

RNG WORKS



How to Finance an RNG Project with Debt (Tax Exempt)



WESTHOFF, CONE
& HOLMSTEDT

OVERVIEW

- ▶ Qualified Project Costs
- ▶ Debt Structure
- ▶ Essential Project Elements
- ▶ Case Studies

Qualified Project Costs

- ▶ Any Depreciable Asset used in the collection, processing, disposal or recycling of solid waste, landfill gas, anaerobic digestion, gasification, compost, and recycling to name a few.
- ▶ With few exceptions, virtually any assets used for waste collection, processing or treatment, recycling and disposal can be financed using tax-exempt bonds.
- ▶ Soft Costs - Engineering, Architectural fees, Feasibility Studies, Legal fees and Permitting.

Qualified Project Costs

- ▶ Land - Limited to 25% of Borrowed amount
- ▶ Existing Buildings - Requires minimum rehabilitation expenditures of 15% of acquisition cost; expenditures must be completed within 18 months.
- ▶ Tax-exempt bonds may be used as part of an acquisition financing - specifically to purchase the real estate assets of a company while the stock and other assets are purchased using conventional debt or equity.

Advantages

- ▶ There are two major advantages of using tax-exempt bonds.
- ▶ 1. Historic interest costs average somewhere between 1.5-3% lower than taxable debt.
- ▶ 2. By using bonds, equipment and other assets can generally be amortized over terms which more closely match their actual useful lives, thereby boosting cash flow by reducing annual principal payments.

Debt Structure

- ▶ “Art not science”
- ▶ Generally 75% debt; 25% equity plus working capital
- ▶ Non-Recourse - secured by Assets and Contracts only
- ▶ Cash Flow is primary focus
 - ▶ Contracted Feedstock
 - ▶ Contracted Revenue
- ▶ Rate Covenant: Minimum 1.25 times EBITDA coverage of annual bond debt service -
- ▶ Projections should produce up to 1.75 times coverage
- ▶ Liquidity covenant - Minimum 45 Days Cash on Hand - maintain Working Capital
- ▶ Debt term to match useful life of project - Generally 15-25 years

Debt Structure

- ▶ The process of issuing tax-exempt bonds requires the participation of a governmental entity which serves as a “conduit” issuer of the bonds.
- ▶ It may be a city, county, a port authority, or a specialized financing authority, depending on the state in which the project is located.
- ▶ We have completed financings and have ongoing professional relationships in most states which allows us to help select the optimum issuer of the bonds.
- ▶ Additionally, we work with many nationally recognized law firms (“bond counsel”) that are experienced in tax-exempt bond issues and assist with eligibility requirements in preparation for the sizing of the transaction.

Essential Project Finance Elements

- ▶ The basic components of a successful project finance are mainly contractual. That is, the project must have secure contracts for waste supply or feedstock and a secure market - preferably a contract or contracts - for the output produced.
- ▶ In addition, the project's waste processing technology should be guaranteed contractually by an engineering, procurement and construction ("EPC") contractor with the financial wherewithal to support its guarantee.
- ▶ Performance guarantees may be aggregated.

Essential Project Finance Elements

- ▶ Below are essential project finance elements to a successful financing (detailed on slides herein):
 - ▶ Construction Contract
 - ▶ Feedstock Contracts
 - ▶ Output Contracts
 - ▶ Operations & Maintenance
 - ▶ Lessons Learned

Essential Project Finance Elements

- ▶ **Construction Contract - Mitigate Cost Increases; Timing Certainty; Maximize Project Efficiency**
 - ▶ Guaranteed Maximum Price (“GMP”) - EPC or design build
 - ▶ Date certain completion
 - ▶ Performance guaranty
 - ▶ Construction Monitor - Schedule to operational start date with major milestones
 - ▶ Major equipment providers, fixed price contracts
 - ▶ Issue: Force Majeure Outs

