



Staff Report

File #: 19-515

Version: 1

Date: 11/12/2019

Item #: 4.a.

TO: Mayor and City Council

THROUGH: Steve Powers, City Manager

FROM: Ryan Zink, Franchise Administer

SUBJECT:

Establishing New Solid Waste Management Service Rates

Ward(s): All Wards

Councilor(s): All Councilors

Neighborhood(s): All Neighborhoods

Result Area(s): Good Governance; Natural Environment Stewardship; Safe Community; Safe, Reliable and Efficient Infrastructure; Strong and Diverse Economy; Welcoming and Livable Community.

ISSUE:

Shall the City Council adopt Resolution No. 2019-82 establishing new solid waste management service rates effective January 1, 2020 and January 1, 2021, and rescinding Resolution No. 2018-81?

RECOMMENDATION:

Adopt Resolution No. 2019-82 establishing new solid waste management service rates effective January 1, 2020 and January 1, 2021, and rescinding Resolution No. 2018-81.

SUMMARY:

In June 2019 the Mid-Valley Garbage and Recycling Association (Mid-Valley), a body comprised of the six solid waste management franchisees serving Salem (haulers), requested rate increases effective January 1, 2020, and provided applicable consolidated financial reports to support its request.

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

City staff and the haulers are again proposing a biennial rate adoption process, adopting rates effective January 1, 2020 and January 1, 2021. The City works with the haulers to maintain a pre-tax return on revenue between 8 and 12%, targeting 10%. Without a rate increase the annual increases fall below this target, specifically: the projected 2020 combined pre-tax return on revenue is 7.1% and in 2021, 5.5%.

The proposed rate increases shown in the following table are calculated to maintain a pre-tax return on revenue for both years within the targeted range, while providing steady rate increases for the next two years. Staff finds the proposed rates to be just, reasonable, and adequate, and recommends that the City Council adopt the proposed solid waste collection rates.

Table 1 - Proposed Rate Increases

Line of Service	2020		2021	
	Marion Co.	Polk Co.	Marion Co.	Polk Co.
Cart Service (mostly residential)	4.25%	5.00%	4.25%	5.00%
Container Service (commercial)	0.00%	7.18%	1.46%	7.50%
Drop Boxes	4.19%	11.50%	2.31%	10.00%
Combined	3.00%	5.50%	3.00%	5.50%

Medical Waste	2020	2021
Heavy-Volume	0.00%	4.30%
Low Volume	0.00%	0.00%
Hospital Collection	0.00%	1.90%

In addition to this staff report, Attachment 7 provides information regarding the rate methodology, recycling, and rate analysis.

FACTS AND FINDINGS:

PROPOSED RATE INCREASES

The proposed rate increases affecting the greatest number of Salem customers are those associated with cart services. The tables below show the monthly increases for commonly subscribed services. Most residential customers will see an annual increase of approximately \$15.00 (\$1.25 x 12 months). While most 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. The full list of rates to be effective January 1, 2020 and January 1, 2021 are provided in Resolution 2019-82 Exhibit A and Exhibit B respectively.

Table 2 and Table 3 below, demonstrate by county, typical monthly rate increases for cart and container service. Drop box services are charged based on use.

Table 2 - Sample Monthly Rates Effective January 1, 2020

Sample Service	Marion County				Polk County			
	Current Rate	Proposed Increase	Proposed Jan-2020	Increase Percent	Current Rate	Proposed Increase	Proposed Jan-2020	Increase Percent
35 Gallon Cart	\$ 29.50	\$ 1.25	\$ 30.75	4.25%	\$ 23.85	\$ 1.20	\$ 25.05	5.00%
2 Yard Container	\$ 132.90	\$ -	\$ 132.90	0.00%	\$ 99.40	\$ 7.15	\$ 106.55	7.18%
20 Yard Drop Box	\$ 438.55	\$ 18.40	\$ 456.95	4.19%	\$ 159.60	\$ 18.35	\$ 177.95	11.50%

Table 3 - Sample Monthly Rates Effective January 1, 2021

Sample Service	Marion County				Polk County			
	Proposed Jan-2020	Proposed Increase	Proposed Jan-2021	Increase Percent	Proposed Jan-2020	Proposed Increase	Proposed Jan-2021	Increase Percent
35 Gallon Cart	\$ 30.75	\$ 1.30	\$ 32.05	4.25%	\$ 25.05	\$ 1.25	\$ 26.30	5.00%
2 Yard Container	\$ 132.90	\$ 1.95	\$ 134.85	1.46%	\$ 106.55	\$ 8.00	\$ 114.55	7.50%
20 Yard Drop Box	\$ 456.95	\$ 10.55	\$ 467.50	2.31%	\$ 177.95	\$ 17.80	\$ 195.75	10.00%

MEDICAL WASTE DISPOSAL RATES:

Mid-Valley submitted a rate analysis and proposed no rate increase for medical waste collection services in 2020 and the following rate increases in 2021: 4.3% for heavy-volume medical waste collection service, 0.0% for low-volume medical waste collection service, and 1.9% for hospital collection service. City staff agree that these rates are necessary to maintain an overall 10% return on revenue for medical waste collection service.

