



Memorandum

Date: April 22, 2020
To: Utilities Commission
From: Stan Gryczko, Public Works Utilities and Operations Director
Adrienne Heinig, Management Analyst
Subject: Item 4A – Solid Waste Annual Fund Review/Rate Adjustment Recommendation to Council

Recommendations

1. Receive informational item on the financial status of the City’s Solid Waste Fund (520) for Fiscal Year 2018-2019.
2. Approve staff recommendation to City Council that the second-year rate adjustment for the Solid Waste Utility be implemented unchanged from the approved Proposition 218 rate adjustment schedule, with the next adjustment occurring on June 1, 2020.

Background

Council Direction in February 2020

When the City Council established the current customer rates for Solid Waste services on February 5, 2019, they also directed staff to return to Council before each rate adjustment within the approved Proposition 218 period (2019/20 through 2022/23), with a report on the fiscal health of the fund, and a recommendation for the next year’s rate adjustment (within the approved adjustments). Generally, this is not done with an approved Proposition 218 period for a utility. However, with the anticipated slow growth of the fund, the City Council has requested this review for each adjustment prior to implementation. The staff report to Council on this item from the February 5, 2019 Council meeting is included for reference as Attachment A.

The current approved rate adjustment schedule is:

Month/Year	Adjustment	\$ Impact	Rate (SFR 65 gal)
Mar 2019	13.5%	\$0.00	\$38.95
Jun 2020	10.0%	\$3.90	\$42.85
Jan 2021	8.0%	\$3.43	\$46.28
Jan 2022	5.0%	\$2.31	\$48.59
Jan 2023	5.0%	\$2.43	\$51.02

Annual Commission Utility Fund Reviews

This update is part of a regular series on the status of the city's Utility funds. The information presented includes a summary of the revenue and expenditures of the preceding closed fiscal year, compared to the projections from the utility model (developed during the most recent cost-of-service study for that utility). The intent of the update is to give a snapshot of the status of the fund and highlight any outstanding differences between the actual data and the projected numbers from the model, in between full cost-of-service studies. The update covers the city's Solid Waste Fund (Fund No. 520) for Fiscal Year (FY) 2018-2019.

Annual Fund Review

Sources of Funds

Solid Waste Fund revenues are largely collected from three sources: service charges paid by the utility customers, revenue from special drop box orders by customers, and interest paid from utility investments.

Service Charges

Service Charge revenue is the largest source of revenue for the Solid Waste Fund. In FY 2018-2019, the service charges for all customers totaled \$11,996,560.

Drop Boxes

Drop Box revenue is based on the number of drop boxes ordered and used in Davis, and is highly dependent on construction activity. In FY 2018-2019, the service charges totaled \$29,635.

Interest from Investments

Interest from investment revenue has historically been the smallest source of revenue for the Solid Waste Fund. With the slow establishment of a reserve fund, and the presence of a fund balance due to the Wastewater Utility loan, however, the interest earned by the Solid Waste fund totaled \$58,695 in FY 2018-2019.

The most recent model developed for the fund was completed in 2019, and actual costs from fiscal year 2017-2018 and city budget for 2018-2019 were used as the basis for the model's projections.

When comparing the revenue included in the model (based on adjusted budget numbers for FY 2018-2019) to the actual revenue received in that year, the estimate is extremely close to the actual revenue collected. The largest difference was the revenue received as income from investments, which had not been included in the model, as the fund did not receive significant interest from investments prior to FY 2018-2019.

