



FRANCHISE AGREEMENT EXTENSION (FAX) COMMITTEE FINAL FINDINGS AND RECOMMENDATIONS REPORT

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Table of Contents

1. RECOMMENDATION	3
2. EXECUTIVE SUMMARY	4
3. BACKGROUND	7
3.1 Goals of the Collection Services Franchise Agreement Negotiations.....	7
3.2 Overview of Negotiation Process.....	8
3.3 Negotiation Team Personnel	8
3.4 2016 Rate Survey	10
3.5 Development of Existing Operations Cost Review.....	10
3.6 Two-tiered Peer Review of Current Collections Operations Costs	11
3.7 Member Agency Input	11
4. Negotiation Results	13
4.1 Achievement of Negotiating Goals	13
4.2 Benefits of the Negotiated Recology Offer.....	14
5. Agreement and Financial Results	14
5.1 Amended and Restated Agreement	14
5.2 Financial Considerations	19
Attachment A: Negotiations Schedule	23
Attachment B: HFH Consulting - 2016 Solid Waste Rate Survey	29
Attachment C: Review of Current Collections Operations Costs	33
Attachment D: TAC/FAX Meeting Context Map and Mandala Visioning	37
Attachment E: SBWMA Member Agency Input Survey: Garbage & Recycling Collection Services	41
Attachment F: SBWMA Member Agency Projected Growth Rate Survey	57
Attachment G: Franchise Agreement Section-by-Section Summary of Proposed Changes	71

1. RECOMMENDATION

The South Bayside Waste Management Authority (SBWMA dba RethinkWaste) is close to completing a year-long negotiation process with Recology of San Mateo (Recology), to extend their hauling contract beyond 2020. The following provides the recommendations agreed upon by the SBWMA, Franchise Agreement Extension Negotiation Ad Hoc Committee (FAX), the Technical Advisory Committee (TAC), and the Financial Committee.

- 1. Authorize staff to provide the SBWMA Board with a Model Franchise Agreement with Recology San Mateo County (Recology) to provide Recyclable Materials, Organic Materials, and Solid Waste Collection Services for 15-year term of January 1, 2021 through December 31, 2036.** The Model Franchise Agreement will have been mutually agreed upon by SBWMA's TAC/FAX/Staff and Recology, and provided to the Member Agencies for use to finalize their own agreements. The goal of the negotiations process is to pursue a sole source agreement with Recology and not to pursue a public procurement process.
- 2. Authorize staff to provide the SBWMA Board with a base-cost proposal for all core collection services outlined in the Model Franchise Agreement to be provided to all 12 Member Agency for 2021** (also known as rate year 11).
- 3. Authorize SBWMA Senior staff to provide technical support with each of our 12 member agencies during their entire negotiation process with Recology** as they discuss agency-specific services and costs (beyond the base-cost proposal).
- 4. Once the Model Franchise Agreement with Recology is accepted by the SBWMA Board, each Member Agency will negotiate with Recology any Member Agency-specific considerations for approval by December 31, 2017.**

First Amended and Restated Joint Exercise Powers Agreement
SBWMA Article 7.1.1.c:

“Entering into or amending Franchise Agreements for the operation of the Facilities require the approval of two-thirds vote of its members”.

The SBWMA TAC/FAX Committees and Recology have agreed to the base-cost proposal for all core collection services, and are in the process of finalizing the Model Franchise Agreement. The TAC/FAX/Staff negotiations team recommends moving forward with the current cost proposal because it has been determined that it is a “good deal” for the Member Agencies. Nearly every aspect of the cost proposal has been reviewed and was deemed “reasonable” and “within local market pricing”. However, the team was unable to receive satisfying cost detail from Recology on what their general and administrative (G&A) costs were in this proposal (these costs represent about 16% of the total cost and increase from 2016 to 2021). Although Recology has not provided sufficient detail in this area, the TAC/FAX/Staff team acknowledges that the G&A costs are within the average for the industry and, therefore, should not hold up the Agreement process.

2. EXECUTIVE SUMMARY

Currently the Member Agencies are in the seventh year of a ten-year Franchise Agreement for Collection Services for Garbage, Recycling and Organic Materials with Recology. In anticipation of the Agreement's expiration in 2020, the SBWMA initiated discussions of a contract extension with the company. A starting point for this process was the gathering of stakeholder input from SBWMA Board Members, Member Agency staff, and community members. All groups surveyed expressed a high-level of satisfaction with Recology and concur that the company has consistently provided professional, competent, reliable service in the execution of their collection services. Based on this strong performance and survey response, the SBWMA Board approved a plan and recommended a negotiation process during Spring 2016. The Plan included a key assumption that all Member Agencies intend to participate in a Franchise Agreement extension with Recology by December 31, 2017.

