



SBWMA REPORT REVIEWING
2017 SOUTH BAY RECYCLING
COMPENSATION APPLICATION

September 8, 2016

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SUMMARY

The 2017 Shoreway Tip Fees are the basis for setting the Shoreway Pass-Through expenses that become part of the Total Collection expense and Revenue Requirement for each Member Agency upon which it sets its solid waste rates for 2017. The compensation paid to South Bay Recycling (SBR) for operations of the Shoreway Facility are a component of the Shoreway Tip Fee. After review of SBR's Compensation Adjustment Application, the Total Compensation for SBR in 2017 is recommended to be \$17,705,969, which is \$327,940 (-1.8%) lower than in 2016.

SECTION 1. SBR Compensation Adjustment and the Rate Setting Process

A. Shoreway Operations Agreement Terms

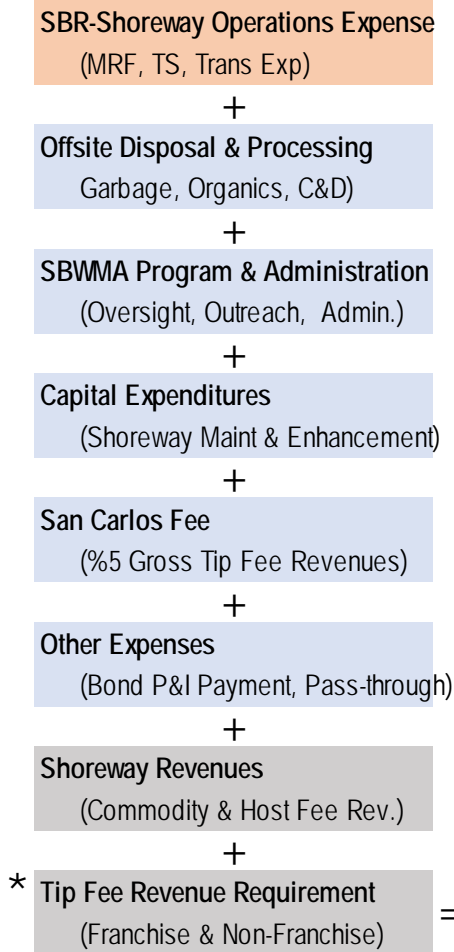
South Bay Recycling, LLC (SBR) was selected as the facility operator on April 23, 2009, and a final Shoreway Operations Agreement ("Agreement") was approved by the Board on July 23, 2009. Article 7 and Attachments 13-A and B of the Agreement prescribe that the SBWMA is responsible for conducting the 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 prescribed compensation adjustment methodology in the Operations Agreement to arrive at the recommended 2017 fees per ton contained in this report. This rate application provides the basis for adjusting SBR's approved fees (SBR is paid monthly based on the approved fees per ton times the actual number of tons processed and transported at Shoreway).

