Metro | *People places. Open spaces.*

REVIEW OF SOLID WASTE DISPOSAL CHARGES

Final Report

April 2011

CONSULTING SERVICES PROVIDED BY:

FCS GROUP
Solutions-Oriented Consulting

FCS GROUP
4380 SW Macadam Ave. Suite 220
Portland, OR 97239
T: 503.841.6543 | F: 503.841.6573

www.fcsgroup.com

This entire report is made of readily recyclable materials, including the bronze wire binding and the front and back covers, which are made from post-consumer recycled plastic bottles. The contents are printed on 30% recycled paper

Redmond Town Center
7525 166th Ave. NE., Suite D-215
Redmond, Washington 98052
T: 425.867.1802 F: 425.867.1937

225 Bush Street
Suite 1825
San Francisco, California 94104
T: 415.445.8947 F: 415.398.1601

4380 SW Macadam Avenue
Suite 220
Portland, OR 97239
T:503.841.6543 F: 503.841.6573

FCS GROUP
Solutions-Oriented Consulting

April 6, 2011

Metro
600 NE Grand Avenue
Portland, OR 97232-2736

Subject: Review of FY 2011/2012 Solid Waste Disposal Charges

Dear Council President Tom Hughes, Members of the Metro Council, and Acting Chief Operating Officer Dan Cooper:

FCS GROUP is pleased to submit the result of our Solid Waste Disposal Charges Review for FY 2011/2012. This completes the second year that Metro has commissioned an independent, expert, technical review of the rate setting process. The current study involved reviewing the status of the recommendations included in our April 2010 final report, consistency of the rate-setting methodology established during the last rate review and confirmation that the proposed FY 2011/2012 rates are calculated properly.

In general the major findings are as follow:

- Implementation of the recommendations in the 2010 study are nearly 30 percent complete with the majority that are pending relating to policy and scheduled to be addressed during the policy review process or Solid Waste Roadmap project.
- Rate process/methodology utilized is consistent with that deemed acceptable in the 2010 review and generally follows industry standard approaches.
- All annual operating and capital financial obligations are being captured.
- Fund balances are meeting (or exceeding) target balances.
- The process used to calculate solid waste disposal rates and charges is standard and follows solid principles.
- The proposed 2011/2012 rates developed by Metro under pay-as-you-go are technically sound and supported by the cost information provided to us for our review.

We appreciate the opportunity to work with Metro on this project. Please do not hesitate to contact me if you have any questions regarding this report or if additional information is needed.

Sincerely,
FCS GROUP

Angie Sanchez

Angie Sanchez Virnoche
Project Manager/Principal

cc: Councilors Craddick, Collette, Hosticka, Harrington, Burkholder, and Roberts; Scott Robinson, Deputy Chief Operating Officer; Margo Norton, Finance & Regulatory Director; and Douglas Anderson, Policy & Compliance Manager

TABLE OF CONTENTS

A. INTRODUCTION

In 1991 Metro established a Rate Review Committee to advise the Metro Council on rate setting procedures and proposed solid waste disposal rates. In November of 2009, a white paper titled *Setting Metro's Solid Waste Rates: An Assessment of Processes and Practices* was written, which provided recommendations to better meet Metro's needs in relation to the changing regional solid waste system and evolving best practices for setting municipal utility rates. One of the recommendations of the white paper is to separate the periodic review of rate policies from the annual rate-making cycle. The white paper further recommended that a truly independent review of the proposed rates be included in the annual rate cycle. This option replaces the Rate Review Committee and instead has Metro retain an independent consultant to review the proposed rates in conjunction with the budget.

2010 was the first year that Metro engaged FCS GROUP to complete a review of the solid waste disposal rate-setting process. The study was undertaken to provide an expert, independent, technical review of the framework and methodology used for setting solid waste disposal fees and charges. The 2011 study will focus on the extent to which Metro has implemented the recommendations noted in the 2010 review along with reviewing the adequacy of the proposed rates for 2011/2012 in meeting the financial obligations of the solid waste fund and the fiscal policies of the agency.

B. SCOPE OF WORK

The comprehensive review of the solid waste disposal charges is intended to provide an objective review of the rate setting process and offer recommendations to Metro for sustaining an open, transparent and credible rate setting process. The 2011 study identified the following key areas for review:

- Status of Implementing the 2010/11 recommendations
- Review of proposed 2011/2012 rates

Each of the key review areas identified above was completed as part of the study for Metro. Each key area's findings and recommendations will be addressed in this report.

