



## MEMORANDUM

**TO:** City Council

**FROM:** Nicole Valentine, Director of Administrative Services

**SUBJECT:** Request from South County Sanitary Service for Integrated Solid Waste Collection Rate Adjustment Effective January 14, 2025

**DATE:** November 12, 2024

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### **RECOMMENDATION:**

- 1) Review the Integrated Solid Waste Collection Rate Adjustment request;
- 2) Set a public hearing for January 14, 2025, to consider adjusting the waste collection services rates to be effective January 14, 2025, and each January 1 from 2026 through 2029; and
- 3) Direct staff to prepare and distribute a Proposition 218 notice for a public hearing scheduled for January 14, 2025, for the proposed waste collection services rate adjustment.

### **IMPACT ON FINANCIAL AND PERSONNEL RESOURCES:**

There is no impact on staff resources related to the proposed action. There will be a minor increase in franchise fee revenue from the adjustment and a minor increase to the City's cost for solid waste collection. If the proposed new four-year minimum indexed rate adjustment methodology is approved, future personnel resources will be required to prepare the appropriate 30-day notice of rate increase in-lieu of the effort required for interim year reviews, thus providing operational efficiency compared to the current two-year maximum schedule. Pursuant to the City's existing Franchise Agreement with South County Sanitary Service ("SCSS"), the costs of consultant services to review SCSS's rate adjustment request are paid by SCSS.

### **BACKGROUND:**

The City has had a Franchise Agreement with SCSS, a subsidiary of Waste Connections, for the collection, diversion, and disposal of solid waste in the City since 1997. On June 10, 2008, a new Solid Waste Collection Franchise Agreement with SCSS was approved and the Franchise Agreement was subsequently amended twice in 2016. Through the terms of the Franchise Agreement, SCSS is entitled to compensation for its "labor, equipment, materials and supplies, taxes, insurance, bonds, overhead, transfer and transport, processing, division, disposal, provide and all other things necessary to perform all of the services required by [the] Agreement." This compensation is received through

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the rates and charges paid by the City’s customers, which are presented to the City through cost-based rate adjustment applications and approved by the City Council following a noticed public hearing pursuant to article XIII D, section 6 of the California Constitution (commonly known as “Proposition 218”).

Per the Franchise Agreement, rates are reviewed in accordance with the “City of San Luis Obispo Rate Setting Process and Methodology Manual for Integrated Solid Waste Management Rates,” which was originally established in 1994 (1994 Rate Manual). The 1994 Rate Manual allows for a cost-based rate adjustment every three years and interim rate adjustments in the other two years. In interim rate periods, the operator is limited to adjustments based on inflation, tipping fee adjustments, and franchise or regulatory fee changes. During cost-based rate adjustment years, SCSS is able to request adjustments due to changes in other operational costs as set forth in the 1994 Rate Manual. The following table summarizes the SCSS rate review history beginning in 2005.

**Table 1: SCSS Rate Review History**

<b>Year</b>	<b>Review Type</b>	<b>Adjustment %</b>
2005	Cost-based	5.60%
2006	Index-based	3.09%
2007	Index-based	3.76%
2008	Cost-based	3%
2009	N/A	0.00%
2010	N/A	0.00%
2011	N/A	0.00%
2012	Index-based	5.15%
2013	Cost-based	3.20%
2014	Index-based	2.05%
2015	N/A	0.00%
2016	Cost-based	3.25%
2017	Index-based	1.00%
2018	Index-based	1.60%
2019	Cost-based	10.06%
2020	Index-based	1.70%
2021	Index-based	0.70%
2022	Cost-based	22.19%
2023	Index-based	9.10%
2024	Index-based	3.00%
2025	Cost-based	4.92%

The City of San Luis Obispo has been working with Waste Connections, SCSS’s parent company, to develop and implement a new rate adjustment methodology to replace the

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30-year-old Rate Manual. The key objectives for a new rate adjustment methodology are to enhance rate stability, predictability, fairness, transparency, ease of administration, and cost-effectiveness. The City of San Luis Obispo contracted with R3 Consulting Group, Inc. (R3) to support development and negotiation of a new rate adjustment methodology and the new rate adjustment methodology is available for consideration by other public agencies in San Luis Obispo County. The City of Arroyo Grande has been following the development of the new rate adjustment methodology, which will be presented to the City Council as an amendment to the agreement with SCSS in association with the January 14, 2025, public hearing regarding the 2025 rate adjustment.

