
Atlanta Environmental Impact Bond Breaks into Public Market.

IN BRIEF

- IN JANUARY 2019, ATLANTA CLOSED A $14 MILLION ENVIRONMENTAL IMPACT BOND (EIB) for stormwater management in the city's Proctor Creek watershed.
- ATLANTA'S BOND WAS OFFERED PUBLICLY, A FIRST FOR MUNICIPAL EIBS and an innovation its architects hope will help pave the way for EIBs to become a mainstream investment and financing tool.
- THE RESULTS FROM THE ATLANTA OFFERING COULD BE SEEN AS VALIDATION of market appetite for EIBs: the Atlanta bond was fully subscribed, mostly by mainstream institutional investors.

The city of Atlanta has new funds for green infrastructure. In January 2019, the city — in partnership with impact investing intermediary firm Quantified Ventures — closed a $14 million environmental impact bond (EIB) for stormwater management in the city's Proctor Creek watershed. The city plans to use the funds for green infrastructure projects that aim to control stormwater flow and improve water quality.

"Proctor Creek is an area that has repeatedly flooded, and as a result has caused a lot of problems with poor housing stock in that community," said Stephanie Stuckey, Atlanta's former chief resilience officer and current director of sustainability services at the Southface Institute. According to Stuckey, these issues have caused damage to housing as well as health problems, including a case of West Nile virus.

Atlanta's EIB follows in the path of the bond set up by DC Water in 2016, but carries an important distinction. The DC deal was privately placed and sold to Goldman Sachs and the Calvert Foundation; Atlanta's bond was offered publicly, an innovation its architects hope will help pave the way for EIBs to become a mainstream investment and financing tool.

Funding Stormwater Management

The Atlanta bond was the result of a partnership between Quantified Ventures, the Rockefeller Foundation, and broker-dealer Neighborly. Aiming to expand EIBs into public markets, the Rockefeller Foundation put out a grant to cover the costs of structuring a public bond; Atlanta's proposal was chosen among applicants from the 100 Resilient Cities network. The project will fund constructed wetlands, floodplain restoration, pervious pavers, and bioretention areas for stormwater runoff.

Proctor Creek passes through Atlanta's downtown, and the watershed includes some of the city's most economically distressed neighborhoods. According to Stuckey, it was chosen for the bond in part because it is the only major watershed to fall entirely within the Atlanta city limits, dodging the jurisdictional questions that could complicate a bond covering an area that spans multiple municipalities.

The watershed is ripe for intervention on stormwater management. "Proctor Creek has consistently been on the 303(d) impaired stream list with the state Environmental Protection department," Stuckey said. It's also a site of the Urban Waters Federal Partnership program operating in 19 cities, focused on urban, impaired, polluted streams in low-income communities.

Atlanta has faced issues in the past with combined sewer overflows. "We're under a [federal] consent order," said Stuckey, making the EIB a way to "control some of the flooding issues that we're legally obligated to address, in a manner that's not only more cost-efficient than some of the heavy gray infrastructure, but it's also more environmentally sensitive."

It's also a financing mechanism that looks to help expand the city's capacity to take on new projects. "Like most utilities, there's a limited number of projects we can deliver, given the funding that is available," said Mohamed Balla, deputy commissioner and CFO of Atlanta's Department of Watershed Management. Resource constraints have ended up "pushing green infrastructure projects to the back of the line perpetually," he said.

The bond has a ten-year term and two-tier structure, with an estimated base interest rate of 3.55%. At the end of the sixth year of the term, if the projects it funds have generated over 6.52 million gallons of new capacity for stormwater capture, investors will receive a performance payment totaling $1 million resulting in an estimated 4.67% effective interest rate. Quantified Ventures calculates a 28% probability of hitting the high-performance mark, which would result in an above-market net interest rate.

The city hopes more cost-effective green infrastructure can be passed as savings to taxpayers. Quantified Ventures estimates that the $14 million in financing will generate around $18 million in economic benefit, in the form of reduced flooding and better water quality. If the high-performance criteria are met, it would represent an additional $1.8 million of value. The bond has been rated Aa3 by Moody's and A+ by S&P.

