Cayucos SANITARY DISTRICT

Mission Country Disposal Rate Review

July 21, 2022

William C. Statler

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	45.93%
Proposed	43.30%

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	$20.25	$29.02	$8.77
64 Gallons	23.92	34.28	10.36
96 Gallons	27.62	39.58	11.96

Two Key Drivers

- Cost increases
- Reasonable profit return

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%

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 17.76% required to achieve 8% operating profit ratio.
  - There is no recovery for the past.
  - This is to achieve allowed profit margin going forward.

Combined Rate Impact

Cost Drivers	25.63%
Deficit in Revenue Requirement	9.67%
Allowed Profit Margin	8.00%
Total	43.30%

- 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 competitive 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 43.3%: ends December 31, 2022
  - Combined temporary delayed implementation plus core rate increase: 86.6%.

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	21.65%
Combined temporary delayed implementation plus core rate increase	64.95%

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 Key Factors

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

Account for 94% of rate 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:
  - Cayucos Sanitary District
  - Cambria CSD
  - 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 • Office salaries • Office expense • Legal and accounting
Direct labor hours	• Truck depreciation • Truck repairs and tires • Mechanic labor
Tonnage	Disposal costs • Landfill • MRF/recycling • Greenwaste
Revenue	• Corporate overhead (adjusted for Rate Manual limitations) • Bad debt expense • Other taxes
Containers	• Container depreciation • Container labor • 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*			
Cayucos	29.02	34.28	39.58

* 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	5,167,055
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	7,998,142
Revenue without Rate Increase	5,757,805
Revenue Requirement: Shortfall (Surplus)	2,240,337
Rate Base Revenue	5,748,478
Percent Change in Revenue Requirement	38.97%
Allowed Revenue Increase	43.30%

Conclusion

- Costs are reasonable.
- Proposed rate increase meets “reasonable return” criteria.

Questions?