Negotiations Process

As part of the Plan and recommended negotiation process, the Board created the Franchise Agreement Extension committee (FAX) with the primary tasks of:

- **Develop an amended and restated Model Franchise Agreement** to be presented to the SBWMA Board of Directors at the April 27, 2017 meeting.
- **Obtain Recology's total revenue requirement (cost) to perform collection services starting in rate year 2021** and establish a compensation adjustment methodology to govern the rate changes in future contract years.
- **Obtain and include feedback from the SBWMA Technical Advisory Committee (TAC)** at its April 13th meeting.

Since November, the SBWMA negotiation team has held special TAC meetings in January and April, ten FAX committee meetings, seven negotiation sessions with Recology (many phone meetings were also held between Recology, HFH Consultants and SBWMA staff), and two additional all-day negotiations sessions were held on April 4th and 6th to finalize negotiations. This negotiated deal will provide:

- **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 of 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 indices.
- **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** beginning with their 2021 Cost Proposal.
- **Avoidance of an estimated \$2-3 million** in avoided RFP and potential contractor-transition costs.
- **Maintain labor peace** by continuing with a known company and management team.

Prior to the negotiation process, the SBWMA performed two studies to provide important cost and rate background for the negotiation process:

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 over 60 other Bay Area cities. The study showed that the SBWMA is currently below the average cost customers are charged for a 32-gallon can each month for surveyed Bay Area cities.
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 by the two consultants 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.

Term, Compensation, and Rate Setting Methodology

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 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 vehicles for a longer term, the member agencies will benefit from a reduction in depreciation and interest expense (approximately \$1.7 million per year, or 3.4% of the total projected cost).

Compensation: The FAX committee is recommending an agreement with a 2021 Base Contractor's Compensation of \$65,303,616 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. This amount will be adjusted for the change in the cost of fuel and customer subscription levels.

Based on these assumptions and subject to the adjustments described above, the Base Contractor's Compensation would increase approximately 2.4% from 2019 to 2020 (instead of a 7% reduction that would have occurred as depreciation payments ended), and increase approximately 10.2% from 2020 to 2021. The actual increase will depend on several future adjustments. For example:

- The actual 2019 and 2020 Base Contractor's Compensation determined in accordance with the existing Agreement are subject to future changes. Recology forecasted this amount based on historical increases from 2013 to 2017 and arrived at an 8.2% increase. Because that period included an extraordinary "true up" of Base Contractor's Compensation to actual cost in 2013, it is not included in the calculation of the 10.2% increase described above.
- Adjustments to the 2021 Base Contractors Compensation as described above. A \$1 per gallon increase to the price of fuel results in a \$987,000 (1.5%) increase to Base Contractor's Compensation. A 2% per year increase in customer subscriptions to all lines of business results in a \$1,023,000 (1.6%) increase to Base Contractor's Compensation.

Thereafter, annual adjustments to the Contractor's Base Compensation would correspond to the changes in the indices for wages, benefits, fuel and other expenses plus a growth adjustment up to a maximum increase of 5%.

Customer rates, plus the use of any reserves, are set to equal the Total Customer Billed Revenue. **Total Customer Billed Revenue is comprised of Recology's cost plus Member Agency fees; plus Disposal and Processing costs.** Based on certain reasonable assumptions regarding these fees, the Total Customer Billed Revenue may annually increase from 2018 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.

It should be noted there are other factors that will affect the customer rates, which include processing costs and tip fees from these other facilities. **The current agreement with Recology for Collection Services represents about two-thirds of the entire waste collection, handling and transportation system costs.** Therefore, the remaining costs which are components of our overall system costs are all tied to contracts outside the Franchise Agreement negotiations discussion. For example, in February 2017, the Agency renewed its contract Construction and Demolition materials processing contract so those costs are now known through 2022. The Agency has, however, three other significant materials handling, processing and/or disposal contracts that will expire before 2020. There is no clear understanding of what the negotiations with those contracts will hold, or what the new rates will be.

Rate setting methodology: This topic has been a primary focus of the negotiation process and maintaining rate stability and predictability has been a major goal for the SBWMA (specifically, Recology's compensation and rate setting methodology regarding depreciation of the vehicles, fuel cost indexing, General and Administrative costs (G&A), and adjustments for growth were areas of focus).

Amended and Restated Franchise Agreement

Throughout the negotiations process the SBWMA has worked closely with Recology in reviewing the 2013 amended Franchise Agreement 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 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:**

1. **Mixed Use Buildings:** The agreement defines a new class of service – Mixed Use Buildings - which contain commercial uses on the ground floor and residential uses above. The residential element of Mixed Use Buildings will receive the services currently provided to multi-family customers and the commercial element shall receive the services currently provided to commercial 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 collections system-wide per day (Recology currently makes approximately 120 bulky item collections per day), and if the number of requests exceeds 150 per day, Recology will roll the service date by one week.
3. **Abandoned Waste Collection:** Member Agencies will continue to receive abandoned bulky waste collection services, but a cap of 30 pick-ups per day has been established. In the future, 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 align data collection and reporting with the collection and customer service goals.

