



Staff Report

File #: 18-510

Version: 1

Date: 11/13/2018

Item #: 4.a.

TO: Mayor and City Council
THROUGH: Steve Powers, City Manager
FROM: Ryan Zink, Franchise Administrator

SUBJECT:

Establishing New Solid Waste Management Service Rates

Ward(s): All Wards

Councilor(s): All Councilors

Neighborhood(s): All Neighborhoods

ISSUE:

Shall City Council adopt Resolution No. 2018-81 establishing new solid waste management service rates effective January 1, 2019, and rescinding Resolution No. 2017-45?

RECOMMENDATION:

Adopt Resolution No. 2018-81 establishing new solid waste management service rates effective January 1, 2019, and rescinding Resolution No. 2017-45.

SUMMARY AND BACKGROUND:

SRC 47.099(b) requires City Council to establish and adjust solid waste management service rates by service or by zone. SRC 47.099(f) specifies the factors that shall be considered in establishing or adjusting rates:

- Current and projected revenues;
- Current and projected operating expenses;
- Acquisition and replacement of equipment;
- Professional and consultant services;
- Reasonable operating margin;
- Construction and maintenance costs;
- Research, training, and development;
- Special services;
- Composting, recycling, reuse, and resource recovery services, if such services are required by

- the City or any other governmental agency with jurisdiction over the activity or service; and
- Any other factor deemed relevant by the City Council.

In May 2018, the Mid-Valley Garbage and Recycling Association (Mid-Valley), comprised of the six solid waste management franchisees serving Salem, requested rate increases effective January 1, 2019, and provided applicable consolidated financial reports to support the request.

The City contracted with Bell & Associates, Inc. (Bell) to assist with solid waste management services rate review and conduct rate analysis. The solid waste haulers made adjustments as suggested by Bell and submitted revised rate increase proposals consistent with what Bell's rate analysis demonstrated to be just, reasonable, and adequate.

FACTS AND FINDINGS:

The City regulates rates to simulate competition and avoid monopolistic pricing. For solid waste management firms in Oregon, a return on investment is consistent with a pre-tax return on revenue of eight to 12 percent. Some Oregon jurisdictions comparable to Salem specify a target for return on revenue in their municipal codes. Beaverton has codified a target of nine percent, and Gresham's code targets 10 percent. The City follows an industry-wide practice of targeting 10 percent pre-tax return on revenue. City Council sets rates that seek to balance the cost of service to customers with a reasonable expectation for total revenue to sustain operations for the haulers.

RATE REVIEW PROCESS

Last year, City staff proposed performing a two-year projection beyond the current year as part of the cost of service analysis (COSA) and adopting solid waste collection rates for both of the projected years. Using a biennium rate setting process allows for more gradual increases in solid waste collection rates, provides savings in time and financial resources dedicated to the solid waste rate review process, and occurs on alternate years from the water, wastewater, and storm water rate setting process, which occurs in even years. In October 2017, City Council approved solid waste management rates effective January 1, 2018, and January 1, 2019.

While the intent of this change in process is to adopt biennial rates, unforeseen events could necessitate an unscheduled rate adjustment, particularly for abnormal conditions such as significant, unexpected increases to the cost of service provision or changes in the commodities market. Unfortunately, abnormal conditions occurred during 2018, requiring Mid-Valley to request an adjustment to the 2019 adopted solid waste management rates. As described later in the report, the most significant of these conditions is a reduction in the amount and types of material accepted in the global recycling market. Fuel prices and the cost of disposal at Coffin Butte (Polk County) experienced unexpected increases as well. While fuel and disposal costs alone may not have triggered an adjustment to the 2019 adopted rates, addressing them with the recycling issues will help to minimize future increases.

Financial reports for the six haulers were compiled by Mid-Valley's certified public accountant into

one representative report for Marion County and one representative report for Polk County. The City's consultant, Bell, has performed several rate reviews of the City's haulers and has experience in Salem's solid waste management system, the methodology used to readily assess the haulers' consolidated financial position, and the factors applicable to the requested rate increases.

As stated in the letter from Bell (Attachment 3), the analysis considered all of the factors set forth in SRC 47.099(f) and included, but was not limited to, the following procedures:

- Reviewed allocations of costs between the City of Salem and other jurisdictions.
- Completed a predictive test of revenues compared to the reported customers in the City of Salem.
- Completed a predictive test of solid waste disposal and yard debris processing expenses compared to the reported customer counts in the City of Salem.
- Compared reported expenses for 2017 to prior years' costs reported results for comparability and reasonableness.
- Reviewed the inflation assumptions proposed by Mid-Valley for the calendar years 2018 and 2019 for reasonableness.
- Projected collection expenses for calendar years 2018 and 2019 that were utilized to calculate the proposed collection rate increases submitted to the City Council for consideration.
- Reviewed medical waste collection expenses from 2017 and the inflation assumptions for the updated rates submitted to the City Council for consideration.