The two-tier set-up is also a departure from the DC model, which — in addition to base and high-performance rates — includes a provision that allows the city to recoup some of the EIB's proceeds from investors if the project underperforms. Atlanta's simplified tiers — just base rate and upside — are an alteration important for the bond's public structure.

Holders of a public bond may also resell it to other parties during the course of its term. For that reason, "it gets more complicated if you do a three-tier structure because once it's in the secondary market, it's more challenging to do that clawback in the case of underperformance," said Andrea Barrios, innovative finance analyst at the Rockefeller Foundation.

From Private to Public

If it's successful, the Atlanta bond could prove to be the next step in an ongoing evolution of EIBs as a tool for financing environmental and conservation projects. Private bonds, like the DC Water EIB, are sold to specific prearranged investors. In contrast, public bonds are offered on an open market — the Atlanta EIB was sold on Neighborly's online platform.

The Atlanta deal may help to build broader acceptance of the model pioneered by DC's EIB. Despite the potential represented by the DC deal, other cities were reluctant to follow suit, according to Barrios.

"DC Water was viewed as a highly sophisticated and resource-rich entity," she said. "Even the base interest rate that they used in their model was higher than [other] municipalities would use, and it scared away some of the smaller ones."

In addition, privately placed EIBs face limitations that may be inherent to their structure. They exist in "what often ends up being an overly engineered private investment world, which gets even more complex in the impact space," said Margot Kane, former senior advisor at Quantified Ventures. "There's another layer of requirements that have to do with social and environmental outcomes."

Private structures can also give outsized influence to single anchor investors and increase transaction costs, according to Kane. In contrast, Barrios hopes that the Atlanta deal will show that EIBs are a tool available to a wide variety of municipalities across the country. Its public offering was key to demonstrating proof of concept.

"It was really tested in the market," Barrios said. That is, Atlanta's bond posed an unanswered question: how would a municipal EIB sell without prearranged buyers? Moreover, only qualified investment buyers could purchase the bond, in increments no smaller than $100,000. This threshold priced out many smaller impact investing outfits that may have had a special affinity for an EIB, according to Barrios, testing the EIB with a segment of the market that less typically purchases them.

"When you talk about municipal debt as an asset class, a lot of people tend to be risk-averse and don't want to put their money into the new flashy innovative thing, they want to put their money into something that's tried-and-true," said Benjamin Cohen, director at Quantified Ventures.

Traditionally, EIBs have been "very boutique, very niche, principal-exposed," with philanthropic investors and complex evaluation structures, Cohen said. "As a company, we're trying to take that model from something that is pretty entrenched in academia and philanthropy and is pretty boutique and trying to turn it into a financial vehicle that can be recognized and adopted by the broader capital market," he said.

The results from the Atlanta offering could be seen as validation of market appetite for EIBs: the Atlanta bond was fully subscribed, mostly by mainstream institutional investors, according to Cohen.

Replication

"Now that we have the Atlanta EIB in the public bond markets, our hope is that now there's one of these," Cohen said, "we hope to see more interest and more appetite from investors."

A further innovation that future bonds could aim for: one initial idea for the Atlanta bond was to make it available for retail sales, allowing any Atlanta resident to invest in their city's green infrastructure if they wished. This proved too challenging to implement, but could form a part of similar deals in the future, according to Cohen.

Broader acceptance of EIBs as tools available to municipalities would, of course, mean more municipalities using them. To continue to push the process forward, Rockefeller and Quantified Ventures are also supporting the city of Camden, New Jersey in developing an EIB to build a mini-grid for public buildings. Perhaps that will pave the way for cities to begin pursuing EIBs of their own accord.

"We'd love for the municipalities to take this on their own. It takes time for these bonds to be replicated, because people wait for the first, the second, the third, the fifth, the sixth," Barrios said. "What would be incredible is if you catalyze this across the entire country, or even internationally."

Conservation Finance Network

by Chris Lewis

June 24, 2019