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May 3, 2019

Mr. Liam Garland
Public Works Director
City of Alameda
950 West Mall Square, First Floor
Alameda, CA 94501-7552

Subject: **DRAFT Report: Review of Alameda County Industries Rate Period Eighteen Contractor's Compensation Application**

Reference Number: *S3973*

Dear Mr. Garland:

HF&H Consultants, LLC's (HF&H) is pleased to present our findings and recommendations to the City of Alameda (City) from our review of Alameda County Industries' (ACI) Rate Period Eighteen (RP18) Contractor's Compensation Application (Application), which was submitted to the City on January 7, 2019. This report presents our findings and recommendations and is organized into the following three sections:

I. Summary and Recommendations;

II. Background; and,

III. HF&H Analyses.

It should be noted that this report is based solely on our review of ACI's Application prepared in accordance with the methodology prescribed in its franchise agreement (Agreement) with the City.

I. SUMMARY AND RECOMMENDATIONS

A. Review of ACI's RP18 Rate Application (for rates effective 7/1/19)

ACI's Application calculated a revenue requirement of $22,488,645 and an incremental revenue requirement, due to growth, of $1,239,433, for a total requirement of $23,728,077 to provide current franchised services for RP18 (see Table 1).

Table 1
ACI's RP18 Rate Application

Rate Period 18 Revenue Requirement	Per Rate App.	Incremental Growth	Total
Operating Exp. Eligible for Profit			
Labor-Related Costs	$4,974,568	$1,003,940	$5,978,508
Vehicle-Related Costs	833,820	-	833,820
Organic Processing Costs	1,064,590	-	1,064,590
Incremental MRF Labor	1,483,562	-	1,483,562
Other Costs	996,817	-	996,817
Depreciation	894,061	-	894,061
General and Administrative Costs	1,279,022	-	1,279,022
Vehicle Maintenance Costs	925,672	-	925,672
Container Maintenance Costs	255,029	-	255,029
Billing Costs	294,656	-	294,656
Total Operating Exp. Eligible for Profit	**$13,001,797**	**$1,003,940**	**$14,005,737**
Profit (90% Operating Ratio)	**$1,444,644**	**$111,549**	**$1,556,193**
Pass-Through Costs			
Disposal	$2,559,628	$0	$2,559,628
Container Reimbursement	300,646	-	300,646
Franchise Fees	2,248,864	123,943	2,372,807
City Fees	1,552,455	-	1,552,455
Interest	115,861	-	115,861
Total Pass-Through Costs	**$6,777,455**	**$123,943**	**$6,901,398**
MRF Recycling Processing	**$1,154,749**	**$0**	**$1,154,749**
Rate Stabilization	**$110,000**	**$0**	**$110,000**
Balancing Account Applied	**$0**	**$0**	**$0**
Total Revenue Requirement	**$22,488,645**	**$1,239,433**	**$23,728,077**
Projected Revenue	**$20,815,206**		**$20,815,206**
Projected Revenue Surplus/(Shortfall)	**($1,673,439)**	**($1,239,433)**	**($2,912,872)**
Rate Increase/(Decrease)	**8.0%**	**6.0%**	**14.0%**

Note: Numbers may not sum exactly due to rounding.

Based on our recommended adjustments to the Application, we have determined that a total revenue requirement of $22,617,502 (including additional compensation for incremental growth of $653,830) and an increase of $283,585 to ACI's projected revenue are appropriate and consistent with the rate setting methodology described in the Agreement. These adjustments result in a 7.31% rate increase to provide the services currently required in the Agreement. HF&H's adjustments to ACI's Application are described in more detail in Section III.C below. We have reviewed our findings with ACI and they are in agreement with the proposed rate adjustment. The 7.31% rate increase to provide current franchised services is due to the following:

- **8.00%** rate impact increase due to ACI's increased operating costs to collect, process, and dispose of solid waste, recyclable material, and organic materials; this rate increase was calculated in accordance with the Agreement between the City and ACI for solid waste, recyclable material, and organic material services;
- **0.66%** rate impact increase due to increases in City fees and a reduction to the Rate Stabilization funding (e.g., AB 939 Fee, Doolittle Landfill Maintenance Fee, Infrastructure Impact Fee, etc.); and,
- **(1.35%)** rate impact decrease due to higher projected revenues in the forthcoming rate year, attributed to an increase in commercial and multi-family customers.

The following table summarizes the components of the projected rate increase (based on current rates). The City may elect to use its rate stabilization fund or funds from the Balancing Account to reduce the actual increase to the City's ratepayers.

Table 2
Components of Rate Impact

	Rate Period 17 Adjusted Compensation	HF&H Adjusted Rate Period 18 Compensation *	$ Change	YOY % Change	Rate Impact
Labor-Related Costs (Driver Wages/Benefits)	$4,775,098	$5,433,667	$658,569	13.8%	3.12%
Route Vehicle-Related Costs (Fuel/Tires/Parts)	608,123	769,161	161,038	26.5%	0.76%
Container Capital Costs	300,646	300,646	0	0.0%	0.00%
Recyclable/Organic Material Processing	3,195,995	3,659,401	463,406	14.5%	2.20%
Solid Waste Disposal	2,493,950	2,557,892	63,942	2.6%	0.30%
Admin Costs (Rent/Insurance/Customer Service)	4,696,728	5,072,608	375,880	8.0%	1.78%
Vehicle Capital Costs/Interest (CNG vehicles)	1,045,572	1,009,922	(35,650)	-3.4%	-0.17%
Subtotal Operating Costs	**$17,116,112**	**$18,803,297**	**$1,687,185**	**9.9%**	**8.00%**
Other City Fees	1,597,591	1,552,455	-45,136	-2.8%	-0.21%
Franchise Fees	2,079,300	2,261,750	182,450	8.8%	0.87%
Total Contractor Compensation	**$20,793,003**	**$22,617,502**	**$1,824,499**	**8.8%**	**8.66%**
Revenue at Current Rates	**$20,793,003**	**$21,076,589**	**$283,585**	**1.4%**	**-1.35%**
Projected Revenue Surplus/(Shortfall) RP18		**-$1,540,914**			**7.31%**

