Mission Country Disposal

SOLID WASTE RATE REVIEW

Cambria Community Services District
Cayucos Sanitary District

August 2019

William C. Statler

Fiscal Policy ■ Financial Planning ■ Analysis ■ Training ■ Organizational Review

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Solid Waste Rate Review
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SOLID WASTE RATE REVIEW
Cambria Community Services District and
Cayucos Sanitary District

REPORT PURPOSE

On October 4, 2018, Mission Country Disposal (MCD) submitted a *Base Year* rate increase application to be effective January 1, 2019 to the Cambria Community Services District (Cambria) and Cayucos Sanitary District (Cayucos). However, due to the complexity and concerns with the rate application, two supplemental applications were submitted, with the most recent one received on July 18, 2019 (Appendix A).

The last application is the focus of this report in reviewing the MCD rate increase request in accordance with adopted Franchise Agreement provisions regarding rate increase applications and to make rate recommendations to these two agencies as appropriate.

This report also addresses the rate impact if the Franchise Fee in Cambria is increased from its current rate of 6% to 10%.

> **Joint Agency Review**
>
> MCD provides similar services to both Cambrai and Cayucos under formally approved franchise agreements that regulate rates and establish procedures for considering rate increases.
>
> Because the financial information for MCD is closely related for these two agencies, this report jointly reviews rate requests and provides recommendations for each of them.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

Overview

In its latest application, <u>MCD is requesting a rate increase of 25.31% for Cambria and 26.43% for CSD.</u> The modest difference is because the Franchise Fee for the Cambria is 6% and 10% for Cayucos

<u>This compares with its initial request in October 2018 of 38.68% for Cambria and 40.40% for Cayucos</u>. As discussed in greater detail below, all of the concerns that surfaced in the iterations and further analysis that followed in addressing issues with

proposed costs for 2019 have been resolved. However, the following highlights two key cost drivers in this review, which together account for about 55% of the rate increase:

- **Materials recovery facility (MRF) costs** for “single stream” recycling (one container for all recyclables that must be sorted at an MRF) have increased from $10.17 per ton in 2017 to $67.50 per ton for 2019, an increase of 564%. This results in cost increases of $264,000 from 2017 and accounts for about 25% of the requested rate increase.

  As discussed below, it is clear from market realities (higher costs to produce higher-quality recyclables and lower prices for the resulting product from MRF operations) and the supporting data provided by MCD, that cost increases in this area are warranted. While the increase is significant, it is acceptable given market conditions and the higher cost of other alternatives.

- **Direct labor costs increased by 23%.** This accounts for about 30% of the rate increase and is primarily due to a correction from past financial statements in accounting for direct labor hours. In 2018, Waste Connections (MCD’s parent company) undertook its first extensive time study in many years in analyzing direct labor hours between its four franchised companies: San Luis Garbage, South County Sanitary Service (SCSS), Morro Bay Garbage (MBG) and MCD.

  As discussed in greater detail in Appendix B, Waste Connections found that hours for MCD were under reported by about 14%, with corresponding over-reporting for MBG. This was due to organizational changes that more efficiently pooled staff between the two companies, However, time keeping records did not accurately reflect the “borrowing” of MBG staff.

  While this past error in accounting for direct labor costs is unfortunate, it is appropriate to fix it going forward as part of this *Base Year* review.

  The balance of the cost increase over two years is about 9%. This is consistent with increases experienced by SCSS from 2017 to 2019 in providing cost of living increases of about 2% per year plus an across the board increase of 5% for retention and attraction. Given the tight labor market, this portion of the direct labor cost increase is reasonable.

  It should be noted that this revised cost accounting drives other major costs that are allocated between companies based on direct labor hours, such as group health insurance, truck operating expenses, fuel and other operating expenses.

Findings

- ***Complete Application.*** With its latest application, MCD has fully provided the supporting documentation required for rate requests under the Franchise Agreements in Cambria and Cayucos. The revised application has been correctly prepared and requests an across-the-board rate increase of 25.31%.in Cambria and 26.43% in Cayucos.

- ***High Level of Service at a Reasonable Cost.*** MCD provides a broad level of high-quality services to these two agencies – including garbage, recycling and green waste collection and disposal as well as hauler-provided “waste wheeler” containers for all three services – at very competitive rates compared with many other communities. In fact, even with the recommended rate increase of 25.31% in Cambria and 26.43% in Cayuco, rates in these two agencies will be among the lowest of those surveyed. In short, these two communities have the best of both worlds: high quality services at a low cost compared with other communities.

- ***Impact if the Cambria Franchise Fee is Increased from 6% to 10%.*** The most common Franchise Fee for solid waste services within the County is 10%. The Board is interested in increasing the Cambria rate to this level. As discussed in greater detail below, this would result in a rate increase for Cambria of 32.05% in implementing MCD's requested rate increase – which would now be 26.43% like Cayucos – as well as generating the added revenue needed for MCD to pay Franchise Fees at 10% rather than 6%.

- ***Need for Updated Rate-Setting Methodology***. Several complex issues have surfaced in this review (most notably corporate overhead, greenwaste and MRF costs as well as rate structure concerns) that have not been encountered in the past in using the rate-setting methodology, which is based on the City of San Luis Obispo's *Rate Setting Process and Methodology Manual for Integrated Solid Waste Management Rates* (Rate Manual) adopted in 1994. In short, with very minor modifications, this approach has been in place for 25 years. Accordingly, given the passage of time and the emergence of issues not envisioned in 1994, it is timely to update this methodology.

  Undertaking this work is supported by Waste Connections (the parent company of MCD) as well as by the staff of many agencies serviced by Waste Connections under Franchise Agreements that reference the *Rate Manual*. This includes the County, cities of San Luis Obispo, Arroyo Grande, Grover Beach, Pismo Beach and community services districts in Avila, Nipomo and Oceano. Waste Connections has conceptually agreed to fund half of this cost; if the remaining cost is shared by the central coast agencies serviced by Waste Connections, the consultant service cost for each agency should be very modest. There are several highly respected consultant firms that could assist with this update, such as:

  HF&H Consultants
  http://hfh-consultants.com

  FCS Group
  http://fcsgroup.com

  NBS
  https://www.nbsgov.com

  MSW Consultants
  https://MSW-Consultants.com

  R3 Consulting Group
  https://r3cgi.com

  Bell & Associates
  Chris@bellassociatesinc.com

  If the governing bodies are interested in pursuing an update, the next steps include developing a funding strategy; preparing and issuing a request for proposals (RFP); and selecting the vendor.

Rate Recommendations

It is recommended that the agencies adopt an across-the-board rate increase of 25.31% in Cambria and 26.43% in Cayucos. For Cambria, this excludes any potential impact if the

Franchise Fee is increase from its current rate of 6% to 10%. (This impact is discussed later in this report.)

Rate Summary for Single Family Residential Customers

Table 1 summarizes the requested rates for single family residential (SFR) customers. As reflected in this summary, given the significant cost drivers facing MCD, the increases will be moderate under the proposed rate increase.

Table 1. Single Family Residential Rates

	Container Size (Gallons)		
	32	64	96
Current			
Cambria	$19.73	$30.28	$36.83
Cayucos	15.64	18.48	21.34
Recommended			
Cambria	24.72	37.94	46.15
Cayucos	19.77	23.36	26.98
Increase			
Cambria	4.99	7.66	9.32
Cayucos	4.13	4.88	5.64

For example, for collection of a 32-gallon garbage container (the most common SFR service level) as well as separate waste wheelers for recycling and green waste, the proposed monthly rate will increase by $4.99 in Cambria and $4.13 in Cayucos.

As reflected in this chart, rates are higher in Cambria than in Cayucos. This makes sense given Cambria's longer distance for landfill, MFR and greenwaste disposal.

BACKGROUND

On October 4, 2019, MCD submitted a *Base Year* rate increase to be effective January 1, 2019. As noted above, due to the complexity and concerns with the rate application, two supplemental applications were submitted, with the most recent one received on July 18, 2019. This application was prepared in accordance with the rate review process and methodology formally set forth in its Franchise Agreements with Cambria and Cayucos.

In establishing a rate-setting process and methodology, each of these Franchise Agreements specifically reference the City of San Luis Obispo's *Rate Setting Process and Methodology Manual for Integrated Solid Waste Management Rates*. This comprehensive approach to rate reviews was adopted by San Luis Obispo in 1994 and establishes detailed procedures for requesting rate increases and the required supporting documentation to do so. It also sets cost accounting standards and allowable operating profit ratios.

About Proposition 218 Notices

For agencies like Cambria and Cayucos that issue "Proposition 218" notices for private sector solid waste rate increases, the notice sets the maximum amount that rates can be increased at the public hearing.

Rates can be approved at lesser amounts without re-noticing. However, agencies cannot adopt higher rates – even if they only apply to a few customers – without another 45-day re-noticing. As such, the rate notices prepared for Cambria and Cayucos reflect the rates requested by MCD along with the impact in Cambria if Franchise Fees paid by MCD are increased from 6% to 10%.

As noted above, the financial information for Cambria and Cayucos is closely related. For this reason, these two agencies jointly contracted with William C. Statler (who has extensive experience in evaluating rate requests in accordance with the adopted methodology) to evaluate MCD's rate increase application.

