MONTEREY REGIONAL WASTE MANAGEMENT DISTRICT

2018 REVENUE BONDS - FACT SHEET

What?

- $25M in Revenue Bonds, structured as a follow-on to the District's 2015 Revenue Bonds.
- Expected interest rate: ~3.5%; Maturity: 20 years.

Why Needed?

- Fund three years of capital expenditures required to maintain existing operations, driven by the need to maintain compliance with environmental regulatory mandates, replace existing operating equipment and invest in the upkeep of existing facilities.
- Investment breaks down as follows:
  - $13.9M - Facilities improvements; Examples: Module 6 development, compost site stormwater compliance, LFG CEC grant-related investment.
  - $9.6M - Facilities upkeep; Examples: LFG systems, storm water management, road paving, building repairs.
  - $6.5M - Equipment replacement; Examples: compactors, dozers, wheel loaders.
  - $0.6M - Capitalized equipment repair & maintenance; Example: LFG engine 93,000 hour rebuild.
- These capital needs do not include additional spending the District anticipates over the next 5-10 years to address emerging regulatory requirements and business opportunities.

Why Debt?

- The District does not generate enough cash from operations to fund both operating expenses and capital spending. Nor has the District built a capital reserve intended to fund such capital investment.
- The use of debt will position the District to meet investment demands and begin to build capital reserves, which will be important to addressing future demands facing the solid waste management industry.
- Using debt now to build reserves for future investment needs will help to minimize the impact on District ratepayers of capital spending by spreading the cost of purchase of long-term assets over the life of the bonds.

Why Now?

- Current interest rates are at historic lows. The District believes that raising funds through debt issuance now represents the most prudent course of financial governance.

Is the money needed?

- $30M in identified capital spending in 3 years dedicated to maintaining current operations. (3 years is expected spending window of bond funds.)
  - Some uncertainty around Compost site project expenditure needs ($5M)
  - What drives needs? Environmental regulatory mandates, maintenance needs in form of equipment replacement, facilities refreshing, upkeep and cost inflation.
- Additional project spending identified ($40M+;) related to other projects and new business opportunities requiring further cost/benefit analysis. Not in current Capital Outlay plan.
- Also not included: development of further organics processing capacity (SB 1393 related).

How would the funds be spent?

- Bond proceeds will be used to fund capital spending.
- Using debt to fund capital spending frees surplus cash generated from operations for other uses, including allocation to other capital needs and to a Capital Investment Reserve for future capital needs.

2018 REVENUE BONDS - FAQS

Does the District have the staff capacity to spend the money?

- Staff believes it can manage the identified projects with the assistance of outside consulting resources for engineering and project management.

Can we trust the District to spend the money wisely?

- Comparisons to similar solid waste management systems show that the District operates with both cost-efficiency and a high level of service.
  - Lowest overall solid waste system cost in region – collection costs, franchise fees and disposal rates.
  - Lowest average ratepayer service fees for franchise customers.
  - Lowest tip fees in region, while providing the broadest set of services.

What's the impact on ratepayers?

- Raising more money in bonds helps lessen pressure to increase tip fees.
- The 5-year outlook included in the current budget includes a $10M debt issuance and 3 years of 10% fee increases – 2018/19 year (done), 2020 and 2021 – followed by an annual increase at a 3% CPI. Assuming the District makes the investments outlined in the Capital Outlay Plan and all else goes as planned, that leaves the District with little available for capital reserves.
- Raising more debt to be spent on capital has the impact of freeing up cash from operations that would otherwise go directly to capital investment. This freed-up cash can be used however the Board chooses. Use of these funds can include:
  - Allocating surpluses to capital reserves,
  - Covering un-budgeted capital investments (organics management, etc.),
  - Covering operating expenses. Using the freed-up cash flow to cover operating costs would lessen the need to raise fees to cover operating expense increases.

Can the District service the debt?

