Ensuring affordable, long term, environmentally sound disposal of MSW

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Joint Venture of the Charter Municipalities of the Municipal Review Committee, Inc.

Management's Discussion and Analysis of Financial Statements for Calendar Year 2014

This report provides a discussion and analysis of the financial performance of the Joint Venture of the Charter Municipalities of the Municipal Review Committee, Inc. (MRC), for the calendar year that ended on December 31, 2014. Please review it in conjunction with the financial statements and associated notes for the Joint Venture that follow.

1.0 Financial Highlights

In 2014, the MRC:

- Distributed $4.097 million to Charter Municipalities, thereby achieving the target values for per-ton waste disposal costs in the first two quarters of $51 per ton for the Equity Charter Municipalities and $54 per ton for the New Charter Municipalities, and in the last two quarters of 2014 of $55 per ton for all Charter Municipalities.

- Represented the Equity Charter Municipalities regarding their ownership interest in the PERC partnership (25.5214 percent of the limited partnership shares, which constitute 90 percent of all shares).

- Maintained a balance of $22.077 million in the Tip Fee Stabilization Fund as of the end of 2014 and managed the investment of the fund balance. The MRC remains positioned to utilize the Tip Fee Stabilization Fund to stabilize tipping fees through and beyond the expiration of existing business arrangements for waste disposal in 2018.

- Maintained the balance in the MRC Operating Budget Stabilization Fund at $1.53 million by the end of 2014 and managed the investment of the fund balance. The MRC Operating Budget Stabilization Fund provides supplemental support to the MRC's budget for administration of the Joint Venture, which budget is managed separately, and serves as a source of funds to stabilize dues assessments, provide for continuation of the MRC mission after 2018, and prepare for unforeseen events.

- Held a total Net Position for the benefit of the Charter Municipalities of $34.810 million at the close of 2014.

2.0 Overview of the Financial Statements

The basic financial statements of the Joint Venture are presented herein in a format that is consistent with the requirements of the Government Accounting Standards Board. The financial statements present the following two different views of the Joint Venture:

1. The Government Funds Balance Sheet / Statement of Net Position (Balance Sheet) identifies and presents values for the key general fund assets and liabilities of the Joint Venture as of the end of the calendar year (see Table 1). The Balance Sheet also identifies and presents adjustments for long-term assets and fund balances that are not readily available for application to expenditures, and identifies and presents the Net Position held for the benefit of the Charter Municipalities after application of the adjustments.

   The key General Fund assets shown on the Balance Sheet include the following:

   - Cash and cash equivalents, which are held in a Custody Account at Bangor Savings Bank.

   - Financial investments, consisting of the Tip Fee Stabilization Fund and the MRC Operating Budget Stabilization Fund, which are invested in a set of federal agency bonds and certificates of deposit having varying maturity dates, and which are managed by an investment advisor, Peoples United Bank, in accordance with investment policies approved by the MRC Board.

   - The Equity Charter Municipality ownership share of the PERC Partnership, which is considered an illiquid asset that is not readily available to meet expenditures. This ownership share is valued on the basis of the equity investment method as of the start of 2014.

   The key General Fund liability shown on the Balance Sheet for the end of 2014 is the distributions payable to the Charter Municipalities in the first quarter of 2015. The remaining assets are the Net Position, which is comprised of the value of the investment in PERC and the values of the various funds in excess of the distributions payable.

2. The Statement of Governmental Fund Revenues, Expenditures and Changes in Fund Balances / Statement of Activities (Income Statement) identifies and presents revenues and expenditures over the course of calendar year 2014 (see Table 2). The Income Statement also identifies and presents the changes in Net Position over the course of 2014.

   The General Fund revenues shown on the Income Statement include the following:

- Performance Credits as a result of PERC operations that were distributed to the MRC on behalf of the Charter Municipalities.

- Cash distributions from the PERC Partnership as a result of PERC operations (Net Cash Flow) that were distributed to the MRC on behalf of the Equity Charter Municipalities that own limited partnership shares in the PERC partnership.

- Appreciation of investments, interest and dividend income and changes in investment fund values.

