Summary Title: Finance Committee Recommendation on Refuse Rates

Title: Finance Committee Recommendation for Rate Increases for the FY 2012 Refuse Fund Budget

From: City Manager

Lead Department: Public Works

Recommendation
The Finance Committee and staff recommend that Council direct staff to:

1. Proceed with plans to retain the FY 2011 rate increases of 6% for residential customers and 9% for commercial customers, and to implement an additional fixed monthly fee of $4.62 for all residential customers to be effective on October 1, 2011;
2. Establish a loan of $1.25 million from the General Fund Budget Stabilization Reserve to the Refuse Fund that will be disbursed in FY 2012 and repaid in FY 2013, with interest on the loan to be based on the average yield on the City's investment portfolio for the loan period; and
3. Proceed with the Proposition 218 public notification process for the rate increases and return to City Council in September 2011 for the public hearing and adoption of the new refuse rates.

Executive Summary
This report provides City Council with staff's recommendation for rate increases to close the $3.7 million Refuse Fund operating deficit for FY 2012. The recommended rate increases consist of retaining the 6% and 9% rate increases from FY 2011 for residential and commercial customers, respectively, and establishing an additional fixed monthly fee of $4.62 for residential customers to be effective on October 1, 2011. To minimize immediate impact to ratepayers, the Committee also recommended a short term $1.25 million loan from the General Fund BSR that will be repaid in FY 2013 from projected savings resulting from scheduled closure of the landfill. The FY 2011 rate increases are scheduled to expire on September 30, 2011. The Finance Committee unanimously recommended this approach at its July 19, 2011 meeting.

Background
In September 2010, City Council adopted refuse rate increases for FY 2011 that became effective on October 1, 2010 and would expire on September 30, 2011. At the April 5,
2011 Finance Committee meeting, staff was directed to propose an initial FY 2012 Refuse Fund budget for adoption by City Council that assumed expiration of the FY 2011 rate increases, and to return to the Finance Committee in July 2011 with recommendations for rate increases and additional expense reductions for FY 2012. The FY 2012 budget, adopted by City Council on June 20, 2011, contains an operating deficit of $3.7 million for the Refuse Fund. Approximately $1.2 million of that deficit is due to the expiration of the FY 2011 rate increases that is scheduled to occur on September 30, 2011.

Staff is proceeding with a detailed Cost of Service Study that will likely result in a new rate structure beyond the interim adjustment recommendations being made in this Action Item. The preliminary results of the study show that residential rates are not covering their proportional expenses. Conversely, while the commercial sector is much more volatile than residential, the preliminary results indicate commercial rates appear to be exceeding expenses. While the Cost of Service Study is not yet complete, the recommendations in this report are based on the need to bring the residential rates up to a fuller cost recovery level while attempting to correct the existing inequities between residential and commercial sectors. The goal of this interim adjustment is to begin implementing fuller cost recovery for residential immediately, in order to avoid a larger deficit problem going forward.

At the July 5, 2011 Finance Committee meeting, staff was directed to prepare options for refuse rate increases which would express a portion (or all) of the residential rate increase as a fixed cost, applicable to all residential users. The Finance Committee also directed staff to prepare a plan for eliminating the Recycling Center and retaining the Household Hazardous Waste Drop-off Area at the Wastewater Quality Treatment Plant. That detailed plan will take several months to produce. Therefore, staff used its cost saving estimate for the elimination of the Recycling Center during FY 2012 (six-month savings) in the refuse rate calculations. The current Recycling Center must be removed following the closure of the landfill, resulting in the six-month savings regardless of whether the Recycling Center is fully eliminated. Staff then developed two options for refuse rate increases expressing some (or all) of the increase as a fixed amount for each residential customer. Those options, as well as an option that does not include a fixed amount, are summarized in the “Discussion” section below.