- Under current assumptions, the Debt Service Coverage (DSC) ratio range for the $25M debt averages about twice the minimum of 1.25.
- Raising $25M versus a smaller amount leaves the District with greater cash reserves available to service the debt.

What are the risks?

- A downside scenario such as a recession could threaten our cash position (and our ability to service the debt) but would have less impact on our ability to meet the DSC covenant.
- Recession scenario - a 15% reduction in all tonnage beginning in 2022 with no adjustments to capital or operating costs results in positive cash balance and DSC above 1.5 (minimum of 1.25)
- Under conditions of an economic correction, the District would have all the tools available to management, including capital investment reductions, spending and staffing cuts, and fee increases, as necessary.

What alternatives to debt does the District have?

- Defer or eliminate capital spending.
- Pursue alternative funding sources such as:
  - Add a surcharge to the garbage bill to fund capital expenses.
  - Increase disposal fees.
  - Create tax levies through jurisdictions to defray unfunded operating costs.
- Analysis of current options show them to offer insufficient funding to meet near-term capital spending needs.

Why not wait to gain more certainty about the future?

- Rates are at historical lows; market experts project a 2% increase in interest rates in next 18-24 months.
- Raising $10M now and $15M in 2 years would add an estimated $3.5M in transaction costs and interest rate increases.

MONTEREY REGIONAL WASTE MANAGEMENT DISTRICT

2018 BOND ISSUANCE

SUMMARY OF FINDINGS & RECOMMENDATION

Presented to Board of Directors
September 21, 2018

2018 Bond Issuance

Background

District staff and the Board have spent the last year engaged in long-term strategic planning. Staff has conducted presentations, discussions and planning sessions with the Finance Committee and the full Board highlighting the organization's history, the state of facilities and assets, and the demands – current and future – coming from bodies regulating the solid waste industry in general and the District in particular. Staff has also provided details on expected capital investments and conducted financial modeling to project potential cash flow impacts. This work has helped to create a common understanding of the choices facing the District with respect to maintaining long term financial viability.

One conclusion from this work was that the District faces significant capital spending requirements over the next decade that exceed the District's ability to fund through cash from operations, grants or 3rd party partnerships. With the FY 2018/19 budget, the Board agreed to raise a minimum of $10 million of debt through the issuance of revenue bonds, in part to fund capital spending. The Board is now considering raising as much as $15 million more, for a total issuance of $25 million in new debt.

Executive Summary

- District staff and the Board Finance Committee recommend raising $25M in revenue bonds to fund approximately three years of capital expenditures required to maintain existing operations.
- Staff has identified over $30M in capital spending during this 3-year period, driven by the need to maintain compliance with environmental regulatory mandates, replace existing operating equipment and invest in the upkeep of existing facilities.
- These capital needs do not include additional spending the District projects over the next 5-10 years to address emerging regulatory requirements and business opportunities. During this period, the District estimates capital needs approaching $130 million, some of which can be addressed through public-private partnerships.
- The District does not generate enough cash from operations to fund both operating expenses and capital spending. Nor has the District built a capital reserve intended to fund such capital investment.
- The use of debt will position the District to build capital reserves, which will be important to addressing future demands facing the solid waste management industry. Using debt now to build reserves for future investment needs will help to minimize the impact on District ratepayers of capital spending.
- Since 2010, District staff and the board of Directors have explored a variety of strategies to enhance the District's long-term financial viability. The District has since acted on the most attractive of these, many of which have yielded significant financial benefit. Staff continues to examine options that can lessen District dependence upon debt but does not believe the available options represent alternatives to debt financing at this time as most are expensive, complicated and time consuming to execute, and lack the scale required to meet the District's capital needs.
- Current interest rates are at historic lows. Financial experts project interest rates to increase by 1.5 to 2 percentage points over the next 18-24 months. While staff intends to continue to explore all potential options to enhance District's financial health, staff believes that raising funds through debt issuance now represents the most prudent course of financial governance available to the District.

