



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Kerrie Romanow

**SUBJECT: COMMERCIAL SOLID WASTE
CUSTOMER SERVICE RATES**

DATE: April 29, 2019

Approved

Date

5/10/19

RECOMMENDATION

- (a) Hold a Public Hearing to confirm that the proposed Maximum Commercial Solid Waste Services Rates are consistent with the terms of the Commercial Solid Waste and Recyclable Materials Collection Franchises Agreement between the City of San José and Allied Waste Services of North America, LLC, dba Republic Services; and
- (b) Adopt a resolution setting Maximum Commercial Solid Waste Services Rates in the City of San José pursuant to the Commercial Solid Waste and Recyclable Materials Collection Franchises Agreement between the City of San José and Allied Waste Services of North America, LLC, dba Republic Services, including the total costs for organics processing services.

OUTCOME

Approval of the recommendation will increase the maximum commercial solid waste service rates for fiscal year 2019-2020 by 1.85 percent.

BACKGROUND

Republic Services' Wet/Dry commercial solid waste collection program, which serves more than 8,000 business sites citywide, was designed and is required to ensure all collected waste is processed and recycled to its highest and best use with no material going directly to landfill. The program is designed to be flexible and customizable to each individual business, with different options for quantity, size and type of container. Waste is separated into two categories: 1) wet or organic material such as food waste or plant trimmings, and 2) dry material such as clean paper or plastic. Customers choose which bin type works best for their business and are provided with consistent rates; compliance with statewide requirements to participate in recycling and organics

diversion programs; dedicated service representatives who provide ongoing technical assistance; and online access to billing and service data.

On May 25, 2017, Environmental Services Department (ESD) staff notified Republic Services of liquidated damages totaling \$1,043,393, which the City alleges is owed for failure to meet contract requirements in 2014, 2015, and 2016; \$107,903 of this sum is for unmet diversion. On November 2, 2018, ESD staff further notified Republic Services of the allegation that it owes liquidated damages totaling \$697,265 for failure to meet contract requirements in 2017; \$25,000 of this sum is for unmet diversion. In addition to diversion under performance, the City alleges that these damages are related to call center customer service, unfulfilled organics recycling, untimely bin repairs, and not installing sustainable infrastructure onsite. Republic Services disputes that these liquidated damages are owed to the City and resolution dialog is ongoing, including discussion of potential liquidated damages for 2018. As staff works with Republic Services to resolve these issues, the annual commercial service rates adjustment requirements remain in effect and continue to go forward under the Republic Services Franchises Agreement (Franchises Agreement).

Under the Franchises Agreement, City Council establishes Maximum Commercial Solid Waste Services Rates. The maximum customer service rates vary based on the type of material collected, container type and size, and frequency of collection. The rates are set and may be adjusted each year to satisfy Republic Services' annual revenue requirement, which is the dollar amount needed to fund the cost of operations, including collection equipment and labor, recyclables processing equipment and labor, compensation to Zero Waste Energy Development Company (ZWED) for organics processing service, and payment of government fees such as Franchise Fees and AB939 Fees. The revenue requirement also allows Republic Services a profit margin of 17 percent based on allowable operating costs as defined in the Franchises Agreement.

The Franchises Agreement includes methodologies for adjusting customer rates annually (either up or down) with specific controls limiting both the costs that can be considered and the total annual adjustment amount allowed, which may not exceed 6% in any given year. The adjustment methodologies are designed to protect both the customers and the franchisee by limiting the annual increase allowed and ensuring Republic Services is compensated appropriately as operating expenses fluctuate from year to year. Both the Franchises Agreement and ZWED Agreement include annual inflationary adjustments.

Inflation-based adjustments occur in all remaining years of the Franchises Agreement term, except for Year Nine (2020-2021), in which a cost-based adjustment will occur. The inflation-based adjustment is an index-based adjustment based on changes in the Consumer Price Index (CPI) and changes in the cost of fuel (compressed natural gas). The CPI index adjustments are applied to the assumed costs of service with no review of the actual costs incurred by Republic Services. In the next Fiscal Year, Year Nine (2020-2021), the cost-based adjustment process will involve a detailed analysis of Republic Services' actual costs of service metrics (staffing levels, routes, route hours, customers and their service levels, etc.), a revenue projection for the following year, and determination of the new maximum service rates to calculate the revenue requirement for the following year.

