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APPENDIX C

Memorandum

To: E. (Beth) Goodger, General Manager
Solid Waste Management Services Division

June 4, 2015

cc: Rob Orpin, Director, Collections and Litter Operations

From: Ernst & Young LLP (“EY”)

Independent Review On The Contracting Out Of Curbside Collection (District 3&4)

Executive Summary

1. Solid Waste Management Services (“SWM”) has prepared a draft staff report dated June 4, 2015 (the “Staff Report”) with respect to the potential benefits of contracting out curbside collection in Districts 3 and 4 (as defined later herein). The Staff Report indicates that there is no clear benefit to be derived by the City of Toronto (the “City”) by contracting out Districts 3 and 4 at this time.
2. SWM has indicated that there are further opportunities for efficiencies and cost savings in respect of in-house curbside collections in District 3 and District 4, and that while contracting out should be deferred, the issue should remain an option for future consideration. Furthermore, SWM believes that a combination of public and private curbside collection provides a method to mitigate operational and financial risks for curbside collection.
3. SWM provided EY with its analysis of the potential costs/benefits of contracting out curbside collection in District 3, District 4 as well as District 3 & 4 together. This SWM analysis was assessed by EY and the results of our analysis is reported herein.

District 3

4. The SWM analysis indicates that, while District 3 has the highest costs per tonne and per household of all four collection Districts, SWM is of the view that the significant costs to re-deploy District 3 staff will significantly reduce any potential savings from contracting out. SWM has been provided with an estimate from the City of Toronto's Human Resources ("**Human Resources**") group, which estimated that 20 staff could be re-deployed each year. The SWM analysis assumed a more aggressive re-deployment rate of 25 staff per year in SWM's analysis, which results in a cost of approximately \$48 million to re-deploy approximately 217 staff (89 with greater than 15 years seniority).

District 4

5. On the other hand, the SWM analysis indicates that the District 4 in-house costs are competitive with Districts 1 and 2 (which are contracted out) on both a cost per tonne and cost per household basis.
6. However, SWM did a complete analysis of the cost/benefit for District 4 as was done for District 3. As with District 3, SWM was provided with an estimate from Human Resources which estimated that 20 staff could be re-deployed each year. The SWM analysis assumed that all 23 could be re-deployed in one year with a cost of approximately \$855,000 to re-deploy the approximately 68 District 4 staff (23 with greater than 15 years seniority). The significant difference between District 3 and District 4 is that approximately 45 District 4 staff could be absorbed into District 3 displacing temporary and seasonal workers, leaving only 23 employees who would need to be redeployed.

Districts 3 and 4 Combined

7. In addition, SWM prepared an analysis of the contracting out of both District 3 and District 4. The SWM analysis for the combined Districts 3 and 4 also used 25 staff re-deployments per year (instead of the Human Resources estimate of 20 per year). The SWM analysis estimated a cost of approximately \$100 million to re-deploy approximately 285 staff (112 with greater than 15 years seniority).

Summary of SWM Analysis

8. After taking into consideration these costs, as well as potential savings due to future efficiencies, the SWM analysis, (as described in greater detail later in this Report) indicates that any savings from any contracting out will be primarily dependent on any potential future bids from third party contractors. In the absence of actual bids, SWM prepared estimates of potential future bids for District 3 based on the 2011 bids for contracting out District 2 (“**2011 Bids**”). SWM then used the 2014 bids for contracting out District 1 (“**2014 Bids**”) as a proxy for future potential bids for District 4. The SWM staff report indicates that the potential cost/(savings) from any potential contracting out for District 3 and District 4 (based on a seven year contract term) are as follows:

Cost/(Savings) (\$Millions)	Low	Average	High
District 3	(12.1)	4.5	21.0
District 4	(11.9)	3.6	19.2
District3 and District 4	27.4	58.4	89.4

9. As noted above, contracting out either D3 or D4 could result in annual savings in the low scenario, though the average and high scenario’s do not show any savings and all of the scenarios are dependent on the third party contract bids which cannot be known with any certainty at this time. Any such bids would be dependent on the market conditions during the procurement process; however, SWM has done a reasonable job of estimating these potential bids based on the 2011 Bids and 2014 Bids.

