KEY ISSUES IN WIFIA IMPLEMENTATION: THE WATER UTILITY PERSPECTIVE

The water utility community is excited about the historic opportunity created by the enactment of the new Water Infrastructure Finance & Innovation Act (WIFIA) program and appreciates EPA's interest in seeking stakeholder input as the agency works to stand up this important new program. To support EPA's effort, the American Water Works Association (AWWA), the Association of Metropolitan Water Agencies (AMWA), the National Association of Clean Water Agencies (NACWA), and the Water Environment Federation (WEF) are pleased to provide the water utility community's perspective on a number of key implementation issues. We believe EPA's interest in considering the perspective and input of the end-users early in this process will ultimately prove vital in achieving the shared goal of an effective and successful WIFIA program, and we appreciate EPA's outreach and engagement.

Our comments focus primarily on eleven critical issues: the application process; project selection; leveraging WIFIA with SRF resources; the credit analysis; aggregating smaller projects; determining the program's leverage (aka the "subsidy cost"; public private partnerships; application fees; additional WIFIA funding; and the implementation timeline and procedures. Finally, we also suggest that EPA consider forming a stakeholder working group to facilitate and coordinate ongoing stakeholder input on these and other key implementation questions.

1. APPLICATION PROCESS

Congress intended for EPA to select among eligible WIFIA projects in a competitive fashion, rather than structuring the pilot as a "first come, first served" program.[1] This suggests that WIFIA will require specific application "windows" and due dates so EPA

[1] In establishing a "first come, first served" process for TIFIA applicants, for example, Congress specifically said as much, instructing the Secretary to "establish a rolling application process under which projects that are eligible to receive credit assistance under subsection (a) shall receive credit assistance on terms acceptable to the Secretary, if adequate funds are available to cover the subsidy costs associated with the Federal credit instrument." In contrast, WIFIA is written as a competitive program with specific selection criteria.

can develop successive pools of applications from which to select projects for credit assistance. As the program matures and if it becomes "permanent" our recommendations about the application process detailed below might change.

Experience has proved that an effective application and selection process is among the most important features of a successful federal credit program. We believe the agency should be guided by a number of important principles:

- **Predictability.** Applicants need a predictable and responsive process, with clear timelines for decisions and transparency as to the status of applications. Potential applicants will be reluctant to apply if they view the program as a "black box" with long wait times and extended uncertainty as to whether a project is likely to receive financing. Consequently, we recommend that applicants be notified as to EPA's decision within 120 days of submitting a complete application.

- **Interest Rates**. WRRDA Section 5029(a)(4) provides that the interest rate on a WIFIA loan shall be "not less than" the rate on United States Treasury securities of a similar maturity. In order to achieve the purposes of the law and provide the lowest cost financing for water infrastructure projects, we recommend that WIFIA loans be offered at rates equal to (not more than) Treasury rate interest on comparable maturities. This recognizes that the Agency's administrative costs are covered through the annual appropriation.

- **Maturities**. In determining "comparable maturities," the federal agencies involved should recognize that each WIFIA loan is in fact a blend of maturities each of which should be matched to its own comparable Treasury maturity. That is, that portion of the WIFIA loan that will be repaid in three months should be matched to the interest rate on three-month Treasury bills; that portion of the loan that will be repaid in six months should be matched to the interest rate on six-month Treasury bills; and so on for the interest rates at each "segment" on the spectrum of Treasury bills, notes, and bonds. This will result in an overall "blended interest rate" that matches the actual repayment of the WIFIA loan; helps hold down the cost of the WIFIA loan and the project it will support; and allows the Treasury to recover the full interest cost of the funds it has provided.

