



DATE: June 13, 2019

TO: Washington County Solid Waste Advisory Committee

FROM: Kathy Folsom, Senior Program Coordinator

RE: Solid Waste and Recycling Collection Rate Review Report for 2019
General Rate Review and Proposed Rate Changes

Background and summary

This staff report covers the 2019 rate review and provides recommendations for changes to residential, commercial and drop/box compactor collection service. Upon review of the 2018 annual financial reports from the certificated haulers it has been determined that the return on revenue (ROR), for the five haulers with the largest amount of revenue, was 8.76%. Based on the target ROR of 10%, rate increases are proposed for each line of collection service. Specifics regarding the proposed rate changes and the annual rate review results are included below.

Following your committee's recommendation regarding the general rate review and the proposed rate changes, the next step will be to present the rate review findings and your committee's recommendations to the Washington County Board of Commissioners (Board) for consideration.

General rate review

Washington County issues sanitary service certificates to 10 private haulers that provide solid waste and recycling collection service to approximately 60,000 customers within the unincorporated area of the County. The County issues certificates in lieu of entering into individual service contracts or using a competitive procurement process to select vendors to provide the service. Accordingly, the County maintains the responsibility of setting rates related to the services delivered by the certificate holders. The process of determining fair, just and reasonable rates includes the review of costs and revenues associated with the provision of solid waste and recycling collection service in unincorporated Washington County.

Rate setting system

Section 8.04.330C of the Washington County Code provides that in considering rate increases or decreases, the board must find that the rates will be just, fair, reasonable, and sufficient to provide proper service to the public.

The Board has broad discretion in setting rates so long as rates provide for prudently incurred operating expenses and capital costs. In establishing fair and reasonable rates, the role of the County is to balance the interests of the certificated haulers to earn a reasonable return on revenue with the rate payers' interest in being protected from unreasonable charges.

Washington County employs a cost-based system to set collection rates. Adjustments to rates are considered after conducting an annual review of the costs associated with the collection of solid waste and recycling. This review is conducted by staff with the assistance of a consultant CPA firm,

Merina & Company, LLP. This process begins by requiring certificated haulers to submit, for review, financial and programmatic information specific to their collection service provision.

Collection rates paid by customers

Collection rates are uniform across the County with all like customers paying the same rate for the same level of service. For example, all urban residential customers that subscribe to 32-gallon garbage, recycling and yard debris collection service pay the same rate of \$22.96, regardless of which certificated collection company provides the service. The rates provide revenue that covers allowable collection costs plus a reasonable return on revenue for the certificated collection companies.

Rate review process and methodology

For the rate review in 2019, staff followed the same cost of service model that was utilized last year. The use of a return on revenue methodology remains the most accurate approach for establishing acceptable profitability in a regulated solid waste collection system. It captures increases and decreases in costs and revenues. Actual costs and revenues are reviewed in order to determine whether rate adjustments are needed. Under this approach, rate payers pay for costs actually incurred for the collection of their garbage/recycling and for a reasonable return on revenue (profit) to the haulers.

Summary of Methodology:

- Cost of service model
 - Use return on revenue (ROR) based methodology = income divided by revenue.
 - Conduct a financial review of the five certificate holders with the largest amount of revenue (rate review group).
- Approach to rate adjustments and rate setting
 - Establish a cycle of full-scale review every three years.
 - Conduct a limited and modest review for interim years.
 - Discontinue the use of estimates or forecasts, except in extraordinary circumstances where future costs are expected to be far outside historical norms.
 - For the purposes of the annual rate review analysis, only the rate review group's year-end financial results will be reviewed. However, once new rates are approved, all 10 haulers would charge the new Board-approved rates.
 - The dollar amount of any needed revenue increase or decrease is spread across all customer classes as warranted (residential, commercial, & drop box) in order to determine the actual rate increases.

Timeframe to achieve 10% ROR target

Staff is proposing to continue a change to the rate setting methodology centered around the timeframe in which the target ROR would be achieved. Last year, the timeframe to achieve the 10% ROR was based on a 12-month period. In theory, at the end of the 12-month period enough new revenue from the higher rates would be collected to reach the 10% target ROR. In past years, rates have been set to reach the target 10% ROR in only six months (by year-end). This had the effect of doubling the rate increase to reach the target in half the time. For example, if a proposed \$2.00 per month rate increase needed to achieve the target ROR was collected over only six months it would require that customers pay a \$4.00 per month increase.

Setting rates effective July 1, 2019 to achieve the target 10% ROR by December 31, 2109 tends to lead to the following year the hauler receiving more than was needed since historically the County has not decreased rates. This leads to large swings in rate increases or decreases.

- Achieving a 10% ROR from either rate increases or rate decreases has led to a more dramatic need for rate increases/decreases after the rate has been in effect for a full year.
 - In 2014, a large rate increase went into effect. This led to a dramatic over collection of revenue for the next three years and the carrying forward balances of excess revenue to offset future years' costs.
- Moving to a 12-month period tends to lead to smaller, albeit more frequent, rate increases.
 - Typically, large swings in either underearning or overearning do not occur.
 - For example, instead of needing a 10% rate increase every third year, the rate payer would likely see 2% yearly rate increases.
- Using a 12-month timeframe for rate adjustments creates a more transparent rate process/methodology and is generally easier to understand.
- Over time, the timeframe to achieve the target ROR won't make a difference since a full 12 months of any prior rate increase will be factored into the next year's rate review analysis.

