March 26, 2019

Board of Supervisors
3501 Civic Center Drive
San Rafael, CA 94903

SUBJECT: Public Hearing for a Marin Sanitary Service Rate Increase

Dear Board Members:

RECOMMENDATIONS: 1) Hold a Public Hearing on March 26, 2019, at 10:30 a.m. to consider an 8.90% rate increase for the Central Marin Franchise Areas 1-6 and Ross Valley North and South Franchise Areas all serviced by Marin Sanitary Service; and 2) authorize the President to execute the First Amendment to the Amended and Restated Exclusive Franchise Agreement to Collect, Transfer, Process, Market and Dispose of Solid Waste, Recyclable and Compostable Materials Between Marin Sanitary Service and the County of Marin.

General Background:
Marin Sanitary Service, Inc. (MSS) holds the exclusive franchise for the collection and disposal of refuse in eight unincorporated Franchise Zones (Central Marin Franchise Areas 1-6, and Ross Valley North and South. The six small Central Marin Franchise Areas include unincorporated parts of Bayside Acres, Country Club Estates, Bret Harte, Point San Quentin, Lucky Drive, and Greenbrae Boardwalk. Ross Valley South includes Kentfield, Greenbrae, Kent Woodlands, and Del Mesa Heights. Ross Valley North includes Sleepy Hollow and Oak Manor.

This report details a proposed rate increase for 2019 necessary to provide adequate rate revenue for Marin Sanitary Service (MSS) to provide refuse, recycling, and organic materials composting, hauling, and processing for customers ("rate payers") including residential homeowners, apartment owners, commercial property owners, and other businesses and tenants. The proposed rate increase of 8.90% over 2018 levels, effective 1/1/19, is based on a rate setting methodology the County has with Marin Sanitary Service as well as a negotiated resolution to ongoing recycling deficits in a Recycling Reserve Fund.

Franchise Background:
Each year, the County holds a public hearing to set the maximum collection rates that can be charged by MSS. These rates are based on a specific methodology contained in the Franchise Agreement MSS. The current
Franchise includes a Recycling Reserve Fund in the rate setting methodology. It was established to capture a portion of recycling revenues (net of expenses) for rate payers since the markets for recycling had been strong for several years, and to provide a cushion for when minor losses occurred. However, the Recycling Reserve Fund is currently not able to accommodate the recent major downturns in recycling markets, which will be discussed more in the Analysis section of this staff report below.

The current Franchise Agreement provides for a detailed, base year review of MSS’s operations every three years. Annual summary reviews using modified indices are conducted for the next two years. The last detailed review was conducted for the 2016 rate year. The proposed rate levels for 2019 are based on a detailed review.

Several jurisdictions in Marin that have similar agreements with MSS work together as the “Franchisors’ Group” to share information and minimize costs. These jurisdictions are: San Rafael, Larkspur, Ross, the Las Gallinas Valley Sanitary District, and the County of Marin. The Franchisors’ Group has retained an independent third party, R3 Consulting Group (R3) to review the MSS Rate Application. Schultz, a principal with R3 will be at this meeting to make a presentation to your Board.

**Recent Turmoil in the Solid Waste Industry**

Recycling commodities markets have been on a steep decline for the past three years, resulting in reduced revenues for recycling companies and the closure of more than 1,000 recycling buy-back centers throughout the State. For example, between January 2017 and February 2018, MSS saw prices drop for mixed paper recycling from approximately $155 per ton to $20 per ton. This market collapse is not only being felt in our local jurisdictions but has been widespread throughout California and the rest of the nation. These market conditions are expected to continue into the foreseeable future.

