

Ad Hoc Franchise Committee Meeting
Wednesday August 1, 2018
4:30 p.m. – 5:30 p.m.
North Conference Room

- 1. Call to Order**
- 2. Selection of Chair**
- 3. Recology Contract Discussion - Rate Increase Request and Status of Recycling Markets**
 - Exhibit A: Recology Rate Adjustment Proposals (3 options)
 - Exhibit B: Draft Consultant Summary and Policy Questions
- 4. Verizon Small Cell Franchise Application** – Staff will introduce a Verizon Small Cell Franchise Application for the installation of six small cell facilities on utility poles in City right of way.



Recology-CleanScapes Recycling Cost of Service Analysis City Summary

NOTES

All results based on data and assumptions provided by Recology.

Assumptions and results are not recommendations from FCS GROUP; results are for informational purposes only.

Results are annualized based on actual financial, commodity revenue, and tonnage activity for recycling processing operations from:

Oct 2017	to	Mar 2018
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Franchise Service Area:	Des Moines	Total months included in analysis:	6
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Recycling Adjustment Options

	Balancing Account	Revenue Sharing	Temporary Adjustment
Description:	Customer rates adjusted based on actual operating expenses, new capital, and return on revenue target (minus commodity revenue).	Customer rates adjusted to recover current operating expenses and new capital. Commodity revenue is shared between customers and Recology. Customers' share of commodity revenues increases with prices.	Customer rates adjusted to cover annualized gap between commodity revenue and operating expenses (based on 2nd quarter of FY 2018), new capital, and return on revenue target. Adjustment is temporary; continues until commodity values recover.
Financial Assumptions Provided by Recology			
Average Commodity Revenue (\$ per Outbound Ton)	\$ 79.42	\$ 79.42	\$ 79.42
Average Operating Cost (\$ per Inbound Ton)	\$ 138.10	\$ 138.10	\$ 138.10
New capital cost to meet contamination thresholds	\$ 5,696,140	\$ 5,696,140	\$ 5,696,140
Monthly capital contribution*	\$ 67,811	\$ 67,811	\$ 67,811
Policy Assumptions Provided by Recology			
Operating cost reduction from capital investment	-7.00%	-7.00%	-7.00%
Return on revenue target:	10.00%	No Target	10.00%
Revenue sharing:	Recology customers retain all commodity revenue once return on revenue target is met.	First \$35 of ACR is shared 50%/50% between Recology and customers. 100% of commodity revenue above \$35 ACR is retained by customers.	Recology retains all commodity revenue. As commodity prices increase above current levels, adjustment to customer rates decreases.
Operating processing fee (\$ per inbound ton)	Adjusted based on actual costs	\$ 128.00	up to \$86.00

* Note: Based on 7 year useful life of equipment

Des Moines Service Area Results**

	Balancing Account	Revenue Sharing	Temporary Adjustment
System Recycling Adjustment Required (Annualized)	\$ 5,849,482	\$ 5,803,591	\$ 5,602,464
% of Inbound Tons from Des Moines	7.5%	7.5%	7.5%
Share of Recycling Adjustment (Annualized)	\$ 437,805	\$ 434,370	\$ 419,317

** Results based on market pricing through first six months of FY 2018. Changes to market pricing will impact results.

Des Moines Customer Class Results

	Balancing Account	Revenue Sharing	Temporary Adjustment
Share of Recycling Adjustment (Annualized)***	\$ 437,805	\$ 434,370	\$ 419,317
% of Des Moines Inbound Recycling Tons from:			
Single-Family Residential	50.8%	50.8%	50.8%
Multi-Family & Commercial	49.2%	49.2%	49.2%
Other Classes****	0.0%	0.0%	0.0%
Total	100.0%	100.0%	100.0%
Share of Recycling Adjustment (Annualized) To:			
Single-Family Residential	\$ 222,612	\$ 220,866	\$ 213,212
Multi-Family & Commercial	215,192	213,504	206,105
Other Classes****	-	-	-
Single-Family Residential (6,669 Accounts)			
Monthly Rate Impact per Account	\$ 2.78	\$ 2.76	\$ 2.66
Multi-Family & Commercial (6,806 cubic yards of recycling service)			
Cost per Cubic Yard of Service	\$ 2.63	\$ 2.61	\$ 2.52

*** Note: Recycling adjustment allocated across customer classes based on share of inbound recycling tons

**** Note: Costs attributed to processing materials outside city franchise service areas are allocated to other classes and excluded from adjustment options.