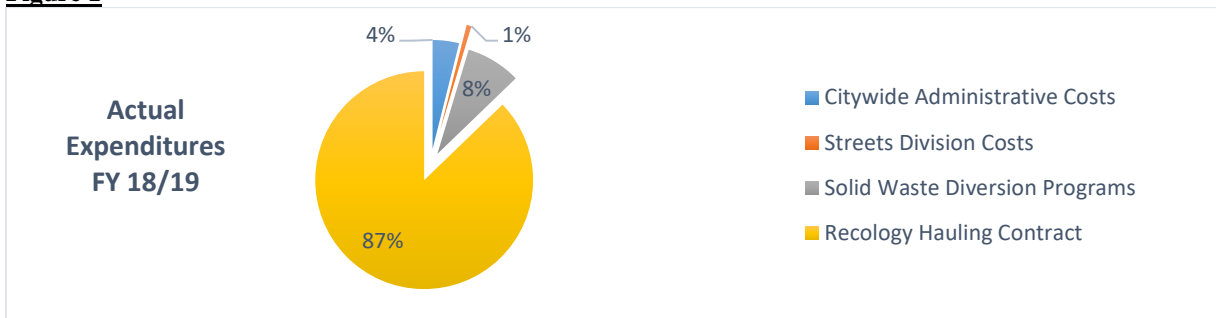
FY 2018/2019	MODEL Adjusted Budget	ACTUAL City Accounting
Service Charges	\$ 11,903,000	\$ 11,996,560
Other Revenues	\$ 40,000	\$ 29,635
Interest from Investments	\$ -	\$ 58,695
TOTAL INCOME	\$ 11,943,000	\$ 12,026,195

Between the two, the Model estimated a return of \$11,943,000. The actual returns totaled \$12,026,195, a difference of \$83,195.

Uses of Funds

Expenditures for the utility are divided into four major sections: overall city administration, costs associated with Public Works Utilities and Operations hazardous waste removal, the diversion programs, and the contract with the City’s solid waste hauler. A breakdown of costs using actual expenditure data is included in Figure 1 below.

Figure 1



City Administration

City administrative costs cover the operations and labor for work done in support of the solid waste utility. This includes support for the Finance Division of the Administrative Services Department, where the billing for the utility is done, the Fire Department, where hazardous waste removal is also performed, and for Public Works Utilities and Operations Department administrative staff outside of the Solid Waste Diversion programs.

Streets Division

Streets Division costs include those incurred when performing hazardous waste and material clean up and disposal. The contract hauler costs associated with the City’s street sweeping are also accounted for in the Streets program budget (in Figure 1 above, the street sweeping contract costs have been included with the waste hauling costs, to show the total cost of the contract.)

Solid Waste Diversion Program

The second largest cost (though only 8% of the total), the Solid Waste Diversion program is the outreach, education, and regulatory side of the Solid Waste utility. Staff within the Diversion program are responsible for providing all materials and tools for customers, from single family

residential customers through commercial customers, to ensure compliance with the City and State solid waste ordinances and requirements. Staff are also responsible for all reporting to regulatory bodies, including to CalRecycle, and tracking upcoming legislation, (such as Senate Bill 1383) which may change solid waste collection requirements for the City, the City’s customers, or both.

Contract Hauler

By far the largest component of the cost of the City’s Solid Waste Utility, the contract hauler constitutes roughly 87% of the cost, and is currently held by Recology Davis. This includes the services to all City customers for waste hauling, the performance of annual waste audits, and the operation of the Materials Recovery Facility (MRF) in Davis, among other contractual obligations.

As with the revenue comparison between the model and the City’s actual operating expenditures, the expenditures shown in the model and the actual expenditures are nearly identical, which is not unexpected given the timing of the creation of the model and the development of the City budget. The costs are included in the table below:

FY 2018/2019	MODEL Adjusted Budget	ACTUAL City Accounting
Citywide Administrative Costs	\$ 559,961	\$ 509,391
<i>Subtotal City</i>	\$ 559,961	\$ 509,391
Streets Division Costs	\$ 87,808	\$ 93,949
Recology Street Sweeping	\$ 452,000	\$ 458,646
<i>Subtotal Streets</i>	\$ 539,808	\$ 552,595
Solid Waste Diversion Programs	\$ 1,000,359	\$ 1,057,092
Recology Hauling Contract	\$ 10,815,107	\$ 10,865,980
<i>Subtotal Solid Waste</i>	\$ 11,815,466	\$ 11,923,072
TOTAL OPERATING EXPENDITURES	\$ 12,915,235	\$ 13,006,358

Debt

In May 2018 (FY 17/18), the Solid Waste Utility received a \$3,000,000 loan from the Wastewater Utility to maintain a positive fund balance and continue program operations in advance of the completion of the cost of service study, which had been delayed by about a year during the activity around the assigning of the City’s waste hauling contract to Recology Davis, after Recology purchased Davis Waste Removal (the former contractor).

