Water Investment Program

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Contents

NORTH AMERICAN DEVELOPMENT BANK
WATER INVESTMENT PROGRAM (WIP) PROPOSAL

1 Introduction

To guide NADBank's focus on fulfillment of its mission, the Board of Directors approved the NADBank Strategic Plan for 2024–2028 (SP 24/28) that will foster the sustainable development of environmental infrastructure and bolster resilient communities in the border region. SP 24/28 addresses the need to develop infrastructure with a comprehensive approach that considers well-managed and sustainable water resources, air quality and the clean energy needed for economic development and a greener economy.

The strategic plan defines critical objectives that NADBank must advance to make sure that infrastructure investment supports the binational agenda for sustainable development in the border region. Among these actions, NADBank has set an ambitious goal to grow its development assets portfolio to US$1.5 billion by 2028, with estimated annual disbursements of US$250 million allocated to an approval pipeline of some 15 or more infrastructure loan projects. Additionally, 15 or more grant projects are expected to be approved annually. Therefore, to accomplish this target, NADBank's internal staffing and procedures must be more efficient and the process for project approval must be ever more agile and responsive.

As referenced in the SP 24/28, a key strategy to accomplish these goals and mitigate challenges for reaching key targets involves considering innovative financing options, as well as additional programmatic approaches to project approval, and ensuring compliance with project approval timelines. NADBank believes these measures can be most effectively applied to water sector investments, which remain its top priority and where it has achieved a strong track record in terms of project certification and financing approval. To date, NADBank has supported the successful implementation of 204 water projects, which cumulatively represents an investment of $1.4 billion dollars, benefiting more than 13 million people in the region.

To support the commitment to maintain at least 30% of the development asset portfolio in the water sector, along with a robust grant pipeline for projects in this sector, NADBank is proposing to create a Water Investment Program (WIP), which would cover projects to be financed with NADBank loans and/or grants through the Border Environment Infrastructure Fund (BEIF) and Community Assistance Program (CAP). Accordingly, NADBank is requesting Board certification on a programmatic basis for projects meeting the eligibility requirements of the WIP, and Board approval of a financing commitment of up to $175 million for the WIP. The financing commitment will apply exclusively to project funding from the CAP and through NADBank loans. BEIF funding for projects certified pursuant to the WIP shall continue to be approved by the applicable regional office of U.S. Environmental Protection Agency (EPA) in coordination with the Mexican National Water Commission (CONAGUA), as appropriate, and an EPA deal sheet will be required to authorize the allocation of BEIF.

Pursuant to this programmatic certification and financing approval, NADBank Management would be authorized to ratify qualified projects with a defined scope and financial structure,

subject to the procedures, guidelines and limitations established under the WIP and subject to compliance with the policies and procedures of the funding source in question. The proposed program will operate as a pilot initiative maturing on December 31, 2026, a period of approximately two years. Upon completion of this initial phase and in consideration of program results, NADBank Management may request that the program sunset, be renewed for another set period of time or be made permanent.

2 Justification for Programmatic Certification

NADBank's proposal for a programmatic certification of projects and approval of a financing commitment under the WIP will streamline the approval process for eligible water projects, while maintaining the same level of due diligence historically provided to these critical infrastructure investments. To meet the objectives under SP 24/28 over the next five years, the value of the development asset portfolio in the water sector must grow 2.2 times to keep up with overall asset portfolio growth. Loan disbursements for water projects must reach an estimated pace of US$70 million per year, which will require five to seven project approvals per year in the water sector. NADBank expects this proposal would apply to most of those projects and facilitate a more efficient timeframe to access necessary investment funds.

Likewise, NADBank has a commitment to meet important disbursement goals established for BEIF by EPA of about two times the annual congressional appropriation to the program. Given a steady rate of funding and a typical two-year development period, the total value of project approvals per year needs to equal or exceed the current year's appropriation. Considering program awards for the last three years have been around US$30 million per year and BEIF project commitments have averaged about US$15 million per year, annual grant approvals from BEIF need to increase to at least two times the current amounts offered for project construction. NADBank expects the proposal to support this goal by increasing the number of projects certified per year.

The NADBank due-diligence process provides a thorough review of the technical, environmental, legal, regulatory and financial aspects of a project, and its project management staff has substantial experience and technical expertise to support the comprehensive review of water sector projects. Their evaluation focuses on regulatory compliance, financial and technical feasibility for implementation, and achievement of environmental objectives. Additionally, coordination efforts with EPA, the Mexican Ministry of Environment and Natural Resources (SEMARNAT), CONAGUA and state water agencies strengthen the due-diligence process and typically result in official documentation to demonstrate compliance with applicable regulations and design standards.

