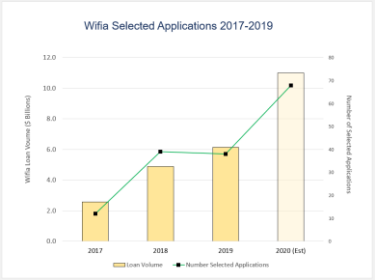
Including an Opportunity Zone Investment Tranche in a Wifia Infrastructure Financing

The huge scale of required investment in US basic infrastructure renewal is both a challenge and an opportunity. How can specialized investor capital participate? One possible path is by adding value to large-scale federal infrastructure loan program financings, illustrated here by including an Opportunity Zone investment tranche in a Wifia financing for a large water system.

Water Infrastructure Finance and Innovation Act (Wifia) Loan Program

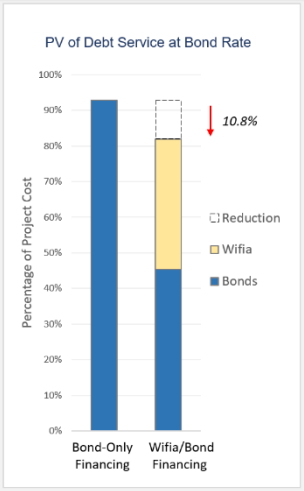
- The EPA's Wifia Loan Program for major water infrastructure projects is new but growing rapidly.
- Most Wifia Borrowers are large, highly rated public water authorities with extensive access to the municipal bond market. They utilize Wifia loans primarily for optimizing long-term debt liability management. This indicates an openness to non-traditional, structured approaches and the need for enhanced capitalization to meet economic, social and environmental challenges.
- The Wifia selection process is competitive. Primary evaluation criteria include the proposed project's resiliency, sustainability and environmental protections, especially in the context of climate change.
- Wifia Borrower service areas often encompass economically stressed communities. The proposed project's impact on these communities is also a primary Wifia evaluation criterion.



- Wifia Loan Program is designed for large-scale, long-lived public water sector systems and assets.
- 90 Selected Applications with $14 billion n volume in first 3 years.

Bond-Only vs. Wifia/Bond Debt Service

- Case: 10-year construction, 30-year amortization term, A3/A- Bond rating



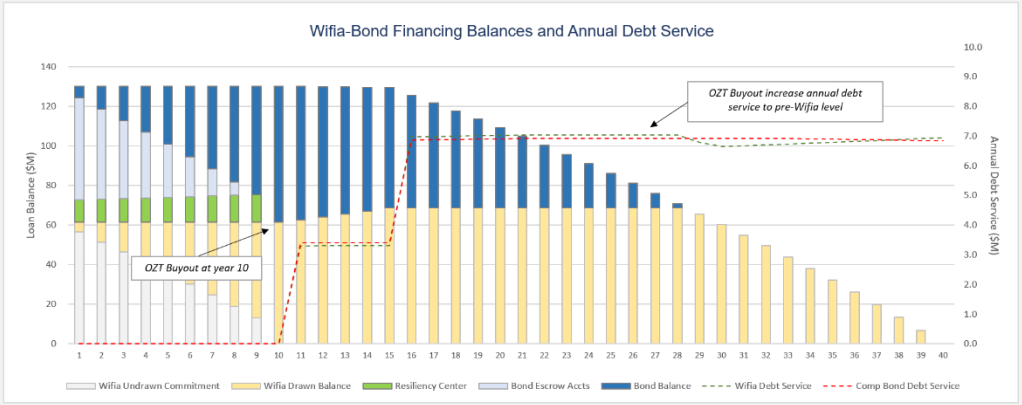
The Wifia Program Delivers Significant Benefits – But Over a Long Time Period

- Relative to a bond-only alternative, the primary benefit of a Wifia financing is lower annual debt service over a long period of time, usually in excess of 40 years. This is a better match for long-lived assets and can be reflected in lower water rate or tax rises over the period.
- In connection with a major system project, however, lower water rates over time may not be the only priority in the service area. A large construction project is a context to consider served communities' related environmental and social goals.
- Potential Wifia financing benefits in the form of long-debt debt service can be redeployed to address these goals by upsizing the project (relative to the bond-only alternative) to include additional assets or operations.
- Project upsizing is an opportunity to consider high-return or high-impact investments that may be outside the public water authority's usual expertise. In these cases, specifically capitalizing the investment with specialized tranches within the overall Wifia financing can help optimize outcomes.

