AGENDA
SAN BRUNO CITY COUNCIL
SPECIAL MEETING - STUDY SESSION
April 16, 2019
6:00 p.m.

Meeting Location: San Bruno City Hall, 567 El Camino Real, Room 115, San Bruno, CA

City Council meetings are conducted in accordance with Roberts Rules of Order Newly Revised and City Council Rules of Procedure. All regular Council meetings are recorded and televised on CATV Channel 1 and replayed the following Thursday, at 2:00 pm. Recordings of the City Council meetings are available for listening at the City Clerk’s Office and video of the City Council meetings may be viewed at www.sanbruno.ca.gov. Audio CDs with recordings of City Council meetings may be purchased at the City Clerk’s office, or may be listened to at the San Bruno Library. In compliance with the Americans with Disabilities Act, individuals requiring reasonable accommodations or appropriate alternative formats for notices, agendas and records for this meeting should notify us 48 hours prior to meeting. Please call the City Clerk’s Office 650-616-7061, or email your request to Melissa Thurman, City Clerk at mthurman@sanbruno.ca.gov.

1. CALL TO ORDER

2. ROLL CALL

3. PUBLIC COMMENT ON ITEMS NOT ON AGENDA
   Individuals allowed three minutes, groups in attendance, five minutes. It is the Council’s policy to refer matters raised in this forum to staff for investigation and/or action where appropriate. The Brown Act prohibits the Council from discussing or acting upon any matter not agendized pursuant to State Law.

4. STUDY SESSION

5. ADJOURNMENT:
   The next Regular City Council Meeting will be held on April 23, 2019 at 7:00 p.m. at the Senior Center, 1555 Crystal Springs Road, San Bruno.

Posted Pursuant to Law 04/12/19
DATE: April 16, 2019

TO: Honorable Mayor and Members of the City Council

FROM: Jovan D. Grogan, City Manager

PREPARED BY: Keith DeMartini, Finance Director

SUBJECT: Receive Consultant Report and Provide Direction Regarding Garbage Rate Increase Proposed by Recology San Bruno for FY2019-20

BACKGROUND

The City’s franchise agreement with Recology San Bruno became effective on July 1, 1998. According to this agreement, Recology is entitled to annual rate adjustments based on a Detailed Rate Year analysis every three years and Interim Rate Year adjustments in other years. Recology requested an Interim Rate Year adjustment of 5.34% for FY2018-19 on January 30, 2018. Recology indicated that the adjustment was due in part to major changes in the international recycling marketplace, increased landfill disposal costs, and Recology’s overall operating costs.

A public hearing was held at the City Council meeting on March 12, 2019 to provide an overview of Recology’s rate application for FY2019-20 and to initiate the property owner notice and protest process required by Proposition 218. Ratepayers received notices indicating that Recology had proposed an increase of 5.34%. The City Council also directed staff to review and evaluate Recology’s application in conjunction with an independent consultant.

In its initial review, staff analyzed expenditure line items and supporting documentation on the rate applications and Recology’s financial statements. Staff compared FY2016-17 and FY2017-18 actual expenditure data with Recology’s projected FY2018-19 expenditures to assess the reasonableness of cost increases being assumed for the remainder of FY2018-19 and the basis for much of the FY2019-20 rate application.

Staff also conducted a review of all projection and adjustment factors that are the basis for the FY2019-20 rate change as stipulated in the franchise agreement. These projection and adjustment factor calculations are documented in the rate application.

The City also retained R3 Consulting Group, an independent consulting firm specializing in utility rate reviews exclusively for public agencies, to conduct a thorough review of Recology’s FY2019-20 rate application. R3 staff members have broad experience conducting rate reviews and performing financial and rate structure analysis for
Honorable Mayor and Members of the City Council  
April 16, 2019  
Page 2 of 4

municipalities, public utilities and regional authorities. The scope of R3’s review of the rate application was as follows:
1. Conduct an initial review of the rate application and supporting documentation;
2. Assist the City with developing the Proposition 218 notice;
3. Conduct a review of Recology’s financial statements;
4. Review non-allowable costs and propose adjustments to costs where necessary;
5. Review cost forecast, recyclables revenues and costs, and pass through costs; and
6. Review the application methodology and calculations for accuracy, completeness and compliance with the franchise agreement.