Monthly Collection Rate Surcharges (2018)

In 2018, the Board approved recycling processing surcharges designed to provide enough revenue to the collection system to cover the unprecedented costs that were the result of significant recycling commodity market disruptions. A monthly surcharge of \$2.00 for residential and commercial cart collection service and a monthly surcharge of 4% for commercial container collection service became effective April 1, 2018.

The cost of processing curbside recycling has risen dramatically since late 2017 and continued to rise through 2018. The reasons for the higher costs include:

- New restrictions imposed by the Chinese government on acceptable recycling material. China, which was the largest buyer of recycled materials, stopped buying our recycling at the beginning of 2018.
- Reduced size and circulation of newspapers.
- Closure of paper mills in Oregon and Washington.
- Increased volume and types of plastics in the manufacturing sector.
- Over-reliance on one end-market
- Contamination in mixed recycling receptacles.
- A need for more advanced recycling processing capabilities.

Due to ongoing market restrictions and the loss of value for recycling commodities, staff is proposing that the interim recycling processing surcharges be made permanent. Further, it is proposed that the surcharge be included within the monthly collection rates and not shown as a separate line item on customer bills.

General rate review

The rate review group (five haulers with the largest amount of revenue) received a full review of its costs and revenues for the 2018 calendar year. The review included the consideration of each hauler's detailed cost report (DCR), including checking the reported data for errors, irregularities or anomalies. The review also included on-site visits of the rate review group.

Based on the findings for the 2019 rate review, which are detailed below, rate increases are proposed for all lines of service (residential, commercial, and drop box/compactor collection). For this year's review the ROR target was set at 10% for all lines of collection service. Last year the target ROR was also set at 10%.

The rate analysis included determining the amount of revenue that was received from the recycling processing surcharges and then determining the incremental additional revenue that is needed to reach the 10% target ROR.

The total amount of additional revenue needed for the Rate Review Group to reach the targeted level of profitability is \$437,215 (by line of service the breakdown is: \$319,675 for residential and commercial can/cart collection service, \$58,568 for commercial collection service and \$58,972 for drop box/compactor collection service). The typical resident with 32-gallon can/cart service will see a rate increase of 36 cents. All proposed new rates are shown in Attachment A.

Findings for 2018 Rate Review and Rate Increase Recommendation

The results of the annual rate review analysis are presented below.

2018 Rate Review Group – 5 Haulers with the Highest Revenue Generated:

	Summary
Revenue	\$31,628,471
Income (Profit)	\$ 2,769,353
ROR	8.76%

Each line of service also generated an ROR, as adjusted, shown below.

	ROR, as adjusted
Residential	8.58%
Commercial	9.13%
Drop Box	9.00%
TOTAL ROR	8.76%

Given an overall Rate Review Group ROR of 8.76%, a general rate increase is proposed for these collection services:

1. Residential collection services, with an ROR of 8.58%.
2. Commercial container collection service, with an ROR of 9.13%.
3. Drop Box/Compactor collection service, with an ROR of 9.00%.

Residential/Commercial Can/Cart Collection Rate Increase

Residential/Commercial can/cart collection service, including commercial food scraps collection, generated a net certificate income of \$1,735,963 in 2018 resulting in a 8.58% ROR. Adjusting the residential collection ROR to 10% will generate an additional \$319,675 in revenue. Meeting this revenue goal requires a rate increase of 1.58%, or \$.36 per average 32-gallon can/cart customer. See Attachment A, Proposed Rates for Residential, Commercial Can/ Carts, Container and Drop Box Services.

Commercial Container Collection Rate Increase

Commercial container collection service, including commercial food scraps collection, generated a net certificate income of \$555,399 in 2018 resulting in a 9.13% ROR. Adjusting the commercial container collection ROR to 10% will generate an additional \$58,568 in revenue. Meeting this revenue goal requires a rate increase of .96%. New rates are shown in the table in Attachment A, Proposed Rates for Residential, Commercial Can/Carts, Container and Drop Box Services.

Drop Box/Compactor Collection Service Rate Increase

Drop Box/Compactor collection service generated a net certificate income of \$477,991 in 2018 resulting in a 9% ROR. Adjusting the drop box/compactor collection ROR to 10% will generate an additional \$58,972 in revenue. Meeting this revenue goal requires a rate increase of 1.11%. New rates are shown in the table in *Attachment A, Proposed Rates for Residential, Commercial Can/Carts, Container and Drop Box Services*.

Washington County Hauler Association

Staff presented the rate review findings to the Washington County Hauler Association (WCHA) at its May 16, 2019 meeting. The WCHA supports a rate increase; they do not support using a 12-month timeframe to achieve the 10% ROR target and propose using a 6-month timeframe (see Attachment C, letter from WCHA to SWAC.)

Staff recommendation

Based on the findings outlined above, staff recommends that the Solid Waste Advisory Committee favorably recommends to the Washington County Board of Commissioners that the following rate changes become effective July 1, 2019:

- 1) A 1.58% general rate increase for residential and commercial can/cart customers, a .96% increase for commercial container customers and a 1.11% increase for drop box collection customers, to reset the composite ROR to 10%.
- 2) Generally, all other rates and service levels remain unchanged.

Further, Staff recommends that the rate changes outlined above become effective July 1, 2019, upon approval by the Washington County Board of Commissioners.

Attachments

Attachment A: Proposed Rates for Residential, Commercial Can/ Carts, Container and Drop Box/Compactor Collection Services

Attachment B: Residential Rate Comparison

Attachment C: WCHA Memo