

White Paper – Infrastructure Banks

A national infrastructure bank has been proposed regularly over the past several years; governors in Massachusetts and New York have proposed or funded such banks; and Chicago has created an “infrastructure trust” to address local funding needs. Such initiatives have led to calls for the District to set up its own infrastructure bank. Particularly as the District approaches its debt ceiling, policy makers would like to know whether this concept represents a potential new source of funding for District infrastructure needs. Our review of various active and prominent infrastructure banks suggests caution. While various bank models have been successfully implemented in several states, replicating one such example would require debt that would be counted under the District’s debt cap. Other bank models would not necessarily increase the private capital that could be expected to be raised for District infrastructure needs, at least in the short term. The following paper will provide the basic background of infrastructure banks in Virginia, Florida, California, South Carolina, Europe and Chicago, and suggest what lessons these examples provide for a potential infrastructure bank in the District. The appendix at the end summarizes data on the described existing infrastructure banks.

1. Basic Structure and Goals

Infrastructure banks can be organized in a variety of ways, such as:

- government agencies, utilizing:
 - their own dedicated staff, or
 - staff from other departments, such as a transportation department
- separate legal entities, such as:
 - independent authorities
 - nonprofit organizations

Government agencies will be controlled by government officials, while separate legal entities can be structured with varying levels of government or independent representation on a board of directors.

Generally, infrastructure banks have been started with initial capital provided by the government (or member governments) and/or a dedicated tax revenue stream that is leveraged through a public bond offering. The capital can then be lent directly to government entities, such as localities and school districts, or to other entities undertaking a project, such as water authorities, transit authorities, or public-private partnerships. Loan repayments (in excess of any bank debt service) are usually designated to be re-lent to additional projects, and hence such banks are often described as revolving loan funds.

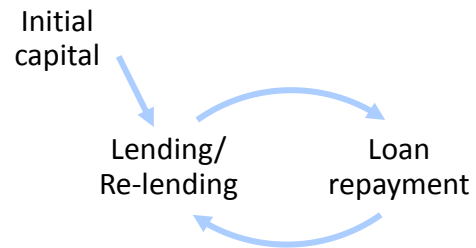
For localities that can apply to receive loans from regional infrastructure banks, such banks are enticing because they may have the flexibility to offer below-market interest rates, subordinate loans, deferred interest loans, or credit enhancement. Providing such favorable terms to borrowers, however, may impair the bank’s ability to make future loans.

This is an inherent tension banks will seek to address through their lending policies and underwriting guidelines.

2. Sources of Capital

A review of the history and financial structure of the most active infrastructure banks has revealed that each has received capital through some combination of two sources: government appropriations and private funds structured as debt, such as a bond offering. Without such private debt, infrastructure banks' lending will be limited by their initial government capitalization and may only be expanded with subsequent appropriations and loan repayments.

Unleveraged Infrastructure Bank



The Virginia Transportation Infrastructure Bank is one example of a recently created bank that has only its state appropriations and future loan repayments to support its mission. The VTIB initially received \$283 million from Virginia, and then it received an additional \$38 million. The bank made its first loan in 2012 and has since committed a total of \$267 million to three projects. As such, it now appears to have very little remaining lending capacity, at least until its initial projects re-pay debt or additional capital is authorized by the state.

If the District also sought to capitalize an infrastructure bank and then lend out that capital, it would not be raising any additional funding for infrastructure in the short term. It would, however, be changing the process and criteria for allocating infrastructure dollars. The District's current process for approving capital budgets (i.e., adoption by the Council and approval by the Mayor) would be substituted for the lending procedures adopted by the bank and its board. Additionally, the projects that would be selected for funding would likely be inherently different than capital budget projects, since ability to repay a loan is currently not a criteria used to establish the capital budget. Eventually, as the bank's loans were repaid with interest, the District's initial capital investment in the bank could yield additional dollars to be recycled into new projects.