BACKUP INFORMATION

Key Definitions

Average Commodity Revenue (ACR)	Commodity revenue divided by outbound tons
Commodity Revenue:	Revenue generated from the sale of recyclable material
Inbound Ton:	Recycling tons delivered to MRF for processing
New Capital:	Cost estimate for MRF facility improvements presented on 5/14 by BHS
Operating Processing Fee:	Fee paid by Recology customers to offset a portion of MRF operating costs
Outbound Ton:	Recycling tons sold
Return on Revenue:	Measure of profitability, calculated by dividing net income by revenue

Recycling Material from Service Area (October 2017 to March 2018):

Recycling Inbound Tons	2,378
As a Percent of Facility Inbound Tons	7.5%

Service Area Characteristics (October 2017 to March 2018)

Customer Class	Accounts	Recycling Tons	Monthly Recycling Service Volume (in cubic yards)
Single-Family Residential	6,669	1,209	13,026
Multi-Family Residential	-	433	-
Commercial	1,083	736	6,806
Other	-	-	-
Extra 5	-	-	-
Extra 6	-	-	-
Total	7,752	2,378	19,832

Customer Class	Accounts	Recycling Tons	Monthly Recycling Service Volume (in cubic yards)
Single-Family Residential	86.0%	50.8%	65.7%
Multi-Family & Commercial	14.0%	49.2%	34.3%
Other Classes****	0.0%	0.0%	0.0%
Total	100.0%	100.0%	100.0%

The Changing Environment for City Recycling Collection Programs

Local governments and their collection contractors have made significant investments in recycling collection programs over the past three decades. Those programs have diverted substantial amounts of material from landfills, extended landfill life, and provide manufacturing materials to local, regional and international markets.

Early recycling collection programs were based on multiple-streams, with paper separated from glass, plastic, and metal containers. Most communities had shifted to single-stream, cart-based collection programs by 2010, aided by the rapidly increasing demand from Chinese end-users, who accepted materials with higher contamination levels than previous industry standards.

Over the past five years, the government of China has become increasingly concerned about the environmental impacts of imported scrap, including materials ranging from scrap electronics to curbside collected materials such as mixed plastics and mixed paper. Through a series of regulatory programs they have implemented increasingly strict controls on imported materials, with the interim goal of importing only materials that are essentially manufacturing-ready feedstocks that do not require additional processing to remove contaminants. Their eventual goal is to not import post-consumer recycled commodities and instead rely solely on domestic instead of imported scrap commodities.

This has created a substantial shift in how recyclables are managed by local collection service contractors, who have had to improve materials collection, handling and processing and also identify alternative markets.

Local Processing Infrastructure

Each of the three major private collection services contractors in King County (Waste Management, Republic Services, and Recology) own and operate their own material recovery facilities (MRFs) that process the materials collected through their city contracts. The capacity, configuration, and specific equipment vary at each MRF, but they all are designed to process commingled single-stream recyclables from both commercial and residential sources, and they were all designed and built to process to the levels required by export markets as they have existed over the past decade.

Since higher contamination levels have been allowed until recently, contractors had little economic incentive to monitor contamination levels in individual carts set-out at the curb, since any marginal increases in material quality (and potential market price) would not offset the higher labor and outreach costs needed to actively enforce and correct customer behavior. Similarly, higher processing throughput

speeds were common at MRFs, since the export markets accepted materials that were not processed to high standards.

This situation fundamentally changed with the recent Chinese market restrictions. Additional customer education and collection labor are needed to monitor and reduce contamination levels in set-outs at the curb, as well as additional labor and/or equipment and/or slower throughput speeds at MRFs to process materials to meet stricter processing standards. But even as MRFs work toward increasing product quality, reduced demand and import restrictions mean lower market values for mixed paper and mixed plastic commodities. The combination of higher processing expenses and lower material revenues has led all three contractors to approach client cities with requests for customer rate increases.

As a first step, the two companies with state-regulated collection areas in King County (Waste Management and Republic Services) requested and received authorization from the WUTC for temporary rate increases to cover increased processing costs and reduced material revenues. These WUTC-regulated areas are essentially cost-plus utilities, so rates are based on a company's actual expenses, provided in confidential submittals for interpretation via formulas established by the WUTC. Revenues from the sale of recyclables are rebated to customers directly as a separate line item on invoices, and the amount of the credit (or debit) adjusts periodically, in keeping with the WUTC's established protocols.

City Collection Contract Structure

The collection contracts used by most King County cities establish rates in a completely different manner from WUTC's approach. City contracts are typically based on a negotiated or competitive procurement process that sets rates at the beginning of the contract, with annual inflation and disposal cost adjustments applied (regardless of actual costs or revenues). In these city collection contracts, revenues from the sale of recyclables are retained by the contractor as part of their overall compensation. This contract structure precludes applying the recyclable commodity rate modification methodology used by the WUTC, since collection contractors do not provide actual expenses and net revenue figures, and also do not allow cities to audit financial records. Since several contracts share many basic operating costs (for example, fueling infrastructure, maintenance facilities, and operation yards) there is no way for a given City to tease out the contractor's actual costs for its service area.

