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DC Water Closes Historic Deal.

PHOENIX – The DC Water and Sewer Authority closed on a historic deal Thursday, issuing the nation's first Environmental Impact Bond (EIB) to fund the initial green infrastructure project in its DC Clean Rivers Project.

The $25 million, tax-exempt EIB was sold in a private placement to the Goldman Sachs Urban Investment Group and Calvert Foundation, netting DC Water a 3.43% interest rate that is comparable on a cost of funds basis to its historic cost.

The proceeds of the bond will be used to construct green infrastructure to absorb and slow surges of stormwater during periods of heavy rainfall, preventing an overflow of untreated sewage (known as a combined sewer overflow, or CSO) into the Potomac and Anacostia Rivers or their tributaries. The green infrastructure includes absorbent materials and gardens that mimic natural rain absorption processes.

The EIB allows DC Water to attract investment in green infrastructure through an innovative financing technique whereby the costs of installing the green infrastructure are paid for by DC Water, while the performance risk of the green infrastructure in managing stormwater runoff is shared among DC Water and the investors. As a result, payments on the EIB may vary based on the proven success of the environmental intervention as measured by a scientific evaluation of the results.

The structure of the deal includes three "tiers" of performance depending on how well the green infrastructure controls the runoff.

The investors will receive interest payments as typical for bondholders. Depending on the results, an additional payment may be due on the bonds' mandatory tender date of April 1 2021.

If runoff reduction is greater than 41.3%, a "tier 1" outcome, the investors will receive from DC Water an "outcome payment" of $3 million. In a tier 2 outcome where runoff reduction is 18.6% or better but less than 41.3%, the investors will be due only their normal principal and interest.

In a failed tier 3 outcome where runoff reduction is less than 18.6%, the investors will owe DC Water a "risk share" payment of $3.3 million that the trustee will then factor into future payments. That would net the investors a roughly 0.5% return, and DC Water would abandon green infrastructure for traditional tunnels or "gray" infrastructure.

"This environmental impact bond represents the first time that DC Water has explicitly tied financial payments to environmental outcomes, in this case reducing stormwater runoff, which causes the CSOs that pollute the District's waterways," said DC Water chief financial officer Mark Kim.

Kim said the EIB is on DC Water's subordinate lien, on par with the majority of its debt. DC Water is a regional water authority that provides services to the District of Columbia, as well as to parts of Maryland and Virginia.

“This unique bond offering is the result of DC Water’s relentless commitment to innovate and pursue every available avenue to provide the best service at the best price to our customers and to the greater community we serve,” said chief executive officer and general manager George S. Hawkins.

Kim said that a tier 2 result is thought to be most likely, and that DC Water and its nontraditional muni investors were willing to make a bet together that green infrastructure would be successful.

“We’re thrilled to partner with DC Water to help pioneer this innovative financing mechanism that will not only benefit the community environmentally, but also stimulate local job creation,” said Margaret Anadu, Goldman Sachs managing director who leads the Urban Investment Group. “This first ever environmental impact bond will finance the construction of green infrastructure and support economic development in the District.”

Beth Bafford, investments director for Bethesda, Md. based nonprofit Calvert Foundation said the foundation was excited to test how effective the green infrastructure would be and noted its potential as a national precedent for water utilities.

“This work is critical for residents in our hometown and has national implications for how to finance green infrastructure solutions to combat the effects of extreme weather on aged, vulnerable sewer systems,” Bafford said.

The White House also commented on the potential of the unique deal to create a model for other issuers. The project’s development was aided by a federal Social Innovation Fund Pay For Success Grant.

“In launching a project that is the first of its kind in the nation, DC Water has opened the door for others to follow their example,” said Dave Wilkinson, director of the White House Office of Social Innovation.

Public Financial Management is financial advisor for the deal, with Squire Patton Boggs as bond counsel and the Harvard Kennedy School Government Performance Lab providing technical advice. Quantified Ventures was the Pay for Success transaction coordinator, and Orrick, Herrington & Sutcliffe is investors’ counsel.

The Bond Buyer

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