B. Calculation of Total Collection Revenue Requirement

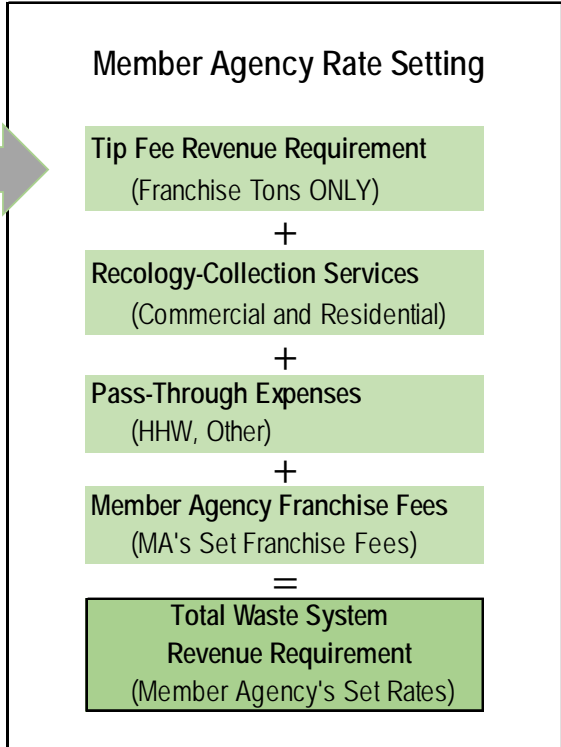
The approved 2017 compensation for SBR will be bundled with all other SBWMA operating budget expenses (e.g., disposal expense, franchise fees paid to the City of San Carlos, debt service, SBWMA program budget, etc.) to set the 2017 Shoreway Tip Fees. The 2017 Shoreway Tip Fees are the basis for setting the Shoreway Pass-Through expenses that become part of the Collection expense and the total Revenue Requirement for each Member Agency upon which solid waste rates for 2017 are set. (These costs are described in detail in "Other Pass-Through Costs" in the 2017 Recology Draft Rate Report and are the result of the Shoreway tipping fees charged on the solid waste and organics tons delivered to Shoreway throughout the year). The Flow Diagram of SBWMA Budget and Collection Rate Setting Process on the following page shows how the SBR-Shoreway Operations Expense (*tan color*) serves as the starting point for computing the Total Waste System Revenue Requirement that forms the basis for the Member Agency Rate Setting process.

**FLOW DIAGRAM OF SBWMA BUDGET
&
COLLECTION RATE SETTING PROCESS**

SBWMA Agency Budget
(Shoreway Operations, Programs & Admin.)



- * *Tip Fees Revenue Requirement Goals*
- Meet Bond Covenant Tests
 - Meet Board Reserve Balances
 - Rate Stabilization Reserve
 - Emergency Reserve
 - Undesignated Reserve (Capital Projects)



C. Description of SBR Fees and Service Elements

The process for adjusting SBR's compensation are detailed in the Operations Agreement in Article 7.03 and Attachment 13-A of the Agreement,

SBR's compensation includes three core services elements that are paid on a per-ton basis:

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

The fees for the above service elements are each comprised of distinct cost components:

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

The above cost components have the following subcomponents:

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

D. Compensation Adjustment Process

A major goal for the Shoreway Operations Contractor selection process concluded in 2010 to make the contractor's compensation adjustment process more predictable and transparent. This cost adjustment methodology is the basis for SBR's Rate Application submittal and the SBWMA staff's subsequent review to ensure accuracy and consistency with the requirements of the Operations Agreement. The compensation adjustment process uses the approved 2016 fees paid to SBR as the basis for adjustment to the new 2017 fees. As detailed in the Agreement, the adjustment process for the 2016 Fees structure is illustrated in following chart. (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).

| SBWMA - CONTRACTOR COST ADJUSTMENT PROCESS | | | |
|--|---|--|---|
| BASE COST - 2016 | | ADJUSTMENT | 2017 CONTRACTORS 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 | = Last Year's Depreciation |
| Profit | + | Based on 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 |

E. Commodity Revenue Sharing

A portion of SBR's compensation comes from the sale of commodities through the "Commodity Revenue Share" program where the commodity revenues from the recyclable materials processed at the Shoreway MRF are split between SBWMA and SBR: in the Commodity Revenue Share program, SBR receives a minority share of the MRF commodity revenues as an incentive to maintain high recovery and obtain the best commodity sales prices. In year 2016, the Commodity Revenue Share to SBR was 28% and while the SBWMA retained 72% of the commodity sales revenue above the Revenue Guarantee. As a result of SBR's continued good performance in maintaining low MRF residue (the MRF residue rate remained at 7%), SBR is again eligible for a 28% share of commodity sales revenue (see Article 7.07 of the Agreement - Residue-Reduction Incentive Program).

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 2016. 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 2016 was \$825,285.

