



SBWMA FINAL REPORT

REVIEW OF

SOUTH BAY RECYCLING

2016 COMPENSATION ADJUSTMENT

APPLICATION

September 17, 2015

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SECTION 1. BACKGROUND

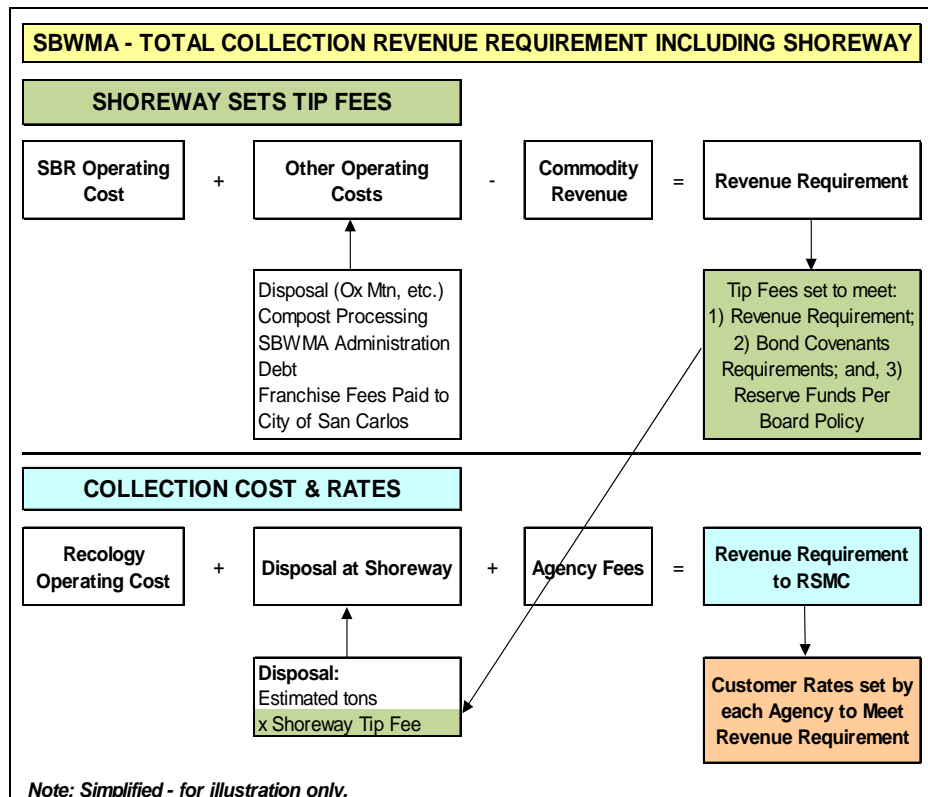
A. Shoreway Operations Agreement Terms

South Bay Recycling, LLC (SBR) was selected as the facility operator on April 23, 2009, and a Shoreway Operations Agreement (“Agreement”) was approved by the Board on July 23, 2009. Article 7 and Attachments 13-A and B of the Agreement prescribe that the SBWMA is responsible for conducting the annual review and analysis of SBR’s compensation application due by July 1st each year. The SBWMA is charged with performing a thorough review to ensure the application is complete and follows the proscribed compensation adjustment methodology in the Operations Agreement to arrive at the recommended 2016 fees per ton contained in this report. This rate application provides the basis for adjusting SBR’s approved 2015 fees per ton for the rate year of 2016. SBR is paid monthly based on the approved fees per ton times the actual number of tons processed and transported.

B. Calculation of Total Collection Revenue Requirement

The approved 2016 compensation for SBR will be bundled with all other SBWMA operating budget expenses (e.g., disposal expense, franchise fees paid to the City of San Carlos, debt service, Agency program budget, etc.) to set the 2016 Shoreway Tip Fees which are considered at the November SBWMA Board meeting each year. The tip fees are budgeted to increase by 2.16% for FY1516.

The 2016 Shoreway Tip Fees are the basis for setting the Disposal Pass-Through expenses that become part of the Total Collection expense and the total Revenue Requirement for each Member Agency upon which it sets its solid waste rates for 2016. These costs are described in detail in “Other Pass-Through Costs” in the 2016 Recology Final Rate Report and are the result of the Shoreway Facility tipping fees charged on the estimated number of solid waste and organics tons delivered to Shoreway throughout the year. The figure below graphically shows how the Shoreway tipping fees are related to the calculation of the Member Agency revenue requirements.