*** Includes allowance for Incremental Growth - Labor-related costs**

Note: Numbers may not sum exactly due to rounding.

II. BACKGROUND

A. General

The City issued a request for proposals for solid waste collection and disposal services, recyclables and organic materials collection, and processing services in August 2001 for services that were scheduled to commence in October 2002. With, and subsequent to, the implementation of the new Agreement, several significant changes have been made to the City's solid waste collection system including:

- Eliminating backyard solid waste collection service at no additional charge;
- Replacing customer-provided solid waste containers with carts provided by the franchisee;
- Switching from biweekly to weekly residential recyclables collection and expanding the list of acceptable materials;
- Switching from biweekly to weekly residential yard waste service and incorporating food scraps;
- Expanding the commercial yard waste collection program and incorporating food scraps;
- Adding a 96-gallon commingled recyclables collection cart and 96-gallon organics collection cart for commercial customers at no additional charge with their solid waste collection service;
- Providing a local office in Alameda;
- Providing an education program/outreach to schools;
- Collecting abandoned waste;
- Gratis integrated waste collection services at 12 City-selected special events per year;
- Collection from 100 additional public litter containers;
- Household battery and latex paint collection at ACI's local Alameda office; and,
- Establishment of the Rate Stabilization Fund.

B. Recyclable Material Commodity Revenue Share

In 2009, the City negotiated with ACI to share in the revenue received from the sale of the recyclable materials collected from the City's residents and businesses. It was agreed that such revenue generated from the sale of recyclable material shall be split as follows: (a) the amount resulting from multiplying the City Tons by the first $26 of the Average Price will belong to ACI; (b) the amount resulting from multiplying the City Tons by the amount by which the Average Price (up to $80) exceeds $26, if any, will be shared 75% by ACI and 25% by the City; and, (c) the amount resulting from multiplying the City Tons by the amount by which the Average Price exceeds $80, if any, will be shared 25% by ACI and 75% by the City.

C. Alternative Fuel Vehicles

In 2009, the City negotiated with ACI to transition the collection fleet to 100% alternative fuel vehicles. ACI successfully completed the transition to 100% alternative fuel collection vehicles in March 2013.

D. Due to / Due from ACI (Balancing Account)

In setting the rates for RP12, ACI and the City agreed to establish the Balancing Account rather than increase or decrease rates due to revenue surpluses or shortfalls and fluctuations in the Commodity Revenue Share. In RP13, the City and ACI agreed to include the difference between the projected interest for the alternative fuel vehicles calculated at 4% and the actual interest paid by ACI in the Balancing Account.

During the rate setting process for RP18, the three components of the Balancing Account were reviewed resulting in the following increases to the Balancing Account.

1) The revenue surplus for RP16 was calculated resulting in an increase of $589,420.

2) The City's RP16 share of commodity revenues resulted in an increase of $175,796.

3) An adjustment for RP16 from the reconciliation of interest paid by ACI vs. interest projected, for the financing of the alternative fuel vehicles resulted in an increase of $30,078.

The balance in the Balancing Account, through RP16, is $2,197,241 due from ACI.

Based on the preliminary review of RP17 financial data: it appears the City's projected share of the commodity revenues will drop by more than 68% due to declines in mixed paper and cardboard recycling markets; there may be a surplus of revenue due to an increase in commercial and multi-family revenues; and, the interest rate for loans from the California Pollution Control Financing Authority (CPCFA) fluctuates based on the market, but it is anticipated to be lower than the 4% used for projection. Therefore, it is anticipated the balance in the Balancing Account may be further increased as part of the RP19 rate setting process. However, should the City elect to use some or all of the funds, the Balancing Account will reflect those changes as well. The table below summarizes the Balancing Account components through RP16:

Table 3
(Due to) / Due from ACI through RP16

"Balancing Account" Summary	
"Balancing Account" through RP 15	$1,401,947
RP 16 Activity	
Add: Revenue - (Shortfall) Surplus	589,420
Add: Commodity Revenue Share	175,796
Add: Interest Expense - (Shortfall) Surplus	30,078
"Balancing Account" through RP 16	**$2,197,241**

E. Rate-Setting Process

In accordance with Article 8 of the Agreement, ACI's compensation was fixed for RP1 and RP2 and shall be adjusted annually, with City Council approval, commencing in RP3 (July 1, 2004 – June 30, 2005), through the remaining term of the Agreement, including any extension periods. The adjustments to ACI's compensation shall be determined using one of two methodologies: (1) an index-based adjustment or, (2) a cost-based adjustment (detailed rate review). The following table summarizes the methodologies to be used during each Rate Period.