SECTION 2. SBR 2017 Compensation Application

A. Analysis of SBR 2017 Compensation Application

SBWMA staff conducted the review of the Compensation Application submitted by SBR and worked closely with the company to ensure that questions and concerns were answered. Their application was modified as necessary to address any changes. Staff has verified that the SBR Compensation Application is complete and meets the requirements of the Operations Agreement. As shown in **Table 1**. below, the Total Compensation for SBR in 2017 is recommended to be \$17,705,969, which is \$327,940 (-1.8%) lower than in 2016.

| 2016 Payment/Ton vs. 2017 Payment/Ton | | | | | |
|---|----------------------|--------------------|-------------------|----------------------|--------------------|
| South Bay Recycling | 2016 | | Adjustment | 2017 | |
| Operating Cost | Total Cost | Payment/Ton | % | Total Cost | Payment/Ton |
| Transfer Station | \$ 4,591,437 | \$ 12.84 | 0.7% | \$ 4,621,962 | \$ 12.92 |
| Recyclable Materials Processing, net of Residue | \$ 5,903,808 | \$ 84.49 | 1.1% | \$ 5,971,246 | \$ 85.39 |
| Transport (<i>cost/ton-mile</i>) | \$ 6,548,766 | \$ 1.08 | -6.0% | \$ 6,156,049 | \$ 1.02 |
| <i>Transport (cost/ton)</i> | - | \$ 18.31 | -6.0% | - | \$ 17.21 |
| Total Operating Cost | \$ 17,044,011 | | -1.7% | \$ 16,749,257 | |
| Contractor Pass-Through Costs | | | | | |
| Total Interest | \$ 164,898 | | -20.1% | \$ 131,712 | |
| Construction Management | \$ - | | | \$ - | |
| Interim Operations | \$ - | | | \$ - | |
| Buyback Payments Estimate | \$ 825,000 | | 0.0% | \$ 825,000 | |
| Total Contractor Pass-Through Cost | \$ 989,898 | | -3.4% | \$ 956,712 | |
| Total Compensation | \$ 18,033,909 | | -1.8% | \$ 17,705,969 | |

Note: Buyback payments have been changed to reflect correct payment amount - 2016 total therefore will not tie to last year's Rate Report.

Note: Total Operating Cost shown in the table are estimated since costs are based on actual tons delivered to Shoreway throughout the year.

B. Description of 2017 Compensation Adjustments

Costs in the SBR 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 CPI index
- Power Cost - adjusted based on the actual change in power rates
- Fuel Cost - adjusted by a fuel index
- Other Operating Costs - various indices such as CPI
- Depreciation Cost - not adjusted
- Interest Expense - based on fixed schedule

Labor Cost Adjustment

CBA wage and benefits are adjusted based on changes to the CPI index. The Labor Cost component represents the largest cost component in SBR's compensation. **Table 2**. shows the individual index changes to Labor for 2017.

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 2017 is \$131,712, a 20% reduction from 2016.

The results of the index-based cost adjustments for the 2017 rates are summarized in **Table 2**. and summary of the cost adjustments for 2017 by all cost categories is presented in **Table 3**.

