

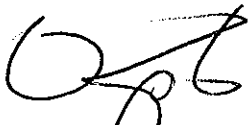



To: Public Works and Transportation Committee **Date:** March 30, 2009
From: Dave Semple **File:** 10-6405-03-01/2009-Vol
Director of Parks & Public Works Operations 01
Re: **T.2988 – Request for Contract Amendment Due to
Economic Downturn in Recycling Commodity Markets**

Staff Recommendation

1. That the General Manager of Engineering and Public Works be authorized to execute an amendment to Contract T.2988, Residential Garbage and Recycling Collection Services as follows:
 - a) Amend the schedule of quantity and prices to:
 - i. reflect proposed increases in recycling material processing costs,
 - ii. eliminate the fixed revenue portion of the Contract.
 - b) Amend Schedule A to reflect financial benefit to the City from increases in commodity market revenues based on market indicators above fixed amounts.

2. That the additional estimated cost of \$520,000 in 2009 be funded from the 2009 Sanitation and Recycling rate stabilization account.


Dave Semple
Director of Parks and Public Works Operations
(604-233-3350)

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|-------------------------------------|---|--|---|
| ROUTED TO: | CONCURRENCE | CONCURRENCE OF GENERAL MANAGER | |
| Budgets | Y <input checked="" type="checkbox"/> N <input type="checkbox"/> |  | |
| Purchasing | Y <input checked="" type="checkbox"/> N <input type="checkbox"/> | | |
| Law | Y <input checked="" type="checkbox"/> N <input type="checkbox"/> | | |
| REVIEWED BY TAG | YES <input checked="" type="checkbox"/> NO <input type="checkbox"/> | REVIEWED BY CAO | YES <input checked="" type="checkbox"/> NO <input type="checkbox"/> |

Staff Report

Origin

The City currently engages Sierra Waste Services Ltd. under contract T.2988 to provide residential curbside garbage and recycling services. This is a 5-year contract for the period January 1, 2008 to December 31, 2012.

Global economic conditions have had a significant impact on the recycling commodities market to the point that Sierra Waste Services has advised that they can no longer sustain financial losses they are incurring under the current contract conditions. They are, therefore, proposing a contract amendment, which is outlined in this report.

Analysis

Contract Provisions

Contract T.2988 is a comprehensive service contract and includes the following service elements. Each component is based on unit prices for each residential unit serviced or per tonne of material collected/processed:

- Garbage collection and transportation service (single-family and designated townhomes)
- Recycling collection and transportation service (all residences)
- Recyclable material processing
- Recyclable material revenue from the sale of recycling commodities
- Yard Waste collection and transportation service (single-family and designated townhomes)
- Blue Box delivery
- Collection service for illegally-dumped items

The existing contract includes annual adjustments to unit prices based on consumer price indices for all service items as well as payment for any additional residential units. The City receives a fixed revenue for newspaper, mixed paper and containers in addition to receiving 10% from the sale of recyclables over and above the fixed revenue amounts. The annual contract value (after revenues from commodity sales) is approximately \$3.3 million.

Impact of Economy on Recycling Commodities

Current economic conditions have severely impacted the global demand for materials collected in recycling programs. The impact is widespread and, as such, has severely impacted the marketable values of recycling materials. The market decline began in the 4th quarter of 2008. By November, newspaper was trading at approximately 75% and mixed paper at 10% of its average pre-decline value. Currently, newspaper is trading at \$89/tonne and mixed paper at \$10-15/tonne. When compared with a 6 year (2003 – 2008) historical average of \$132.27/tonne and \$88.42/tonne for newspaper and mixed paper respectively, the impact of the economic decline in material values is very apparent. On the positive side, there continue to be markets for these fibre-based materials at this time, although at much reduced values. Further, the longer-term outlook is not clear. Higher-grade plastics (recycling codes 1 and 2 – milk jugs, plastic bottles, etc.) and clear glass are still

trading, but at reduced values. There are limited to no markets for plastics 3 – 7 and mixed glass. The market for recycled metals has been similarly affected.

Given the unprecedented and widespread nature of this decline in recycling commodities, the City's service provider has requested an amendment to the contract in order to be able to sustain their operations and services to the City.

Contractor's Proposal

In considering the contractor's proposal, it is helpful to understand the three key components of the recycling portion of the work:

1. Collection of the recycled materials from households, and delivery to a central processing facility;
2. Processing of recycled materials at the central facility; and
3. Commodity/material sales to the market.