The General Fund expenditures shown on the Income Statement include the following:

- Cash distributions to the Charter Municipalities paid quarterly.

- Transfers from the Operating Budget Stabilization Fund to the MRC operating fund, which is the fund used by the MRC for its administrative expenses and for expenses associated with planning for fulfillment of the MRC mission after the existing arrangements expire in 2018. The MRC made such transfers in 2014 in the amount of $686,000.

The Income Statement includes adjustments to reconcile the excess of revenues over expenditures with the change in Net Assets by accounting for changes in the cash distributions payable each quarter; the release of reserve funds, if any; and the change in the valuation of the ownership position in PERC on an annual basis.

3.0 Analysis of Overall Financial Position and Results of Operations

The MRC manages the assets of the Charter Municipalities in order to achieve two key objectives. First, the MRC seeks to distribute sufficient cash on a quarterly basis to the Charter Municipalities in order to reduce their net cost for disposal of waste at the PERC facility to a pre-determined system-wide average per-ton net cost known as the "target value." In the first two quarters of calendar year 2014, the target values were $51 per ton for Equity Charter Municipalities and $54 per ton for New Charter Municipalities. In the last two quarters of calendar year 2014, the target value was $55 per ton for all Charter Municipalities. Second, the MRC seeks to position the Charter Municipalities to continue to achieve target values to be determined by the MRC Board of Directors through 2018 by (a) ensuring that the Facility maintains its performance in providing waste disposal services; (b) maintaining an appropriate ownership position in the PERC partnership; (c) setting aside sufficient funds in the Tip Fee Stabilization Fund, and (d) managing other Net Assets, The MRC distributed sufficient cash in each of the four quarters of 2014 to achieve the target values as shown in the following table:

Quarter	*1*	*2*	*3*	*4*
Tip fee, prior quarter	$74.75	$76.00	$77.00	$77.00
Distribution to Equity Charter Municipalities	$23.75	$25.00	$22.00	$22.00
Net disposal cost for Equity Charter Municipalities, system weighted average	$51.00	$51.00	$55.00	$55.00
Target value for Equity Charter Municipalities	$51.00	$51.00	$55.00	$55.00
Distribution to New Charter Municipalities	$20.75	$22.00	$22.00	$22.00
Net disposal cost for New Charter Municipalities	$54.00	$54.00	$55.00	$55.00
Target value for New Charter Municipalities	$54.00	$54.00	$55.00	$55.00

All values are in dollars per ton.

At the end of 2014, the balance in the Tip Fee Stabilization Fund was $22.077 million. Accounting for this balance, and accounting for anticipated Performance Credits, and PERC partnership distributions (assuming that the PERC facility will continue to perform in the future as it has in the past few years), as of the end of 2014 the MRC continued to project that the Charter Municipalities would have sufficient resources to continue to achieve the projected target values through 2018.

A key purpose of the Tip Fee Stabilization Fund is to position the Charter Municipalities to realize the benefits of continuance of the MRC mission of affordable, long-term, environmentally sound disposal of MSW beyond 2018. The MRC recognized that maintaining the existing target values unchanged would deplete the balance in the Tip Fee Stabilization Fund and could undermine the MRC's capability to achieve its mission beyond 2018.

In this context, at its October 2010 meeting, the MRC Board of Directors voted to adopt a Target Value Step Increase Implementation Plan (the "Plan") to implement an increase in target values on an annual basis through 2018. The Plan establishes increased target values for the Equity Charter Municipalities as follows:

$46 per ton as of July 1, 2011
$48 per ton as of July 1, 2012
$51 per ton as of July 1, 2013
$55 per ton as of July 1, 2014
$59 per ton as of July 1, 2015
$63 per ton as of July 1, 2016
$67 per ton as of July 1, 2017

The target value for the New Charter Municipalities was set at $54 per ton through July 1, 2014, then set at $55 per ton for the remainder of 2014. From 2015 and thereafter, the target values for the New Charter Municipalities are the same as the target values for the Equity Charter Municipalities per the scheduled set forth above.

