

Review of FY 2017-18 Solid Waste Rates

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In February 2017, Metro engaged CH2M HILL Engineers, Inc. (CH2M), to conduct an independent review (in accordance with Metro Code 5.02.020) of Metro's FY 2017-18 Solid Waste rate model and the associated proposed rates. The rate model was received on February 1, 2017 via e-mail and no updates were made to the data or the model after it was received. This technical memorandum presents the results of that review, including a review of the model for accuracy, completeness, and fairness. The review is also intended to help ensure that Metro's financial goals for targeted fund balances and other policies are met. Finally, the review presents findings and recommendations for Metro to consider.

This review did not attempt to verify any assumptions or information relating to system operating costs, waste volumes, staffing, capital project costs, etc. that were used in the rate model calculations. Assuming that this information and assumptions were valid for the purposes of this rate analysis, this review evaluated whether the model was fairly and equitably allocating the system costs to users in accordance with their cost causal responsibility.

The review of the model resulted in the following observations:

- The model is well designed and functions properly. While Metro is currently only using the model to calculate rates for a single year (FY 2017-18), the model does have the functionality to prepare longer term projections.
- Current cost allocation methods appear to be sound and fair, given the available information that the analysts had available to them. Allocations are generally consistent with the FY 2016-17 model.
- Recommended rates are projected to generate revenues that are slightly less than the estimated revenue requirements. In particular, proposed rates for wood and commercial organics are lower than the calculated cost of service rates. The decline in wood tonnage and the emphasis on commercial organic waste programs resulted in the decision to propose rates for these wastes that are lower than the rates calculated by the model. The estimated shortfall in revenues can be absorbed by drawing on the working capital and/or rate stabilization fund balances.

- Even though the model does not have a programmed increase in the solid waste rates, the projected revenues for FY 2017-18 are expected to grow by approximately \$3.5 million over budgeted FY 2016-17 revenues because of the forecast increase in overall tonnage across the region.
- Metro operating and capital fund targets are forecast to be met in FY 2017-18. Based on tonnage growth and the current CIP in the model, the ending Operating Fund balance will grow by over \$4.2 million by the end of FY 2017-18 to approximately \$15.4 million, exceeding the minimum target balance of \$8.4 million. Capital Fund balance is projected to grow well above the target balance of \$1.2 million (to approximately \$8.1 million at the end of FY 2017-18). While it is recognized that actual future spending may differ from the planned CIP spending presented in the model, it appears the Operating and Capital Fund balances exceed the recommendations in the FCS Group memo from August 2015.
- Metro is required by state and federal laws and regulations to provide financial assurance for the coverage of post-closure care estimated costs. Metro is currently providing this financial assurance through an Alternative Financial Assurance Mechanism which has been approved by the Oregon Department of Environmental Quality (DEQ) and consists of its Solid Waste Fund, a post-closure funding guarantee of future revenues to cover these costs, and a Landfill Post-Closure Account. Metro is required to submit annual re-certifications of this mechanism. According to Metro's Consolidated Annual Financial Report (CAFR) for FY ending June 30, 2016, DEQ approved the March 9, 2016 annual recertification.
- The Landfill Closure Reserve is expected to transfer approximately \$700,000 in FY 2017-18 to the Capital Fund to pay for CIP projects related to Landfill post closure care activities.
- The Rate Stabilization fund beginning fund balance is approximately \$11.9 million in FY 2017-18, an increase of approximately \$3.8 million from the previous year. The fund balance exceeds the recommended target of 10 percent of rate revenues, or \$6.8 million, as defined in the FCS Group project memo dated August 28, 2015.
- A number of O&M expense line items fluctuated more than expected from FY 2016-17 to FY 2017-18. Many of the changes reflect the organizational change undertaken by Metro that created the new SW Information and Analysis Department. Additional personnel expenses for Disposal Enforcement also increased significantly with the addition of new personnel that were transferred from other cost centers. Finally, an increase in SW Communications expenses was a result of staff being moved from the General Fund to the Solid Waste Fund.

Recommendations:

- 1) Implement a rate review process that looks at a longer horizon period (current period is 1 year). We recommend a 3-5 year planning period so potentially large rate impacts associated with unusually large capital replacements or other large one time expenditures can be spread out over a period of years rather than a single year. This strategy would help avoid potential large spikes in rates. Strategic use of reserves,

- such as the Rate Stabilization Fund, can also be used to mitigate the effects of significant increases in costs.
- 2) Where applicable in the model, refer to actual historical revenues and expenditures instead of budget data when information is available.
 - 3) Metro may want to consider options for redefining its capital funds to meet specific needs. For example, Metro could consider setting a target balance in its capital fund that is sufficient to meet its needs if a large component of its system were to fail prematurely. This is consistent with the recommendation from the FCS Group Review of Reserve Funds from August 2015.
 - 4) By funding the rate stabilization fund from annual budget surpluses, the balance of this fund has been climbing. Metro may want to define a target balance for its Rate Stabilization Fund, or range within which this fund will be managed.
 - 5) Based on the current balances in the utility's reserve funds, Metro may want to consider drawing down some of the reserves in its operating and rate stabilization funds to offset the need for rate increases in the current or future years. Similarly, additional contributions to the Capital Fund may not be warranted given the existing and projected capital improvement plan. Thus, funds that may have been accumulating in the Capital Fund could be used to offset rate increases in the current or future years.
 - 6) The model that was provided for CH2M's review includes financial projections that are based on Metro's existing rates and charges. In the future, Metro may want to consider updating its financial model to reflect its proposed rates, prior to having its model results reviewed by an outside consultant. This would help ensure that the independent review can evaluate Metro's pro forma financial results given the rates that are proposed for adoption. For the current year review, the rates that are being proposed for FY 2017-18, reflect only minor changes from the rates that are currently in effect, and thus should not have materially different results. However, if more significant rate adjustments had been proposed, it will be important for the outside consultant to evaluate the financial results given those proposed rate adjustments.