This means it is logical for city collection contracts to be designed as "fixed" for the entire term with few, if any, opportunities to renegotiate rates. The main goal of the contract is to provide stable rates over the life of the contract and also eliminate a given city's need to audit contractor expenses. Rates only increase by a defined inflation escalator plus a disposal cost pass-through based on King County-set disposal rates. Most collection contracts do not allow adjustments for commodity value, though some newer contracts have a mechanism to deal with both short term

and long term recycling market failure. However, all contracts allow for negotiations to adjust for certain defined circumstances such as changes in transfer station locations and changes in tax rates.

All commodity price risk and reward is borne by the contractors. During periods when commodity prices rise (such as 2011-2013) contractors gain additional revenues, but if commodity prices drop contractors may make less than their expected revenue from sale of recyclables. The main advantage of this approach is that cities do not need to be constantly involved in decisions to optimize collection, processing, or marketing parameters, nor do cities audit material sale revenues to determine the appropriate rebate (or debit) to customers. When a contractor formulates proposed rates, they must project the range of expected and average commodity revenues over the course of the contract. All the initial rates in city contracts have been developed by contractors who have kept all such risks in mind. City contract managers have no way of knowing the commodity market assumptions used by their contractor when the contract began, and are in no position to determine if the contractor's risk assumptions were reasonable and economically sound, or factored-in higher risk/reward thresholds.

City Options for Responding to the Changes in Recycling Markets

As stated previously, the current market situation has led collection contractors to approach client cities to request rate increases to offset additional processing costs and reduced market value.

These requests raise a number of questions for cities:

- If the contractor's costs of processing increases to meet higher market standards, does this constitute an extraordinary condition (force majeure or otherwise) that would require the contract to be opened and the city to consider granting an increase in rates?
- What is a reasonable expectation for normal fluctuations in commodity value? How long does a market condition change need to persist to justify additional compensation to the contractor? If a city allows this, at what point in a stronger market would "excess" revenues flow back to ratepayers, eliminating the need for a surcharge?
- Adequate or additional public education related to contamination monitoring and enforcement must be considered. These costs should be borne by the contractor – especially if the contractor is out of compliance with current contract provisions to limit contamination levels. Cities are being put into a position where verification of contractor in compliance is necessary, and Cities must determine if this compliance is a pre-condition before consideration of rate relief.
- Should the accepted list of commingled recyclables be updated to reduce contractor costs (e.g. cut back on range of plastics, polycoated cups/cartons,

‘wet strength’ treated paperboard, glass, etc.). Would these changes be required regionally for the MRF to see any difference in overall throughputs or marketability – and therefore to see any economic difference? Would ratepayer behavior change occur fast enough to have a meaningful impact?

- If certain costs are deemed allowable for increased customer rates, are there countervailing cost savings that should offset those costs? For example, recent changes in Federal tax rates that are favorable to contractors.
- After determining acceptable costs and reviewing potential offsetting savings, how much of a surcharge should be allowable? Is the amount worth amending the contract and establishing additional review/audit procedures?

These questions need to be considered by city staff as part of determining a framework to review the contractors’ cost proposals, even before rate increases can be discussed.

Some cities may decide that current circumstances argue against granting further consideration of potential rate relief. Other cities may approve a surcharge to improve commodity processing (and therefore help to sustain current recycling diversion levels) and/or a commodity price surcharge.

Advantages/Disadvantages of Proceeding with Market Adjustment/Surcharge Amendment Negotiations

<i>Advantages</i>	<i>Disadvantages</i>
<ul style="list-style-type: none"> • Allows contractors additional revenues to make processing improvements. • Covers contractor’s loss of expected revenue during poor market conditions while likely gaining rebate for customers if markets recover. • Reduces financial stress on contractors that might result in service degradation. • Allows city to require increased contamination monitoring and reduction. • Allows city to eliminate some problematic recyclable materials from the ‘accepted’ list, potentially reducing contamination and/or miss-sorting of recyclables during processing 	<ul style="list-style-type: none"> • Depending on contract language, the city may not be required to open contract discussions. This option would allow the city to sidestep making a decision on the rate increase. • Opening a contract can set a precedent for other increase requests such as fuel and compost contamination. • Other solid waste rate increases are likely for disposal tipping fees and local hazardous waste fees. Adding a recycling processing and/or marketing surcharge on top of these would be burdensome on ratepayers. • Negotiating a contract amendment would require staff and possibly consultant time. • A contract amendment would

<ul style="list-style-type: none">• Allows city to set limited and verifiable conditions under which unmarketable processed recyclable materials may be landfilled.	<p>likely increase staff requirements to monitor/audit market values and perform due diligence.</p> <ul style="list-style-type: none">• King County Responsible Recycling Task Force may develop alternatives over the next few months that may negate the need for hurried negotiations.
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In the event a city does opt to grant a rate increase, the following conditions should be contemplated and addressed in a contract amendment:

- **A surcharge is preferable to a rate increase.** In embedded rate structures, a rate increase would be applied to each individual garbage rate across all service levels which are, in most contracts, subject to an annual CPI escalator. The allowance of an escalator compounds these CPI increases to the benefit of the contractor, whereas a surcharge would not have an escalator.
- **A surcharge should be subject to a time limitation.** Upon expiration, the renewal of the surcharge should be subject to review by the city and may be renewed at the sole, reasonable discretion of the city.
- **A specific line item describing the surcharge and amount of the surcharge should appear on customer bills.** For example, *“Waste Management Recycling Processing and Commodity Surcharge.”*
- **The amount of a surcharge should be substantiated by a review of the hauler’s pertinent financial data.** Some contracts allow the city to request a third party review, at the hauler’s expense, of the hauler’s financial or other proprietary information applicable to the rate increase request.
- **No profit margin should be allowed in a surcharge.** Additional revenues from the surcharge should be allowed only to offset increased processing costs and/or decreased revenues from the sale of affected commodities.
- **A surcharge should exclude landfilling of recyclable materials.** A surcharge should preclude and disallow any form of landfilling of non-residual materials from the processing of recyclables. Further, it could create an incentive for the hauler to provide more accurate reporting of the composition of residuals to help direct education and set-out inspection protocols.
- **The calculation of the processing component of a surcharge should be subject to a recycling characterization audit to determine the average**

contamination levels per ton in a given city. This audit would recognize that some cities have lower contamination rates relative to other cities thereby reducing or increasing the surcharge to a given city relative to another city.

- **The surcharge amount should be reduced to reflect and acknowledge the in-kind investments, if any, cities have made in assisting the contractor in reducing contamination.** Such reductions could include accrued and ongoing staff time, printing and postage costs.



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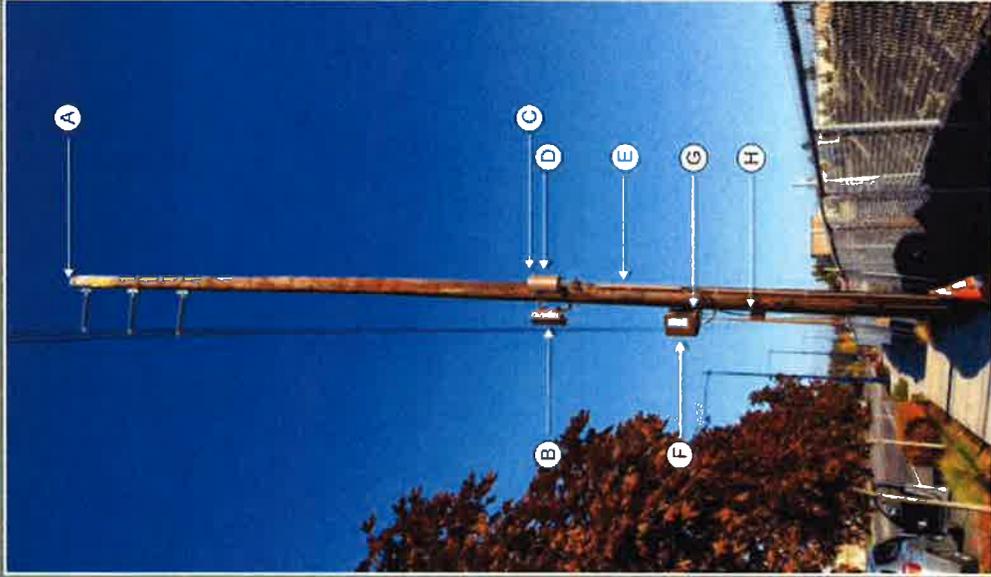
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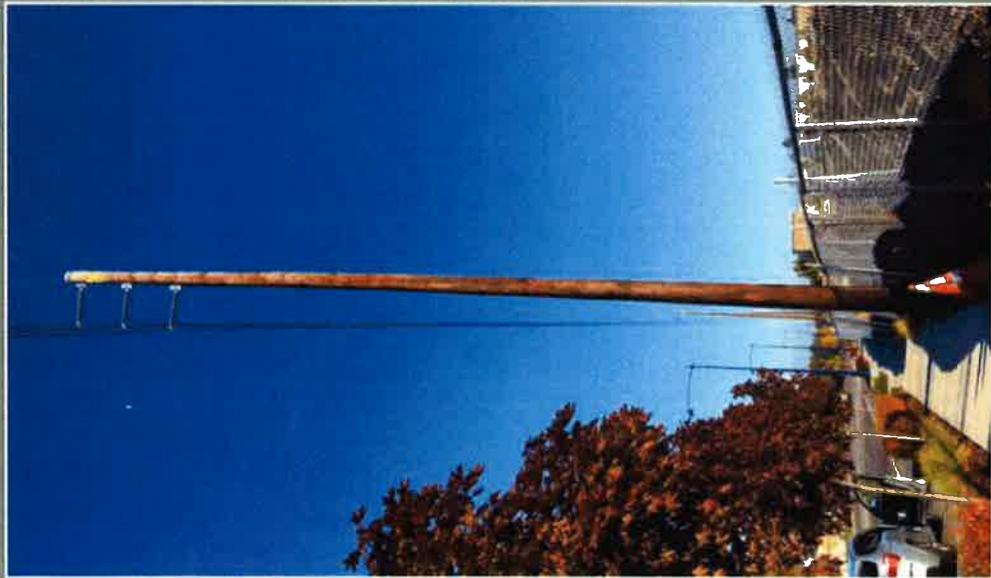
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 NODE 54
 PHOTOSIM 1