Optimizing Wifia Financing Benefits with Specialized Tranches

- When the additional investment involves risks related to new technology, social or environmental outcomes or similar factors, a specialized Wifia tranche will likely be designed around pre-tax risks and returns that are of interest to specific investor types (e.g. P3 private equity, impact investors).
- The additional investment may also have tax attributes that the public water authority cannot fully utilize directly. In these cases, the specialized tranche can be designed to maximize after-tax value for tax-oriented investors.
- Since many tax benefits rely on the passage of time to be realized, the low-risk and long-term characteristics of a Wifia financing framework for basic infrastructure provide an especially suitable attachment point for tax-oriented tranches.

Illustration Case: A New Resiliency Center for a Public Water System's $100 Million System Project



Embedded Opportunity Zone Tranche (OZT) Structure

1. System asset or operation within OZ is generally sized to utilize future reductions in debt service of overall financing.
2. OZ investor manager arranges for completion of OZ asset and lease to public water system for 10 years base term, with 30-year renewal option and one purchase option at base term end.
3. The purchase option is designed to be exercised by the system through a final drawdown of overall financing's construction phase, at a price that reflects utilization of debt service savings.
4. The OZT investment is specifically sized to provide a target a pre-tax return to buyout in year 10.

Comparable Investment: Tax-Exempt Bond

10-year A3/A- water revenue bond held to maturity

Pre-Tax Yield	2.0%
After-Tax Yield	2.0%
Pre-Tax Equivalent	2.7%

$10 million OZT: Early sale in 2026

Capital gain deferral and exclusion only

Minimum Pre-Tax Yield*	2.8%
After-Tax Yield	3.7%
Pre-Tax Equivalent	4.9%

$10 million OZT: Sale in 2029 (10 yrs.)

Cap gain deferral and exclusion, FMV basis step-up

Minimum Pre-Tax Yield*	2.8%
After-Tax Yield	4.1%
Pre-Tax Equivalent	5.4%

* *Minimum PT Yield equal to system's Wifia financing rate. It is expected to be higher when OZT provides additional pre-tax or other value.*

Resiliency Center

- For simplicity, this illustration considers (1) a commercial real estate investment located in an OZ within the water system's service area that is (2) dedicated to system resilience control, management and education. This 'Resiliency Center' facility could house leak-detection data monitoring operations, central climate-related design and educational functions and specialized workforce training.
- The OZT manager would complete the facility (either new or rehab) and lease it to the public water authority for their resiliency-related operations, which can include specialized tenant improvements.
- The OZT investor would capitalize and own the Resiliency Center, with an expected hold period of 10 years. Most likely buyer at that point will be public water authority exercising its purchase option. If the option is not exercised, the facility may be sold subject to the remaining 30-year lease with the authority.
- The amount and base terms of the OZT investment will be generally determined by Wifia financing debt service benefits. In this illustration for a $100 million system project by a A3/A- water authority, the PV of Wifia financing benefits is approximately $10 million. Resiliency Center design and cost will be targeted to this amount. Indicative results are shown in the sidebar.
- Many other water system assets or operations that can be efficiently sited in an OZ should also be considered. Combining the tax aspects of the investment with other specialized pre-tax value (e.g. innovative technology or social impact) can provide an even more compelling case for investors, the public water authority and community stakeholders alike.
- **Most importantly, encouraging the public water authority to site such investments in an OZ fulfills the fundamental policy objective of OZ tax benefits.**