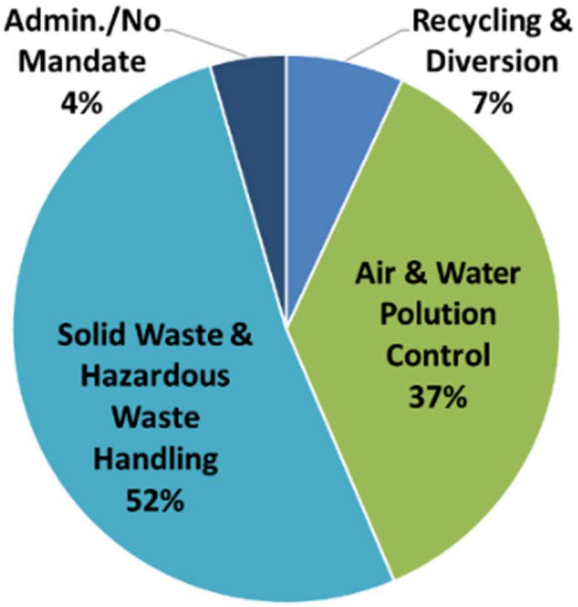
2018 Bond Issuance

Long-Term Capital Outlay Plan

In the District's FY18/19 five-year Capital Outlay Plan, staff identified $16.3 million of investment in the current fiscal year, a total of $30 million over the next 3 years and nearly $50 million over the five-year plan period. The spending is driven by the need to maintain compliance with environmental regulatory mandates, replace existing operating equipment and invest in the upkeep of existing facilities. The details of these investments are fully outlined in the FY18/19 Budget.

Most of this capital spending is planned in service to maintaining regulatory compliance in the highly regulated areas of the District's operations. These regulations govern how the District handles solid and hazardous waste, how air emissions are controlled, and how liquids and groundwater runoff are managed. The District's spending is also driven by the recycling and waste diversion regulations that the District's member agencies face. A small portion of District operations can be can be considered truly discretionary. The most obvious is the Last Chance Mercantile facility. For the purposes of this analysis, we include as discretionary some administrative costs, though an argument can be made that these costs could be allocated to regulated operations. Figure 1 below shows the breakdown of how the five-year Capital Outlay Plan relates to relevant regulatory obligations facing the District.

Figure 1



Anticipated Needs Outside the Five-Year Plan

The Capital Outlay Plan does not include investments in projects designed to expand beyond current operations. This includes development of new organics processing capacity to address SB 1383 requirements and other projects mostly targeted toward improving business operations. Costing out organics processing solutions requires significant engineering analysis, which the District will conduct this fiscal year. This project is a likely candidate for a public-private partnership due to the expected

2018 Bond Issuance

high investment cost, estimated at $30-$40 million. The other known potential projects are listed in Table 1 below. All will be subject to further engineering and business case analysis. Over the next 10 years, the District anticipates the potential need for up to $130 million in capital investment.

Table 1

NEW PROJECTS	2019	2020	2021	2022	2023	5-Yr TOTAL
LFG						
2MW POWER ADD			$0.5M	$4.0M		$4.5M
LFGTE ISLANDING/SCADA*		$0.5M	$1.5M			$2.0M
MICROGRID**		$0.5M	$2.5M	$2.5M	$2.5M	$8.0M
LFO						
DISTRICT OWNED COMPOST			$1.0M	$4.0M	$7.0M	$12.0M
NE EXTERNAL SW BASIN					$0.2M	$0.2M
MRF						
BALE STORAGE COVER		$0.7M				$0.7M
BALER ADD		$0.6M				$0.6M
C&D SORT LINE +	$0.2M	$6.0M				$6.2M
MRF 2.1 BLDG IMPROVEMTS	$0.2M	$0.5M	$2.5M			$3.2M
MRF 2.1 w/o BLDG IMPROVEM	$0.5M	$0.0M	$4.5M			$5.0M
SITE						
ENTRANCE ROAD MOD	$0.2M	$1.0M	$0.0M	$0.0M	$0.0M	$1.2M
Grand Total	**$1.1M**	**$9.8M**	**$12.5M**	**$10.5M**	**$9.7M**	**$43.6M**

*Grid isolation allows District to run even if PG&E drops power and kicks the District off-line
** Microgrid to be designed to cover MRWMD/M1W demand without need for PG&E interconnection.