SHEET:
 A1.2



PROPOSED



CURRENT

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- B PROPOSED POLE-MOUNTED ANTENNAS x 2
- C TOP OF PROPOSED ANTENNAS 26.0'
- D RAD CENTER OF ANTENNAS 25.0'
- E PROPOSED CONDUITS ON STANDOFF BRACKET
- F PROPOSED SCREENED EQUIPMENT ON STANDOFF MOUNT
- G BOTTOM OF EQUIPMENT 15.5'
- H TOP OF PROPOSED DISCONNECT 12.0'

PACIFIC RIDGE NODE 54





PROJECT INFORMATION:

PACIFIC RIDGE SC
GROUP #1
NODE 55
21600 26TH AVE S
DES MOINES, IA 96198

CURRENT ISSUE DATE:

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SEAL OF APPROVAL:



SHEET TITLE:

NODE 55
PHOTOSIM 1

SHEET:

A1.2



- A. TOP OF EXISTING POLE 74.0'
- B. PROPOSED POLE-MOUNTED ANTENNAS x 2
- C. TOP OF PROPOSED ANTENNAS 26.0'
- D. RAD. CENTER OF ANTENNAS 26.0'
- E. PROPOSED CONDUITS ON STANDOFF BRACKET
- F. PROPOSED SCREENED EQUIPMENT ON STANDOFF MOUNT
- G. BOTTOM OF EQUIPMENT 16.5'
- H. TOP OF PROPOSED DISCONNECT 12.0'

PACIFIC RIDGE NODE 55





PROJECT INFORMATION:

PACIFIC RIDGE SC

GROUP #1
NODE 56
21455 PACIFIC RYDS
BES MOJES, WA 98128

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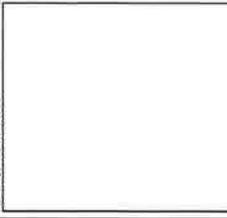
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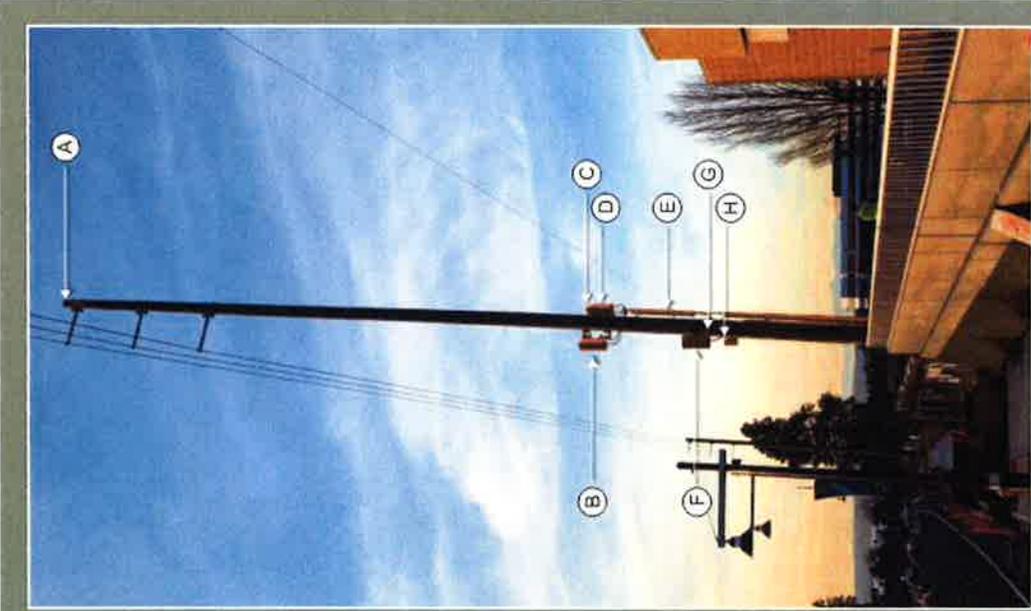