The City of San Luis Obispo also contracted with R3 to conduct a detailed review of the 2025 cost-based rate applications submitted by Waste Connections to ten agencies in San Luis Obispo County, including the City of Arroyo Grande. The City of Arroyo Grande received an initial rate adjustment request from SCSS on July 3, 2024, for an adjustment to the City's solid waste rates of 3.97% effective in January, 2025 following a noticed public hearing pursuant to Proposition 218. After R3's review, and adjustments necessary for effectuation of the new rate methodology and new regional service enhancements, the recommended 2025 rate adjustment is 4.92%.

#### **ANALYSIS OF ISSUES:**

##### *Review of 2025 Rate Adjustment Request*

R3 completed a thorough review of SCSS' 2025 cost-based rate adjustment application and adjustments necessary for the new recommended rate adjustment methodology. After careful review of the rate adjustment request, and the outcomes of negotiations of a new rate adjustment methodology between the City of San Luis Obispo and Waste Connections, R3 completed a report evaluating the 2025 rate adjustment request and the new rate methodology (Attachment 1). R3's review suggests that the original 3.97% adjustment proposed to be effective January 2025, is justifiable in accordance with the 1994 Rate Manual and may be accepted by the City in the event that the City does not adopt the new rate adjustment methodology. R3's report further recommends the new rate adjustment methodology and the corresponding rate adjustment of 4.92%, which will provide key benefits to the City in terms of rate predictability and stability and new enhanced services.

##### *New Rate Adjustment Methodology*

The City of San Luis Obispo, in its capacity as the lead agency on the solid waste rate adjustment methodology update process, and in partnership with Los Osos Community Services District and Waste Connections, completed negotiations and arrived at tentative agreement with Waste Connections regarding the terms and conditions of a new methodology. The outcome was the result of extensive good faith negotiations between the City and Waste Connections, with due consideration to input provided by other public agency stakeholders, including the City of Arroyo Grande.

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Pending City Council approval, the new methodology will replace the 1994 Rate Manual and will regulate annual rate adjustments for the City's solid waste rates starting in 2026. The new methodology fulfills key objectives including rate stability, predictability, fairness, transparency, ease of administration, and cost-effectiveness. Additionally, the new methodology can be applied on a regional scale and is available as recommended alternative to the 1994 Rate Manual for all agencies, including the City of Arroyo Grande. The key features of the new methodology include:

- **Capped CPI Adjustments:** Starting in 2026, rate adjustments will be based on the Consumer Price Index ("CPI") for all urban consumers U.S. City Average for all urban consumers U.S. City Average for Garbage and Trash Expenditure Category as published by the U.S. Bureau of Labor Statistics, with a floor of 2% and a cap of 5%. Amounts over 5% will carry forward. The CPI adjustment will apply to Waste Connections' collection and post-collection cost centers.
- **Revenue Balancing Mechanism:** Starting in 2027, adjustments to rates will account for shortfalls or surpluses in Waste Connections' actual revenues compared to projected revenues from prior years. For example, if Waste Connections' 2025 revenues exceed projections, the amount of surplus revenues will be credited to the rates in 2027 (and vice versa), achieving fairness in compensation and rates for the company and for ratepayers. Such adjustments would take place annually and will be independent of the CPI cap and floor noted above. It should be noted that SCSS's 2023 net income was such that, were a revenue balancing mechanism in place at the time, surplus revenues would have been carried forward to the 2025 rate year and would have offset the forthcoming rate adjustment.
- **Less Frequent Cost-Based Adjustments:** Currently, solid waste rates are adjusted based on the 1994 Rate Manual every three years on Waste Connections' costs. Via the new methodology, cost-based adjustments would occur a maximum of every five years, and only if requested by Waste Connections or the City. The first opportunity for a cost-based adjustment will be for the 2030 rate year. If neither Waste Connections nor the City request a cost-based adjustment, then the CPI adjustment approach will be applied. Cost-based adjustments will be based on Waste Connections' consolidated audited financial statements for the region. Timeframes for cost-based adjustment application and review process will be ample, such that the City will have sufficient time for review and approval processes and such that the potential for delay in implementation is minimized.
- **Updated Depreciation Lifespan for Trucks:** The 1994 Rate Manual set a 7-year depreciation schedule for solid waste collection trucks. Modern solid waste

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collection trucks have a 10-year lifespan, and the depreciation schedule was adjusted accordingly.

