

## OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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**Item Number:** 5

**Subject:** Construction and Demolition Ordinance

### OVERVIEW

In October 2005, the City Council adopted a Construction and Demolition (C&D) Ordinance, which required C&D materials to be recycled in an effort to extend the life of Miramar landfill and to increase the City's diversion rate as required by the California Integrated Waste Management Act. It is estimated that diverting C&D material could increase the City's diversion rate by 4% - 5%. The C&D Ordinance was designed to become effective 45 days after a certified mixed C&D facility became operational within the City of San Diego.

To date, no such facility has become operational within City limits. However, a private mixed C&D facility operated by EDCO (SANCO) is currently located in Lemon Grove. As such, an amendment is proposed to the C&D Ordinance that would cause the Ordinance to be triggered by any certified mixed C&D facility that is located within 25 miles of downtown San Diego. Should this amendment be approved, the C&D Ordinance would become effective upon certification of the SANCO facility.

Efforts to increase recycling and waste diversion, such as the C&D Ordinance, present unique financial challenges for the Environmental Services Department. Due to the intricate and complex nature of the City's refuse disposal rate structure, such efforts often come with significant and interrelated financial impacts, which may not be immediately apparent.

This report provides an analysis of City's refuse disposal rate structure by examining the fees that are charged when refuse is disposed and how those fees impact various City funds, including the General Fund. In addition, the financial impacts of the C&D Ordinance are examined, and the proposed fiscal mitigations are briefly discussed. Finally, this report looks at how compliance with the C&D Ordinance is approached, and highlights the difficulty with other possible approaches.

## **FISCAL/POLICY DISCUSSION**

### Refuse Disposal Fees

In FY 2007, approximately 1.3 million tons of waste was disposed in the Miramar landfill. This waste is brought to the landfill by numerous types of haulers, including residents, businesses, City franchised haulers, and the City itself. Each hauler that brings waste to the landfill is charged for the disposal of that waste.

In general there are two ways that these charges are assessed: as a flat rate and per ton. Haulers that transport their waste in smaller vehicles, such as cars, pickups, or small trailers, are charged a flat rate depending on the type of vehicle they are using, the type of waste they are disposing, and whether the waste was generated within the City of San Diego. These haulers make up a very small percentage of the waste that is disposed in the landfill.

Larger haulers are charged based on the tons of waste they dispose. A variety of charges are levied on each ton of waste that is disposed. These charges, collectively known as disposal fees, support the General Fund, the Refuse Disposal Enterprise Fund, and the Recycling Enterprise Fund. The analysis in this report focuses on the per-ton charges, as they are charged on approximately 90% of all waste disposed at the Miramar landfill.

Disposal fees levied by the City are composed of four different types of fees: tipping fees, AB 939 or recycling fees, franchise fees, and the Refuse Collector Business Tax (RCBT). A brief description of each of these fees is provided below.

Tipping Fee – The basic fees charged for use of the Miramar landfill. Tipping fees are authorized by Municipal Code Section 66.0129, and are the primary funding source for the Refuse Disposal Enterprise Fund. The disposal fee differs depending on the type of hauler and whether the waste is generated within the City (“City waste”). The disposal fee paid by the City and by franchised haulers is \$24 per ton for City waste and \$34 per ton for non-City waste.

AB 939 (Recycling) Fee – The Integrated Waste Management Act (AB 939), passed by the State of California in 1989, authorized local agencies to impose fees in order to establish and implement an integrated waste management plan. The AB 939 fee is levied at \$7 per ton. All revenue derived from this fee is paid into the Recycling Enterprise Fund to support the City’s recycling program.

Refuse Hauler Franchise Fee – Municipal Code Section 66.0108 requires all commercial refuse haulers obtain a franchise agreement with the City in order to provide solid waste collection services. The franchise is required in order to regulate such businesses to ensure health and safety standards, and for the use of

the City's rights-of-way. Class I franchises are granted to those haulers that collect 75,000 tons or less per year, who are charged \$11 per ton. Class II franchises are granted to haulers that collect over 75,000 tons, who are charged \$12 per ton. Revenue from refuse hauler franchise fees is allocated to the General Fund.

Refuse Collector Business Tax (RCBT) – The Refuse Collector Business Tax (RCBT) is charged at a rate of \$8 per ton on non-City waste disposed by franchises haulers, and on each ton of waste disposed by non-franchised haulers and residents self-hauling over two tons. The RCBT was originally approved in 1993, and all revenue is allocated to the General Fund.

Due to the various types of fees that are charged and the different amounts of the fees depending on the hauler type and where the waste is generated, it is difficult to generalize about the refuse disposal fee structure. However, this complexity may be averted by simply examining the fee structure for one particular hauler type. The following diagram reflects the fees that are charged on each ton of waste that is disposed by Class II franchise haulers.