DISCUSSION

Following its review, R3 prepared the attached preliminary report. In the summary contained in Section 4, R3 is recommending a rate increase of 4.43%, which is just under 1 percentage point lower than Recology’s proposed rate increase. The rate reduction from Recology’s proposed rate increase is primarily attributable to the following adjustments:
1. A reduction to Recology’s proposed disposal and organics processing expenses based on the actual tons of waste applicable to the City’s services and the current and projected tipping rates for those tons;
2. Including a depreciation adjustment for certain assets not exclusively used for providing services to the City;
3. Adjusting the projected revenue calculations for timing differences in periods used to establish the projections and excluding accounting adjustments for City fees that aren’t actually included in revenues to Recology; and
4. Removing AB 939 and franchise fee pass through costs so that city fees reflect actual remittance of fees from Recology.

Table 1 below shows a summary of Recology’s proposed rate increase of 5.34% and the rate recommended by R3 for typical residential services.

<table>
<thead>
<tr>
<th>Toter Size</th>
<th>Existing Rate</th>
<th>Proposed Rate-5.34% by Recology</th>
<th>Recommended Rate – 4.43% by R3</th>
</tr>
</thead>
<tbody>
<tr>
<td>20-gallon toter</td>
<td>$23.34</td>
<td>$24.59</td>
<td>$24.37</td>
</tr>
<tr>
<td>32-gallon toter</td>
<td>$30.09</td>
<td>$31.70</td>
<td>$31.42</td>
</tr>
<tr>
<td>64-gallon toter</td>
<td>$60.18</td>
<td>$63.39</td>
<td>$62.85</td>
</tr>
<tr>
<td>96-gallon toter</td>
<td>$90.27</td>
<td>$95.09</td>
<td>$94.27</td>
</tr>
</tbody>
</table>

Recology, R3 and staff have agreed with the rate application methodology changes. The changes are in compliance with the franchise agreement between the City and Recology San Bruno, and the revised methodology is planned to be used in future rate reviews as it is a more reliable and repeatable methodology.
R3 consulting fees for performing the comprehensive rate application review are budgeted at $30,000. As a result of the staff’s and R3 rate application review, the proposed rate increase was reduced from 5.34% to 4.43%, a reduction of 0.91%, or $175,883. This represents a net savings to ratepayers in excess of $145,000.

**Protest Period and Timeline to Implement New Rates**

The public hearing and protest procedures consistent with Proposition 218 provide notice to residential and commercial property owners and residents 45-days in advance of a public hearing, following which the City Council can act to approve the rate increase. Only if written protests are received from a majority of property owners would the proposed rate increase be disallowed.

Notices were mailed on March 28, 2019 to begin the protest period. As noted above, the notices stated that Recology had proposed a 5.34% rate increase. As of April 11, 2019, the City Clerk received 20 protest letters.

The following schedule outlines the City’s implementation of the proposed process for considering the proposed rate adjustment.

<table>
<thead>
<tr>
<th>Date</th>
<th>Status</th>
<th>Item</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 12, 2019</td>
<td>Complete</td>
<td>City Council directs staff to provide 45-day notice to property owners.</td>
</tr>
<tr>
<td>March 28, 2019</td>
<td>Complete</td>
<td>Notices mailed / start 45-day period.</td>
</tr>
<tr>
<td>April 16, 2019</td>
<td>In Process</td>
<td>City Council Study Session on the Rate Application</td>
</tr>
<tr>
<td>May 14, 2019</td>
<td>Hearing Scheduled</td>
<td>City Council holds public hearing, considers any protests, take action to introduce new rate ordinances for first reading, and the 45-day protest period ends.</td>
</tr>
<tr>
<td>May 28, 2019</td>
<td>Hearing Scheduled</td>
<td>City Council conducts second reading and takes action to adopt new rates by ordinance.</td>
</tr>
<tr>
<td>July 1, 2019</td>
<td>Planning Underway</td>
<td>New FY2019-20 rates become effective.</td>
</tr>
</tbody>
</table>

**FISCAL IMPACT:**

The amount and explanation of the proposed rate adjustment is outlined in the Discussion section of this report and the consultant’s report. The proposed rate increase does not have a direct effect on City operations.

