



California Used Mattress Recovery and Recycling 2017 Program Budget

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Submitted by:

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Submitted to:

California Department of Resources Recycling and Recovery
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California Used Mattress Recovery and Recycling Plan Budget

Pursuant to Section 42988 of the California Public Resources Code and §18963 of the Used Mattress Recovery and Recycling Program Regulations (the Regulations), the Mattress Recycling Council (MRC), a non-profit corporation, is pleased to submit to the California Department of Resources Recycling and Recovery (CalRecycle) its 2017 budget (including years 2016 and 2018).

As requested by §18963(b) of the Regulations, the MRC Budget is submitted by:

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Introduction

In September 2013, California enacted SB 254 (the Act), codified beginning at Section 42985 of the California Public Resources Code, which requires mattress producers to create a statewide recycling program (the Program) to collect and recycle mattresses and foundations discarded in the state. The Program is funded by a visible recycling fee collected from consumers and other purchasers on the sale of each mattress and foundation for use in the state.

In late 2013, the mattress industry, through its trade association, the International Sleep Products Association (ISPA), formed MRC with the sole purpose of designing, implementing, and administering recycling programs in states with mattress recycling legislation. MRC serves as the responsible party for meeting the industry's obligations in this regard.

MRC is a tax-exempt non-profit corporation incorporated in the state of Delaware under Section 501(c)(3) of the Internal Revenue Service. Pursuant to Section 42987 of the Act, CalRecycle has certified MRC as a mattress recycling organization.

As required by Section 42987(a)(3)(B) of the Act, MRC consulted with the Program's advisory committee by distributing this budget for review and comment prior to its submittal to CalRecycle.

Section 42988 of the Act

Section 42988 of the Act provides that:

On or before July 1, 2015, and on or before July 1 annually thereafter, the mattress recycling organization shall prepare and submit to the department a proposed used mattress recycling program budget for the following calendar year that includes all of the following:

- (a) Anticipated revenues and costs of implementing the program, including related programs, projects, contracts, and administrative expenses.
- (b) A recommended funding level sufficient to cover the plan's budgeted costs and to operate the mattress recycling program over a multiyear period in a prudent and responsible manner.
- (c) The amount of the mattress recycling charge and itemization of costs that each charge covers.

§18963(b) of the Regulations

§18963(b) of the Regulations provides that:

(b) In addition to the requirements of subdivisions (a), (b), and (c) of section 42988 of the Public Resources Code, the information submitted in the used mattress recycling program budget shall contain the following:

- (1) Contact information. Identify the corporate officer of the mattress recycling organization responsible for annual used mattress program budget submittal.
- (2) Anticipated revenues and costs. Describe anticipated revenues and costs of implementing the program, including related programs, projects, contracts, and administrative expenses.
- (3) Mattress recycling charge and itemization. Identify the amount of the mattress recycling charge, including an itemization of costs that each charge covers.

Pursuant to these provisions, MRC has calculated a “recommended funding level sufficient to cover the plan’s budgeted costs and to operate the mattress recycling program over a multiyear period in a prudent and responsible manner” based on its projected costs and revenues for years 2016-2018. In some instances, MRC refers to Sections of its Used Mattress Recovery and Recycling Plan (the Plan).

For purposes of calculating the charge, MRC has estimated its costs to create, launch and operate the Program over the three-year period 2016 to 2018. Based on MRC’s

anticipated costs and revenues over this multi-year period (including related start-up costs), MRC has set a charge of \$11 per mattress or foundation unit.

Given that MRC is developing a state-wide mattress recycling system that is several times larger than current mattress recycling capabilities in California, and the fact that the Act requires MRC to operate in a fiscally prudent and responsible manner, MRC has been conservative in estimating both the costs and revenues that it expects to incur and earn over the 2016-2018 period.

In preparing this budget, MRC has allocated revenues and expenses in accordance with Generally Accepted Accounting Principles, as requested by §18962(a)(6) of the Regulations.