C. Description of Cost Components

As described in Article 7.03 of the Agreement, SBR's basic compensation includes payment for the three core services provided. Payment is based on the fees per ton times the number of tons for:

- **Transfer Station Processing**
- **Recyclable Materials Processing**
- **Transportation to Disposal and Processing Sites**

As described in Attachment 13-A of the Agreement, the fees for the above fee services each comprised of four distinct cost components:

- A. Labor Costs
- B. Fuel and Power Costs
- C. Depreciation Cost
- D. Other Operating and Maintenance Costs

Three of these cost components (i.e., labor, fuel and power, and other operating and maintenance costs), in turn, have subcomponents as follows:

- A. Labor Costs
 1. Wages for CBA labor (*index*)
 2. Benefits for CBA labor (*index*)
 3. Workers' compensation insurance (CBA labor) (*index*)
 4. Payroll taxes (CBA labor) (*non-index*)
 5. Outside contracted workers from third-party sources (VRS) (*index*)
- B. Fuel and Power Costs
 1. Electricity (*non-index*)
 2. Fuel (*index*)
- C. Depreciation Cost (*no adjustment*)
- D. Other Operating and Maintenance Costs (*index*)
 1. Wages and benefits for non-CBA employees
 2. Wages and benefits for CBA clerical
 3. Repair and maintenance expenses
 4. Equipment rental expenses
 5. Other vehicle-related expenses (e.g. licensing, taxes)
 6. Insurance, safety and claims
 7. Other general & administrative expense

D. Cost Adjustment Process

A major goal for the Shoreway Operations Contractor selection process that was initiated in 2005 was to make the contractor's cost adjustment process more predictable and transparent. Article 7.05 and Attachment 13-A of the Operations Agreement prescribes a detailed cost adjustment methodology that ties most of the cost adjustments to standard indexes (i.e., CPI). This cost adjustment methodology is the basis for SBR's Rate Application submittal and the SBWMA staff's subsequent review for completeness, accuracy, and consistency with the requirements of the Agreement.

The cost adjustment process uses SBR's approved 2015 Fees as the basis for adjustment to the new 2016 Fees. As detailed in the Agreement, the adjustment process for the 2016 Fees structure is illustrated in the chart on the next page.

SBWMA - Shoreway Operations Contractor Cost Adjustment Process		
2015 Base Cost	Adjustment	2016 Compensation
CBA: TS/MRF, Mechanics, Drivers, & Clerical (wages and benefits)	+ Index	= Base plus Adjustment
Other Cost	+ Index	= Base plus Adjustment
Power	+ Blend of actual PG&E rate & ISH Solar rate	= Base plus Adjustment
Depreciation	+ No Change	= Prior year's Depreciation
Profit	+ Profit calculated on total adjustments at Operating Ratio in Proposal	= Base plus Adjustment
Pass-Through Cost		
Interest	Interest is fixed on sliding scale based on final capital cost	Annual Interest Expense per Interest Schedule
Other	Actual cost reimbursed (i.e., Buyback payments, new regulatory fees, etc.)	Actual Cost
Total Base Compensation	+ Total of Above	= Total of Above

Note: Simplified - for illustration only.

E. Commodity Revenue Sharing

Another portion of SBR's compensation comes from Commodity Revenue Share. The commodity revenues from the recyclable materials processed at the Shoreway MRF are split between SBWMA and SBR -- SBR receives a minority share of the MRF commodity revenues as an incentive to maintain high recovery and obtain the best commodity sales prices. However, SBR guarantees to the SBWMA commodity revenue of \$5.5 million and the Revenue Share only starts after the guarantee threshold is met (\$5.5 million).

In year 2015, the Commodity Revenue Share to SBR was twenty-eight percent (28%) and SBR was paid a 28% of the commodity sales revenue above the Revenue Guarantee. In 2016, as a result of the MRF's high recovery and low residue in year 2015, SBR is again eligible for a 28% share of commodity sales revenue (see Article 7.07 of the Agreement - Residue-Reduction Incentive Program). In 2015, the residue rate at the MRF remained at 7% and subsequently the revenue share remains at 28% in 2016. (Note: the actual value of the revenue share is not shown in this report, since it is based on the actual tonnage and commodity revenue for the full-year of 2015. Hence, an estimate is used in the SBWMA Annual Budget and calendar year projections. As a point of reference, the commodity sales revenue share paid to SBR in year 2015 was \$1,422,795.)