In November 2016, MSS notified the Franchisors’ Group that the deficit in the Recycling Reserve Fund had exceeded the amount necessary to trigger a provision in the Franchise Agreement, which called for a meet-and-confer process to address the deficit. The Franchisors Group and MSS began the meet-and-confer negotiations in 2017. In addition, the Franchisors and MSS agreed to use the opportunity to review and adjust the overall methodology for setting customer rates each year, known as Exhibit B in our Franchise Agreement. There has been broad agreement that the current methodology can be confusing, has become costly and time-consuming, and does not provide an adequate level of predictability or stability for rate payers or MSS.
Rate Application Review
Over the past ten years rate adjustments have ranged from less than one percent to over 10% with an average of 5.82%. Last year’s adjustment was 9.31% (5.57% based on MSS’s rate application and 3.74% for a Regulatory Compliance Fee). Waste haulers around the state are experiencing recycling losses and increases in labor and benefits expenses, among other things. In the past year other Marin County jurisdictions have experienced rate adjustments ranging from approximately 14% to 19% in Mill Valley, Belvedere, Corte Madera, Tiburon, and Tamalpais Community Services District. In the past two years, rates increased by 15% in San Francisco to more than 50% in Piedmont, Windsor and Santa Rosa, with similar adjustments occurring or forthcoming in many other Bay Area jurisdictions. This is the result of many factors, including a growing amount of solid waste, recycling, and compostable materials generated by residents and businesses, increasing requirements to divert waste from landfill, increasing costs of processing recyclables and compostable materials, decreasing value of recyclable materials, increasing costs of capital and equipment to implement new standards and requirements, and increasing costs of labor in a constrained labor market.

MSS’s initial Rate Application (Attachment 1) proposed a 13.98% increase over 2018 rates, not including treatment of prior recycling losses and 2019 recyclables processing costs. Had those elements been fully included in the 2019 rate adjustment, R3 estimates that the rate adjustment would have been 21.40%.

R3 reviewed the application and all relevant documents and financial schedules with MSS and recommends an increase of 8.90% to the County’s rates in 2019, including resolution of prior recycling deficits. These will be carried in the rates over three years from 2019 through 2021 at a rate impact of approximately 0.44% in 2019. The full rate review and proposed adjustments are contained in the attached “Review of Marin Sanitary Service’s 2019 Rate Application by R3 Consulting (Attachment 3). With the above recommendation, the cost of the 32-gallon residential landfill cart package would increase $3.86 per month, from $43.32 to $47.18.

Proposed First Amendment Franchise Agreement
In addition to a Rate Review, the Franchisors’ Group, with the assistance of R3 Consulting addressed the following five issues:

1. Recycling Reserve Fund Deficits
To date, the Marin Franchisors’ Group share of the deficit in the Recycling Reserve Fund total approximately $1.15 million. MSS has agreed to forego two-thirds of the total Franchisors’ share and to amortize the remaining one-third (approximately $350,000) over three years. This is a 0.44% rate impact each year for 2019, 2020, and 2021. This would be a separate item from the annual rate adjustment calculation, so it will not be compounded over time, nor will there be interest added.
Note that this $1.15 million only represents the half of the losses that were assigned to the Franchisors in the Fund; MSS assumed the liability for their half equaling $1.15 million. This agreement to cut the Franchisors' share of the deficits by two-thirds is a significant concession by MSS resulting in minimal impact to our rate payers.

2. New Model for Recycling Costs and Revenue
If approved, the proposed First Amendment would eliminate the current Recycling Reserve Fund and replace it with a net processing fee. MSS would be paid an annually adjusted processing fee minus revenues from the sale of recyclable materials. This new method of calculating recycling in the annual rate application includes an incentive for MSS to seek the best prices for selling the materials. This would be accomplished by only funding 90% of MSS's cost to process recyclables (yielding a shortfall for MSS to fill) while allowing MSS to keep 90% of the recycling revenues (as a means of funding the shortfall noted above). Since the cost of recyclables processing is greater than the revenues, MSS would then be incentivized to maximize recycling revenues in order to cover the costs of recyclables processing.

The processing costs and recycling revenues will be reviewed annually, and should there be significant changes to the markets again there is a provision to review and adjust as necessary to mutually benefit rate payers and MSS. This threshold is being set at 10% difference in either revenues or losses for two consecutive years. In this way, should markets completely drop out MSS has a means to address further significant losses. However, should markets rebound significantly the County also has a means to ensure that these revenues help offset customer rates.