Essential Project Finance Elements

▶ Feedstock Contracts

- ▶ Contracted Feedstock equal to amount required to exceed financial covenants; preferably 1.50x or greater
- ▶ The longer the contracts the better, although don't need to be coterminous with bond maturity. What is market?
- ▶ Market study
 - ▶ Total market availability and characteristics
 - ▶ Feedstock required as percentage of market
 - ▶ Historical analysis of demand and pricing

Essential Project Finance Elements

▶ Output Contracts

- ▶ Fixed price contracts ideal
- ▶ Market Study
 - ▶ RINS; LCFS Pricing
 - ▶ Volume vs. Demand
- ▶ Price floors are ideal
- ▶ However, if output on a floating price, need data relative to assumed floating price vs. market prices
- ▶ Contracted sales must show (at a minimum) ability to pay debt service and match projections
- ▶ Contract Term - Doesn't need to match Debt Term. Depends upon market - market study should show broad demand; may require cash trap and accelerated debt repayment

Essential Project Finance Elements

▶ Operations & Maintenance (“O&M”)

- ▶ O&M agreements should match the bond term
- ▶ Financial models/projections need to show different scenarios and expected coverage based on expected operation and contracted feedstock and output.
 - ▶ Investors will want to see worst case scenarios as well.
- ▶ Capital Maintenance Fund
 - ▶ Replacement of long-lived assets (10-20 years)

Essential Project Finance Elements

▶ Lessons Learned

- ▶ No such thing as a Guaranteed Maximum Price, Date Certain Completion, Performance Guaranty

- ▶ Anything can happen and force majeure clauses are imposed

▶ Liquidity

- ▶ Need to be able to show that there is enough working capital available to get through ramp up period.

- ▶ Investors need assurance that there is a reasonable cushion for the project to support itself until it is fully built and operational.

Essential Project Finance Elements

▶ Lessons Learned

- ▶ Higher Operational / Maintenance Expense
 - ▶ The more working capital the better
- ▶ Lower Throughput
- ▶ Less Efficient Output
- ▶ Feedstock Risk
 - ▶ Mitigated by solid long-term contracts and a market study
- ▶ Output Price / Demand Risk
 - ▶ Mitigated by contracts with price floors and a market study

Case Studies

▶ Anaerobic Digestion

- ▶ Rialto Bioenergy Facility (Anaergia)
- ▶ \$117,200,000 project finance (Green Bonds)
- ▶ Design build contract, fixed price equipment, additional limited corporate guaranty, cash trap non-renewal contract.
- ▶ Designed to accept 700 tons per day (“TPD”) of organics/food waste and up to 300 TPD of biosolids
- ▶ Contracts for 100% of its feedstock by commercial operation date
- ▶ RNG Offtake contracts with Southwest Gas, the City of Anaheim and the University of California



Case Studies

▶ Biosolids Gasification

- ▶ Aries Linden, LLC
- ▶ \$50,000,000 project finance (Green Bonds)
- ▶ The construction contract provided a combination fixed price and target price on a time and expense basis with equal sharing of cost savings with the Borrower and date certain completion and process guaranty with liquidated damages.
- ▶ Designed to process 430 tons of wet biosolids per day and convert that into 100 tons of Class A biosolids which will further be converted into 19 tons per day of biochar.
- ▶ Contracts for 100% of its feedstock by commercial operation date



Case Studies

► Landfill gas to RNG

- Dallas Clean Energy McCommas Bluff Landfill
- \$40,200,000
- Offtake RNG contract matched term of debt; fixed price
- Forward Purchase Electricity Contract - Mitigate Major O&M Variable
- Rated Investment Grade (“BBB-”)



Case Studies

- ▶ Landfill gas to CNG
 - ▶ Canton Renewables, Sauk Trail Hills Project
 - ▶ \$12,000,000 project finance
 - ▶ Offtake term matched debt term; fixed price



Case Studies

▶ Post-Consumer Recycled PET

- ▶ CarbonLITE Industries LLC
- ▶ \$50,000,000 Dallas; \$61,800,000 Pennsylvania; \$10,000,000 Pennsylvania
- ▶ No feedstock contracts - Large supply; competitive pricing
- ▶ Fully committed offtake contracts - strong demand from major beverage companies



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