Franchise Agreement Summary

While there are minor differences in Franchise Agreements in Cambria and Cayucos, they have similar key provisions:

Table 2. Franchise Agreement Effective Dates

Agency	Agreement	Amended
Cambria	July 27, 2001	May 27, 2010
Cayucos	August 11, 2006	March 16, 2017

- Each agency contracts with MCD for garbage, green/food waste and "single stream" recycling; and MCD provides the container (waste wheelers) for each service.
- As noted above, each agency has adopted the same rate-setting methodology.

The most significant difference is the Franchise Fee, which is 6% in Cambria and 10% in Cayucos.

RATE REVIEW WORKSCOPE

This report addresses four basic questions:

- Should MCD be granted a rate increase? And if so, how much?
- How much does it cost to provide required service levels?
- Are these costs reasonable?
- And if so, what is a reasonable level of return on these costs?

The following documents were closely reviewed in answering these questions:

- Franchise Agreements and any Amendments for each agency
- Audited financial statements for MCD for 2016 and 2017
- City of San Luis Obispo's *Rate Setting Process and Methodology Manual for Integrated Solid Waste Management Rates* (*Rate Manual*)
- MCD rate increase application and supporting documentation
- Follow-up interviews, correspondence and briefings with MCD staff
- Rate surveys of Central Coast communities

This report also addresses the rate impact if the Franchise Fee in Cambria is increased from its current rate of 6% to 10%.

REVENUE AND RATE SETTING OBJECTIVES

In considering MCD's rate increase request, it is important to note the revenue and rate setting objectives for solid waste services as set forth in the Franchise Agreements via the *Rate Manual*.

Revenues. These should be set at levels that:

- Are fair to customers and the hauler.
- Are justifiable and supportable.
- Ensure revenue adequacy.
- Provide for ongoing review and rate stability.
- Are clear and straightforward for the agency and hauler to administer.

Rate Structure. Almost any rate structure can meet the revenue principles outlined above and generate the same amount of total revenue. Moreover, almost all rate structures will result in similar costs for the *average* customer: what different rate structures tell us is how costs will be distributed among *non-average* customers. The following summarizes adopted *rate structure* principles for solid waste services:

- Promote source reduction, maximum diversion and recycling.
- Provide equity and fairness within classes of customers (similar customers should be treated similarly).
- Be environmentally sound.
- Be easy for customers to understand.

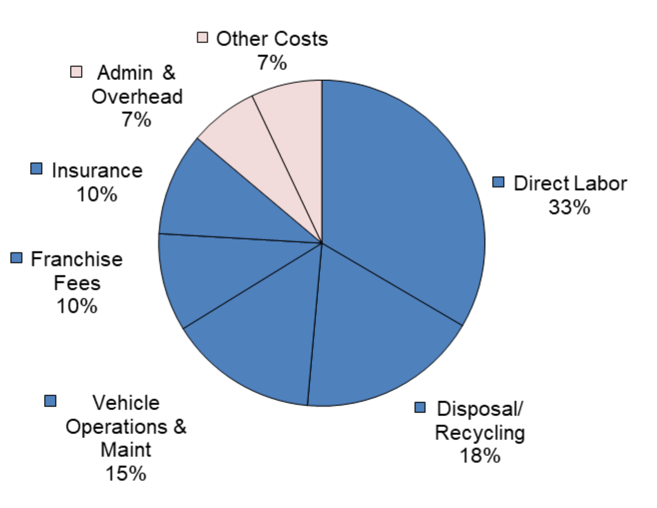
FINANCIAL OVERVIEW

While detailed financial and service information is provided in the MCD rate request application (Appendix A), the following summarizes their actual costs, revenues and account information for 2017 (the last completed fiscal year for which there are audited financial statements) for all areas serviced by them.

Costs by Type. Total expenses for 2017 (after deducting for non-allowable and limited costs as discussed later in this report) were $4.6 million. As reflected in Table 3, five cost areas accounted for over 85% of total costs:

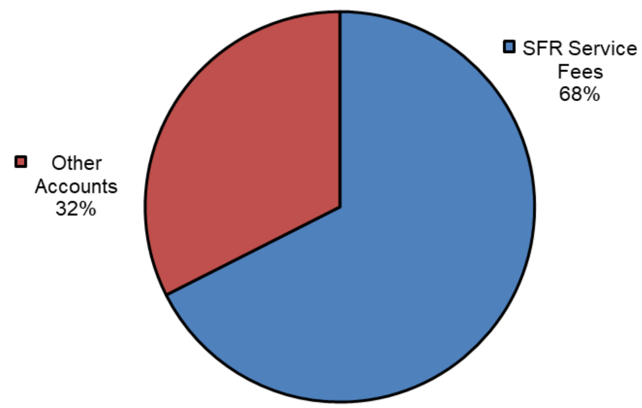
- Direct labor for collection: 33%
- Disposal and recycling: 18%
- Vehicle operations and maintenance (including depreciation): 15%
- Franchise fees: 10%
- Insurance: 10%

Table 3. Costs By Type: $4.6 Million



Revenues by Source. Total revenues in 2017 were $4.6 million. As reflected in Table 4, over two-thirds of MCD's revenues come from single-family residential (SFR) accounts.

Table 4. Revenues by Source: $4.6 Million



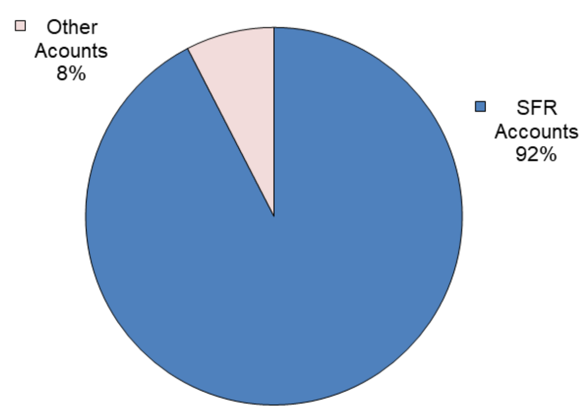
Services to multi-family residential and non-residential customers account for 32% of their revenues, with less than 1% from other revenues.

It should be noted that revenues and expenses in 2017 were virtually the same. This means that MCD earned no profit in 2017. As discussed below, this compares with the target of 8% profit on "allowable" costs under the *Rate Manual*.

Restoring MCD to this target from 2017 accounts for about 30% of the proposed rate increase.

Service Accounts by Type. While single-family residences account for 68% of revenues, they represent 92% of total accounts (Table 5).

Table 5. Accounts By Type: 11,618



This reflects the fact that per account, multi-family and non-residential customers generate more solid waste than single-family residential customers (and thus more revenue per account).

RATE-SETTING PROCESS

Under the *Rate Manual*, the rate-setting process follows a three-year cycle:

- ***Base Year.*** The first year of the cycle—the *Base Year*—requires a comprehensive, detailed analysis of revenues, expenses and operating data. This information is evaluated in the context of agreed upon factors in the franchise agreements in determining fair and reasonable rates.

- ***Two Interim Years.*** In both the second and third years, MCD is eligible for *Interim Year* rate adjustments that address three key change factors: changes in the consumer price index for "controllable" operating costs; changes in "pass-through costs" (primarily landfill tipping fees, which MCD does not control: they are set by the County Board of Supervisors); and an adjustment to cover increased franchise fees.

The rate review for the two *Interim Years* requires less information and preparation time than the *Base Year* review, while still providing fair and reasonable rate adjustments.

RATE SETTING METHODOLOGY

Are the Costs Reasonable?

The first step in the rate review process is to determine if costs are reasonable. There are three analytical techniques that can be used in assessing this:

- Detailed review of costs and service responsibilities over time.
- Evaluation of external cost factors, such as general increases in the cost of living (as measured by the consumer price index).
- Comparisons of rates with other communities.

Each of these was considered in preparing this report, summarized as follows.

Detailed Cost Review

In its rate application (Appendix A), MCD provides detailed financial data for five years:

- Audited results for the two prior years (2016 and 2017).
- Estimated results for the current year (2018, which is still in progress).
- Projected costs for the Base Year (2019).
- Estimated costs for the following year (2020).

Additionally, for virtually all line items, MCD provided supplemental detail upon request to support cost increases from 2017 to 2019. A detailed response from MCD on key issues is provided in Appendix B.

Table 6 below provides actual costs for 2017 (most recent audit results) compared with \cost projections for 2019.

While there are significant cost increases in several categories, they are reasonable given the cost drivers facing MCD; and in the case of MRF costs, this is an acceptable increase due to higher processing costs and lower revenues combined with the lack of other viable alternatives.

The Short Story. The key drivers behind the proposed rate increase for 2019 can be summarized by four cost factors over the past two years:

- 7.5% for direct labor
- 5.5% for recycling via MRF operations.
- 3.5% for vehicle operations and maintenance.
- 2.7% for all other cost increases and pass-through costs.

As reflected above, cost factors account for about 80% of the rate increase. The remaining balance is due to restoring MCD to an 8% operating target on allowable cost (compared with a loss of $21,529 in 2017), offset by modest increases in the revenue base from 2017.

