

# Wifia Loan Program: Transformational Development Concepts

Discussion Outline

December 30, 2019

# 1. Overview

The Water Infrastructure Finance and Innovation Act Loan Program (Wifia) has had a successful start as measured by number of applications, completed loan volume, project cost, etc. But beyond these standard metrics, Wifia also appears to be headed in a **transformational** direction. This has important implications for future development not only of Wifia itself, but for other federal loan programs as well.

Transformative trends:

- The vast majority of successful Wifia applicants are highly-rated (Aa3/AA- or better) public water systems.
- These applicants generally have excellent access to low-cost tax-exempt bond financing – yet still they seek Wifia loans.
- Most applicants take full advantage of Wifia structural options (rate lock, long-tenor, sculpting, deferral, etc.)
- Most financed projects are necessary system rehabilitations or legally required expansions that are (1) long-lived and low-risk but (2) must be completed despite a reluctance to raise rates.

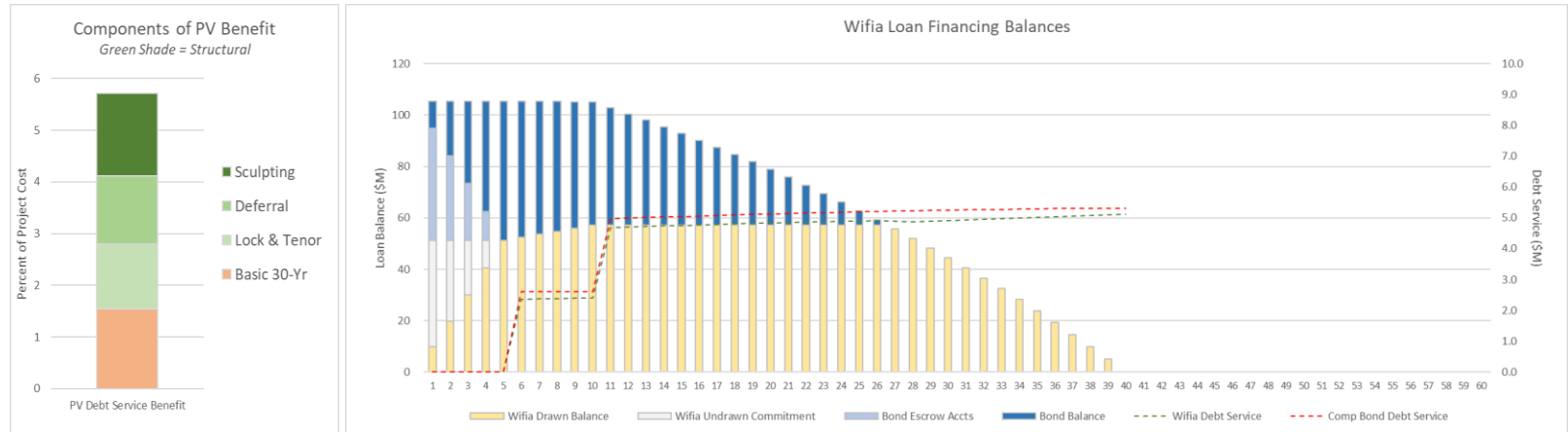
These trends indicate that Wifia is being utilized for long-term debt **liability management**, not just for the interest rate subsidy (which may be minor relative to the easily-accessed subsidy from tax-exempt bond issuance). This reflects a general need for liability management tools for fiscally-constrained public-sector infrastructure authorities, a factor which can guide future Wifia and other infrastructure loan program development.

This Outline considers development concepts in three timeframes:

- **Current** (slides 2-3): Clarification and messaging of liability management for Wifia borrowers and the federal lender.
- **Near-Term** (slides 4-5): Possible minor but impactful amendments to Wifia statute to increase liability management benefits and Program applicability, utilization and financial innovation.
- **Longer-Term**: (slides 6-7): Wifia as guidance for existing federal loan programs and for a new program focused on social infrastructure; large-scale infrastructure liability management programs as a macroeconomic tool, a 'Lender of Realistic Resort'.

## 2. Liability Management for Highly-Rated Borrowers

A highly-rated borrower can utilize a Wifia loan to manage interest rate risk during construction and deferral periods, efficiently extend tenor beyond the standard 30-year limit and minimize use of bond capacity. These liability management features are the basis of about 75% of the Wifia loan's PV benefit and the primary reason why a highly-rated system would apply to Wifia.