Discussion

At the July 5, 2011 Finance Committee meeting, staff recommended that a residential rate increase be adopted for FY 2012, 100% of which would vary by the size of the garbage can. This recommendation was in addition to retaining the FY 2011 6% rate increase that is scheduled to expire on September 30, 2011. Staff recommended that commercial rates have no increase for FY 2012 beyond retaining the FY 2011 9% rate increase. This approach would begin to address the apparent inequities of the current rate structure between residential and commercial sectors initially identified by the
ongoing Cost of Service Study without subjecting residential customers to a rate increase that is significantly higher than other rate increases in the past.

On July 19, 2011, staff returned to the Finance Committee with additional options involving the use of fixed amounts for some (or all) of the increase for residential customers. Under these options, residential customers would continue to pay the current rate (which varies by can size), and an amount would be added to the current rate with an element of fixed cost. Two new options were calculated (50% and 100% fixed costs) and the fixed rate portion and percent increase to the existing variable rate are shown in Table 1 for each of these options. Table 1 also provides the new total fee for each can size. Table 2 expresses the increases as percentages. Although Table 1 provides the combined variable and fixed rates, the variable and fixed rates would be shown separately on customer bills. The rate increases presented in Table 1 are in addition to retaining the 6% residential and 9% commercial rate increases that were adopted in FY 2011.

Table 1: Options for fixed and variable residential rate increases and resulting residential rates.

<table>
<thead>
<tr>
<th></th>
<th>Option 1</th>
<th>Option 2</th>
<th>Option 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>FY11 Rates</td>
<td>100% variable</td>
<td>50% fixed, 50% variable</td>
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</tr>
<tr>
<td>Fixed Rate</td>
<td>--</td>
<td>$0.00</td>
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<tr>
<td>Variable Increase</td>
<td>--</td>
<td>13.4%</td>
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<td>Mini</td>
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<td>96 gallon</td>
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</tr>
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Table 2: Percent increases over existing FY11 residential rates for fixed and variable residential rate increase options

<table>
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Staff and Finance Committee recommend Option 3 (100% fixed cost), to address rate inequities at this time. The Finance Committee expressed a strong preference for a 100% fixed cost increase in order to better assure the revenue pending completion of the cost of service study. Reduced expenses in FY 2013 because of the closure of the landfill allow the Refuse Fund to receive a $1.25 million loan from the Budget Stabilization Reserve in FY 2012 that will be repaid in FY 2013. The loan from the Budget Stabilization Reserve minimizes the rate increases for FY 2012. The Finance Committee unanimously recommended that City Council direct staff to proceed with Option 3, including provision of a $1.25 million loan from the Budget Stabilization Reserve to the Refuse Fund.

Once the Cost of Service Study is completed this fall, future rate increases (as needed) will be based on Cost of Service data. Regardless of which option Council directs staff to proceed with at this time, staff will return to the Finance Committee in approximately six months with fixed costs data based on the Study upon which to base future changes to the rate structure, as planned.

**Resource Impact**
The proposed rate increases (all 3 options) are estimated to erase the $3.7 million deficit and result in a balanced Budget for FY 2012 and FY 2013. The proposed rate increases include a loan of $1.25 million in FY 2012 from the General Fund Budget Stabilization Reserve (BSR) to be repaid in FY 2013. Interest on the loan would be paid based on the average yield on the City's investment portfolio for the loan period. The BSR balance would be reduced to $25.8 million or 17.6% of expenditures, which is above the 15% minimum balance approved by Council.

**Timeline**
Following direction by City Council, staff will send Proposition 218 notifications to refuse customers. At the conclusion of the 45 day notification period, staff will return to City Council for the public hearing and adoption of the new refuse rates in September 2011. Following City Council adoption, the new rates will become effective on October 1, 2011.

**Policy Implications**
The proposed Refuse Rate increase is consistent with current City Policies.

**Environmental Review**
The proposed actions do not constitute a project pursuant to CEQA.

**Attachments:**
- A - Refuse Fund Slides (PPT)
• B - 7/19/11 Finance Committee Draft Excerpt Minutes (DOC)

Prepared By: Brad Eggleston, Manager, Environmental Control Programs

Department Head: J. Michael Sartor, Interim Director

City Manager Approval: James Keene, City Manager
Finance Committee Recommendation for FY 2012 Refuse Rates

City of Palo Alto
City Council
July 25, 2011
Long Term Strategy

- Establish rates that fully cover expenses and establish necessary expense reductions for FY12
- Complete forecasting model and current cost of service analysis
- Prepare options for new structural changes to rates
- Implement first of new structural rate changes for FY13

Oct 2011  
Nov 2011  
Jan 2012  
July 2012
Long Term Strategy (cont.)

