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

MEMORANDUM

April 18, 2022

TO: Mario Iglesias, General Manager, Nipomo Community Services District

FROM: Bill Statler 

SUBJECT: SOLID WASTE RATE REVIEW

RECOMMENDATION

Approve the proposed rate increase from South County Sanitary Service (SCSS) for solid waste services of 21.27%.

DISCUSSION

Background

SCSS submitted an initial rate application on October 20, 2021 requesting a 23.23% rate increase for all customers. However, due to complexity, concerns with pending rate increases by the Integrated Waste Management Authority (IWMA) and significant subsequent reviews and information exchanges, a revised application was submitted on February 18, 2022 proposing a rate increase of 21.27%.

The final application is the focus of this report in reviewing the SCSS rate increase request in accordance with adopted Franchise Agreement provisions regarding rate increase applications. This revised application was prepared in accordance with the District's Franchise Agreement with SCSS, which calls for rate requests to be prepared based on the "City of San Luis Obispo Rate Setting Process and Methodology Manual for Integrated Solid Waste Management Rates" (*Rate Manual*).

The SCSS application supporting the proposed 21.27% increase is provided in Attachment 1; and provided in Attachment 2 is a comprehensive rate review prepared for the communities of Arroyo Grande, Grover Beach, Oceano and Pismo Beach, which provides the foundation for this report.

Summary of Findings and Recommendations

There are two key differences between the initial and revised application:

- Greenwaste processing costs have been reclassified as “pass-through” costs: while costs may be recovered, no profit is allowed on them.
- IWMA fees have been excluded from the fee analysis. These are approved by a separate agency and will be charged separately on customer bills.

As detailed in Attachment 2, key cost drivers in this review include the following, which account for almost 90% of the cost increases since 2020 (last audited financial statements):

2022 Cost Increase from 2020			
	Amount	% of Total	Rate Impact*
Depreciation	998,708	36%	7.72%
Greenwaste	956,783	35%	7.39%
Insurance	298,612	11%	2.31%
Gas and Oil	131,422	5%	1.02%
Total Key Drivers	2,385,525	87%	18.43%
Other Costs	367,275	13%	2.84%
Total	\$2,752,800	100%	21.27%

Rate Request Review

SCSS, a subsidiary of Waste Connections, provides service to all south county communities under formal Franchise Agreements, including the:

- City of Arroyo Grande
- City of Grover Beach
- City of Pismo Beach
- Oceano Community Services District
- Nipomo Community Services District
- Avila Beach Community Services District
- County of San Luis Obispo for other unincorporated areas in the south county such as Rural Arroyo Grande

As noted above, Attachment 2 provides a comprehensive rate review prepared for the communities of Arroyo Grande, Grover Beach, Oceano and Pismo Beach, which provides the foundation for this report. As discussed in Attachment 2, joint agency review for these four agencies – with the District “piggybacking” on this review – makes sense because:

- SCSS provides the same services to each of these agencies under formally approved Franchise Agreements.
- Each of these Franchise Agreements use the same methodology for regulating rates and establishing procedures for considering rate increases.

- Financial information for SCSS is closely related for these four agencies (as well as all other south county communities).
- Except for Oceano CSD (where the rate is 5%), all agencies have adopted franchise fees of 10%.

In general, all the findings set forth in Attachment 2 are applicable to the District, with two key differences:

- The “allowable profit” (which is described in the attached report) is 7% (versus 8% in the other communities).
- Requirement that SCSS demonstrate that the requested rates are 1% less than what other agencies are paying for similar services.

These factors are why the requested rate increase of 21.27% is less than the proposed rate increase of 22.19% in other south county communities (except for Oceano CSD: as noted above, the franchise fee there is 5%, resulting in a slightly lower rate increase of 21.03%). Compared with similar agencies as presented in the rate survey on page 15 of Attachment 2 (Table 8) as well as other south county communities, SCSS has met their “1%” requirement.

Findings

The key findings presented in the attached report also apply to the District:

- ***Complete Application.*** With its revised application, SCSS has fully provided the supporting documentation required for rate requests under the District’s Franchise Agreement.
- ***High Level of Service at a Reasonable Cost.*** SCSS provides a broad level of high-quality services to the District – 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, rates in the District will be among the lowest of those surveyed. In short, south county communities have the best of both worlds: high quality services at a low cost (compared with other communities).
- ***“Trigger Option.”*** As discussed in greater detail in Attachment 2, the rate increase exceeds the cost of living threshold that “triggers” the option of terminating the Franchise Agreements within nine months after rate approval.
- ***Need for Updated Rate-Setting Methodology.*** The rate-setting process 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 almost 30 years. Because of several complex issues that surfaced in the 2019 rate review that had not been encountered in the past in using this rate-setting methodology (most notably corporate overhead, greenwaste and materials recovery facility (MRF) costs as well as rate structure concerns), I

recommended updating the Rate Manual before the next *Base Year* review. This has not occurred, and accordingly, this review is based on the current methodology. However, the need for an update is even greater now: along with the 2019 concerns, new issues have surfaced in this review. As discussed in greater detail in Attachment 2, these include depreciation amortization period, interim rate reviews, cost allocation methodologies, accounting for disposal costs, timeframe for submitting and reviewing applications and trigger option.