**ALTERNATIVES:**

1. Recology San Bruno is entitled to a Detailed Rate Year adjustment in FY2019-20 per the franchise agreement. The City Council may direct that the proposed adjustment be amended based on R3’s report and recommendations.
2. Do not proceed with the process to adopt new rates.
RECOMMENDATION:

Receive the consultant report and provide direction regarding the garbage rate increase proposed by Recology San Bruno for FY2019-20

ATTACHMENTS:

1. R3’s Preliminary Report

DATE PREPARED:

April 11, 2019
DRAFT REPORT

Review of Recology San Bruno FY 19-20
Rate Application

SUBMITTED TO:

City of San Bruno

April 12, 2019
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April 12, 2019

Mr. Keith DeMartini  
Finance Director, City of San Bruno  
567 El Camino Real  
San Bruno, CA 94066

Subject: Detailed Rate Review of Recology’s FY 19-20 Rate Application, Draft Report

Dear Mr. DeMartini:

R3 Consulting Group, Inc. (R3) is pleased to submit the attached draft report detailing the results of our review of Recology San Bruno’s (Recology) FY19-20 Rate Application for the City of San Bruno (City). Per the Franchise Agreement rate setting methodology, FY19-20 is a base year which uses actual revenues and expenses to develop projected revenues and expenses for the rate year.

On February 1st, 2019 Recology submitted a rate adjustment application for a 5.13% rate increase to its solid waste rates, to be effective July 1, 2019. The City commenced review of the application and Recology further refined its calculations; a number of changes and updates netted a 5.34% requested rate increase. R3 was engaged to conduct a detailed review of the updated application. Our review included a thorough assessment of all relevant documents for completeness and compliance with the procedures agreed upon by Recology and the City, and verified the mathematical accuracy and logical consistency of the supporting documents.

Based on our review of Recology’s application, we have initially determined that a rate increase of 4.43% is appropriate to compensate Recology for providing solid waste services. As a result of this recommended increase, most residential customers will see increases in their monthly services rates of between approximately $1.00 and $2.60 per month. R3 reviewed our proposed adjustments and recommended rate increase with Recology, and Recology has indicated acceptance of our recommendations. Changes in the recyclables marketplace is a primary driver of increases in rates, accounting for approximately 1% of the recommended increase. R3 recommends that future rate adjustments take into account any increases in revenues from the sale of recyclables materials.

During the review, we found that the City conducts customer billing, an uncommon arrangement as most jurisdictions prefer their solid waste service provider to bill their customers directly; in the future the City may wish to consider a transition to Recology conducting customer billing, the pros/cons of which will be discussed in our final report. In addition, new state legislation SB 1383 Short-Lived Climate Pollutants will have significant impact on future solid waste rates and services. The requirements of SB 1383 focus on organic materials and food waste recovery, including municipal code updates, solid waste service contract amendments, implementation of an edible food program, local government procurement, and enforcement.
We appreciate the opportunity to submit our draft report to the City. Should you have any questions regarding this Report or need any additional information, please contact me by phone at (510) 292-0853 or by email at gschultz@r3cgi.com.

Sincerely,

R3 CONSULTING GROUP

Garth Schultz | Principal
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Background

Industry Update

The industry is undergoing a series of changes in response to markets and state legislation, driving the creation of a more adaptive solid waste system that can respond to economic pressures while supporting greater resource recovery. Recycling, long a source of revenue (though not historically applied as revenue to offset rates in San Bruno), has become a net cost to divert material from landfill due to China’s National Sword policy. Organic materials have become the focus of new state law SB 1383 Short-Live Climate Pollutants, which will require local government to implement several programs and policies with the goal of reducing organic waste sent to landfill. The City’s responsibility to arrange for the collection, recycling and disposal of solid waste generated by San Bruno’s residents and businesses is growing, and by extension places greater demand on San Bruno’s solid waste services provider.

The City outsources collection services to Recology, who delivers San Bruno’s waste for processing and disposal. The City and Recology work together to comply with the many state laws regulating solid waste services. Established in 1989, California’s foundational solid waste law, AB 939, sets program requirements for recycling and established a statewide goal of 50% reduction in landfilled waste by 2000. This law was followed by AB 32 in 2006, which recognizes solid waste as a contributor to greenhouse gas emissions and set another goal to reduce greenhouse gas levels to 1990 levels by 2020. AB 341 Mandatory Commercial Recycling (2012) and AB 1826 Mandatory Commercial Organics Recycling (2014) places waste diversion program participation requirements on commercial and multi-family properties; AB 341 and AB 1826 also increased statewide goals: 75% diversion for recycling and organic waste reduced by 50% by 2020. New and costly mandates will be taking effect in the new few years.