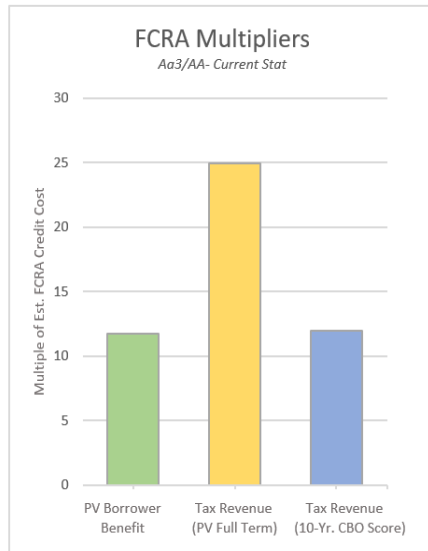
Although liability management is a primary need among public infrastructure borrowers (the vast majority of which are in fact highly rated), it is different and more technical than the simple conception of a loan program's purpose as a vehicle for subsidies. A better understanding of the effectiveness of infrastructure loan programs for liability management would be transformational.

### Current Action Items

- Engage with Wifia administration, water sector stakeholders and policymakers to demonstrate and refine liability management concepts
- In-depth analysis of the specific purpose and objectives of Wifia and other infrastructure loan programs (particularly with respect to existing capital markets) in the context of OMB Circular 129 (see Appendix A).

### 3. Liability Management as a Federal ‘Comparative Advantage’

The federal government has intrinsic and circumstantial comparative advantages in providing liability management tools to sub-national public-sector borrowers. When fully understood and deployed effectively, this results in improved economic efficiency and an overall gain in national welfare – a true ‘win-win’ outcome, not a zero-sum transfer among taxpayers.



One measure of efficiency is a ‘FCRA Multiplier’ – the ratio of benefit to the estimated primary economic cost of a loan, credit loss (estimated in the FCRA framework).

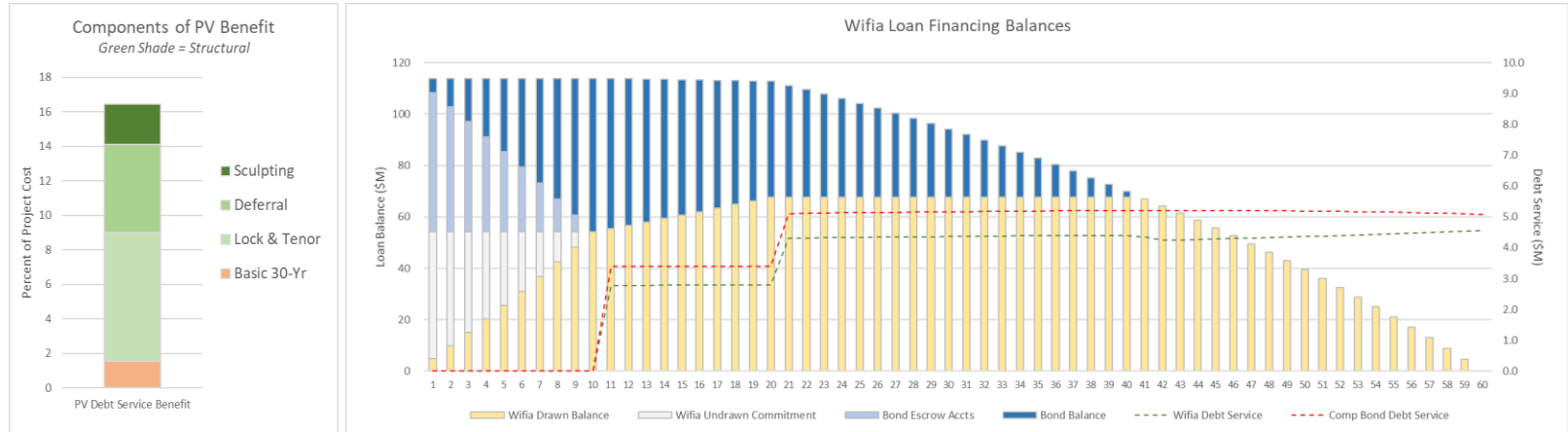
- **PV Borrower Benefit:** A ratio of over 11x for typical Aa3/AA- borrower– reflects federal intrinsic financing advantage vs. private sector lenders (who require a liquidity premium, equity return, etc.).
- **Tax Revenue Increase (Full PV):** The typical Wifia loan will displace an equal amount of tax-exempt financing, resulting in lower federal tax expenditure and higher revenue. The full FCRA Multiplier for this federal circumstantial advantage reflects both the inefficiency of the tax-exempt subsidy and the efficiency of federal liability management products for highly-rated borrowers.
- **Tax Revenue Increase (10-yr, Budget):** With corrected assumptions, the FCRA Multiplier for JCT 10-year CBO scoring will reflect a significant portion of the full gains. This is critical for valid policy and legislative guidance.