Specifically, in preparing this budget, MRC calculated its revenues and costs as follows:

Revenues

The recycling charge collected on all sales of mattresses and foundations in the state is the Program's only source of revenue. MRC followed the steps described below in calculating its budgeted revenue:

1. The starting point for budgeting MRC's recycling charge revenue is to estimate the quantity of mattresses sold annually in California. Given the lack of California-specific mattress sales data, MRC estimated mattress sales in California by first calculating the total sales of mattresses and foundations in the United States. MRC used two sources for this information. For U.S. sales (at wholesale) of finished mattresses and foundations manufactured in the United States (including Puerto Rico), MRC used annual sales data collected and published annually by the International Sleep Products Association (ISPA). Second, MRC added to this figure the quantity of finished mattresses and foundations imported into the United States annually. This mattress and foundation data, published annually by the International Trade Commission (ITC), includes imports of mattresses for use by both humans and animals. To adjust for this fact and to eliminate pet mattresses from the figure, MRC has conservatively estimated that approximately 40% of the total quantity reported by the ITC consists of mattresses and foundations intended for human use.
2. MRC then allocated the sum of the new U.S. manufactured and U.S. imported mattress and foundation units calculated in Step 1 to California based on relative population. Specifically, the aggregate data from Step 1 are for the entire United States (including Puerto Rico). Therefore, MRC multiplied the total national quantity by California's share of the U.S. population (including Puerto Rico) published by the Census Bureau to determine the California share of the ISPA data (12.04%).
3. The quantity calculated in Step 2 allocates national mattress sales quantities according to California's share of the U.S. population, based on the assumption

that California consumers purchase mattresses and foundations with exactly the same frequency as the average U.S. consumer. To be conservative, however, MRC must recognize that the allocation in Step 2 may overstate or understate the actual quantity of mattresses sold in California. In order to not overstate MRC's revenue assumptions, MRC has reduced its California quantity from Step 2 by 10%.

4. MRC is aware that in addition to new mattresses and foundations, used and renovated mattresses are also sold in California. Research conducted for MRC by the consulting firm of Reclay StewardEdge (RSE) has provided us estimates of the quantity of used and renovated mattresses and foundations sold in California in 2014. We added these quantities to the quantities of new U.S.-produced and imported mattresses and foundations calculated in Step 3 above.
5. The quantity calculated in Step 4 is based on mattress and foundation sales data for 2014. For purposes of this budget, however, MRC must estimate charge revenue for the years 2016 to 2018. Following the recession, the quantity of mattresses and foundations sold in the United States by U.S. mattress manufacturers grew from 2009-2014 on average by approximately 2.6% per year. For these purposes, MRC assumes that the total sales figure calculated in Step 4 above will continue to grow at an annual rate of 2.6% over both the period from 2014 until 2016 (when the Program launches), as well as for each of the years for which we provide forecasted revenues (that is, 2017 and 2018).
6. Finally, MRC must take into account the fact that over the period covered by the budget and forecasted revenues (that is, 2016-2018), a certain percentage of entities that are legally required to collect the recycling charge on mattress and foundation sales and remit those charges to MRC will not do so for a variety of reasons. Initially, we assume that some of these entities may not be aware of their charge-related obligations. We also anticipate that some will seek to evade their legal and financial obligations to MRC and the Program.

In an effort to minimize such noncompliance, MRC is actively communicating with such entities to inform them of the Act, the Program, their obligations under the law, and the consequences of noncompliance. In addition, MRC understands that CalRecycle's enforcement staff will assist in verifying compliance with such charge collection and remittance obligations. Nevertheless, to be conservative, MRC has assumed that it will not receive recycling charges on some mattress and foundation unit sales described above.

The noncompliance rates used in MRC's budget decline over time as the sellers become more familiar with their charge remittance obligations, and the MRC and CalRecycle enforcement activities take effect.

Based on the foregoing analysis, the revenues for the years 2016-2018 reported on the last page of this document are calculated in this manner, based on a Program launch date

of December 30, 2016.

Costs of Implementing the Program

For purposes of preparing this budget, MRC has classified its expenses under the following categories:

- Collection Costs
- Transportation & Processing
- Communications & Consumer Education
- California Government Oversight Expenses
- Administration, Research & Advisory

In preparing this budget, the following general comments apply:

- In addition to the California mattress recycling program, MRC is also responsible for developing, launching and operating mattress recycling programs in Connecticut and Rhode Island. When MRC incurs an expense, it determines whether that expense is attributable to a specific state's program, or benefits more than one state program. If the latter, the shared expense is allocated to the specific state budgets based on the relative population of the states whose recycling program will benefit from the expense.
- In establishing itself and in developing the plan, MRC has incurred certain pre-operational or start-up expenses. When incurring such an expense, MRC has determined in which of the above categories those expenses would be classified. For purposes of this budget, California's share of the MRC start-up expenses is allocated to 2016. Since the bulk of the start-up expenses were incurred in setting up the program, most of them are allocated to the last three cost categories listed above.