Table 6. Detailed Cost Review: 2017 vs 2019

	2017	2019	Increase	
	Actual	Proposed	Amount	Percent
Direct Labor	1,550,238	1,910,261	360,023	23%
Adminstrative Costs	315,481	259,345	(56,136)	-18%
Other Expenses				
Depreciation on Bldgs & Equip	2,061	14,448	12,387	601%
Depreciation on Trucks & Containers	182,827	194,149	11,322	6%
Gas and Oil	310,503	436,926	126,423	41%
Office Expense	92,526	113,848	21,322	23%
Operating Supplies	14,165	17,423	3,258	23%
Insurance: Health Care	229,654	325,234	95,580	42%
Insurance: Liability and Other	244,056	162,104	(81,952)	-34%
Outside Services: Food/Green Waste	250,825	260,866	10,041	4%
Outside Services: Truck Repairs	6,009	14,953	8,944	149%
Outside Services: Temporary Labor	3,197	24,039	20,842	652%
Truck Repairs	132,851	163,564	30,713	23%
All Other Costs	206,814	211,655	4,841	2%
Total Allowable Costs	3,541,207	4,108,815	567,608	16%
Pass-Through Costs				
Tipping Fees: Landfill	535,426	502,894	(32,532)	-6%
Tipping Fees: MRF	46,429	310,687	264,258	569%
Franchise Fees	450,588	479,619	29,031	6%
Interest, Related Party (1)	35,904	54,143	18,239	51%
Transportation, Related Party	4,400	3,996	(404)	-9%
Facility Rent, Related Party	20,288	96,323	76,035	375%
Total Pass-Through Costs	1,093,035	1,447,662	354,627	32%
Total Costs	$4,634,242	$5,556,477	$922,235	20%

The following describes the basis for each for major cost areas and significant changes.

Allowable Costs

- **Direct Labor.** This reflects a two-year increase of 23%. As discussed above, during an in-depth review in 2018, Waste Connections found that hours for MCD were under reported by about 14%, with corresponding over-reporting for MBG. This was due to organizational changes that more efficiently pooled staff between the two companies, However, time keeping records did not accurately reflect the “borrowing” of MBG staff. The balance of the cost increase over two years is about 9%, which is consistent with increases experienced by SCSS from 2017 to 2019 in providing cost of living increases of about 2% per year plus an across the board increase of 5% for retention and attraction. Given the tight labor market, this portion of the direct labor cost increase is reasonable.

As reflected below in other cost categories, this revised cost accounting drives other major costs that are allocated between companies based on direct labor hours, such as group health insurance, truck operating expenses, fuel and other operating expenses.

- **Administrative Costs.** This is a combination of corporate overhead (which is limited to increases in the consumer price index) and office salaries. This reflects a net decrease of $56,000 (18%) from 2017.

- **Depreciation: Buildings and Equipment**. This increase results from the MCD share (22%) of yard repaving costs of $346,222, amortized over twenty-five years, offset by other minor reductions.

- **Gas and Oil.** This cost increase reflects two factors: cost increases in diesel and the increased allocation for fuel use based on revised direct labor costs. Given the volatility in diesel and CNG costs (both up and down), cost per gallon assumptions are reasonable for 2019. Moreover, given the revised direct labor allocation, the overall projection for 2019 appears reasonable.

- **Office Expense and Operating Supplies.** These are both up by 23%, reflecting the revised direct labor cost allocation.

- **Insurance: Health Care.** These costs are projected to increase from 2017 by about 5% annually. Given increases in health care costs, this is a reasonable assumption for 2019 costs. However, this cost increases by more than 10% due to the increase in direct labor allocations.

- **Insurance: Liability and Other.** Projected costs have decreased significantly from 2017, which reflects favorably on MCD's risk management efforts.

- **Truck Repairs: Outside Services and In-House.** As summarized below, the rate application requests an increase of $39,000 (28%) in this cost category:

Table 7. Truck Repair Costs: 2017 vs 2019

	Actual 2017	Proposed 2019	Increase Amount	Increase Percent
Outside Services	6,009	14,953	8,944	149%
In-House	132,581	163,564	30,983	23%
Total	$140,607	$178,517	$39,927	28%

This is due to two factors: an increase in allocated costs based on direct labor combined with a more proactive approach to vehicle maintenance, which MCD believes is necessary in meeting safety concerns. Along with other efforts, this focus on safety appears to be working, as reflected by the significant reduction in insurance costs.

- **Outside Services: Temporary Labor.** The cost increases in this category were incurred for dispatch and container cleaning in backfilling for vacancies. While costs in this category may decrease in the future if vacancies are filled, any decreases will be offset by increases in direct labor costs.

- **All Other Allowable Costs.** While there are ups and downs in individual line items, in total these reflect modest annual increases of 1%.

Pass-Through Costs

- **Tipping Fees: Landfill.** No rate increases are reflected in the rate application. The projected costs for 2019 reflect a modest decrease from 2017 of 6%.

- **Tipping Fees: MRF (Related Party).** This cost category reflects a significant cost increase from 2017. As summarized below, this is driven by a rate increase from $10.17 per ton to $67.50 per ton by a separate company that is controlled by Waste Connections (Cold Canyon Processing Facility):

Table 8. MRF Costs: 2017 vs 2019

	Actual 2017	Proposed 2019	Increase Amount	Increase Percent
Tonnage	4,556	4,603	47	1.0%
Cost per Ton	10.17	67.50	57.33	563.7%
Annual Cost	$46,335	$310,703	$264,368	570.6%

Waste Connections believes that its MRF rates are not subject to regulatory review and that its basis for setting these rates is proprietary and not subject to disclosure under the Franchise Agreements. That said, MCD offers the following explanation for this cost increase:

Competitive Rates. The following information was provided by MCD in comparing their proposed rate with other communities:

Table 9. MRF Rates Survey

			Per Ton Pricing				
Facility	Location	Distance (Miles)	Processing	Reload (If SLO)	Transport from SLO	Revenue Sharing	All-In Cost
Cold Canyon Processing Facility	San Luis Obispo	0	$67.50	$0.00	$0.00	No	$67.50
Monterey Regional Waste Facility (1)	Monterey	144	50.00	10.00	45.00	No	105.00
Burrtec (2)	West Valley	215	57.50	10.00	45.00	No	112.50
Mid Valley Disposal	Fresno	140	67.50	10.00	40.00	No	117.50
Gold Coast Recycling	Ventura	162	77.44	10.00	40.00	No	127.44
Mid-State (3)	Templeton	23	78.00	10.00	25.00	No	113.00
Tajiguas Landfill	Santa Barbara	112	160.00	10.00	30.00	No	200.00
Recology	Pier 96 (Bay Area)	214	190.00	10.00	45.00	Unknown	245.00

1. Expected rate in 90 days.
2. Eliminated revenue share
3. Unable to handle SLO County volume

In short, MCD believes its pricing is far lower than that otherwise available to north coastal communities; and even if loading and transportation costs are excluded, Waste Connections' MRF costs are very competitive.

In reviewing these costs, it is important to note that while MCD is responsible under the Franchise Agreements for separately collecting co-mingled recyclables and delivering them to a recycling facility that will accept them for processing, it is not required to operate such a facility. As such, the $67.50 rate, while a significate increase, is more cost-effective for MCD than other alternatives.

Given increased costs and lower market prices, the increased rate for 2019 reflects the same operating margin as 2017. Subject to several key caveats, this may be true.

1. It is clear that market realities have significantly impacted the net cost of recycling. As discussed by the President of the Boston Group in Appendix C, this is largely due to the collapse of markets in China, which affects both costs and revenues: the quality of the recycled product needs to be higher (resulting in higher costs); and the price of recycled products is significantly lower.

2. It reasonable for operating margins for recycling to be higher than they are for collection services like those provided under the Franchise Agreements. As discussed below under Rate-Setting Methodology, MCD is allowed an operating profit margin of 8% for "non-pass through costs." In essence, this recognizes that while there are risks in effectively managing costs, there are minimal revenue risks, since rates are guaranteed and service is required. However, with recycling costs, revenues are highly volatile depending on the market. Thus, there is both cost and revenue risk.

   A complex econometric model developed the firm of Sound Resource Economics (located in Tacoma Washington: Neal Johnson, PhD, Principal) indicates that 16% is an appropriate operating profit margin for utilities where costs and revenues are at risk. Setting aside the math and assumptions behind this conclusion, it intuitively makes sense that operating margins should be higher where both costs and revenues are at risk, versus where just costs are. Placed in context for MCD collection services, which have an 8% operating margin for cost risks, an added margin for revenue risks (especially in a volatile market) makes sense.

3. Based on a non-disclosure agreement, MCD shared with me very high-level data showing that based on projected higher costs and lower revenues from 2017, that the operating margin between 2017 and 2019 remained the same.

4. While I was not provided with the underlying detail for the high-level cost and revenue data provided to me, I can conclude that based on market forces that are driving higher costs and lower revenues, and a reasonable operating margin in excess of 8%, that a significant increase in recycling costs is reasonable. The question is: how much?

Answering this question clearly is made difficult by the fact that the *Rate Manual* did not foresee this situation (in fact, it thought there would be net revenues offsetting rate requirements). More appropriately addressing this cost issue is a key factor in my recommendation to update the *Rate Manual*.