Table 4
Rate Setting Methodology Schedule

Rate Year	Commencement Date	Adjustment Method
1	October 6, 2002	Not Applicable
2	July 1, 2003	Not Applicable
3	**July 1, 2004**	**Cost-Based**
4	July 1, 2005	Index-Based
5	July 1, 2006	Index-Based
6	**July 1, 2007**	**Cost-Based**
7	July 1, 2008	Index-Based
8	July 1, 2009	Index-Based
9	**July 1, 2010**	**Cost-Based**
10	July 1, 2011	Index-Based
11	July 1, 2012	Index-Based
12	**July 1, 2013**	**Cost-Based**
13	July 1, 2014	Index-Based
14	July 1, 2015	Index-Based
15	**July 1, 2016**	**Cost-Based**
16	July 1, 2017	Index-Based
17	July 1, 2018	Index-Based
18	**July 1, 2019**	**Cost-Based**
19	July 1, 2020	Index-Based
20	July 1, 2021	Index-Based

The Term of the Franchise Agreement shall continue until midnight September 30, 2022, unless terminated in accordance with Section 11.2 of the Franchise Agreement.

III. HF&H ANALYSES

A. Scope of Work

Our approach to this engagement was to work objectively to follow the compensation adjustment terms of the Agreement between ACI and the City. When performing the procedures described in the Agreement for the cost-based adjustment, we relied on the Company's audited financial statements, current year-to-date financial results of operations data, copies of transactions, reports of operations, and other information provided by ACI, ACI's proposal to the City, and industry standards.

The results of our review and our findings were documented by the HF&H staff that performed the engagement and were consequently objectively reviewed by the Engagement Manager. This documentation and subsequent HF&H adjustments were made available to the City and ACI for review. While taking direction from the City, we worked cooperatively with ACI in an open and transparent manner to ensure that they understood our procedures and preliminary findings. In this capacity, the City and ACI had the opportunity to correct any misunderstandings, and understand the reasons for any adjustments to the Application that we recommended.

HF&H staff performed this review based upon: procedures agreed upon by the City and HF&H, as documented in our proposal; and, the agreement between the City and ACI. These procedures included the following activities:

- We reviewed the Application to ensure its completeness and compliance with the methodology described in the Agreement;
- We reviewed the Application for mathematical accuracy and internal consistency. We also checked that the summary schedules agreed to the supporting schedules and worksheets;
- We verified ACI correctly calculated their RP18 compensation using the allowable expenses and the correct percentage changes in CPI in accordance with the Agreement;
- We reviewed the Application by performing: a review of revenue; a variance analysis of RP16 actual expenses to RP18; a verification of solid waste tonnage and disposal expenses; a review of organic material tonnage and processing expenses; and, a review of recyclable commodity revenue;
- We tested projected revenues to ensure that they are consistent with past trends and anticipated conditions;
- We compared actual costs to projections;
- We verified that the RP18 compensation was correctly calculated;
- We met with the City and ACI management to review the recommended adjustments to the Application described herein; and,
- We prepared a written draft and final report to document our findings and recommendations to share at the council meeting.

B. Limitations

Our review was substantially different in scope than an examination in accordance with Generally Accepted Auditing Standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion. Such a review was conducted and an opinion expressed by ACI's independent accountants V T Accounting Associates, LLP.

Our conclusions are based on the review of ACI's projections of its financial results of operations. Actual results of operations will usually differ from projections because events and circumstances frequently do not occur as expected, and the difference may be significant.

C. Review of ACI's RP18 Rate Application (July 1, 2019 – June 30, 2020)

The City engaged HF&H to perform a review of ACI's Rate Application submitted in accordance with Section 8.3.2B.3 of the Agreement. ACI submitted its application on January 7, 2019. HF&H's procedures included the following steps:

Step 1: Verification of the Mathematical Accuracy

HF&H reviewed ACI's application to determine completeness, mathematical accuracy, reasonableness, and logical consistency of the assumptions supporting the projected revenues and expenses. This included:

- Verification that all cost indices used to project expenses conformed to Section 8.3 of the Agreement;
- Verification of the mathematical accuracy of ACI's compensation adjustment calculations; and,
- Verification of the consistency and integrity of the spreadsheets housing calculations.

Findings

In a cost-based rate adjustment year, Section 8.3.2.B.5 of the Agreement requires the percentage change in the Consumer Price Indices (CPI) to be based on the most recent available month's indices. The October CPIs were available at the time the Application was submitted, ACI correctly used the annual change in the October CPIs to estimate projected RP18 costs.

HF&H noted cell reference errors that led to errors in calculations, notably in the calculation of allocated G&A, Vehicle Maintenance and Container Maintenance costs. HF&H revised the Application and the net effect to each cost component is described below.

Step 2: Determine Current Cost Components

As required by Section 8.3.2.B.5 of the Agreement, we found that ACI correctly used the allowed expenses incurred for RP16 (Vehicle-related costs, fuel, etc.) as the starting point for calculating their RP18 allowable compensation, with the exception of equipment rental expense (see Step 3: Adjust Each Cost Component below for adjustment of exception).

Step 3: Adjust Each Cost Component

Cost components were adjusted to reflect changes in CPI and other corrections and are summarized in Table 6.

Labor-Related Costs

1. Base Labor-Related Costs

ACI correctly projected union-related wages in accordance with the agreed-upon methodology described in the Second Amendment to the Agreement entered into in April 2009. In accordance with Section 8.3.2.B.5a of the Agreement, CBA-related Labor Costs shall be calculated by adjusting costs in accordance with the procedures described in the then-current CBA.