10. With respect to the net cost/(savings) in the above table, it should be noted that the employee re-deployment costs as calculated by SWM are one-time costs only and that the ongoing savings, after the initial contract phase, would be significantly higher. However, it should also be noted that future contract prices are not guaranteed and that the reduction of in-house collection services could negatively impact the City’s ability to keep prices competitive, though competitive market forces will mitigate some of this risk.

EY Comments on SWM Analysis

- 11.** EY believes that the cost centre data used by SWM was appropriate and found that the key assumptions used by SWM were reasonable and applied in a fair minded manner.
- 12.** EY reviewed the SWM calculations of the cost and benefits of contracting out D3 and D4 as well as the methodologies used in the SWM financial models and believes that SWM's approach are reasonable, the calculations are numerically accurate and that methodologies have been correctly applied.
- 13.** While the Human Resources estimates are based on prior experience with the 2011 SWM re-deployments, EY believes that key assumptions with respect to the time to re-deploy staff should be reconsidered. In our experience with re-deployments (even those in unionized environments) the timelines could be significantly shorter than have been assumed by SWM and Human Resources and there are a number of strategies (some of which are outlined later in this Report) which could be used to reduce these re-deployment costs.
- 14.** In the absence of a market sounding (a survey of industry players to determine their interest, the ability of industry to meet the City's requirements and potential financial bids which the City could expect if contracting out was considered) or an RFQ to obtain bids from qualified bidders for contracting out D3 or D4, the approach taken by SWM to estimate potential bids (low, average and high) was reasonable under the circumstances and represents a good proxy for discussion purposes. However, we would caution (as would SWM), that these estimated potential bids are hypothetical in nature and should not be taken to represent actual bid potentials. There are many factors which may change the industry's interest in such a project including future economic conditions, supply constraints, regulatory issues and individual company's financial constraints.
- 15.** In any consideration of contracting out curbside collection the financial benefits must also be balanced against any operational risks. The risk of disruption to curbside collection from the private contractor due to financial, operational or regulatory factors must be weighed against the risk of in-house disruptions due to strikes or work to rule campaigns. The ability of the City to replace the service provider in the event of a service disruption, whether in-house or outside contractor should be a key consideration in the cost/benefit analysis.
- 16.** The City should also consider the balance between in-house and outside contractors to maintain a competitive tension with the service providers. While market forces will ensure that outside contractors are competitive with each other, the ability of the City to provide in-house curbside collection is an added element which undoubtedly ratchets

up the competitive tension. In addition, the use of outside contractors is certainly a factor for in-house service providers to consider during labour negotiations.

17. Finally, the sustainability of outside contractor pricing is an issue to be considered. It is not uncommon for private sector companies to submit low bids in an attempt to gain market share. While the City can take steps to ensure that the lowest bidder is qualified and is financially sound, the long term sustainability of lower pricing or the willingness of contractors to supply the service at lower margins indefinitely, may be questionable. Accordingly, the long term sustainability of lower cost bids should be considered in the contracting out decision making process.

18. The City may wish to consider further analysis including the following:

- i. Detailed analysis of the costs of re-deployment including the age, and other demographic data of the in-house employees. In addition, a review of potential mitigating strategies including early retirement packages, the use of outside downsizing agencies (to assist with Human Resources who are resource constrained), the possibility of transfers to other City agencies such as the TTC and other possible strategies. Such an analysis would require discussions with the union as well City staff, SWM and Human Resources; and
- ii. An analysis of the cost drivers in District 3 to determine the factors which are resulting in higher costs per tonne and per household and which may be rectified or which may impact the analysis of potential bids.

Introduction

19. We have completed our engagement to review the of analysis performed by the Solid Waste Management (“SWM”) Services Division (the “SWM Division” or the “Division”) of the City of Toronto (“the City”) on the contracting out of daytime residential curbside collection in District 3 and nighttime collection (“D3 Collection”), the contracting out of curbside collection in District 4 (“D4 Collection”) and contracting out D3 Collection and D4 Collection. Our engagement was performed in accordance with our engagement agreement dated January 12, 2015, and our procedures were limited to those described in this draft report (the “Report”).

Period covered by our procedures

20. EY performed a review of the Division’s analysis of the contracting out of D3 Collection and D4 Collection operations. The conclusions resulting from our work are stated herein,

Background

21. The City is currently divided into 4 collection areas (Districts 1 to 4, or “D1”, “D2”, “D3” and “D4”). District 1 residential curbside collection is currently under contract with Green for Life Environmental Inc. (“GFL”) and will transition to Miller Waste Systems Inc. (“Miller”) on July 1, 2015. District 2 was contracted out to GFL starting in 2012.