C. RATE SETTING METHODOLOGY

Industry standard rate setting methodologies for utility services follow a general approach that is tailored to the service being provided. An important starting point to any methodology is understanding the legal, regulatory and debt covenant requirements of the agency since it forms the foundation and parameters for the rate review.

Oregon Revised Statutes Chapter 268 Metropolitan Service Districts, section 268.317 provides solid and liquid waste disposal powers. Oregon Revised Statutes section 459.335 (as revised by House Bill 2671) restricts the use of money collected by a metropolitan service district from service or user fees on solid waste disposal. Under Section 1 of the House Bill money collected shall be used for "...activities of regional concern that are directly related to reducing the environmental impact from the generation, collection, transportation, processing and disposal of solid waste; and planning, administrative and overhead costs for activities of the district related to solid waste." Metro Charter Chapter III Finance further clarifies the limits of user charges. Section 15 of the charter states "...Charges for the provision of goods or services by Metro may not exceed the costs of providing the goods or services. These costs include, but are not limited to, costs of personal services, materials, capital outlays, debt service, operating expenses, overhead expenses and capital and operational reserves attributable to the good or service." State law and the Metro charter set the parameters and framework for the rate setting process.

The mission, policies, objectives and the role of the agency as a regional service provider are also important to the rate setting process. These factors will inform the process along the way and highlight the tradeoffs that may be required.

A simplified explanation of any rate setting process generally follows three key analytical steps.

- Step 1: Identify revenue requirements. This step identifies the total annual financial obligations of the system. This includes operations, debt service, capital improvements and replacements and fiscal policy achievement. Ideally, the ongoing rate revenue of the system should support the annual ongoing expenses of the solid waste system. Many agencies including Metro refer to this as a "pay-as-you-go" policy.
- Step 2: Allocate Costs. This step establishes rate equity through cost causation or the cause and effect relationship between different costs and the activities that cause those costs to be incurred.
- Step 3: Establish Fees/Charges. This step achieves required revenue levels by establishing rates and charges that accurately reflect the cost to provide a particular service.

D. 2010 RATE REVIEW RECOMMENDATIONS – STATUS OF IMPLEMENTATION

The results of the methodology review in 2010 indicated that the rate process and methodology used to calculate rates are technically sound and generally follow standard industry practice. The review offered recommendations for consideration to enhance rate-making transparency, consistency and equity. The rate recommendations were summarized in sixteen (16) recommendations, grouped into three areas of emphasis: (1) Rate Resource Requirements, (2) General Cost Allocation and (3) Internal Cost Allocation. In addition, the recommendations identified the type of change as either a methodology, technical or policy change.

A summary of the last year's recommendations and status of implementation is provided in **Table 1**.

Table 1 – 2010 Rate Setting Methodology Review Recommendations - Status of Implementation

						Type of Change		
	Recommendation	Completed	In Process	Pending	Status of Implementation	Methodology	Technical	Policy
1	Incorporate a systematic practice of evaluating the sufficiency of long-term rates .			X	**Scheduled to be captured with upgrade of Solid Waste Information System (SWIS)**	X		
2	Develop policy regarding establishment of under-spend allowance .			X	**Will be Addressed during Policy Review**			X
3	Develop a policy regarding the revenue generated from special programs.			X	**Will be Addressed during Policy Review**			X
4	Reconsider and update the capital financing policy for new capital to accompany the capital plan.	X		X	**Repair/Replacements funded through rates. Funding new major capital addressed during policy review.**			X
5	Develop policy regarding prioritizing use of end of year balances.			X	**Will be Addressed during Policy Review**			X
6	Add a reserve fund sheet to rate model		X		**Draft incorporated, will be refined over time**	X		
7	Confirm policy regarding replenishment of reserves.			X	**Will be Addressed during Policy Review**			X
8	Separate the four major contract costs into their own cost center line item for clarity and transparency of cost allocation.			X	**Will be Addressed during Policy Review. Rate recovery objective policy or cost based.**		X	
9	Review the station management and station operation costs to identify fixed costs.			X	**Will be Addressed during Policy Review. Approach as policy or cost based**	X	X	
10	Review the 50% allocation of overhead costs to the regional fee approach.			X	**Will be Addressed with Solid Waste Roadmap project. Rate Recovery objective policy or industry standard.**	X		X
11	Allocate attorney cost based on actual time spent, not on prospective time.	X			**Recommendation noted. Current Allocation meets Requirements of Federal Circular A87 related to Cost Allocation Plans.**		X	
12	Consider more appropriate allocation basis for IT cost center (workstations, IT time charges) or clarify existing basis.	X			**Recommendation noted. Current Allocation meets Requirements of Federal Circular A87 related to Cost Allocation Plans.**		X	
13	Consider using FTE rather than payroll for overhead costs (admin/budget/finance).	X			**Recommendation noted. Current Allocation meets Requirements of Federal Circular A87 related to Cost Allocation Plans.**		X	
14	Conduct a time estimate study for direct transfer costs (may require more than one to normalize results).			X	**Based on effort and staff time estimates from employee and/or manager. Work survey scheduled for this year.**		X	
15	Strengthen cost allocation documentation or develop alternative basis for direct transfer of Senior Planner costs .			X	**Based on effort and staff time estimates from employee and/or manager. Work survey scheduled for this year.**		X	
16	Continue true-up of G&A costs at year end.	X		X	**a) Indirect costs are trued up budget to actual at year end for Circular A87. Changing to fixed carry forward method. b) Direct inter-fund transfers trued-up budget to actual. The cost allocations are not trued up. Should be updated once work survey completed.**		X	