- Achieve +$3 million operating reserve ~ 3 Years
- Achieve:
  - All rate payer categories pay their actual costs ~ 3 – 5 Years
  - Full implementation of structural rate changes
Short Term Strategy

- Council adoption of FY12 budget (including refuse fund deficit without rate increase)  
  - June 2011
- Finalize FY12 plans (Finance Committee)  
  - Expense reductions  
  - October 2011 rate recommendations  
  - early July 2011
- Council consideration of FY12 plans  
  - early July 2011
- Notice rate increase  
  - mid July 2011
- Council adoption of October 2011 rates  
  - September 2011
- Implementation of October 2011 rates  
  - October 1, 2011
- Continue to develop forecasting model and ongoing Cost of Service analysis  
  - Ongoing
Finance Committee Discussions of FY 2012 Refuse Fund Budget and Rates

- **4/5/11:**
  - Finance Committee directed staff to prepare FY 2012 budget assuming expiration of FY 2011 rate increases and return in July with rate increase recommendation

- **5/24/11:**
  - Finance Committee recommended Council approval of FY 2012 Refuse Fund budget with $3.7 million deficit

- **7/5/11:**
  - Staff recommended obtaining $1.25 million loan from Budget Stabilization Reserve, keep 6% residential and 9% commercial rate increases from FY 2011, and raise residential rates by additional 13% to close budget deficit
  - Finance Committee directed staff to prepare options for a fixed residential rate in lieu of the 13% residential increase recommended by staff

- **7/19/11:**
  - Finance Committee recommended Council approval of $1.25 million loan, retaining 6% and 9% rate increases from FY 2011, and fixed rate of $4.62 per month for residential customers
Refuse Fund FY 2010 Expense Actuals (thousands of dollars)

GreenWaste Contract - 39.7%
SMaRT Station - 7.5%
Kirby Canyon Disposal Fee - 6.2%
Kirby Canyon Put-or-Pay - 0.6%
Landfill Operations - 8.4%
Landfill Rent - 13.6%
Interest on Landfill Rent - 2.4%
CIP - 0.6%
Allocated G&A, Transfers - 5.9%
Admin - 3.4%
Permitting/Enforcement - 1.1%
Zero Waste - 2.7%
HHW - 1.6%
Street Sweeping - 6.4%
Landfill Closure Results in Reduced Expenses in FY 2013 Compared to FY 2012

- FY12 expenses are higher than FY13 expenses due to landfill rent and operations costs
  - FY12 landfill rent = $4.29 million
  - FY13 landfill rent = $2.09 million
  - FY12 landfill operations = $2.24 million
  - FY13 landfill operations = $1.13 million
- Loan of $1.25 million in FY12 can be repaid in FY13 to minimize FY12 rate increase (with no rate increase in FY13)
## Options for Residential Rate Increase

*(additional to retaining 6% increase from FY 2011)*

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Staff and Finance Committee Recommendation: Option 3
### Percent Increases Over FY 2011 Rates of Residential Rate Increase Options

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Staff and Finance Committee
Recommendations

- Retain 6% residential and 9% commercial rate increases from FY 2011
- Implement fixed residential rate of $4.62 per month to be effective 10/1/2011
- Obtain $1.25 million loan from the General Fund Budget Stabilization Reserve to be disbursed in FY 2012 and repaid in FY 2013
Next Steps on Refuse Rates

- Council direction on Finance Committee recommendation for FY 2012 rates 7/25/11
- Mail Proposition 218 notifications 7/29/11
- Council adoption of FY 2012 rates 9/19/11
- Complete current Cost of Service analysis and continue public outreach November 2011
- Prepare options for new structural changes to rates January 2012
- Implement first of new structural changes for FY 2013 July 2012
Next Steps on Recycling Center and Household Hazardous Waste Facility