**Table 1. Disposal Fees for Class II Franchise Haulers, per ton**

	City Waste	Non-City Waste		
Tipping Fee	\$24.00	\$34.00	→	<b>REFUSE DISPOSAL FUND</b>
AB 939 Fee	\$7.00	\$7.00	→	<b>RECYCLING FUND</b>
Franchise Fee	\$12.00	\$0.00	→	<b>GENERAL FUND</b>
RCBT	\$0.00	\$8.00	→	<b>GENERAL FUND</b>
<b>TOTAL</b>	<b>\$43.00</b>	<b>\$49.00</b>		

Again, it should be noted that these fees only pertain to Class II franchise haulers. Class I franchise haulers and City waste haulers pay almost identical fees, except that the franchise fee for Class I haulers is \$11 per ton. City waste haulers pay the same tipping fee and AB 939 fee, but do not pay franchise fees or RCBT.

This intricate network of fees and charges generates significant revenue for the various City funds. The Table 2 shows how much revenue each of these fees is anticipated to generate in FY 2008, and to which funds.

**Table 2. Disposal Fee Revenues, FY08 Budget in millions**

		FEE				
FUND		Tipping	AB 939	Franchise	RCBT	TOTAL
	Refuse Disposal	\$31.1				<b>\$31.1</b>
	Recycling		\$11.5			<b>\$11.5</b>
	General			\$10.1	\$2.0	<b>\$12.1</b>

But the City does more than just receive revenue from these fees; it also pays them. Tipping fees and AB 939 fees are charged on each ton of waste that the City disposes in Miramar. Since the General Fund provides for residential refuse collection, it bears the largest share of these costs. The table below shows the funding budgeted in FY 2008 for disposal fee expenses.

**Table 3. Disposal Fee Expenditures**

Fund	FY08 Budget
General Fund	\$ 13,134,448
<i>Collection Svcs.</i>	<i>11,950,158</i>
Recycling	841,054
Refuse Disposal	281,716
Water	400,000
Sewer*	832,000
Other Funds	11,500
<b>TOTAL</b>	<b>\$ 15,500,718</b>

*\* Includes both Muni and Metro Funds*

This analysis illustrates the complexity of City’s refuse disposal fee structure and the impact that disposal fees can have on various City funds and departments, both as revenues and as expenditures. This reflects the inherent difficulty with enhancing recycling efforts: the City loses money for each ton of material that is diverted away from the landfill.<sup>1</sup> Furthermore, increasing certain fees will increase expenditures for certain funds, primarily the General Fund. As discussed in ensuing sections, this rate structure

<sup>1</sup> This is often referred to as “deferred” revenue since the space in the landfill still exists, and fees will be charged on the use of that space in the future. However, this foregone revenue still presents a serious cash flow impact on a year-by-year basis, and for practical purposes may be considered lost.

and the intricately linked funding network tends to limit the City’s options in terms of implementing compliance measures or fiscal mitigations related to recycling programs.

Financial Implications of C&D Ordinance

The Environmental Services Department estimates that the total financial impact of the C&D Ordinance will be \$4.1 million in FY 2009 and \$8 million in FY 2010 and each year thereafter as diversion rates are maximized. This represents the cumulative impact across various funds, as summarized in the table below.

**Table 4. Estimated Financial Impacts**

	<u>FY 2009</u>	<u>FY 2010</u>
General Fund	\$0.3 million	\$0.3 million
Refuse Disposal Fund	\$3.1 million	\$7.0 million
Recycling Fund	\$0.6 million	\$0.6 million
Other City Funds	\$0.1 million	\$0.1 million
<b>TOTAL</b>	<b>\$4.1 million</b>	<b>\$8.0 million</b>

The estimated financial impacts are composed of both increased expenditures and decreased revenues. For instance, there are increased costs to certain General Fund and non-General Fund departments related to recycling C&D material, and increased costs to the Recycling Fund associated with new positions needed to administer the C&D program. However, the largest financial impact of the C&D Ordinance is the lost or deferred revenue that results from diversion of material away from Miramar landfill.