22. Based on a review of the operations, SWM determined that it would not be possible to contract out District 3 without also contracting out the night collections (as they use the same equipment) as well as the Toronto Islands garbage collection as that is also part of the duties of District 3. All of the forecasted analysis prepared by SWM incorporates the costs for District 3 as well as night collections and the Toronto Islands and forms the basis for SWM’s estimate of the potential bid from a third party contractor.

23. On January 6, 2015, the Public Works and Infrastructure Committee (“PWIC”) directed the General Manager of SWM to report at its April 9, 2015 meeting options to achieve savings and efficiencies in curbside collection. The staff report was to include staff’s assessment of curbside collection service delivery options including contracting out curbside collection services east of Yonge Street (D3 and D4). The staff report was to also include an independent third party review of staff’s analysis.

Scope of our work

24. EY conducted the following steps as part of this engagement:

- i. Conducted a review of the data compiled and analyzed by SWM, Policy, Planning, Finance & Administration, Human Resources and Fleet Services staff;
- ii. Conducted meetings with SWM operations, Human Resources, Fleet Services and SWM senior Management;
- iii. Conducted an analysis of staff’s evaluation of the City’s SAP financial reports used to estimate the cost/benefit impact of potentially contracting out D3 and D4 collections as well as any allocations of costs between the cost centres;
- iv. Reviewing on the service requests received by the City between the four Districts; and

- v. Assessing the staff's analysis of the potential cost/benefit impact of potentially contracting out D3 and D4 collections and commenting on the methodology used by staff to determine if it was reasonable and relevant.

25. The following activities were considered outside the scope of this engagement:

- i. A review of the effectiveness of the current service provided;
- ii. Identification of efficiencies or improvements to the existing service level;
- iii. Recommendations for the modification of services level; and
- iv. An audit of the SAP financial system, cost centre allocations or the data provided by SWM.

Disclaimer

26. In preparing this Report, EY has been provided with and, in making comments herein, EY has relied upon the City's SAP financial system, the financial information and estimates prepared by the SWM Division and discussions City staff and the management of SWM ("SWM Management"), as well as information provided by Finance, Human Resources and Fleet Management (collectively the "Information"). EY has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would wholly or partially comply with the Generally Accepted Assurance Standards pursuant to the Chartered Professional Accountants Canada Handbook and, accordingly, EY expresses no opinion or other form of assurance in respect of the Information.

EY Methodology

27. The SWM Division provided EY with data from the City's SAP financial system to allow EY to assess the reasonableness of the financial assumptions and calculations prepared by the SWM Division in respect of the costs of providing curbside collections in D3 and D4.

28. As part of this assessment process, EY undertook the following approach:

- i. Agreed the 2013 year end cost data by cost centre as prepared by SWM into the SAP financial system;
- ii. Agreed the 2014 year end cost data by cost centre as prepared by SWM into the SAP financial system;
- iii. Reviewed the cost centre allocations for the year ended 2013 and 2014 with SWM Management and with Finance staff;
- iv. Reviewed the cost centre allocations for fleet charges and contract administration for the year ended 2013 and 2014 with SWM Management;

- v. Compared year end actual costs with the budget for the years ended 2013 and 2014;
- vi. A consideration of the cost and revenue elements that should be considered in assessing the cost of curbside collections; and
- vii. An estimation of the relevance and materiality of the cost and revenue elements noted above.

29. In its analysis the SWM analysis has relied on two sets of figures from the SAP financial system to represent the baseline cost for D3 and D4 Collections:

- 2013 direct costs
- 2014 direct costs

Cost Centres (\$millions)	2013 Year End	2014 Year End
SWM - COLLECTIONS DISTRICT 1	9.2	9.4
SWM - COLLECTIONS DISTRICT 2	23.6	20.7
SWM - COLLECTIONS DISTRICT 3 ^A	19.5	18.5
SWM - COLLECTIONS DISTRICT 4	12.9	14.1
SWM - COLLECTIONS NIGHT SHIFT ^B	6.1	6.1
SWM - LITTER COLLECT	16.2	14.8
SWM-PARKS COLLECTION	5.7	6.5
Allocation of contract admin	<u>0.7</u>	<u>0.7</u>
Grand Total SWM	<u>\$93.9</u>	<u>\$90.8</u>
District 3 & Night Shift Collections (A & B)	<u>25.5</u>	<u>24.6</u>

SWM's Methodology and Key Assumptions

30. SWM used the 2014 year-end financial data as noted in the table above as the basis for its analysis. The 2013 data was not adjusted for the costs with respect to parks which was included in the costs for D3 and D4 in 2013. These costs with respect to parks were reallocated in 2014 and therefore 2014 was used as the go forward basis for the SWM analysis, as the most recent cost data available.