Reserve Calculations

The reserve calculation within the study, developed by the consultant working with the City in lieu of a formal reserve policy (which was in development) was set at 15% of annual operating expenses for the utility. On January 28, 2020, the City Council adopted a formal reserve policy, which set the reserve calculation for the Solid Waste fund at 12 months of non-contractual operating expenses. When the costs associated with the Recology Davis contract are removed

from the annual expenses, the remaining costs are roughly equivalent to 13% of annual operating costs, or about \$1.8 to \$2 million on average. The gradual nature of the growth of the Solid Waste fund, due to the adjustments spaced out across five years, means the development of reserve is still in progress.

Fund Balance

As previously mentioned, the Solid Waste Utility received a loan in May of 2018, due to the utility expenditures outpacing revenue for periods of time. In addition, the overall fund balance for the utility was at risk of running into deficit. With the loan, the fund balance increased, as can be seen by the sharp increase in Figure 2 during FY 17/18 below. With the slow growth intended from the five-year rate adjustments, the initial steep decrease and slow shift to the next increase was anticipated, and is shown in the actual fund balance amounts included in Figure 2. It was assumed that the expenditures would continue to outpace revenue, and draw more from fund balance, until the third year of this 5-year rate structure, when the revenue would overtake expenditures. After the third year of the adjustments, the fund balance would slowly trend upwards. This is shown in Figure 3, which models the approved Proposition 218 rate adjustments.

Figure 2

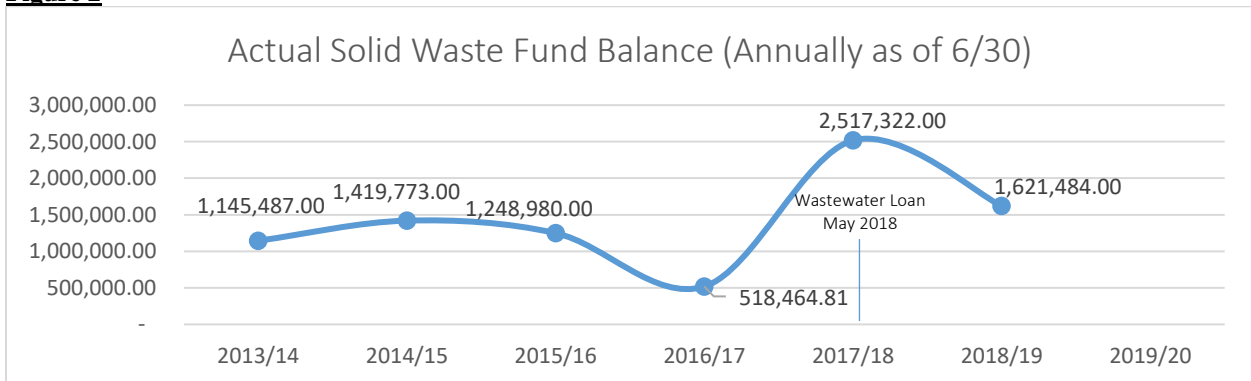
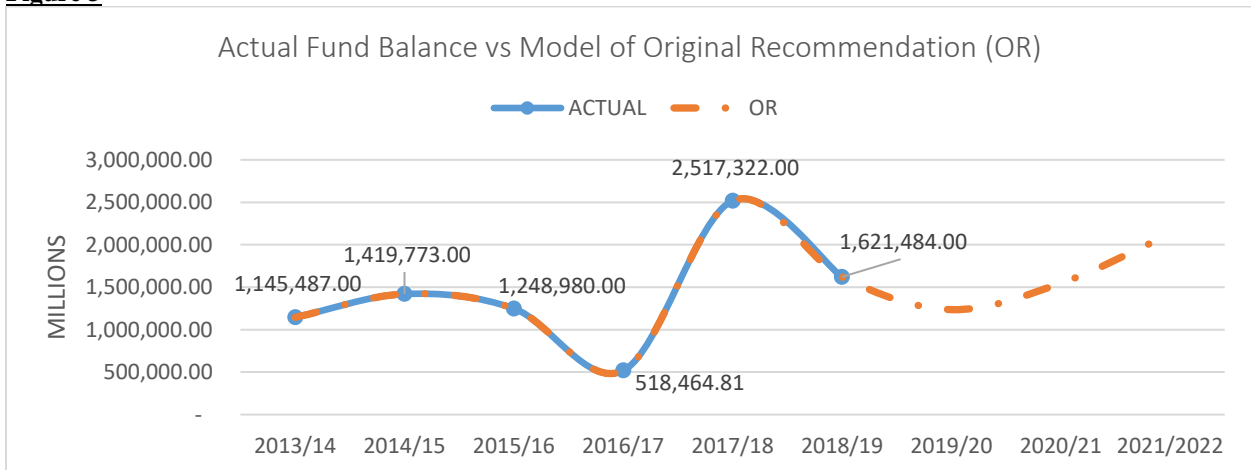