Debt Financing

The District does not generate enough cash from operations to fund all operating expenses and projected capital spending for its baseline operational needs. Nor has the District built a capital reserve intended to fund such capital investment for the baseline operations that are known to be required in the near future.

The use of debt will position the District to fund near-term capital investment and begin to build capital reserves, which staff believes will accomplish fiduciary stewardship requirements and be important to addressing future demands facing the solid waste management industry. Using debt now to purchase long-term assets and build capital reserves for future investment needs will help to minimize the impact on District ratepayers of projected capital spending.

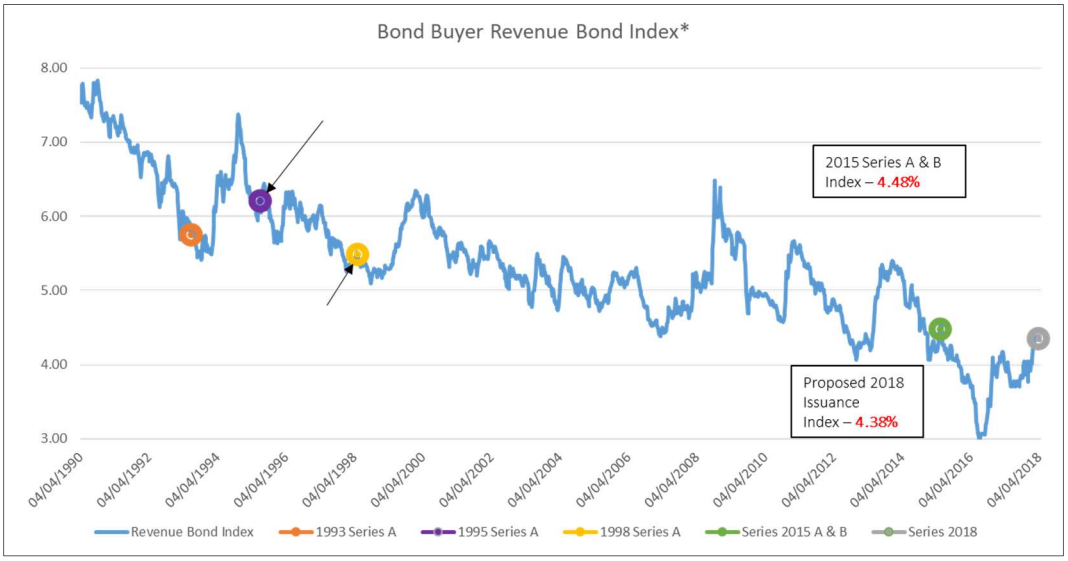
Costs and Risks of Debt

Interest Rates

Current interest rates are at historic lows. Financial experts project interest rates to increase by 1.5 to 2 percentage points over the next 18-24 months. Figure 2 below shows historical interest rate levels along with MRWMD debt issuance milestones.

2018 Bond Issuance

Figure 2*



* Graph courtesy of CFW

Debt Service and Transaction costs

A bond issuance of $25 million will add approximately $1.9 million in annual debt service to the District's existing obligations. (Debt service for the 2015 Bonds is approximately $2.3 million per year.) The estimated total interest paid over the 20-year life of the bonds will be approximately $10 million. The bonds will carry a Debt Service Coverage (DSC) covenant requiring an excess coverage ratio equal to or greater than 1.25, as measured by dividing net revenues (revenues less operating expenses) by all debt service. Current financial projections indicate the District's coverage ratio will remain approximately twice the minimum DSC requirement.