It should be noted that the estimated financial impacts are based on a host of assumptions and unknown elements, such as the effectiveness of the C&D Ordinance and the future flow of waste into the Miramar landfill. However, it is relatively easy to understand the financial impact of diverting C&D material from the landfill. The Environmental Services Department estimates that approximately 400,000 tons of C&D material is disposed in the Miramar landfill annually. The City hopes to divert 75% of this material by FY 2010. This means that the City will no longer be able to charge tipping fees on around 300,000 tons of material that was previously disposed at Miramar. Using the “City Waste” rates listed in Table 1, a simple calculation reveals that this will reduce revenues in the Refuse Disposal Fund by approximately \$7 million per year.<sup>2</sup>

As shown in Table 4, the Refuse Disposal Fund is most significantly impacted by diverted material pursuant to the C&D Ordinance. The Recycling Fund and the General

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<sup>2</sup> While this is an oversimplification of how the estimated financial impacts are calculated, it illustrates the concept and of how diverted tonnage results in lost revenue, and the general magnitude of such impacts.

Fund are less impacted, because both AB 939 and franchise fees will continue to be charged on each ton of diverted C&D material.<sup>3</sup> This is in contrast with the diversion of other recyclable material, where these fees are not charged. The reason for this discrepancy is that the Municipal Code currently defines C&D material as solid waste, as these fees are designed to be levied against solid waste that is generated, processed or disposed in the City.

### Proposed Fiscal Mitigations

Two measures are proposed to mitigate the estimated financial impacts of the C&D Ordinance: increasing the flat rate (self haul) disposal fees at the Miramar landfill and implementing a replacement fee for automated refuse containers. If implemented, the increased flat rates will partially mitigate the financial impacts to the Refuse Disposal Fund, while the automated refuse container replacement fee will more than offset the impact to the General Fund.

As previously mentioned, flat-rates are charges to persons transporting their waste in small vehicles, such as cars, trucks and small trailers. The flat rate charges differ depending on the type of vehicle, the type of waste being disposed, and whether the waste was generated within the City of San Diego. It is proposed that the flat-rate charges be increased for all vehicle types in FY 2008 and again in FY 2009. The Department estimates that these fee increases will generate approximately \$700,000 for the Refuse Disposal Fund in FY 2008 and \$2.5 million in FY 2009.

In 1994 the City began to permanently convert to automated refuse collection, and provided one refuse container to each customer in order to ensure that all containers would be fully compatible with the new automated and semi-automated collection systems. These containers generally have a life expectancy of 10 to 12 years, and a vast majority of the 319,000 containers currently in use are nearing or have surpassed their useful life. Currently, the General Fund bears the expense of replacing automated refuse containers, and it is anticipated that the number of containers needing replacement will accelerate in upcoming years. To offset the cost of container replacement, it is proposed that a \$70 charge be levied on all replacement containers provided to City customers. It is estimated that such a charge would generate \$500,000 for the General Fund in FY 2008, and \$1 million each year thereafter.

The IBA supports these financial mitigations in concept; however, additional time is needed to conduct sufficient analysis of these proposals. One point that should be clearly noted is that the proposed increase in flat rates will only partially mitigate the impact to the Refuse Disposal Fund, and no mitigations are currently proposed for the Recycling Fund. However, as the Department has shown previously, both of these funds are facing

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<sup>3</sup> There is a very minor impact to both the Recycling Fund and the General Fund due to the loss of AB 939 fees and RCBT on C&D material that is self-hauled, since the City has no way of tracking this tonnage.

negative fund balances in the near future, and more robust fiscal mitigations will likely be necessary in upcoming years in order to maintain the financial health of these funds.

Compliance With C&D Ordinance

One of the more significant aspects to the C&D Ordinance is a system of refundable deposits, designed to ensure compliance with the intent of the program. Under this system, the City would collect a refundable deposit from applicants who are applying for building or demolition permits for specified construction, renovation or demolition projects. Deposits would be paid prior to issuance of the permit, and in order to receive a refund the permit holder would need to provide documentation that C&D materials from their project were recycled at a certified C&D recycling facility.

While this system is designed to achieve compliance by creating an incentive to recycle, it is not the only possible means of creating such an incentive. The optimal situation would be one in which it was cheaper to recycle C&D material than to dispose of it. This would create a natural incentive to recycle. Unfortunately, this is not currently the case. The SANCO facility, operated by EDCO, currently charges \$46 per ton of mixed C&D material. This is in addition to the AB 939 fees and franchise fees charged by the City. As shown in the table below, the combination of these charges creates a situation where disposal is more cost-effective than recycling.

**Table 5. Cost of Disposal\* v. Recycling**

	<u>Miramar</u>	<u>SANCO</u>
Tipping Fee	\$24.00	\$46.00
AB 939 Fee	\$7.00	\$7.00
Franchise Fee	\$12.00	\$12.00
<b>TOTAL</b>	<b>\$43.00</b>	<b>\$65.00</b>

*\* Reflects disposal cost for a Class II Franchise*

Again, in an optimal situation the cost of recycling would be less than the cost of disposal, thereby creating a natural economic incentive to recycle. However, the only way to achieve such an incentive currently would be through some combination of raising disposal costs and lowering recycling costs. Unfortunately, doing this would have significant financial implications for the City.

