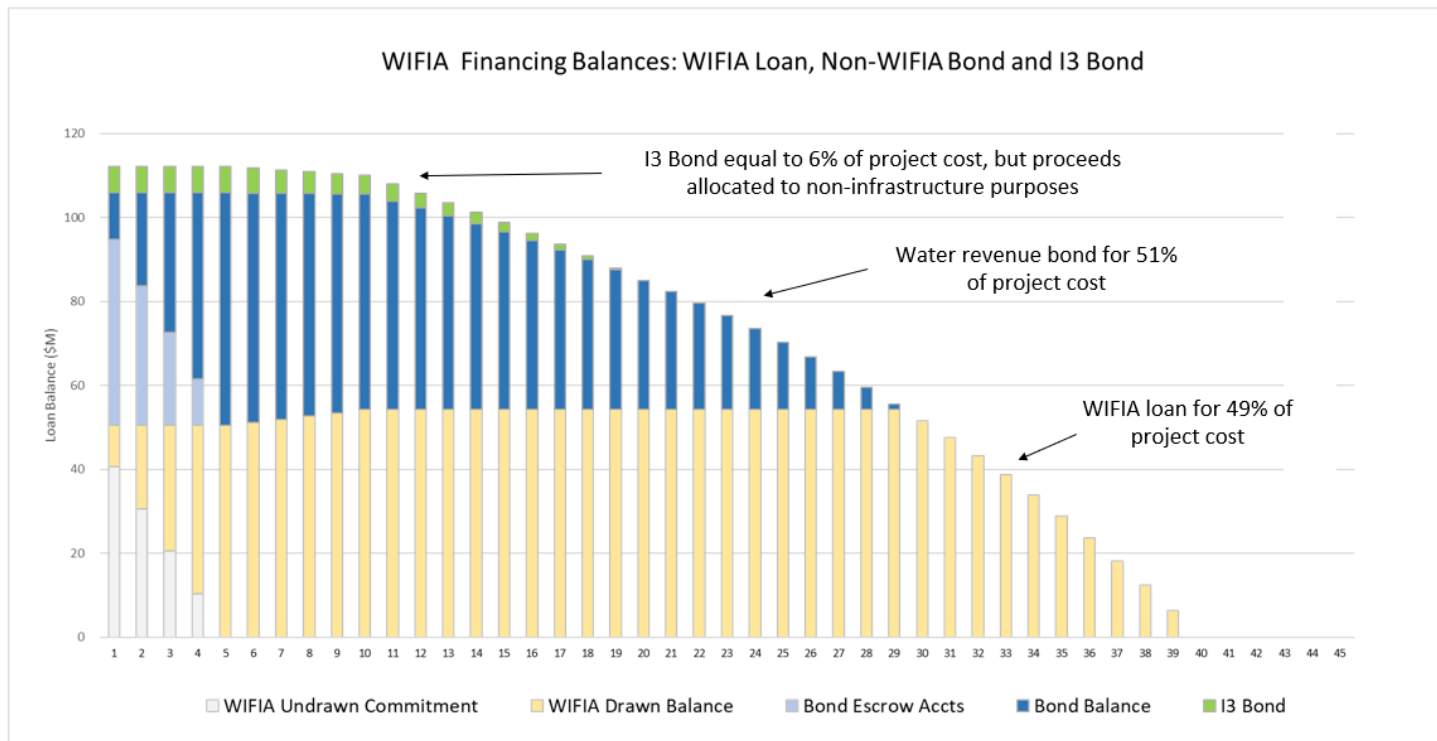
3. I3 Bond Concept

A portion of future cash savings made possible by a WIFIA financing can be allocated to support the debt service of a small additional financing, the proceeds of which can be dedicated to innovative purposes with the system's service community. This approach (provisionally called an **Innovative Infrastructure-Related Initiative Bond or I3 Bond**) simply allows the long-term profile of WIFIA loan benefits to be flexibly utilized by the water system more immediately and in an efficient scale. The I3 Bond's transparent and cost-effective flexibility is intended to significantly expand the range of potential innovative uses for WIFIA loan benefits.