Figure 3



Current Fund Status

As anticipated, fund expenditures remain higher than revenue received by the Solid Waste Utility, and the fund balance continues to drop. Actual revenue was approximately \$100,000 higher than what was anticipated, showing that the slow approach to develop the fund back to a sustainable level is working as planned.

Upcoming 2019-2020 Budget & Model projections

The request on hand is to review the current state of the Solid Waste Fund, and recommend a rate adjustment at, or below the second-year approved adjustment of 10%. This report will also include a discussion of current unforeseen circumstances (and upcoming regulatory changes), and how those circumstances may impact fund revenue, however this section will focus on the current model/budget comparison for the second-year adjustment.

With the planned slow development of the fund, the first two years of the rate adjustments are the most important to keeping the fund on track. The table below shows the revenue comparison of the model versus the current City budget for the fiscal year that ends in June.

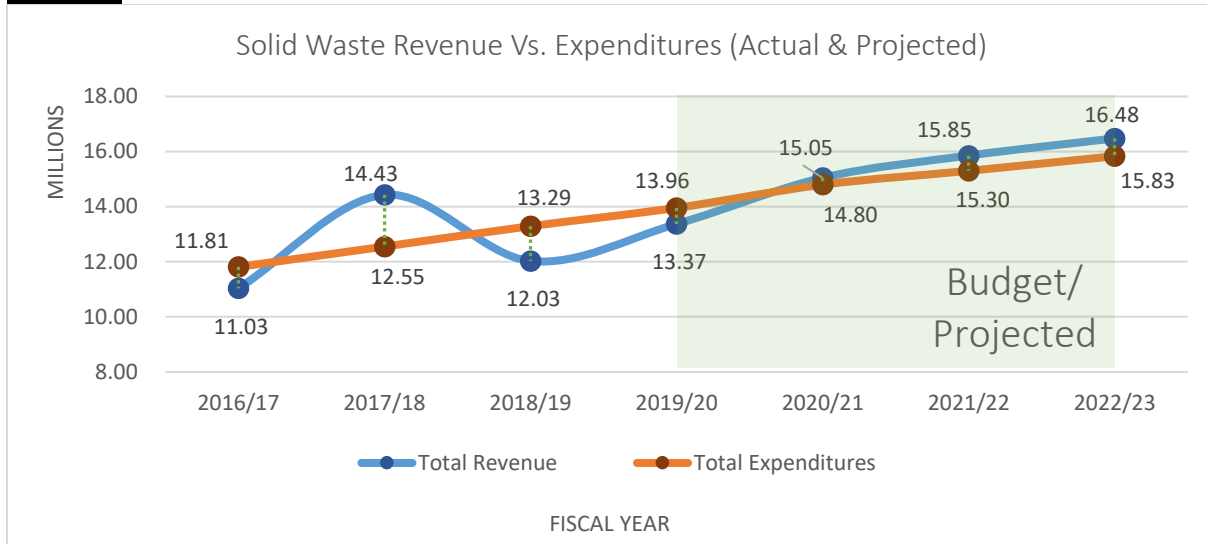
FY 2019/2020	MODEL Forecast	ACTUAL City Budget
Service Charges	\$ 12,910,198	\$ 13,310,000
Other Revenues	\$ 40,000	\$ 60,000
Interest from Investments	\$ -	\$ 48,000
TOTAL INCOME	\$ 12,950,198	\$ 13,370,000