That said, given the higher costs and lower revenues undoubtedly faced by the MRF combined with the lack of more cost-effective options, the proposed rate of $67.50 is acceptable.

Provided in Appendix D is additional information from Waste Connections about its MRF operations.

- **Franchise Fees**. This reflects a modest two-year increase of 6% based on customer growth.

- **Interest (Related Party).** Interest is an allowable cost under the *Rate Manual.* In this case, interest costs are assessed internally by Waste Connections based on a methodology that considers its corporate costs of borrowing and financed assets. Accordingly, this is treated as a "pass-through" cost. MCD's auditors have provided a written opinion on the reasonableness of the methodology; and I have reviewed the calculations underlying the projected costs in accordance with this methodology. Based on this, I believe the projected interest costs for 2019 are reasonable.

  It should be noted that MCD believes there is a case for treating this interest as a non-related party allowable expense since there is no internal mark-up on the interest; however, they chose not to press the matter at this time. This is another issue that should be addressed as part of a *Rate Manual* update and future rate applications.

- **Transportation (Related Party).** These costs have decreased modestly.

- **Facility Rent (Related Party).** This increase is based on an updated assessment of the market value of MCD's share of the yard and office facilities. Based on reviewing a recent independent market value assessment and Waste Connections methodology for allocating MCD's share of these costs (which reflect the revised allocation of direct labor costs), I believe that the cost increase is reasonable.

Trends in External Cost Drivers

The most common external "benchmark" for evaluating cost trends is the consumer price index. Over the past two years, the U.S. CPI-U increased by 4.4%. Excluding the cost drivers discussed above, all other costs increased by 2% over the last two years (about 1% annually).

It should be noted that MCD believes that operating on the central coast of California presents higher cost pressures than the national CPI suggests, which leads to lower margins in interim years and higher base rate increases. They would like to address this concern in the *Rate Manual* update and future rate applications.

Rates in Comparable Communities

Lastly, reasonableness of rates (and underlying costs) can also be evaluated by comparing rates with comparable communities. However, survey results between "comparable" communities need to be carefully weighed, because every community is different. In short, making a true "apples-to-apples" comparison is easier said than done.

Nonetheless, surveys are useful assessment tools—but they are not perfect, and they should not drive rate increases. Typical reasons why solid waste rates may be different include:

- Franchise fees and AB 939 fee surcharges.
- Landfill costs (tipping fees).
- Service levels (frequency, quality).
- Labor market.
- Operator efficiency and effectiveness.
- Voluntary versus mandatory service.
- Direct services provided to the franchising agency at no cost, such as free trash container pick-up at city facilities, on streets and in parks.
- Revenue collection procedures: Does the hauler or the franchising agency bill for service? And what are the procedures for collecting delinquent accounts?
- Services included in the base fee (recycling, green waste, containers, pick-up away from curb).
- Different rates structures.
- Land use and density (lower densities will typically result in higher service costs).
- Mix of residential and non-residential accounts, and how costs and rates are allocated between customer types. This factor is particularly relevant to MCD, where commercial revenues that often help offset residential rates, make up only 32% of revenues.
- Distance from collection areas to disposal sites. This is also a key cost factor for MCD.

With these caveats, the following summarizes single family residential rates for other cities in the Central Coast area compared with the proposed rates for MCD. As reflected below, even with the proposed rate increases, Cambria and Cayucos will have among the lowest rates of the agencies surveyed.

Table 10. Single Family Residential Rate Survey

Single Family Residential Monthly Trash Rates			
	Container Size (Gallons)		
	30-40	60-70	90-101
Atascadero	$26.49	$41.56	$52.18
Morro Bay	17.91	35.81	53.72
Paso Robles	32.33	42.41	46.81
San Luis Obispo	16.48	32.97	49.45
Santa Maria	na	30.69	34.81
San Miguel	28.23	44.48	61.06
Templeton	28.72	41.15	45.67
Requested: Mission Country Disposal Service Area			
Cambria	24.72	37.94	46.15
Cayucos	19.77	23.36	26.98

Summary: Are the costs reasonable? Based on the results of the three separate cost-review techniques—trend review, external factor review and rate comparisons—the proposed cost assumptions for 2019 are reasonable.

What Is a Reasonable Return on these Costs?

After assessing if costs are reasonable, the next step is to determine a reasonable rate of return on these costs. The rate-setting method formally adopted by Cambria and Cayucos in their Franchise Agreements with MCD includes clear criteria for making this assessment. It begins by organizing costs into three main categories, which will be treated differently in determining a reasonable "operating profit ratio:"

Allowable Costs (Operations and Maintenance)

- Direct collection labor
- Vehicle maintenance and repairs
- Insurance
- Fuel
- Depreciation
- Billing and collection

Pass-Through Costs

- Tipping fees
- Franchise fees
- Payments to affiliated companies (such as facility rent, interest and trucking charges)

Excluded and Limited Costs

- Charitable and political contributions
- Entertainment
- Income taxes
- Non-IRS approved profit-sharing plans
- Fines and penalties
- Limits on corporate overhead

After organizing costs into these three categories, determining "operating profit ratios" and overall revenue requirements is straightforward:

- The target is an 8% operating profit ratio on "allowable costs."

- Pass-through costs may be fully recovered through rates but no profit is allowed on these costs.

- No revenues are allowed for any excluded or limited costs.

In the case of MCD, about 75% of their costs are subject to the 8% operating profit ratio; and 25% are pass-through costs that may be fully recovered from rates, but no profit is allowed. No recovery is allowed for excluded costs.

Preparing the Rate Request Application

Detailed "spreadsheet" templates for preparing the rate request application—including assembling the required information and making the needed calculations—are provided in the *Rate Manual*. MCD has prepared their rate increase application in accordance with these requirements (Appendix A); and the financial information provided in the application for 2016 and 2017 ties to its audited financial statements.

Rate Request Summary

The following summarizes the calculations that support the requested and recommended rate increases:

Table 11. Rate Increase Summary

Rate Setting Factors	Cambria	Cayucos
Allowable Costs	$4,108,815	$4,108,816
Allowable Profit (8% Operating Ratio)	357,287	357,287
Pass-Through Costs		
Tipping Fees: Landfill	502,894	502,894
Tippping Fees: MRF	310,687	310,687
Franchise Fees	479,619	479,619
Related Party Costs	154,462	154,462
Total Pass-Through Costs	1,447,662	1,447,662
Allowed Revenue Requirements	5,913,764	5,913,765
Revenue without Rate Increase	4,778,462	4,778,463
Revenue Requirement Shortfall	1,135,302	1,135,302
Rate Base Revenue	4,772,485	4,772,486
% Change in Revenue Requirement	23.79%	23.79%
Allowed Revenue Increase *	25.31%	26.43%

**Adjusted for franchise fees of 10% in Cambria and 6.0% in Cayucos*

As reflected above, all the rate setting factors are the same for Cambria and Cayucos, except for the final adjustment for Franchise Fees: 6% in Cambria and 10% in Cayucos. (Increased Franchise Fees are due on added revenues from a rate increase: this final adjustment accounts for this.)

Implementation

The following summarizes key implementation concepts in the adopted rate-setting model:

- The "8%" operating profit ratio is a target; in the interest of rate stability, adjustments are only made if the calculated operating profit ratio falls outside of 10% to 6%.
- There is no provision for retroactivity: requested rate increases are "prospective" for the year to come; there is no provision for looking back. This means that any past shortfalls from the target operating profit cannot be recaptured.
- On the other hand, if past ratios have been stronger than this target, then the revenue base is re-set in the *Base Year* review.
- As discussed above, detailed *Base Year* reviews are prepared every three years; *Interim Year* reviews to account for focused changes in the consumer price and tipping fees are prepared in the two "in-between" years.
- Special rate increases for extraordinary circumstances *may* be considered.

The result of this process is a proposed rate increase of 25.31%.in Cambria and 26.43% in Cayucos.

IMPACT OF CAMBRIA INCREASING FRANCHISE FEE FROM 6% TO 10%

The Board has expressed interest in considering an increase in the Franchise Fee from its current rate of 6% to 10.0% (which is the prevailing Franchise Fee throughout the County).

There would be two rate impacts resulting from this change:

- Even if no rate increase from MCD was being considered, an increase of 4.44% would be needed to increase the Franchise Fee from 6% to 10%. (The increase is slightly more than the 4% rate difference to account for the additional Franchise Fees that will be required to paid from the added revenues.)
- With a Franchise Fee of 10.0%, the allowable rate increase for 2019 would also be higher: 24.63% (like Cayucos) rather than 25.31%.

Since these two percentage rate increase factors are compounded rather than additive, the allowed rate increase or Cambria at a 10% Franchise Fee is 32.05%: (1.0444 x 1.2463)-1.
The following chart summarizes the different rate impacts of the recommendation based on the current rate of 6% and the rate impact if the Franchise Fee is increased to 10.0% in single family residential accounts.