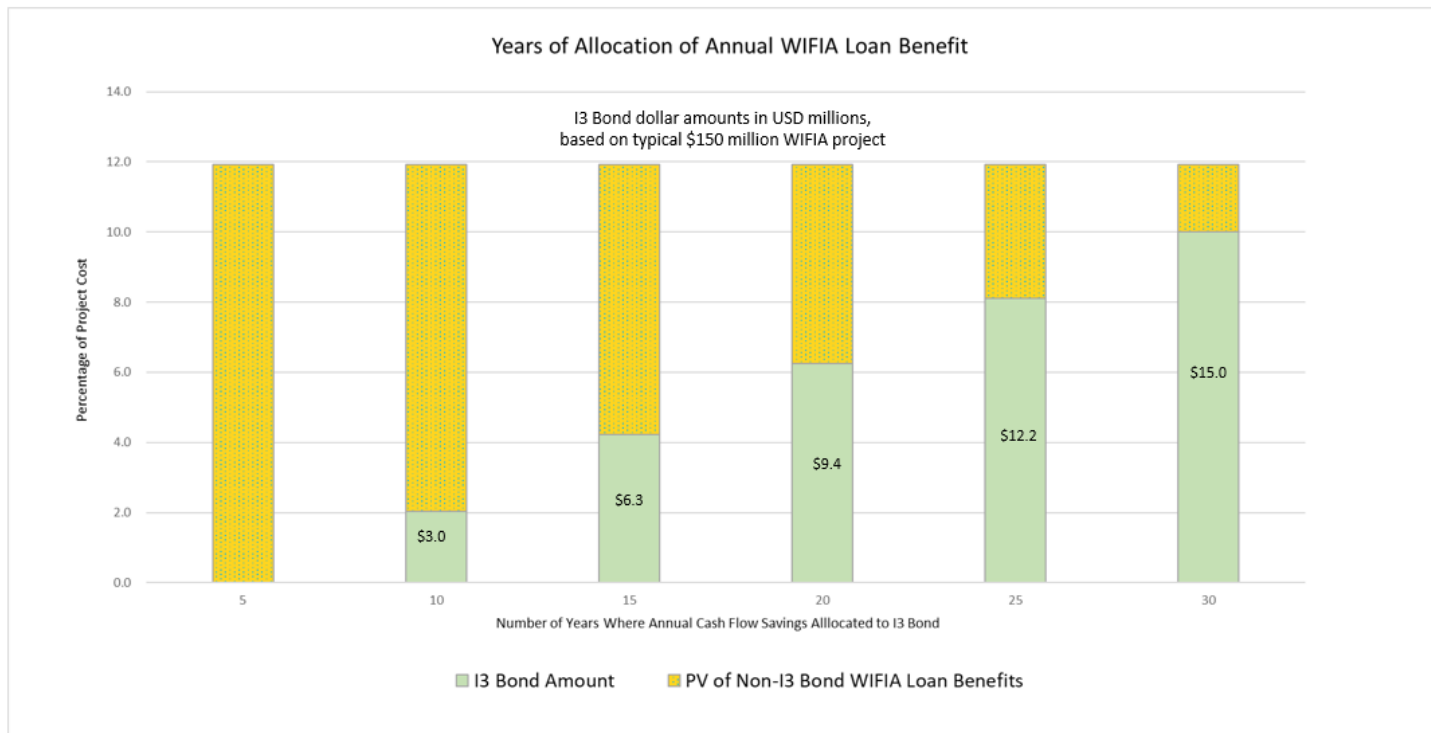
4. The I3 Bond in Context of a WIFIA Financing

A WIFIA loan is limited to financing 49% of project cost, with the 51% balance provided by other debt sources, most usually a tax-exempt water revenue bond issue. A WIFIA financing will therefore have at least two tranches of capitalization. In this context, the I3 Bond is a minor additional tranche of financing that can be efficiently integrated into overall capitalization, but with the critical distinction that I3 Bond proceeds may be allocated to non-project purposes within the water system's service community.