With an anticipation of slightly higher revenue based on the returns from FY 2018-2019, the fund shows a steady growth. Expenditures compared across the model and the City’s budget show slight increases in the budget over the model, but a difference of about \$300,000 overall. This is summarized in the table below:

FY 2019/2020	MODEL Adjusted Budget	ACTUAL City Budget
Citywide Administrative Costs	\$ 577,000	\$ 610,293
<i>Subtotal City</i>	\$ 577,000	\$ 610,293
Streets Division Costs	\$ 90,700	\$ 95,128
Recology Street Sweeping	\$ 466,000	\$ 774,000
<i>Subtotal Streets</i>	\$ 556,700	\$ 869,128
Solid Waste Diversion Programs	\$ 1,025,100	\$ 1,157,942
Recology Hauling Contract	\$ 11,236,300	\$ 11,043,000
<i>Subtotal Solid Waste</i>	\$ 12,261,400	\$ 12,200,942
TOTAL OPERATING EXPENDITURES	\$ 13,395,100	\$ 13,680,363

Future model forecasting, built with the assumption of a 10% rate adjustment on June 1, 2020, shows the revenue exceeding expenditures in early FY 20/21, likely after the 8% adjustment on January 1, 2021.

Figure 4



Current Events

COVID-19

Since March 18, 2020, Yolo County has been under a shelter-in-place order to reduce the spread of the novel coronavirus, COVID-19. This order has significantly impacted the community, with many local businesses struggling to maintain operations with low to no customers, and residents experiencing layoffs and mounting bills. On March 24, 2020, the City Council approved an urgency ordinance to in part waive new City utility bill late fees for all residential and commercial customers, allowing late payments without penalty through May 2020 (or longer, if extended).

On April 7, 2020, the City Council received an update on the City’s response to the COVID-19 which included the following statement related to the potential impacts on the city’s budget and revenue:

“Finance is working on identifying the impacts of COVID-19 pandemic on the City’s financial position for the current fiscal year as well as the upcoming fiscal year. It is expected the impact will be across all City programs. With respect to the General Fund, it is estimated that there will be notable impact on the general tax revenues such as sales tax, transactions and use tax, transient occupancy tax, and business license tax. Property tax revenue will be affected, but likely, the City will not see the full impact until fiscal year (FY) 2021-22. All departments are being asked to re-evaluate fee-based programs revenue projections for the current and coming fiscal years.”

What is clear in this situation (and perhaps the only thing that is clear), is that there is no ‘playbook’ for understanding impact on revenue in the current or upcoming fiscal years from the shelter-in-place order, or for understanding how and when the economy (local, state and national) might recover. It is also unknown if the likely delay in the payment of utility bills, or the loss of utility customers will be a shorter- or longer-term impact. As of April 9, 58 commercial solid waste customers have either reduced or stopped their solid waste collection service.

With these considerations in mind, staff have reviewed the current rate adjustment schedule for Solid Waste rates, and have two scenarios for the Commission to review. Basic assumptions are included in these calculations:

1. The full anticipated adjustment for the Proposition 218 approval period will be implemented. Scenarios which dropped a year of the adjustments demonstrated the action was not feasible to maintain the fund.
2. The scenarios assume that the next rate study (to be conducted in 2022/23) would likely result in recommended rate adjustments slightly higher than anticipated with the original recommendations, and would be necessary to maintain the fund and to be able to implement projects and studies beyond basic utility operations.
3. For the remainder of the approved rate adjustment period, planned expenditures for any activities not immediately required for operations by the utility would be deferred indefinitely.
4. The target reserve would likely not be reached within the approved rate adjustment period, and the City would not have any cushion (fund balance above a reserve) to aid in rate impacts associated with the implementation of Senate Bill (SB) 1383, which is currently still on track to be implemented in phases beginning in 2022. This implementation is also discussed later in this report. The fund would also not provide a cushion for additional regulatory changes, detailed rate reviews requested by the contract hauler, major emergencies, or other unforeseen financial impacts.