Nearly 30 percent of the recommendations have been completed. Over half of the recommendations are policy related and will be addressed during the periodic policy review recommended in the 2009 white paper on *Setting Metro's Solid Waste Rates: An Assessment of Policies and Practices*. This policy review is likely to take place later in CY 2011.

In addition to the recommendations noted in Table 1, the current rate model supplied by Metro for the FY 2011/2012 review included additional features that improve the transparency and accuracy of the rate model. Added features include:

- Tip and transaction fee rate comparison showing the rates applicable at Metro Transfer Stations and private disposal sites.
- Cost reconciliation calculation in the budget drop page.

- New tab for major contract pricing. Shows pricing parameters and will track pricing history.
- Allocation of revenue requirements is now linked to the allocation basis. No longer a hard number input.
- Station management cost basis calculation detail added to the allocation factors for transparency.
- Comparison of prior year operating budget and revenue requirement to current year.
- Reconciliation to budget revenue appropriations.
- Excise tax and yield analysis detailed calculation

E. PROPOSED 2011/2012 RATES

The review of 2011/2012 solid waste disposal fees and charges is intended to verify that the proposed rates will meet the solid waste fund's annual revenue requirements (expense minus program revenue) and target fiscal policies. Metro provided the rate model with the solid waste fund budget updated for the 2011/2012 rate setting period. Establishing the total solid waste revenue requirements includes accounting for disposal operating costs, other program operating costs, program revenue, general income and capital.

- Disposal operations include: scalehouses, major contracts, pass-throughs, station management and facility & asset management.
- Other program operating costs include: resource conservation & recycling, system planning, private facility regulation, illegal dump site cleanup, hazardous waste reduction, latex paint recovery, landfill stewardship and general & administrative. The general & administrative costs are accounted for as direct charges and indirect and direct inter-fund transfers.
- Capital costs are from Metro's five year capital plan and include new capital, renewal and replacements, and landfill closure projects over $5,000 in value. The renewal and replacement contribution is established every three years by an independent study and are rate funded. The Renewal and Replacement Account and the St. Johns Landfill Closure Account were last updated in 2009 and 2010, respectively.
- Debt service obligations would include the annual debt service (principal and interest) associated with outstanding bond/loan obligations. There is currently no outstanding debt obligation associated with the solid waste fund.

The reserve fund activity is accounted for in the budget, separate from the rate model. An added feature of the current rate model is the tracking of sources of funds and uses of funds for the fund balances. FCS GROUP requested the target balances and ending balances for each of the reserve funds; capital, renewal & replacement, St. Johns Landfill closure, operating, working capital, environmental impairment liability and PERS (Public Employees' Retirement System) reserve. The PERS reserve will be transferred next year to the general fund per agency policy. Based on the information provided for each of the funds, all funds are meeting or exceeding their target balance.

Once revenue requirements are established, a portion of general and administrative costs are allocated to each cost center and the loaded costs of each center are assigned to the fee categories of staffed transaction fee, automated transaction fee, tonnage charge or regional system fee. The fee category assignment by cost center is summarized in **Table 2**.