For BEIF projects, there is already a high level of involvement and review from NADBank and EPA, along with CONAGUA, as applicable, to complete the due diligence process prior to certification. In particular, water investments funded with BEIF, including those with a combination of BEIF and loans, are subject to concurrence by EPA and, for projects in Mexico, by CONAGUA, prior to approval. Likewise, NADBank coordinates with relevant authorities for design or implementation phase approvals required for CAP projects, especially those with complementary funding from other sources.

The WIP defines eligible project types and sets limits to any loan financing amount to reduce risk factors related to project complexity and investment size. Eligible project types are aligned with water infrastructure for which NADBank possesses extensive knowledge and capacities, including drinking water treatment, storage, distribution and metering; wastewater collection, conveyance and treatment; stormwater management and ancillary works to support the implementation and/or operation of water infrastructure. Most of the eligible project types are also compatible with grant programs offered by NADBank.

BEIF-funded projects, for example, address water infrastructure needs selected through a prioritization process, and technical assistance is provided to complete development tasks, such as environmental clearance and design, assuring compliance with applicable laws and aligning the appropriate technologies to the institutional capacity of the project sponsor and community need. CAP projects are relatively simple and have generally included small first-time service extensions, household connections, water storage, system performance improvements (such as metering and looping), equipment acquisition and small stormwater management investments. Therefore, eligible project types supported under the programmatic certification are consistent with the project pipeline for both programs.

With respect to investment size, BEIF grants have been awarded, on average, for less than US$6 million per project, with an average total project cost of about US$16 million. For CAP projects, which are simple from a technical standpoint, the total investment has never exceeded US$3.5 million, and NADBank's participation is limited to US$750,000 per project. The level of sophistication for these transactions has proven to be manageable with minimal social or environmental risks.

Regarding the loan program, **financing has also typically been approved for traditional water infrastructure investments, which rarely have significant technical or environmental complexities.** In particular, 43 of the 50 loans approved by NADBank for water projects have been for less than US$15 million, and the proceeds are typically used to extend water or wastewater services and rehabilitate water distribution systems, wastewater collection systems and wastewater treatment plants. The vast majority of those projects have included works at existing sites and within available rights of way, minimizing the number of permits and clearance studies required to advance to implementation.

Larger, more complex projects would not fall within the parameters of the proposed WIP and, therefore, would require consideration by the Board.

The proposed WIP will allow NADBank to streamline its participation, expand its reach and be more efficient in providing support for water sector projects that comply with the WIP eligibility criteria. At the same time, the improved process will create space to focus NADBank staff and the Board on more complex projects and innovative structures to meet needs that no other agency or market has the bandwidth to support.

3 Water Infrastructure Pipeline Expectations

The SP 24/28 requires a significant volume of transactions per year in the water sector to achieve the strategic objective of at least 30% of the development asset portfolio in the water sector. Currently, NADBank is working to achieve this ambitious target by developing opportunities for water and wastewater projects that represent an estimated US$235 million in loans. There are also about 30 projects in development for BEIF grants, with a total grant need of approximately US$130 million. For the CAP program there are more than 20 new applications representing a total investment of about US$20 million. New water infrastructure needs within the region are continuously identified, keeping the NADBank pipeline for the sector robust and dynamic. A programmatic approval process will allow NADBank to be agile in evaluating those requests and to respond quickly to financing demands.

Water sector investments will continue to support expanding service coverage, rehabilitating aging infrastructure and improving the quality of service (e.g., reliability and water quality). Furthermore, investments are needed to move beyond the provision of basic infrastructure and support border communities in strengthening and diversifying their water supply sources, particularly considering the effects of climate change.

As NADBank strives to achieve in all its projects, WIP contemplates incorporating tactics to improve the operation and maintenance (O&M) practices and overall operational performance of water utilities through its financing products and other technical assistance tools. Funding agreements include covenants, such as:

- Sponsor participation in the NADBank Utility Management Institute for free training related to water utility operations;
- Establishing reserve accounts O&M, typically equal to 45-60 days of the annual O&M budget, and for repair and replacement (R&R) primarily focused on cash required to address the failure of key operational equipment (i.e., pumps), or line breaks;
- Submittal of annual financial and operational reports, and
- Where applicable, improving practices related to collection efficiencies and/or implementing operational policies such as industrial pretreatment programs or mandatory connection ordinances.