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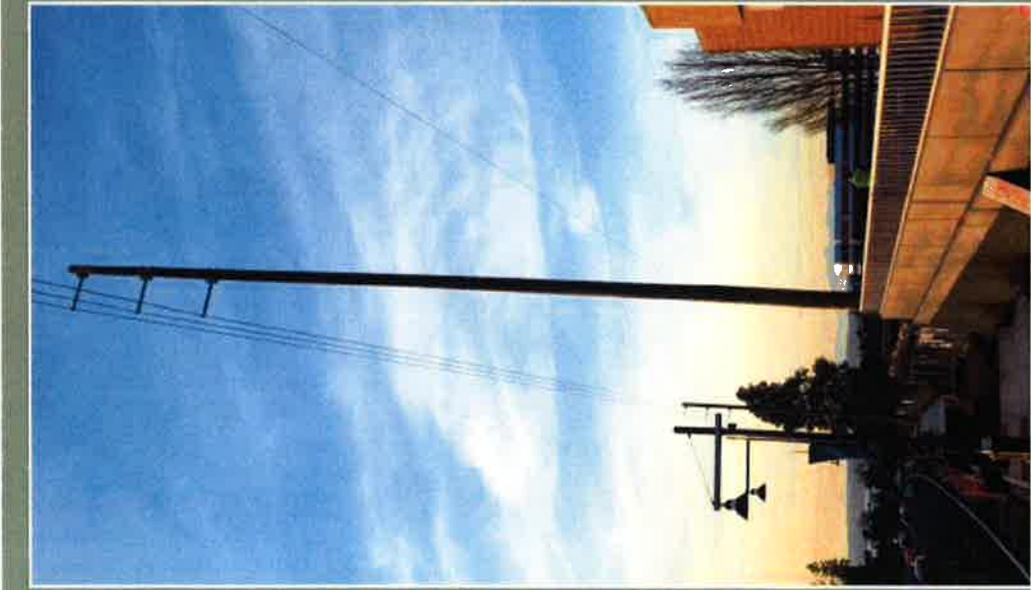
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PHOTOSIM 2

SHEET:

A1.3



PROPOSED



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- C TOP OF PROPOSED ANTENNAS 26.0'
- D RAD CENTER OF ANTENNAS 25.0'
- E PROPOSED CONDUITS ON STANDOFF BRACKET
- F PROPOSED SCREENED EQUIPMENT ON STANDOFF MOUNT
- G BOTTOM OF EQUIPMENT 15.5'
- H TOP OF PROPOSED DISCONNECT 12.0'

PACIFIC RIDGE NODE 56





PROJECT INFORMATION:
 PACIFIC RIDGE SC
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 21624 PACIFIC RYKYS
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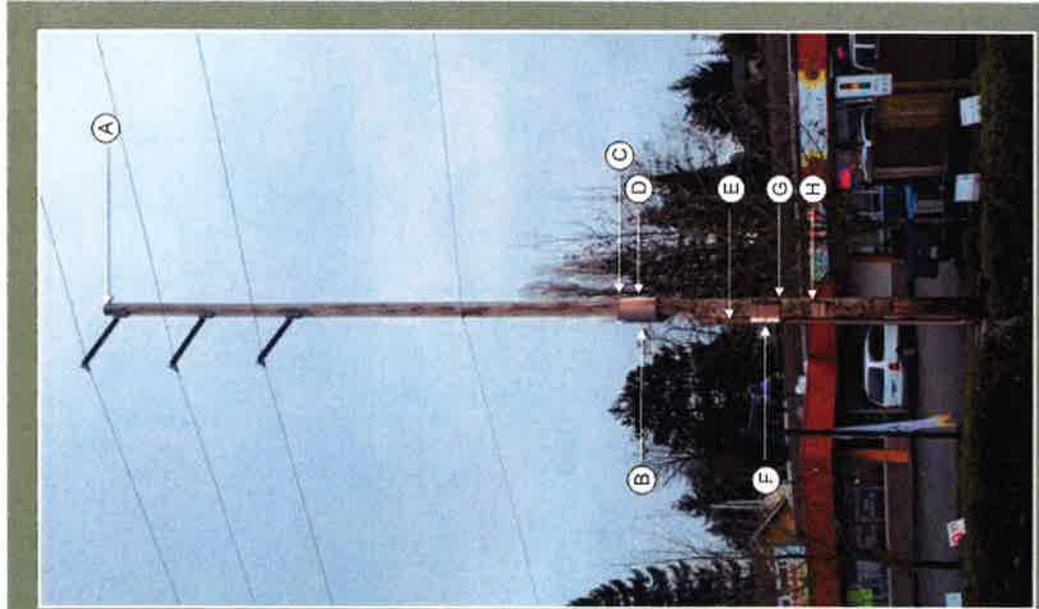


