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STAFF REPORT

To: SBWMA Board Members
From: Joe La Mariana, SBWMA Executive Director
Date: April 27, 2017 Board of Directors Meeting
Subject: Franchise Agreement Extension Committee Findings and Recommendations to Proposed Recology Model Franchise Agreement and Compensation Package

Recommendation

This is an informational report and no action is necessary.

Summary

The Franchise Agreement for Collection Services for Garbage, Recycling and Organic Materials with Recology expires on December 31, 2020. The SBWMA's ad hoc Franchise Agreement Extension (FAX) committee, staff and consultants have negotiated with Recology of San Mateo County (Recology) representatives since November 2016 to arrive at a mutually-agreeable, amended and restated Model Franchise Agreement and cost for service. The proposed agreement extension is for a term of 15-year (through 2025) and will provide the member agencies the same comprehensive high-quality services currently delivered by Recology. This staff report and the attached **FAX Committee's Final Findings and Recommendations Report (Attachment A)** and **Redlined Model Franchise Agreement (Attachment B)** are the outcome of the negotiation process. Because several negotiation points are still being finalized, detailed financial worksheets will be presented and handed out in the May 3rd ½ day workshop and will be discussed at the May 25th Board meeting and distributed by May 18th as part of this board meeting's agenda packet.

Analysis

Staff was tasked to negotiate a restated and amended Model Franchise Agreement and cost for services with Recology. During these negotiations, SBWMA staff worked with the FAX committee, consultants and Recology during numerous meetings to develop these two deliverables for the collection of garbage, recycling and organic materials within the SBWMA service area for 2020 and beyond.

Prior to beginning negotiations, the SBWMA performed two studies to provide important cost and rate background information:

1. **A Solid Waste Rate Comparison by Jurisdiction Study** to quantify the SBWMA's rates for garbage, recycling and organics collection compared to the rates that are charged by other Bay Area cities. The study showed that **the SBWMA is currently below the average cost customers are charged for a 32-gallon cart in over 60 Bay Area cities**. This study was conducted by HF&H Consultants in April 2016.

2. **A Recology Operations Collection Cost Review** to assess the “reasonableness” of Recology’s cost proposal. The cost review analyzed all aspects of Recology’s operations and compared this against industry norms. The review concluded that **Recology’s total annual cost of operations were “reasonable” and varied by only 5.5% from the consultant’s model and were within the norms of the solid waste industry.** This analysis was performed by Sloan Vasquez Consultants between April 2016 and February 2017. A second review was commissioned with RJ Proto Consultants to peer review the Sloan Vasquez results and provide a second opinion. RJ Proto verified that the original review was accurate and that Recology’s costs of operations were within industry norms.

During the last six months of the negotiation process, the FAX committee, SBWMA staff and consultants have worked closely with Recology to define the cost for services, the rate setting methodology, and an amended and restated Franchise Agreement. The following outlines the results from these discussions.

- **Term:** Recology has proposed the option of a 10-year or a 15-year term for the new Agreement. After considering the financial benefits of spreading the depreciation cost of a new collection fleet, the FAX committee is recommending a 15-year term. At the end of the current contract, Recology’s \$36.3 million collection fleet will be fully depreciated, however, the company has indicated that it can continue to use the vehicles for 2-3 additional years. By agreeing to a 15-year term, and combining the use of the current and new vehicle for a longer term, the member agencies will benefit from a reduction in depreciation and interest expense (approximately \$1.7 million per year) resulting in a 3.4% favorable effect on Recology’s costs when compared to the 10-year option.
- **Compensation:** The FAX committee is recommending an agreement with a 2021 Base Contractor’s Compensation of \$65,330,616 which assumes a 15-year term and the inclusion of depreciation expense for the replacement collection vehicles in rate year 2020 of the Current Agreement. Based on these assumptions, the Base Contractor’s Compensation will:
 - Increase 2.4% from 2019 to 2020 (instead of a ~7% reduction built into the current Agreement).
 - Increase 10.2% from 2020 to 2021.
 - Adjust thereafter per changes in industry indices and service levels changes (capped at 5% increase/year).
- **Rate setting methodology:** This topic has been a focus of the negotiation process with the goal of maintaining rate stability and predictability (specifically, Recology’s compensation and rate setting methodology regarding depreciation of the vehicles, fuel cost indexing, administrative costs (G&A), and adjustments for growth).
- **Amended and Restated Franchise Agreement:** Throughout the negotiations process the SBWMA staff has worked closely with Recology to streamline the Agreement and make changes to clarify service expectations. The newly amended and restated Franchise Agreement language is approximately 90% unchanged and has been reviewed by both the SBWMA’s and Recology’s legal counsel. Though residential and commercial customers will not experience any changes to their current collection services, there are four minor modifications to the Franchise Agreement for residential and commercial services, which include:
 1. **Mixed Use Buildings:** The Agreement defines a new class of service – Mixed Use Buildings which contain commercial on the ground floor and residential above. The commercial element shall receive the services currently provided to commercial customers and the residential element of Mixed Use

Buildings will receive the services currently provided to multi-family customers. This building type and other multifamily and commercial customers will also be able to receive bin relocation services (at an additional fee) which may be required due to the below-street level location of bin enclosures on the property.