The CBA specifies that the annual cost-of-living percentage increase be determined on the basis of the CPI for the San Francisco/Oakland-Hayward, CA All items, Urban wage earners and clerical workers (CPI-U), but in no event shall such an annual percentage increase be less than 2.7% or more than 12%. Additionally, pension contributions are annually adjusted by 3.4%. In its Application, ACI used the October year-over-year change in the CPI-U to escalate labor related costs, with the exception of pension and health and welfare premiums. HF&H recalculated pension related costs using the change in the most recent month available (February year-over-year change per the union agreement) and reduced the estimated percentage change in projected pension premiums from 4.39% to 3.56%. These changes resulted in a decrease of $6,510 to pension expenses. Additionally workers compensation premiums were lower than anticipated at the time the Application was submitted resulting in a decrease of $44,529 to workers compensation expense. A decrease of $725 to payroll taxes due to a calculation errors was also noted, for a net recommended decrease of $51,764 to ACI's base labor related costs as shown in Table 5a.

Table 5a
HF&H Adjusted Base Labor-Related Costs

	ACI Rate App. Base Labor-Related Costs	HF&H Adjustments	HF&H Adjusted Base Labor-Related Costs
Rate Period 18 Revenue Requirement			
Operating Exp. Eligible for Profit			
Labor-Related Costs (include regular & pool personnel)			
Regular Wages	$2,212,174	$0	$2,212,174
Overtime Wages	180,542	-	180,542
Holiday Wages	118,509	-	118,509
Vacation Wages	130,360	-	130,360
Sick Leave Wages	118,509	-	118,509
Workers Compensation Insurance & Claims	297,398	(44,529)	252,869
Health & Welfare	832,411	-	832,411
Pension/ Retirement Benefits	819,008	(6,510)	812,498
Payroll Taxes	222,827	(725)	222,102
Union Training Fund	886	-	886
Medical Testing	3,899	-	3,899
Safety Expense	9,266	-	9,266
Uniforms/Gloves/ETC.	28,779	-	28,779
Labor-Related Costs	**$4,974,568**	**($51,764)**	**$4,922,804**

2. Incremental Growth Labor-Related Costs

Exhibit J, Section A of the Agreement provides information that shall be used in determining ACI's compensation. Section A addresses allowable personnel and labor hours and states that, in order to ensure that the City continues, over the term of the Agreement, to benefit from ACI's proposal, labor costs shall not increase as a result of an increase in the number of personnel or the number of labor hours unless ACI can demonstrate that the increased labor personnel and/or hours are necessary to provide service to additional customers due to growth in the City. In recognition of this limitation on ACI's compensation, the allowable personnel and labor hours listed in the exhibit historically have been used in determining ACI's compensation.

As part of its application, ACI proposed additional labor-related costs due to growth in certain areas. ACI provided current customer/container counts and compared them to those counts established in Exhibit J to demonstrate that growth has taken place in the City's customer base.

ACI used the percentage change in customers (container lifts) to request a corresponding percentage increase in labor-related expenses. As shown in Table 1 due to this incremental growth, ACI requested $1,003,940 in labor-related expense eligible for profit, $111,549 in profit, and $123,943 of associated franchise fees, for a total of $1,239,433 as summarized in Table 5b.

HF&H reviewed the underlying current customer counts/lifts provided by ACI and verified that additional containers have been put into service since Exhibit J was revised in 2009. We also reviewed payroll records to confirm the number of hours (regular, overtime, holiday, vacation, and sick time) and headcount ACI is currently utilizing to provide service to the City's customers. HF&H noted collectively for certain lines of business (e.g. residential solid waste) route statistics, such as lifts per route hour, were not performing to the same standard as those listed in Exhibit J of the Agreement. We reduced the number of hours to match the Agreements standard of performance for the additional customer counts/lifts. HF&H then compared the adjusted hours and headcount to the current compensation methodology outlined in Exhibit J and recommends: a <u>decrease</u> of $474,339 to the allowable incremental growth labor-related expenses; a <u>decrease</u> of $52,704 to ACI's associated profit; and, a <u>decrease</u> of $58,560 to franchise fees, as shown in Table 5b below.

Table 5b
HF&H Adjusted Incremental Growth Rate Application

	ACI Rate App. Incremental Growth	HF&H Adjustments	HF&H Adjusted Incremental Growth
Rate Period 18 Revenue Requirement			
Operating Exp. Eligible for Profit			
Labor-Related Costs (include regular & pool personnel)			
Regular Wages	$446,303	($621,730)	($175,427)
Overtime Wages	36,424	360,084	396,508
Holiday Wages	23,909	21,704	45,613
Vacation Wages	26,300	85,962	112,262
Sick Leave Wages	23,909	(18,304)	5,605
Workers Compensation Insurance & Claims	60,000	(38,646)	21,354
Health & Welfare	167,938	(128,570)	39,368
Pension/ Retirement Benefits	165,234	(126,808)	38,426
Payroll Taxes	44,866	(17,712)	27,154
Union Training Fund	187	(187)	-
Medical Testing	825	(825)	-
Safety Expense	1,960	(1,960)	-
Uniforms/Gloves/ETC.	6,087	(6,087)	-
Labor-Related Costs	$1,003,940	($493,078)	$510,863
Container Maintenance Costs	$0	$18,739	$18,739
Total Operating Exp. Eligible for Profit	**$1,003,940**	**($474,339)**	**$529,602**
Profit (90% Operating Ratio)	**$111,549**	**($52,704)**	**$58,845**
Pass-Through Costs			
Franchise Fees	$123,943	($58,560)	$65,383
Total Pass-Through Costs	**$123,943**	**($58,560)**	**$65,383**
Total Revenue Requirement	**$1,239,433**	**($585,603)**	**$653,830**
Projected Revenue Surplus/(Shortfall)	**($1,239,433)**	**$585,603**	**($653,830)**
Recommended Rate Increase/(Decrease)	**5.95%**		**3.10%**