31. Key Assumptions used by SWM include the following:

- i. The rate of inflation will be 2% for the potential contract period under analysis (2017 to 2014);
- ii. D1 and D4 are similar in terms of route complexity, number of households and nature of streets;
- iii. D2 and D3 are similar in terms of route complexity, number of households and nature of streets; however, District 3, while similar to District 2 has some unique characteristics which include older neighbourhoods/row housing, more one way or narrow streets and more street parking. In addition, District 3 has the collection from the Islands as well as the toxic taxi;
- iv. Only 25 SWM employees can be re-deployed per year in any cascade of laid off employees;
- v. Internal efficiency savings rate is estimated to be 2% per year;
- vi. D3 is assumed to include the night collections, the collection from the Toronto Island as well as the toxic taxi;
- vii. The discount rate used for the net present value calculations is 3%;
- viii. The vehicle replacement inflation rate is also 2% per year;
- ix. SWM vehicles are replaced on average every 7 years;
- x. Any contract for a third party service provider would be for 7 years; and
- xi. An increase of internal costs of 2% for long term disability liabilities.

32. The SWM analysis included the following significant steps:

- i. Converting the cost data into cost per tonnes and cost per household to determine their comparability between the Districts;
- ii. Adjusting the cost data to add the annual fleet replenishment reserve;
- iii. Taking the cost data for D3 and D4 for 2014 and adjusting the costs using an assumed 2% annual inflationary adjustment for the duration of the potential seven year contract;
- iv. Adjusting the cost data for D3 and D4 downward by 2% per year for potential costs savings due to efficiencies;

- v. Estimating a low, average and high outside contractor bid for D3 and D4 using the 2011 bids and 2014 bids for the contracting out of D2 and D1, respectively;
- vi. These “contractor bids” were then adjusted annually for inflation at 2% per year;
- vii. Human Resources provided SWM with an estimate of the number of staff (20) which could be re-deployed each year for the displaced employees from either D3, D4 or both assuming that these Districts were contracted out to third parties. SWM used a more aggressive re-deployment rate of 25 per year;
- viii. Added to these costs were then the estimated contract supervision costs. These were also adjusted for inflation at 2% per year;
- ix. Added to these costs is an estimate to account for potential future LTD liabilities;
- x. SWM then deducted the annual fleet replenishment costs for the District which would be avoided if the in-house curbside collection services were contracted out; and
- xi. The net annual cost or savings was then net present valued to give a total value in today’s dollars for the length of the projected contract.

Comments on SWM Methodology and Key Assumptions

- 33.** Based on our discussions with SWM, our review of the Information provided and our experience in these matters, we comment as follows:
- i. With the exception of the estimates of the re-deployment costs and the assumptions with respect to the number of staff which could be re-deployed each year, EY believes the key assumption used to by SWM to be reasonable and to have been applied in an even and fair minded manner;
 - ii. With respect to the potential bids, SWM based their estimates on actual bids for District 1 and 2. However, what potential qualified bidders would do an actual contracting out of District 3 or District 4 cannot be determined outside of an RFQ/RFS.
 - iii. EY reviewed the calculations and methodologies with the SWM staff and believes that the approach and estimates are reasonable in the circumstances.
 - iv. SWM did not include one-time gains from the sale of any equipment; however, these gains are de minimis with respect to the decision threshold.
 - v. EY discussed the redeployment cost estimates with SWM and Human Resources and determined the following:
 - a. The costs are based on the experience with the 2011 SWM redeployments after the contracting out of District 2;