It is important to note that the recommendation before the Commission and Council is only for the June 1, 2020 increase of up to 10%. Potential delays on future adopted rate increases do not have to be determined now. The scenarios are presented to show the modeled impacts to the fund if such delays were ultimately chosen by Council.

Solid Waste Rate Adjustment Scenario A:

Defer the June 1, 2020 rate adjustment to January 1, 2021, and push the scheduled third-year rate adjustment to July 2021. Each adjustment annually thereafter in either July (Table 1) or January (Table 2).

Scenario A - Table 1

Month/Year	Adjustment	\$ Impact	Rate (SFR) 65 gal
Mar 2019	13.5%	\$0.00	\$38.95
Jun 2020	None	\$0.00	\$38.95
Jan 2021	10%	\$3.90	\$42.85
Jul 2021	8%	\$3.43	\$46.28
Jul 2022	5%	\$2.31	\$48.59
Jul 2023	5%	\$2.43	\$51.02

Scenario A - Table 2

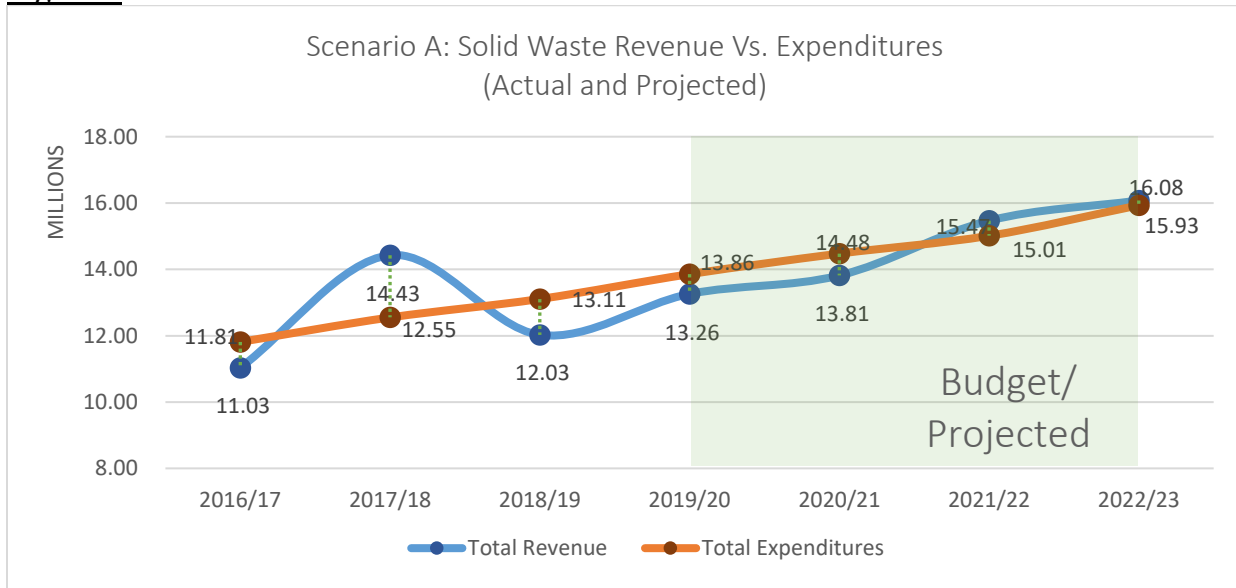
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Jan 2022	5%	\$2.31	\$48.59
Jan 2023	5%	\$2.43	\$51.02

A.1: Total increase in 2021: \$7.33

A.2: Total increase in one year: \$9.64

This scenario was developed to demonstrate the impact to revenue and on the fund development should the Commission recommend postponing the next scheduled rate adjustment on June 1, 2020 to January 1, 2021, and bump the third-year rate adjustment to July 1, 2021. The current approved Proposition 218 rate schedule has annual adjustment in January of each year after 2020. However, if the June 1, 2020 rate adjustment is shifted forward to January 2021, and the annual adjustments continue to occur on January 1, the rate payers will have a 23% increase in one year. If the fourth- and fifth-year adjustments are shifted to July 1 as well, the increase is 18%.