- **Interest Rate Certainty**. Potential applicants also need to know up front at what interest rate WIFIA loans will be offered as they assess whether or not to apply. In a traditional financing (such as the issuance of municipal bonds or an SRF loan), the interest rate is set at the time the bond purchase agreement or the application is approved. Thus, both the borrower and the lender have certainty about the interest rate (and related fees) and can decide whether or not to proceed to closing. Importantly, neither the borrower nor the lender needs to incur all of the costs of proceeding to closing without knowing that the deal is workable. We strongly recommend that EPA follow a similar approach with WIFIA and publish a target interest rate at the time it makes a call for applications. While movements in Treasury rates between the initial call for applications and a loan closing may cause the final rate to adjust up or down (and may cause some applicants to withdraw if costs increase), publishing a target rate will ensure program transparency and provide both EPA and applicants with a reference point as the application process gets underway.

- **Scalability.** Applicants need a scalable or step-wise process in which they will not incur the majority of the costs and effort typically associated with closing a large-scale transaction unless and after they are selected as a likely recipient of financing. Applicants will be deterred from WIFIA if they must develop and submit upfront all of the materials and fees required to close a transaction, when the reality is that many may not secure financing under a competitive program. A scalable process will allow applicants initially to submit only the level of information and fees required for EPA to make project selection decisions and allow the Agency to then select applicants to go through the full loan documentation and closing process.

- **Availability.** WIFIA will be a more attractive and effective credit window if it is open more than once per year. Some applicants may not be in a position to submit by a given arbitrary deadline nor able to wait a full annual cycle for the next round. To balance the need for a competitive process against having an available credit window, WIFIA should begin accepting applications on at least tri-annual cycles, potentially increasing to quarterly application cycles as EPA develops sufficient application flow and comparative context to make project selection decisions. Applicants need not be given priority in subsequent rounds for having applied in a previous cycle. To increase clarity and transparency applicants should be required to re-submit each cycle, with applicants offered the option of having an unsuccessful application automatically re-submitted in each subsequent cycle that year. Applicants should be able to promptly receive their scoring and reviews, as well as overall WIFIA application statistics, to make informed decisions as to re-application.

Based on these principles, we believe that the three-stage TIFIA application process provides the basic model WIFIA should follow. The TIFIA process begins with an initial application (called a “Letter of Interest”) sufficient to allow the TIFIA office to apply the statutory eligibility and review criteria. In the next stage, the TIFIA office works with selected applicants to address follow-up questions and conduct a more detailed credit and financial analysis, at which time a preliminary rating opinion letter and additional fees are required. In the third stage, qualifying applicants are invited to submit final documentation, with the next set of fees due at closing. Applicants invited to submit final documentation are expected to receive the loan subject to a successful closing and satisfaction of all legal and statutory requirements. Once TIFIA receives the final documentation, it has 30 days to deem it complete and 60 days from receipt for loan approval or disapproval. For WIFIA, applicants not selected at any stage should be notified immediately.

2. PROJECT SELECTION

As a pilot program, it is imperative that WIFIA seek balance and diversity in the types of projects and project financing models selected to receive credit assistance. This is reflected in the overriding criteria Congress set forth in WRRDA Section 5023 (“Authority to Provide Assistance”), which provides that the Administrator “may provide financial assistance under this subtitle to carry out pilot projects, *which shall be selected to ensure a diversity of project types and geographical locations.”* We believe EPA should seek to support a mix of drinking water and clean water projects; large-scale projects submitted by a single utility; smaller-scale projects aggregated into a single application; pure utility projects; and projects involving private equity partners. Such a diversity of projects is critical to evaluating the effectiveness of the program and demonstrating how it can help meet the nation’s water infrastructure needs with innovative financing models.

WIFIA applicants should identify the category of eligibility through which they seek funds for their project. Paragraphs (2) through (9) of Section 5026(b) list the types of projects eligible for EPA assistance through WIFIA, so directing applicants to identify the eligibility category related to their project will help EPA appropriately consider diverse project types, while also easing the agency’s task of confirming eligibility.