- **Delayed Rate Implementation.** In the past, there has been no consideration of delayed rate implementation. However, the Rate Manual does provide for this if there is a delay of more than 120 days after application if it is “no fault of the franchise hauler.” Given the initial October 20, 2021 submittal date, this would indicate rate approval by March 1. However, there are three factors that mitigate this 120-day period:

1. When the 120-day period was set, the understanding at the time was that Proposition 218 45-day notice and protest requirements did not apply to approval of private company solid waste rates. However, since then many agencies have determined that these provisions are applicable to approval of rates by companies like SCSS. This alone conceptually adds up to 75 days to the review process.
2. Review was delayed pending consideration of rate increases by the IWMA and their possible impact on SCSS rates. These new rates were not adopted by the IWMA until March 9, 2022. Moreover, it was subsequently determined that since these rates are set by the IWMA – and not the franchising agencies – that they did not affect agency rate-setting. (As noted above, this resulted in a revised application from SCSS on February 18, 2022).
3. While SCSS has been very responsive in following-up on requests for supporting data, the scope and complexity of the 2022 application has been significantly greater, and subsequently taken longer, than envisioned in the Rate Manual.

About Proposition 218 Notices

Not all agencies prepare and issue “Proposition 218” notices for private sector solid waste rate increases. However, for those that do, 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, it is recommended that the notices reflect the rates requested by SCSS.

In accounting for these factors, I recommend that delayed rate implementation apply for any rates with a May 1, 2022 start date. In short, while these delays were “no fault” of SCSS, they were not the fault of the District, either. That said, SCSS believes the delayed rate implementation start period should be March 1, 2022.

Where delayed rate implementation is applicable, the following temporary rate increases would be required depending on whether the delayed rate implementation start period is March 1 or May 1. (Note: The added rate increase goes up for each month of delay to be

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recovered while the amortization period is shortened.) Under either start date, rates would be reset in January 2023 to the “core rate” for the Interim Year adjustment.

Temporary Delayed Implementation Rate Increase*

Effective Date	Start Period	
	March 1	May 1
May 1	5.55%	0.00%
June 1	9.51%	3.17%
July 1	14.80%	7.40%
August 1	22.19%	13.32%
September 1	33.29%	22.19%

* Ends December 31, 2022

The District has indicated an interest in absorbing the cost of delayed rate increases. In that case, the following presents the one-time costs depending on start and implementation rates:

Effective Date	Start Period			
	Months		Cost	
	March 1	May 1	March 1	May 1
May 1	2	-	\$68,035	\$0
June 1	3	1	102,053	34,018
July 1	4	2	136,071	68,035
August 1	5	3	170,088	102,053
September 1	6	4	204,106	136,071

It should be noted that while the report recommends a May 1 start date for delayed rate implementation, a reasonable case could be made for an even later start date (such as June 1 or July 1) based on the mitigation factors discussed above.

Lastly, several of these review timeframe factors are not unique to the 2022 review. Accordingly, the application submittal and review schedule should be considered in the Rate Manual update.

Proposed Single Family Residential Rates

Container Size	Current	Proposed	Increase
32 Gallons	\$20.24	\$24.54	\$4.30
64 Gallons	29.00	35.17	6.17
96 Gallons	38.02	46.11	8.09

Key Rate-Setting Factors

As discussed in Attachment 2, reviewing rates under the Franchise Agreement with SCSS is based on organizing costs into three main categories, which will be treated differently in determining a reasonable “operating profit ratio”.

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Allowable Costs. Under the District’s Franchise Agreement, SCSS is allowed a profit of 7% on “allowable” costs, such as:

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

Pass-Through Costs. SCSS can recover “pass-through” these costs but not earn a profit on them, such as:

- Disposal costs (landfill, recycling, food/greenwaste)
- Franchise fees
- Payments to affiliated companies (such as facility rent, interest and trucking charges)

Excluded and Limited Costs. No revenues are allowed for excluded or limited costs, such as:

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

Rate Request Summary

The following summarizes the calculations that support the requested and recommended rate increase compared with other south county agencies:

	Nipomo	Others*
Allowable Costs	10,751,370	10,751,371
Allowable Profit **	809,242	934,901
Pass-Through Costs		
Disposal		
Landfill	1,805,407	1,805,407
MRF (Recycling)	1,143,280	1,143,280
Greenwaste	1,781,655	1,781,655
Franchise Fees	1,454,123	1,454,123
Related Party Costs	438,303	438,303
Total Pass-Through Costs	6,622,768	6,622,768
Allowed Revenue Requirements	18,183,381	18,309,041
Revenue without Rate Increase	15,260,677	15,260,678
Revenue Requirement: Shortfall (Surplus)	2,922,704	3,048,363
Rate Base Revenue	18,183,381	18,309,041
Percent Change in Revenue Requirement	19.14%	19.98%
Allowed Revenue Increase ***	21.27%	22.19%

* Excludes Oceano CSD which has 5% franchise fee.

** 7% operating ratio for Nipomo CSD and 8% for all others.

*** Adjusted for 10% franchise fee.

As noted above, all the factors discussed in the Attachment 2 that drive rate increases are the same for the District, except its operating profit ratio is 7% compared with others at 8%.

This factor is why the requested rate increase of 21.27% is less than the proposed rate increase of 22.19% in other south county communities. Accordingly, the schedules supporting the rate increase on pages 2 to 6 of the application (Attachment 1) are the same as the rate review report (Attachment 2). It is only page 1 of the application that is different in reflecting the difference noted above and the current rates in Nipomo.

SUMMARY

Based on the rate-setting policies and procedures formally adopted by the District, this report concludes that:

- SCSS has submitted the required documentation required under its Franchise Agreement with the District.
- This results in a recommended rate increase of 21.27%.

ATTACHMENTS

1. Rate Application to the Nipomo Community Services District
2. Solid Waste Rate Review for the Communities of Arroyo Grande, Grover Beach, Oceano and Pismo Beach