SB 1383 (2016) sets sweeping new mandates on local governments. Final rulemaking is underway, with many specific subscription, outreach and program requirements anticipated. For example, the draft regulatory language calls for the creation of an edible food recovery program which requires partnership with local organizations distributing extra food to people in need. Full SB 1383 implementation will begin in 2022, allowing jurisdictions some time plan and prepare for achieving compliance. SB 1383 also sets a statewide goal for the reduction in organic waste to landfills, 50% by 2020 and 75% by 2025, in addition to 20% of food waste recovered for human consumption.

China’s National Sword is a policy banning the importation of certain types of solid waste and set strict contamination limits on recyclable materials. As a result, China will no longer accept shipments of recyclables that are mixed with trash, the wrong type, or of low-quality. The policy was announced in July 2017 and officially began January 1, 2018. National Sword has caused massive disruptions in recycling markets, and as a result the industry has been faced with volatility, commodity price decreases and increased costs in operations.

Like San Bruno, cities across California are facing solid waste rate increases to meet rising costs. As a point of comparison the City of Fairfax recently approved a 19.85% rate increase with recycling accounting for approximately 3% of the increase. Mill Valley Refuse Service in Marin
City of San Bruno | Review of Recology’s FY 19-20 Rate Application | DRAFT

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Section 1

Background

County had an overall cumulative rate increase of 14.41% approved by the nine jurisdictions it serves; the majority of this rate adjustment due to recycling markets.

Description of Recology Services

Recology provides franchised garbage, recyclable materials, and organics collection services to the residents and businesses of San Bruno. Solid waste collected within the City service area is taken to the San Bruno Transfer Station—garbage is transported to Ox Mountain Landfill for disposal, organic materials are delivered to South Valley Organics Composting Facility for composting, and recyclable materials are directed to Greenwaste Recovery for processing. Recology also provides debris box service to residents and businesses that contract for it.

Recology also provides outreach, education, compliance, technical assistance, and other high-diversion programs to the City, including outreach and education to commercial and multi-family customers (to meet the obligations of State Laws AB 341 and AB 1826, which require commercial recycling and organics collection) and other related services. New State Law, SB 1383 Short-lived Climate Pollutants, will require further collaboration to implement with the goal of reducing organic materials disposed in landfill. All services provided by Recology remain unchanged as a result of this review.

The City conducts the billing for solid waste services for residential and commercial customers; Recology independently bills for its debris box service. This arrangement allows the City to offer combined utility billing for both water and garbage services for the convenience of its customers. However, greater operational coordination between the City and Recology is required to make sure customers are billed correctly for garbage service. See Section 3 for further discussion of customer billing.

Rate Adjustment Methodology

Recology’s compensation is based on solid waste rates, which are reasonably anticipated by the City to provide for Recology’s operating, allocated and pass-through costs plus profit, as well as for the City’s fees and charges. Recology looks to the City only for payments of money it receives from waste generators (net of City fees and charges). Recology is not compensated for any shortfall in the actual revenues, nor does the City claim any surplus in actual revenues.

In Detailed Rate Years, Recology submits a rate adjustment request based on audited financial statements for the preceding fiscal years and containing forecasts of its compensation for the Detailed Rate Year and the year immediately following. Per the Agreement, indices are applied to labor-related costs, vehicle-related costs, and other costs to forecast operating expenses. Recology also provides supporting documentation for its assumptions underlying the forecasts and allocation adjustments made to ensure operating expenses accurately reflect the cost to serve San Bruno.

Some costs are allocated between agencies served by Recology based on performance metrics. For example Truck and Garage Department, and General and Administration, costs are allocated among the agencies served by Recology using debris box pulls. Depreciation and interest costs are allocated based on asset designation. R3 reviewed and recommended adjustments to allocation methodologies as part of this review, with the results reflected in the recommended FY19-20 rate increases.
In projecting the FY19-20 costs, the rate application should include the direct costs for the City’s garbage, organics and recycling collection, costs for transfer, processing and disposal of garbage, organics and recycling. Recology’s operating costs also reflect the administration of diversion programs including outreach, education and technical assistance.