Under the law, total costs for a WIFIA-eligible project must be reasonably expected to exceed $20 million, except in limited circumstances. Section 5028(a)(2)(B) lowers the expected project cost threshold to $5 million for "small community water infrastructure projects" that will serve communities of not more than 25,000, and which are eligible for WIFIA via paragraphs (2) or (3) of section 5026. This means that only small community water infrastructure projects which are also eligible for assistance through the Drinking Water or Clean Water SRFs may take advantage of this lower-size threshold. Individual projects that qualify for WIFIA through another paragraph of Section 5026 (such as enhanced energy efficiency projects, for example) should be expected to cost at least $20 million, regardless of the size of the community served.

We also recommend that EPA convene a stakeholder working group to provide input into the development of the project selection criteria. In addition to calling for project diversity and balance, the statute directs EPA to establish specific project selection criteria based on eleven broad factors outlined in the law. However, not all criteria are applicable to all project types (*e.g.,* drinking water projects vs. clean water projects) and it is important that the selection criteria not favor one project type over another. Additional topics for stakeholder input include how EPA will determine "the extent to which [a] project uses new or innovative approaches" and how EPA will conclude if a project "addresses identified municipal, state, or regional priorities." We believe stakeholder input would be highly beneficial to EPA in developing and refining these criteria.

3. Leveraging WIFIA with SRF Resources

EPA should clarify and facilitate the State Revolving Funds' ability to leverage WIFIA resources. We believe this meets the clear goals throughout the legislation of coordinating with the SRF program and leveraging other resources for maximum efficiency and impact. To ensure WIFIA project sponsors can fully leverage and coordinate with the SRFs, it is critical that EPA clarify that SRF assistance, including the initial capitalization grant, is not "Federal assistance" for the purposes of the "Maximum Federal Involvement" in a project under WRRDA Section 5029(b)(9).

The ability to leverage SRF loans is especially important in light of the limitation on using tax-exempt debt in conjunction with WIFIA. This prohibition imposes a severe limit on utility resources available to complete a project financing package. The use of SRF loans should fully satisfy the limitation on tax-exempt finance under Section 5028(a)(5) so long as the SRF loans come from the corpus of the revolving fund and are not the proceeds of any tax exempt obligations the SRF may itself have issued. This is no different from a utility using cash to fund the non-WIFIA portion of a particular project while it uses tax-exempt proceeds for other projects.

WRRDA Section 5028(a)(6) requires that EPA notify the applicable SRF when a WIFIA application is received and triggers a response to EPA by the state. We understand and support this provision of the law. This provision recognizes that SRF funds can supplement WIFIA funding in three ways: a) by replacing some or all of the funding which would otherwise be provided by WIFIA; b) by providing some or all of the funds for the non-WIFIA portion of the project; or c) through some combination thereof. When EPA notifies an SRF of an application, the notice to the SRF should request that the state specifically identify which of the WIFIA supplements identified above the state will provide, if any. The response to that request will establish a clear financing plan related to the application and identify the degree to which an applicant needs to provide an alternative source of funding other than the SRF.

It is critical that EPA and the states strictly adhere to the deadlines in the law, so that WIFIA applications are not delayed or held in limbo pending a response from the state. We recommend that EPA proceed with processing the WIFIA application pending the state's reply concerning its intention to fund a WIFIA project. If the deadline for the state's response passes without an answer, the state should be deemed to have replied in the negative regarding its intention to provide any funding for the project.

There are also circumstances in which there is no possibility that a WIFIA project would or could be funded by the state. For example, WIFIA is open to investor-owned utilities while some SRFs are precluded by state law from funding private systems. As another example, some WIFIA projects may be clearly ineligible for SRF funding based on the applicable state's established requirements and regulations. Moreover, some WIFIA-eligible activities listed in paragraphs (4) through (7) of Section 5026 (such as brackish or sea water desalination projects; projects to enhance energy efficiency in the operation of a water system; or acquisition of real property necessary to carry out any of these projects) may be beyond the scope of SRF funding parameters in some states. In such cases, EPA should move forward with the application under the presumption that it will not receive state SRF funding, even while awaiting a formal response from the state. If no indication has been received from the state by the 60-day deadline for the state's response, EPA should deem that the state has answered in the negative and proceed with the application accordingly. Additionally, the EPA should request that, if a state determines in advance of the 60 day deadline whether or not it will fund a project, the state should promptly notify EPA so as to reduce delays in the WIFIA application process.