Figure 5



This scenario also impacts the development of the fund. As shown in Figure 5 above, the transition to taking in enough revenue to support expenditures is pushed out further than the original recommendation has modeled, and FY 19-20, and 20-21 would likely further lower the utility fund balance.

Solid Waste Rate Adjustment Scenario B:

Continue with the June 1, 2020 rate adjustment, and push the scheduled third-year rate adjustment to January 2022. Each adjustment annually thereafter either July.

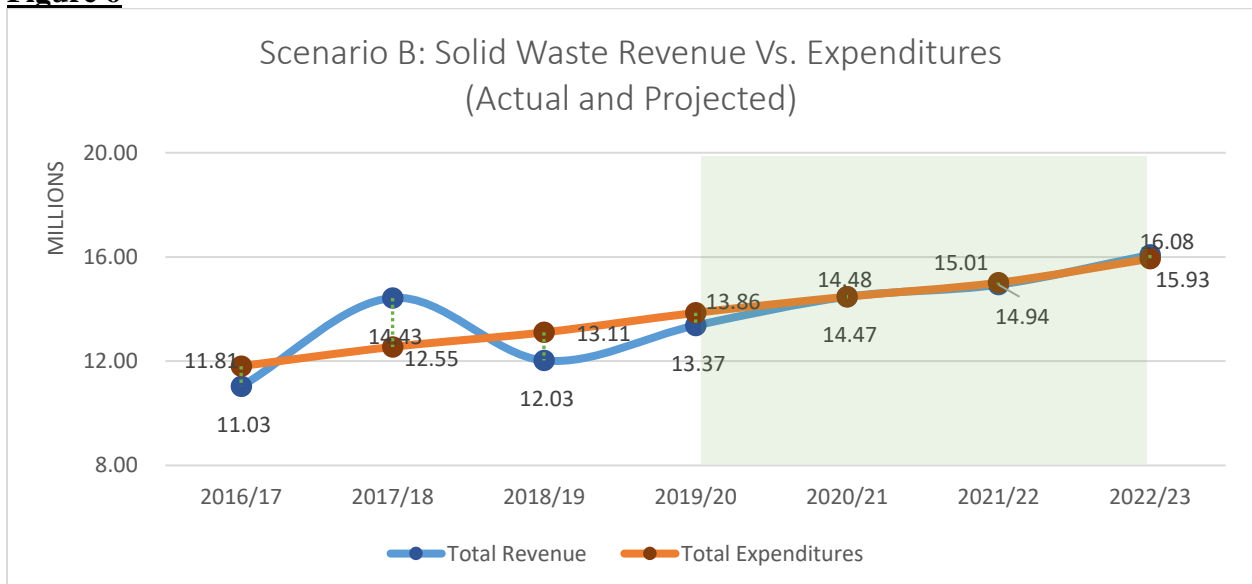
Scenario B

Month/Year	Adjustment	\$ Impact	Rate (SFR) 65 gal
Mar 2019	13.5%	\$0.00	\$38.95
Jun 2020	10.0%	\$3.90	\$42.85
Jan 2021	None	\$0.00	\$42.85
Jan 2022	8%	\$3.43	\$46.27
Jul 2022	5%	\$2.31	\$48.59
Jul 2023	5%	\$2.43	\$51.02

B: Total increase in 2022: \$5.74

This scenario was developed in case the Commission wished to recommend the currently scheduled rate adjustment, but defer the adjustments scheduled for FY 21/22, anticipated to be when the full impacts of the current shelter-in-place order on revenue would be clearer. This scenario maintains the important first two years of adjustments, but offers another potential slowdown on the remaining years. As shown in Figure 6 below, the revenue continues to come in below expenditures until next fiscal year, when the revenue and expenditure totals remain nearly identical for a few years, until a slight revenue shift upwards.

