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December 27, 2018

Mr. Dave Staub
Deputy Director of Public Works
City of Santa Clara Public Works Department
1700 Walsh Avenue
Santa Clara, CA 95050

Subject: Review of Proposed Tariff Adjustment for Recology South Bay

Dear Mr. Staub:

The City of Santa Clara (City) has an Exclusive Franchise Agreement (Agreement) with Recology South Bay (Recology) for the collection and processing of recyclables. Services provided by Recology via the Agreement are set to end as of January 10, 2020.

The City currently pays Recology a monthly tariff of \$2.98 for recycling collection and processing services to each single-family residence, townhouse residence, and multi-family residence in the City. The tariff was originally set in 2010 at \$2.39 per unit per month and has been escalated annually by the Consumer Price Index (CPI) in accordance with Section 7.b of the Agreement, with the total increase from 2010 through 2018 being approximately 25%. Outside of these annual adjustments, Recology's tariffs have not been adjusted to account for actual changes in Recology's costs or revenues associated with providing services required by the Agreement.

The City is seeking to revise the end date for the Agreement with Recology to be December 30, 2021, coterminous with the City's other Exclusive Franchise Agreement with Mission Trail Waste Systems. On November 21, 2018, Recology issued a letter to the City indicating Recology's interests in such an extension and requesting a \$1.36 increase to the monthly per unit tariff on the basis that revenues Recology receives from the sale of recyclables have decreased substantially since the Agreement was executed. If accepted by the City, the new tariff would be \$4.34 per unit per month, effective as soon as January 1, 2019.

R3 Consulting Group, Inc. (R3) has reviewed the basis of Recology's proposed tariff adjustment and finds Recology's assumptions to be supported and reasonable. Recology's proposal is consistent with our professional understanding of changes that have occurred in recyclables processing and commodities marketplace, up to and including significant changes in 2018 via China's "National Sword" policy.

Summary of Findings

Recyclables Processing Net Revenues are Now Costs

Recology's proposal is solely due to the fact that recycling revenues have declined steadily since 2010. Recology's original 2010 tariff of \$2.39 per unit per month was based on Recology receiving a net payment

of \$70.00 per ton for recyclable materials that it delivers to recycling processors. Recology collects recyclable materials in the City and delivers those materials for processing to other outside companies and is therefore not in control of the processors' costs to sort and market recyclables nor the revenues received from the sale of those recyclables. Per Recology's letter, net revenues from the processing and sale of recyclables have declined from \$70.00 per ton in 2010 to a projected *net cost* of \$10.00 per ton in 2019. This represents a swing of \$80.00 per ton, effectively eliminating all net revenues Recology previously received from the sale of recyclable materials and introducing a *net cost* to Recology for the same recyclables processing and marketing services.

Recology has provided documentation to R3 demonstrating that Recology was, in fact, receiving net revenues from processing of recyclable materials in the range of \$70.00 per ton in 2010. Recology has further provided R3 with documentation (in the form of an executed agreement with a new materials processor) that, under current market conditions, Recology will pay a net cost of \$10.00 starting in 2019 for processing of recyclables materials. This net cost could change over time depending on the changes in the value of recyclable commodities and changes in the quality or contamination of materials collected by Recology in the City. Importantly, as proposed, there would be no mechanism for changes in the monthly per unit tariff if revenues or material quality were to change, meaning the City is under no obligation to make further adjustment to the tariff in response to market changes between now and the expiration of the Agreement. Adjustments to the tariff would continue to be based on the annual CPI escalation as described in the Agreement.

Recology's Proposed Tariff Increase

Recology's proposal demonstrates that the \$80 per ton swing in the net revenue/cost of recycling has resulted in an annual change in revenues of approximately \$753,920 compared to 2010, based on Recology's projection of 9,424 tons to be collected in 2019. R3 compared this annual tonnage figure to the City's records of tonnages and found that Recology's projection of 9,424 tons in 2019 is supportable and reasonable. R3 recommends that the City accept Recology's projections of 9,424 tons in 2019.

Given Recology's proposed tariff increase of \$1.36 per unit per month, and the estimated net revenue change of \$753,920, R3 infers that Recology's proposal assumes monthly tariffs on approximately 46,200 units. R3 compared this number with the City's records for the number of units served by Recology and found that Recology's assumption is supportable and reasonable. R3 recommends that the City accept the unit basis for Recology's proposed \$1.36 per unit per month increase in the tariff.

Benchmarking Recology's Proposal

The City is not alone in considering increases in costs due to changes in net revenues received from the processing of recyclable materials. In the last several months, R3 has provided support to several Bay Area cities in reviewing adjustments to recyclables processing costs and per customer rates. For example, the City of Berkeley recently approved a new recyclables processing agreement that instituted a per ton cost of processing recyclables at approximately \$80.000 per ton. Additionally, several cities in Marin County have approved rates including changes in recyclables processing costs ranging from \$40.00 to \$100.00 per ton. Finally, staff reports published by the City of San Jose in December 2018 demonstrate that the all-in cost of recyclables collection and processing will soon be on the order of approximately \$13.00 per unit per month, well above the \$4.34 that the City would pay if it accepts Recology's proposal (see Attachment A to this letter).

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Based on the findings above we see no reason for the City to decline Recology's proposal for a one-time tariff adjustment due to changes in the international marketplace for recyclable commodities.

We appreciate the opportunity to be of service to the City. Should you have any questions regarding our proposal or need any additional information please contact me by phone at (510) 292-0853 or by email at gschultz@r3cgi.com.

Sincerely,

R3 CONSULTING GROUP



Garth Schultz | Principal

Enclosure:

Attachment A	City of San Jose December 4, 2018 Staff Report "Actions Related to Negotiations of Recycle Plus Residential Solid Waste Agreements"
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