

CITY OF SANTA ROSA
CITY COUNCIL

TO: MAYOR AND CITY COUNCIL
FROM: JASON NUTT, ASSISTANT CITY MANAGER
TRANSPORTATION AND PUBLIC WORKS
SUBJECT: APPROVE REFUSE RATE INCREASE EFFECTIVE JANUARY 1,
2024 SET BY RECOLOGY AS CONSISTENT WITH SOLID
WASTE COLLECTION SERVICES AGREEMENT AND
AUTHORIZE CITY MANAGER TO NEGOTIATE AND APPROVE
A FIFTH AMENDMENT TO THE COLLECTION SERVICE
AGREEMENT BETWEEN CITY OF SANTA ROSA AND
RECOLOGY SANTA ROSA

AGENDA ACTION: RESOLUTION

RECOMMENDATION

It is recommended by the Transportation and Public Works Department that the Council, by resolution: 1) approve the 4.33% increase set by Recology to be effective January 1, 2023 as correct and in accordance with the City's existing Solid Waste Collection Services Agreement; and 2) authorize the City Manager to negotiate and execute a Fifth Amendment to Solid Waste Collection Agreement between the City and Recology Marin, dba Recology Santa Rosa, to update the refuse rate index methodology, subject to approval as to form by the City Attorney.

EXECUTIVE SUMMARY

Santa Rosa grants Recology Sonoma-Marin dba Recology Santa Rosa ("Recology") an exclusive franchise for collection and hauling of solid waste, including garbage, recycling, and organic materials. The City awarded this Solid Waste Collection Agreement ("Franchise Agreement") to Recology in November 2017 through a competitive process. Recology's rate increases are subject to City oversight.

The Franchise Agreement allows for a detailed rate review every three years. The next detailed rate review would occur in 2026 for rates that will be effective January 1, 2027. The review is discretionary; either City staff or Recology may request the review. In this case, City Staff requested a detailed rate review to ensure Santa Rosa's residents' refuse rates are competitive while also providing fair compensation to Recology. In alternate years, Section 4.03.8 of the Franchise Agreement stipulates that rates are to be increased based on the Refuse Rate

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Index (RRI), which, unlike a detailed rate review, does not consider actual changes in Recology's cost structure.

As part of the review process, Recology submitted its rate application and supporting documentation. The documentation includes its forecasts for revenue projections, annual costs of operations, and any pass-through costs. The contractor will also project its profitability as defined in the Franchise Agreement, which is defined as a 90% operating margin based on allowable costs.

BACKGROUND

Franchise Agreement and Amendments

On August 29, 2017, the City Council adopted Resolution No. RES-2017-172, approving the Agreement with Recology Sonoma Marin for the collection of the City's garbage, recyclable material and organic waste.

On December 19, 2017, the City Council adopted Resolution No. RES-2017-250, approving the First Amendment to the Agreement between the City of Santa Rosa and Recology, Inc., creating a low-income rate discount program.

On September 25, 2018, the City Council adopted Council Resolution No. RES-2018-163, approving the Second Amendment to the Agreement, revising certain refuse rate indices and the time periods used to determine service recipient rate adjustments under the Agreement.

On May 7, 2019, the City Council adopted Council Resolution No. RES-2019-051, approving the Third Amendment to the Agreement between the City of Santa Rosa and Recology, Inc., to add infrequent service rates, reallocate several operating costs in the Refuse Rate Index, correct typographical errors in Section 10.07.13.2 and inadvertent omissions in Section 13.04.

On May 24, 2022, the City Council adopted Council Resolution No. RES-2022-101, approving the Fourth Amendment to the Agreement between the City of Santa Rosa and Recology, Inc., to comply with SB 1383 Regulations and implement a 3-container organic waste collection service.