- b. The barriers to re-deployments are often with the management of other departments which do not make such re-deployments a priority as they prefer to hire their own candidates and may not want people from other departments;
- c. The time to set up appointments for internal interviews and tests to determine if an applicant is suitable is done by each department and is a time consuming process as these are not a priority for the target department and any delays and the associated costs do not get applied to the target department;
- d. A direction from Council or the City Manager providing direction to these departments may be helpful and may save time;
- e. The Human Resources department is also resource constrained and do not have sufficient staff to manage large scale re-deployments in a timely manner;
- f. The use of outside agencies to assist Human Resources with the re-deployment has not been considered as part of the analysis nor has the potential for early retirements (as these have not been well received in the past) or transfers to other city agencies (such as the TTC which may be hiring drivers); and
- g. A more detailed analysis of these estimates, the demographic of the workforce and any potential mitigation strategies would be recommended. A study of the age and other demographics of the workforce may suggest the best time to consider contracting out or that contracting out is fiscally impractical.

Review of Staff's Analysis of Options to Achieve Savings in Curbside Collections

34. A summary of the number of Households per District and tonnes collected per District are estimated by SWM to be as follows:

	Total Households	2014 Tonnes Collected	2014 Cost per Household	2014 Cost per Tonne	2014 Diversion rates
District 1	66,057	77,625	142.9	121.6	58.6%
District 2	155,445	183,100	133.2	113.1	54.5%
District 3	116,416	124,902	172.7	160.9	61.5%
District 4	121,440	126,423	126.9	121.9	62.7%

Note: District 3 figures before night collections but including a prorated vehicle reserve amount for District 3 only.

35. SWM has based its analysis using costs per household and has used this to prepare its estimates of the hypothetical bids for contracting out. It should be noted that "Household" refers to the number of curbside collection points on the routes and includes all customer types (ie. Multi-Residential, Commercial, ABCCs, Non-Residential and Residential

Units above Commercial). While other measures of performance could include cost per tonne, accidents/injuries per km, OT hours as percentage of total hours, or number of complaints per district; the use of per household data is appropriate as this is the primary driver for operations and costs.

District 3

- 36.** Based on a review of the operations, SWM determined that it would not be possible to contract out District 3 without also contracting out Night Collections (as they use the same equipment as District 3 as well as the same yard), as well as the Toronto Island/toxic taxi garbage collection as that is also part of the duties of District 3. A review of the night collection routes in the SWM staff report supports this analysis, as almost all of the night collection routes are in D1, D2 and D3. All of the analysis prepared by SWM with respect to District 3 incorporates the costs associated with District 3 Night Collections and Toronto Island/toxic taxi, the related employees for re-deployment purposes and is the basis for SWM's estimate of the potential bid from a third party contractor.
- 37.** The 2014 Costs for District 3 and Night Collections were adjusted for inflation at a rate of 2% per year to 2017, the potential start date for contracting out of D3.

Year	Adjusted Cost Base (\$ millions)
2014	24.6
2015	25.0
2016	25.6
2017	26.1

- 38.** The costs for curbside collection were then adjusted for inflation at a rate of 2% for the duration of the contract. In addition, the in-house costs were reduced by 2% per year based on planned efficiencies. Added to this was an estimate for costs related to LTD liabilities.

District 3 & Night collections (\$millions)	In-house Operating Costs	Internal Savings	LTD Costs	Total In House Costs After Adjustments
2017	26.1	(0.5)	0.5	26.1
2018	26.6	(0.5)	0.5	26.6
2019	27.1	(0.5)	0.5	27.1
2020	27.7	(0.6)	0.6	27.7
2021	28.2	(0.6)	0.6	28.2

2022	28.8	(0.6)	0.6	28.8
2023	29.3	(0.6)	0.6	29.3
Total 2017 to 2023	<u>193.8</u>	<u>(3.9)</u>	<u>3.9</u>	<u>193.8</u>
NVP	<u>172.1</u>	<u>(3.4)</u>	<u>3.4</u>	<u>172.1</u>

39. The SWM analysis indicates that while District 3 has the highest costs per tonne and per household of all four collection Districts, the most significant barrier to the contracting out is the time and costs to re-deploy staff from District 3.

40. As noted previously, the SWM analysis estimated a cost of approximately \$48 million to re-deploy approximately 217 staff (89 with greater than 15 years seniority).