3. New Methodology for Setting Rates
The proposed First Amendment includes a substantially streamlined and simplified annual rate adjustment methodology. Unlike the current methodology, which sets rates based on actual MSS costs and profits (aka a “cost-plus contract”) the new methodology would set rates based on set revenues due to MSS, which would be escalated annually based on one simple Water, Sewer, and Trash (WST) index, which has increased between 2% to 5% annually in recent years. This will streamline and simplify the rate setting process, placing more incentive on MSS to live within the regulated revenue amount, and will significantly reduce annual costs and time for consultants and staff to conduct the annual reviews. Every five years, MSS or the Marin Franchisors’ Group may request a detailed review should there be a need. This differs from the current Agreement, which stipulates an automatic detailed review every third year. All true-up provisions of the old methodology would also be removed. Staff expects a 70% to 80% reduction in time and costs annually to prepare the rate review.
In addition to the streamlining stated above, the proposed third amendment would include a 2.5% minimum and a 5% maximum rate cap for MSS operational expenses. This excludes franchise/agency fees and the cost of processing, recycling, composting and disposal (the latter of which are not subject to MSS control but are subject to fluctuation based on market conditions and amounts of waste generated by residents and businesses). This will not eliminate the possibility of experiencing an overall rate increase greater than 5% on occasion, but generally should curtail the likelihood of large future year rate increases.

As part of the analysis, R3 conducted a thorough review of MSS’ expenses and revenues for 2019. This was important to do concurrently with the new amendment to the Franchise Agreement in order to have third party verified figures for the recycling deficits and a better understanding of the projected costs and revenues for future years using a new methodology. One significant outcome of this analysis projects that using our new methodology and barring any significant upsets in the industry, rates are more likely to adjust by approximately 3% to 4% annually. This new proposed rate setting methodology would require MSS to manage all of their controllable expenses to the greatest extent possible while also providing greater rate certainty with which to do so.

4. Performance Metrics
While MSS is known for quality services, a dedication to recycling and composting, and environmental stewardship; they have agreed to establish new performance metrics for outreach and education as well as regular operations, billing, and customer service. Details of the specific performance metrics and MSS reporting procedures will be established collaboratively between the Marin Franchisors’ Group agencies and MSS.

5. Succession Planning & Assignment
Although MSS has stated they are not selling nor are they interested in selling the company, they agreed to prepare formal succession planning documentation to be provided to the Franchisors’ Group in the coming year and regularly thereafter. They have also developed and provided new assignment language for the Franchise Agreement that would give the Franchisors more control over any proposed sale of the company. This will now also provide up to $200,000 for agency costs to review and assist with our interests if the company were to sell in the future, while ensuring that the MSS standards of service continue to be met.

In addition to the above, Exhibit A, the MSS Description of Services, was updated to catch up to current State legislation around organic materials collection and processing. Commercial, multi-family, and single-family organic materials collection and composting services were added where appropriate, and other minor updates and clarifications were completed as well.
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SUMMARY: In conclusion, staff, MSS, and R3 concur that the proposed First Amendment to the Franchise Agreement would help achieve the following outcomes:

- More stable and predictable rates and a firm basis for rate control in future years
- Continued verifiable high levels of quality services for customers
- Simplified annual rate setting methodology that saves significantly on consultant costs and staff time; while improving accuracy and transparency

The First Amendment is provided in Attachment 2 – and the new rate setting methodology would be applicable for the 2020 rates. Accordingly, your Board is asked to authorize the Board President to execute First Amendment to the Amended and Restated Exclusive Franchise Agreement to Collect, Transfer, Process, Market and Dispose of Solid Waste, Recyclable and Compostable Materials Between Marin Sanitary Service and the County of Marin to effectuate the improvements and modifications outlined in this Report.

FISCAL IMPACT: There is an estimated County revenue increase of approximately $55,000 in fees. There are no additional impacts to the General Fund by this action.

REVIEWED BY:  
[ ] County Administrator  
[ ] Department of Finance  
[ X ] County Counsel  
[ ] Human Resources

[ X ] N/A  
[ X ] N/A  
[ ] N/A  
[ X ] N/A

Respectfully submitted,

Steve Devine  
Program Manager

cc: Marin Sanitary Service

Attachments:
1. MSS Rate Adjustment Request Letter
2. First Amendment to the Amended and Restated Exclusive Franchise Agreement to Collect, Transfer, Process, Market and Dispose of Solid Waste, Recyclable and Compostable Materials Between Marin Sanitary Service and the County of Marin
3. Review of Marin Sanitary Service’s 2019 Rate Application by R3 Consulting
4. New Franchise Exhibit A – Marin Sanitary Service Description of Services
5. New Franchise Exhibit B - Collector’s Revenue Requirement and Rate Adjustment
6. New Franchise Exhibit D – 2019 Rate Schedule

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