Adjustments and questions on the reports were discussed with the haulers' representatives and applicable adjustments were made. The adjusted consolidated report was used to calculate the system's return on revenue to provide a measure of the adequacy of rates. The return on revenue percentage is total revenues minus total expenses, divided by total revenues. The return on revenue target for rate setting is based on the consolidated financial report. When return on revenue is anticipated to fall below this range, rates are recalibrated to approximate a 10 percent pre-tax return on revenue.

As demonstrated in Table 1, the cost of service model predicts the combined return on revenue for calendar year 2018 - 5.0 percent - is well below the target range. The return on revenue for both Marion and Polk counties, without an adjustment to the adopted rates for 2019, is projected to be below the target range, 3.8 percent and 0.1 percent, respectively, with a combined rate of return of 3.4 percent. The proposed monthly rate increases are intended to maintain a 10 percent return on revenue for 2019.

Table 1

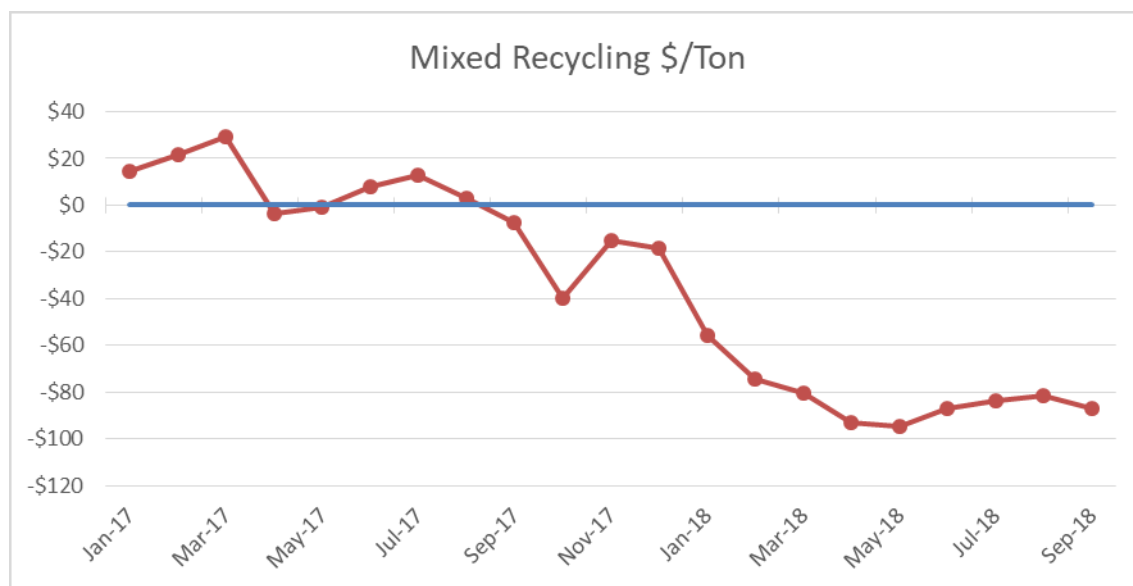
Review Year	Combined Return on Revenue	Marion Co. Return on Revenue	Polk Co. Return on Revenue
2017	8.0%	7.9%	9.3%
2018*	5.0%	5.2%	2.7%
2019*	3.4%	3.8%	0.1%

*Projected

FACTORS DRIVING RATE INCREASES

Sale of Recycled Material:

When rates for 2018 and 2019 were adopted in October 2017, no increase or decrease in recycled material revenue was projected as is the practice due to the volatility of the recycled materials market. In 2017, the haulers received an average of \$0.33 (33 cents) per ton of recycled material collected. At the end of 2017, China announced that it would no longer allow the importation of most post-consumer plastics and unsorted paper, and greatly reduced its allowable contamination level for recycled material to 0.05 percent from 1.5 percent. The abruptness of China's announcement resulted in major disruptions in global recycling markets. Now, haulers are paying a recycling process cost of over \$80 per ton and are experiencing a large gap between their recycling costs and their recycling revenue.



A key element of the COSA was to determine the additional rate revenue necessary to cover deficits caused by the increased cost of recycling operations. For cart services, a flat rate of \$2.00 per customer, added to the monthly rate, was calculated to cover the increased cost of recycling services. Due to the variability in recycling services for commercial customers, a percentage increase for container services is appropriate (4.74 percent for Marion County and 7.29 percent for Polk County).

Even with this drastic decrease in revenue and increase in cost of recycling, the recycling processing cost is still less than the cost of garbage disposal, so it remains a viable and valuable program.