Year	Re-deployment Costs (\$millions)
2017	13.0
2018	11.3
2019	9.5
2020	7.7
2021	5.8
2022	3.7
2023	1.7
Total	<u>\$52.7</u>
Net Present Value	<u>\$48.3</u>

41. After taking into consideration these costs, as well as potential savings due to future efficiencies, the SWM analysis indicates that any savings from contracting out will be dependent on the future bids from third party contractors. SWM has used the bids for contracting out District 2 in 2011 (“2011 Bids”) as a proxy for future potential bids for District 3 as District 2 and District 3 are similar in nature and complexity.

2011 Bids		
Proponent	Total Bid Price Per Year (\$millions)	7 Year Bid Price (\$ millions)
GFL	17.5	122.5
Miller	21.0	147.0
Emterra Environmental	23.9	167.3
Waste Management of Canada	25.6	179.2

42. SWM estimated the potential contracting out bids using an average of the 2011 Bids, using a proxy of the highest and lowest of the 2011 Bids. As well, the 2011 bids were adjusted for the number of households in District 3 versus District 2. In each case, these bids were adjusted using a 2% inflation factor to bring these bids from an effective 2012 start of contract to a 2017 assumed start of contract and to adjust the bid by 2% per year over the life of the contract.

(\$ millions)	Estimated Contractor Price - Low	Estimated Contractor Price - Average	Estimated Contract Price - High
2017	20.6	23.2	25.7
2018	21.1	23.6	26.2
2019	21.5	24.0	26.7
2020	21.9	24.6	27.2
2021	22.3	25.1	27.8
2022	22.8	25.6	28.3
2023	23.3	26.0	28.9
Total 2017 to 2023	<u>\$153.5</u>	<u>\$172.1</u>	<u>\$190.8</u>
Net Present Value	<u>\$136.3</u>	<u>\$152.9</u>	<u>\$169.4</u>

43. These estimated contractor prices were added to the re-deployment costs, contract management costs, additional costs for Toronto Island and toxic tax less costs related to new vehicle purchases which would be avoided if the curbside collections were contracted out as shown in the table below:

NPV Estimated Contractor Price seven years (in \$ millions)	Low	Average	High
Estimated Contractor Bids	136.3	152.9	169.4
Re-deployment Costs	48.3	48.3	48.3
Toronto Island Collection Costs	1.9	1.9	1.9
Contract Management	3.2	3.2	3.2
Vehicle Replacement	<u>(29.7)</u>	<u>(29.7)</u>	<u>(29.7)</u>
Net Contracting Out Costs	160.0	176.6	193.1

44. After all of these adjustments and the SWM analysis indicates that the net cost/(savings) from contracting out District 3 over a seven year contract term is estimated as follows:

Net Cost/(Savings) (in \$millions)	Low	Average	High
Total In House Cost	172.1	172.1	172.1
Contractor Costs	<u>160.0</u>	<u>176.6</u>	<u>193.1</u>
Net Costs/(Savings)	(12.1)	4.5	21.0

45. As noted above the potential cost/benefit is dependent on the third party contract bids which cannot be known with any certainty at this time. Any such bids would be influence on the market conditions at the time. SWM has done a reasonable job of estimating these potential bids based on the 2011 Bids. It should be noted that the employee re-deployment costs are one-time costs only and that on-going savings could be significantly higher. However, it should also be noted that future contract prices are not guaranteed and that the reduction of in-house collection services could negatively impact the City's ability to keep prices competitive, though competitive market forces may be a counter balance to this.

District 4

46. As noted previously in this Report, the SWM analysis indicates that District 4 is cost competitive with Districts 1 and 2 on both a cost per tonne and cost per household basis. However, the SWM analysis demonstrates, that depending on the bid price, contracting out of District 4 may result in cost savings to the City.
47. SWM did a complete analysis of the costs. The SWM analysis for District 4 uses the same methodology as we described for District 3, so we have limited our Report to highlighting the differences from District 3 and describing the final estimated cost/(savings) of contracting out District 4.

48. As noted earlier, the SWM analysis estimated that it would take one year and cost approximately \$855,000 to re-deploy approximately 68 staff (23 with greater than 15 years seniority). The significant difference between District 3 and 4 re-deployment costs is that approximately 45 District 4 staff could be absorbed into District 3 displacing out temporary and seasonal workers, leaving only 23 employees who would need to be redeployed.
49. SWM has used the 2014 Bids for contracting out District 1 as a proxy for future potential bids for District 4 as District 1 and District 4 are similar in nature and complexity.