3. BACKGROUND

SBWMA is 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 Member Agency staff, SBWMA Board Members and community members surveyed, demonstrated that Recology has consistently provided professional competency in the execution of their operations. As a result of their strong performance, the SBWMA Board finalized a plan and recommended process for negotiations during Spring 2016. This section details the goals of the Recology negotiations and provides background and clarification regarding the plan and recommended process followed.

3.1 Goals of the Collection Services Franchise Agreement Negotiations

Three goals were identified during the planning phases of the Recology negotiation process. These goals were the primary focus of the FAX committee, and include:

- Develop an **amended and restated Model Franchise Agreement** to be presented to the SBWMA Board of Directors at the April 27, 2017 meeting. The Model Franchise Agreement is to serve as a template document for each member agency to further refine and approve.
- **Obtain Recology's Total Revenue Requirement to perform collection services in future rate year 2021, as well as establishing an ongoing compensation adjustment methodology.** Upon SBWMA Board approval of these documents, each member agency is strongly encouraged to immediately work with Recology to finalize the contract language, specific scope of services and the pricing of any added or changed services for their respective agency by December 31, 2017. A RFP process to solicit a new collection services provider will be initiated if at least eight Member Agencies are not formally in contract with Recology by December 31, 2017.
- **Obtain and include feedback from the SBWMA Technical Advisory Committee (TAC)** at its April 13th meeting.

3.2 Overview of Negotiation Process

The Final Plan and Recommended Process for Supporting Member Agencies with Negotiating a Potential Franchise Agreement Extension with Recology (Plan) was approved by the SBWMA Board of Directors 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 2017. The timeline for this plan was adjusted to allow the new Executive Director, who began in August 2016, time to address other urgent contractual matters, to establish a new timeline (as seen in Attachment A), 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 within the afore mentioned timeline. The Plan included a key assumption that all Member Agencies intended to negotiate a Franchise Agreement extension with Recology and were required to notify SBWMA staff by May 31, 2016 of their intent to participate in the process. All Member Agencies provided their commitment to participate by the deadline.

3.3 Negotiation Team Personnel

SBWMA staff was tasked with developing a team to drive the negotiation process and work closely with the FAX Committee. The FAX Committee was created and approved by the SBWMA Board of Directors, and provides a well-rounded team of senior Member Agency staff for the negotiation process. The following details provide the background on each team.

FAX Committee Formation and Composition

During the April 28, 2016 SBWMA Board of Directors meeting, the Franchise Agreement Extension (FAX) Ad Hoc Committee was formed to represent the interests of the community's rate payers as the SBWMA staff and consultants negotiated with Recology to deliver a new contract. This FAX Committee consists of six members, as presented in Table 1.

Table 1. FAX Committee Team Members

FAX Committee Team Members	
Title	Personnel
City of Belmont, Public Works Director, TAC Chair	Afshin Oskoui
City of East Palo Alto, Finance Director	Brenda Olwin
City of Menlo Park, Environmental Services Manager	Heather Abrams
City of Redwood City, City Manager, FAX Vice Chair	Melissa Stevenson Diaz
City of San Mateo, City Manager	Larry Patterson
County of San Mateo, Public Works Director, FAX Chair	Jim Porter

In addition to these six (6) city representatives, senior SBWMA staff, two industry experts, a leading solid waste industry financial consultant, and the Agency's attorney also participated with this committee to provide technical support throughout the negotiation process.

In February 2017, Heather Abrams left the City of Menlo Park and, thereby, stepped off the FAX Committee. Significant discussion occurred between the SBWMA Board of Directors and FAX committee members regarding their options on how to address this unexpected vacancy. The City Managers from two Member Agencies (Atherton and Menlo Park) each stated their interest in filling the vacancy on the FAX committee. On February 23, 2017, the SBWMA Board of Directors decided to keep the FAX committee at five city representatives and not to add anyone to the FAX committee.

Eight FAX committee meetings were held between December 6, 2016 and March 28, 2017, and one additional joint TAC/FAX meeting was held on April 13, 2017. The primary purpose of this joint meeting was to seek input and feedback on the scope of services to be provided by Recology and provide recommendations to the Negotiation and FAX committees. The TAC/FAX committee reviewed the FAX Committee’s Findings and Recommendations prior to consideration by the SBWMA Board at their April 27th meeting.

SBWMA Negotiation Team Members

The SBWMA staff established a Negotiations Team composed of SBWMA staff and consultants who had primary responsibility for direct negotiations with Recology. This team was established to provide continuity, support and expert navigation to the FAX committee during the negotiation process and provide the key deliverables of a draft Model Franchise Agreement and Recology’s cost proposal for rate year 2021. These members are shown in **Table 2**.