#### Current Action Items

- Thorough analysis of Wifia’s selected applications (89 to date) to substantiate potential federal intrinsic and circumstantial efficiency gains.
- Increase awareness among policymakers and stakeholders of need for JCT and CBO assumptions to be consistent with emerging facts. Current assumptions have become demonstrably invalid.

## 4. Expanding Liability Management Structural Benefits

Once the benefits of liability management for highly-rated borrowers are understood, it can be shown that relatively minor, technical-seeming amendments to current Wifia statute will have a dramatic effect on PV benefits for qualified borrowers. The main amendments would be an extension of terms: explicit 10-year rate-lock, 10-year deferral and 50-year post-completion tenor.



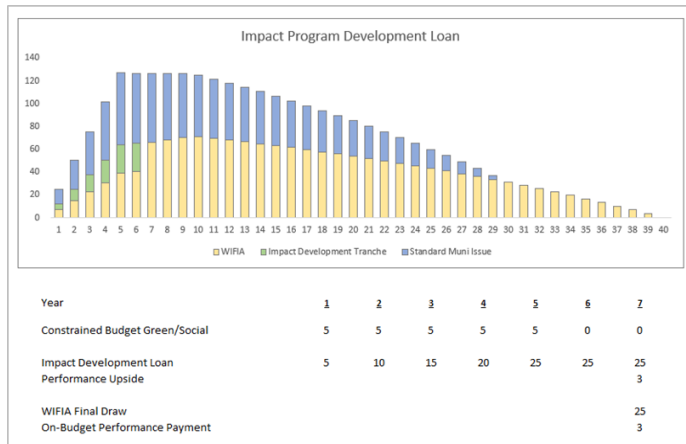
To ensure prudent lending, extended terms would be available only to highly-rated systems in connection with a long-term liability management plan for very long-lived infrastructure assets. This limitation would also minimize required increases in FCRA Credit Subsidy, resulting in significant increases in FCRA Multiplier metrics for PV borrower benefit and federal tax revenue increases.

### Near-Term Action Items

- Circulate draft amendment language among policymakers and stakeholders (see Appendix B).
- Engage in ongoing academic and think tank discussion on how liability management for public-sector infrastructure authorities may be an important component of overall US infrastructure policy development.

## 5. Increasing Applicability and Utilization with Expanded Eligibility

In cases where minimizing the PV of debt service for an infrastructure project is a lower priority than other goals (e.g. environmental, climate resiliency, social), Wifia liability management benefits can be directed towards those ends. In the simplest form, a slightly more costly project can be financed for the same level of debt service. Alternatively, a Wifia financing may allow the inclusion of a specialized P3 or impact investment tranche in the project’s capitalization. This potentially more powerful approach could be encouraged by expanding Wifia’s scope of Eligible Costs to include capitalizable costs of environmental and social programs directly related to the project.



For example, a Wifia financing could incorporate a social impact investment tranche that financed a workforce development program during an infrastructure project’s construction phase.

- Performance-oriented impact capital will be more expensive than debt (if successful). The savings from the Wifia loan could balance the potential extra cost.
- To the extent development costs were capitalizable Eligible Costs, they could be financed over the long-term within the permanent debt capitalization.
- The combination of social program development and a Wifia loan may significantly improve stakeholder consensus-building.

### Near-Term Action Items

- Circulate draft amendment language among policymakers and stakeholders (see Appendix C).
- Engage in discussion with P3 and impact investors directly for ideas and degree of interest.

