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Agenda Item: ID16-207 (3-B)

Date: 2/25/16

CITY CLERK, FRESNO, CA

## FRESNO CITY COUNCIL



### Supplemental Information Packet

Agenda Related Item(s) – ID16-207 (3-B)

### Contents of Supplement: Memo from City Manager and Director of Public Utilities

#### Item(s)

Actions pertaining to processing of co-mingled recyclables (Citywide)

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DEPARTMENT OF PUBLIC UTILITIES  
MEMORANDUM

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CITY CLERK, FRESNO CA



Providing Life's Essential Services

DATE: February 24, 2016

TO: HONORABLE MAYOR ASHLEY SWEARENGIN  
COUNCIL PRESIDENT PAUL CAPRIOGLIO  
COUNCILMEMBERS

THROUGH: BRUCE A. RUDD, City Manager  
City Manager's Office

FROM: THOMAS C. ESQUEDA, Director  
Department of Public Utilities

SUBJECT: Preliminary Assessment of Recyclable Materials Processing  
Contracts

The purpose of this memorandum is to provide a preliminary assessment of the Recyclable Materials Processing Contracts that are scheduled for Council consideration on February 25, 2016. Based on a review the contracts, as presented in the Council Agenda for February 25, 2016, it is strongly recommended that the Council reject the Recyclable Materials Processing Contracts and issue a new Request for Proposal (RFP) as was recommended by the City Manager on December 10, 2015.

This recommendation is based on the process in which these agreements were negotiated, the introduction of new and onerous conditions that will negatively impact the actual cost of these agreements, and a new rate structure that is considerably less than what was offered on October 8, 2015 (\$10.00 per ton floor rate down to a \$1.00 per ton floor rate). **As structured, the resulting rated represents a net revenue loss of \$2.7 million over the next 10 years.**

## BACKGROUND

On October 8, 2015, the Director of Public Utilities presented a recommendation to the Fresno City Council to award a Recyclable Materials Processing Contract to Mid-Valley Disposal. The Director's recommendation was to award 100% of the City's residential recyclable materials (approximately 30,000 tons per year) to Mid-Valley Disposal for a term of 10 years, with revenue paid to the City using an indexed-based pricing structure. As proposed, the City would have received, at a minimum, \$3 million over the life of the contract for the value of its recyclables, which would be used to help mitigate the cost of providing residential recycling services and future rate increases.



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Mid-Valley Disposal’s proposed compensation to City was based on a Floor Price of \$10 per ton and an additional 40-cents per ton for every dollar the recyclable materials commodity price increased above \$130 per ton. The proposed reference index was the PPI Recovered Paper – Export, and the commodity designation was Mixed Paper (2) – OBM LA. The number two bidder for the recyclable materials processing contract was Cedar Avenue Recycling and Transfer Station, LP (CARTS). CARTS’ proposed compensation to the City was based on a fixed-price structure of \$7.50 per ton, which equates to \$2.25 million over the life of the contract.

The bids from Mid-Valley Disposal and CARTS were received through a sealed-bid, competitive selection process, and the RFP document included information regarding the percentage of contamination present in the City’s recyclable materials that should be used in the preparation of a vendor’s (see attached).

On December 10, 2015, the Fresno City Council set aside the City Manager’s recommendation to issue a new RFP as the previous RFP was terminated on October 21, 2015, due to concerns related to the previous process as well as Council’s desire to materially alter the scope of services, including a splitting of material between two vendors. The Council disregarded the recommendation of the DPU Director and the City Manager and subsequently directed the City Attorney’s Office to negotiate new agreements with Mid-Valley Disposal and CARTS, based on each vendor receiving approximately 50% of the City’s recyclable materials, provided that CARTS would match the rate being offered by Mid Valley.

As is outlined below, the rates now being considered are not consistent with the direction given by Council on December 10, 2015, in that both vendors have reduced their rates considerably from \$10.00 to \$1.00 per ton. In addition, the proposed contracts include conditions related to contamination levels that should not be accepted as currently presented in the contracts. If the contamination rate varies from the 25-percent specified in the RFP, then the City should be provided a period of time to cure, and provisions allowing the vendor to reject loads based on contamination levels should be removed.

A comparison of the October 8, 2015, recommendation and the February 25, 2016 recommendation for recyclable materials processing is presented in Table 1.

**Table 1 - Comparison of Proposed Compensation  
Recyclable Materials Processing Contract**

Commodity Price Schedule (1)		Proposed Compensation (\$/ton), 2/25/2016	Proposed Compensation (\$/ton), 10/08/2015	
\$ -	\$109.99	\$1.00	\$10.00	\$10.00
\$110.00	\$119.99	\$2.00	\$10.00	\$10.00
\$120.00	\$129.99	\$3.00	\$10.00	\$10.00

\$130.00	\$139.99	\$5.00	\$10.00	\$14.00
\$140.00	\$149.99	\$7.50	\$14.00	\$18.00
\$150.00	\$159.99	\$9.50	\$18.00	\$22.00
\$160.00	\$169.99	\$12.00	\$22.00	\$26.00
\$170.00	\$179.99	\$14.00	\$26.00	\$30.00
\$180.00	\$189.99	\$16.00	\$30.00	\$34.00
\$190.00	\$199.99	\$18.00	\$34.00	\$38.00
\$200.00	\$209.99	\$20.00	\$38.00	\$42.00