Table 2. SBWMA Negotiation Team Members

SBWMA Negotiation Team Members	
Title	Personnel
SBWMA, Executive Director	Joe La Mariana
SBWMA, Sr. Facilities & Major Contracts Mgr.	Hilary Gans
Team Administrative Support	Cyndi Urman, SBWMA, Tracie Bills (SCS Engineers)
Solid Waste Industry Subject Matter Expert	Ron Proto, RJ Proto Consulting
Solid Waste Industry Financial Consultants, Lead Negotiators	Bob Hilton, Tracy Swanborn, Marva Sheehan (HFH Consultants)
SBWMA Attorney	Jean Savaree, ADLC

Recology Negotiation Team Members

The Recology Negotiation Team consists of seven members, as shown in **Table 3**.

Table 3. Recology Negotiation Team Members

Recology Negotiation Team Members	
Title	Personnel
Vice President, San Mateo/South Bay Region	Mario Puccinelli
General Manager, San Mateo County Division	Mike Kelly
Controller, San Mateo/South Bay Region	Carl Mennie
Administrative Services Manager, San Mateo Division	Tammy Del Bene
Public Affairs Manager, San Mateo Division	Gino Gasparini
Customer Service Manager, San Mateo Division	Jeanette Haskell
Attorney, Recology Corporate	Bryce Giddens

The team’s first joint meeting was held as a two-day introductory orientation on November 2 and 3, 2016, with the goal to identify critical discussion points that would shape the scope of the negotiations. These initial two meetings did not include HFH Consultants (their contract was approved in December), Jean Savaree (SBWMA staff and Recology agreed to have an open dialogue prior to attorneys becoming involved), or Bryce Giddens. There were a total of nine, three-hour negotiation meetings and two final eight-hour meetings.

3.4 2016 Rate Survey

The SBWMA contracted HF&H Consultants, LLC (HF&H) to survey the solid waste rates for the jurisdictions located in the Bay Area counties of Alameda, Contra Costa, Marin, Santa Clara and San Mateo. The results of this survey showed that the SBWMA is currently below the Bay Area average cost that is charged to residential customers for a 32 gallon garbage can each month (average cost for a residential 32 gallon garbage can within the SBWMA averages \$32.55 per month (monthly service costs ranged from \$22 - \$55 between jurisdictions) while the Bay Area surveyed averaged is \$33.14 per month (costs ranged from \$24.41 - \$43.75 between jurisdictions). For further information, refer to **Attachment B** which details the rates for each jurisdiction and how they compare to member agency rates.

3.5 Development of Existing Operations Cost Review

The SBWMA engaged Sloan Vasquez McAfee (SVM) in May 2016, to review and assess Recology’s 2016 costs, and to develop an Operational Cost Model (pro forma) that provides a cost of service analysis of Recology’s cost to deliver services required by their agreement with the SBWMA. The pro forma was used to validate Recology’s cost of service for reasonableness. SVM used Recology’s actual costs as of 3/31/2016 to develop the pro forma. Recology calculated those costs using 6 months actual costs, October 2015 - March 2016, then projected the remaining 6 months. Where Recology did not provide information, SVM developed estimates based on accounting and financial principles, and their extensive experience and knowledge of the waste industry.

3.6 Two-tiered Peer Review of Current Collections Operations Costs

As a secondary step, a peer review was performed of the SVM pro forma by R.J. Proto Consulting Group (RJP) in order to evaluate its accuracy. After this review, RJP provided findings to SVM, who then developed a restated pro forma which included those findings. RJP reviewed the SVM **Original Pro Forma** and found it was a thorough, well-developed model, drawing numbers, formulas, and calculations from multiple interactive worksheets.

The findings showed the Total Annual Cost of Operations variance between the SVM pro forma and Recology's 2016 Actual Costs of 3/31/16 is -5.5%, (meaning the SVM pro forma costs were 5.5% lower than Recology's 2016 costs as of 3/31/16) and that it was within a reasonable margin of error for this type of analysis. SVM took the findings from RJP's analysis and made changes to the original pro forma, developing a **Restated Pro Forma**. The difference between the original and restated pro forma is mostly due to a pension cost variance which was only 0.5%, or \$146,000 more than Recology Actual costs. SVM also attributed some of the other findings to timing differences. The restated pro forma has a variance of -1.8% meaning the SVM pro forma costs were 1.8% lower than Recology's 2016 actual costs.

The Total Annual Cost of Operations variance between the SVM original and restated pro formas and Recology's Actual Costs as of 3/31/16 ranges between -5.5% to -1.8%. This variance is within a reasonable margin of error for this type of analysis. The results from this analysis can be found in **Attachment C**.

3.7 Member Agency Input

Member Agency input is always highly-valued, and was specifically solicited by staff during the negotiation process in a variety of ways that are identified in this section. This feedback provided the SBWMA Negotiation Team (Team) with clarification on ratepayer satisfaction with Recology's collection services, customer support, and rates. This clarification, in turn, shaped the Team's discussion and deal points for the entire negotiation process with Recology. This stakeholder input process is detailed below.