The contract structure for the collection portion is driven by Sierra's costs for labour and trucking (capital, operations and maintenance, fuel, etc.). This contract provision is on a dollar/household basis. Sierra is not a processor, and as such delivers the materials to other agencies for processing and sale. The processor is paid a fee (again driven by labour, equipment/facility costs, etc.) and the processor pays Sierra once materials are sold. The contract provision for processing fees and revenue are on a dollars-per-tonne basis.

A review of Sierra's financial model indicates that collection costs have been partially cross-subsidized by commodity/material sales based on historical values. Processing costs have increased and commodity revenues have substantially decreased in light of the current economic situation. Sierra is, therefore, suffering financial losses under the existing contract terms.

As a result, Sierra Waste has proposed 3 key changes to the existing unit price contract:

- An increase in subcontracted processing fees paid for recycling materials -- commencing April 1, 2009.
- Elimination of the fixed revenue portion of the contract, retroactive to November, 2008.
- Revenue payments to the City based on market indicators above fixed amounts for newspaper and mixed paper -- commencing April 1, 2009.

All for the duration of the contract term, or to December 31, 2012. These are the only elements of the contract that will be considered and all other provisions and representations remain as tendered.

This increases the City's costs, reduces fixed revenues, and shifts the recycling commodity risk to the City. At the same time, however, the City benefits directly from any recovery in the recycling markets for fibre materials. An analysis of the financial impact of these proposed changes is described in the financial impact section of this report.

Options

1. Amend Existing Contract (recommended option)

Under this option, the City would accept the contractor's proposal and agree to amend the tendered unit rates. As T.2988 is a fixed price contract, any amendment requires the mutual agreement of both parties.

This option represents additional cost to the City, but at the same time, provides the opportunity for direct financial benefit from any recovery in the recycling commodity markets. The overall added cost to the City in 2009 for this option is estimated at \$521,244, as detailed in the financial impact section. This increases the annual contract value in 2009 to approximately \$3.8 million.

Staff recommend this option since it ensures continuity of services to residents, recognizes the unprecedented economic impact to recycling commodity markets, and represents best value when compared with other options. In addition, Sierra Waste's performance has been sound since assuming this contract in January, 2008. This option also represents the opportunity for direct financial benefit to the City from any recovery in the recycling commodities market.

2. Maintain the Existing Contract Conditions

Under this option, the City would not accept Sierra's proposal, and advise that the contract must be continued as tendered. Sierra would be forced to look for opportunities to reduce costs; thereby potentially impacting service levels to residents. As Sierra has indicated their company cannot sustain the financial losses they would incur, they would be unable to continue to perform to the contract specifications. In essence, this option would drive the contractor into default.

The City would eventually be forced to call the Performance Bond and go to the marketplace for a new service provider. A service tender would be issued which would subject the City to new pricing under current market conditions. Similar service contracts recently awarded in other Lower Mainland jurisdictions with fewer households than Richmond are in the order of \$5.2 million and \$6 million. Collection costs have increased substantially since Richmond's contract was awarded due to volatility of the fuel and recycling commodity markets, increases in vehicle costs due to new emission standards, wage increases and other inflationary factors.

This option is not recommended since costs are expected to be substantially higher than Option 1. Any new contract would have to be restructured to address current risks and uncertainties in the marketplace to ensure competitive bidding; additional time would be required to allow for the bidding and award process to take place, etc. In the interim, there could be service impacts to residents. Therefore, this option is not recommended.

Financial Impact

The proposed contract amendment, as per Option 1, has financial impacts to the 2008, 2009 and future budgets, summarized as follows. Amounts for 2009 and future budgets are estimates based on current market conditions. These amounts may vary depending on variations in the recycling commodity market. Additional financial breakdown information is provided in Attachment 1.

| Budget Year | Item | Financial Impact | Comments |
|-------------|----------------------------|------------------|--|
| 2008 | Reduced revenues | \$85,000 | No overall impact as anticipated recycling commodity revenue targets were exceeded. No budget adjustment is necessary. |
| 2009 | Estimated reduced revenues | \$411,000 | Difference between budgeted and anticipated. Estimated net budget impact. Fund from rate stabilization account. |
| | Increased processing costs | \$110,000 | |
| | Total | \$520,000 | |

The 2009 total cost impact is an estimate only and is based on current recycling market conditions. This amount could increase or decrease based on changes in the recycling commodities market. It is recommended that the source of funds be from the rate stabilization account within the sanitation and recycling budget. There are sufficient funds within this account to accommodate this additional expenditure. This reinforces the benefit and foresight of City Council in creating and maintaining a rate stabilization account to effectively manage these unforeseen circumstances without the requirement to reduce service levels.