District staff has evaluated possible downside risk scenarios, such as a recession, that could threaten our cash position (and, therefore, our ability to service the debt) and our ability to meet the DSC covenant. An example is a recession scenario beginning in 2022, with a resultant 15% reduction in all tonnage. (The financial crisis beginning in 2007 resulted in a reduction in waste of approximately 10%.) Under these conditions, the District remains able to service the debt and meet the DSC covenant requirements assuming no commensurate reductions in operating costs. Of course, under conditions of an economic correction, the District would have all the tools available to management to respond, including capital investment reductions, spending and staffing cuts, and fee increases, as necessary.

Table 3 below summarizes the costs associated with debt options ranging from $10 million to $25 million in project funding.

2018 Bond Issuance

Table 3

Par Amount	Project Fund	Transaction Costs [1]	Underwriter Fee [2]	Total Cost of Issuance	% of Total COI Trans.	Max Ann. Debt Service	Total Net Interest Paid	Total Debt Service	2020 Debt Service Cov.
$10,620,000	$10,000,000	$250,000	$53,100	$303,100	2.9%	$768,344	$4,109,990	$14,729,990	3.11
$15,795,000	$15,000,000	$250,000	$78,975	$328,975	2.1%	$1,142,425	$6,110,013	$21,905,013	2.82
$20,975,000	$20,000,000	$250,000	$104,875	$354,875	1.7%	$1,516,113	$8,113,119	$29,088,119	2.58
$26,155,000	$25,000,000	$250,000	$130,775	$380,775	1.5%	$1,889,569	$10,118,312	$36,273,312	2.38

[1] Transaction Costs include: FA Fee, Rating Agency Fee, Bond Counsel, Trustee, & Contingency
[2] UW Fee: Flat Percentage based on Par Amount
[3] Debt Service Reserve Fund: Approxmiately the maximum debt service payment

Deferring Additional Debt

The District Board has discussed the advisability of raising less money now and deferring a decision on additional debt to some time in the future. The District's Financial Advisor, CFW, compared a scenario of one $25 million bond issuance in 2018 versus a $10 million issuance now and an additional $15 million in 2020. This analysis assumes interest rates will continue to climb over the next two years. The impact of a two-issue debt strategy versus a single issuance is a higher cost of debt service and added transaction costs. Overall, the approach would result in an estimated additional cost of nearly $3.5 million.

Table 4

	One Series		Two Series		
	Series 2018A	Total	Series 2018A	Series 2020B	Total
Amount:	*$25 million*	**$25 million**	*$10 million*	*$15 million*	**$25 million**
Issue Date:	*Sep 2018*	-	*Sep 2018*	*Sep 2020*	-
Term:	*20 years*	-	*20 years*	*20 years*	-
Expected Interest Rate:	*3.54%*	**3.54%**	*3.54%*	*4.79%*	**4.29%***
Cost of Issuance:	*$382,614*	**$382,614**	*$306,165*	*$336,087*	**$642,252**
Total Debt Repayment:	*$37,985,133*	**$37,985,133**	*$15,424,095*	*$25,759,498*	**$41,183,593**
	Total Cost:	**$38,367,747**		**Total Cost:**	**$41,825,845**

Cost Analysis	
Repayment Difference (Savings):	**$3,198,460**
COI Difference (Savings):	**$259,638**
Total Difference (Savings):	**$3,458,098**

**Weighted average interest rate*

* Table courtesy of CFW

2018 Bond Issuance

Use of Debt Proceeds

2018 Bond proceeds will be used to fund $25 million of the roughly $30 million of the capital expenditures planned over the next three years.