- Develop Plan and Options for Recycling Center and HHW Facility considering:
  - Community outreach
  - Costs for additional Cleanup Day and community’s use of current Cleanup Day program
  - Costs for HHW facility improvements
  - Options for disposing of universal wastes and other items with limited alternatives
  - Role of Extended Producer Responsibility in the HHW program

- Staff is scheduled to return to Finance Committee with the Plan and Options in September
1. Recommendation for Rate Increases for the FY12 Refuse Fund Budget

Interim Director of Public Works, Mike Sartor gave a brief presentation on the history of the rate increase discussions. Staff had initiated the rate increase request to the Finance Committee in April of 2011. Staff was requested to proceed with a budget including the 6 to 9 percent rate increases and return to the Committee in July with a proposal. Staff presented a proposal on July 5, 2011 to take a $1.25 million loan from the Budget Stabilization Reserve and add 13 percent to the top for residential customers keeping the 6 and 9 percent which had previously been approved in 2010. The Committee had requested Staff consider a flat rate which was what had been brought forward for discussion.

Solid Waste Manager, Brad Eggleston presented the 3 options Staff had brought forward for discussion: Option 1 was 100 percent variable, essentially the proposal presented on July 5th; Option 2 had a fixed rate incorporated into the option where 50 percent of the revenue was generated through the fixed and 50 percent was generated through the variable; and Option 3 was a 100 percent fixed rate which ended up being $4.62 per month per residential customer. The Staff recommended the Committee select Option 3. Staff was on the City Council agenda for July 25, 2011, if Council decided to move forward the Proposition 218 notices would be mailed out to the public by the end of the week. The goal would be to return to the Council in September for approval and set the rate changes in effect for October 1, 2011. He stated the Cost of Service Analysis was scheduled to be completed by November.

Mr. Sartor stated Staff had been requested to review options for eliminating the Recycling Center. He noted Staff had engaged the community in a discussion at an environmental partners meeting last week, there had been feedback received by a number of the users of the recycling center. He noted Staff was looking into the cost for an additional clean-up day and the use for the community of said day.
Chair Scharff asked for clarification on hazardous items being included in the Household Hazardous Waste (HHW) recycling center, items such as anti-freeze.

Mr. Sartor stated yes, anti-freeze was an item that would be accepted at the HHW center. He stated used appliances and electronics were not accepted at the HHW center; although, those items would typically be collected at an annual household clean-up day.

Council Member Shepherd asked if a customer had a large box or an oversized piece which did not fit into the household bin, what happened.

Mr. Sartor stated there were two options for the customer if the recycling center were to be eliminated; 1) the customer could store the item and wait for the clean-up day or 2) the customer could haul the item themselves to the sMaRt Station in Sunnyvale.

Council Member Shepherd confirmed it was not within the Green Waste contract to pick up items which were not in the bin.

Mr. Eggleston asked for clarification on the type of box.

Council Member Shepherd stated a large cardboard box filled with recycled materials.

Mr. Eggleston stated that would be considered a curbside item and could be placed on the curb next to the bin.

Council Member Shepherd stated they would pick it up with the regular recycle bin.

Mr. Eggleston stated yes, as long as the items were contained within a biodegradable container such as a cardboard box or a paper bag.

Council Member Schmid asked if the advantage of a fixed rate was secured revenue.

Mr. Sartor stated there were two answers for your question; 1) the fixed rate may reduce the impact of switching from a larger can size to a smaller one, and 2) it had a greater impact on reducing the inequities between the can sizes.

Council Member Schmid stated the gaps between the can sizes were considerable.

Mr. Sartor stated yes, there were inequities which would be addressed with the Cost of Service Study. He noted Staff had previously mentioned there were still uncertainties with the model.
ATTACHMENT B

Council Member Schmid stated Palo Alto retained conservation pricing and added an element where we know the amount of money being generated. He asked how much would be generated by the increased figure.