- **Updated Profit Allowance:** The 2025 rate adjustment will include a 9% profit allowance of projected collection costs and in 2026 and thereafter the profit allowance will be 10%. For context, the 2025 profit allowance is approximately 5% of revenues and R3 estimates that the 2026 profit allowance will be approximately 5.5% of revenues.
- **Removed Limitation on Corporate Overhead:** The 1994 Rate Manual placed a limitation on corporate overhead costs. Today, corporate overhead costs fund legal, tax, payroll, human resources, engineering, compliance, IT, training and recruiting programs to the extent these costs are attributable to the actual costs of providing solid waste services. The City and Waste Connections agreed to remove the prior limitation in order to fund these services.
- **Extraordinary Adjustments:** The California Air Resources Board (CARB) Advanced Clean Fleets (ACF) regulation is requiring all solid waste collection trucks to be zero emissions in 2042. This includes a phased in plan to get the percentage of the fleet to be zero emission vehicle (ZEV) with 10% by 2030, 25% by 2033, 50% by 2036, 75% by 2039 and 100% by 2042. During CPI Adjustment years, Waste Connections may request extraordinary rate adjustments due to changes in law affecting collection operations, including for compliance with CARB's ACF electrification mandate (which may necessitate change to depreciation schedules). The City may, but is not obligated to, consider requests for extraordinary rate adjustments due to changes in law affecting post-collection operations. Requests for extraordinary change are subject to good faith meet and confer negotiations between City and Waste Connections.
- **Regional Service Enhancements:**
  - **Customer Assistance Program:** 20% low-income discount provided to residential customers using 32-gallon cart service, using existing jurisdictional practices on low-income relief for their offered utility type services with evidence of qualifying financial hardship. Funding for the low-income assistance program shall be from SCSS's other revenue sources and not paid for through rate payer funds.
  - **Free Bulky Waste Collections:** Collection of a bulky waste item twice annually from residential accounts at no cost via bi-annual clean-up weeks.
  - **Annual Cart Exchange:** Once annual exchange of a residential solid waste, recycling, or organics cart per customer account.

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*Primary Factors Affecting Rate Adjustment*

Per R3’s report, the key factors affecting the 2025 rate adjustment are summarized as follows:

- A doubling of post-collection costs for organics processing since 2022 due to updated costs for processing infrastructure to meet the requirements of Senate Bill (SB) 1383.
- Market rate adjustment of post-collection costs for landfill disposal, which have remained flat since 2016. Landfill disposal costs have been below market at \$41 per ton since 2016 and will increase to a fair market cost of \$70 per ton in 2025.
- Cost-of-living changes in collection costs, which include labor, capital, operating expenses, insurance and overhead costs, for 2025 increases over 2024 amounting to 4.21%.
- Additional costs for regional service enhancements, described above, which add 0.45% to the 2025 rate adjustment.

Taken altogether, and including appropriate adjustments to SCSS’ original request to achieve the objectives of the new rate methodology, the 2025 rate adjustment that would be effective January 14, 2025, following a successful Proposition 218 proceeding, is 4.92% as shown in the table below:

**Table 2: 2025 Rate Adjustment Breakdown**

<b>Original Adjustment per 1994 Rate Manual</b>	<b>3.97%</b>
Revised Depreciation Schedule	-1.33%
Remove Limitation on Corporate Overhead	1.51%
Regional Service Enhancements	0.45%
Updated Profit Allowance	0.23%
Recalculated Franchise Fee	0.09%
<b>Revised Adjustment for New Methodology</b>	<b>4.92%</b>

*Franchise Agreement Termination Clause*

The Franchise Agreement also contains language that provides that if the rate adjustment request compared with the rate in effect at the date of the Franchise Agreement exceeds the cumulative cost of living increase from that same date, the City has the option of terminating the Franchise Agreement at any time within nine months following approval of the requested rate adjustment. The “trigger” calculation does not limit the amount of adjustment that SCSS can request; it simply incentivizes SCSS to keep its requested adjustments below the cumulative increase in CPI to avoid the City opting to terminate the Franchise Agreement.

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At this time, staff recommends that the City not pursue the termination (“trigger”) option set forth in Section 8.3 of the City’s Franchise Agreement with SCSS. Based on a detailed review of costs as presented in Attachment 1, the costs are reasonable and rates have been calculated in accordance with the 1994 Rate Manual and the recommended new rate adjustment methodology. The following table shows that solid waste rates for Arroyo Grande are among the lowest in the Central Coast area for single family residential services.