Proponent	Total Price Per Year (\$ millions)	7 Year Bid Price (\$ millions)
Modern	8.1	56.7
Miller	9.0	63.0
Emterra Environmental	9.4	65.8
BFI	10.6	74.2
Waste Management of Canada	11.0	77.0

50. As with District 3, SWM estimated the impact of contracting out bids using an average of the 2014 Bids, using a proxy for the highest and the lowest of the 2014 Bids. In each case these bids were adjusted using a 2% inflation factor to bring these bids from an effective 2016 start of contract to a 2017 year assumed start of contract as well as adjusted for the number of households in District 4 versus District 1.
51. After all of these adjustments and the SWM analysis indicates that the net present value (i.e. the future cash savings in today's dollars) of the cost/benefit from contracting out District 4 over a seven year contract term is as follows:

Net Cost/ (Savings) (\$millions)	Low	Average	High
Total In-House Cost	98.8	98.8	98.8
Contractor Cost	<u>86.9</u>	<u>102.4</u>	<u>118.0</u>
Net Cost/ (Savings)	(11.9)	3.6	19.2

52. As noted above the potential benefit is highly dependent on the third party contract bids which cannot be known with any certainty at this time. Any such bids would be dependent on the market conditions at the time. SWM has done a reasonable job of estimating these potential bids based on the 2014 Bids. However, it should also be noted that future contract prices are not guaranteed and that the reduction of a public employees in collection could negatively impact the city's ability to keep prices competitive, though competitive market forces should be a counter balance to this.

District 3 and 4 Combined

- 53.** In addition, SWM did an analysis of the combined contracting out of both District 3 and District 4.
- 54.** As with District 3 and District 4, SWM did a complete analysis of the potential costs and savings for contracting out District 3 and District 4. As noted earlier, the SWM analysis estimated it would cost approximately \$100 million to re-deploy approximately 285 staff (112 with greater than 15 years seniority). The significant difference between District 3 and 4 contracting out individually and contracting out both together, is that the District 4 staff cannot be re-deployed into District 3 and the savings from that cannot be realized.
- 55.** SWM has used the 2014 Bids and the 2011 Bids as a proxy for future potential bids for District 3 and 4 as described above. SWM estimated the impact of contracting out bids using an average of the 2014 Bids and the 2011 Bids, using a proxy for the highest and lowest of the 2014 Bids and the 2011 Bids. In each case these bids were adjusted using a 2% inflation factor to bring these bids from an effective 2016 start or 2012 start as appropriate of contract to a 2017 year assumed start of contract as well as adjusted for the number of households in District 4 and 3 versus Districts 1 and 2.
- 56.** After all of these adjustments and the SWM analysis indicates that the net present value (i.e. the future cash savings in today's dollars) of the cost/benefit from contracting out District 3 and 4 over a seven year contract term is as follows:

Net Cost/(Savings) (\$millions)	Low	Average	High
Total In-House Cost	270.9	270.9	270.9
Contractor Cost	<u>298.3</u>	<u>329.3</u>	<u>360.3</u>
Net Cost/(Savings)	27.4	58.4	89.4

- 57.** As noted above the potential benefit is dependent on the third party contract bids which cannot be known with any certainty at this time. Any such bids would be dependent on the market conditions at the time. SWM has done a reasonable job of estimating these potential bids based on the 2014 Bids and 2011 Bids. It should be noted that the employee re-deployment costs are one-time costs only and that future savings could be significantly higher. However, it should also be noted that future contract prices are not guaranteed and that the reduction of a public employees in collection could negatively impact the city's ability to keep prices competitive, though competitive market forces should be a counter balance to this.
- 58.** Based on the SWM analysis and the high cost of re-deployment of staff (which appear to be high) contracting out Districts 3 and 4 together would not make economic sense at this time. However, additional analysis of the re-deployment costs should be performed.