Fuel Costs:

When 2018 rates were adopted in 2017, fuel costs were projected to increase 1.5 percent in 2018 and 5.0 percent in 2019. The actual increase experienced and projected for the remainder of 2018 is 34.0 percent, while 2019 is projected to remain flat (0.0 percent).

Coffin Butte Disposal Costs (Polk County Customers):

When 2018 rates were adopted in 2017, disposal costs at Coffin Butte were not projected to increase during 2018 and 2019. However, disposal costs increased 4.17 percent in 2018, and in 2019, are projected to increase 4.76 percent.

RATE REQUEST

A summary of the rate request is provided in the tables below, with the full list of proposed rates provided in Exhibit A to Resolution 2018-81.

Table 2 provides a summary of rate increases proposed in Marion County. The amount requested to address the increased cost of operations (fuel) is listed separately from the amount requested to offset losses in recycling.

Table 2 - Marion County

Line of Service	Operations	Recycling	Total
Roll Cart Services (mostly residential)	3.26%	\$2.00	8.9% - 11.7%
Container Services (commercial)	0.58%	4.74%	5.32%
Drop Boxes	2.34%	-	2.34%

Table 3 provides a summary of rate increases proposed in Polk County. The amount requested to address the increased cost of operations (fuel and disposal) is listed separately from the amount requested to offset losses in recycling.

Table 3 - Polk County

Line of Service	Operations	Recycling	Total
Roll Cart Services (mostly residential)	5.71%	\$2.00	13.6% - 16.9%
Container Services (commercial)	1.71%	7.29%	9.00%
Drop Boxes	9.13%	-	9.13%

PROPOSED RATE INCREASES

The proposed rate increases affecting the greatest number of Salem customers are those associated with roll cart services. While all rates are established by the City Council as monthly charges, subscribers to solid waste management services are typically billed for two months of service at a time. Tables 4 and 5 below demonstrate, by county, the increase a resident of Salem would expect to see on their bi-monthly garbage bill starting January 1, 2019.

Table 4 - Marion County

Cart Size	2018 Current	2019 Adopted	%	2019 Proposed	% *	Bi-Monthly Bill Increase
20 Gallon	23.55	24.05	2.2%	26.30	11.7%	5.50
35 Gallon	26.65	27.25	2.2%	29.50	10.7%	5.70
65 Gallon	35.30	36.10	2.2%	38.45	8.9%	6.30

* Represents 3.26% increase plus \$2.00/month

Table 5 - Polk County

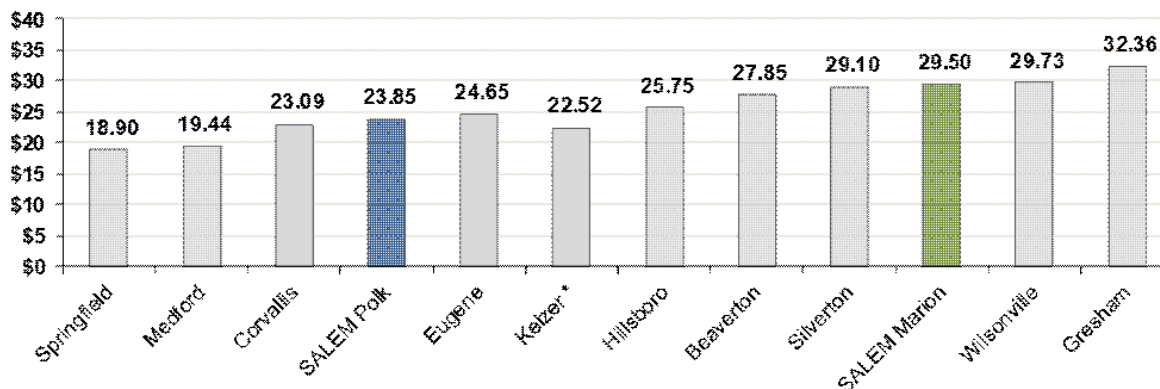
Cart Size	2018 Current	2019 Adopted	%	2019 Proposed	% *	Bi-Monthly Bill Increase
20 Gallon	18.10	18.30	1.2%	21.15	16.9%	6.10
35 Gallon	20.65	20.90	1.2%	23.85	15.5%	6.40
65 Gallon	25.40	25.70	1.2%	28.85	13.6%	6.90

* Represents 5.71% increase plus \$2.00/month

RATE COMPARISONS

When comparing the proposed residential monthly refuse rate for 35 gallon roll cart services to the current rates in neighboring cities and those with relatively comparable service levels, the proposed rates remain reasonable. Haulers in Salem provide a number of services not provided in many other communities, such as weekly mixed organics curbside collection and curbside recycling of motor oil, antifreeze, latex paint, cooking oil, and household batteries.