5. Flexible Allocation

Projected WIFIA loan benefits can be precisely determined at financing closing. Savings can then be allocated to support a I3 Bond in terms of number of years, a percentage of projected savings, or any combination of these or other metrics. As a practical matter, minimum and maximum time frames are about 10 and 30 years respectively, corresponding to typical post-construction debt service profiles and debt market limits. I3 Bond principal amounts will be small relative to overall infrastructure project size, but potentially significant for a wide range of local social and environmental purposes.



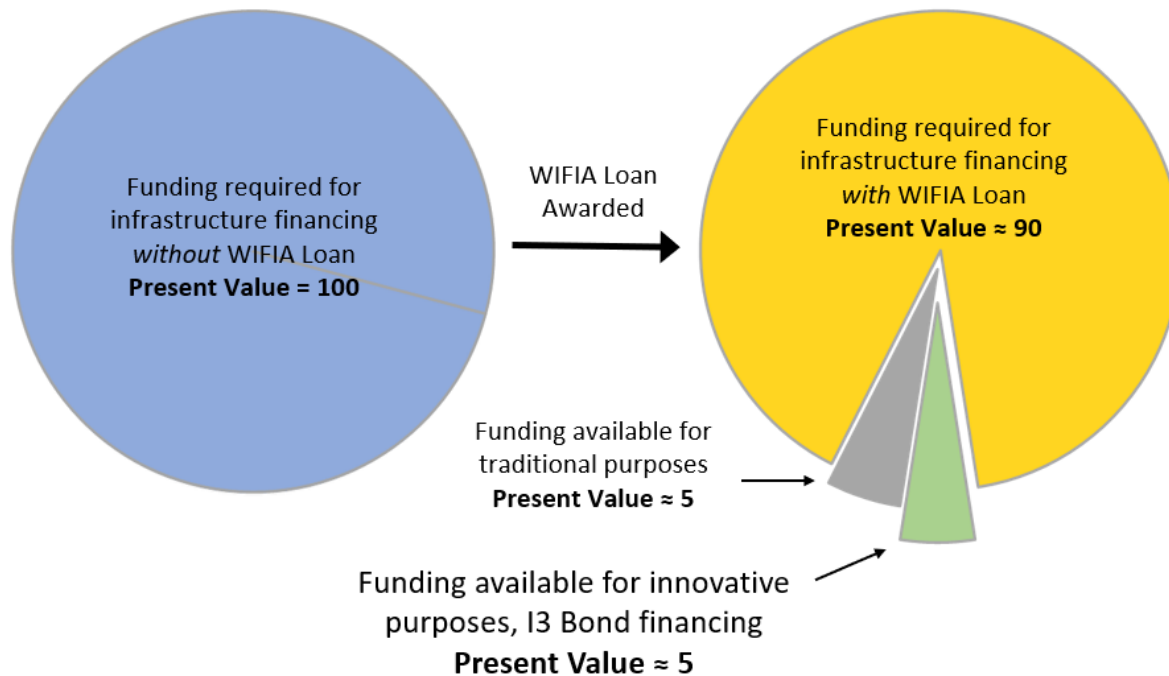
6. I3 Bond Structural Options

A WIFIA loan must achieve an investment-grade rating. In practice, almost all WIFIA borrowers are highly rated public water system with access to the municipal bond market. A I3 Bond financing can simply reflect these credit and market factors, which will maximize efficiency. However, innovative social and environmental objectives will likely be attractive to specialized investors (ESG-focused, impact, philanthropic, etc.) who can offer non-market, customized terms designed to assist the underlying objective. The I3 Bond concept may be an especially effective way to explore this interest.