RATE REVIEW PROCESS

ORS 459.017 (b) gives local jurisdictions the primary responsibility for solid waste management. ORS 459A.085(3) provides legislative intent "that a city or county may displace competition with a system of regulated collection service by issuing franchises which may be exclusive if service areas are allocated." Further, SRC 47.099 (f) (5) provides that a "reasonable operating margin" for the haulers is a factor that must be considered when establishing or adjusting rates. For decades Salem has targeted a pre-tax margin of 10% for Salem haulers. If the pre-tax margin is below a range of 8-12%, rates are adjusted.

SRC 47.099(d) requires the 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.

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 accumulated knowledge of Salem's solid waste management system, the methodology used to readily assess the haulers 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 2018 to prior years' costs reported results for comparability and reasonableness.
- Reviewed the inflation assumptions proposed by Mid-Valley for the calendar years 2019 to 2020 for reasonableness.
- Projected collection expenses for calendar years 2019 to 2020 that were utilized to calculate the proposed collection rate increases submitted to the City Council for consideration.
- Traced the line item revenues and expense from the 2018 cost of service analysis submitted by Republic Services to the company's detailed income statement for Capital Disposal.
- Completed a site visit to D&O Garbage and Recycling to review the supporting documentation and information used to generate the report submitted to the City. A separate confidential report was submitted to the City on the finding.

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, which provides a measure of the adequacy of rates. The return on revenue target is derived from a simple calculation: total revenues minus total allowable expenses, divided by total revenues. When return on revenue is anticipated to fall below this range, rates are recalibrated to approximate a 10% pre-tax return on revenue.

While previous rate setting processes have attempted to target a 10% pre-tax return on revenue, the following table demonstrates that the actual margin for at least the last six years has fallen short of the target.

Table 4 - Actual Pre-Tax Return on Revenue

Completed Years	2018	2017	2016	2015	2014	2013
Combined Pre-Tax Return	5.6%	8.0%	9.0%	8.7%	7.7%	9.0%

FACTORS DRIVING RATE INCREASES

DISPOSAL COSTS:

The cost of processing recycled material continues to be an area of focus when reviewing the cost of service. In 2017 the haulers generated revenue at an average of \$0.33 (33 cents) per ton of mixed recycled material collected. However, in 2019, haulers paid over \$80 per ton to have recycling processed and are now paying \$110 per ton. 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%. The abruptness of China's announcement resulted in major disruptions in global recycling markets. While the rising cost to process recycled material has slowed and appears to be flattening, no relief is anticipated over the next few years.



Tipping fees for garbage are remaining steady. No increases are anticipated in Marion County (Covanta) and Polk County (Coffin Butte) is only projected to see a small inflationary increase of 2.81% in 2021. Additionally, disposal fees for mixed organics (yard debris and kitchen waste) are projected to increase 10.15% in 2020 with a smaller increase of 1.64% in 2021.

HB 3427 COMMERCIAL ACTIVITY TAX:

In 2019, the Oregon State Legislature passed HB 3427 establishing a commercial activity tax on Oregon businesses effective for the tax year beginning January 1, 2020. The annual tax is \$250 plus 0.57% on taxable commercial activity above \$1 million. A deduction equal to 35% of the greater of input costs or labor costs is allowed. Approximately 0.5% of the proposed rate increases are attributable to this additional business expense.

OTHER FACTORS:

Table 5 displays other adjustment factors used for projecting the cost of service which include fuel,

labor, medical insurance, vehicle depreciation, and general inflation.

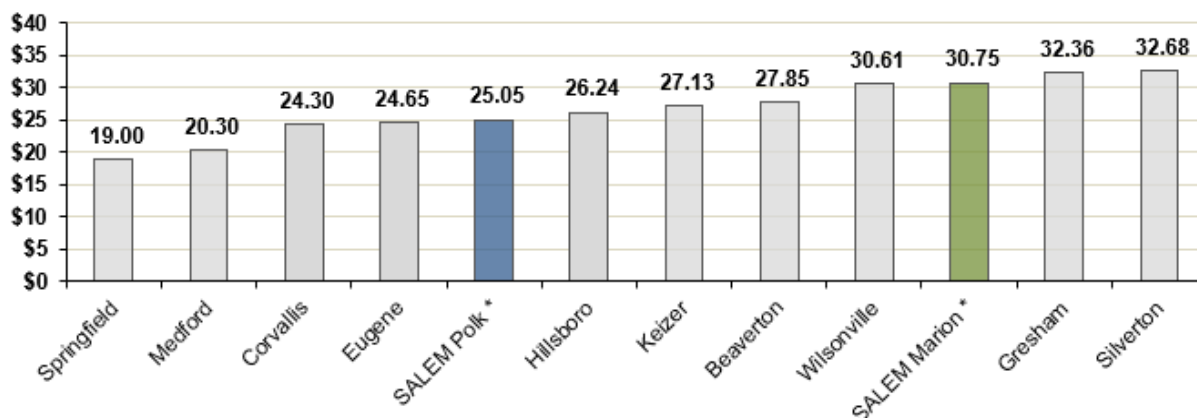
Table 5

Cost Factor	2019	2020	2021
Fuel	-5.70%	9.40%	5.00%
Labor	3.00%	3.00%	3.00%
Medical Insurance	5.00%	4.30%	4.30%
Vehicle Depreciation	2.35%	2.35%	2.35%
General Inflation	2.81%	2.81%	2.81%