A. SBWMA TAC Meetings

There were two SBWMA TAC meetings that allowed for participation by each Member Agency during the Recology negotiation process.

- **January 5, 2017:** HF&H Consultants facilitated an agency-wide input session with the TAC and FAX members to identify and rank important discussion points for the Franchise Agreement negotiations. The results from this collaborative dialogue included a Context Map and Mandala Visioning session that provided clarity on the concerns and direction the Member Agencies would like to see. This session was attended by over forty Member Agency representatives. For further detail, see **Attachment D**.
- **April 13, 2017:** A joint TAC and FAX committee meeting was held to provide context, share results and seek feedback on the recommendations by the Negotiation and FAX committee. This meeting was the first glimpse the TAC members had of the proposed changes and compensation package. The feedback was positive regarding the direction of the negotiations and the progress made to date.

The biggest take-away from the meeting was for SBWMA staff to provide a half-day workshop and financial review for the TAC, to be briefed on the Amended and Restated Franchise Agreement, and compensation package. The TAC members believe this would help with understanding the changes and prepare them for the council meeting discussions in May. A second half-day will also be scheduled for early/mid-May to review the financial data and contract language with the Member Agency legal staff. The other feedback provided by TAC members included:

- Upon confirmation of all deal points, provide more detailed financial information to understand all changes in the Amended and Restated Franchise Agreement.
- Confirming public outreach efforts associated with the Master Franchise Agreement should be managed by the Member Agency, as they define their own Amended and Restated Franchise Agreement and rate structure.
- Collaborating on any common negotiating points between the Member Agencies, as they discuss options with Recology, it would be good to identify other Member Agencies that are working on the same topic to try and streamline the negotiation process.
- Providing an outline of all changes in the Amended and Restated Franchise Agreement to make the review easier.

A half day workshop will be held on May 3, 2017 for the TAC representatives and Member Agency staff (those working with Recology and SBWMA when the new contract is executed) to outline changes to the Amended and Restated Model Franchise Agreement and Cost Proposal with Recology. The intent of this workshop is to provide opportunity to ask questions and walk through the details in preparation for the Member Agency City Council meetings during the month of May.

B. SBWMA Member Agency Input Survey: Garbage & Recycling Collection Services

A survey was generated to seek input from Elected Officials in order to understand satisfaction with different services provided by Recology, and to seek feedback on the level of interest for each Member Agency in pursuing new or changed services. These details provided critical insight and guidance for the negotiation process. The survey was distributed to all SBWMA TAC members on December 16, 2016, who then sent the survey to their fellow Elected Officials for feedback. The information was gathered via SurveyMonkey and a response was requested by January 6, 2017. The deadline was extended to January 13 to allow for every Member Agency to respond. All Member Agencies responded. Results of the Survey can be found in **Attachment E**.

C. SBWMA Member Agency Projected Growth Rate Survey

A survey was generated to seek input from all Member Agency Senior Planning staff in order to understand projected development in their service area. This aspect was significant to our discussions throughout the negotiations due to the concerns Recology has stated surrounding their lack of compensation for an increase in accounts due to the growth in commercial and multi-use buildings over the past few years. The survey was distributed to all SBWMA TAC members on January 9, 2017, who then sent the survey to their planning departments for feedback. The

information was gathered via SurveyMonkey and a response was requested by January 27, 2017. All but one Member Agency responded. Results of the Survey can be found in **Attachment F**.

D. Redline Franchise Agreement Submittals

In December 2016, the SBWMA staff provided a redline franchise agreement document to all Member Agency TAC members with the initial intent to seek feedback on any areas that would be a concern. This redline document was provided by Recology as an initial step during the negotiations process. An additional redline document was provided to the Member Agencies on April 20, 2017, which incorporated all feedback from Recology, the FAX committee, Negotiation committee and SBWMA staff.

E. Monthly Board Briefings

The SBWMA Executive Director provided negotiation progress updates to the SBWMA Board of Directors, on the related activities that had been performed during the previous month, including critical highlights of events, and next steps during the negotiation process. These updates were provided to the SBWMA Board on November 17th, 2016; January 26th, 2017; February 23rd, 2017; and March 23rd, 2017.

4. Negotiation Results

This section provides overall results on committee feedback, achievements of negotiating goals and the benefits of the negotiated Recology offer.

4.1 Achievement of Negotiating Goals

Since November, the SBWMA negotiation team held ten FAX Committee Meetings, two special TAC meetings in January and April, seven planned joint negotiation meetings, and also many phone meetings between Recology, HFH Consultants and SBWMA staff to continue moving the process forward to maintain the Board's FAX schedule. Negotiations moved along smoothly, however, Recology's initial cost proposal for the current agreement's last rate year (2020) and the start of the presumed new agreement (2021) known as the "jump-off point" was not in line with Agency expectations, which was to remain under a two digit percent increase. Both parties agreed to hold subsequent final discussions during two all-day meetings that were conducted on April 4th and 6th, 2017. Although the negotiation team experienced a bit of a delay with negotiations, the team was able to obtain and include feedback from the SBWMA Technical Advisory Committee (TAC) at its April 13th meeting, provide an amended and restated Model Franchise Agreement to the SBWMA Board of Directors at the April 27, 2017 meeting, to obtain Recology's total revenue requirement estimated to perform these services in future rate year 2021, and to establish a compensation adjustment methodology. These deliverables are highlighted in Section 5 to follow.