Vehicle-Related Costs (excluding capital costs)

In Section 8.3.2.B.5b, the Agreement states that projected vehicle-related costs for the coming rate year shall equal the allowable vehicle-related costs (1) multiplied by one plus the percentage change in the Motor Vehicle Related Index, All Urban Consumers, and U.S. City Average and (2) multiplying the result of step one by the same percentage change used in step one. We reviewed and verified the reasonableness of ACI's vehicle-related expenses for each department (i.e., residential solid waste, commercial recycling, debris box, etc.) with the exception of an equipment rental expense not specified in Exhibit J and included by ACI. We verified the other vehicle-related costs were reasonable to provide services required by the Agreement and the number of routes did not exceed the maximum allowable routes in accordance with Exhibit J of the Agreement. HF&H recalculated the projected vehicle-related costs for the coming rate year and recommend a decrease of $64,659.

Organic Materials Processing Costs

Section 8.3.2.B.5d of the Agreement describes the projected cost to process organic materials shall be calculated based on the total tons of organic materials processed during the period from January 1, 2018 through December 31, 2018 multiplied by the allowable per-ton processing fee.

ACI calculated $1,064,590 of annual costs to process organic materials and based its calculation on tonnage for the period December 1, 2017 through November 31, 2018. HF&H reviewed tonnages for the allowed period January 1, 2018 through December 31, 2018 and recommends an increase of 169.56 tons to organic materials tons processed. Additionally ACI did not project the per ton organic materials processing rates as set forth in its processing agreement with BFI Newby. HF&H recalculated the processing rates according to the BFI Newby agreement, and recalculated the total processing cost using the corrected tonnage and rate information. HF&H recommends an increase of $42,436 in processing costs, for a total projected costs of $1,107,026.

Incremental Labor Materials Recovery Facility (MRF)

In 2015 ACI requested, and was granted, a special rate adjustment for the incremental costs of providing its MRF employees union wages and benefits. The incremental costs were allocated to the City based upon its portion of the recycling tons processed at the MRF. In setting the RP14 rates, it was anticipated the City would not receive franchise fees on the additional costs and ACI would not include the costs in the calculation of its profit. However, the City elected to receive its franchise fees on the additional costs in RP14. ACI requested, and the City agreed, to include the additional costs in its profit calculation commencing with RP17.

HF&H reviewed the incremental labor costs calculation of $1,483,562 for RP18 costs and recommends a decrease of $85,937 due to the following: a reduction in workers compensation premiums for the coming rate period which were not known at the time the application was submitted; and, additionally, the City's portion of shared expenses are based upon the number of tons collected. After reviewing tonnage reports provided by ACI, HF&H recommended reducing the City's percentage share of tons thereby reducing its expense.

Other Costs

In accordance with Section 8.3.2.B.5e of the Agreement, ACI calculated costs using the October CPI and applied the change in the CPI-U of 4.36% to all other operating costs (corporate overhead, billing costs, customer service labor costs, bad debt, etc.) to projected RP18 costs of $996,817. Inconsistent with the Agreement ACI included $98,533 of approved RP17 costs for the transfer and transport of the City's Organic Materials with its allowable RP16 expenses, thereby overstating its projected expenses. HF&H recalculated the transfer and transport portion of other expenses by applying the CPI-U once to the approved RP17 costs, reducing ACI's request by $4,296, to $992,520.

Depreciation

In accordance with Section 8.3.2.B.5f of the Agreement, the depreciation expense shall be the amount specified in Exhibit J, which was $0 at the commencement of the Agreement because ACI leased its vehicles. However, having purchased vehicles with City approval, ACI's Application included a depreciation expense of $894,061, the majority of which was for the purchase of new alternative fuel vehicles placed in service in the first quarter of 2013. No adjustment recommended.

Allocated Costs

Allocated costs include; General and Administrative, Vehicle Maintenance, Container Maintenance, and Billing Costs. HF&H reviewed ACI's projection of costs as prescribed by the Agreement. Due to spreadsheet cell reference errors, incorrect application of the indices to the approved RP16 allocated labor costs, and non allowed incremental growth labor costs; HF&H recalculated the allocated costs as follows:

General and Administrative – a net decrease of $20,029 due to misapplied CPI increases and an increase of $66,494 for a cell reference error (the applicable Health and Welfare expenses for the department was not included). HF&H recommends a net increase of $46,465 to General and Administrative expenses.

Vehicle Maintenance – a decrease of $2,334 for non allowable equipment rental expense, an increase of $26,473 due to errors in the application of CPI increases, a decrease of $70,612 due to a cell reference error (disposal expenses not attributable to the department were included), and a decrease of $85,506 due to a duplicate profit calculation. HF&H recommends a net decrease of $131,979 to Vehicle Maintenance expenses.