RATE COMPARISONS

When comparing the proposed residential monthly refuse rate for 35-gallon roll cart services to the current rates in neighboring cities, the proposed rates remain reasonable when compared to other jurisdictions with comparable service levels. Marion County rates continue to be higher than Polk County rates due to the varying economics of solid waste management in each county. It is important to note that haulers in Salem provide several 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.

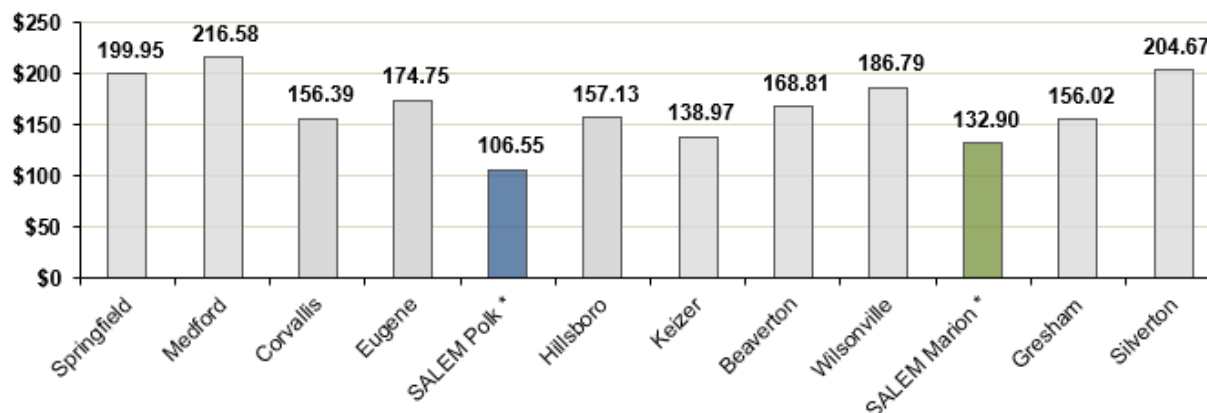
Rate Comparison - Residential Monthly Rate 35 gallon roll cart service



* Salem's Proposed Rates Effective January 1, 2020

While Salem maintains a practice of calculating and applying the cost of service to each line of service equally (targeting a 10% return on revenue for each line of business), a review of the Comparative Rate Summary (Attachment 6), shows that other jurisdictions appear to allow certain lines of service to subsidize other lines of service. 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.

Rate Comparison - Commercial 2-yard Container Service



* Salem's Proposed Rates Effective January 1, 2020

BACKGROUND:

In 2017 City staff proposed performing a two-year projection beyond the current year as part of the cost of service analysis and adopting solid waste collection rates for two projected years. Using a biennial rate setting process would allow for more gradual increases to solid waste collection rates, tracking general inflation rates more closely; provide savings in time and financial resources dedicated to the solid waste rate review process; and occur 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 did occur in 2018, requiring Mid-Valley to request an adjustment to the 2019 adopted solid waste management rates. City staff and the haulers are again proposing a biennial rate adoption process, adopting rates effective January 1, 2020 and January 1, 2021.

The City regulates rates to simulate competition and avoid monopolistic pricing. For many solid waste management firms in Oregon, a pre-tax return on revenue of 8 to 12% is used to determine the need for rate adjustments. Some Oregon jurisdictions comparable to Salem specify a target for return on revenue in their municipal codes. For example, Beaverton has codified a target of 9% and Gresham's code targets 10%. The City follows an industry-wide practice of targeting 10% 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.

RYAN ZINK
FRANCHISE ADMINISTRATOR

Attachments:

1. Resolution No. 2019-82

2. Resolution Exhibit A - Schedule of Monthly Solid Waste Management Service Rates Effective January 1, 2020
3. Resolution Exhibit B - Schedule of Monthly Solid Waste Management Service Rates Effective January 1, 2021
4. Letter from Bell & Associates, Inc., Solid Waste Cost of Services Analysis
5. Comparison of Current and Proposed Solid Waste Collection Rates Effective January 1, 2020 and January 1, 2021
6. Mid-Valley Comparative Rate Summary - Monthly Rates for Solid Waste Service
7. Additional Information and Frequently Asked Questions