Capitalized Pool Financings: Accelerating Investment and Lowering Cost of Finance

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Accelerating Investment in Schools

• Jacobs study recommends an investment of $3bn for the State’s schools
  • $700m necessary to address health and safety issues – warm, safe and dry
  • Study recommends prioritization process to address greatest need
  • Further recommendation to consider public/private partnerships
  • Different cities and towns have different issues and priorities

• Maximizing investment in short term can alleviate significant problems and lower cost

• Limited capital available (e.g., State, local capital funds, other sources)

• Capitalized pool financings can be a tool to accelerate investment and lower financing costs
Rhode Island Infrastructure Bank

- Rhode Island Infrastructure Bank (RIIB) is a quasi-state agency that manages investments in local infrastructure.

- We mobilize private sector funds combined with institutional capital to provide lower than market finance.
RIIB Business Model

• RIIB’s business model is to combine a number of smaller infrastructure loans into a “pool” and finance the larger pool

• This pool is financed with a combination of limited capital and proceeds from a public market bond sale
  • Capitalized pool financing or leveraged pool financing
  • This “leveraged” financing model enables RIIB to finance more projects today than would be possible with the limited capital alone

• Pooling smaller sized loans within a capitalized model has the following benefits:
  • Lower cost of issuance to borrowers by spreading fixed costs over larger transaction
  • Lower interest cost to borrowers – combination of capital and credit diversification of pool provides higher credit rating of bond transaction than that of individual borrowers which lowers cost
  • Risk transfer – risk of non-performance of loans in pool borne by bond investors; RIIB’s exposure limited to capital
  • Capital is recycled and supports new loans as older loans are paid back

• RIIB’s investments are prioritized based on a project priority list developed transparently by State department partners
Revolving Loan Fund Model

Equity Capital → Issue Bonds → Revolving Loan Fund → Bond Holders

Bond Holders: Issue Bonds, Bond Proceeds, Bond Repayments

Loan Repayments → Disbursements → Pool of Borrowers

Pool of Borrowers → Invoice Payments → Construction
Capitalized Pool Financing Example

- RIIB 2016 Clean Water State Revolving Fund pooled transaction

- $40.8mm of projects financed in 3 cities
  - Newport ("AA" rated) = $33.4mm
  - North Kingstown ("AA" rated) = $3.6mm
  - Warwick ("A" rated) = $3.7mm

- Projects financed by:
  - "AAA" rated bonds issued by RIIB to private sector investors = $30.8
  - RIIB “capital” contribution = $10mm
  - One loan reduced by $890,000 due to principal forgiveness aspects of program which incentivized certain project investments

- Interest rate paid was 33% lower than market
  - Blended average market cost of funds for 3 borrowers = 3.36%
  - Blended average loan rate = 2.12%
  - Results in interest savings in excess of $500,000 in first year
Warwick Wastewater Example - $3.7 Million

• Warwick’s cost of issuance was 50% lower in a $41 million pooled transaction compared to a $3.7 million single issue transaction
  • $45,000 in the pooled transaction compared to $90,000 through a single issue transaction

• Cost of Issuance includes the following costs:
  • Underwriters’ fees and underwriters’ counsel
  • Rating agency fees
  • Printing costs of Preliminary Official Statement and Official Statement
  • Paying agent
  • Bond Counsel
  • Financial Advisor
  • Trustee fees and trustee counsel fees
  • Other miscellaneous expenses

• Warwick saved $500,000 on interest costs through this pooled transaction versus a market transaction
  • Pooled interest rate of 2.285% compared to Warwick’s market rate of 3.526%
Pooled Loan Models

• Conduit

• Leveraging Model
  • Reserve Fund Model
  • Cash Flow Model
Conduit Issue

• Loans with similar characteristics (e.g., credit rating) pooled

• 100% of loans in pool financed with bonds issued by conduit issuer

• Interest rate on loans equals interest rate on bonds
  • Costs reduced by spreading fixed costs over larger transaction

• In the event of default on one or more loans, bond investor loses money, not conduit issuer
Leveraging Models

• Revolving loan fund structure

• Capital is contributed to the transaction

• Effective tool when demand exceeds available funds

• Benefits of leveraging model
  • Lower cost of issuance to borrowers by spreading fixed costs over larger transaction
  • Lower interest cost to borrowers – combination of capital and credit diversification of pool provides higher credit rating of bond transaction than that of individual borrowers which lowers cost
  • Risk transfer – risk of non-performance of loans in pool borne by both bond investors and issuer’s
    • Issuer’s exposure limited to contributed capital
  • Capital is recycled and supports new loans as older loans are paid back
Reserve Fund Model

- Capital invested in a long term, highly-rated investment
- Bond proceeds and remaining capital invested into loans
- Interest on reserve fund used to support debt service payments to bond holders
Cash Flow Model

• Both capital and bond proceeds invested directly in loans

• Larger loan portfolio greater than bond proceeds

• Interest rate to borrowers less than rate on bonds
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