2. **Bulky Item Collection:** Residential customers will continue to receive up to two bulky item collection services annually without charge, within one week of request, however this service will be capped at 150 per day (Recology currently provides approximately 120 bulky item collections per day), and if the number of requests exceeds 150 per day, Recology will roll the service date one week.
3. **Abandoned Waste Collection:** Member Agency's will continue to receive abandoned waste collection services but a cap of 30 pick-ups per day has been established (when the average number reaches 25 daily events, the SBWMA and Recology will meet to add collection resources and provide additional compensation to Recology or take some other action to respond to the increased demand).
4. **Reporting:** Recology's reporting requirements have been adjusted to streamline data collection and reporting with the collection and customer service goals.

Background

SBWMA member agencies are currently in the seventh year of a ten-year Franchise Agreement for Collection Services for Garbage, Recycling and Organic Materials with Recology. During this time, feedback provided by Board Members, Member Agency staff, and community members surveyed, has consistently established that Recology has provided a high-level of professional competency during the execution of their operations throughout this period, in addition to the intense three-year pre-service rollout period.

The SBWMA Board of Directors approved the Final Plan and Recommended Process for Supporting Member Agencies with Negotiating a Potential Franchise Agreement Extension with Recology (Plan) on April 28, 2016, which recommended a schedule that, if adhered to, was intended to result in negotiating amendments to each member agency's existing Franchise Agreements with Recology by the end of 2016. The timeline for this plan was adjusted to allow the new Executive Director time to address other urgent contractual matters, to establish a new timeline, and to initiate the Recology negotiation meetings, the FAX committee meetings, and all internal SBWMA staff meetings that were necessary for moving the negotiation process forward.

At the SBWMA Board of Directors' (Board) direction, the FAX committee, Staff and consultants have worked closely with Recology since November 2016 holding a special TAC meeting in January and April, ten FAX committee meetings, seven negotiation sessions with Recology (several phone meetings were also held between Recology, HFH Consultants and SBWMA staff) and two additional all-day negotiations sessions to finalize negotiations. The team was able to obtain and include feedback from the SBWMA Technical Advisory Committee (TAC) at its April 13th meeting.

The final goal of the process is to have the SBWMA Board of Directors approve these documents and for the SBWMA staff to provide assistance to each member agency to coordinate with Recology to finalize the contract language, specific scope of services and the pricing of additional services for their respective agency by December 31, 2017. A RFP process to solicit a new collection services provider will be initiated if the majority of member agencies are not formerly in contract with Recology by December 31, 2017.

The negotiated deal to be considered by the Board provides:

- **Consistency with all existing solid waste, recycling and organics services.**
- **No new-service provider transition pitfalls** (i.e., container switch-out, customer service center setup & billing setup, driver route training, hard-rollout a new truck fleet, developing a new rate setting process, and end-of-contract buyouts (e.g. Allied Waste's exit)
- **Rate-setting stability/predictability**-after an initial rate true-up, rate increases are tied to indexes.
- **SBWMA rates will continue to be in-line** with Bay Area communities.
- **Continued cost savings from collection efficiencies** gained by Recology's years of experience.
- **Sharing of future inflation risk by Recology** in their 2021 Cost Proposal.
- **Savings of an estimated \$2 million** in avoided RFP and contractor-transition costs.
- **Labor peace** by continuing with a known company and management team.

Fiscal Impact

Recology's operating costs are anticipated to increase between rate years 2020 and 2021. There are many variables that will occur between 2017 and 2021 that will affect the cost of collection services including inflation, fuel cost, collective bargained labor, new laws, and fleet replacement. Additionally, the specific cost of collection services will vary based on the specific services requested by each member agency and their individual rate-setting philosophy. The FAX committee and Recology have attempted to forecast each cost element and actual costs will be used to determine the final costs that will be implemented in 2021. Note that Collection Services represents approximately 63% of the total costs to provide solid waste management services, and does not include Member Agency fees, disposal & processing costs and SBWMA .Based on certain reasonable assumptions regarding these other costs Customer Rates may increase from 2019 to 2020 by 3.3% and from 2020 to 2021 by 7.8%. Other reasonable assumptions could be made regarding these future fees and the results would be different i.e., the rate impact on any specific Member Agency customer would be affected by its existing rates and any surplus it may be generating (or may have generated) that could be applied to offset these increases.

Attachments:

Attachment A: FAX Committee's Findings and Recommendations

Attachment B: Model Franchise Agreement (DRAFT)—redline version (Available online only at www.rethinkwaste.org)