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 at least

eight of the Member Agencies are not formally in contract with Recology by December 31, 2017, (in accordance with section 7.1.1.c of the Agency's overarching JPA agreement).

4.2 Benefits of the Negotiated Recology Offer

Recology has been a proven and reliable partner over the last seven years and has provided excellent service to the SBWMA community. The negotiations team recognizes that Recology's cost of operations are similar to other companies (industry experts have verified that Recology's costs are within industry norms) and that no large cost savings are likely to be gained by installing a new collection contractor. Additionally, it is important to recognize that Recology has provided excellent service to the SBWMA community and that there is no guaranty that another service provider will meet the same standards. The FAX committee believes that the negotiated deal to be considered by the SBWMA 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 indices.
- **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** beginning with their 2021 Cost Proposal.
- **Avoidance of an estimated \$2-3 million** in avoided RFP and potential contractor-transition costs.
- **Labor peace** by continuing with a known company and management team.

5. Agreement and Financial Results

This section details the financial impact associated with the agreed upon compensation package and Model Franchise Agreement.

5.1 Amended and Restated Agreement

Over the past few months the SBWMA has worked closely with Recology in reviewing the 2013 amended Franchise Agreement to streamline and make critical changes that will enhance the overall clarity and productivity of the document. This document's language is approximately 90% unchanged and received legal review by both the SBWMA and Recology's legal counsel. **It is important to note that, while this document is substantively complete, it still must complete a final, comprehensive legal review. This review will be completed in early May and a final proposed Model Franchise Agreement document will be distributed in the May 25th SBWMA Board agenda packet.** (A section-by-section summary of the proposed changes can be seen in **Attachment G**).

The FAX and TAC committee participants expressed satisfaction with the current scope of services, however, enhancements were requested. The most significant of these included:

- Providing recycling, organic, and bulky waste services to the residential component of mixed use development.
- Improving public education and technical support services to commercial customers.
- Modifying the compensation adjustment methodology to:
 - provide greater stability and predictability;
 - ensure that the allocation of costs fairly affects each Member Agency's rates; and
 - simplify the adjustment process and explanation of rate changes.
- Considering "clean fuel" vehicles when the replacement of the existing fleet occurs.
- Providing reports that are easy to read, useful and not redundant.

Recology also identified areas where it wished to see changes (Note: not all of Recology's requests were accepted). The most significant of these included:

- Increasing the current Base Contractor's Compensation to reflect Recology's actual higher costs of operations (True Up) during the remaining term of the current Agreement.
- Converting to an annual compensation adjustment methodology that adjusts compensation to account for actual costs.
- Adding additional fees to "Attachment Q" that capture the cost of services (e.g., relocation fee).
- Provide a cap and additional compensation for bulky item collection.
- Allowing Recology to retain all revenues from customer billings.
- Reducing the number of performance standards and related liquidated damages.
- Reducing reporting requirements.

The driver for many of Recology's request was, in part, due to their stated decrease in their profitability during the past seven years. Recology has also stated that, if this current trend line were to continue, their division could operate at a loss by this end of the current term of this agreement. The current Recology franchise agreement has compensation based on adjustments using different industry indices (e.g. Consumer Price Index for fuel) and independent of cost factors (e.g. labor rates). **In the last seven years many of the Member Agencies have experienced significant growth in their commercial sector, and this growth was not factored into the current compensation model. As an example, for every new business added, Recology incurs the expense of providing service, but the new revenue is retained by the individual member agencies.** To date, Recology has effectively managed these new and additional costs by evaluating their operations and streamlining efficiencies to make up for any losses, but the company's senior management has stated that they have now hit a point of diminishing returns. The findings outlined in section 3.6 and **Attachment C** of this report provide two levels of independent review corroborating Recology's operational efficiencies.

The following sections describe the results of the negotiations.

Residential and Commercial Services

Residential customers will not experience any changes to their collection services, thus avoiding complaints resulting from the implementation of new services or the change in service providers. Most commercial customers will also not experience any changes to their collection services. A very small sub-set of commercial accounts (Recology has identified about 20 accounts) will need to improve their container access for Recology's workers, or they will be subject to a new container relocation fee due to the special handling that will be required to properly service those units.

There are four primary modifications to the amended and restated Franchise Agreement for residential and commercial services, which include: mixed use building services, bulky item collection, abandoned waste collection and reporting requirements.