## 6. Wifia as a Guide for Other Infrastructure Loan Programs

Wifia's successful start and transformational direction can provide guidance for improving other existing infrastructure loan programs and for establishing new programs.

### **Wifia as Guide for Modifying and Expanding Existing Programs**

- **TIFIA:** Wifia's relatively efficient selection and execution processes should be considered by Tifia. If Tifia can be viewed by borrowers as equally efficient, the program's existing framework could easily accommodate additional focus on liability management for highly-rated borrowers, including state transportation infrastructure banks and loan funds.
- **RRIF:** New pilot program emphasizes efficient implementation. An exploration of liability management for highly-rated railroads and (especially) public transit systems could be included in pilot development.
- **DOE:** Existing 1703 Loan Program is focused on innovation. But investment-grade loan products have precedent in DOE's 1705 ARRA programs, especially the FIPP. Liability management for high-rated transmission systems and power utilities could be explored in context of reestablishing 1705 framework.

### **Wifia as Model for New Programs**

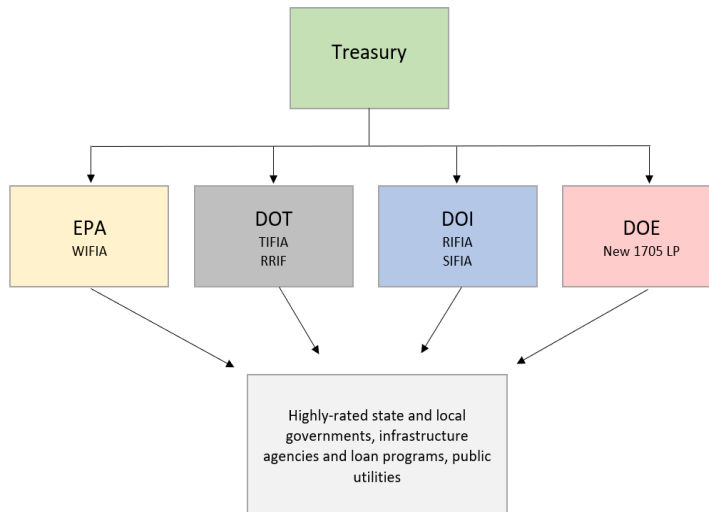
- **RIFIA:** As proposed in HR 2473, RIFIA is closely modelled on Wifia. Explore usefulness of liability management for reclamation project borrowers.
- **SIFIA:** There is a critical need for liability management tools for social infrastructure among US local governments. Many are highly-rated but fiscally constrained. A new 'Social Infrastructure Finance and Innovation Act' program could address this need.

### **Long-Term Action Items**

- Engage with administrators, stakeholders and policymakers on existing and proposed programs.
- For SIFIA in particular, engage with state and local government and agency advocacy organizations to assess scale of need and interest in this approach.

## 7. Macroeconomic Role of Infrastructure Loan Programs

The scale and nature of required US infrastructure investment is very significant in macroeconomic terms. If federal infrastructure loan programs are expanded to their realistic potential, they too will have a significant macroeconomic impact. The liability management aspects of this should be primarily managed, not for policy or stimulus purposes, but in a traditional central bank context, as a **'lender of realistic resort'** for public-sector borrowers.



**Treasury:** Macro lending parameters of tenor, price, rate-lock period, deferral, etc. These can be adjusted counter-cyclically for economic and credit market conditions.

**Sectoral agencies and departments:** Broad long-term policies for eligibility and qualification, implementation and borrower relationship management.

**Borrowers:** Large, highly-rated public sector infrastructure borrowers who utilize federal loan programs primarily for liability management, not credit support or subsidy. They should have confidence that a **'lender of realistic resort'** will be available during an economic downturn, but not as permanent first-best alternative to their standard capital sources (i.e. 30-year munis).

### Long-Term Action Items

- Engage in current discussions about the rationale and practicality of a national infrastructure bank.
- Raise as an academic or think-tank topic, especially in context of specific connection of infrastructure policy to broader economic and financial theory.



# Appendix A

Notwithstanding current JCT assumptions, most current Wifia Program loans displace tax-exempt debt, especially the larger transactions. Possible extended term modifications will highlight this displacement and the resulting increase in federal revenue. Potential policy issues about the purpose of the Program can be addressed in context of OMB Circular 129.

