CAMBRIA COMMUNITY
SERVICES DISTRICT

# Mission Country Disposal Rate Review

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Fiscal Policy ■ Financial Planning ■ Analysis ■ Training ■ Organizational Review

# Report Purpose

- Analyze rate request by MCD for:
  - **Cambria Community Services District**
  - Cayucos Sanitary District
- Why jointly?
  - Same services
  - Similar franchise agreements
    - Key difference: franchise fee rate
  - Same rate review methodologies
  - Financial information closely related for each agency

# Rate Recommendation

| Percent Increase | |
|---|---|
| Initial | 43.98% |
| Proposed | 41.46% |

# Key Changes

- Greenwaste processing costs reclassified as "pass-through" costs
  - Costs may be recovered but no profit is allowed on them.
- IWMA fees excluded from fee analysis.
  - Approved by separate agency and will be charged separately on customer bills.

# Single Family Residential Rates

| Container Size | Current | Proposed | Increase |
|---|---|---|---|
| 32 Gallons | $26.12 | $36.95 | $10.83 |
| 64 Gallons | 52.22 | 73.87 | 21.65 |
| 96 Gallons | 78.35 | 110.83 | 32.48 |

*85% of area customers selected 32-gallon service*

# Two Key Drivers

- Cost increases
- Reasonable profit margin

# Key Cost Drivers

| 2022 Cost Increase from 2020 | | | |
|---|---|---|---|
| | Amount | % of Total | Rate Impact |
| Depreciation | 389,631 | 25% | 6.48% |
| Greenwaste | 368,547 | 24% | 6.13% |
| Direct Labor | 370,550 | 24% | 6.17% |
| Insurance | 164,788 | 11% | 2.74% |
| Gas and Oil | 151,160 | 10% | 2.52% |
| Total Key Drivers | 1,444,676 | 94% | 24.04% |
| Other Costs | 95,506 | 6% | 1.59% |
| Total | $1,540,182 | 100% | 25.63% |

**Top 5 account for 94% of cost increase**

# Operating Profit Ratio

- MCD allowed operating profit ratio of 8% (excluding "pass-thru" costs)
  - <u>Negative</u> 8.8% in 2020
  - <u>Negative</u> 24.3% in 2021
- Additional rate increase of 15.83% required to achieve 8% operating profit ratio.
  - There is no recovery for past losses.
  - This is to achieve allowed profit margin going forward.

# Combined Rate Impact

| | |
|---|---|
| Cost Drivers | 25.63% |
| Deficit in Revenue Requirement | 7.83% |
| Allowed Profit Margin | 8.00% |
| Total | 41.46% |

- 60% cost driven
- 40% for recovery of allowed profit margin

# Findings

- Complete application.
  - Initially submitted October 20, 2021
  - Revised March 24, 2022
- Comprehensive level of service – curbside trash, recycling and green waste – at reasonable rates compared with similar communities.
- Need for updated rate-setting methodology.
- Temporary delayed rate increase.

# Delayed for Several Reasons

- Background
  - 120-day review period from application envisioned in Rate Manual
    - Retroactivity allowed beyond this.
  - On its surface, this would imply March 1 retro start date.

- Delay Factors
  - Proposition 218 notice requirements
  - IWMA rates
    - 5.4% effective 7-1-22
  - MCD very responsive but complex review
  - Current rate concerns (resolved)

**Recommended Retro Start Date: July 1**

# Temporary Delayed Implementation Rate Increase

- Several options depending on retro start date, effective date and amortization period.
- Most likely
  - July 1 start date.
  - October 1 effective date.
  - Ends December 31, 2022.
- Results in
  - Three months retroactivity.
  - Three-month recovery period.
  - <u>Temporary</u> added rate increase of 41.46% ends December 31, 2022.
  - Combined temporary delayed implementation plus core rate increase: 82.92%.

# Recovery Period Option: March 31, 2023

- Extends the recovery period by three months.
  - The amount of recovery the same.

| Rate Impacts | % Increase |
| --- | --- |
| Temporary added rate increase: ends March 31, 2023 | 20.73% |
| Combined temporary delayed implementation plus core rate increase | 62.19% |

# Rate Application Review

# Three Year Rate Review Cycle

- **Base Year.** The first year of the cycle - *Base Year* - requires comprehensive, detailed analysis of revenues, expenses and operating data.
  - Last "base year" analysis completed in April 2019.
  - <u>This is a "base year" review.</u>

- **Interim Years.** In second and third years, MCD is eligible for *Interim Year* rate adjustments that address three key change factors.
  - Consumer price index (CPI) for "controllable" operating costs
  - "Pass-though costs" (primarily disposal costs)
  - Adjustment for franchise fees

# Proposed Interim Year

- As in 2019, MCD proposes straightforward CPI increase for 2023 and 2024.

# Base Year: Two Key Questions

- Should MCD be granted a rate increase for 2022?
- If so, how much?
  - How much does it cost to provide required service levels?
  - Are these costs reasonable?
  - And if so, what is a reasonable level of return?