For banks that have opted to leverage their resources using debt, such debt has taken one of three forms. In each case the debt is classified by the revenue available to re-pay it:

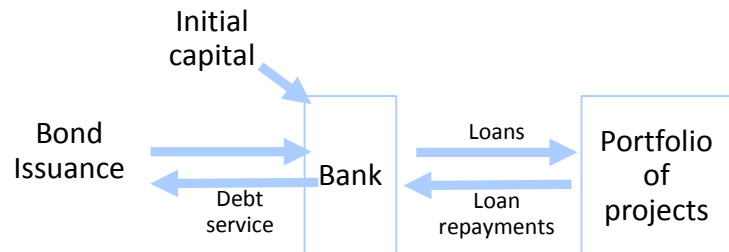
- A. debt supported by a diversified stream of loan repayments due to the bank
- B. debt supported by state tax or fee revenue dedicated to the bank
- C. debt supported by revenue to be generated by a particular project

Below we provide examples of active infrastructure banks utilizing one of the debt scenarios mentioned, and describe how publicly-issued bank debt has been assessed by credit rating agencies:

- A. Issuing debt supported by a diversified stream of loan repayments due to the bank

Banks that have made a diversified portfolio of loans can access the debt markets to raise additional capital, based on the estimated repayment strength of their loan portfolio. In order to get to such a point, however, such banks require an initial capitalization. The state infrastructure banks of California and Florida, for example, received state funding to make their initial pool of loans. California's revolving loan fund within its infrastructure bank was capitalized with \$161 million of state appropriations in the early 2000s¹, and by 2004 it was able to issue \$51 million of bonds backed by its loan repayments. Currently the bank is issuing \$95 million of bonds to refund its 2004 bonds and support new projects. Florida's transportation infrastructure bank was allocated \$227 million of state funds between 2000 and 2005, and it sold two series of bonds in 2005 and 2007 to raise an additional \$123 million (Florida's bank receives an additional, annual \$10 million appropriation of state funds).

Leveraged Infrastructure Bank – Example A



The ability of such banks to issue debt solely backed by its loan repayments is based on the make-up of its loan portfolio, the bank's management and credit practices, and bondholder protections such as debt service reserves. Credit rating agencies will underwrite the bank's entire loan portfolio to review its concentration and the credit strength of the borrowers. To achieve an investment grade rating under Moody's rating criteria, for example, the pool of loans should include at least 20 loans, with the top 5 largest loans representing less than 50% of the portfolio². Rating agencies will also analyze the expected cash flow coverage ratio for the bond debt service; Fitch recently rated California's I-Bank financing AAA based in part on a 1.8x expected debt service coverage ratio³.

Similarly, but on a much larger scale, Europe's infrastructure bank, the European Investment Bank (EIB), received initial capital from its member states when it was established in 1957, and it has since been able to leverage 57% of its capital through bond offerings. Although the bank's bonds have received the highest AAA-rating, its member governments plan to expand lending capacity through a \$14 billion (€10 billion) capital injection in the near future. The bank's history of such capital infusions and expectations of future capital infusions if necessary (due to the political importance of the bank to the policies of European integration) have been critical to the bank's AAA credit rating.

B. Issuing debt supported by a dedicated tax revenue source

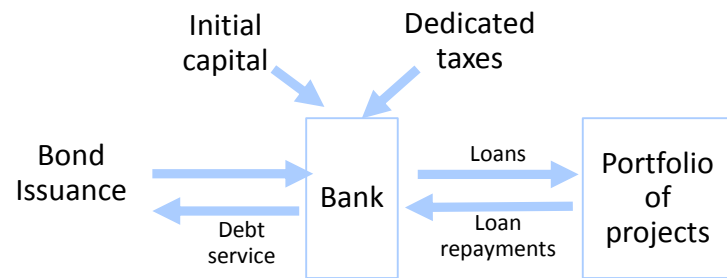
¹MacCleery, Rachel, Urban Land magazine of the Urban Land Institute, "Lessons from California for a New National Bank for Infrastructure Bank, November 11, 2010

² Moody's Rating Criteria, US Municipal Pool Program Debt

³ Business Wire, January 10, 2014, "Fitch Rates California Infrastructure & Econ Devel Bank's Ser 2014A SRF Bonds 'AAA'; Outlook Stable

South Carolina's Transportation Infrastructure Bank (SCTIB) is the most prominent example of a bank with this type of structure, which has allowed it to be significantly larger than the Florida and California banks. During its 2011 fiscal year, its dedicated revenue sources totaled \$128 million and came primarily from truck registration fees (36%), gasoline tax (15%), and motor vehicle registration fees (22%).⁴ The bank has leveraged its revenue streams through the issuance of \$2.1 billion of bonds. In the summer of 2013, the South Carolina legislature authorized a number of additional state revenues for the bank, which are expected to allow the bank to borrow an additional \$500 million for new projects.

