

San Francisco Rate Application

COST OF LIVING ADJUSTMENT (COLA) MECHANISM

Prepared by:

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On behalf of:

Recology Sunset Scavenger, Recology Golden Gate and Recology San Francisco

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I. Introduction

This report summarizes the Cost of Living Adjustment (COLA) mechanism that is included in the Companies' rate application for the Rate Year July 1, 2017 through June 30, 2018. The COLA Mechanism would be applied to all subsequent rate years until new rates are set as a result of a rate proceeding. The Companies have filed a rate application using their projected costs for the rate year ending June 30, 2018. The COLA would be applied to future rate years in order to produce additional revenue sufficient to account for inflationary increases in the Companies' costs. Without the COLA, the Companies would likely need to submit notice of a new rate application by the end of rate year 2018.

The COLA proposed by the Companies is based on the COLA approved by the Director of the Department of Public Works ("the Director") in 2001 and incorporated into the rates for the period 2002 - 2006 and carried over, with a modification to include a fuel index, for the rate period 2007 - 2011, then subsequently modified to better reflect current labor contractual requirements and a separate Health & Welfare component for the rate period 2012 - 2017. The Company is not recommending any modifications to the COLA structure other than including Pension expense as a component of fixed versus variable labor. This change from the approved 2013 COLA mechanism is consistent with previous rate filings and reflects management's belief that Pension expense, as a component of the current labor agreements is more fixed in nature and should be reflected as such in the annual COLA calculation. This modification, along with updated expenses included in the rate application, require an adjustment of the COLA component weighting. Table 1 provides the calculated COLA weight rate for each of the components. For illustrative purposes only, a weighted COLA was calculated for rate years 2017 and 2018.

II. The COLA Methodology Used in Previous Rate Submissions

In the 2001 Director's Report, the Director followed the Department of Public Works (DPW) Staff's recommendation and approved a Cost of Living Adjustment (COLA) proposed by the Companies using a three component weighting system (first three bulleted components noted below). That COLA modified rates so as to recover cost increases resulting from inflation over the five-year rate period 2002-2006. In the subsequent rate submission, the COLA mechanism was modified to include both fuel and capital cost indexes (Bullets four and five noted below). That COLA modified rates to cover cost increases over the five-year rate period 2007 - 2011. In 2013, the COLA mechanism was modified to include a separate Health and Welfare component as well as tie future labor related COLA adjustments to the new labor agreement. The 2013 COLA mechanism modified rates to cover cost increases over the five-year rate period 2012 – 2016.

The COLA mechanism approved during the last rate proceeding includes the following components:

- A fixed labor cost inflation rate reflecting the Companies fixed labor contracts.
- A variable cost inflation rate based on the Consumer Price Index for Urban/San Francisco ("CPI-U/SF")

- A variable materials cost inflation rate based on the Producer Price Index for Industrial Commodities ("PPI").
- A California Diesel Fuel Index
- Capital cost - zero inflation

- Health & Welfare cost inflation rate based on a five-year historical weighted average as calculated by the Companies third-party insurance carrier

The weights assigned to these components were designed to reflect the proportions associated with the types of cost incurred by the Companies, and therefore to reflect the expected increases the Companies were to incur due to inflation.

III. Modifications of the COLA

The Companies are not proposing the addition of any new components to the COLA mechanism in this Rate Order. The one proposed change is to allocate pension related costs as a component of the fixed labor attribute. Under the current labor agreement, the Company must make an annual minimum fixed payment that is not based on any variable attribute but rather by employee. The Companies do not anticipate material variation in the number of employees and, accordingly, consider pension costs largely fixed in nature. This is consistent with the previous rate filings.

IV. Calculation of Weights

The COLA is a composite inflation factor that is calculated as the weighted average of the specific inflation indices. As the weights reflect the Companies' projected costs as they are included in the rate application, the COLA will correctly adjust the rates for inflation in costs. The COLA weights have been calculated based on the estimated costs of the rate year July 1, 2017 - June 30, 2018. Once approved, the component weights will not change for the duration of the period until a new rate is approved.