Rate Adjustments Over Time

Recology rate adjustments in the City have remained relatively low over time; FY19-20 is the largest rate increase in over ten years. Table 1, and Figure 1 on the following page, demonstrate rate adjustments since FY08-09. From FY08-09 through proposed FY19-20, the cumulative rate increase is 40.36%, at an average annual increase 2.72% which is generally lower than R3’s experience reviewing the actual costs of maintaining solid waste operations, which typically increase at a rate of 4-5% per year.

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Review Type</th>
<th>Rate Adjustment</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY2008-09</td>
<td>Detailed Rate</td>
<td>4.52%</td>
</tr>
<tr>
<td>FY2009-10</td>
<td>Interim Rate</td>
<td>2.46%</td>
</tr>
<tr>
<td>FY2010-11</td>
<td>Detailed Rate</td>
<td>4.93%</td>
</tr>
<tr>
<td>FY2011-12</td>
<td>Interim Rate</td>
<td>1.45%</td>
</tr>
<tr>
<td>FY2012-13</td>
<td>Interim Rate</td>
<td>2.34%</td>
</tr>
<tr>
<td>FY2013-14</td>
<td>Detailed Rate</td>
<td>2.17%</td>
</tr>
<tr>
<td>FY2014-15</td>
<td>Interim Rate</td>
<td>3.93%</td>
</tr>
<tr>
<td>FY2015-16</td>
<td>Interim Rate</td>
<td>1.65%</td>
</tr>
<tr>
<td>FY2016-17</td>
<td>Detailed Rate</td>
<td>1.82%</td>
</tr>
<tr>
<td>FY2017-18</td>
<td>Interim Rate</td>
<td>2.32%</td>
</tr>
<tr>
<td>FY2018-19</td>
<td>Interim Rate</td>
<td>2.45%</td>
</tr>
<tr>
<td>FY2019-20</td>
<td>Detailed Rate</td>
<td>4.43%</td>
</tr>
<tr>
<td>Cumulative</td>
<td></td>
<td>40.36%</td>
</tr>
<tr>
<td>Annual Average</td>
<td></td>
<td>2.72%</td>
</tr>
</tbody>
</table>
Figure 1: Historic Trends in San Bruno Rate Adjustments FY08-09 to FY19-20
Rate Review Approach

Recology submitted its July 2019 Rate Adjustment Request to the City on February 1, 2019. The request is for a 5.34% rate increase to be made effective July 1, 2019. To support its request, Recology included a calculation of the FY19-20 revenue requirement and a detailed profit and loss schedule showing revenues and expenses for the last two audited years. In addition, Recology provided a detailed listing of each projection factor used to calculate the FY19-20 revenues and expenses prior to any adjustments, a detailed list of each adjustment factor used to calculate the FY19-20 revenues and expenses (i.e., adjust out costs for operations outside of city limits and not related to the services performed for San Bruno), a depreciation schedule, and several other supporting documents.

City Initiated Review

City staff began the review of Recology’s rate application for compliance with the Agreement, accuracy, and reasonableness. City staff identified several adjustments including the removal of expenses that are not allowable for the purposes of setting the City’s rates, including:

- Donations;
- Travel and promotion;
- Amortization; and
- Employee bonuses.

These costs were removed from the rate application prior to R3 conducting our review.

R3 Scope of Review

Building upon the work of its initial evaluation, the City engaged R3 to perform a review of the application in accordance with the current adopted rate adjustment methodology. R3’s review focused on the reasonableness of Recology’s rate adjustment request given the supporting documentation, mathematical accuracy and logical consistency.