One option would be to eliminate AB 939 and franchise fees on recycled C&D material, combined with an increase in tipping fees on disposed material. While this option has the potential to create a natural economic incentive to recycle, it would result in significant revenue loss to both the Recycling Fund and the General Fund, as well as significant additional expenses for the General Fund. While it would be possible to make the

Recycling Fund whole by increasing AB 939 fees on waste disposed at Miramar, this would only further increase General Fund costs.

Ultimately, the most preferable situation would be to pass the costs of refuse disposal – including the necessary charges for recycling programs – along to those who generate the waste. This would not only create an incentive to increase the recycling effort, but would also place the financial burden on those who strain the City’s landfill system.

Unfortunately, the People’s Ordinance prohibits the City from passing along refuse collection and disposal costs to a very large contingency of waste producers. Were the City able to charge for refuse collection, increases in tipping fees and AB 939 fees could be passed along to City customers, thereby alleviating the General Fund of adverse financial impacts. This would allow for a greater degree of flexibility in not only mitigating additional costs of recycling programs such as the C&D Ordinance, but also in terms of creating more natural economic incentives for recycling.

In the absence of this flexibility, ESD is proposing to narrow the gap between the cost of disposal and recycling for C&D materials by imposing an additional fee on C&D material that is disposed in the Miramar landfill. This additional fee would be equivalent to 50% of the current tipping fee for each ton of material disposed, and would create a disincentive for disposing non-City C&D material at the Miramar landfill. While disposal rates for C&D material generated within the City would still be higher than the cost of recycling, this additional fee would certainly narrow the cost gap. The table below compares the cost of recycling with the cost of disposal, including the additional fee for C&D material.

**Table 6. Cost of Recycling vs. Disposal\*, with C&D fee**

	<b>Miramar (City waste)</b>	<b>Miramar (Non-City)</b>	<b>SANCO</b>
Tipping Fee	\$36.00	\$51.00	\$46.00
AB 939 Fee	\$7.00	\$7.00	\$7.00
Franchise Fee	\$12.00	\$0.00	\$0.00
RCBT	\$0.00	\$8.00	\$8.00
<b>TOTAL</b>	<b>\$55.00</b>	<b>\$66.00</b>	<b>\$61.00</b>

*\* Reflects disposal cost for a Class II franchise*

Overall, the system of refundable deposits should achieve the desired compliance with the C&D Ordinance, while minimizing the financial impacts to the City. However, it is recommended that the deposit rates be closely monitored to ensure that they are high enough to create the proper incentive to recycle C&D material. Finally, it should be strongly noted that the financial implications of changing the City’s disposal rate structure will likely need to be contemplated in the near future, as new proposals to

mitigate financial imbalances in the Refuse Disposal and Recycling Funds are likely to include a variety of disposal rate increases.

## CONCLUSION

The City has an intricate network of fees related to refuse disposal. Each ton of refuse that is disposed in the Miramar landfill is charged a variety of different fees. Tipping fees support the Refuse Disposal Fund, and vary depending on the type of refuse hauler. The Recycling Fund is supported by AB 939 fees, while franchise fees and the Refuse Collector Business Tax are allocated to the General Fund. In addition, several funds within the City must also pay these refuse disposal fees, since they too dispose waste in the landfill. The General Fund bears the largest expense for disposal fees, as a result of providing residential refuse collection.

The C&D Ordinance aims to divert nearly 300,000 tons of C&D material from the Miramar landfill per year. The benefits of diverting recyclable C&D material from the landfill are maintaining the 50% diversion rate as required by the California Integrated Waste Management Act, and extending the life of the Miramar landfill. However, these benefits come with a cost. The fiscal impact of the C&D Ordinance is estimated to be approximately \$4.1 million in FY 2009 and \$8.0 million in FY 2010 and thereafter, with the greatest impact hitting the Refuse Disposal Fund. Two fiscal mitigations have been proposed that would partially offset the impact to the Refuse Disposal Fund, and fully offset the impact to the General Fund. However, additional mitigations will be necessary in the near future to ensure the financial health of both the Refuse Disposal Fund and the Recycling Fund.

Finally, the C&D Ordinance relies on a system of refundable deposits to create an incentive to recycle, and to ensure compliance with the Ordinance. Other possible approaches to creating incentives, such as lowering the cost of recycling and increasing the cost of disposal, cannot be easily implemented without significant financial impacts to various City funds, particularly the General Fund. This is due in large part to the People's Ordinance, which prohibits the City from charging for residential refuse collection, and thus does not allow increase expenses to be passed on to consumers.

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