V. Conclusion

The Companies believe the City should adopt the proposed modification to the COLA mechanism and include pension cost as an allocation within fixed costs. Under the current labor agreement, the Company must make a minimum pension contribution annually not based on hours worked or other variable attributes but rather by employee, working or not. Applying the COLA with pension reflected as a fixed cost will allow the Companies to recover inflationary increases during interim periods before new rates are set.

**Recology Sunset Scavenger/ Recology Golden Gate
Historical COLA Increases**

Table 1. COLA Mechanism with H & W with Fixed Labor Inflation Factor at 2.75%

	1	2	3
	2016	2017	2018
1 Year Ending June 30			
2 Fixed Labor Inflation Factors (a)		2.75%	2.75%
3 Fixed Labor COLA Rate Weight		59.18%	57.94%
4 Weighted Fixed COLA Increase (line 2 x line 3)		1.63%	1.59%
5 Variable Labor COLA Rate (b)			
6 SF-CPI (U) Index February 2016	262.600		
7 SF-CPI (U) Index February prior to Rate Year		270.531	278.701
8 Annual Percent Change From March- February		3.02%	3.02%
9 Variable COLA Rate Weight		6.50%	7.43%
10 Weighted Variable COLA Increase (line 8 x line 9)		0.20%	0.22%
11 Variable H & W Rate (c)			
12 Mercer Analysis		5.50%	5.50%
13 Variable COLA Rate Weight		12.29%	12.16%
14 Weighted Variable COLA Increase (line 12 x line 13)		0.68%	0.67%
15 Variable Materials PPI Rate (d)			
16 PPI Index February 2016	191.800		
17 PPI Index February prior to Rate Year		187.964	184.205
18 Annual Percent Change From March- February		-2.00%	-2.00%
19 Variable PPI Rate Weight		13.52%	14.73%
20 Weighted Variable PPI Increase (line 18 x line 19)		-0.27%	-0.29%
21 Diesel Fuel Forecasted Rate (e)			
22 EIA Diesel Fuel Price February 2016	2.399	2.944	2.944
23 Annual Percent Change From March- February		22.72%	22.72%
24 Fuel Rate Weight		2.44%	2.40%
25 Weighted Forecasted Fuel Increase (line 23 x line 24)		0.55%	0.55%
26 Capital Cost Inflation Factor			
27 Capital cost assumed to be constant			
28 Annual Percent Change From March- February		0.00%	0.00%
29 Cost of Capital Weight		6.07%	5.33%
30 Weighted Forecasted Fuel Increase (line 28 x line 29)		0.00%	0.00%
31 COLA Increase (Lines 4+10+14+20+25+30)		<u>2.78%</u>	<u>2.74%</u>

Notes:

(a) 2.75% has been used base on current collective bargaining agreements which provide for a range between 2.25% and 3.25% for 2017 - 2018 based on CPI for the Bay Area.

(b) The Bureau of Labor Statistics (BLS) Index San Francisco-Oakland-San Jose Consumer Price index - All Urban Consumers, All items, 1982-84=100, Series ID: CUURA422SA0 will be provided for in each year. The use of the April index number assumes that the rate increase is in effect July 1. The example above uses the twelve months ending February 262.600/254.910).

(c) The Vairable H & W index was developed by MERCER. MECER received historical rate data that included fully insured medical and dental renewal rate increase as well as the self insured medical fully equivalent rate increases for the years 2012-2016. The rates related to medical and dental plans cover Recology's active San Francisco population.

(d) The BLS Index Producer Price Index-Industrial Commodities les Fuels, Base: 1982 Series ID: WPU03T15M05 will be provided for in each year. The use of the April index number assumes that the rate increase is in effect July 1. The example above uses twelve months ending February.

(e) The U.S. Energy Information Administration, Petroleum & Other Liquids, Weekly California No 2 Diesel Retail Prices will be provided for in each year. The use of the April index number assumes that the rate increase is in effect July 1. The example above uses twelve months ending February.