Detailed Rate Review Compared to Refuse Rate Index

Under the existing Franchise Agreement, Recology is entitled to an annual increase of their rates; the next rate adjustment is scheduled to be effective on January 1, 2024. Rate adjustments are requested through an application process where Recology submits a rate adjustment application to the City no later than October 1 annually. The Franchise Agreement stipulates that the rate application include a Refuse Rate Index

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("RRI") Adjustment using five Bureau of Labor Statics indices (labor, diesel, vehicle replacement, vehicle maintenance, and all other) as well as changes in landfill tipping fees, recyclable material revenue, and organic waste processing fees. As an alternative to the RRI adjustment, the Agreement allows the City or Recology to request a detailed rate review every three years.

Annual customer rate adjustments may be calculated one of two ways:

Refuse Rate Index (RRI): The purpose of the RRI methodology is to cost-effectively offset the inflationary pressures on the hauling company as costs increase without the need to perform an extensive Detailed Rate Review. The goal is to minimize the gap between revenue and costs and adequately compensate Recology for the services provided, and to avoid a significant rate increase once a Detailed Rate Review is performed.

Detailed Rate Review Process: Per Santa Rosa's Franchise Agreement either the City of Santa Rosa or Recology may request a Detailed Rate Review. Based on Section 4.05 of the Franchise Agreement a Detailed Rate Review may occur every three years starting with 2024, then in years 2027, 2030, and continuously every three years throughout the term of the contract. A Detailed Rate Review adjusts rates by reviewing Recology's actual operating costs and maintaining profit within the terms of the Agreement.

Recology is entitled to an operating ratio of 90%, which equates to approximately a 10% operating profit. A detailed rate review is an in-depth analysis of Recology's revenue and expenses in relation to the Santa Rosa franchise. The ultimate goal of a Detailed Rate Review is to align revenue and expenses ensuring a 90% operating ratio.

A Detailed Rate Review includes analyzing:

1. Subscription levels by line of business to test the reasonableness of revenue projections.
2. Forecasted costs such as labor-related costs, vehicle related costs, other others, and lease expenses.
3. Establishing a 90% operating ratio.

PRIOR CITY COUNCIL REVIEW

See Background.

ANALYSIS

APPROVE A RECOLOGY REFUSE RATE INCREASE, EFFECTIVE JANUARY 1, 2024 AND AUTHORIZE CITY MANAGER TO NEGOTIATE AND APPROVE A FIFTH AMENDMENT TO THE COLLECTION SERVICE AGREEMENT BETWEEN CITY OF SANTA ROSA AND RECOLOGY SANTA ROSA

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The City engaged R3 Consulting, Inc. to conduct a comprehensive rate application review for mathematical accuracy, its compliance with contractual terms defined in the Franchise Agreement, and consistencies with industry standards. The Detailed Review of Recology's 2024 Rate Application provides a detailed step-by-step analysis of their review and is included as Attachment 2. Based on the review, R3 is proposing an adjustment to a 4.33% increase in rates from the original Recology request of a 7.48% increase in rates, based on the recommended adjustments and understandings:

1. **Compensation:** From 2022 to projected 2024 total compensation increased from \$10.7 million to a projected \$14.0 million. Compensation increased due to double-digit increases in wages, increased holiday benefits, and additional staffing. R3 is proposing an \$807,000 reduction in General and Administrative costs due to refinement in the allocation methodology. Total compensation costs would be reduced from \$14.0 million to \$13.2 million.
2. **Leased Assets Useful Life:** Recology's lease schedules factored in a useful life of seven years as the useful life of all leased assets. The Franchise Agreement specifies a different useful life by asset category:
 - a. Hauling Trucks assets are to be depreciated at a useful life of 8 years.
 - b. General & Administration assets are required to be depreciated at a useful life of 5 years.
 - c. Support Vehicles & Equipment assets are to be depreciated at a useful life of 8 years.
 - d. Containers are required to be depreciated at life of 10 years.

By extending the deprecation life for each asset category to the terms of the Franchise Agreement, Recology is being fully reimbursed but over a longer period of time resulting in a cost reduction of \$659,000.

3. **Profitability:** Based on the recommended adjustments, profitability is reduced from \$3.6 million to \$3.4 million.
4. **Franchise Fees:** Based on the adjustments described above, franchise fees are reduced by \$395,000 from \$9.1 million to \$8.8 million.
5. **Future Capital Asset Purchases:** The rate application includes future asset purchases and associated depreciation costs of \$3.1 million for 2024, 2025, and 2026 resulting in \$9.3 million in total cost recovery.

