

MEMO



Item #: 7.b

Meeting Date: September 20, 2024

To: Finance Committee
From: Guy R. Petraborg, Director of Engineering & Compliance
Approved by: Felipe Melchor, General Manager

Subject: Approve Reserve Policy Revisions and Add Landfill Closure and Post-Closure Reserve Funds

RECOMMENDATION

That the Board of Directors approve revisions to ReGen's current Reserve Policy including, but not limited to, the addition of both Landfill Closure and Post-Closure Reserve Funds.

BACKGROUND AND DISCUSSION

Landfill Closure and Post-Closure are regulatory mandated events for every owner/operator. The Federal Register's 40 CFR Part 258 and California Code of Regulations Title 27 are the primary governing regulations for California landfills. The regulations define not only technical requirements for these two event categories but also policy and financial assurance requirements. Annually, landfill owners are required to demonstrate financial assurance for closure and post-closure. For ReGen, this consists primarily of a) an annual calculation of relative landfill capacity consumed that in turn is used to define the annual deposit of funds to the Closure Financial Assurance account and b) a Pledge of Revenues assurance certification accepted by CalRecycle as the Post-Closure Financial Assurance for the Monterey Peninsula Landfill. The current balance of the Closure Financial Assurance account as of June 2024 is about \$3,000,000 and annual deposits have been on the order of \$150,000 to \$200,000. The use of Closure Financial Assurance funds are regulatory controlled and have been limited to funding Final Closure activities (the event at the end of the landfill's service capacity when disposal operations have ceased or about to cease) and not for Partial Closure events that occur during the operating life of the landfill. The current balance of the Post-Closure Financial Assurance account as of June 2024 is \$0 (zero dollars) as the Pledge of Revenue attestation satisfies the regulatory financial assurance requirements at this time.

While these financial assurance instruments have served to meet a regulatory administrative requirement for ReGen for almost 59 years now, neither are sufficient to address the financial preparation for and completion of the actual Closure and Post-Closure events. The current Closure liability is estimated at \$60,000,000 (2024 cost basis) and the Post-Closure liability is estimated at \$17,000,000 (2024 cost basis); a combined liability of \$77 million (2024 cost basis). The financial preparation for such liabilities is best addressed by funding them over the longest period of time as possible. The longer the period of time of accruing funds for known liabilities, the smaller the annual funding contributions (and 'per customer' charge) result. Thus, for ReGen's interests, the sooner the funding of Closure and Post-Closure Reserve Funds are started, the smaller the annual contributions will be and the earlier sufficient funds will be available for completion of Partial Closure events (which creates the opportunity for those events to be scheduled at the times that are most advantageous for

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those construction activities to occur). Therefore, starting funding of Closure and Post-Closure Reserve funds at this time will allow ReGen to achieve the longest period of time that is currently available to ReGen to address these two known financial liabilities.

In general, reserves are essential to ensuring fiscal responsibility, a key organizational goal of the ReGen. The reserves can also provide the savings necessary to balance budgets during periods of fiscal constraint, allow for emergency preparedness, assist in maintaining stable solid waste service rates, provide for a well-maintained infrastructure, and demonstrate a commitment to investing in the future. Maintaining reserves can support the organization's credit rating and periodic debt borrowing capacity. The Government Finance Officers Association recommends that organizations adopt a policy governing the amount of resources to be held in reserve and the conditions under which those reserves can be used. A reserve policy is central to a strategic, long-term approach to financial management for the ReGen.

In June 2022, the Board adopted a Reserve Policy (attached) which stipulated that the ReGen maintain a minimum cash reserve (Operating Reserve of 20%) designed to serve as a rainy-day fund in the event that revenue flow or operating expenses are impacted by unexpected occurrences; and both Capital Equipment and Capital Infrastructure Reserve funds. The Landfill Closure and Post-Closure Reserve Funds were deferred at that time given the Board's desire to experience how the new reserve policy was accomplished in the annual budget and year-end financial reporting processes. Since the time that this policy was adopted, a reserve balance has been designated each year during the budget process in a routine manner without issues.

Staff supports continuation of the current cash reserve and recommends updating the policy statement as it contains descriptions of conditions that are no longer present at ReGen and lacks certain elements that could add clarity to the policy's administration. In addition, staff recommend the inclusion of both Closure and Post-Closure Reserve funds in a new Reserve Policy. A draft of the new reserve policy was presented to the Finance Committee at their September meeting. Staff received guidance from the Finance Committee to provide additional information, to elaborate on the proposed approach for funding of the new reserves, and to bring an updated version to the Board for their review and consideration of approval at their September 20, 2024 regular meeting.

During strategic planning activities conducted in recent years, staff and the Board have discussed the value of the reserve policy. The purpose of such a policy would be to designate funds on an ongoing basis that are dedicated to funding future capital investments and certain regulatory required liabilities. The main benefits of doing so are: 1) increasing the likelihood funds are available for investment or expenditure when needed, and 2) spreading the cost of replacing assets over the life of the assets as they are used or depleted; or spreading the funding of certain capital events like "closure" or financial liabilities like "post-closure" over many years and all customers using the landfill facility. Sequestering funds in this way will help ReGen pursue a 'pay-as-you-go' investment practice, thereby reducing reliance on debt or the imposition of extreme fee or rate increases during times of high capital investment demand.