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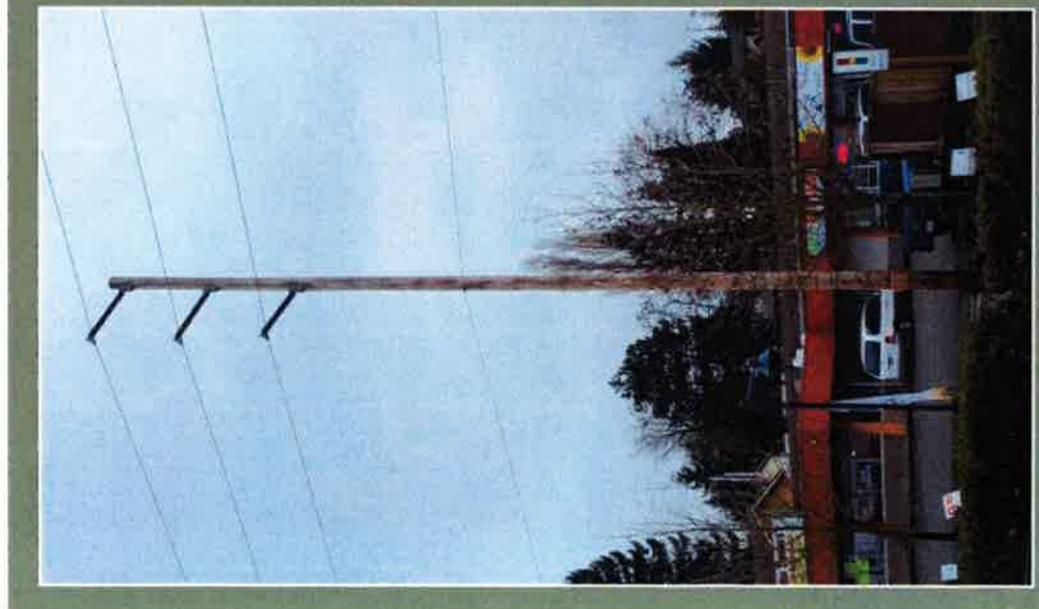
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**NODE 57
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**SHEET:
 A1.2**



PROPOSED



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- C TOP OF PROPOSED ANTENNAS 26.0'
- D RAD CENTER OF ANTENNAS 25.0'
- E PROPOSED CONDUITS ON STANDOFF BRACKET
- F PROPOSED SCREENED EQUIPMENT ON STANDOFF MOUNT
- G BOTTOM OF EQUIPMENT 15.5'
- H TOP OF PROPOSED DISCONNECT 12.0'

PACIFIC RIDGE NODE 57





PROJECT INFORMATION:
 PACIFIC RIDGE SC
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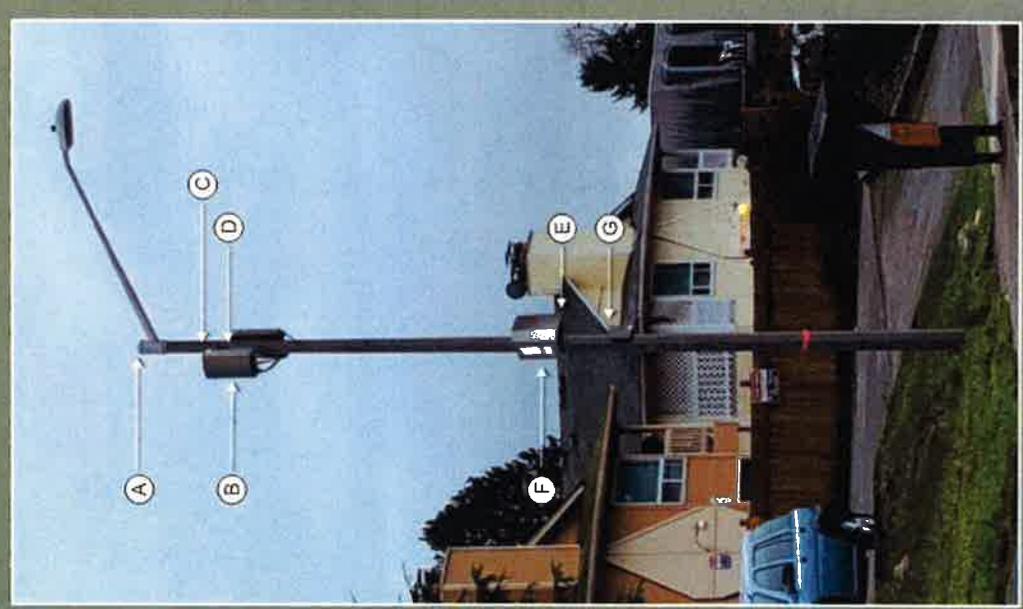
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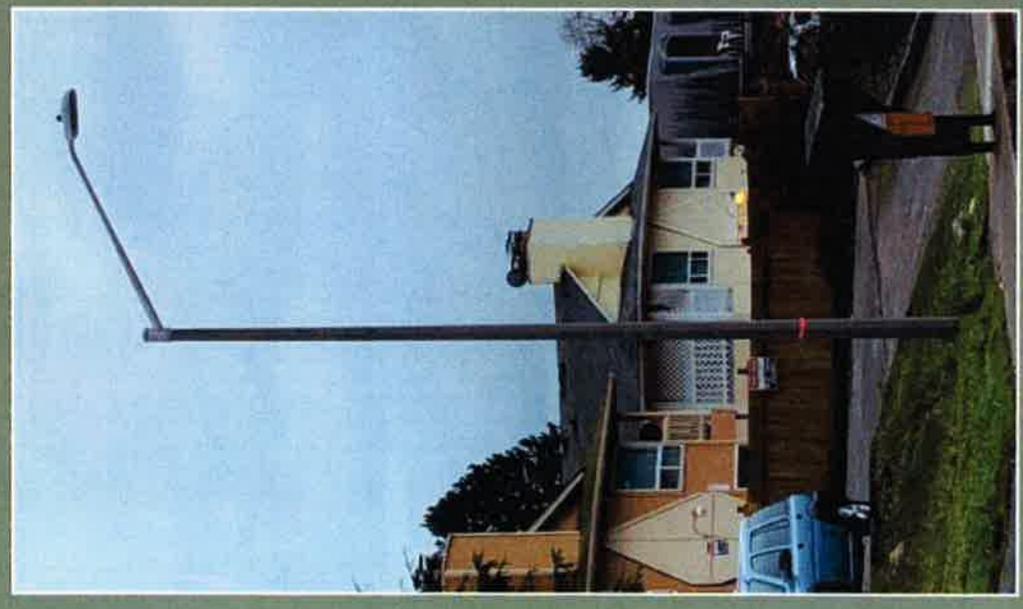
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 NODE 58
 PHOTOSIM 2