Mixed Use Buildings: The residential component of Mixed Use Buildings will receive all services currently provided to multi-family customers (including recycling, organics and bulky item collection) and the commercial element shall receive the services currently provided to commercial customers. This building type and other multifamily and commercial customers will also be able to receive bin relocation services (at an additional fee) which are required due to the below street level location of bin enclosures on the property.

Bulky Item Collection: Residential customers will continue to receive up to two bulky item collection services annually within one week of request, without charge. Currently, approximately 120 bulky item collections occur daily. Once the demand for these services increases to 150 (a 25% increase), Recology can extend the service delivery date by one week. (This was done to align the services with the costs included in Recology's Base Contractor's Compensation.) At such time, the Member Agency, SBWMA and Recology will meet to address whether to add an additional route and compensate Recology; or, take some other action to respond to the increased demand.

Abandoned Waste Collection: Member Agencies will continue to receive abandoned bulky waste collection services at no cost to the agencies or customers. A limit of thirty (30) pick-ups per day has been established, to align the services with the costs included in Recology's Base Contractor's Compensation. When the average number reaches 25 daily events, the SBWMA and Recology will meet to address whether to add collection resources and compensate Recology or take some other action to respond to the increased demand.

Reporting: Reporting requirements have been streamlined, reducing effort in the preparation of the reports, while maintaining the reporting elements.

Compensation and Rate Setting Methodology

The compensation and rate setting methodology discussions took the longest to complete and are, by far, the most critical element to the negotiation process. Major discussions during the meetings contained the rate setting methodology in order to provide stability and predictability, depreciation of the vehicles, fuel cost, administrative costs, and compensation adjustments for growth in the number of accounts. Extensive discussions during the FAX Committee meetings involved the current agreement and any changes that would be made to Recology's compensation. Ultimately, the Amended and Restated Agreement:

- Avoids any increase (or True-Up) during the remaining term of the current Agreement.
- Allows Member Agencies to retain the difference between actual revenues and the Total Customer Billed Revenue (Base Contractor's Compensation plus disposal/processing expense and Member Agency fees).
- Includes two reasonable new "Attachment Q fees" for bin relocation services that are 1) particularly applicable for buildings with below street level bin enclosures, and 2) a charge for agency-specific reporting requirements for Abandoned Waste support services.

Evaluation and agreement upon Recology's initial cost proposal for the current agreement's last rate year (2020) and the start of the presumed new agreement (2021) referred to as the "jump-off point" was negotiated. The agreed upon compensation for 2021 reflects a one-time increase to bring the Base Contractor's Compensation up to Recology's actual costs. It includes an amount for inflation between 2017 and 2021 (@2%) except for fuel expense which reflects 2016 fuel prices. It does not include any increase in the cost of operations from the increase to customer subscription levels experienced since the start of Recology's services. It also includes estimated depreciation and interest expense for the replacement of the existing fleet of collection vehicles.

This agreed upon compensation for 2021 will be adjusted according to a methodology as follows:

- The projected Base Contractor's Compensation will not be adjusted for differences between the assumed and actual inflation rate between 2017 and 2021 with the exception of changes in the fuel price index.
- The Base Contractor's Compensation will not be adjusted for costs arising from collective bargaining agreement changes.
- The Base Contractor's Compensation will be adjusted for changes to fuel prices, based on changes in a Bay Area fuel index.
- The Base Contractor's Compensation will be adjusted annual for changes to subscription levels using a 3-year rolling average of subscription levels to moderate the effect of such changes. The subscription level change for 2021 will reflect service level changes from 2016 to 2020.
- Effective in 2027 through the remaining term, the Base Contractor's Compensation will be adjusted for the difference between the assumed depreciation and interest expense for replacement collection vehicle fleet and the actual expense. (Adjustments by 50% for any depreciation expense increase up to \$700,000 and no adjustment for increase greater than \$700,000; adjustments for change in interest expense from that assumed resulting from the increase in the actual cost of the replacement vehicle fleet.)

The Amended and Restated Agreement maintains incentives for Recology to continue to manage costs and provides stability and predictability of changes to the Base Contractor's Compensation.

- It continues to use published indices to adjust Base Contractor's Compensation, rather than Recology's actual costs. New indices have been selected to more appropriately reflect changes to the Bay Area's costs.
- An annual adjustment to Base Contractor's Compensation for changes to customer subscription levels has been provided. This adjustment uses a 3-year rolling average of customer subscription to moderate fluctuations.
- Only 50% of the increase in depreciation up to \$700,000 resulting from the increase in cost of the replacement collection vehicle fleet is compensated to Recology.
- A new 5% cap on the annual increase to Base Contractor's Compensation has been agreed to by Recology. Any excess amount will roll-forward to the following year to be compensated but such roll-forward amount will still be subject to the 5% cap in the following year. Should the roll-forward amount equal more than 10% of Base Contractor's Compensation, the Agency and Recology shall meet and confer to discuss the Agency's plan to compensate Recology for the roll forward amount during the remaining term of the current Agreement.