Recology Sunset Scavenger/Recology Golden Gate Summary COLA Weights

Percentage Weights for Combined Companies

	Weights RY 2017			Weights RY 2018		
	Unadjusted	Adjustment	Adjusted	Unadjusted	Adjustment	Adjusted
1 Fixed COLA Adjustment Factor (Fixed Labor)	59.18%		59.18%	57.94%		57.94%
2 Variable COLA Adjustment Factor (Variable Labor)	6.50%		6.50%	7.43%		7.43%
3 Health and Welfare	12.29%		12.29%	12.16%		12.16%
4 Variable PPI (Materials)	13.52%		13.52%	14.73%		14.73%
5 Fuel	2.44%		2.44%	2.40%		2.40%
6 Total	93.93%	0.0%	93.93%	94.66%	0.0%	94.66%
7 Capital Costs	6.07%		6.07%	5.33%		5.33%
8 Total Capital	6.07%	0.0%	6.07%	5.33%	0.0%	5.33%
9 Total Percentage COLA	100.00%		100.00%	99.99%		99.99%

**Recology Sunset Scavenger/Recology Golden Gate
 Percentage Weighted Allocated Expenses Summary**

RSF COLA Rate Weight

	Fixed Labor	Variable Labor	H & W	Other Material	New Capital	Fuel	Existing Capital
RY 2017	48.67%	12.76%	11.59%	22.84%	0.00%	2.70%	1.45%
RY 2018	45.48%	14.33%	10.71%	25.32%	0.00%	2.42%	1.73%

RSS and RGG Combined - COLA Rate Weight

	Fixed Labor	Variable Labor	H & W	Other Material	New Capital	Fuel	Existing Capital
RY 2017	59.18%	6.50%	12.29%	13.52%	0.00%	2.44%	6.07%
RY 2018	57.94%	7.43%	12.16%	14.73%	0.00%	2.40%	5.33%

Calculate the COLA Rate Weight for RSF, SSC/GGD Combined

SF Recycling & Disposal COLA Rate Weight

	Fixed Labor	Variable Labor	H & W	Other Material	Fuel	Existing Capital	Total
RY 2017	48.67%	12.76%	11.59%	22.84%	2.70%	1.45%	100.01%
RY 2018	45.48%	14.33%	10.71%	25.32%	2.42%	1.73%	99.99%

RSF Processing & Disposal Costs	Total From spreadsheet	Fixed Labor	Variable Labor	H & W	Other Material	Fuel	Existing Capital	Total
RY 2017	119,641,925	58,231,348	15,263,821	13,863,790	27,330,447	3,224,920	1,727,598	119,641,925
RY 2018	138,648,662	63,057,644	19,873,809	14,852,925	35,099,872	3,360,523	2,403,889	138,648,662

RSS and RGG Alloc disposal costs	SSC I/C disp & proc costs	Fixed Labor	Variable Labor	H & W	Other Material	Fuel	Existing Capital	Total
RY 2017	106,028,786	51,604,210	13,529,273	12,288,736	24,216,975	2,862,777	1,537,417	106,039,389
RY 2018	125,403,836	57,033,665	17,970,370	13,430,751	31,752,251	3,034,773	2,169,486	125,391,296

RSS & RGG Costs	Fixed Labor	Variable Labor	H & W	Other Material	Fuel	Existing Capital	Total
RY 2017							
Expenses before recycling alloc (from SS tab)	112,344,510	4,473,968	21,749,273	13,238,622	3,890,304	15,282,831	170,979,509
Allocated I/C disp & proc costs	<u>51,604,210</u>	<u>13,529,273</u>	<u>12,288,736</u>	<u>24,216,975</u>	<u>2,862,777</u>	<u>1,537,417</u>	<u>106,039,389</u>
Total	163,948,721	18,003,241	34,038,009	37,455,597	6,753,081	16,820,249	277,018,898
COLA Rate Weight	59.18%	6.50%	12.29%	13.52%	2.44%	6.07%	100.00%
RY 2018							
Expenses before recycling alloc (from SS tab)	122,698,809	5,079,457	24,301,673	13,939,493	4,418,155	14,369,117	184,806,704
Allocated I/C disp & proc costs	<u>57,033,665</u>	<u>17,970,370</u>	<u>13,430,751</u>	<u>31,752,251</u>	<u>3,034,773</u>	<u>2,169,486</u>	<u>125,391,296</u>
Total	179,732,474	23,049,827	37,732,424	45,691,745	7,452,928	16,538,603	310,198,001
COLA Rate Weight	57.94%	7.43%	12.16%	14.73%	2.40%	5.33%	100.00%