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Upon review, the supporting schedules for the same three-year period support cost recovery of \$7.7 million, will result in a net difference of \$1.6 million, or an average of \$527,000 annually. These costs presented represent future asset purchases that are for the benefit of Santa Rosa ratepayers.

Recology, in coordination with City staff, pledges to purchase capital assets equivalent to the \$527,000 in annual depreciation. Recology also agrees to provide a list of those assets and their in-service dates to City Staff for consideration and review.

For example, a \$527K annual depreciation cost is the equivalent of a \$2.6 million purchase with a useful life of 5-years. The equivalent purchase for an 8-year useful life is \$4.2 million. Table 1 below illustrates the relationship between purchase price and annual depreciation.

Table 1: Future Asset Purchases In-Service Date: 2024

Asset's Useful Life	Capital Purchase	Annual Depreciation	2024	2025	2026	Total Cost Recovery
5 Years	\$2.6M	\$527K	\$527K	\$527K	\$527K	\$1.6M
8 Years	\$4.2M					

Forecasted Residential Rate Increases

R3 conducted a survey of solid waste rates focusing primarily on agencies located in Sonoma County and served by Recology. When comparing rates in Sonoma County, it is important to consider that The Ratto Group (dba Santa Rosa Disposal) held most of the region’s solid waste service contracts until they were substantially acquired by Recology in late 2017. For many years, The Ratto Group extended artificially low pricing, maintained by limiting investments in its operations. Recology has since implemented core improvements including safety and environmental compliance and has submitted corresponding cost-based rate adjustment requests for agency consideration throughout the County.

Tables 2 and 3 below provide the most current rates for jurisdictions in Sonoma County.

In comparing the City’s proposed rates to those jurisdictions in **Tables 2 and 3**, it is important to note that the City of Santa Rosa and Town of Windsor went through a competitive procurement process, secured new collection service agreements, and transitioned to new service providers. Most Sonoma County jurisdictions have now had their rates adjusted through a detailed rate review or procurement since Recology’s acquisition of The Ratto Group assets. The rates noted in both tables are reflective of current rates published on each of the respective hauler’s websites.

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Table 2: Weekly Residential Garbage, Recycling, and Organic Waste Collection Rate Comparison

Hauler	Jurisdiction	Effective Date	20-Gal Cart	30-40 Gal Cart	60-65 Gal Cart	90-100 Gal Cart
Sonoma Garbage	Sonoma	7/1/2023	\$14.27	\$22.91	\$48.27	\$73.40
Recology	Cotati	1/1/2023	\$18.62	\$26.17	\$68.61	\$105.74
Recology	Petaluma	7/1/2023	\$16.18	\$28.64	\$54.32	\$89.60
Recology	Sebastopol	7/1/2023	\$16.83	\$29.43	\$42.61	\$57.65
Recology	Healdsburg	1/1/2023	\$22.52	\$29.78	\$42.61	\$57.65
Recology	Cloverdale	12/1/2022	\$24.84	\$34.00	\$53.35	\$68.99
SCRR	Windsor	4/1/2023	\$27.09	\$35.56	\$54.75	\$82.95
Recology	Santa Rosa	Current	\$32.52	\$36.57	\$53.40	\$81.79
Recology	Santa Rosa	Proposed	\$33.93	38.15	\$55.71	\$85.33