The Amended and Restated Agreement modifies the current method of calculating each Member Agency's Base Contractor's Compensation. Currently, total Base Contractor's Compensation is determined and then it is allocated among the Member Agencies. The new method starts with the agreed upon 2021 Total Base Contractor's Compensation and allocates these costs among the Member Agencies. Thereafter, each Member Agency's Base Contractor's Compensation will be adjusted in accordance with the change in the indices and for its own change to customer subscriptions, without regard to any other Member Agency's change to customer subscriptions.

Other Key Terms and Conditions

Other non-financial changes that were made include the discussion of a Public Education and Technical Assistance Plan, and the type of vehicles that may be selected come the new term. Both are outlined below.

Prior to 2021, and every three years thereafter, Member Agencies, the SBWMA and Recology will jointly develop a Public Education & Technical Assistance Plan. The plan will include specific objectives, tasks, performance standards, reporting requirements and costs. This will allow the Plan to be responsive to the then current conditions, local policies and State requirements. Should the Plan require costs beyond those included in the Base Contractor's Compensation, the parties shall meet and confer to agree upon an appropriate compensation amount and the allocation of that amount among the Member Agencies.

Prior to the replacement of the existing fleet of collection vehicles (estimated in year 2023), the Member Agencies, SBWMA and Recology shall agree on the type of replacement vehicles. This will allow the parties to consider current conditions, the then available technologies and their costs, local policies and State requirements. Should the Plan require costs beyond those included in the Base Contractor's Compensation, the parties shall meet and confer to agree upon an appropriate compensation amount and the allocation of that amount among the Member Agencies.

5.2 Financial Considerations

This section outlines financial considerations for the franchise agreement and compensation package. It should be noted that there are other factors that will affect the customer rates, which include processing costs and tip fees. The current agreement with Recology for Collection Services represents about two-thirds of the entire waste collection, handling and transportation system costs. Therefore, the remaining costs which are components of our overall system costs are all tied to contracts outside the Franchise Agreement negotiations discussion.

In February 2017, the Agency renewed its contract Construction and Demolition materials processing contract so those costs are through 2022. The Agency has, however, three other significant materials handling, processing and/or disposal contracts that will expire before 2020. There is no clear understanding of what the negotiations with those contracts will hold, or what the new rates will be. These contracts are identified below in Table 4.

Table 4. SBWMA Major Contract Values

SBWMA Major Contract Values				
Contract	Contract Expires	Tons Per Year	Percent of Total Amount	Annual Contract Value
Zanker C&D Processing Agreement	2017	38,625	37%	\$ 1,588,000
Newby Composting Agreement	2018	50,100		\$ 2,653,000
Recology-Grover Composting Agreement	2020	50,891		\$ 1,817,000
Ox Mountain Disposal Agreement	2019	217,900		\$ 8,960,000
SBR- Shoreway Operations Agreement	2020	471,890		\$ 18,936,513
Recology-Collection Services Agreement	2020	N/A	63%	\$ 58,500,000
Total Solid Waste System Costs:			100%	\$ 92,454,513

Source:2016/17 Budget

Proposed 2021 Compensation and potential Customer Revenue Impacts

The agreed upon 2021 Base Contractor's Compensation is \$65,303,616. It 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 and subject to the adjustments described above, the Base Contractor's Compensation would:

- Increase 2.4% from 2019 to 2020 (instead of a 7% reduction).
- Increase 10.2% from 2020 to 2021 (+5%, range of 5.2% to 15.2%).
- Thereafter, adjustments would correspond to the changes in the indices plus the growth adjustments up to a maximum increase of 5%.

Because several important deal-points are still being finalized, detailed financial worksheets will be presented and handed out in the May 3rd half-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.

Compensation Subject to Adjustment in 2020 to set 2021

Customer rates, plus the use of any reserves, are set to equal the Total Customer Billed Revenue. This is comprised of Recology's Base Compensation (approximately 58% of the total Rates); plus Member Agency fees (~27%); plus Disposal and Processing Fees (~15%). Between 2017 and 2021, Member Agency fees and disposal and processing fees will be adjusted. Based on certain reasonable assumptions regarding these fees, the Total Customer Billed Revenue 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. 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.

Methods to Mitigate Rate Increase

By including a portion of future depreciation expense in 2020, extending the term of the Amended and Restated Agreement 15-years instead of 10-years, and providing a 3-year rolling average for the change in customer subscription levels, steps have already been taken to mitigate increases in Base Contractor's Compensation. Additional steps Member Agencies may take include:

- Applying existing reserves to offset the increase.
- Increasing rates between 2017 and 2020 to have a higher base rate in 2019 and, thereby, reduce the amount of the increase to rates in 2020, and to use the excess revenue generated to add to existing reserves or create reserves that can be used to phase in the customer rate increase.
- Changing the rate structure to incorporate rates for recycling services and increase the rates for organic services, to mitigate the increase in garbage rates.