Container Maintenance - a decrease of $1,423 for non allowable equipment rental expense, an increase of $18,739 for incremental growth, a decrease of $208 due to errors in the application of CPI increases, a decrease of $1,423 for a reduction in the workers compensation premium not known at the time of the application, and a decrease of $25,426 for a duplicate profit calculation. HF&H recommends a net decrease of $9,740 to Container Maintenance expenses.

Billing Costs - a decrease of $42,426 for non allowable incremental growth expenses and a decrease of $4,026 due to errors in the application of CPI increases. HF&H recommends a net decrease of $46,452 to Billing expenses.

Profit

We found that ACI correctly calculated its allowable profit by applying a 90% operating ratio (approximately a 10% profit) to its allowable operating costs; however, due to the calculated adjustments described above, we recommend an $88,778 decrease to ACI's profit.

Disposal

Section 8.3.2.B.7a of the Agreement states the projected cost to dispose of solid waste is calculated based on the total tons of solid waste collected during the period from January 1, 2018 through December 31, 2018 multiplied by the projected per-ton disposal fees at the City-designated disposal facility (Waste Management Inc.'s (WMI) Davis Street Transfer Station).

ACI calculated annual disposal costs of $2,559,628, basing its calculation on tonnage for the period December 1, 2017 through November 31, 2018. HF&H reviewed tonnages for the allowed period January 1, 2018 through December 31, 2018 and recommends an increase of 34.37 tons to solid waste tons disposed. Additionally ACI did not project the per ton disposal rate as set forth in the City's agreement with Waste Management Inc. HF&H recalculated the per-ton disposal fee in accordance with the Agreement. The per-ton rate decreased from the projected $93.41 per ton to $93.23 per ton, resulting in a net decrease to the annual RP18 disposal cost of $1,736.

Interest Expense

Section 8.4.5.C.2 of the Agreement states interest expense shall be zero. However, ACI's Application included an interest expense of $115,861 to reflect a previously agreed-upon interest expense from the purchase of alternative fuel vehicles that were put in place the first quarter of 2013. For projection purposes, ACI has assumed an annual interest rate of 4%. ACI has financed the purchase of new alternative fuel vehicles using loans from the California Pollution Control Financing Authority (CPCFA). The CPCFA assists California businesses with the acquisition of qualified pollution-control equipment. The interest rate fluctuates based on the market. HF&H recalculated the interest expense using the 4% annual interest rate and recommends no adjustment to interest expense.

The City and ACI agreed to make an adjustment to ACI's future compensation based on the actual interest paid by ACI. The difference between the interest calculated at 4% and the actual interest paid is part of the annual revenue reconciliation. See Section II Subsection D (Due to / Due from ACI – Balancing Account) of this report for the results of RP16 Interest reconciliation.

Container Reimbursement – Replacement Cap

ACI included $300,646 for container replacement costs in RP18. The City and ACI agreed (during the RP11 rate negotiations) to limit (cap) the annual container purchases to $300,646 (based on the average purchases during the previous three-year period). ACI is responsible for reporting actual container purchases to the City on a quarterly basis. It was further agreed that should ACI spend less than the cap, the amount would be netted against the cap in the current expense projection. ACI spent more than the cap amount in RP16; therefore, there were no savings to net against the RP18 allowable cap of $300,646. No adjustment recommended.

Pass-Through Franchise Fees and Other City Fees

Other City Fees: Other City Fees (e.g., AB939 Fee, Infrastructure Impacts Mitigation Fee, Doolittle Landfill Maintenance Fee, and City Parks Fee) will increase by the change in CPI-U. ACI correctly used the October change in CPI-U (4.36%) to calculate RP18 City Fees. No adjustment recommended.

Rate Stabilization Fund: In RP12, the City established a rate stabilization fund to reduce future rate volatility. The Rate Stabilization Fund is currently being funded at $110,000 per year. ACI included the continued funding in its Application. Per direction received from City Staff HF&H removed the funding for RP18 to utilize the fund as intended and mitigate the proposed RP18 rate increase.

Franchise Fees: According to Article 7 of the Agreement, ACI is required to remit Franchise Fees and Other City Fees to the City. Franchise Fees have been calculated at 10% of gross revenues. HF&H recommends decreasing franchise fees by a net $111,058 as a result of the recommended decreases in Operating Expenses Eligible for Profit, Operating Profit, and the Pass-Through Costs.

Recyclable Materials Processing Costs

MRF Processing Costs: In Section 8.3.2.B.2p and Exhibit J, Section E of the Agreement, projected recyclable material processing costs for the coming rate year shall equal the allowable recyclable material processing costs approved last year multiplied by one plus the percentage change in the CPI-W (4.39%). No adjustment recommended.

Balancing Account Applied

In setting the rates for RP12, ACI agreed to establish the Balancing Account rather than increase or decrease rates due to revenue surpluses or shortfalls and fluctuations in the Commodity Revenue Share. In RP13 the City and ACI agreed to include the difference between the projected interest for the alternative fuel vehicles calculated at 4% and the actual interest paid by ACI in the Balancing Account (Section II Subsection D of this report). ACI included $0 from the balancing account in its RP18 Application to provide a one-time reduction to its Revenue Requirement. Due to the uncertainties of the impact on revenues from the full implementation of AB1826 and SB1383, and the volatility of revenue from the sale of recyclable materials, the City has elected to maintain the Balancing Account at the current level and is in agreement with the $0 included in the Application. Therefore HF&H proposes no adjustment.