Table 12. Sample Rate Increase with Franchise Fee at 10%

Current Rate: 32-Gallon Container	$19.73
Revised Rate: Franchise Fee Increase (4.44%)	20.61
Revised Rate: MCD Rate Increase (26.43%)	26.05
Difference	6.32
Percent Increase	32.05%

The following summarizes this rate increase for single family residential customers:

Table 13. Cambria SFR Rates: 6% vs 10% Franchise Fee

Container Size	Current Charge	6% Franchise Fee 25.31% Rate Increase		10.0% Franchise Fee 32.05% Rate Increase	
		Proposed	Increase	Proposed	Increase
32 Gallons	$19.73	$24.72	$4.99	$26.05	$6.32
64 Gallons	30.28	37.94	7.66	39.98	9.70
96 Gallons	36.83	46.15	9.32	48.63	11.80

COORDINATION WITH OTHER AGENCIES

MCD has submitted similar rate requests to the County, which regulates rates in other areas served by MCD. The County is likely to act on the requested rate increases within the same time frame as the two agencies covered in this report. Based on discussions with County staff, they are planning to rely on the findings in this report in making their recommendations to the Board of Supervisors.

SUMMARY

Based on the rate-setting policies and procedures formally adopted by Cambria and Cayucos in their Franchise Agreements, this report concludes that:

- MCD has submitted the required documentation required under its Franchise Agreements with the two agencies.
- This results in a recommended rate increase of 25.31% for Cambria and 26.43% for Cayucos.
- If Cambria decides to increase its Franchise Fee from the current rate of 6% to 10%, a rate increase of 32.05% is recommended.

ATTACHMENTS

Appendix A: Base Year Rate Request Application from South County Sanitary Service
Appendix B: Follow-Up Information provided by Mission Country Disposal
Appendix C: Boston Group Outlook on Recycling Costs
Appendix D: Cold Canyon Processing Facility Background

Appendix A
BASE YEAR RATE REQUEST APPLICATION

Base Year Application Summary

- Cambria Community Services District
- Cayucos Sanitary District

Supporting Schedules

- Financial Information: Cost and Revenue Requirements Summary
- Revenue Offset Summary
- Cost Summary for Base Year
- Base Year Revenue Offset Summary
- Operating Information

Mission Country Disposal

Base Year Rate Adjustment Application-Amended

Summary **CAYUCOS SANITARY DISTRICT**

Requested Increase

	Trucks/Infrastructure	4.83%
	Organics	0.42%
	Recycling	6.15%
	Operation Cost Increases	15.03%
1. Rate Increase Requested		**26.43%**

Rate Schedule

	Rate Schedule	Current Rate	Increased Rate	Adjustment (a)	New Rate
	Single Family Residential				
2.	Economy Service (1 - can curb)	$15.64	$4.13		**$19.77**
3	Standard Service (2- can curb)	$18.48	$4.88		**$23.36**
4	Premium Service (3 - can curb)	$21.34	$5.64		**$26.98**

(a) Calculated rates are rounded up to the nearest $0.01.

5 ***Multiunit Residential and Non-residential***

Rate increases of **26.43%**
will be applied to all rates in each structure
with each rate rounded to the nearest $0.01

Certification

To the best of my knowledge, the data and information in this application is complete, accurate, and consistent with the instructions provided by the Rate Setting Manual.

Name: Jeff Smith Title: District Manager

Signature: Date: 07/25/19

Mission Country Disposal

Base Year Rate Adjustment Application-Amended

Summary **CAMBRIA CSD**

Requested Increase

	CNG Trucks/Infrastructure	4.83%
	Organics	0.42%
	Recycling	6.15%
	Operation Cost Increases	13.91%
1. Rate Increase Requested		**25.31%**

Rate Schedule

	Rate Schedule	Current Rate	Increased Rate	Adjustment (a)	New Rate
	Single Family Residential				
2.	Economy Service (1 - can curb)	$19.73	$4.99		**$24.72**
3	Standard Service (2- can curb)	$30.28	$7.66		**$37.94**
4	Premium Service (3 - can curb)	$36.83	$9.32		**$46.15**

(a) Calculated rates are rounded up to the nearest $0.01.

5 ***Multiunit Residential and Non-residential***

Rate increases of **25.31%** will be applied to all rates in each structure with each rate rounded to the nearest $0.01

Certification

To the best of my knowledge, the data and information in this application is complete, accurate, and consistent with the instructions provided by the Rate Setting Manual.

Name: Jeff Smith Title: District Manager

Signature: Date: 07/25/19

Mission Country Disposal

Base Year Rate Adjustment Application-Amended

Financial Information	Historical		Current	Projected	
				Base Year	
	2016	2017	2018	2019	2020
				(from Pg. 4)	
Section I-Allowable Costs					
6. Direct Labor	$1,489,417	$1,550,239	$1,797,126	$1,910,262	$1,982,852
7. Corporate Overhead	$85,479	$55,806	$87,627	$90,168	$93,595
8. Office Salaries	$125,896	$259,675	$165,701	$169,177	$175,606
9. Other General and Admin Costs	$1,484,404	$1,675,487	$1,888,904	$1,939,207	$2,012,897
10 **Total Allowable Costs**	**$3,185,196**	**$3,541,206**	**$3,939,358**	**$4,108,815**	**$4,264,949**
Section II-Allowable Operating Profit					
11. Operating Ratio	94.4%	100.6%	120.4%	92.0%	92.0%
12. **Allowable Operating Profit**	$187,379	($21,529)	($668,554)	$357,288	$370,866
Section III-Pass Through Costs					
13. Tipping Fees	$614,922	$581,855	$828,446	$813,581	$844,498
14. Franchise Fees	$434,503	$450,588	$473,932	$479,619	$497,845
15. AB939 Fees	$0	$0	$0	$0	$0
16. Other Pass-through Costs	$21,105	$60,592	$148,119	$154,462	$160,332
17. **Total Pass Through Costs**	**$1,070,530**	**$1,093,035**	**$1,450,497**	**$1,447,662**	**$1,502,674**
Section IV - Revenue Requirement					
18. Revenue Requirement				$5,913,765	$6,138,489
19. **Total Revenue Offsets** (from Page 3)	**$4,443,105**	**$4,612,712**	**$4,721,302**	**$4,778,462**	**$4,835,673**
Section V - Net Shortfall (Surplus)					
20. Net Shortfall (Surplus)				$1,135,303	

21. Total Residential and Non-residential Revenue without increase in Base Year (pg.3, lines 32+40)	$4,772,485	**Cambria**
22. Percent Change in Residential and Non-residential Revenue Requirement	23.79%	23.79%
23. Franchise Fee Adjustment Factor (1 - 6 percent)	90.00%	94.00%
24. Percent Change in Existing Rates	**26.43%**	**25.31%**

6 (Cayucos)

Mission Country Disposal

Base Year Rate Adjustment Application-Amended

Revenue Offset Summary

	Section VII - Revenue Offsets				
	Historical		Current	Projected	
				Base Year	
	2016	**2017**	**2018**	**2019**	**2020**
28. Single Family Residential	$2,999,112	$3,113,227	$3,175,792	$3,213,902	$3,252,468
Multiunit Residential Dumpster					
29. Number of Accounts	0	0	0	0	0
30. Revenues	$0	$0	$0	$0	$0
31. Less Allowance for Uncollectible Resid Accounts					
32. **Total Residential Revenue**	**$2,999,112**	**$3,113,227**	**$3,175,792**	**$3,213,902**	**$3,252,468**
Non-residential Revenue (without increase in Base Yr.)					
Account Type					
Non-residential Can					
33. Number of Accounts	25	29	34	34	35
34. Revenues			$10,910	$11,040	$11,173
Non-residential Wastewheeler					
35. Number of Accounts	239	242	245	248	251
36. Revenues			$130,428	$131,993	$133,577
Non-residential Dumpster					
37. Number of Accounts	613	599	584	591	598
38. Revenues	$1,437,505	$1,495,735	$1,398,765	$1,415,550	$1,432,536
39. Less: Allowance for Uncollectible Non-resid	$0	$0	$0	$0	$0
40. **Total Non-residential Revenue**	**$1,437,505**	**$1,495,735**	**$1,540,102**	**$1,558,584**	**$1,577,287**
45. **Interest on Investments**	$1,155	$13	$13	$393	$139
46. **Other Income**	$5,333	$3,738	$5,395	$5,584	$5,779
47. **Total Revenue Offsets**	**$4,443,105**	**$4,612,712**	**$4,721,302**	**$4,778,462**	**$4,835,673**