	Simple Upsizing	Special Series	Impact Features	Private Placement
Description	Increase size and modify amortization schedule in non-WIFIA debt component	Add separate series to water revenue bond indenture	Yield terms to reflect upside and downside of I3 Bond results	Private placement loan agreement
Form	Undifferentiated portion of non-WIFIA debt tranche, I3 Bond objective reflected in use of proceeds (e.g., 90% to project, 10% to innovative purposes)	Series bond with I3 Bond amortization schedule, otherwise same terms as non-WIFIA bond component	Wide range of possible forms. Minimally a series bond with modified yield terms.	Standard unrated, non-public private placement loan agreement with single lender
Investors	Same investors as non-WIFIA debt tranche (e.g. muni revenue bonds buyers)	Generally same investors, but possible ESG labelling or similar highlighting may slightly affect placement	Specialized investors willing to accept risk/return associated with I3 Bond results	Institutional, likely philanthropic or ESG-focused
Rate or Return	Same as non-WIFIA debt tranche, as adjusted for amortization schedule	Very similar or same as non-WIFIA debt tranche, reflecting series amortization schedule	Dependent on impact terms; likely a band centered on market rates	In light of WIFIA borrowers' usual bond alternatives, likely below-market return for philanthropic reasons
Transaction Costs	Likely incrementally immaterial	Minor, if series is completely standard except for additional description of purpose	May be relatively significant depending on terms, relative to I3 Bond size	Possibly minor relative to I3 Bond amount if loan agreement is straightforward, single lender

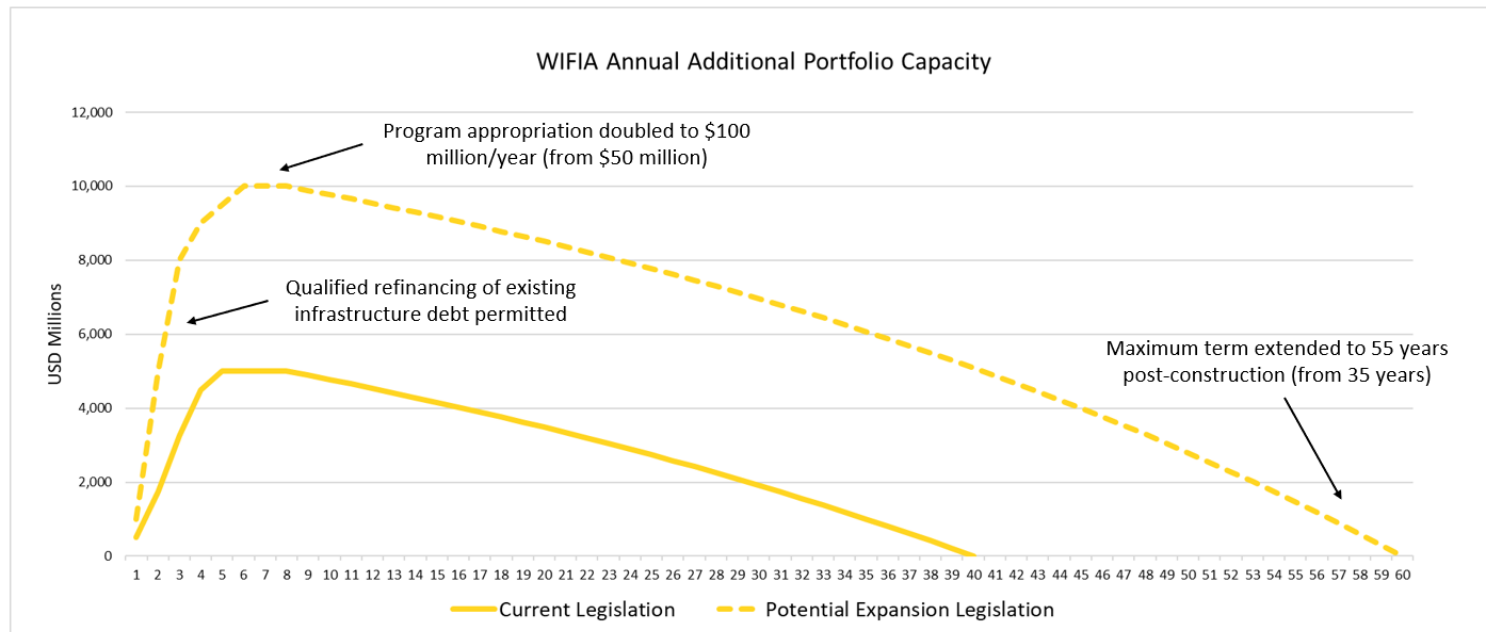
7. I3 Bond Characterization: Financing from WIFIA's Effect on Funding