The intent of these increases is to avoid a spike in disposal costs, to prepare the Charter Municipalities for post-2018 disposal costs; and to maintain funds in reserve for use in enhancing the negotiating position and capacity of the MRC to make available the best possible post-2018 arrangements for management of MSW by the Charter Municipalities.

4.0 Significant Transactions

The MRC managed the following transactions on a routine basis during the year:

- Receipt of Performance Credits from PERC on a monthly basis.
- Receipt of partnership distributions from PERC on a monthly basis.
- Distribution of cash to Charter Municipalities to achieve the target values on a quarterly basis.
- Transfer of funds from the Custody Account to the Tip Fee Stabilization Fund in the fourth quarter of 2014.
- Transfer of funds to the MRC Operating Account from the Custody Account in the first, third and fourth quarters of 2014.

5.0 Capital Assets and Debt Administration

The MRC had no outstanding debt in 2014.

The MRC no longer receives payments of principal and interest on the Promissory Note from Bangor Hydro as had been the case in 2008 and previous years. Bangor Hydro made the last payment of principal and interest on the Note in May 2008.

6.0 Economic Factors and Significant Foreseeable Future Conditions

The MRC notes the following significant foreseeable future conditions with the potential to affect performance in 2015 and beyond:

- Facility maintenance costs. The facility operator, acting for PERC, LP, is planning to incur major maintenance expenditures for the Facility to ensure that operations continue through and beyond 2018. Implementation of capital and maintenance investments in the Facility's major processing and production systems will continue to be an integral factor in maintaining economic performance in 2015 and thereafter. The total cost of the investments required to sustain economic performance has increased in recent years. There is no assurance that the level of future investment in capital and major maintenance projects at the Facility as required to maintain current levels of performance will not exceed projections in the coming years, or that performance will be maintained at current levels.

  As a facility with a nameplate generating capacity of more than 20 MW, the Facility is required to comply with new requirements for the reliability and security of the regional electric grid as overseen by the Northeast Power Coordinating Council (NPCC), the North American Electricity Reliability Corporation (NERC) and other related organizations of applicable jurisdiction. These requirements, which can require changes to physical plant and software as well as development and documentation of operating procedures, continue to evolve and expand. There is no assurance regarding the nature of the full set of NPCC and NERC requirements that the Facility might be required to implement, nor is there assurance regarding the cost and impact on performance of satisfying such requirements.

- Waste acquisition. In 2014, PERC received 312,315 tons of municipal solid waste (MSW). The MSW included 119,344 tons of MSW from commercial and spot market arrangements to supplement the 179,493 tons of MSW reported by PERC as delivered by Charter Municipalities and 13,478 tons of MSW delivered by other municipalities. MSW deliveries to PERC by Charter Municipalities increased by 345 tons (0.2 percent) from 2013 to 2014, and, per PERC's records, fell short by 4,759 tons of the guaranteed annual tonnage (GAT) that the Charter Municipalities, in aggregate, were obligated to deliver to PERC in 2014 to avoid shortfall penalties. Such shortfall does not account for MSW delivered to PERC that originated within the boundaries of Charter Municipalities but was credited to the accounts of commercial haulers. Whether such shortfall penalties will be assessed in 2015 for shortfalls in 2014 and prior years, and the magnitude of such penalties, had not been finalized as of this writing.

  Quantities of MSW available to the PERC facility have declined for a number of reasons, including lingering effects of the economic downturn; waste reduction or diversion through pay-as-you-throw and similar programs; and increased recycling resulting from new single-stream programs. There is no assurance that MSW from the commercial and spot market arrangements will continue to be available to PERC in the future in the same quantities as it was acquired in the past, nor is there assurance that the quantities of MSW delivered by the Charter Municipalities, which include significant amounts of MSW originating from commercial sources within their borders and delivered to the account of the municipalities, will not decline from delivery levels in prior years. Thus, there is no assurance that the Charter Municipalities will not be exposed to further delivery shortfall penalties in future years. Moreover, there is no assurance that the Charter Municipalities will not be exposed to reduced Performance Credits and distributions of cash from the PERC Partnership due to reduced economic performance at PERC as a result of declines in waste deliveries.