PROPOSED PLAN FOR LANDFILL CLOSURE AND POST-CLOSURE RESERVE

Staff is intentionally proposing a two phased approach to building the Landfill Closure and Post-Closure Reserves. The first phase, Phase A, is proposed as ten (10) years in duration and calls for flexible annual contributions to the Closure and Post-Closure Reserves with a suggested minimum annual contribution of \$550,000 to the Closure Reserve and \$200,000 to the Post-Closure Reserve. The second phase (Year 11 and thereafter), Phase B, is proposed as the defined contribution phase with a staff recommended accrual period of no less than 50 years and no greater than 75 years. The '75 years' maximum term corresponds to the Board adopted policy of having 75 years of landfill

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disposal capacity reserved for ReGen’s Member Agencies (interpreted here as the Member Agency franchise waste collection contract materials). Refer to the tables below for details of each phase.

There are multiple reasons for this proposed two phased approach. The primary reason is for ReGen to start the annual process of building these financial reserves. While the past years represents a lost opportunity for building landfill reserve funds, it is ‘now’, today, that represents the next best available choice for ReGen to begin the annual contributions to both the Closure and Post-Closure Reserve funds. A Partial Closure construction event will likely occur in the next 25 to 35 years. Starting annual contributions to the Closure Reserve now will provide the funding for Partial Closure events in the future. There is also more information needed regarding the definition of the Partial Closure and Final Closure scopes of work, the scheduling of those events, the design of those events, and updated cost estimates associated with the Closure and Post-Closure activities. It is necessary to update the Landfill’s Master Plan. Staff anticipates that this information will be determined in the next 10 years corresponding with the first phase of the Closure and Post-Closure Reserve policy. There will also need to be a methodology established to manage the Closure Reserve contributions given the separate funding of the regulatory required Closure Financial Assurance account; so as to avoid ‘over funding’ Closure as a result of the combined account balances. That potential circumstance will not occur anytime soon and is anticipated to occur in the later years of ‘defined period’ selected before the second phase (Phase B) of the Closure Reserve policy.

PHASE A - (YEARS 0 - 10)

CATEGORY	PERIOD "n" (YEARS)	PRESENT VALUE (2024)	ASSUMED NET INTEREST RATE	CALCULATED ANNUAL CONTRIBUTION AMOUNT	SUGGESTED MINIMUM ANNUAL CONTRIBUTION AMOUNT	CURRENT FINANCIAL ASSURANCE INSTRUMENT ANNUAL FUNDING AMOUNT (Approximated)	APPROXIMATE PERCENT OF COMBINED ANNUAL CONTRIBUTIONS
Closure	60	\$60,000,000	1%	\$1,334,667	\$550,000	\$200,000	56%
Post-Closure		\$17,000,000		\$378,156	\$200,000	\$0	53%
Closure	85	\$60,000,000	1%	\$1,051,199	\$550,000	\$200,000	71%
Post-Closure		\$17,000,000		\$297,840	\$200,000	\$0	67%

PHASE B - (YEARS 11 - 60 Minimum or YEARS 11 - 85 Maximum)

CATEGORY	PERIOD "n" (YEARS)	ADJUSTED PRESENT VALUE (2034)	ASSUMED NET INTEREST RATE	CALCULATED ANNUAL CONTRIBUTION AMOUNT	DEFINED ANNUAL CONTRIBUTION AMOUNT (Less Financial Assurance Annual Amount)	CURRENT FINANCIAL ASSURANCE INSTRUMENT ANNUAL FUNDING AMOUNT (Approximated)	APPROXIMATE PERCENT OF COMBINED ANNUAL CONTRIBUTIONS
Closure	50	\$54,555,000	1%	\$1,391,847	\$1,191,847	\$200,000	100%
Post-Closure		\$15,020,000		\$383,201	\$383,201	\$0	100%
Closure	75	\$54,555,000	1%	\$1,037,423	\$837,423	\$200,000	100%
Post-Closure		\$15,020,000		\$285,622	\$285,622	\$0	100%

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The proposed revisions to ReGen's Reserve Policy (Attachment 1) include the following features for the Closure and Post-Closure Reserves:

- Flexible annual contributions Years 0 to 10 proposed by staff & approved by the Board (Phase A)
- Suggested minimum annual contribution amounts (Closure \$550,000; Post-Closure \$200,000 – Phase A)
- Funding annually within 60 days of the end of the Fiscal Year (Phases A and B)
- Defined annual contributions Years 11 to ("n" + 10) contingent on length of adopted accrual period (Phase B)

Should the Board approve the attached revised reserve policy, staff recommends that the first contributions to the Closure and Post-Closure Reserves be made for the FY2023/24 period.

FISCAL IMPACT

Updating the existing Reserve Policy results in no material change to ReGen's financial position. Establishing new Closure (~\$60 million liability {2024 dollar basis; 20% estimate adjustment}) and Post-Closure (~\$17 million {2024 dollar basis; 20% estimate adjustment}) reserves would result in a more accurate representation of the true cost of ReGen's disposal operations and be a positive approach to addressing these known liabilities. Successful implementation of these reserves could have the effect of reducing ReGen's reliance on debt or the use of unusually high fee increases during times of heavy capital spending like, for example, a Partial Closure or the Final Closure event. Note that the revisions to the reserve policy specifically for funding of the Closure (a capital infrastructure investment) and Post-Closure events may have an effect on the frequency of the routine rate setting process. This is because these two reserves would essentially represents an additional cost of operations than has historically been the case and thus, it may affect undesignated cash amounts and net positive revenue.

CONCLUSION

That the Board approve the proposed revisions to the reserve policy and addition of a Closure Reserve and Post-Closure Reserve. The new Reserve Policy is consistent with ReGen's stewardship responsibilities and ReGen's pillars of sustainability. Updating the current Reserve Policy and adopting the new Closure and Post-Closure Reserves will assist ReGen in planning and fulfilling its commitment to providing responsible, cost-effective services to the communities it serves.

Attachments:

1. Revised MRWMD Reserve Policy (September 20, 2024)

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