Such measures seek to complement local regulatory enforcement by creating structures, incentives, and capacity that facilitate local water authorities to invest in O&M.

As previously noted, some water projects will require the full Board review and approval process. For example, NADBank continues to work with state governments to structure sustainable bond schemes to meet their environmental infrastructure investment needs. NADBank is also evaluating projects that propose reuse of treated wastewater for potable water or in industrial parks and factories. Additionally, NADBank has increased efforts to identify needs in the agriculture sector, as well as opportunities for improved biosolid management at wastewater treatment facilities. All of these projects are expected to require a more intensive use of time and human resources to conduct an adequate due diligence process and develop financial structures with a secure source of payment. The Board's input on these projects will add value.

The WIP and resulting programmatic certification will free up resources to address those more complex water sector needs and other project types critical to the environment and public health in the region.

4 Additionality

NADBank Management and Staff believe there are meaningful water infrastructure projects requiring responsive access to financing. Population growth, limited water sources and regulatory changes are putting increased pressure on the sector. Climate change and the lack of adequate planning have exacerbated the situation. Additionally, the constant corrective actions required to keep services running have resulted in deferred attention to operational performance improvements, facility upgrades, diversification of water supply and long-term planning, and implementation of sufficient user rates and commercial efficiencies. Because of these factors, utilities have limited time, attention, and resources to navigate financing options. The WIP proposal will allow NADBank to respond expeditiously and with a clear financing structure to address the utilities' needs.

NADBank plays a key role, not only with the financing of projects but also with expert technical support to utilities during project development and implementation, including planning and design, environmental clearance, procurement oversight, and supervision during construction. In addition to NADBank's traditional reserve requirements for operation and maintenance, as well as repair and replacement, grant resources and favorable lending terms can help to leverage the implementation of other best management practices and training resources. By introducing operational performance assessments at the beginning of project development, requiring operational performance reporting, and building utility staff capacity through the Utility Management Institute, NADBank supports greater sustainability in border region water providers. Finally, creating innovative financial structures will support improved affordability and long-term monitoring opportunities.

5 Program Procedures and Guidelines

Eligibility Criteria

In order to be eligible for consideration under the WIP, a project must meet the following criteria:

A. ***Project Location***

Within the U.S.-Mexico border region, defined as the area within 100 kilometers north and 300 kilometers south of the international boundary between the United States and Mexico (the "border region").

B. ***Project Types***

Water infrastructure projects that have a direct environmental or health benefit including:

Category	Infrastructure Types (indicative list)
Water resources management	Rehabilitation and construction of new facilities to diversify water sources, increase climate resilience, or make more efficient use of water supplies for both municipal and agricultural purposes, such as water conservation, treated wastewater reuse and development of alternative water sources.
Drinking water treatment and distribution	Rehabilitation and construction of new drinking water treatment, transmission, storage, distribution, and metering infrastructure.
Wastewater collection and treatment	Rehabilitation and construction of wastewater collection, conveyance, treatment and sludge management facilities installation of new sanitary sewer connections, on-site systems.
Stormwater management	Piped systems, retention basins, culverts, canals, berms, erosion control, flow velocity control, green infrastructure.
Ancillary works to above sectors	Operational equipment (e.g., backup pumps and generators, sediment removal equipment, etc.), alternative energy source, projects to increase operational efficiency (energy efficiency, telemetry and technology to improve commercial systems), climate change resiliency, system/source security.

These projects may include the construction of new infrastructure and equipment acquisitions, as well as investments for rehabilitation or to improve operations. Details of eligible water investment infrastructure and environmental benefit indicators are provided in Annex 1.

C. ***Environmental and Financial Risk Limits***

Using established NADBank risk analysis tools, eligible projects for programmatic certification must meet the following requirements:

- *Financial Risk Assessment*:
  Sponsors and/or borrowers must possess the requisite capacity and expertise to implement and operate the project and ensure the attainment of its objectives. In the case of loans, NADBank will not lend to projects rated B- or lower under its internal credit risk models, which is based on Standard & Poor's scorecard methodology and uses its nomenclature: 22 categories ranging from AAA to D.

- *Environmental and Social Risk Management System (ESRMS)*:
  Project must fall within category B or C (medium to low risk): Transactions typically involve projects with few or no adverse environmental and social impacts. Categorization is based on project type, project cost, site condition and location, and document/permit requirements.