4. THE CREDIT ANALYSIS

EPA should determine and implement the most efficient and cost-effective format for the Preliminary and Final Rating Opinion Letters, reflecting the fact that virtually all WIFIA loans will be backed by a pledge of system-wide revenues in water utilities with established credit ratings. The credit analysis of water infrastructure projects should be substantially more straightforward than TIFIA credit analysis, which generally requires complex modeling of project-specific revenues such as tolls. Further, even in TIFIA, the preliminary opinion letter is based on stated assumptions rather than full financial modeling and analysis. In WIFIA a rating agency should be permitted to rely on the utility's latest credit rating to issue the preliminary assessment as to whether the WIFIA loan has the potential to receive an investment- grade rating. Alternatively, if an applicant has received a new rating or an updated rating within the prior twelve months for the applicable revenue stream, the applicant should be able to submit documentation of such rating to satisfy the preliminary opinion letter requirement. The full process of updating the rating would then occur as part of the Final Rating Opinion Letter, if necessary.

It is also important to emphasize that the law established creditworthiness as an eligibility requirement, not as a selection criterion. In other words, creditworthiness is a "yes/no" threshold, with all creditworthy projects then eligible for consideration based on the project selection criteria.

EPA needs to recognize that applicants may have multiple ratings reflecting systems that serve different customer bases (geographical); provide different services (drinking water, wastewater, stormwater, etc.); or have separate revenue streams and legal distinctions (service contracts, etc.). As a result, an applicant may not be able to pledge the entirety of its revenues as security, but only the revenues relevant to the system which the WIFIA project will benefit. Similarly, EPA needs to recognize that for some applicants outstanding bonds, loans, etc. may have a superior lien on system revenues.

5. Aggregating Smaller Projects

Where an SRF aggregates smaller projects to reach the $20 million minimum threshold, the SRF should be the obligor on the loans and the creditworthiness evaluation should take place with respect to the SRF which is to provide the common pledge. This feature is essential to allowing an SRF to leverage its credit to support smaller projects while permitting a single, efficient application process for each group of projects. Projects that are aggregated into a package reaching at least the $20 million threshold should not individually be held to any minimum project size.

6. Determining Program Leverage

In developing the so-called "subsidy cost model" to determine program leverage, it is critical that EPA and OMB take into account the unique credit strengths of water utility projects and the credit history of water and sewer bonds. Water utilities have a built-in, monopolistic revenue stream and long credit histories. While TIFIA generally serves as a model for WIFIA, the credit features and analysis are very different between water projects (which have a customer base and revenue stream), and highway projects (which generally require project-specific analysis, new tolls, and complex demand forecasting). As Fitch Rating Agency states in its rating guidelines, "Municipal water and sewer utilities in the U.S. are enduring natural monopolies that provide highly essential services. As such, the sector exhibits extremely strong credit characteristics with a minimal default history for the past quarter century…" Fitch studied defaults on water and sewer bonds over an 18 year period and found that the cumulative default rate for such bonds was 0.04 percent.

In scoring the WIFIA program, CBO estimated that the "subsidy rate" (used for determining by how much appropriated funds can be leveraged) could be as low as 3%. One of the pre-eminent objectives of WIFIA is indeed to highly leverage a small appropriation so as to make a significant impact on the Nation's water infrastructure needs. We believe that a review of the extensive credit history for water and sewer bonds, as well as the security features that make loans to water utilities such a low credit risk, strongly support a very low "subsidy rate" and consequently a very high leverage ratio. This should be the case even where the utility has a private partner and project revenues are dedicated in whole or in part to that partner, as long as the overall project carries a low credit risk.