Step 4: Determine Projected Revenue at Current Rates

As required by Section 8.6 of the Agreement, "the City shall use its best efforts to set rate ceilings so as to generate sufficient revenues to cover Contractor's Compensation, etc."

Current revenue is used to project future revenue, which is then used to calculate the necessary rate adjustment to generate sufficient revenue to cover the approved projected costs. ACI based its requested increase on assumed current year's revenue of $20,815,206. HF&H reviewed the reasonableness of ACI's method of calculating its increase.

Several methods of projection are used in the industry for projecting future revenue. One method is based upon subscription levels. The subscription method is representative of a point in time and does not capture fluctuations in service due to seasonality or economic conditions. Another method uses several months of current revenue annualized using the average for the remaining months of the year. This method will catch fluctuations depending on the number of months sampled.

HF&H is recommending using 6 months of actual revenue (July 2018 through December 2018), provided by ACI, and annualizing using the average of the 6 months for the remaining year ($21,076,589). The recommended 7.31% increase is based on the likelihood that revenue for RP18 will achieve, at a minimum, an amount that will cover the Contractor's Compensation.

Should revenues exceed or fall short of the approved Contractor Compensation requirement, a reconciliation process will take place in the subsequent rate period.

Step 5: Adjusted Revenue Requirement

The following tables summarize: 1) ACI's requested revenue requirement of $23,728,077 (including incremental growth of $1,239,433) to provide current franchised services for RP18 (see Table 1, 2, and 5) HF&H's adjusted Application (see Table 6). Based on our recommended adjustments to the Application described in Section III of this report, we have determined that a total revenue requirement of $22,617,502 (a decrease of $1,110,575 from ACI's Application) is appropriate and a recommended 7.31% increase is consistent with the rate-setting methodology described in the Agreement.

Table 6
HF&H Adjusted Rate Application

	RP18 Revenue Requirement Per Rate App.	Incremental Growth Per Rate App.	HF&H Adjustments	HF&H Adjusted Rate App.
Rate Period 18 Revenue Requirement				
Operating Exp. Eligible for Profit				
Labor-Related Costs	$4,974,568	$1,003,940	($544,841)	$5,433,667
Vehicle-Related Costs	833,820	-	(64,659)	769,161
Organic Processing Costs	1,064,590	-	42,436	1,107,026
Incremental MRF Labor	1,483,562	-	(85,937)	1,397,625
Other Costs	996,817	-	(4,296)	992,520
Depreciation	894,061	-	-	894,061
General and Administrative Costs	1,279,022	-	46,465	1,325,487
Vehicle Maintenance Costs	925,672	-	(131,979)	793,693
Container Maintenance Costs	255,029	-	(9,740)	245,289
Billing Costs	294,656	-	(46,452)	248,204
Total Operating Exp. Eligible for Profit	**$13,001,797**	**$1,003,940**	**($799,004)**	**$13,206,733**
Profit (90% Operating Ratio)	**$1,444,644**	**$111,549**	**($88,778)**	**$1,467,415**
Pass-Through Costs				
Disposal	$2,559,628	$0	($1,736)	$2,557,892
Container Reimbursement	300,646	-	-	300,646
Franchise Fees	2,248,864	123,943	(111,058)	2,261,750
City Fees	1,552,455	-	-	1,552,455
Interest	115,861	-	-	115,861
Total Pass-Through Costs	**$6,777,455**	**$123,943**	**($112,793)**	**$6,788,605**
MRF Recycling Processing	**$1,154,749**	**$0**	**$0**	**$1,154,749**
Rate Stabilization Fund	**$110,000**	**$0**	**($110,000)**	**$0**
Balancing Account Applied	**$0**	**$0**	**$0**	**$0**
Total Revenue Requirement	**$22,488,645**	**$1,239,433**	**-$1,110,575**	**$22,617,502**
Projected Revenue	**$20,815,206**	**$0**	**$261,382**	**$21,076,589**
Projected Revenue Surplus/(Shortfall)	**($1,673,439)**	**($1,239,433)**	**$1,371,957**	**($1,540,914)**
Recommended Rate Increase/(Decrease)	**8.04%**	**5.95%**		**7.31%**

Note: Numbers may not sum exactly due to rounding.

SECTION IV. SURVEY OF COMPARABLE RATES

Attachment 1 shows the results of HF&H's survey of solid waste rates for jurisdictions located throughout Alameda County. We have applied the recommended rate increase of 7.31% specific to each service level for purposes of comparing ACI's rates to other jurisdictions. It should be noted that some of the comparable jurisdictions will be considering rate increases either July 1, 2019 or January 1, 2020, but they are unknown at this time. We understand the City is considering using a portion of the balancing account and/or rate stabilization fund to reduce the actual increase to rates. Therefore, the Proposed Rates for the City may be higher than the final approved rates.

Residential rates for a 30-35 gallon container range from $18.92/month (Emeryville) to $84.60/month (Piedmont), while ACI's proposed rate is $43.21/month. Commercial rates for a 1-yard bin serviced one time per week range from $100.71/month (Fremont) to $294.07/month (Castro Valley Sanitary District), while ACI's proposed rate is $164.61/month.