Mr. Eggleston stated he did not have the exact figure; although he noted it was close to $800,000.

Council Member Schmid asked if the amount being generated per household was $4.62 multiplied by 17,500 households.

Mr. Eggleston stated 17,500 households was the number used.

Council Member Schmid stated that amounted to approximately $100,000.

Mr. Eggleston stated the amount was $4.62 per month and there were considerations in there was not a complete 12 months in the remainder of the year since the rates would not be affective until October 1, 2011.

Council Member Schmid stated to refer back to the budget, taking into account the $6 million reserve there was a $3.6 million deficit and $1.25 million would come from the loan and $1.2 million from the earlier rates, then through the upgraded savings there was approximately $500,000.

Mr. Sartor stated the $500,000 was the savings from the landfill.

Council Member Schmid stated the rate increase was designed to cover the gap.

Mr. Eggleston stated $500,000 for the landfill seemed high, but that was the process followed.

Mr. Sartor stated a valid point to mention was the $3.7 million assumed the 6 and percent would not be retained.

Council Member Schmid stated Staff would be returning in September.

Mr. Sartor stated yes, with the Recycling Center and then in January of 2012 with the next round of the 2013 budget and the Cost of Service Study results.

Council Member Schmid stated the rate changes currently being discussed; the 9 percent and the 6 percent would complete the rates for 2012.

FILENAME 3
Mr. Sartor stated that was correct.

Council Member Schmid stated a concerned he had was with the use of the term fixed cost.

Mr. Sartor stated another term used in the Staff Report was flat rate which was a flat rate of $4.62 for a residential customer plus the 6 percent from residential and the 9 percent from commercial.

Chair Scharff stated it was critical to have community outreach and have them agree to the decisions made in the Committee and Council. He stated he was satisfied with the direction of the rates and he felt it managed to move the City into the direction it needed to go, while it maintained a differential while completing the Study and encouraged people financially switch to the mini-can.

Council Member Shepherd stated her concerned for using the term flat rate. She felt it sounded as if were a steady rate for everyone. She agreed to the terminology of 100 percent fixed costs which made more of a clear message.

Mr. Eggleston stated another term Staff considered was a base rate.

Council Member Shepherd stated the purpose of the increase was to recover or begin to differentiate the fact that there were four vehicles moving throughout the streets weekly. She stated the end result was to have a rate for the movement and possibly separate out the refuse collection.

Mr. Sartor stated there were four vehicles plus a street sweeper; Staff was reviewing options for the street sweeper as well.

Council Member Shepherd stated the cost was a service cost not necessarily a fixed rate.

Mr. Eggleston clarified at this stage; it was difficult to identify the process with precision since it was not calculated based on fixed costs or service costs. He stated there was revenue needed and rather than doing a percentage increase Staff went in the fixed rate direction. He noted when Staff returned with the Cost of Service Study there would be a clearer rate structure.

Council Member Shepherd stated since this structure would be a first she suggested researched other communities to see what their structures and rates were.
ATTACHMENT B

Mr. Sartor stated there were steps in the Proposition 218 process.

Council Member Shepherd stated she understood the Proposition 218 process but wanted to ensure Staff included incentives and what needed to be analyzed beyond the 218.

**MOTION:** Council Member Shepherd moved, seconded by Council Member Schmid to recommend that the 6 percent residential and 9 percent commercial rate increases from FY 2011 be retained, that a fixed residential rate of $4.62 per month be implemented, and that a $1.25 million loan from the Budget Stabilization Reserve to the Refuse Fund be provided in FY 2012 and repaid in FY 2013.

Council Member Shepherd stated her appreciation to Staff for their attempts to stabilize the refuse by reviewing the fact that the landfill would be closing. She stated there was flexibility by easing into the process.

Vice Mayor Yeh stated from the revenue perspective the fixed rate made clear sense and it was a mid-term step prior to the completion of the Cost of Service Study.

Chair Scharff stated it was important for people to realize the goal was still to achieve zero waste and encourage people to use mini-cans but there was a cost to recycling.

**MOTION PASSED:** 4-0