- *Environmental, Social and Governance (ESG) Risk Score*:
  Project must fall within categories 1 through 3 (Very low to medium risk): Projects are rated on a 1 to 5 numeric scale, with 1 indicating very low ESG risk and 5 indicating very high ESG risk. Scores between 1 and 3 suggest effective mitigation mechanisms are in place to minimize ESG impact.

D. *Certification Criteria*

For approval, the project sponsor must be able to demonstrate that the project complies with NADBank's Certification Criteria and/or has the ability to comply with the criteria, including compliance with all applicable permitting and environmental clearance regulations.

Projects not eligible under WIP because they do not meet all program guidelines and criteria contained herein, must be submitted to the Board of Directors for consideration of certification and financing approval.

Uses of Funds

Funds may be used for project construction and related costs, including design, project management and supervision, as well as other project components, such as equipment or materials acquisition and/or installation. Loan funds may be used for the start-up of operations, process testing and to establish reserve accounts.

Financing Options

Subject to the rules established for each funding program, the financial structure proposed for a project eligible under the WIP may involve a traditional loan, grant, blended financing product or a combination thereof. The appropriate option will be determined based on the characteristics of the project sponsor and benefited population, as described below.

Funding Type	Applicable Characteristics
NADBank Loan	For public and private entities, including public-private partnerships, to support the implementation of water infrastructure projects. Financing may be provided as a direct loan or through participation in municipal bond issuances and will follow all applicable regulations such as Mexico's Financial Discipline Law for States and Municipalities. Other financing instruments, such as quasi-equity or subordinated loans, are not available for the purposes of the WIP.
CAP grant	For disadvantaged or underserved communities, with strong financial need, limited debt capacity, and no/low credit rating. Any project receiving a BEIF grant is not eligible for a CAP grant.
BEIF grant	For communities with a strong financial need and selected through the applicable prioritization process based on existing conditions impacting environment and human health. Project selection is authorized by EPA Regional Offices and CONAGUA, as appropriate, and BEIF grants are approved by EPA through a formal deal sheet process that is based on recommendations by NADBank considering an affordability and debt capacity analysis.

Funding Type	Applicable Characteristics
Blended financing	Financial need and limited credit capacity; subsidy required to achieve affordable rate and repayment structure for a high impact project; operational performance standards may be applied.

An affordable financial structure for a project may require one or more of these financing options, along with funding participation from external programs. Additionally, new financial products may be introduced over time and included for approval under the WIP given similar eligibility requirements can be met.

Program Procedures

With the approval of this program, the Board will programmatically certify projects meeting the eligibility requirements of the WIP and will approve financing for such projects that will be funded through the CAP or a NADBank loan. NADBank will then be authorized to award financing based on its internal due-diligence and approval process, and upon ratification of the Managing Director and Chief Environmental Officer. In the case of BEIF resources, EPA will continue to authorize the use of funds through the project deal sheet approval process, and such funds will not be included as part of the financing approved by the Board under the WIP.

Each financing request would be subject to NADBank's due diligence and internal approval processes as follows:

1) *Cumulative Approvals*. WIP will not exceed a cumulative approval amount of US$175 million applied exclusively to project funding from the CAP and through NADBank loans.

2) *Loan Limitation Compliance*. All loan financing proposals must comply with the following limits:

    i. The tenor will not exceed 30 years, providing an opportunity to monitor operational performance for the expected useful life of the financed infrastructure.

    ii. The principal amount per project will not exceed US$15 million.

    iii. Borrowers will have access to loan proceeds during a maximum disbursement period of three (3) years from financial closing.

3) *Grant Program Compliance*. All grant financing proposals must comply with the program requirements as determined by the NADBank Board for CAP and by EPA for BEIF.

4) *Board Ex-ante notification*. Management shall give notice to the Board as soon as the initial evaluation by NADBank indicates that a potential project appears to be capable of meeting WIP eligibility criteria, subject to completion of the due-diligence process.

If no comments are received from the Board within a 15 days after notification, the project will proceed through NADBank's standard due-diligence process. If comments are received and depending on their nature, the project may proceed through the due-diligence process and be: (i) considered for ratification under the WIP (see 6 below) subject to addressing received comments; (ii) individually considered by the Board through the Bank's standard certification and financing approval process; or (iii) eliminated from the Bank's pipeline.