R3 started its review with an assessment of Recology’s rate application and all supporting documentation provided, comparing Recology’s calculations and methodologies against the Agreement. These procedures included the following activities:

- Reviewing Recology’s actual achievement of revenues for the three months ending December 31, 2018 (Q1 2019), and projections for FY19-20, including a detailed assessment of actual revenues paid by the City to Recology and actual revenues directly billed by Recology to City customers;
- Reviewing Recology’s audited financial statements for FY16-17 and FY17-18, comparing to FY18-19 projections, and requesting explanations for variances;
- Reviewing the appropriateness of Recology’s classification of expenses into the various expense categories;
- Reviewing Recology’s projection of other expenses including but not limited to:
o Labor, benefits and workers’ compensation;
o Garbage landfilling and organics processing;
o General and administrative;
o Depreciation;
o Maintenance;
o Fuel and oil;
o Recyclables processing costs net of revenues and redemption;
o Interest; and
o Franchise and other government fees.

- Preparing this Report that documents findings and recommendations;
- Reviewing initial draft findings with City staff and Recology;
- Establishing concurrence with findings between City and Recology; and
- Finalizing draft findings.
Recommended FY19-20 Rate Increase

Summary of Adjustments

Labor-Related Costs
R3 reviewed and does not recommend an adjustment to Recology’s proposed labor expenses. Per the Agreement, Recology forecast Labor-Related Costs by applying the percentage change in Consumer Price Index (CPI) Urban Wage Earners Oakland-San Francisco-San Jose of 4.4%, appropriately escalating twice in accordance with the approved methodology since FY18-19 expenses were accrued during the period of Oct 17 to Sept 18 (nearly two years prior to the FY19-20 Rate Year). Recology then adjusts for Outside City Limits (OCL) expenses by department to arrive at Labor-Related Costs specific to San Bruno. Consistent with other solid waste operations R3 has reviewed, outside of normal increases in labor and benefits Recology’s health insurance expense outpaces CPI, and is a cost driver in this expense category.

Vehicle-Related Costs
R3 reviewed and does not recommend an adjustment to Recology’s proposed Vehicle-Related expenses. In alignment with the Agreement, Recology forecast Vehicle-Related Costs by applying the percentage change in the appropriate Motor Fuel Index (-1.9%), escalating twice in accordance with the approved methodology. Recology then adjusts by the percentage of OCL pulls multiplied by the percentage of debris box rolling stock compared to the total rolling stock. Cost drivers include tires and tubes, parts, gas and oil, and liability insurance. Tires, tubes and parts are essential to fleet operations, and typically constitute a substantial portion of this expense category. Overall, gas and oil costs have increased significantly (24.7%) from FY 17-18 to FY18-19 due to the rising price per gallon of fuel. Recology is taking measures to increase safety training and supplies to reduce its liability insurance costs.

Disposal and Organics Processing
R3 reviewed and recommends adjustments to Recology’s proposed Disposal expense. Recology proposed $1,631,676 in garbage landfilling expenses and $400,128 in organics processing expenses (for a total expense of $2,031,804), with profit being allowed on the organics processing expense. R3 recommends total disposal and organics processing expenses of $1,899,067 ($132,737 less than Recology’s projection) based on the actual tons of waste applicable to the City’s services and the current and projected tipping rates for those tons. R3 further recommends that organics processing expenses not be included in Recology’s calculation of operating project, and Recology has agreed to that adjustment.

Recyclables Processing
Recology’s Rate Application includes a projected $76,740 net cost for Recyclables Processing. Recyclables are currently sent to GreenWaste for processing in its San Jose facility, and this projected cost is based on the net expense to process San Bruno’s recyclables the three months ending 2018 ($19,185) annualized to estimate FY 19-20 costs. Other local recycling processors are not accepting more materials, and in many cases are stockpiling what they process until
recycling markets improve. R3 recommends that future rate adjustment processes account for any increases in recycling revenues as an offset to future rate increases.

**Depreciation**

Per the Agreement, Depreciation shall be calculated based on the total agreed-upon depreciable value included in Recology’s proposal using eight years for vehicles, ten years for containers, and twenty-five years for buildings and improvements. R3 reviewed Recology’s projections and recommended applying an adjustment to the projected expenses to account for the fact that certain assets on the depreciation schedule are not exclusively used for providing services to the City. The recommended adjustment was a decrease of $33,871 which was accepted by Recology.

**Other Costs**

R3 reviewed and does not recommend an adjustment to Recology’s proposed Other Costs. Other Costs include general and administrative expenses such as accounting and management, telephones and office supplies, public outreach and education, and other overhead costs. Per the Agreement, Other Costs are forecasted by multiplying allowed expenses in this category by the percentage change in the National Producer Price Index Industrial Commodities (3.25%), escalated twice per the approved methodology, and adjusted for OCL costs with an allocation using the total annual OCL debris box pulls as a percentage of total number of incoming customer telephone calls.