Impacts to the 2010 and future year's budgets is approximately equal to that of 2009. There will be no impact to ratepayers in 2009 since rates have already been established and funding is proposed from the rate stabilization account. The impact of this adjustment in 2010 could be approximately \$12.00/single-family dwelling unit, \$5.50/townhouse unit, and \$4.25/apartment unit. This is an estimate only at this time to help gauge the potential impact to ratepayers. The 2010 rate is not being set at this time. Council will have the opportunity to review the overall budget and consider rates in the Fall, 2009. We anticipate that recycling commodity market conditions may stabilize somewhat by that time and revenue estimates can be refined. For example, if the recycling commodities market recovers to the previous 6-year average (i.e. \$132.27/tonne for newspaper and \$88.42/tonne for mixed paper), the City would recover \$450,000 in revenues to offset the added financial impact. A further 15% increase in the prices for newspaper and mixed paper would completely offset the financial impact. Anything over and above a 15% increase would be a net gain to the City.

Conclusion

Recycling commodity markets have been severely impacted by current economic conditions, thereby increasing processing costs and severely reducing material values. This issue is global in nature and was not anticipated at the time Richmond's garbage and recycling service contract was entered into. Cities and vendors everywhere are facing this same challenge. Contract terms

were based and tendered on traditional commodity markets for recycling materials. The City's service provider, Sierra Waste Services, is seeking a contract amendment to address the demonstrated financial losses they are experiencing under the current contract terms. Sierra is not expected to be able to sustain these losses without relief being provided by the City. To ensure continuity of service to the residents of Richmond, protect the integrity of our recycling programs, and in recognition of sound performance by Sierra Waste, it is recommended that the proposed amended contract terms be accepted. This approach is considerably more cost effective than re-tendering for services. The City also benefits directly from any potential recovery in recycling commodity markets.

There remain uncertainties with the viability of the processing market for recycling materials. This issue is outside of the City's control. We are, however, working with Metro Vancouver and other member municipalities to monitor the situation and consider short and long-term options to ensure the ongoing viability of our recycling programs.



Suzanne Bycraft
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SJB:

Summary of Financial Impact: 2008, 2009 and 2010

| Budget Year: 2008 | | | |
|---|-------------------------------|---|---------------------------------|
| Proposed Amendment | Financial Impact | Budget Impact | Rate Impact to Residents |
| 1. \$0 fixed revenue paid to the City for recycling commodities (November/December) | \$84,457.79 (revenue loss) | None. Revenue estimates in 2008 for recycling commodities were exceeded by more than \$60,000 due to higher than anticipated revenues due to market conditions. | None |

| Budget Year: 2009 | | | |
|---|-----------------------------------|---|---|
| Proposed Amendment | Estimated Financial Impact | Budget Impact | Rate Impact to Residents |
| 1. \$0 fixed revenue for recycling commodities (effective January 1/09) | \$532,405 (revenue loss) | Revenue accounts will under-recover by a net approximate amount of \$411,347. | None, as rates already established. Will impact 2010 rates. |
| 2. Pay recycling commodity revenues based on market indicators above fixed amounts (newspaper and mixed paper). Assumes \$87/T for newspaper (only) less fixed amounts to Sierra (effective April 1/09) | (~121,058) (revenue gain) | | |
| Net Reduction in Revenues | \$411,347 | | |
| 3. Increase in per tonne cost for processing recycling materials per Sierra's proposal (effective April 1/09) | ~\$109,897 | Increased expense. | |
| Total Cost Impact (Reduced Revenues plus increased processing cost) | \$521,244 | Net estimated overall budget impact. Recommend funding from reallocation of existing budgets and/or from the rate stabilization account, as required. | |

| Budget Year: 2010 | | | |
|--|-----------------------------------|--|---|
| Proposed Amendment | Estimated Financial Impact | Budget Impact | Estimated Net Rate Impact to Residents |
| 1. Estimated annual net revenue loss over present contract arrangement. Assumes \$87/T for newspaper (only) less fixed amounts to Sierra | \$371,728 | Need to recover \$517,591/year more via rates to make long-term budget structurally balanced. This assumes revenue for newspaper only based on the current market conditions. Should the market rebound, any additional profits could be re-directed to the rate stabilization account to replenish what is suggested to draw down at this time. However, should the market situation worsen and newspaper commodity revenues decline further, there would be a further negative financial impact. | \$12.00/single-family dwelling unit |
| 2. Additional annual processing cost | \$145,863 | | \$5.60/townhouse dwelling unit |
| Net Annual Financial Impact | \$517,591 | | \$4.25/apartment dwelling unit |