Mission Country Disposal

Base Year Rate Adjustment Application-Amended

Cost Summary for Base Year

	Description of Cost	Section VIII-Base Year Cost Allocation			
		2016	**2017**	**2018**	**Base Year 2019**
	Labor	$1,392,056	$1,443,887	$1,674,826	$1,783,511
	Payroll Taxes	$97,361	$106,351	$122,300	$126,750
48.	**Total Direct Labor**	$1,489,417	$1,550,239	$1,797,126	$1,910,262
49.	Corporate Overhead	$85,479	$55,806	$161,907	$168,059
	Less limitation (enter as negative)			($74,280)	($77,891)
	Total Corporate Overhead	$85,479	$55,806	$87,627	$90,168
	Office Salary	$118,454	$253,968	$159,102	$164,224
	Payroll Taxes	$7,442	$5,707	$6,599	$4,953
50.	**Total Office Salaries**	$125,896	$259,675	$165,701	$169,177
	Bad Debt	($638)	($1,150)	$1,711	$1,732
	Allocated expenses	$0	$0	$0	$0
	Bond expense	$4,724	$4,630	$4,630	$4,806
	Depreciation on Bldg and Equip	$0	$2,061	$0	$14,448
	Depreciation on Trucks/Containers	$164,270	$182,827	$187,762	$194,149
	Drive Cam fees	$10,594	$11,408	$10,542	$10,943
	Dues and Subscriptions	$2,029	$2,243	$1,832	$1,901
	Facilities	$0	$21,112	$0	$0
	Gas and oil	$255,998	$310,503	$430,270	$436,926
	Laundry (Uniforms)	$8,052	$10,679	$7,281	$7,558
	Legal and Accounting	$18,683	$20,011	$22,694	$23,556
	Miscellaneous and Other	$4,995	$2,492	$9,565	$9,929
	Office Expense	$79,362	$92,526	$109,680	$113,848
	Operating Supplies	$13,973	$14,165	$26,487	$17,423
	Other insurance - Medical	$487,692	$473,710	$473,563	$487,338
	Other Taxes	$10,653	$11,411	$12,638	$13,118
	Outside Services	$175,059	$269,094	$296,916	$311,027
	Public Relations and Promotion	$495	$362	$3,054	$3,170
	Permits	$29,725	$30,299	$31,444	$32,639
	Postage	$8,664	$775	$871	$9,530
	Relocation	$0	$0	$6,672	$6,926
	Rent	$5,400	$5,400	$4,950	$4,950
	Telephone	$9,521	$8,166	$7,591	$7,880
	Tires	$40,416	$53,222	$35,693	$35,962
	Travel	$11,697	$4,917	$12,721	$13,204
	Truck Repairs	$130,617	$132,851	$178,119	$163,564
	Utilities	$12,424	$11,774	$12,217	$12,682
51.	**Total Other Gen/Admin Costs**	$1,484,404	$1,675,487	$1,888,904	$1,939,207
52.	**Total Tipping Fees**	$614,922	$581,855	$828,446	$813,581
53.	**Total Franchise Fee**	$434,503	$450,588	$473,932	$479,619
54.	**Total AB 939/Regulatory Fees**				
55.	**Total Lease Pmt to Affil Co.'s**	$19,700	$20,288	$92,796	$96,323
55a.	**Interest Expense (to affiliate)**	$0	$35,904	$51,473	$54,143
55b	**Transportation costs (to affiliate)**	$1,405	$4,400	$3,850	$3,996
56.	**Total Cost**	$4,255,726	$4,634,241	$5,389,855	$5,556,477

Mission Country Disposal

Base Year Rate Adjustment Application-Amended

Base Year Revenue Offset Summary **For Information Purposes Only**

		Section VII-Revenue Offsets						
	Description of Revenue	Overall	Franchise	Refuse Collection				Non
		Total	Total	LO CSD	Cayucos	Cambria	County	Franchised
	Residential Revenue							
	(without increase in Base Year)	10,976	10,976	5,161	1,883	3,799	133	
57.	Single Family Residential	$3,213,902	3,213,902	1,494,802.71	527,805.89	1,147,367.54	43,925.44	$0
	Multiunit Residential Dumpster							
58.	Number of Accounts	$0	$0	0	0	0	0	0
59.	Revenues	$0	$0	$0	$0	$0	$0	$0
60.	Less Allowance for Uncollectable	$0	$0	0	0	0	0	0
61.	**Total Residential Revenue**	**$3,213,902**	**$3,213,902**	**$1,494,803**	**$527,806**	**$1,147,368**	**$43,925**	**$0**
	Non-residential Revenue (without increase in Base Year)							
	Account Type							
	Non-residential Can							
62.	Number of Accounts	34	34	4	3	0	27	0
63.	Revenues	$11,040	$11,040	$1,352	$824	$0	$8,865	$0
	Non-residential Wastewheeler							
64.	Number of Accounts	248	248	69	35	94	50	0
65.	Revenues	$131,993	$131,993	$42,363	$18,563	$45,101	$25,966	$0
	Non-residential Dumpster							
66.	Number of Accounts	591	591	151	73	133	235	0
67.	Revenues	$1,415,550	$1,415,550	$349,859	$148,170	$301,465	$616,056	$0
68.	Less: Allowance for Uncollectible Non-residential Accounts	$0	$0	$0	$0	$0	$0	$0
69.	**Total Non-residential Revenue**	**$1,558,584**	**$1,558,584**	**$393,573**	**$167,557**	**$346,566**	**$650,887**	**$0**
74.	**Interest on Investments**	$393	$0	$0	$0	$0	$0	$393
75.	**Other Income**	$5,584	$0	$0	$0	$0	of 6 (Cayucos)	$5,584
76.	**Total Revenue Offsets**	**$4,778,462**	**$4,772,485**	**$1,888,376**	**$695,363**	**$1,493,934**	**$694,813**	**$5,977**

Mission Country Disposal

Base Year Rate Adjustment Application-Amended

Operating Information

		Historical		Current			Projected		
	2016	Percent Change	2017	Percent Change	2018	Percent Change	Base Year 2019	Percent Change	2020
Section IX-Operating Data									
Residential & Commercial Garbage									
77. Los Osos Residential Accts	5,067	-0.4%	5,047	1.1%	5,100	1.0%	5,151	1.0%	5,203
Cayucos Residential Accts	1,824	-0.7%	1,812	2.7%	1,861	1.0%	1,880	1.0%	1,898
Cambria Residential Accts	3,717	-0.6%	3,696	1.6%	3,754	1.0%	3,792	1.0%	3,829
County Residential Accts	129	3.1%	133	-1.5%	131	1.0%	132	1.0%	134
Los Osos Commercial Accts	214	-0.5%	213	10.3%	235	1.0%	237	1.0%	240
Cayucos Commercial Accts	111	-0.9%	110	0.0%	110	1.0%	111	1.0%	112
Cambria Commercial Accts	247	1.2%	250	-5.2%	237	1.0%	239	1.0%	242
County Commercial Accts	309	-0.6%	307	1.3%	311	1.0%	314	1.0%	317
78. Routes	8	0.0%	8	0.0%	8	0.0%	8	0.0%	8
79. Tons Collected	13,443	-7.7%	12,410	-2.2%	12,132	1.0%	12,253	1.0%	12,376
80. Direct Labor Hours*	22,939	0.0%	22,939	0.0%	22,939	0.0%	22,939	0.0%	22,939
Recyclable Materials - Curbside Recycling-Los Osos, Cambria, Cayucos, & San Simeon									
85. Accounts	11,618	-0.4%	11,568	-5.2%	10,966	1.0%	11,076	1.0%	11,186
86. Routes	5	0.0%	5	0.0%	5	0.0%	5	0.0%	5
Tons Collected	4,524	0.9%	4,566	-0.2%	4,557	1.0%	4,603	1.0%	4,649
87. Direct Labor Hours*	10,927	0.0%	10,927	0.0%	10,927	0	10,927	0.0%	10,927
Recyclable Materials - Greenwaste Collection-Los Osos & Cambria									
88. Accounts	8,784	-0.5%	8,743	-0.4%	8,712	1.0%	8,799	1.0%	8,887
89. Routes	3	0.0%	3	0.0%	3	0.0%	3	0.0%	3
Tons Collected	4,194	24.6%	5,227	-3.0%	5,071	1.0%	5,122	1.0%	5,173
90. Direct Labor Hours*	10,840	0.0%	10,840	0.0%	10,840	0	10,840	0.0%	10,840

* In the absence of formal time studies in 2016 and 2017, a 2018 time study was used to populate those earlier years

Appendix B

Mission Country Disposal

4388 Old Santa Fe Road • San Luis Obispo, CA 93401

July 18, 2019

Bill Statler

RE: Response to Mission Country Rate Application Questions Dated July 15, 2019

Dear Bill:

The majority of questions can be resolved by addressing the issue of driver hours and labor expense. Once you are comfortable with the increase in driver labor expense, other large expense increases that are allocated on labor, such as truck fuel, safety expenses, operating supplies, insurance, outside services and truck repairs become reasonable.

Before we launch into driver hours, we would also like to point your attention to the amended application that accompanies this letter. Please keep in mind that our draft application to Mission Country that we shared with a limited audience requested a 40% increase. Our actual application filed in March incorporated much of what we learned from our negotiations on South County Sanitary, plus the actual audited results for 2018. The March application was for a 27% increase, a 13% reduction that can largely be attributed to negotiations with you. Thus, we are not prepared to reduce our application much more. Per our discussion on July 17, we reduced operating supplies and telephone expense. This amendment reduces our original revenue requirement by $20,541, equivalent to 10 cents per month on 32 gallon service in the Los Osos CSD, our most populated rate zone.

While on the subject of rate application adjustments, we would like to reluctantly inform the jurisdictions you represent that recycle markets have eroded more since our original application, and that the digester system is struggling with operational issues. We have been approached by both the Cold Canyon MRF and Hitachi-Zosen with requests for rate increase. To this point, we have told them that they need to continue working out the operational kinks prior to us supporting an additional appeal. It is possible that in a relatively short period of time, we may need to approach Mission Country areas with a larger than normal interim increase request to address these issues with commingle, green waste, or both.