SECTION 2. SBR 2016 COMPENSATION APPLICATION

A. Analysis of SBR 2016 Compensation Application

The SBWMA staff conducted the review of the SBR Compensation Application and worked closely with the company to ensure that questions and concerns were answered and their application was modified as necessary to address any changes. Staff has verified that the SBR Rate Application is complete and meets the requirements of the Agreement. The results of the review and recommended rate adjustment are summarized in **Table 1** below.

Table 1					
2015 Payment vs. 2016 Payment					
Cost Category	2015		Rate Adjustment	2016	
	Total Cost	Payment/Ton	%	Total Cost	Payment/Ton
Operating Cost					
Transfer Station Fee	\$ 4,502,919	\$ 12.59	1.97%	\$ 4,591,441	\$ 12.84
MRF Fee (net of residue)	\$ 5,777,977	\$ 78.06	2.17%	\$ 5,903,812	\$ 79.76
Transport Fee (cost/ton-mile)	\$ 6,508,106	\$ 1.075	0.62%	\$ 6,548,766	\$ 1.081
Transport (cost/ton)	-	\$ 18.19	0.62%	-	\$ 18.31
Total Operating Cost	\$ 16,789,002		1.52%	\$ 17,044,019	
Contractor Pass-Through Costs					
	Total Cost	Payment/Ton	%	Total Cost	Payment/Ton
Total Interest	\$ 196,470		-16.07%	\$ 164,898	
Buyback Payments Estimate	\$ 888,000		0.00%	\$ 888,000	
Total Contractor Pass-Through Cost	\$ 1,084,470		-2.91%	\$ 1,052,898	
Total Compensation	\$ 17,873,472		1.25%	\$ 18,096,917	

Note: Buyback payments reflect current payment amount - 2015 total therefore will not tie to last year's Rate Report.

In aggregate, the recommended 2016 fee adjustments results in an estimated total compensation increase of 1.52%. (Note: the total costs shown in the above table are for illustration purposes only. SBR is paid the approved fee per ton on the **actual** tons received at the Shoreway facility).

B. Description of 2016 Compensation Adjustments

Costs in the current compensation application are adjusted primarily based on changes in indexes. Cost categories are adjusted based on the following criteria:

- Labor Cost (CBA for Operators, Mechanics, Drivers, and Clerical) – adjusted by index
- Power Cost - adjusted based on the change in power rates
- Fuel Cost - adjusted by an index
- Other Operating Costs - various indices such as CPI
- Depreciation Cost - is not adjusted
- Interest Expense - based on sliding fixed schedule

The results of the index-based cost adjustments for the 2016 rates are summarized in **Table 2** on the next page. A summary of the cost adjustments for 2016 by all cost categories are summarized in the subsequent **Table 3** of the report.

Table 2
Cost Adjustments by Year for Index Changes

Labor Cost: CBAs Wages & Benefits

Index: U.S. Department of Labor, Bureau of Labor Statistics, Private Industry Employment Cost Index for Service-Producing Industries (seasonally adjusted, total compensation, series no. (cis201s000000000i)

Year	2015	2014	2013	2012
Avg. Index - April	122.63	119.78	117.55	115.33
% Change	2.38%	1.89%	1.93%	2.17%

Labor Costs: Workers Compensation Ins. & Workers from Third Party (VRS)

Index: U.S. Department of Labor, Bureau of Labor Statistics, Private Industry Employment Cost Index for Total All workers (not seasonally adjusted, total benefits, series no. CIU2030000000000A).

Year	2015	2014	2013	2012
Avg. Index - April	123.45	120.50	118.07	115.90
% Change	2.45%	2.06%	1.87%	3.41%

Fuel Costs:

Index: U.S. Department of Labor, Bureau of Labor Statistics, Producer Price Index - Commodity Index for #2 diesel fuel (not seasonally adjusted, fuels and related products and power, series no. wpu057303).

Year	2015	2014	2013	2012
Index	314.87	314.87	323.28	325.80
% Change	-18.54%	-2.60%	-0.78%	25.57%

Operating and Maintenance Costs

Index: U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index – All Urban Consumers, U.S. city average (not seasonally adjusted, all items, base period: 1982-84=100, series no. cuur0000sa).

Year	2015	2014	2013	2012
Index (Annual)	236.66	234.15	230.76	226.93
% Change	1.07%	1.47%	1.69%	3.25%
80% of Index Change	0.86%	1.18%	1.35%	2.60%

Note: There is no adjustment to depreciation expense in 2016.