Table 3: Commercial Garbage Collection Rate Comparison

Hauler	Jurisdiction	Effective Date	1.5 CY 1x/week	2 CY 1x/week	3 CY 1x/week	4 CY 1x/week
Sonoma Garbage	Sonoma	7/1/2023	N/A	\$293.04	\$432.59	\$573.38
Recology	Cloverdale	12/1/2022	\$281.58	\$351.87	\$436.78	\$515.56
Recology	Cotati	7/1/2023	\$299.36	\$395.98	\$495.38	\$589.98
Recology	Sebastopol	7/1/2023	\$352.52	\$418.06	\$582.21	\$657.24
Recology	Healdsburg	1/1/2023	\$376.49	\$471.98	\$647.94	\$808.01
Recology	Petaluma	7/1/2023	\$425.43	\$499.77	\$668.70	\$734.69
SCRR	Windsor	4/1/2023	\$570.50	\$634.65	\$833.40	\$961.99
Recology	Santa Rosa	1/1/2023	\$419.66	\$512.11	\$626.01	\$783.51
Recology	Santa Rosa	Proposed	\$437.83	\$534.28	\$653.12	\$817.44

Figure 1, below, shows a summary of rates for residential customers with 30- to 40-gallon garbage service in various jurisdictions. The 2024 proposed 32-gallon rate of \$37.73 for the City is approximately 24% higher than the overall Sonoma County average of \$29.50 for 30- to 35-gallon containers; this average is expected to rise as more cost-based rate adjustments are adopted in more jurisdictions.

Figure 1: 30-40 Gallon Residential Rate Comparison

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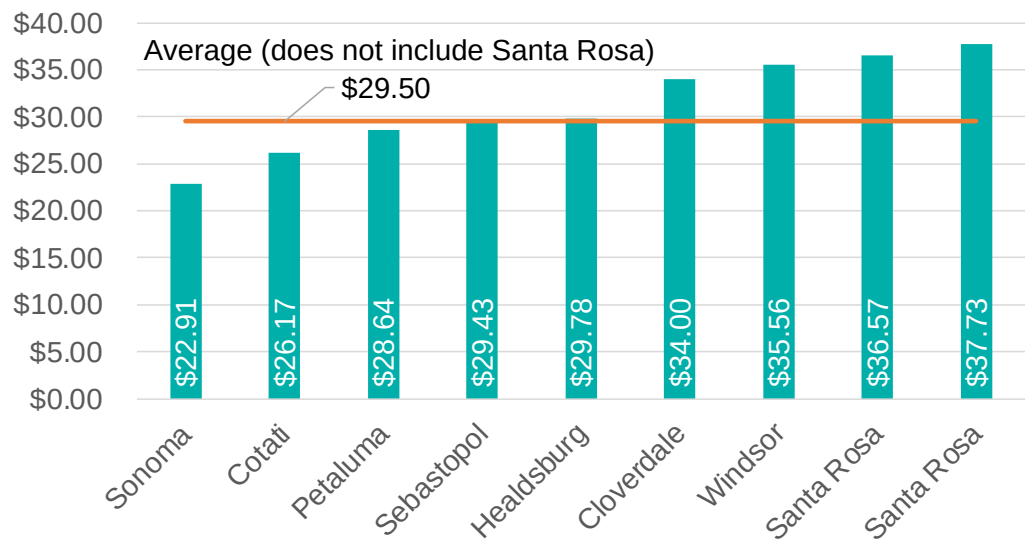
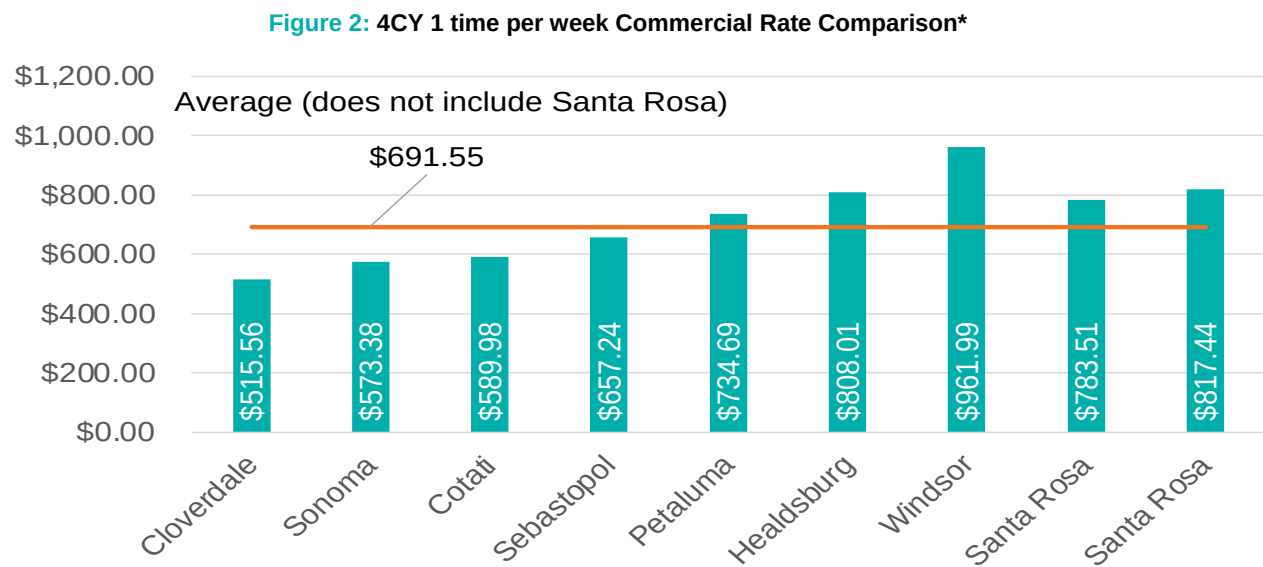