5) *NADBank Due-diligence Process*. Based on its established standards and practices to ensure projects are eligible for NADBank financing and comply, or able to comply, with the certification criteria and NADBank loan policies**,** the Bank will review each financing request taking into consideration:

    i. a technical and environmental review of the project, including the population that will benefit, the use of appropriate technologies and the operational performance and O&M practices of the utility;

    ii. verification that all required permits and environmental clearance (including those related to the U.S. National Environmental Policy Act (NEPA) in the case of BEIF) will be obtained prior to disbursement.

    iii. a comprehensive assessment of the sponsor and borrower, including ESG risk and their capacity to execute the project and contract and repay a loan, as applicable;

    iv. a legal review of the sponsor, borrower and guarantor, as applicable, legal authorizations, and the financing package; and

    v. a financial and tax advisory review, including the business or operating plan and financial and tax model assumptions.

6) *Project Ratification*. The Managing Director and Chief Environmental Officer must ratify each project financing approval upon successful completion of the due-diligence process, confirming the proposed transaction's compliance with all elements of the applicable program guidelines.

7) *Financing Execution*. After project approval, the Bank can proceed to close financing with the project sponsor under the approved terms and conditions, which shall include compliance with all related program requirements and operational performance expectations as an obligation under the loan and/or grant agreement(s).

8) *Report to Board*. Management will report to the Board any project ratified, including a description of the project, compliance with all necessary permits and environmental authorizations prior to disbursement, expected environmental and social benefits, any unique requirements included in the funding agreements for operational strengthening and general terms of the financing within 15 business days of such ratification.

6 Program Evaluation and Reporting

To identify and report the environmental benefits expected from each project, a tailored results matrix will be developed based on the pertinent indicators presented in Appendix 1.

The project sponsor will commit to providing information on the use of the grant and/or loan proceeds in order to identify the environmental benefits. NADBank and the project sponsor will agree on the terms of such reporting based on the type of project, the disbursement period, and the end of the financing implementation period. A closeout report summarizing the results will be produced at the end of the implementation period.

NADBank Management will provide a general assessment of the program and its estimated environmental benefits as part of the NADBank quarterly status report.

Annex 1:
Types of Eligible Investments and Indicators

Category	Infrastructure Types	Indicators (not exhaustive)
Water resources management	Rehabilitation and construction of new facilities to diversify, increase climate resilience, or make more efficient use of municipal and agricultural water supplies, such as water conservation, treated wastewater reuse and development of alternative water sources	▪ New or improved water supply capacity (m^3/year) ▪ Water conserved (m^3/year) ▪ Water reused (m^3/year) ▪ Diversification of water resources (concentration index)
Drinking water treatment and distribution	Rehabilitation and construction of new drinking water treatment, transmission, storage, distribution, and metering infrastructure	▪ Population benefitted (quantity) ▪ New connections (quantity) ▪ Volume of treated drinking water (lps, m^3/year) ▪ New or improved water distribution infrastructure (pipelines [km]; pump station capacity [lps]; storage capacity [m^3]) ▪ Water losses eliminated (m^3/year) ▪ Energy efficiency (MWh/year; tons/year of emissions avoided)
Wastewater collection and treatment	Rehabilitation and construction of wastewater collection, conveyance, treatment and sludge management facilities, installation of new sanitary sewer connections, on-site systems	▪ Population benefitted (quantity) ▪ New connections (quantity)) ▪ Volume of treated wastewater (lps, m^3/year) ▪ New or improved wastewater collection infrastructure (pipelines [km]; pump station capacity [lps]) ▪ Wastewater discharges eliminated (m^3/year) ▪ Volume of sludge treated (ton/year) ▪ Energy efficiency (MWh/year; tons/year of emissions avoided)

Category	Infrastructure Types	Indicators (not exhaustive)
Stormwater management	Piped systems, retention basins, culverts, canals, berms, erosion control, flow velocity control, green infrastructure	▪ Houses protected from flooding (quantity) ▪ Area protected from flooding (hectares) ▪ Volume of storage capacity [m^3] ▪ Stormwater protection infrastructure (levees/canals [km], culverts [km, quantity], basins [m^3, quantity #], pump stations [m^3/day]
Ancillary works to above sectors	Operational equipment (e.g., backup pumps and generators, sediment removal equipment, etc.), alternative energy source, projects to increase operational efficiency (energy efficiency, telemetry and technology to improve commercial systems), climate change resiliency, system/source security	▪ Energy efficiency [MWh/year) ▪ Water conservation [m^3/year] ▪ Cost savings [USD/MXP]