Assessment of Outsourcing Advantage and Disadvantages

59. EY notes that there are certain advantages and disadvantages with respect to keeping a balance between in-house curbside collection and contracting out curbside collection including the following:

i. Advantages

- Maintaining District 3 and District 4 in house will allow SWM to implement its future cost efficiency plans;
- A strong public presence may ensure that District 1 and District 2 remain cost competitive with the public sector;
- The private collection in District 1 and District 2 exert pressure on the public sector employees to be competitive in terms of service and price with the private sector;
- Allows for the renewal/amendments to services on easier basis than under a collective agreement;
- Avoids potential strike of union workers as many of the private companies are non-union; and
- The risk of disruption to curbside collection from a private contractor due to financial, operational or regulatory factors must be weighed against the risk of in-house labour disruption.

ii. Disadvantages

- Once fully contracted out, it would be difficult for the City to re-establish in-house curbside collection;
- The City may have less control over discipline or service quality of Contractors. This may impact safety, quality and environmental/sustainable actions of the Company;
- Service quality ranges from contractor to contractor which is difficult to monitor or execute disciplinary actions on drivers; and
- Risk of total loss of service if one of the contractors either shuts down or is their licence is removed. GFL, as an example was downgraded in their CVOR rating which, if they didn't satisfy future requirements, would not be able to operate.

Conclusion

60. EY traced the cost centre data used by SWM to the SAP financial system which was the basis for SWM's analysis of contracting out of curbside collection. EY believes that the cost centre data used by SWM was appropriate and relevant to the analysis.

61. EY discussed the key assumptions used by SWM in its staff report and found that the key assumptions were reasonable and were applied in a fair minded manner.

- 62.** EY reviewed the SWM calculations of the cost and benefits of contracting out D3 and D4 as well as the methodologies used in the SWM financial models and believes that SWM's approach are reasonable, the calculations are numerically accurate and that methodologies have been correctly applied.
- 63.** While the Human Resources estimates are based on prior experience with re-deployments of SWM staff and the financial models used to produce the estimates are reasonable, EY believes that key assumptions with respect to the time to re-deploy staff should be reviewed. In our experience with re-deployments (even those in unionized environments) the timelines should be significantly shorter than have been assumed by Human Resources;
- 64.** SWM did not include the impact of the sale of any surplus equipment; however, the proceeds would be de minimis and would not impact the decision;
- 65.** In the absence of an RFQ to obtain bids from qualified bidders for contracting out D3 or D4, the approach taken by SWM to estimate potential bids (low, average and high) was reasonable under the circumstances and represents a good proxy for discussion purposes. However, we would caution (as would SWM), that these estimated potential bids are hypothetical in nature and should not be taken to represent actual bid potentials. There are many factors which may change the industry's interest in such a project including future economic conditions, supply constraints, regulatory issues and individual company's financial constraints.
- 66.** In any consideration of contracting out curbside collection the financial benefits must also be balanced against any operational risks. The risk of disruption to curbside collection from the private contractor due to financial, operational or regulatory factors must be weighed against the risk of in-house disruptions due to strikes or work to rule campaigns. The ability of the City to replace the service provider in the event of a service disruption, whether in-house or outside contractor should be a key consideration in the cost/benefit analysis.
- 67.** The City should also consider the balance between in-house and outside contractors to maintain a competitive tension with the service providers. While market forces will ensure that outside contractors are competitive with each other, the ability of the City to provide in-house curbside collection is an added element which undoubtedly ratchets up the competitive tension. On the other hand, the use of outside contractors is certainly a factor for in-house service providers to consider during labour negotiations.
- 68.** Finally, the sustainability of outside contractor pricing is an issue to be considered. It is not uncommon for private sector companies to put in low ball bids in an attempt to gain market share. While the City can take steps to ensure

that the low ball bidder is qualified and is financially sound, the long term sustainability of low bids is questionable. Therefore it is critical that the long term sustainability of potential bids be considered in the contracting out decision making process.

69. The City may wish to consider further analysis which may include the following:

- i. Detailed analysis of the Human Resources' estimates of the costs of re-deployment including the age and the other demographic data of the in-house employees. In addition, a review of potential mitigating strategies including early retirement packages, the use of outside downsizing agencies (to assist with Human Resources who are resource constrained), the possibility of transfers to other City agencies such as the TTC and other possible strategies. Such an analysis would require discussions with the union as well , SWM, City staff and Human Resources; and
- ii. An analysis of the cost drivers in District 3 to determine the factors which are resulting in higher costs per tonne and per household and which may be rectified or which may impact the analysis of potential bids.

70. In summary, EY supports the SWM recommendation to defer the decision with respect to contracting out, based on the assumption that a review of the implementation of service efficiencies suggested by SWM and the additional analysis suggested above will be undertaken.