Rate Comparison - Residential Monthly Rate 35 gallon roll cart service

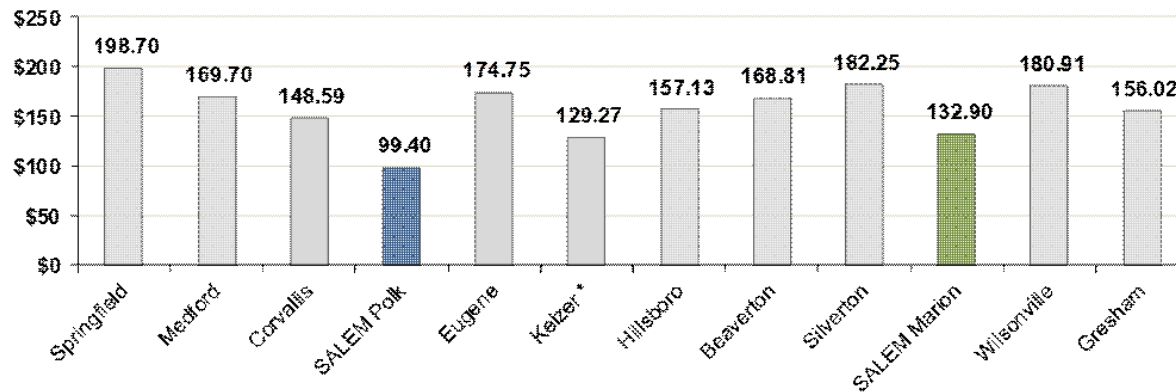


* Keizer's pending rate increase not reflected

A review of the Comparative Rate Summary (Attachment 5), shows that some other jurisdictions appear to allow subsidization among line of service. Unlike these other jurisdictions, Salem maintains a practice of calculating and applying the cost of service to each line of service equally (targeting a 10 percent return on revenue for each line of business). This ensures all customers pay the full cost for the service they use. The most commonly used commercial service is the 2-yard container. The graph below shows how Salem's 2-yard container service rates compare with other jurisdictions.

When comparing these two graphs, the subsidy between services in other jurisdictions is made apparent.

Rate Comparison - Commercial 2-yard Container Service



* Keizer's pending rate increase not reflected

20-GALLON EVERY OTHER WEEK SERVICE

During the solid waste rates public hearing held October 9, 2017, Estle Harlan, the consultant for Mid-Valley, reported that the haulers would return to City Council within 3 to 6 months with a plan to offer 20-gallon every other week (EOW) service. This service offering was in response to requests and public testimony received prior to the public hearing.

In February 2018, staff reported that Salem haulers would offer a 20-gallon cart EOW service starting in April 2018. It would be offered as a full-service option to include commingled recycling and mixed organics. Subscribers of 20-gallon EOW service would be expected to adhere to recycling standards, including all changes as a result of the China recycling ban.

Following this report, two franchisees, covering the majority of residential customers in Salem, reached out to customers that would most likely benefit from 20-gallon EOW service. These customers were those currently subscribed to 20-gallon weekly service and customer subscribed to on-call garbage service. As a result of this outreach and the offering of 20-gallon EOW service, only one customer has signed up. Customers expressed very little interest in this service option. This low interest could be due to recent changes in the local recycling program in response to the global changes in the recycling market.

MEDICAL WASTE DISPOSAL RATES

Mid-Valley submitted a rate analysis and proposed rate increase for medical waste collection services. The analysis found that an increase for the low-volume service of 8.4 percent and an increase for the high-volume service of 31.3 percent would be necessary to maintain an overall 10 percent return on revenue for medical waste collection service. For low-volume customers, the increase will be up to \$2.35 per box and for high-volume customer, the increase will be up to \$4.70

per box, depending on box size and number of boxes picked up. These rates reflect the continued effort to balance the cost of service between lines of medical waste disposal services. Mid-Valley provided a Comparative Rate Summary (Attachment 6) listing low-volume and high-volume rates for medical waste collection which indicates that the new rates would remain reasonable when compared to other jurisdictions with comparable service levels.

CONCLUSION

Staff finds the proposed rates to be just, reasonable, and adequate, and recommends City Council adopt the solid waste collection rates, effective January 1, 2019.

RYAN ZINK
FRANCHISE ADMINISTRATOR

Attachments:

1. Resolution No. 2018-81.
2. Resolution No. 2018-81 Exhibit A - Schedule of Monthly Solid Waste Management Service Rates Effective January 1, 2019.
3. Letter from Bell & Associates, Inc., Solid Waste Cost of Services Analysis.
4. Comparison of Current and Proposed Solid Waste Collection Rates Effective January 1, 2019.
5. Mid-Valley Comparative Rate Summary - Monthly Rates for Solid Waste Service.
6. Mid-Valley Comparative Rate Summary - Medical Waste Disposal.