Leveraged Infrastructure Bank - Example B



For these types of banks, ratings on the bonds will depend on the strength and forecast of the dedicated revenue sources and the projected cash flow coverage for the bond debt service. Because the dedicated funding streams may be less diversified than the jurisdiction's overall revenue sources, and because the bank will tend to be more leveraged than the jurisdiction, the bonds of such infrastructure banks may not be rated as highly as the state's general obligation bonds. The SCTIB's bonds are rated A, while South Carolina's general obligation bonds enjoy a AAA rating.

C. Issuing Project-Specific Debt

Infrastructure banks can also raise capital in the bond markets or privately through the issuance of bonds benefitting, and repaid by, a single project. This has been the initial strategy of the Chicago Infrastructure Trust. When proposing the bank, Mayor Emanuel's administration announced that the CIT aimed to secure over \$1 billion from private investors who would underwrite projects on a deal-by-deal basis, rather than upfront.⁵ The first CIT project that has been approved by the City Council was announced in January 2014 and it totaled just \$13 million. The funds will finance energy efficiency upgrades at 62 public buildings, and the investor's funds will be repaid from projected energy savings. Clearly many more projects must be identified, and willing lenders must commit before the CIT becomes a significant source of funding for Chicago's infrastructure needs.

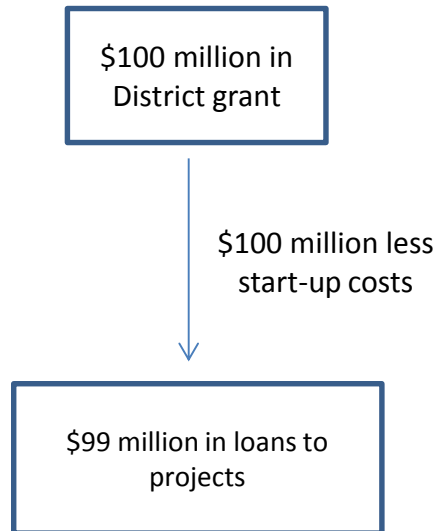
⁴ Sc Financial statements, p. 1, 5, 6, 7

⁵ http://articles.chicagotribune.com/2013-11-12/news/ct-met-chicago-infrastructure-trust-1113-20131113_1_energy-efficiency-retrofit-chicago-city-council

An Infrastructure Bank in the District

As previously discussed, the District has the option of taking some of its current revenue and budgeting for an initial capitalization of an infrastructure bank. An unleveraged infrastructure bank would be able to provide loans in an amount roughly equal to its initial grant from the District, less expenses:

Unleveraged Infrastructure Bank Funded by a Grant

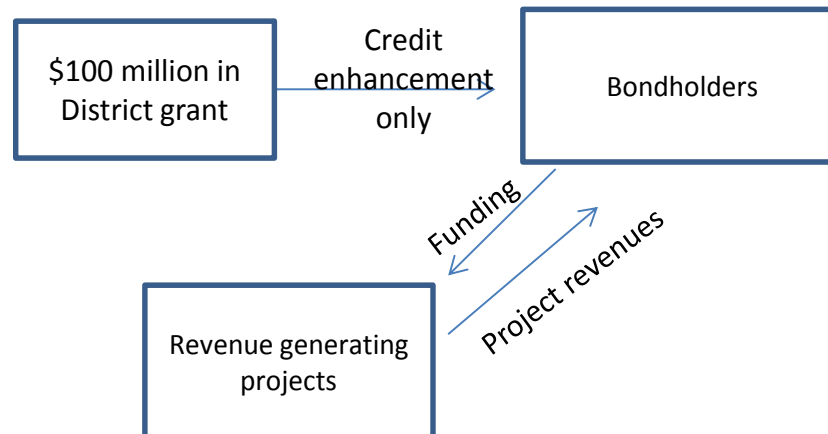


Before it could leverage additional funding from loan repayments, such as Florida and California have done, the bank would need to have a diversified pool of high-performing loans. Such diversity may be hard to achieve within a single city jurisdiction; in addition, it would require several years of successful operations. If this loan diversity could be achieved, debt issued by the bank would likely not count against the District's debt cap, provided the District offered no guarantees of the bank's performance. The model as deployed in Florida and California, however, does not serve as the states' primary source of infrastructure funding.