Table 3 2016 Cost Adjustment by Cost Category			
Cost Category	Basis for Adjustment	Adjustment Percentage	Explanation
Direct Labor - (All CBAs)			
Wages	Index	2.38%	CBA wage adjustment based on index change.
Benefits	Index	2.38%	CBA benefit adjustment based on index change.
Worker's Compensation Insur.	Index	2.45%	Workers compensation adjustment based on index change
Payroll Tax	Tax rate & change in wages	2.38%	The payroll tax rate changes with any changes in federal or state payroll tax rates. The payroll tax expense changed due to higher base wages. The tax rate did not change.
Direct Labor - Non CBA (VRS)	Index	2.45%	Non-CBA (VRS) adjustment based on index change.
Power	PG&E & Solar Rates	4.80%	Power is adjusted by the blend of actual PG&E electricity rates and the Solar Power rate.
Fuel	Index	-18.54%	Fuel expense is adjusted by the actual change in the fuel index.
Depreciation	n/a	0.00%	There is no adjustment to depreciation.
Other Operations & Maintenance	Index	0.86%	Other O&M expense includes non-CBA personnel, maintenance parts, insurance, general office expense, safety, etc. Other O&M expense is adjusted by 80% of an index.
<i>The 2015 cost components are adjusted to arrive at new costs for 2016. For all four CBA contracts and non-CBA costs, various indexes are used to adjust cost. Contractor 2016 compensation is based on 2016 cost per ton while payment is based on the calculated cost per ton and the actual monthly tons.</i>			

C. Changes to Annual Labor Costs

CBA wage and benefits are adjusted based on index changes. Since the labor cost component is the largest cost component in SBR's compensation the modest rate increase for 2016 can be attributed to all of the labor costs being indexed.

D. Pass-Through Costs

Pass-through costs are not subject to profit but are reimbursed to SBR at actual cost. The pass-through costs in the Facility Operations Agreement (Article 7.09) are as follows:

- Payments to buyback customers for purchase of recyclables are a pass-through expense. (Actual buyback payments to public customers will be reimbursed monthly in arrears).
- Changes to regulatory fees qualify as pass-through costs.
- Interest expense on allowed capital (paid to SBR monthly at one-twelfth of the annual interest expense denoted in Attachment 13A, Interest Cost Form 3-M which schedules-out interest expense for the ten-year life of the contract on a sliding scale). The annual interest expense for 2016 is \$164,898, a 16% reduction from 2015.

SECTION 3. RECOMMENDED SBR FEES/TON FOR 2016

Staff recommends that the Board approve the following fees paid to SBR on a per-ton basis for 2016:

Transfer Station Processing Fee. The 2016 Transfer Station fee is \$12.84 per Ton.

MRF Processing Fee. The 2016 MRF Processing fee is \$84.49 per ton (note the Contractor pays for MRF residue transportation and disposal which is deducted from MRF Processing Fee resulting in an *Estimated Net MRF Processing Fee* as shown in **Table 5**).

Transportation Fee. There are multiple transportation fees for each material type (i.e., Solid Waste, Inerts, Construction and Demolition Debris, Plant Materials, and Organics) and for each destination. The average 2016 Transportation fee is \$1.081 per ton mile or approximately \$18.31 per ton. (The transportation rate detail for each material type and destination are presented in the **Appendix A - Cost Adjustment Worksheets**).

Table 4			
2015 vs 2016 Adjustments to Compensation			
	2015	Adjustment Percentage	2016
Cost Components	Payment/Ton		Payment/Ton
Transfer Station Processing Fee	\$ 12.59	1.97%	\$ 12.84
MRF Processing Fee (gross)	\$ 82.72	2.14%	\$ 84.49
Transport Fee (Blended Total cost/ton-mile)	\$ 1.075	0.62%	\$ 1.081
<i>Transport Fee (Shown as cost/ton)</i>	\$ 18.19	0.62%	\$ 18.31
Total Adjustment		1.52%	

Table 5			
2015 MRF Processing Fee vs. 2016 MRF Processing Fee			
	2015	Adjustment Percentage	2016
Cost Components	Payment/Ton		Payment/Ton
MRF Processing Fee (gross)	\$ 82.72	2.14%	\$ 84.49
MRF Residue (estimate)	\$ 4.66	1.45%	\$ 4.73
<i>Estimated Net MRF Processing Fee</i>	\$ 78.06	1.79%	\$ 79.76
<i>Note: Actual MRF residue is deducted from the gross MRF fee shown above.</i>			