It is important to note that although both the WIFIA loan and I3 Bond are forms of *financing*, their primary purpose is related to *funding* (permanent resource transfers) provided by the service community. The lower cost of a WIFIA loan means that *less funding* is required to achieve same infrastructure financing result. Savings may be allocated to traditional purposes or innovatively for other community needs. Once that funding allocation decision is made, a I3 Bond financing allows the allocated amounts to be utilized more immediately and in scale.



8. I3 Bond and Possible Future Expansions of the WIFIA Program

The WIFIA Loan Program is relatively new but already very successful. The Program can be significantly expanded with a minor increase in federal credit subsidy appropriations, and its capabilities for qualifying projects can be prudently broadened with extended terms and refinancing options. Such changes require legislative action, bipartisan support for which may arise in the context of increasing infrastructure and COVID-19 recovery challenges. Expanding the WIFIA Program would dramatically enlarge the scope for I3 Bond financings by increasing the number of financings and the value of loan benefits. In turn, I3 Bond financings can highlight the social and environmental value of this infrastructure loan program.



9. I3 Bond Concept Development

The fundamental financial aspects of the I3 Bond are straightforward. In addition, there are a significant number of recent precedents that utilize specialized debt financings in connection with ESG objectives (impact investments, Green Bonds, etc.). Developing the I3 Bond concept should therefore focus on identifying actual situations where financing water-related social and environmental initiatives might be a practical way to address a need. A number of factors need to be present for the I3 Bond to be a solution in such situations:

- 1. WIFIA-qualified water infrastructure project:** Since a I3 Bond financing is based on WIFIA benefits, this is obviously a necessary factor. A qualified water infrastructure project of sufficient size (about \$100 million is likely minimum) must be planned or in process, ideally including plans for a WIFIA application. Given the vast requirements of US water infrastructure, and WIFIA's broad eligibility, this factor will be widely pervasive in the US for some time.
- 2. The WIFIA borrower is a stakeholder in a social or environmental initiative:** Allocation of WIFIA loan benefits is the responsibility of the WIFIA borrower, most usually a public water system. The proposed initiative should be a recognized responsibility of the WIFIA borrower. For public water systems, the scope for this may be especially broad in light of water equity issues, environmental concerns and COVID-19 recovery.
- 3. The initiative requires near-term actualization in feasible scale:** Simply as a practical matter, the potential scale of WIFIA loan benefits (and therefore the I3 Bond amount) should match the initiative's need as an actualizing factor.
- 4. Potential for consensus among stakeholders:** Since WIFIA loan benefits can be (and usually are) allocated to established traditional purposes such as lowering overall water rates, a consensus among water system stakeholders about the trade-offs is required to prioritize an innovative initiative.
- 5. Active initiative advocacy:** Most importantly, even if all the other factors are present, an innovative initiative, funded and financed with an innovative approach like the I3 Bond, requires focused and energized advocacy.