Figure 6



As previously stated, while these scenarios are possible, the Solid Waste fund would likely require significant increases in outlying years (after FY 23/24) to continue to build the fund balance, and protect the fund against unforeseen fiscal impacts. The fund operations would be

likely be limited to essential services only. This would be especially concerning given the upcoming implementation of SB 1383.

SB 1383

Another upcoming impact on rates is the implementation of SB 1383, Short-Lived Climate Pollutants: Organic Waste Methane Emissions Reductions by the California Department of Resources, Recycling and Recovery (CalRecycle). These regulations (still being finalized) are extensive.

As it pertains to CalRecycle, SB 1383 establishes targets to achieve a 50 percent reduction in the level of the statewide disposal of organic waste from the 2014 level by 2020, and a 75 percent reduction by 2025. The law grants CalRecycle the regulatory authority required to achieve the organic waste disposal reduction targets and establishes an additional target that not less than 20 percent of currently disposed edible food is recovered for human consumption by 2025.

There are a number of items in the regulations that would have impacts on Davis, and utility ratepayers, including the following:

- Changing the labels and lid colors for all Recology Davis collection bins to be compliant with the regulations (current bins do not match the requirements)
- The establishment of an edible food recovery program
- Translate a variety of mandated outreach items to customers in their native language (for any language spoken by 5% of more of our customers)
- New reporting requirements to the state
- Inspections, audits and recordkeeping of organic waste generators, and more

The regulations (when formally adopted) are currently scheduled to go into effect January 1, 2022, and strict enforcement of the regulations would be in place by 2024. It is anticipated that the regulations will be finalized by July 2020. Given the current situation with the COVID-19 pandemic however, advocacy groups have asked that CalRecycle delay implementation of the regulations. Staff has not yet heard from CalRecycle if any additional delays will be granted.

The City plans to release a request for proposals (RFP) in the coming months for a consultant to assist staff in developing the best path forward towards compliance. Fortunately, the city-wide organics collection program that began in 2016 is a huge benefit to the City (and to ratepayers), as Davis is one of only a handful of agencies in California that already requires organics collection from all customers, and is already accounting for that service in the rate structure.

Staff Recommendation

There is a great deal about the current situation that is, unfortunately, unknown. At this time, only assumptions can be made about revenue impacts to City utilities, general fund impacts due to sales tax revenue reduction, or other fiscal challenges brought by COVID-19. It is also

unknown what the economic recovery timeline might look like once the order is lifted. What is known, however, is that there will be demands on the Solid Waste Utility in addition to the costs associated with COVID-19, and currently the fund is not able to support those demands (let alone unforeseen costs) without additional rate adjustments. As has been stated in presentations to the Commission and to Council, the first two years of the rate adjustments for the utility are the most important to bringing stability to the fund, and smoothing out the future year rate adjustments.

It is again also important to keep in mind that this rate recommendation to Council is for the rate adjustment scheduled on June 1, 2020. If the timeline of rate adjustments continues to follow the approved Proposition 218 rate schedule, the Commission will have another opportunity to review the fund and recommend rate adjustments in November of this year.

With these considerations, staff recommend the second-year rate adjustment for the Solid Waste Utility be implemented unchanged from the approved Proposition 218 rate adjustment schedule, with the next adjustment of a 10% increase occur on June 1, 2020.

Next Steps

The discussion and any recommendations from the Utilities Commission will be presented to Council in May, as the next rate adjustment is scheduled for June 1, 2020. If the current schedule of adjustments does not change, the next fund review of the Solid Waste Utility will be presented to the Commission in November 2020, with a recommendation to Council for the rate adjustment on January 1, 2021. If recommendations shift the dates of the rate adjustments, the timeline for the next fund review may be shifted.

Attachments

1. Fund Update Detail Spreadsheets for the Original Recommendation and Scenarios A & B
2. Feb 5, 2019 City Council Meeting Item 04 - Solid Waste Rate Proposition 218 Public Hearing and Rate Recommendations