We caution the City that this survey is presented for information only. The City should not draw conclusions from this information because rate comparisons are intrinsically difficult and often misleading. This difficulty results from differences in items such as:

- Services provided by ACI that may not be provided (or only partially provided) to other jurisdictions;
- The terrain in which the service is performed;
- Disposal costs;
- Rate structures (as illustrated in the rate survey where three jurisdictions have higher 32-gallon rates than Alameda's proposed 32-gallon rate; however, five jurisdictions have a higher rate for commercial 1 cubic yard bin serviced once per week); and,
- Governmental fees (e.g., franchise fees, vehicle impact fees, etc.)

* * * * *

We would like to express our appreciation to ACI's management and staff for their assistance. In addition, we express our appreciation to you for your assistance and guidance during the course of the review. Should you have any questions, please contact Marva Sheehan directly at (925) 977-6961 or msheehan@hfh-consultants.com.

Very truly yours,
HF&H CONSULTANTS, LLC

Marva M. Sheehan, CPA
Vice President

Colleen A. Costine
Senior Associate

cc: HF&H Client Files

ATTACHMENT 1:
ALAMEDA COUNTY RATE SURVEY

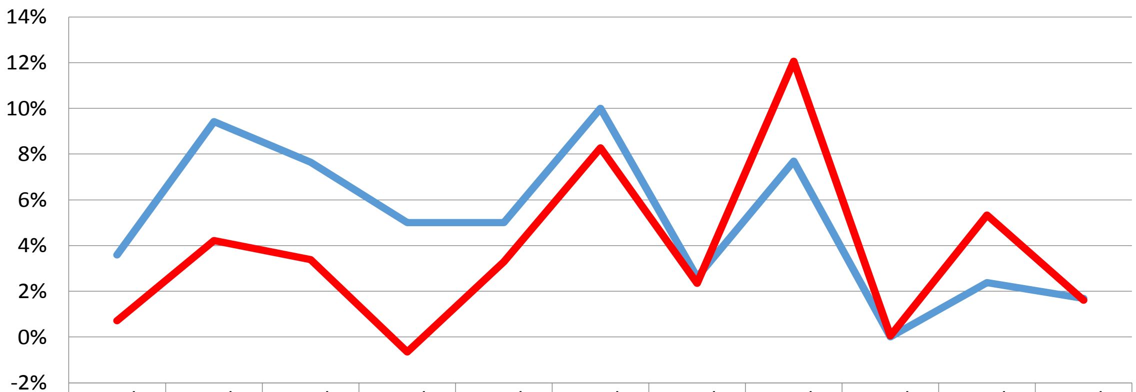
	Residential Single - Family				Commercial			
Jurisdiction	20-Gal.	30-35 Gal.	60-64 Gal.	90-96 Gal.	1 YD Bin 1X/Week	1YD Bin 3X/Week	3 YD Bin 1X/Week	3 YD Bin 3X/Week
City of Alameda - Current	$31.90	$40.27	$66.17	$92.41	$153.40	$469.39	$460.20	$1,408.17
City of Alameda - Total Proposed	**$34.24**	**$43.21**	**$71.00**	**$99.17**	**$164.61**	**$503.70**	**$493.84**	**$1,511.11**
City of Albany	$38.09	$42.65	$73.72	$104.77	$169.95	$509.85	$509.85	$1,529.55
City of Berkeley	$26.25	$41.98	$83.91	$125.82	$167.07	$470.74	$462.36	$1,373.34
City of Dublin	N/A	$26.09	$47.93	$69.76	$126.59	$442.77	$379.77	$1,202.31
City of Emeryville	$11.43	$18.92	$37.84	$56.75	$107.78	$323.34	$323.34	$970.02
City of Fremont	$34.04	$34.77	$38.12	$55.93	$100.71	$289.69	$226.39	$666.69
City of Hayward	$23.02	$33.64	$59.99	$86.32	$143.08	$387.89	$368.63	$1,017.38
City of Livermore	$29.03	$38.42	$57.54	$90.41	$116.72	$364.16	$350.16	$1,115.62
City of Newark	$29.30	$32.56	$57.68	$82.77	$131.95	$411.70	$349.10	$952.03
City of Oakland	$41.54	$47.17	$83.26	$125.13	$230.70	$692.03	$549.39	$1,648.11
City of Piedmont	$79.84	$84.60	$116.55	$130.52	$216.20	$648.60	N/A	N/A
City of Pleasanton	N/A	$26.06	N/A	$45.48	$116.72	$370.53	$350.16	$1,091.18
City of San Leandro	$24.01	$29.91	$49.79	$69.64	$131.15	$396.53	$396.53	$1,189.58
City of Union City	$42.93	$50.31	$87.23	$124.09	$153.17	$423.06	$401.39	$1,093.91
Castro Valley Sanitary District	$26.68	$41.37	$71.80	$102.26	$294.07	$882.31	$782.32	$2,192.12

Note: Oro Loma Sanitary District is not included in the survey; Oro Loma customers receive bi-weekly recycling service, while all other jurisdictions represented above receive weekly service.

(MONTHLY RATES IN EFFECT AS OF MARCH 2019)

ATTACHMENT 2:
HISTORICAL RATES VERSUS REVENUE

Rates versus Revenue



	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
	3.59%	9.42%	7.65%	5.00%	5.00%	10.00%	2.62%	7.70%	0.00%	2.38%	1.68%
	0.71%	4.23%	3.38%	-0.65%	3.29%	8.28%	2.35%	12.07%	0.05%	5.33%	1.61%

Rate Increase Change in Revenue

Revenue change % for 2018/19 is based on projected revenue.

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