- <u>Competition with other disposal facilities</u>. PERC actively competes with other disposal facilities to acquire MSW as needed to allow the facility to operate at capacity. Competing disposal facilities at the start of 2015 include two other operating municipal waste combustion facilities in Maine; operating landfills that are permitted to accept MSW in Maine; and facilities that are located outside of Maine. Failure of PERC to attract sufficient MSW to allow the facility to operate at capacity, or loss of significant quantities of MSW to competing disposal facilities, could have a significant adverse impact on the economic performance of PERC in 2015 and thereafter, and could adversely affect the capability for Charter Municipalities to achieve the target values through 2018.

  The competitive market for disposal of MSW in Maine changed dramatically in 2013 due to the following events:

  1. The Maine Energy Resource Company (MERC) facility in Biddeford was shut down permanently at the end of 2012. The MERC facility had previously accepted for disposal about 120,000 tons per year of MSW generated in Maine and nearly 170,000 tons per year of MSW from other states. Such MSW must now be managed through other facilities.

  2. The Juniper Ridge Landfill in Old Town applied for and received approval from the Maine DEP to amend its operating license to allow acceptance for disposal, under a number of stated conditions, of unprocessed in-state MSW that had previously been accepted at the Maine Energy Resource Company (MERC) facility in Biddeford. The license amendment was requested by a corporate affiliate of Casella Waste Systems, Inc. (Casella), which operates the Juniper Ridge Landfill, and which owned and operated the MERC facility, through corporate affiliates.

3. In light of the above, the PERC partnership, PERC's private owners, and Casella negotiated a new contract (the Casella-PERC Contract) regarding delivery of MSW to the PERC facility from in-state sources, including MSW that had previously been delivered to the MERC facility.

   The new Casella-PERC contract would have Casella deliver up to 100,000 tons per year of MSW to the PERC facility, including up to 30,000 tons per year of MSW that had previously been delivered to the MERC facility from in-state sources. Thus, the new arrangements were intended to provide additional assurance that the PERC facility would secure sufficient MSW to operate at or near its full capacity with maximum reliance on MSW generated within Maine and with reduced reliance on MSW imported from other states. Actual deliveries from Casella's affiliated companies in 2014 were on the order of 68,000 tons and did reduce reliance on other sources of out-of-state MSW to enable the PERC Facility to operate at or capacity. Nonetheless, there is no certainty that the PERC facility will not face shortfalls in the availability of MSW as required to operate at full capacity. Such circumstances might have a significant adverse impact on the economic performance of PERC in 2015 and beyond.

- <u>Environmental regulation</u>. Many aspects of the operation of the Facility are subject to stringent regulation by the Maine Department of Environmental Protection (the Maine DEP) and by other federal, state and local agencies. Thus, there is always a risk that changes in applicable, law, regulations, or regulatory policies and enforcement practices will have an adverse impact on the Facility's performance or the economics of continuing Facility operation. The Facility works diligently to comply with all applicable environmental laws, regulations, permits and policies. In addition, the MRC works jointly with PERC on an ongoing basis to monitor potential changes in applicable laws, regulations, permits and policies in order to identify initiatives that might have an adverse impact on the Facility and to ensure that such impacts are recognized and given due consideration. Nevertheless, there is no assurance that the Facility will not be adversely affected in the future by changes in applicable law, regulation, regulatory policy or enforcement practices

  The products of combustion at the Facility that are emitted to the atmosphere include, among other things, carbon dioxide, which is considered a contributor to global warming and, pursuant to a 2009 ruling of the U.S. Environmental Protection Agency, is also considered a regulated pollutant. The contributions to global warming of the Facility's emissions of carbon dioxide are more than offset by two factors of its operation. First, the Facility combusts municipal solid waste that, had it been deposited in a landfill, might have caused emissions to the atmosphere of methane and other greenhouse gases with a greater overall contribution to global warming than what was emitted from the Facility. Second, the Facility generates electricity from the combustion of waste that displaces a like amount of electricity that might have been generated from combustion of fossil fuels at facilities with emissions that contribute proportionately more to global warming than the Facility. Nonetheless, both the U.S. Congress and the U.S. Environmental Protection Agency are considering new measures to control carbon dioxide emissions and global warming that might have an adverse impact on Facility operations. There is no assurance as to what the nature or magnitude of such impacts might be.