7. Public Private and Public-Public Partnerships (P3s)

We fully support the law's definition of private entities (including corporations, partnerships, joint ventures, and trusts) as eligible WIFIA applicants, alongside federal, state, tribal, and local government agencies. But it is critical for EPA to clarify the requirements in WRRDA Section 5028(a)(4) for public sponsorship to ensure that a private party has adequately consulted with and gained the support of the relevant public entity. Given the breadth of potential WIFIA project types, the statutory language is understandably broad in identifying the public entity that can serve as the sponsor (*e.g.,* a state, local, or tribal government entity). In practice, it is critical that a private party applying for a WIFIA loan be the specific partner of the directly concerned and responsible public authority through a defined P3 project.

We also recommend the Agency be open to Public-Public Partnerships, a type of P3 in which two or more public entities are prepared to cooperate through a consolidation agreement, concession agreement, or other arrangement, in lieu of involving a private party. Such arrangements often have unique features that differentiate them from either a typical utility model or a Public-Private Partnership. In these arrangements, the public entity that has primary responsibility to fund capital improvements and pay the associated debt service on the related financing should be the party eligible for the WIFIA loan.

8. Application Fees

As discussed above, fees should be assessed based on the stage of the application process with no fee assessed at the time of an initial expression of interest. We also recommend that WIFIA establish fees only at the minimum level required to cover program transactional costs that cannot be reasonably covered by the administrative appropriation. A single large upfront application fee will be an obvious deterrent to applicants. Rather, some fees should be triggered once a project is selected for detailed financial analysis, and any necessary remaining fees should be due at closing and eligible to be rolled into the loan. This would mirror the TIFIA program, which requires a fixed fee before DOT initiates the external creditworthiness review, and considers that only a "down-payment" on the total fees is due at closing.

9. Implementation Timeline and Procedures

We strongly urge EPA to take steps necessary to allow WIFIA to become operational and begin accepting applications in FY2015. EPA should aim to have WIFIA's programmatic infrastructure fully developed and operational during FY2015, allowing projects to be funded quickly once appropriations become available.

We also urge EPA to develop a WIFIA Program Guide with stakeholder input, in lieu of promulgating regulations. A Program Guide should be the ultimate resource for applicants. This approach has worked well in TIFIA, and all updates to the program (including major statutory changes) have been implemented through the Program Guide as opposed to promulgating and revising regulations. This approach minimizes the time otherwise required to stand up the program and begin delivering its benefits.

10. Additional WIFIA Funding

The law provides that up to 25 percent of the appropriation each year can be used for loans in excess of 49 percent of total project costs, and we recommend that the Agency take full advantage of this flexibility. Moreover, in determining what the 25 percent applies against, we strongly recommend that only the incremental cost of support in excess of 49 percent of total project cost count against this 25 percent flexible funding. For example, if a project were funded by WIFIA at a level equal to 80 percent of total project cost, only 31 percent of that project – the incremental amount - should count against the 25 percent flexible funding cap. While this may result in fewer WIFIA loans, it means that some projects can receive far more federal support than would otherwise be available.

11. STAKEHOLDER WORKING GROUP

As noted in several sections above, we strongly recommend that EPA form an informal stakeholder working group to address these and other issues in the implementation process. We believe EPA and WIFIA would benefit from stakeholder input in refining the selection criteria, understanding the credit profile of water infrastructure projects, and generally developing the program and program materials in a way that will meet the needs of end users and be successful for all parties. A stakeholder working group would provide a convenient and continuing platform for EPA to engage with diverse stakeholders in addressing these questions and standing up the program.

We look forward to working with EPA and other stakeholders to help develop the WIFIA program and ensure it lives up to its potential as a significant new tool in water infrastructure finance.