Table 2 – Summary of Cost Center Fee Category Assignment

Cost Center	Transaction Fee		Tonnage Charge	Regional System Fee	Basis of Assignment/Allocation
	Staffed	Automated			
Disposal Operations					
Scalehouses	x	x			Based on combination of FTE, Transaction usage and Accounts Receivable time split.
Major Contracts			x		100% Tonnage
Pass-Throughs			x		100% Tonnage
Station Management	x	x	x		Based on the share of personal services and materials & services costs within each function covered by station management and split by FTEs.
Hazardous Waste Reduction				x	100% Regional System Fee
Latex Paint Recovery				x	100% Regional System Fee
Landfill Stewardship				x	100% Regional System Fee
Facility & Asset Mgmt.			x	x	Based on the professional time spent on facilities
Sustainability Center & Planning					
Resource Cons. & Recycling				x	100% Regional System Fee
System Planning				x	100% Regional System Fee
Finance & Regulatory Services					
Private Facility Regulation				x	100% Regional System Fee
Illegal Dumping				x	100% Regional System Fee
General & Administrative					
50% of Total G&A				x	50% based on policy to RSF. Remaining 50% loaded on to each of the cost centers using algorithms and factors developed with advice and review of the Rate Committee in 2003/04 and are consistent with cost-of-service approaches. Allocation factors based on usage or strong correlation with usage and are updated each year.

Metro departs from cost-of-service allocation/assignment only in that it loads half (vs. all in a more standard utility environment) of the G&A into each cost center; the remaining half is allocated directly to the Regional System Fee. This policy stems from the Metro Council’s 1998 decision to allow privately-owned transfer stations to handle a significant portion of the region’s wet waste – but only under a financial arrangement that minimizes the risk of stranding public investment. This policy was implemented through the rate system – specifically, through a cost allocation approach in which all of Metro’s major fixed costs that were undertaken on behalf of the regional disposal system – debt service on the transfer stations, the fixed cost of the transport and disposal contracts, and general and administrative costs – were allocated to the Regional System Fee and paid by all regional ratepayers, not just users of the transfer stations. Public investment would not be stranded financially under this arrangement. In the years after 1998, the fixed contract costs were negotiated out of the contracts and debt service was later retired, leaving only G&A among the costs to be broadly shared. In this environment, and in recognition of the significantly reduced risk to the stranding of public investment, in 2005 Metro began loading half of the G&A onto cost centers using a standard cost-of-service approach, and left half in the surcharge paid by all ratepayers, the Regional System Fee.

In the next few years the Solid Waste Roadmap project will be looking broadly at the future of the disposal system, including its financing. This project will either confirm, modify, or rewrite the current rate approach consistent with the relationship between public and private investment in the disposal system of the future.

As stated in the 2010 review of solid waste disposal charges and within the policy context described above, the current Metro approach to allocating costs is within industry standard approaches. The technical mechanics of the cost allocation are accurate with all costs allocated to the transaction fees, tonnage charge, regional system fee or a combination.

The final step in the rate model development is calculating the required unit cost for each of the fee categories. The revenue requirements by fee category are divided by one of the following unit bases to calculate the fee/charge per unit; Count of Metro staffed transactions, Count of Metro automated transactions, Metro transfer station tonnage or regional tonnage.

Based on the proposed unit cost results for 2011/2012, increased rates and charges appear warranted. Existing solid waste fee and charge levels are not sufficient to meet the 2011/2012 ongoing annual revenue requirements under the pay-as-you-go policy. Key trends identified during the rate review include:

- Major contract prices per unit are up, however, due to reduced tonnage total major contract costs are down with the exception of fuel
- Program costs (excluding disposal) up slightly
- Administrative and General expenses down reflecting reduction and efficiencies
- Tons are projected to be down from both the FY 2010/2011 budget assumption and current experience in 2011/2012 both at Metro transfer stations (6.6 percent) and for regional waste generated inside the district (5.7 percent)
- Transactions are projected to be down both staffed (3 percent) and automated (10.4 percent)

Both the reduction in tons and reduction in transactions have the greatest effect on the need for a rate increase. Target fund balances are in place in order to help Metro weather unforeseen events. However, the current state of the economy together with new diversion initiatives makes it unlikely that tonnage will return to historical levels in FY 2011/12. Therefore, it is important for Metro establish rates under the reduced tonnage that will support the solid waste fund's on-going costs. The development of the proposed 2011/2012 rates by Metro under pay-as-you-go and reviewed by FCS GROUP are technically sound and supported by the cost information provided for review.

It should be noted that FCS GROUP was not asked to review the accuracy of the specific amounts provided in the budget for direct costs, capital requirements, and fund balances; nor review of contracts with transfer station operators, transport and fuel providers, or landfill/disposal operators; nor demand forecasting techniques; or tonnage or transaction assumptions. Rather the intent is to establish if all costs provided have been captured appropriately and if all cost allocations are technically sound and generally using industry standard approaches.