Investment breaks down as follows:

- $13.9M - Facilities improvements; Examples: Module 6 development, compost site stormwater compliance, LFG CEC grant-related investment.
- $9.6M - Facilities upkeep; Examples: LFG systems, storm water management, road paving, building repairs.
- $6.5M - Equipment replacement; Examples: compactors, dozers, wheel loaders.
- $0.6M - Capitalized equipment repair & maintenance; Example: LFG engine 93,000 hour rebuild.

Table 2 below shows the 3-year capital spending plan by MRWMD department. Allocation of bond proceeds is based upon District project priorities and optimization of bonds structure.

Table 2

DEPARTMENT	3-Yr. Capital Plan	Use of Bond Proceeds
Admin.	340	100
Last Chance Merc.	380	230
Landfill Gas Ops.	2,805	2,605
Landfill Operations	21,193	19,630
MRF	1,985	-
Scales	1,270	1,095
Maintenance Shop	1,210	110
Site	1,440	1,230
TOTAL	**30,623**	**25,000**

Alternatives to Additional Debt

In examining the considerations around raising more debt than the $10 million amount included in the FY18/19 Budget, staff explored the question of whether alternative funding strategies could adequately replace or reduce the need for additional debt.

As part of a strategic planning process conducted in 2010, the District identified 25 potential options to enhance the District's long-term financial viability. The District has since acted on 14 of these options, creating meaningful funding and improvement to the District's financial foundation. Of these 14 options, none has the potential to contribute new funds (that is, not already factored into projections) without additional, unbudgeted capital expenditures.

Staff analyzed the remaining 11 options as well as others not considered in 2010. Most of these options are conceived to provide direct cost recovery for District capital or operating expenses through mechanisms other than existing disposal fees. Some of these options are mutually-exclusive. That is, they represent different approaches to recovering the same operating costs (HHW costs, public education and outreach), though there may exist ways to further differentiate them. Analysis of those

options staff believes have the highest potential impact indicates that aggressive pursuit of the most promising of these could produce as much as $2.0 to $2.5 million in funding during the next three years.

These options, however, will be expensive, complicated and time consuming to execute. All will require broad stakeholder consultation and agreement, significant third-party consultant support, and, potentially, alignment with collection agreements and/or jurisdiction budget cycles. Some may require voter approval, a process that brings its own set of costs, communications hurdles and timelines. Staff believes that it would be difficult to implement any of these strategies in under 2 years.

While the assessed options area not good candidates for offsetting the debt required to meet District's near-term capital needs, they represent potential approaches to long-term funding diversification. Staff plans to continue exploration of these and others for future consideration.

Impact on Ratepayers

Using debt to fund capital investment allows the cost of large infrastructure expenditures to be spread over time rather than impacting just one budget year when the assets necessary to operate the District need to be repaired or replaced. Debt helps ensure equity between current and future ratepayers, allocating a cost across the useful life of a long-lived asset.

The 5-year outlook included in the current budget includes a $10M debt issuance that covers only a portion of the Capital Outlay Plan. The plan also include 3 years of 10% fee increases – 2018/19 year (completed), 2020 and 2021 – followed by annual increases at a 3% CPI. Assuming the District makes the investments outlined in the Capital Outlay Plan and all else goes as planned, that leaves the District with little available for capital reserves.

Raising more money in bonds to apply to capital spending can help lessen pressure for tip fee increases. Raising more debt has the impact of freeing up cash from operations that would otherwise go directly to capital investment. This freed-up cash can be used however the Board chooses. Use of these funds can include:

- Allocating surpluses to capital reserves,
- Covering un-budgeted capital investments of the type we have discussed (organics, etc.),
- Covering operating expenses. Using the freed-up cash flow to cover operating costs would lessen the need to raise fees to cover operating expense increases.

Conclusion

District staff is committed to pursuing all avenues of funding in the interest of building a sustainable, long-term financial plan and fulfilling its fiduciary stewardship responsibilities for the community. This includes the use of debt, when appropriate. Given the District's historically high capital requirements and historically low interest rates, staff believes this is an opportune time to utilize debt.