Figure 2 (below) shows a summary of rates for commercial customers utilizing the 4-CY bin in various jurisdictions. The 2024 proposed 4-CY rate of \$817.44 is approximately 18% higher than the overall Sonoma County average of \$691.55.

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***Note:** Commercial Collection Rates include the selected trash rate bundled with recycling and organic waste for all comparable jurisdictions, except Windsor. The rates for Windsor include the rate for garbage collection, plus a weekly collection for a 96-gallon recycling cart, and a 64-gallon organic waste cart for a more comparable comparison.

When comparing rates, it is also important to understand the subscription levels at each cart size. **Table 4**, below, provides the current distribution of residential accounts by cart size (service level). As shown, more than 75% of accounts subscribe to a 32-gallon or 64-gallon service.

Table 4: Residential Accounts by Service Level

Cart Size	Number of Accounts	Percent of Total	Cumulative % of Total
20 gallon	7,376	15.2%	15.2%
32 gallon	22,528	46.4%	61.6%
64 gallon	15,645	32.2%	93.8%
96 gallon	2,998	6.2%	100%
Total	48,547	100%	

Table 5, on the following page, provides the current distribution of commercial accounts by garbage bin size (service level). As shown, subscription to 2-, 3- and 4-CY bins account for over 80% of the commercial customer base.

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Table 5: Commercial Accounts by Service Level

Bin Size	Number of Accounts	Percent of Total	Cumulative % of Total
1.0 CY	93	5.2%	5.2%
1.5 CY	80	4.4%	9.6%
2.0 CY	410	22.8%	32.4%
3.0 CY	411	22.8%	55.2%
4.0 CY	709	39.4%	94.6%
6.0 CY	98	5.4%	100.0%
Total	1,801	100%	

FISCAL IMPACT

Approval of this action will result in rate increases collected by Recology and generate estimated franchise fee payments to the City of \$8.7 million annually. AB 939 fees are estimated to be \$145,000, which are earmarked to support programs to divert solid waste material from landfills.

ENVIRONMENTAL IMPACT

This action is exempt from the provisions of the California Environmental Quality Act (CEQA) under CEQA Guidelines Section 15061(b)(3) and 15378 in that there is no possibility that the implementation of this action may have significant effects on the environment, and no further environmental review is required.

BOARD/COMMISSION/COMMITTEE REVIEW AND RECOMMENDATIONS

Not applicable.

NOTIFICATION

Not applicable.

ATTACHMENTS

- Attachment 1- Santa Rosa Detailed Rate Review Analysis Report by R3 Consulting Group, Inc.
- Resolution / Exhibit A - Fifth Amendment to Solid Waste Collection Services Agreement Between the City of Santa Rosa and Recology Sonoma Marin, DBA Recology Santa Rosa

PRESENTER

Jason Nutt, Assistant City Manager