Driver Labor Hours:

4. **Direct Labor.** These are up by 23% from 2017 compared with 10.7% for SCSS, with reported annual hours in the application remaining constant at 22,939. The explanations you give could equally apply to SCSS. Accordingly, it will be difficult for me to support an increase greater than that for SCSS.

We have four franchised companies that include San Luis Garbage (SLG), South County Sanitary (SCS), Mission Country Disposal (MCD) and Morro Bay Garbage (MBG). Each driver is on the payroll of one of those companies and in the past, attempts were made to keep employees assigned to the areas where they worked. All the companies were moved into a centralized facility creating numerous efficiencies by borrowing or loaning employees to collect in areas other than their assigned payroll company. Such borrowing and loaning can be challenging to account for, but did create overall improvement with escalating labor costs.

In 2018, we undertook the first extensive time study in many years. In that process, we found that some employees assigned to MBG and SCS regularly performed collection activities in Mission Country. In 2018, we made changes to payroll companies for some employees and began to split wages between companies for others who spend time in multiple jurisdictions. This change revealed that MCD customers were under paying for many years. Labor expense has increased about 23% over the previous rate application in 2016. About 14% of this increase is related to corrections of the allocations, and the remaining 9% (about 3% per year) is related to increased wage expense.

We recognize that a shift of 15% of labor hours, plus the burden of benefits, payroll taxes, and labor dependent costs like truck operating expense, insurance expense, and some facilities expenses are having a significant effect on MCD. There are offsetting savings that primarily benefitted SCS and MBG. To help validate this large adjustment, we wanted to make sure our labor expense across all companies was reasonable and we looked to comparative productivity to validate the result allocations of expense to the individual companies.

Overall labor expense at what we call SLO Hauling—the combination of the 4 garbage companies under review—is up 9.3% since the 2016 base case. That is a reasonable annual average increase of about 3.1%. The following table represents dollar changes in Waste Connections' "Labor Expense" accounts in our company general ledgers in 2015, prior to the time study, and in 2018, subsequent to the time study. We would have preferred to use numbers from filed rate applications, but because we have different base years for MBG, we don't have completed rate applications for all companies. Still, we believe the table illustrates how MBG labor expense can grow so much while the combined companies have overall reasonable labor expense growth.

Direct Labor By Company 2015-2018

	2015	2018	15-18%	Average Growth
SLG	2,280,526	2,588,634	13.5%	4.5%
SCS	2,540,661	2,684,495	5.7%	1.9%
MCD	1,351,182	1,675,285	24.0%	8.0%
MBG	584,206	435,435	-25.5%	-8.5%
Combined	6,756,575	7,383,849	9.3%	3.1%

While we cannot change the past, we can correct it going forward. Customers in Mission Country have benefited from a "good deal" relative to their cost of service, and now in a base year, it is reasonable to correct the allocations. It makes sense that the Mission Country areas should have some of the highest rates do to longer travel times from our base and the landfill, plus reduced density. However, that is not the case, at least in Cayucos. For example, SLO Haul average residential productivity is 45 homes per hour, the productivity in Cayucos is 25 homes per hour, which makes sense due to geography and demographics.

The reader may be drawn to Page 6 of our 2019 rate application and note that driver hours appear to be flat from 2016 to 2019. We did not create a time study in 2017, and the 31,200 hours estimated in our application back in 2016 were understated as described above, and also excluded any overtime hours. Given these circumstances, we reported all years using our 2018 time study, the best information that we have to describe the hours actually worked from 2016 through our 2019 estimate.

Once we understand that labor is increasing 23% over three years because of a correction of prior time allocations, many of the issues identified in your memo can be immediately explained by this change in driver hour allocations. Fuel, for example, is allocated on driver hours. If MCD now has 23% more hours, it will also likely have 23% more fuel, all things being equal. As we go through your concerns, we will identify the items related to driver hours by referencing this portion of our response.

1. **Corporate Overhead.** I do not have a concern with the net number per se; however, I can't readily see where the "reclassifications" come from.

In 2017, the Corporate OH reported on the audited financial statements did not include locally paid bonuses or a region office charge. We provide the reclassifications to the 2017 number to restate that number in an apples-to-apples comparison to the reported amounts in 2018/2019.

As a matter of policy, we believe the 2017 presentation is correct. However, to expedite the rate case, we agreed to include bonuses and the regional office charge in overhead to remain consistent with pre-2016 practice. We plan to work with the regulators to arrive at a consensus presentation in our next application.

3. **Gas and Oil.** While cost/gal increases look reasonable (and consistent with SCSS), total CNG gallons increased by 64% from 2017 while diesel stayed the same.

Our explanation indicated that we added a CNG truck in 2018, and a second was added in 2019, so overall CNG use is rising very significantly. CNG gallon equivalents are not equal to diesel gallons so they cannot be simply added together. The larger underlying issue is the labor hour allocation correction described above.

6. **Office**. This reflects an increase of 23% vs 18% for SCSS. Unless there is a compelling/unique circumstance otherwise, I can support 18%.

As our explanations indicate, most of the growth in the office category is related to investments in safety, and safety is allocated on labor hours. Like other cost categories that are linked to labor, this category has increased at an outsized percentage at Mission Country.

7. **Operating Supplies.** These are up by 94% compared with 6% for SCSS. . Unless there is a compelling/unique circumstance otherwise, I can support 6%.

This account change of $13,000 over 3 years is not material to the financial statements. The parts expense is also linked to driver hours, which are discussed above. Our reported number is a modest increase from the actual audited results for 2018. However, to reflect additional conservatism, our amended application reduces the increase to the 2017 balance plus 23% for the "labor effect" in the hopes that we will achieve efficiency in this account.

8. **Insurance**. While a modest increase of 2.9% from 2017, for SCCS this cost was down from 2017 by $180,000 (15%) for liability, offset by increases in medical, for a net decrease of 10% ($115,000). I would expect to see similar savings for MCD.

Insurance is made up of two major components—risk insurance and group health insurance. Indeed, group insurance expense has dropped significantly since 2016. This benefit has been nearly cancelled however, by increased allocations of group insurance expense. South County saw the benefit of risk insurance without offsetting significant increases in group insurance. Group insurance rates have increased faster than basic inflation.

Insurance Type	2017	2019	% Change
Group	$229,654	$325,234	41%
Casualty	244,056	162,104	(44%)
Total Insurance	$473,710	$487,388	2.9%

9. **Outside Services: Temporary Staffing**. This is up by $20,000 to cover vacancies. Not a problem per se, except direct labor is already up significantly, so I might expect some offsetting savings.

The costs were truly incurred. We already forecasted overall savings in truck-related labor prior to filing this application. Since this account is linked to labor, it is receiving a larger allocation than the past and should be right-sized now for future rate applications.

11. **Telephone**. As you note, your application needs to be revised downward by $8,000.

Our amended application removes this issue from consideration.

13. **Truck Repairs.** This is up by 23% compared with 20% for SCSS. Unless there is a compelling/unique circumstance otherwise, I can support 20%.

Note that the 23% increase is a number that repeats itself. We've already taken the truck expense reductions that we agreed to at South County. The change here is a result of the increased and appropriate hour recalculation for Mission Country.

Regards,

Jeff Smith
District Manager

GLOBAL OUT LOOK

CHINA NOT IN THE FUTURE

It seems odd that in the middle of the Amazon craze we are looking at a decrease in the demand of waste paper from China. In fact, it's hard to understand why China is not on board with the recent growth of the packaging sector. International Paper, Georgia Pacific etc. are having record years.

This is a complex issue. First, we have to look at the government which is the polar opposite of the United States. I know this sounds simple but it really is not. We are a free capitalistic republic and China is, well a Communist country. We continue to say, this just does not make sense, and it truly does not. Communist Countries do not look for sense but control. This control is in the form of new regulations that come down from the leaders without understanding the economic impact to their own country. What is truly amazing is all the paper mills in China feel the same way but if they were to say anything against the Chinese Government they would literally be thrown in jail or removed from their position. China is really not about a "Team approach".

Here is a little history on how we all got to 2018 and the new laws and regulations currently being enforced by the Chinese Government. 20 years ago, China began building infrastructure, buildings and equipment to help propel them to an industrial power. Included in this was papermills, to be able to make packaging for all the products that were going to be produced in China. Previous to 2000, very little waste paper was consumed in China. Other countries such as European countries, Taiwan, Korea, Indonesia and Japan were the largest consumers. Interestingly enough the quality standards in these countries was very high. You either needed to make this quality or you would not be able to sell your product to these mills. This was also indeed the practice in the USA. Part of this was because the technology of cleaning equipment was very expensive and cost prohibitive. It was actually more cost effective to pay more for cleaner paper than to pay less for lesser quality paper.

In the 1990's sorting lines were being built to help separate office paper produced from large office buildings to help the growing demand of pulp substitutes. Sorted white ledger and sorted office paper arrived as a very good alternative to expensive pulp. The unfortunate remaining product of this process was mixed paper, such as groundwood grades, file folders, OCC and other unbleachables. Concurrently, China was building state of the art paper mills. They were looking for low cost fiber to make their products. That low cost contaminated mixed paper combined with OCC was a viable raw material for them and they started purchasing machines that could clean this fiber from contamination and make paper. Still USA mills were not going to entertain this because they new it was not sustainable with costs.