- Electric utility regulation. In 2014, approximately 58 percent of the revenue realized by PERC was in the form of payments for electricity purchased by Bangor Hydro pursuant to a Power Purchase Agreement (PPA) that was originally executed in 1984 and is expected to remain in effect through the first quarter of 2018. Such purchases undertaken pursuant to the PPA in 2014 were at prices generally in excess of market rates for electricity and associated products. In recognition of the PPA prices for electricity and related contract terms, in 1998 the PPA was amended to provide cost mitigation to Bangor Hydro. Such amendment was reviewed and approved by the Maine Public Utilities Commission (the Maine PUC), which has regulatory jurisdiction over Bangor Hydro and its power purchase arrangements. The Maine PUC ruled that the above-market purchases of electricity by Bangor Hydro pursuant to the PPA qualify as "stranded costs" and has set forth a procedure for recovery of such costs on an ongoing basis. Nevertheless, there is no assurance that the Facility might not be adversely affected in the future by changes in the regulatory treatment of electricity purchases pursuant to the PPA or by changes in the procedures for recovery of stranded costs.

- Emerging technologies. The MRC is aware of numerous new technologies that are being developed to process and dispose of municipal solid waste, including approaches that utilize new equipment for mixed waste processing, sorting, pelletization, gasification, pyrolysis, plasma arc destruction, anaerobic digestion, thermal de-polymerization and for other purposes. Several reference facilities utilizing these technologies are being constructed and operated in the United States on a commercial basis. Although there are no facilities applying such technologies to mixed MSW that are operating or under construction in Maine, it is possible that such facilities will be developed and emerge in the future with adverse economic consequences on the PERC Facility. The MRC continues to monitor and evaluate the emergence of such technologies from the perspective of (a) modifying the PERC facility to incorporate such technology; or (b) evaluating whether a facility incorporating such technology might be developed as a successor for managing MSW delivered to the PERC facility after the existing disposal agreements expire in 2018.

- Post-2018 planning initiative. The MRC is proceeding with development of a new facility to manage MSW originating in its member municipalities after the existing disposal agreements expire in 2018. To this end, the MRC has selected a developer of an emerging technology, Fiberight, Inc. (Fiberight), that would own and manage design, permitting, financing, construction and operation of the new facility on a site secured by the MRC. The MRC has also taken steps to secure commitments from its member municipalities to consider participation in the facility being developed.

  At this time, the MRC intends to have its member municipalities manage their MSW through delivery to the PERC Facility through and into 2018 in accordance with the existing disposal agreements. Nonetheless, the MRC recognizes that its efforts to evaluate and develop alternatives after the disposal agreements expire in 2018 might have impacts on the performance of the existing facilities and under the existing arrangements prior to their expiration in 2018. There is no assurance as to what the nature or magnitude of such impacts might be.

  There has been disagreement between the private and public sector partners in the PERC Partnership regarding the preferred course of action after 2018 and the management of funds related to the future of the PERC Facility. The partners have disagreed regarding expenditure of partnership funds on professional and legal services; on government relations and lobbying regarding legislation that might affect the competitiveness of the PERC Facility after 2018; and on related matters. As 2018 approaches, additional disagreements might occur regarding expenditures on capital projects or improvements to the PERC Facility related to life extension or continued operations after 2018. There is no assurance as to what the nature or magnitude of the impacts might be of such disagreements or expenditures on the economic performance of the PERC Facility. In this context, the MRC has filed suit in federal court against the private general partner in the PERC facility to seek recovery of certain funds that such general partner diverted from the PERC Partnership without what the MRC would consider to be proper authorization. There is no assurance as to the costs or results of such suit or how such results might affect future cash flows from the PERC Partnership or to the MRC.

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