SHEET:
 A1.3



PROPOSED

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- C TOP OF PROPOSED ANTENNAS 26.0'
- D RAD CENTER OF ANTENNAS 25.0'
- E PROPOSED SCREENED RADIO EQUIPMENT STRAP MOUNTED TO POLE
- F BOTTOM OF EQUIPMENT 15.5'
- G TOP OF PROPOSED DISCONNECT 12.0'



CURRENT

PACIFIC RIDGE NODE 58





PROJECT INFORMATION:
 PACIFIC RIDGE SC
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 NODE 63
 21644 29TH AVE S
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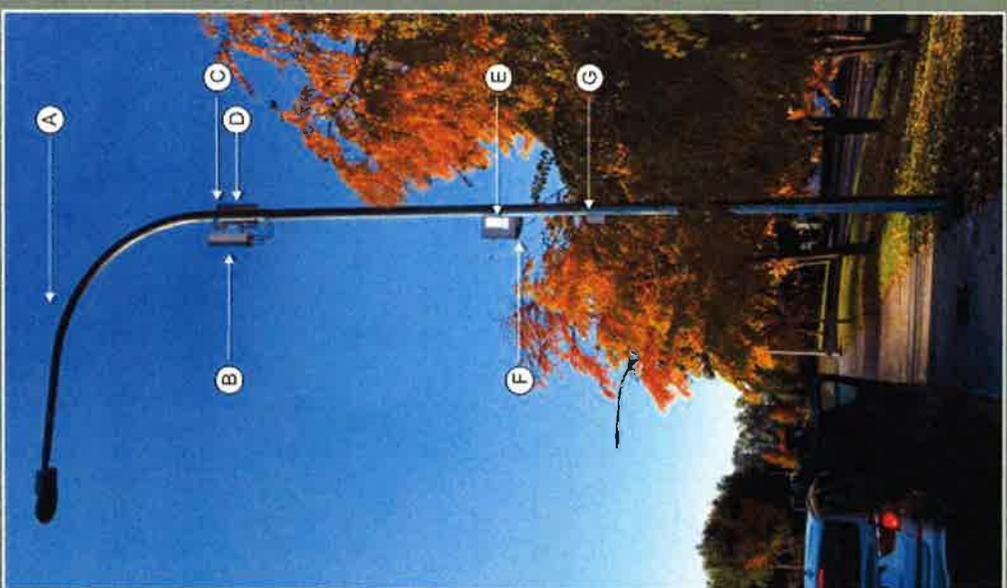
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PROPOSED



CURRENT

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- B PROPOSED POLE-MOUNTED ANTENNAS x 2
- C TOP OF PROPOSED ANTENNAS 25.0'
- D RAD CENTER OF ANTENNAS 25.0'
- E PROPOSED SCREENED RADIO EQUIPMENT STRAP MOUNTED TO POLE
- F BOTTOM OF EQUIPMENT IS 5'
- G TOP OF PROPOSED DISCONNECT 12.0'

PACIFIC RIDGE NODE 63



PHOTOSIM SCALE: 1/8" = 1'-0"
 PLAN SCALE: 1/8" = 1'-0"