While capitalizing a bank by bonding off a dedicated revenue stream (in the manner of South Carolina's) is a quicker and more impactful model (due to the potential for increased size), this model would be difficult to implement in the District: it would likely require new taxes and would certainly require a reallocation of planned debt issuance, because otherwise the bank's debt would cause the District to exceed its debt limit.

Project-specific financing, in the model of the Chicago Infrastructure Trust is a feasible option for the District to consider. The feasibility of this model assumes there are projects that attract lenders without requiring a specific guarantee from the District or other covenant that may cause the loan to be counted as District debt. However, District

financing could be used as credit enhancement if it were provided to the bank in the form of a grant. The bank's credit enhancement would reduce the cost of the project's funding by reducing risk to the lenders. Examples of the use of the bank's capital as credit enhancement could be (1) to have the bank establish a debt service reserve fund for the project, or (2) to have the bank pay a certain portion of the bond holder's debt service if the project wasn't generating sufficient cash flow. The grant provided for credit enhancement could also be used by the bank to provide a second position loan to a project.



The types of projects that can be funded in this way are characterized as public-private partnerships, because they are projects with a public purpose which also generate revenues which can repay private investors. It is important to note that despite the feasibility of this model in the District, it may not be necessary to establish an infrastructure bank in order to undertake such project: these types of public-private partnership transactions can also be pursued directly by District agencies. The District capital provided to the bank for credit enhancement in the example above could also be granted directly to the public-private partnership to reduce its need for private funding or reduce the cost of such funding.

The rationale for setting up a bank for such transactions should therefore rest upon an argument for increased expertise or efficiency as compared to current District processes. However, the expertise and efficiency goals may require that the bank be set up with a level of autonomy that may contradict policy makers' desire for sufficient input. Any proposal for a District infrastructure bank will have to carefully balance such competing considerations. Additionally, policy makers should plan on the bank receiving at least interim funding until it can generate fees to cover its operations.

Conclusion

In conclusion, we recommend policymakers consider the following questions before preparing the structure and funding plan for an infrastructure bank:

- What types of needs should the bank be expected to fund?

- How much, and through which mechanisms, should policy makers influence the bank's lending decisions?
- What resources does the District wish to put toward the bank's initial capitalization or ongoing needs?
- How should the bank be staffed?
- What authorities will the bank have for issuing debt?

Appendix

Existing Infrastructure Banks / Key Points	European Investment Bank (EIB)	California Infrastructure and Economic Development Bank (I-Bank)	Florida State Infrastructure Bank (FSIB)	The South Carolina Transportation Infrastructure Bank (SCTIB)	Virginia Transportation Infrastructure Bank (VTIB)	Chicago Infrastructure Trust (CIT)
Funding Focus	Projects that promote growth, employment, economic development, and environmental sustainability	Projects that stimulate economic development and revitalization and improve CA's business climate	Transportation Projects	Transportation Projects	Transportation Projects	Infrastructure projects in general
Source of initial Capitalization	EU member states	State	Federal, state, and bond proceeds	State	State	City
Funding Sources	European member governments Bond issuances	State funding Administration fees charged on bonds Bond issuances	State funding Bond issuances	State funding Federal funding Truck registration fees Gasoline taxes Motor vehicle registration fees Sales taxes	State funding Federal funding Bond issuances	State funding Private capital on a project-by-project basis (this has not yet been realized)
Credit Rating (of Bond Issuances)	AAA	AAA	Aa2	A	Not yet rated	Not yet rated
Sample Project	2013: Lent \$275M for projects that small and medium enterprises in Belgium pursue	2013: Sold \$200M in bonds to finance the construction of the University of California, San Francisco's neurosciences center; the project is structured as a lease-lease back between the I-Bank and the University of California's governing board, the Board of Regents, whereby the Board of Regents repays project debt in the form of lease payments	2011: Lent \$1M to acquire the land to facilitate industrial connectivity to Bob Sikes Airport from Highway 90; project was repaid with airport revenues	2001: Initially made a \$65M loan to the Interstate I-20 project, which was undertaken to address rising traffic volume; it then made a second loan of \$95M, and a third loan of \$18M; debt service was paid with the bank's revenue sources.	2012: Closed on a \$151M loan to finance the expansion of Dominion Boulevard in the city of Chesapeake; the project is being repaid with toll revenues.	To come: Plans are in the works to undertake a \$25M energy retrofit of 75 municipal buildings; the Trust plans to enter into an energy savings agreement with a private investor, who would only get paid if the agreed-upon energy savings goals are reached