**Profit**

R3 reviewed and recommends adjustments to Recology’s proposed operating profit, which is calculated based on allowed expenses and a 90% operating ratio. Recology proposed $862,691 in profit based on allowed operating expenses included in their application; based on all other adjustments described in this Report, R3 recommends profit of $814,469. The $48,222 reduction is solely due to recommended adjustments to operating costs described above.

**Interest**

Recology’s Rate Application did not forecast an Interest Expense for the upcoming Rate Year; no Interest Expense is reported in Recology’s FY18-19 Profit and Loss Statement.

**Projected Revenue at Current Rates**

R3 reviewed and recommended adjustment to Recology’s forecast 2019 revenues at current rates ($11,043,439). Recology projected revenue at current rates by taking booked Q1 FY19 revenues, dividing by three and then multiplied by twelve. This annualized revenue figure is then adjusted for OCL revenues: Recology took the three months ending 12/31/18 and divided by three then multiplied by twelve for services provided outside the city limits of San Bruno. R3 adjusted projected revenues at current rates to $9,973,194 based on actual City payments to Recology and actual Recology receipts from direct billed customers.

The difference between R3’s calculations and Recology’s calculations are primarily due to a) timing differences in the periods used for establishing projections and b) Recology’s use of booked general ledger revenue which includes accounting adjustments for City fees that aren’t actually included in revenues to Recology or payable by Recology to the City. Recology reviewed our adjustments to projected revenues, proposed refinements to those adjustments, and has agreed to the recommended projected revenues.
City Fees

R3 reviewed and recommends adjustments to Recology's forecast of FY19-20 franchise fees. The City collects a Franchise Fee equal to 10% of the gross receipts collected in connection with services provide under the Agreement, and an AB 939 Fee equal to 1% of gross receipts collected in connections with services provide under the Agreement. Since the City conducts customer billings, the City retains these fees from its remittance to Recology in payment for solid waste services.

Recology forecasted $1,163,336 in Franchise Fees and R3 recommends projected City fees paid by Recology to City of $236,737. This difference is exclusively due to Recology projecting City fees based on booked accounting adjustments whereas R3’s recommendation is based on actual remittance of fees from Recology to the City, and for which Recology directly receives rate revenues (Recology direct billed customers only).

FY19-20 Rate Increase Calculation

Based on a total recommended FY19-20 rate revenue requirement of $10,387,235 and projected 2019 revenues at current rates of $9,973,194, there will be a $414,041 shortfall in revenues vs. expenses, and thus a need to increase rates consistent with the terms and conditions of the Agreement.

Taking the $414,041 shortfall over projected revenues collected from rate-payers at current rates (projected at $9,339,114, which is less than the $9,973,194 in total revenues because total revenues includes other non-rate-payer sources of revenue) yields a recommended rate increase of 4.43% effective July 1, 2019.

Table 2, below, shows current FY18-19 residential customer rates, and the projected rates at the recommended rate increase. As shown, the projected monthly increase ranges from approximately $1 per month to $4 per month, depending on garbage container size. R3 projects that most residential customers will see a monthly increase in the range of $1.03 - $2.67 per month. The projected rates shown are still subject to review and confirmation by Recology.

<table>
<thead>
<tr>
<th>Service Level (Based on Garbage Container Size)</th>
<th>Current 2018/19 Rate ($/mo.)</th>
<th>Proposed 2019/20 Rate ($/mo.)</th>
<th>$ Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 gallon cart</td>
<td>$23.34</td>
<td>$24.37</td>
<td>$1.03</td>
</tr>
<tr>
<td>32 gallon cart</td>
<td>$30.09</td>
<td>$31.42</td>
<td>$1.33</td>
</tr>
<tr>
<td>64 gallon cart</td>
<td>$60.18</td>
<td>$62.85</td>
<td>$2.67</td>
</tr>
<tr>
<td>96 gallon cart</td>
<td>$90.27</td>
<td>$94.27</td>
<td>$4.00</td>
</tr>
</tbody>
</table>
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