Also, and as previously reported to the Council in 2022, the requirements of SB 1383 have created significant new regulatory requirements, burdens, and costs for the City, its solid waste partners such as the San Luis Obispo Integrated Waste Management Authority (IWMA) and SCSS. SCSS is required by agreement to help the City meet certain SB 1383 requirements, and termination of the Franchise Agreement with SCSS at this time would create disruption in the City’s efforts to comply with State regulations.

*Proposition 218 Process*

Per the provisions of Proposition 218, all property owners receiving solid waste collection services will receive written notice by mail at least 45 days prior to the date of a public hearing where the City Council will consider approving solid waste rate adjustments. The notice will include the amount of the fee, the reason for the increase, the basis on which the fee was calculated and the date, time, and place of the public hearing and must clearly advise of the right to protest the rate adjustment. Most recently, the City conducted Proposition 218 rate hearings for waste collection service rates in 2014, 2015, 2016, 2019 and 2022.

It is recommended that the City Council set the public hearing for January 14, 2025, and direct staff to ensure that notices are provided to affected property owners of the proposed rate adjustments stated in the following table in compliance with Proposition 218. A summary of changes in residential rates at the 4.92% rate adjustment are shown in the table below.

**Table 3:** Summary of Residential Rate Changes

<b>Service Description</b>	<b>Current Monthly Rate Effective 1/1/2024</b>	<b>Proposed Rate Adjustment</b>	<b>Proposed Monthly Rate Effective 1/14/2025</b>
32 Gallon Waste Wheeler	<b>\$27.33</b>	\$1.34	<b>\$28.67</b>
64 Gallon Waste Wheeler	<b>\$35.52</b>	\$1.75	<b>\$37.27</b>
96 Gallon Waste Wheeler	<b>\$43.73</b>	\$2.15	<b>\$45.88</b>

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#### **Next Steps**

If staff's recommendations are approved, next steps for the solid waste rate adjustment will include:

- November 30, 2024 – Deadline for mailing the 45-day public hearing notice in compliance with Proposition 218.
- January 14, 2025 – Conduct a public hearing to consider protests regarding the proposed rate adjustments identified in the Proposition 218 hearing notice.
- January 14, 2025 – If approved, new rates go into effect. The rate adjustment will be prorated based upon a January 14 start date.

#### **ALTERNATIVES:**

The following alternatives are provided for the Council's consideration:

1. Adopt staff's recommendations to 1) Review the South County Sanitary Service Integrated Solid Waste Collection Rate Adjustment request; 2) Set a public hearing for January 14, 2025, to consider adjusting the Solid Waste Collection Rates for by 4.92% effective on January 14, 2025, and via the new rate adjustment methodology each January 1 from 2026 through 2029; and 3) Direct staff to prepare and distribute a Proposition 218 notice for a public hearing to consider increases to the solid waste rates;
2. Adopt staff's recommendations to 1) Review the South County Sanitary Service Integrated Solid Waste Collection Rate Adjustment request; 2) Set a public hearing for January 14, 2025, to consider adjusting the Solid Waste Collection Rates by 3.97% effective on January 14, 2025, and via the 1994 Rate Manual on January 1, 2026 and January 1, 2027; and 3) Direct staff to prepare and distribute a Proposition 218 notice for a public hearing to consider increases to the solid waste rates; or
3. Provide other direction to staff.

#### **ADVANTAGES:**

Approval of the rate adjustment is consistent with the underlying conceptual approach in the 1994 Rate Manual with appropriate revisions to effectuate the new rate adjustment methodology. The new rate adjustment methodology provides advantages that are not available under the 1994 Rate Manual, including:

- Lengthening the time between cost-based rate adjustments, providing for greater rate predictability and stability.
- New service enhancements including the low income rate customer assistance program, the free bulky waste collections during clean-up weeks, and free annual cart exchanges.

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**DISADVANTAGES:**

Solid waste customers will see slightly higher rate adjustments in 2025 via the new rate methodology compared to the 1994 Rate Manual. However, rather than the next cost-based rate adjustment occurring in 2028, the earliest cost-based adjustment via the new rate adjustment methodology will be in 2030.

**ENVIRONMENTAL REVIEW:**

No environmental review is required for this item.

**PUBLIC NOTIFICATION AND COMMENTS:**

The Agenda was posted at City Hall and on the City's website in accordance with Government Code Section 54954.2.

**ATTACHMENTS:**

1. R3 Report on 2025 Rate Adjustment and New Rate Methodology