(1) **Commodity Market:** PPI Recovered Paper - Export, Mixed Paper (2) - OBM LA

**COST FACTORS**

For any solid waste material processing agreements, whether it is for recyclables or other materials, vendors consider the following three factors whenever they are preparing price proposals for competitive bids:

**The conditions of commodity markets**

Commodity markets are constantly changing, and in some state of a falling or rising cycle. Recyclable materials are, by definition, raw materials that are used for the manufacturing and production of other goods and products. As raw materials for other goods and products, recyclable material prices are subject to the same supply and demand market forces that affect all other commodities. When a vendor prepares a price proposal, the vendor evaluates the current condition of the commodity markets, makes a determination of future market conditions, and submits a price that balances the vendor’s forecast of commodity market prices with the vendor’s tolerance for financial risk. The vendor’s tolerance for financial risk is a function of the vendor’s financial strength. Therefore, the length of an agreement is important as it relates to the mitigation of risk and the opportunity of strong market conditions that drive commodity prices upwards.

**Vendors’ ability to absorb the fluctuations in commodity prices**

Due to nature of these markets a vendor will prepare a market forecast based on number of commodities in question (e.g., paper, plastic, glass) and the length of an agreement (e.g., how many, and how long). The vendor’s forecast will include an estimate of when, and how long, commodity prices may fall below the vendors targets/floor. During these periods – when prices are below a vendor’s targets – the vendor will rely on their financial reserves to get through the downward pressure on commodity prices. Generally, the stronger the financial health of a vendor, the more aggressive the per-ton pricing that can be offered. This is not unlike other markets, where vendors are constantly competing with each other on pricing, and some competitors attempt to undercut the competition to capture greater market share by

temporarily reducing their profit margin or calling on financial reserves. This is a common free-market principle resulting in the survival of the fittest.

### **The volume of material offered for sale**

As raw materials for goods and products, recyclable materials are sold on the open market to buyers of such materials. Some buyers are domestic and some buyers are foreign. When preparing a bid price for recyclable materials (e.g., price per ton to purchase), the vendor must factor in the internal costs for such items as capital, labor, transportation, overhead, and profit. The cost per ton offered has to be sufficient to cover these and other costs over the term of the contract – recognizing that market prices will rise and fall during term of the contract. As with any commodity sold on the open market, the more units a vendor has available to sell, the more favorable the pricing offered by buyers, and the more units a vendor sells, the more revenue a vendor generates to recover costs for capital, labor, transportation, overhead, and profit. The recyclable material market is sensitive to volume – the more volume available, the more favorable the pricing.

### **Findings**

The unit-price reduction observed between October 8, 2015 and February 25, 2016 (140 days) for recyclable materials is a classic illustration of how short term factors can influence vendor pricing for recyclable materials that can adversely impact ratepayers. Specifically, the downward pressure that currently exists in the commodity markets and the reduction in the amount of material offered to the vendors. No assessment can be made regarding how, if at all, the financial strength of the two vendors factored into the revised price reduction. However, this could be readily evaluated through a new request for proposal solicitation, which can also evaluate other factors, such as the price of transportation, which has benefited from a significant drop in fuel prices prior to and since the City received proposals in June of last year.

### **CONSIDERATION OF RATE PAYERS**

It appears that both agreements have been structured to mitigate the level of risk potentially borne by the vendors, which is reflected in the cost per unit and other conditions not contained in the original RFP. Conversely, it is as equally, if not more important to recognize that the City of Fresno requires ratepayers to expend personal effort to source-separate their waste materials from their recyclable materials at their individual homes. This is an important task, which contributes significantly to the rates that our residents pay as well as the City's ability to comply with State mandates for waste diversion.

Therefore, the City has a fiduciary responsibility to our rate payers, who have a vested interest in how these agreements are managed, to maximize the amount of revenue



and/or savings being generated from these types of agreements in order to mitigate the cost of the services being provided.

### **RECOMMENDATION**

It is apparent that the changes made by Council to the original RFP have not resulted in the outcome that was used by the Council to justify bypassing the competitive bid process and the belief that the rate being proposed by CARTS needed to be consistent with the rate being offered by Mid-Valley (e.g., \$10.00 per ton).

Therefore, both the City Manager and Public Utilities Director again reiterate our previous recommendation that Council reject the agreements for Recyclable Materials Processing, issue a new Request for Proposal (RFP) that will be managed by an outside independent consultant, and that the new RFP be issued for processing 100% of the City's recyclable materials.

The financial impact of accepting the proposed agreements equates to a net revenue loss of \$2.7 million over the life of the contract. If through a new RFP, downward pressure in the commodity markets continues and the bids remain at \$1 per ton, then staff will recommend that the Council award the recyclable materials contract for a shorter term to allow the markets to recover. This is industry standard practice when market volatility or depressed market prices are a concern. The recommended term under depressed market conditions would be two years, with two one year extension options.