ANALYSIS

For 2019-2020, Republic Services' proposed a 2.27% increase to the 2018-2019 commercial service rates to satisfy their proposed annual revenue requirement amount of \$63,206,392. Staff assessed the proposed annual revenue requirement and rate adjustment based on the Franchises Agreement requirements and the assumed, inflationary adjusted costs of collection and processing operations. For 2019-2020, Staff found that Republic Services included in their proposal \$263,832 in processing costs related to non-San José material. Staff have excluded those costs in the proposal below.

The proposed maximum rates (with an effective date of July 1, 2019) are detailed in the resolution accompanying this report. In addition to collection services, the 1.85 percent rate increase impacts all associated commercial rates including those for bin cleaning, bin locks, pushing and pulling containers into a serviceable position by the truck drivers, and delivery of containers. The resolution also includes a cost of living adjustment of 3.30 percent to the rates paid to ZWED by Republic Services for organics processing as allowed in ZWED's agreement with the City.

The 2019-2020 annual revenue requirement amount is proposed at \$63,109,929. Of this amount, \$41,171,846 is for Republic Services' operations, a portion of ZWED residue, and applicable cost of living adjustments, which comprises 1.56 percent of the total rate adjustment for 2019-2020. The ZWED portion of the revenue requirement is \$7,207,736, a decrease of \$106,885 from the 2018-2019 level, which covers the cost of anaerobically digesting the organic material and is -0.17 percent of the total rate adjustment for 2019-2020. The ZWED portion also includes a \$263,832 reduction in processing costs to correct for an error in Republic Services' calculation of the tonnage attributed to San José businesses.

City Fees of \$14,730,347 include a Franchise Fee of \$12,030,347 (to the General Fund) and an AB939 Fee of \$2,700,000 (to the Integrated Waste Management Fund). The Franchise Fee funds services in the General Fund and may be adjusted each year based on the CPI. The 2018-2019 Franchise Fee revenue is currently estimated at \$11,743,789. Application of the CPI to the actual Franchise Fee figure necessitate a \$286,549 (2.44 percent) increase and 2019-2020 Franchise Fee of \$12,030,347, which is included in this memorandum. The AB939 Fee funds several City functions including oversight, administration, and enforcement of the City's commercial solid waste system; a portion of ZWED residue disposal; and targeted commercial sector waste diversion programs, including public litter cans in commercial districts and technical assistance for recycling and outreach. The AB939 Fee may be adjusted each year based on the operating needs of the City and is set at \$2,700,000 for 2019-2020, as shown in the 2019-2020 Proposed Fees and Charges Report, which is the same as the 2018-2019 level. Overall, the City Fees portion of the rate increase will be adjusted by \$286,549, which comprises 0.46 percent of the total rate adjustment for 2019-2020.

The table below summarizes the components of the overall increase of 1.85 percent for 2019-2020.

<u>Adjustment</u>	<u>2018-2019 Total</u>	<u>Annual Revenue Change</u>	<u>2019-2020 Total</u>	<u>Rate Impact</u>
Republic Contract	\$40,207,540	+\$964,306	\$41,171,846	+1.56%
ZWED Contract	\$7,314,621	-\$106,885	\$7,207,736	-0.17%
City Fees	\$14,443,798	+\$286,549	\$14,730,347	+0.46%
Total Revenue Requirement	\$61,965,959	+\$1,143,970	\$63,109,929	1.85%

The City's rates will remain lower than average following the recommended rate increase compared to rates charged elsewhere in the San Francisco Bay Area. The table in the Attachment compares San José's proposed maximum rates for two common service levels with the 2018-2019 rates from 14 nearby jurisdictions with comparable rate structures. Furthermore, these other jurisdictions do not provide the same recycling services offered by Republic Services and ZWED, which includes processing all collected materials and anaerobic digestion of organics to produce energy and compost.

EVALUATION AND FOLLOW-UP

The Commercial Solid Waste Franchise Fee and AB939 Fee are included in the 2019-2020 Proposed Operating Budget (released May 1, 2019) and 2019-2020 Proposed Fees and Charges Report (released May 3, 2019).