## Guidance from OMB 129:

1. *The Federal objectives to be achieved, including:*
  - a. *Whether the credit program is intended to:*
    - i. *Correct a capital market imperfection, which should be defined and quantified;*
    - ii. *Subsidize borrowers or other beneficiaries, who should be identified; and/or*
    - iii. *Encourage certain activities, which should be specified.*
  - b. *Why they cannot be achieved without Federal credit assistance, including:*
    - i. *A description of existing and potential private sources of credit by type of institution, and the availability, terms and conditions, and cost of credit to borrowers;*
    - ii. *An explanation as to whether and why these private sources of financing must be supplemented and/or subsidized;*
    - iii. *Whether any Federal credit or non-credit program exists that addresses a similar need and why it or a modification to it would not be adequate to address the need.*
5. *The effects on private capital markets. The review should estimate the extent to which the program substitutes directly or indirectly for private lending and analyze any elements of program design that encourage and supplement private lending activity, with the objective that private lending is displaced to the smallest degree possible by agency programs.*

## Factors to Consider for Wifia Loan Program:

- Highly-rated water systems have abundant and efficient access to the tax-exempt bond market, but for very long-lived assets that require financing with minimization of annual debt service, the 30-year limit on market depth is effectively an ‘imperfection’.
- Very long-term planning and affordable execution of basic system rehabilitation should be a fundamental objective of American infrastructure renewal.
- The tax-exempt bond market is efficient within 30-year terms; taxable private placements are relatively efficient for much longer tenors, but taxable spreads are higher than public water systems are used to. A Wifia financing *uniquely* combines interest rates that are close to tax-exempt bonds with a very long-term private placement structure.
- Extended Term Modifications will add to the unique structural features that are both needed by public water systems and not provided in private capital markets.
- Wifia Loan financings, especially with Extended Term Modifications, will not compete with or displace the primary 30-year tax-exempt bond market to the extent that that market is typically the ‘first-best’ solution for a capital financing. Only ‘second-best’ utilization will be displaced, strictly in accordance with borrower preference for very long-term financings.

# Appendix B

## Extended Term Modifications

Policy goals:

- Encourage American water systems to address major deferred maintenance and delayed investment as quickly and efficiently as possible.
- Extending long-term WIFIA loan features that permit moderate, steady and affordable water rate increases while ensuring prudent lending practice.
- Encourage commitment to a long-term plan that achieves sustainable full cost recovery.

## Proposed modifications to USC Title 33 § Section 3908(c)(3):

(3) Deferred Payments [and Extended Construction and Repayment Periods]

(A) Authorization

(ii) In connection with a long-term plan to achieve full-cost recovery for necessary projects while implementing sustainable and affordable rate increases, the Secretary or the Administrator, as applicable, subject to subparagraph (C), may allow obligor to:

- (a) implement a programmatic construction plan with a period of up to [10] years in which the schedule of Eligible Project Costs may be amended and resubmitted in accordance with achieving obligor's long-term plan objectives;
- (b) for the purpose of implementing sustainable and affordable rate increases in accordance with obligor's long-term plan, allow obligor to add principal and interest to the outstanding balance for a period of up to [10] years after substantial completion of the construction program
- (c) for the purpose of implementing sustainable and affordable rate increases in accordance with obligor's long-term plan, allow obligor to extend final maturity date of the secured loan for up to [50] years after the date of substantial completion of the construction program, subject to expected useful life of construction program assets.

# Appendix C

## Expanded Eligibility for Community Workforce Training and Affordability Programs

Proposed modifications to USC Title 33 § 3906. Activities eligible for assistance:

(5) local workforce development program related to future operation and maintenance of the project, to the extent such costs may be capitalized<sup>1</sup> as determined by the Secretary or Administrator, as applicable, and;

(6) development of a long-term program [including reasonably required and dedicated reserve funds<sup>2</sup>] to address affordability issues arising from any increases in local water rates, charges or taxes that are associated with the revenue source of the project, to the extent such costs may be capitalized as determined by the Secretary or Administrator, as applicable.

Notes:

<sup>1</sup>/ Training cost of individual employees is not capitalizable (since the expense relates to the employee, not the asset) but the cost of establishing a long-term workforce development program may be, if tied directly (in whole or part) to the asset.

<sup>2</sup>/ A reserve fund for water rate affordability may have analogous precedent in capitalizable reserve funds for low-income housing.

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