

Developing WIFIA's Guarantee Capabilities for Taxable Municipal Bonds

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WIFIA's Need for Innovation

US EPA's WIFIA Loan Program needs to develop innovative loan products in order to (1) diversify Program policy impact and relevance, (2) manage portfolio interest rate risk and compliance issues, and (3) most importantly, more fully utilize WIFIA's institutional lending capabilities. Innovation objectives should include:

- A focus on clear and demonstrable additionality in climate change adaptation, water equity and affordability, and utility regulatory compliance.
- Products based on federal lending strengths in term, scale, risk absorption and policy-oriented analysis.
- Minimization of additional Program interest rate and other difficult-to-manage financial risk.

General Reasons to Develop WIFIA's Loan Guarantee Capabilities

While WIFIA can develop new and innovative direct loan products, there are compelling reasons for the Program to focus on development of its loan guarantee capabilities:

- For WIFIA's large and highly rated borrowers, a WIFIA guarantee will be useful solely for new approaches to water infrastructure challenges, not business-as-usual. This will naturally focus innovation on real-world impact, not financial fine-tuning, as is currently the case.
- Guarantees are an intrinsically simple mechanism. They can be designed to mitigate specific risks that demonstrably dovetail with federal strengths and policy objectives.
- Standard payment guarantees will not increase WIFIA's interest rate exposure and should augment (not compete with) private-sector debt market functions.

Specific Reasons to Focus Development on Taxable Municipal Bonds

A WIFIA guarantee can be attached to taxable municipal bonds, an established and growing segment of the US municipal bond market. This is WIFIA's most practical path for effective innovation:

- The municipal bond market is the primary source of large-scale infrastructure finance in the US, especially for WIFIA's large and highly rated utility borrowers. An innovative WIFIA guarantee on a taxable muni will benefit synergistically from a wide range of existing and highly efficient financial market capabilities. The guarantee can serve a purely catalytic role -- avoiding the unnecessary and duplicative aspects of a federal direct loan.
- Taxable municipal bonds are generally public, resulting in high visibility and liquidity. This can foster interest in co-investment in innovative projects and features (e.g., pay-for-performance upside). There is huge supply of impact and ESG-oriented investment capital that is looking for large-scale and relatively liquid infrastructure products. The availability of a WIFIA guarantee for innovative taxable municipal bonds can unlock this potential.
- The municipal bond market has a politically powerful lobby. Whereas WIFIA direct loans generally compete with tax-exempt munis, innovative WIFIA guarantees on taxable muni bonds will likely receive significant support from this group.