PUBLIC OUTREACH

The Environmental Services Department sent a courtesy letter in April to all businesses served under the Republic Services Franchises Agreement notifying them of a potential rate increase to be considered by Council at its May 21, 2019 meeting. In addition, Republic Services is required to notify all customers of the rate change adopted by City Council at least thirty days before the effective date.

This memorandum will be posted on the City's website for the May 21, 2019 Council meeting.

COORDINATION

This memorandum was coordinated with the City Attorney's Office and the City Manager's Budget Office.

COMMISSION RECOMMENDATION/INPUT

No commission recommendation or input is associated with this action.

COST SUMMARY/IMPLICATIONS

Republic Services bills customers at the maximum customer service rates and in 2019-2020 will retain \$41.2 million of the \$63.1 million to fund the cost of their operations, which includes their guaranteed 17 percent profit margin. Republic Services will remit the remaining balance of \$21.9 million between the City (\$14.7 million), as part of the City's Fees, and ZWED (\$7.2 million) for organics processing services.

The City Fees portion (\$14.7 million), consists of the Commercial Solid Waste Franchise Fee of \$12.03 million received in the General Fund – an increase of approximately \$287,000 from 2018-2019 levels and consistent with the assumptions included in the 2019-2020 Proposed Operating Budget – and \$2.7 million for AB939 Fees approximately \$300,000 of which will be retained by Republic Services to pay for the disposal of ZWED processing residue. The remaining \$2.4 million will be received in the Integrated Waste Management Fund to pay for the associated costs within the Environmental Services Department for the management and administration of the Franchises Agreement and associated service agreements for the Commercial Solid Waste program. However, as the 2019-2020 Proposed Operating Budget assumed receipt of the full \$2.7 million, a clean-up action will be brought forward to lower this revenue estimate by \$300,000 as part of the Recommended Amendments to the 2019-2020 Proposed Operating and Capital Budgets Manager's Budget Addendum to be issued at the end of this month.

CEQA

Statutorily Exempt, File No. PP17-005, CEQA Guidelines Section 15273, Rates, Tolls, Fares, and Charges, Adjustment to Fees, Rates & Fares without changes to or expansion of services.

/s/

KERRIE ROMANOW
Director
Environmental Services Department

For questions, please contact Valerie Osmond, Deputy Director, Environmental Services Department, at 408-535-8557.

Attachment - Rate Comparison by City

ATTACHMENT - RATE COMPARISON BY CITY

Rate Comparison by City Garbage/Wet Container Service

City	3 Cubic Yard Container Collected Once Per Week (monthly rate)		City	40 Cubic Yard Container (per collection rate)
Palo Alto*	\$504.40		Mountain View	\$1,229.55
Sunnyvale*	\$424.53		Milpitas†	\$1,180.82
Los Altos	\$405.48		Santa Clara	\$1,140.80
Saratoga	\$396.37		Palo Alto**	\$1,095.29
Monte Sereno	\$373.02		Cupertino	\$997.08
Mountain View	\$352.50		<i>Average (non-San Jose)</i>	<i>\$970.04</i>
Morgan Hill‡‡	\$347.56		Los Gatos	\$962.14
<i>Average (non-San Jose)</i>	<i>\$338.41</i>		Sunnyvale*	\$954.50
Los Gatos	\$332.39		Saratoga	\$920.97
Gilroy‡‡	\$306.88		Monte Sereno	\$905.67
Campbell	\$280.20		San José Proposed†	\$903.75
Milpitas	\$275.18		Campbell	\$899.48
Cupertino	\$258.63		San José Current†	\$887.34
San José Proposed	\$255.47		Gilroy	\$883.52
San José Current	\$250.83		Fremont**	\$881.12
Santa Clara	\$247.26		Morgan Hill	\$800.16
Fremont	\$226.39		Los Altos‡	\$729.41

* Bin rental fee plus hauling

**Includes delivery fee

† Average of the north and south district rates

‡ Additional disposal charges exist, but not shown

‡‡ Includes optional lock/unlock and push/pull service to remove and return containers to trash enclosures. These services are extra charges in all other jurisdictions including San José.