# Are costs reasonable?

- Looked at costs from three separate perspectives
  - Detailed review of costs and changes by key cost components from 2020 to 2022
  - Comparison of cost increases with CPI
  - Rates in comparable communities

# Detail Review of 9 Key Factors

- Allowable Costs
  - Direct labor
  - Office salaries
  - Depreciation
  - Gas and oil
  - Insurance
- Pass-Through
  - Disposal
    - Landfill
    - MRF/recycling
    - Food/greenwaste
  - Franchise fees

**Account for 94% of cost increase**

# Cost Accounting Issues

- Waste Connections central coast companies
  - MCD
  - San Luis Garbage Company
  - South County Sanitary Service
  - Morro Bay Garbage Service
  - Coastal Roll-Off Service
  - Cold Canyon Landfill
  - Cold Canyon Processing Facility (Recycling)
- MCD service area includes:
  - Cambria CSD
  - Cayucos Sanitary District
  - Los Osos CSD
  - Other north coastal unincorporated areas

**Audited financial statements for each company**

# Direct and Allocated Costs

- Direct Costs
  - Labor hours for collection (and related compensation)
  - Liability insurance
  - Franchise fees
- Revenues
- All other costs allocated in accordance with generally accepted accounting principles

| Allocation Basis | Major Cost Categories |
|---|---|
| **Customer counts** | • Region and division overhead<br>• Office salaries<br>• Office expense<br>• Legal and accounting |
| **Direct labor hours** | • Truck depreciation<br>• Truck repairs and tires<br>• Mechanic labor |
| **Tonnage** | Disposal costs<br>• Landfill<br>• MRF/recycling<br>• Greenwaste |
| **Revenue** | • Corporate overhead (adjusted for Rate Manual limitations)<br>• Bad debt expense<br>• Other taxes |
| **Containers** | • Container depreciation<br>• Container labor<br>• Container repairs |
| **Gallons** | • Fuel |

# ❶ Direct Labor

- Labor cost increases: about 5% annually.
- Allocation of direct labor costs between companies
  - Compared with 2020, detailed analysis of direct labor costs between companies results in 11% increase in direct labor costs.
  - This change drives other major costs allocated between companies based on direct labor hours, most notably
    - Vehicle operating costs (depreciation, repairs, tires and mechanic labor).
    - Group health insurance.

# ❷ Depreciation

- 2019 Base Year review noted that as fully depreciated trucks were replaced, significant continuing higher depreciation costs were expected in future due to two factors:
  - Annual depreciation costs on fully depreciated trucks would go from zero to about $60,000 each.
  - Cost basis for new trucks would be significantly higher than in the past.
- Combined with likely change in amortization schedule from 7 years to 10 years with Rate Manual update, planned replacements should result in stabilized costs in future.

# ❸ Gas and Oil

- Cost increases
  - Projected to increase by about 9% annually.
  - Reasonable assumption given volatility (both up and down) of fuel costs.
- Allocation based on gallons used
  - Based on driver hours in 2020.
  - For 2022, uses the more accurate gallon usage as allocation basis.
  - Results in an increased allocation base of 23%.

# ❹ Insurance

- Cost increases
  - Projected to increase significantly by about 12.5% annually (7.5% for health care and 22.5% for liability insurance).
  - Reasonable assumptions given increases in health care costs and current liability insurance market.
- Allocation of labor costs between companies
  - More detailed analysis of direct labor costs between companies results 13% increase compared with 2020.

# ❺ Food and Greenwaste

- Largest area of increase from 2020
  - Costs incurred under on-site agreement with HZI and reflect costs to build (via depreciation), operate and maintain the anaerobic digestion plant.
  - Plant processes local food and greenwaste in meeting California regulation SB 1383.
  - Complex operation with start-up challenges.

# Cost of Living Index

- U.S. CPI-U increased by 8.5% over the past two years (about 4.2% annually).
- Excluding detailed review of cost drivers, MCD costs increase by 3% (about 1.5% annually).

# SFR Rates Comparison

| Single Family Residential Monthly Trash Rates | | | |
|---|---|---|---|
| | Container Size (Gallons) | | |
| | 30-40 | 60-70 | 90-101 |
| Atascadero | $28.55 | $44.50 | $55.77 |
| Morro Bay | 24.95 | 49.90 | 74.86 |
| Paso Robles | 30.90 | 51.12 | 57.25 |
| Pismo Beach* | 21.15 | 42.32 | 63.47 |
| San Luis Obispo (City)* | 20.94 | 41.87 | 67.56 |
| San Miguel | 28.33 | 44.48 | 61.06 |
| Templeton | 31.40 | 45.01 | 45.95 |
| **MCD Proposed*** | | | |
| Cambria | 36.95 | 73.87 | 110.83 |

* Excludes temporary delayed rate increases

# What's a reasonable return on these costs?

- Allowable costs (operations and maintenance)
  - 8% operating profit ratio
- Pass-through costs
  - Disposal fees
  - Franchise fees
  - Related party lease and transportation costs
- Excluded costs
  - Charitable and political contributions
  - Entertainment
  - Income taxes
  - Non-IRS approved profit-sharing plans
  - Fines and penalties
  - Limits on officer compensation

# Allowed Revenue Increase

| | |
|---|---|
| Allowable Costs | 5,167,054 |
| Allowable Profit (8% Operating Ratio) | 449,308 |
| Pass-Through Costs | |
| Disposal | |
| Landfill | 514,221 |
| MRF (Recycling) | 415,318 |
| Greenwaste | 721,229 |
| Franchise Fees | 493,114 |
| Other Pass-Through Costs | 237,896 |
| Total Pass-Through Costs | 2,381,778 |
| Allowed Revenue Requirements | 7,998,141 |
| Revenue without Rate Increase | 5,757,804 |
| Revenue Requirement: Shortfall (Surplus) | 2,240,337 |
| Rate Base Revenue | 5,748,477 |
| Percent Change in Revenue Requirement | 38.97% |
| Allowed Revenue Increase | 41.46% |

# Conclusion

- Costs are reasonable.
- Proposed rate increase meets "reasonable return" criteria.

# Questions?