By 2000 China had begun its journey as the largest mixed paper consumer in the world. Growing Chinese mill groups were able to convince all of the major waste haulers in the United States that they could make paper out of this mixed paper. Even lowering the grade and consolidating it as single stream in their recycling programs. When the waste haulers figured out the money they could save by using one truck instead of multiple trucks, sorting lines started being purchased. These sorting technologies came from the basics of mining equipment to efficiently separate grades of paper, OCC, news and mixed paper. However, this material would be comingled with glass, plastic, tin, aluminum cans, plastic bags, dog poop, kitty litter and garbage. That's right garbage, if you're garbage can overflowed, toss it in the recycling bin who will say anything there is no quality control. (wishful recycling) In fact, the City of Los Angeles in the late 1990's had residual garbage at 40% from their single stream. However, China kept buying this material. You would see quality claims on a consistent basis but you knew this was part of the business and you paid the claim and moved on.

During this industrial boom China was recognizing that there was a cost to all of this growth to China's Environment. In 2012, President Jinping Xi was elected by the Communist party and started to enforce new reforms and initiatives including new Environmental policies. The first which was made very public was the computer recycling business in many documentaries.

In 2014, Green Fence policy was put into place after China realized that the wastepaper stream developed was a majorly flawed system. Mixed paper and curbside news were containing approximately 5 to 10 percent prohibitive and the yield from this grade is approximately 70 percent. Simple math tells us if China is importing 6 million tons of mixed paper they are also importing 1.8 million tons of material that will go to the landfill. Part of this however is the papermaking process, but with lower grades you get lower yield. As mentioned earlier, the US papermills were very aware this was going to happen this is why we don't buy much mixed paper domestically.

This new influx of landfill bound material caused China's government to have a knee jerk reaction. China decided to hold strict inspections and they started rejecting material and sending shipments back to their origin. Green fence policy was created to get control of the waste that was being shipped. Since 2014, China noticed that mills were still disposing the same amount of waste and instead of telling the government that this is part of the paper making process the mills kept quite as new regulations became stricter. Once again, in a communist country you don't have the freedom to find a reasonable solution, you just hit the brakes.

In 2017, China flat out made a decision to no longer accept recycled plastic in any form. Before this, they were the largest consumer of HDPE, PET, plastic bags and a grade called MRF film. Once again China developed this market by accepting low quality plastic that in some cases like MRF film was filled with terrible contamination. Previous to this there was no market for MRF grade. So instead of coming to a reasonable standard, the Chinese government just banned plastic all together and all the factories that were recycling plastic just went under.

Currently we are watching the same scenario play out with metals. It could be partially related to the trade talks but we are unsure. We do know that China has said it will ban importing metals by the end of 2018.

So where does this leave waste paper. Currently as of January 1st 2018 mixed paper is banned from China. That is 6 million tons of paper. Who will buy this, for now it is limited, India is a far second to China and everyone is running to shove 6 million tons into a market that will consume 1 million tons.

The next question is what has happened to our waste stream at our homes in just 10 years. There is a simple answer, look at your recycling bin at your house. You have lots of OCC, lots of junk mail with little to no newsprint. The newsprint market is limited and there are only a couple of mills in the world now that produce recycled newsprint. This leaves only a couple of answers for diversion from the landfill for mixed paper, use it for fuel for a waste to energy plant or anaerobic digesting. Both of these options are the same, they will cost landfill rates if not higher.

Under the current China Leadership, they want to move away from importing paper and have an initiative to be self sufficient by 2020. It is hard for us to believe this is possible with billions of dollars of investments in paper mills. If China follows what they are currently doing with computers, plastic and metal recycling then, they can do this with wastepaper as well. Our belief at the Boston Group is that the market for grades like OCC and office paper will continue to be in demand globally. Mixed paper by pure recycled stream at the house hold will continue to be an item that will be in to much supply for the demand. As mentioned earlier, it will have to be used in other manners that will divert it from the land fill but will be costly. It is also important to note that garbage at the curbside is not sorted but mixed paper that is destine for more expensive tip fees will be sorted.

The conclusion of our cost of recycling is no longer a shared profit but pure cost. Adding labor to sort mixed paper is at a minimum doubling you're costs. In California, my estimate at profitable recycling and diversion will be $75 per ton charge at the door of recycling facilities.

I am more than welcome to always talk about different markets and how they will change in the future. Always feel free to call me.

Regards,

Kevin Kodzis
President
The Boston Group Inc.

COLD CANYON PROCESSING FACILITY

A Waste Connections Company

March 19, 2019

Aaron Floyd
Deputy Public Works Director
City of San Luis Obispo
Public Utilities
879 Morro Street
San Luis Obispo, CA 93401

Subject: MRF Recycling Background

Dear Mr. Floyd,

It is my pleasure to continue with the partnership created many years ago between the City of San Luis Obispo, San Luis Garbage Company and the Cold Canyon Processing Facility.

As the local service provider, the Cold Canyon Processing Facility has always tried to stay a few steps ahead of the trends affecting the processing of recyclables. Global commodity markets are volatile. As of 2012, we stopped sending material to China as we began to see that with China, there was too much unpredictability in the market. We also started seeing price manipulation that was actually hurting the local market. We knew then that, as a local service provider, we needed to manage volatility and build stronger relationships within our own community. We started building those relationships with our local partners like George Kardashian at San Miguel Garbage and Faron Bento in Cayucos. We did this by securing reasonably priced transportation when and where we needed it for our local community, as we are approximately five hours from any port or mill. These moves allowed us to keep recycling costs as low as possible for our customers.

We also continued to build relationships along the West Coast with mills and manufacturers that use our recyclable materials. We moved materials within California as much as possible with an eye on cost predictability and control. Mixed paper is approximately 30% of our recycle stream, so we had to find a way to recycle this material type. While others in the County were disposing of mixed paper in landfills, we continued to maintain relationships in places such as Malaysia, Vietnam and South Korea, which allowed us to continue processing mixed paper, although often at a significant loss.

In late 2013 and early 2014, China rolled out a program called the "Green Fence," through which China began restricting the recycling materials the country was willing to accept. Luckily, our relationships with our other partners were well established by this point, minimizing the initial impact of this program. Then in 2017, China instituted what amounted to a ban on foreign recyclables. Called the "National Sword" campaign, this action created a new norm—going forward, China would only accept materials with no more than 0.5% of what the Chinese now deemed 'trash.' In 2018, China banned 24 materials from being imported at all.

These changes meant that a typical MRF in the U.S., like the Cold Canyon Processing Facility, had to alter its operations drastically. The first step was to slow the line down from processing 20 to 22 tons of materials per hour, to 12 to 14 tons per hour. This has greatly increased costs at our facility by requiring the doubling of our workforce and increasing overtime by over 100% in order to process the materials.

Since the inception of the "National Sword" campaign, commodity values have continued to drop. In the past three months, we have seen another 60% decrease in commodity values. Many markets have completely shut down and no longer accept recyclable materials. However, we have still been able to move all materials types to our end market processors because of our trusted relationships and ability to navigate challenging market conditions.

As the local service provider, we chose to do the right thing, at the right time, for the right reason. During the beginning of this crisis in 2017 and 2018, many other processors began disposing of recyclable materials in landfills because they couldn't sell them, didn't want to pay for acceptable disposal, or couldn't create a product that anyone could take even at cost. The Cold Canyon Processing Facility is one of the few MRFs in the region that chose to continue to process materials even if it cost us more money through additional processing costs, increased transportation fees, and final destination fees.

Between the additional headcount to process the materials correctly and produce a product that is marketable, coupled with a decrease in the overall average commodity price of 35% to 65% depending on the material type, we have no choice but to increase our per-ton processing fee. The per-ton processing fee increase allows us to continue operations as the lowest cost service provider to our customers, and it is our intent to continue to operate in a manner that will allow us to be the lowest cost service provider going forward.

You have our commitment that we will continue to work to find the best value for the materials generated. We will continue to focus on outreach and education to eliminate non-recyclable materials from our recycle stream. We will look for opportunities to update our equipment to meet future recycling needs as California marches on toward a 75% diversion goal.

For the reasons outlined above, and as we've discussed with you over the past several months, the purpose of this notice is to inform you that the Cold Canyon Processing Facility will be increasing its per-ton recyclable materials processing fee it charges San Luis Garbage Company for the City's recyclable materials from $7.80 to $67.50, effective June 1, 2019.

For your reference, I have included below links to a couple of articles that may further help the City understand how the recycling market has changed.

https://www.npr.org/sections/goatsandsoda/2019/03/13/702501726/where-will-your-plastic-trash-go-now-that-china-doesnt-want-it

https://www.theatlantic.com/technology/archive/2019/03/china-has-stopped-accepting-our-trash/584131/

We thank you for your long-term partnership and look forward to many more years of working together toward common goals with regard to recycling.

Sincerely,

John Ryan
District Manager
Cold Canyon Processing Facility
a Waste Connections company

cc: Mychal Boerman, Peter Cron, Ron Munds, Bill Statler, Jeff Smith, Sue VanDelinder