| Table 2 | | | | | |
|---|--|---------|---------|--------|--------|
| Cost Adjustment for Index Changes | | | | | |
| COST CATEGORY | | | | | |
| LABOR COSTS: CBAs Wages & Benefits | | | | | |
| 1 | <i>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)</i> | | | | |
| | | 2016 | 2015 | 2014 | 2013 |
| | Avg. Index - April | 124.78 | 122.63 | 119.78 | 117.55 |
| | % Change | 1.75% | 2.38% | 1.89% | 1.93% |
| (VRS) | | | | | |
| 2 | <i>Cost Index for Total All workers (not seasonally adjusted, total benefits, series no. CIU2030000000000A).</i> | | | | |
| | | 2016 | 2015 | 2014 | 2013 |
| | Avg. Index - April | 125.08 | 123.45 | 120.50 | 118.07 |
| | % Change | 1.32% | 2.45% | 2.06% | 1.87% |
| OTHER OPERATING AND MAINTENANCE COSTS | | | | | |
| 3 | <i>Urban Consumers, U.S. city average (not seasonally adjusted, all items, base period: 1982-84=100, series no. cuur0000sa).</i> | | | | |
| | | 2016 | 2015 | 2014 | 2013 |
| | Index (Annual) | 237.87 | 236.66 | 234.15 | 230.76 |
| | % Change | 0.51% | 1.07% | 1.47% | 1.69% |
| FUEL COSTS: Fuel | | | | | |
| 4 | <i>Commodity Index for #2 diesel fuel (not seasonally adjusted, fuels and related products and power, series no. wpu057303).</i> | | | | |
| | | 2016 | 2015 | 2014 | 2013 |
| | Index | 158.41 | 256.49 | 314.87 | 323.28 |
| | % Change | -38.24% | -18.54% | -2.60% | -0.78% |
| DEPRECIATION - there is no adjustment to depreciation expense in 2017. | | | | | |

| Table 3 | | | |
|--|------------|-------------------------|--|
| Results of Cost Adjustments | | | |
| Cost Component | Adjustment | Basis | Description |
| Labor - (all CBAs) | | | |
| Wages | 1.75% | Index | CBA wages compensation adjustment based on index change. |
| Benefits | 1.75% | Index | CBA benefits compensation adjustment based on index change. |
| Worker's Comp Insurance | 1.32% | Index | Workers compensation adjustment based on index change. |
| Payroll Tax | 1.75% | Wages & tax rate change | The payroll tax rate changes with any changes in federal or state payroll tax rates. |
| VRS Labor non-CBA | 1.32% | Index | Non-CBA (VRS) compensation adjustment based on index change. |
| Power | 5.37% | PG&E & Solar Rates | Power is adjusted by the blend of actual PG&E electricity rates and the Solar Power rate. |
| Fuel | -38.2% | Index | Fuel expense is adjusted by the actual change in the fuel index. |
| Depreciation | 0.0% | n/a | There is no adjustment to depreciation. |
| Other O&M | 0.51% | Index | 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 cost components are adjusted from prior year . For all four CBA contracts and non-CBA costs, various indexes are used to adjust cost.</i> | | | |

SECTION 3. SBR per ton Fee Adjustment for 2017

After review of the SBR Compensation Adjustment Application, staff recommends the following Fees be paid to SBR on a per-ton basis for 2017:

- Transfer Station Processing Fee. The 2017 Transfer Station fee is \$12.92 per Ton.
- MRF Processing Fee. The 2017 MRF Processing fee is \$85.39 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*).
- Transportation Fee. There are multiple transportation fees for each material type (i.e., solid waste, inerts, construction and demolition, and organics) and for each destination. The average 2017 Transportation Fee is \$1.02 per ton mile which is 6% lower than prior year (the transportation rate detail for each material type and destination are presented in the **Appendix A – SBR Compensation Adjustment Application Worksheets**).

Table 4. below provides the fee paid to SBR in 2016, the adjustment for 2017 and the Fee to be paid to SBR in 2017. The total adjustment to SBR's compensation from year 2016 to year 2017 is negative 1.8%

| Table 4 | | | |
|---|----------------|-------------------|----------------|
| SBR - 2017 Fee Adjustments to Basic Compensation | | | |
| | 2016 | Adjustment | 2017 |
| Cost Components | Fee/Ton | % | Fee/Ton |
| Transfer Station | \$ 12.84 | 0.7% | \$ 12.92 |
| Recyclable Materials Processing, gross | \$ 84.49 | 1.1% | \$ 85.39 |
| Transport Blended Total (cost/ton-mile) | \$ 1.08 | -6.0% | \$ 1.02 |
| Total Adjustment | | -1.8% | |