Frequently Asked Questions

What are the main benefits of using an EIB?

Environmental Impact Bonds (EIBs) are a tool for helping cities finance innovative programs and projects where traditional sources of financing may be harder to access. Benefits of EIBs include the ability to:

- **Pilot new projects** (such as green infrastructure, which may be perceived as risky)
- **Transfer risk** if the projects are not successful (investors agree to take a lower return based on outcome of the project)
- **Engage new payors** (the co-benefits of projects like green infrastructure—job creation and improved neighborhoods—could mean other municipal or philanthropic budgets may be leveraged to pay for part of the project based on the achievement of these outcomes, such as by helping to cover “success” payments to investors)
- **Measure outcomes and efficacy** (given its roots in “pay for success” models, EIBs always have a measurement component for evaluation)

Are EIBs always applicable? What are some additional considerations?

We don’t expect EIBs to be the mechanism that finances all of a municipality’s stormwater investment requirements, but they can certainly be used to manage uncertainties while venturing into new territory. EIBs allow cities to learn from smaller investments that are made more quickly, and what is learned about the performance of these projects can then be incorporated into broader investment plans to make those plans more cost-effective.

There are additional transaction costs for EIBs vs. traditional municipal financing, including transaction structuring and monitoring and evaluation by a third party. The work of Quantified Ventures and CBF is provided pro bono for this particular opportunity.

We think the costs of an EIB are outweighed by what municipalities learn during the process. We are looking at the long game and believe this new type of financing is a viable source of funding for future projects. There are likely higher costs for the first EIB issuance in a local jurisdiction related to setting up relevant legal documentation which would be lower in the future once a legal template was in place from the first transaction.

Why should a municipality spend time negotiating this new financial arrangement if the interest rate of an EIB is similar to municipal bonds?

EIBs make sense when other funding is hard to find or where there are other local investment priorities above the environmental project or program in question. We don’t want cities to do something more expensive or complicated if there are better alternatives. EIBs make sense for projects that are:
- Viewed as new or risky
- Not prioritized compared to other infrastructure efforts
- In danger of being delayed in the absence of funding

For localities that don’t have a good credit rating or for whom borrowing is difficult, it is possible (though not guaranteed) that EIBs may provide a chance to bring in a new type of impact investor, who in some cases may be willing to provide concessionary (lower interest rate) capital because they’re interested in the outcome.

Finally, it should be noted that EIBs can be issued as true municipal bonds, or they can be issued as performance-based loans or contracts—meaning there is flexibility to adapt the mechanism to best suit municipalities and their unique needs.

We have fixed obligations for nutrient and sediment reductions. Can you provide more details on additional potential metrics for measuring performance?

We believe there are additional social and economic outcomes that could be used for performance measurement. Determining the right outcome metrics that make sense for a given municipality is a key component of the work we would do with localities in this project.

Quantified Ventures is currently working with cities to explore how green infrastructure and related resilience projects can have co-benefits such as health outcomes, real estate tax revenue increases, economic improvement, and job creation. There is a possibility for some of the repayment of the EIB to come from other city departments’ budgets because of these co-benefits.

The EIB model provides a platform to explore this kind of collaboration and alignment. It is also a chance to test how well new interventions work as related to other best management practices.

I don’t fully understand the performance incentive. Why should a municipality pay a higher interest rate for overperformance?

If these projects significantly overperform and trigger a performance payment from the local jurisdiction to the investors, the localities would be avoiding additional spending on less effective projects. They would have learned that in fact the interventions they were pursuing, such as green infrastructure, were more effective at achieving desired outcomes than previously thought, so less of these investments would be required over time. This is particularly compelling for municipalities where there is a regulatory requirement to achieve a certain level of stormwater retention or management.
The amount of risk that cities can transfer to investors is determined in term sheet negotiations. In the case of DC Water, there is a 2.5% chance that DC Water will have to make an over-performance payment to investors, and a 2.5% chance that their interest payments would be recouped if the project underperforms. Effectively, the EIB protects budget and taxpayer dollars by saving money on more expensive alternatives (overpayment) and reserving funds to try something else if the project doesn’t perform as expected. *Each transaction and its terms are tailored to the particular local context.*

In some cases, philanthropic funds can also be brought in to “backstop” or support a performance payment, if projects outperform or underperform, thereby reducing risks and overall costs of the transaction to both the locality and the investors.

An EIB can be structured as a bond or loan. When should a municipality choose one option over the other?

We work with municipalities to see which is best based on their particular financial context. A good credit rating and excess borrowing capacity might indicate that a locality would prefer to do a bond issuance. This approach may help the municipalities access larger amounts of capital from a wider array of institutional investors.

On the other hand, structuring an EIB as a loan might make more sense for cities where their credit rating results in an interest rate on bonds that is too high to be compelling, where local investors or philanthropies want to support the program through a direct loan approach, or where it is determined that issuance costs would be too high. In the majority of Pay for Success transactions or “Social Impact Bonds” that have occurred in the United States, the transactions are actually a multi-party loan contract and not a bond.

How do I know if an EIB makes sense for my municipality?

This is a new and emerging field, and some criteria for when an EIB makes sense are outlined below. The Chesapeake Bay Foundation and Quantified Ventures are also happy to serve as a resource at any point for municipalities with additional questions or concerns.

Checklist for when an EIB may be appropriate:

- Is there a **new environmental intervention** perceived as risky that needs to be **piloted**? OR Is there a proven intervention that needs to be **scaled**?
- Do stakeholders have **aligned interests but need incentive** to work together?
- Is an **EIB the easiest, cheapest way to** finance this project?
- Is there a **revenue stream or allocated budget** for repayment?
• Is the transaction large enough to warrant an EIB (~$2-3M+, $5M if bond issuance)?
• Are at least some stakeholders driven by regulatory requirements related to the environmental issue at hand?
• Is there a champion willing to help coordinate the process?
• Does the jurisdiction want to foster innovation?

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<tr>
<th>Benefits of EIBs</th>
<th>Challenges of EIBs</th>
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<td>• Provide access to capital for projects that would otherwise be difficult to finance</td>
<td>• Require a transaction of sufficient size to warrant incurring additional transaction costs beyond a traditional bond issuance (e.g., transaction coordinator, measurement &amp; evaluation)</td>
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<td>• Get projects financed more quickly if they are not a priority by tapping new investors - “jumpstart” investment agenda</td>
<td>• Require stakeholder engagement &amp; education to create systems for deploying Environmental Impact Bond</td>
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<td>• Enable piloting new projects that may be viewed as risky</td>
<td>• Require identifying a measurable outcome that stakeholders value, and assigning a financial value to that outcome</td>
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<td>• Transfer risk if the projects are not successful</td>
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<td>• Engage new payors who benefit from a project’s outcomes</td>
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<td>• Allow a municipality to measure outcomes and efficacy of projects to inform future investment decisions, generating the potential for avoided costs</td>
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