We now turn to a brief description of each of the above cost categories:

Collection Costs:

Before a discarded mattress may be recycled, it must be collected and made ready for transport to a recycler. This cost category covers the following activities:

- Collection/storage container rental fees (fees will vary depending on the size of the containers used and location of the site)
- Solid waste facility handling fee on free drop-offs (see Plan, Section "o")
- Consumer incentive payment (see Plan, Section "k")
- Collection site signage and materials
- Fund to collect illegally dumped mattresses (see Plan, Section "d")

All of these expenses are for services provided by third parties. At present, no

MRC staff are involved in collecting discarded mattresses, so no direct staff expenses are charged directly to this activity.

Transportation & Processing Costs:

MRC requested proposals from transporters and recyclers to provide shipping and processing services to MRC (see Plan, Sections “i” and “j”). These costs vary widely depending on the distance the discarded mattresses must be transported from the collection point to the recycler, population density, etc.

At present, data prepared for MRC by RSE show that approximately 370,000 discarded mattress units are recycled annually in California. MRC proposes to increase that volume by up to five times in 2016, the Program’s first year of operation. MRC intends to increase those statewide recycling volumes steadily in subsequent years. The transportation and recycling costs identified under this category reflect our estimated distribution of this quantity across all counties in the state by relative population.

To be conservative, MRC has included various inflation factors in its cost estimates. In addition, given the tremendous increases in recycling volumes that MRC is planning from the start of the Program, we anticipate incurring a number of problems and associated operating costs that we are unable to anticipate at this time. For that reason, MRC has included a contingency fund to cover such unforeseen operational expenses, with that fund declining over time as MRC gains experience in implementing and operating the Program.

As with the collection costs discussed above, all of these expenses are for services provided by third parties. At present, no MRC staff are involved in transporting or processing discarded mattresses, so no direct staff expenses are charged directly to this activity.

Communications & Consumer Education:

Section “n” of the Plan describes in detail the specific elements of the communications and consumer education effort that MRC has planned. Many of these costs will benefit all of MRC’s state programs. As a result, the California-allocated portion of those costs will cover the following activity:

- General marketing outreach to producers, retailers, municipalities and others
- Retailer compliance marketing
- Media buys/advertising
- Website & online activity
- Conferences & Events
- Participation in collection events
- Retailer point of sale materials

- Customer service
- Staff expense
- PR agency

By way of explanation, MRC has classified collection event activities as a communications expense. Although such events will certainly generate some volumes of discarded units for recycling, we consider a primary function of such activities as educating the public and promoting public awareness of the Program.

In addition, MRC will have employees and PR consultants that will implement these activities, and their associated costs are included under this category.

California Government Oversight Expenses:

Section 42988.2 of the Act requires that MRC reimburse CalRecycle for its direct costs incurred to implement and enforce the Act. The costs identified on this line of the budget and for the forecasted years reflect estimates of these reimbursements (including such costs incurred by CalRecycle prior to the Program's launch).

Since this category represents only costs to be reimbursed to CalRecycle, no direct staff expenses are charged directly to this activity.

Administration, Research & Advisory Expenses:

This cost category reflects MRC's costs to administer the program (including staff and various consultants, and their related travel costs), as well as allocated amounts for research to improve the Program's operations, increase recycling volumes, improve markets for recycled mattress materials, etc. Start-up expenses that are not directly related to other cost categories noted above are allocated to this category.

This cost category covers the following activities:

- Participant compliance audits
- Retailer implementation reimbursement
- MRC annual report and financial audit
- Interest expense
- Bank charges
- MRC staff and consultants (e.g., program planning, HR, accounting, legal)
- Travel
- ISPA services
- Prepaid expenses (2013-15)

When MRC was established, it initially retained a variety of consultants to assist it in designing and developing the Program. MRC's goal, however, has been to quickly hire staff to assume many of the functions initially provided by these consultants. The combined MRC staff and consultants item refers to the sum of these expenses. This shift will continue as MRC formally launches and improves the Program.

The ISPA services item refers to certain services that ISPA provides to MRC, for which ISPA bills MRC at cost. For example, MRC's offices are housed within ISPA's offices, and ISPA provides a number of support services to MRC and its employees (office space, management, accounting, health insurance, etc.).

Regarding the line captioned "Retailer implementation reimbursement," Section 42989.1(c) of the Act requires MRC to "develop reimbursement criteria to enable retailers to recover administrative costs associated with collecting the charge." This cost category implements this requirement. A retailer may request a one-time reimbursement from MRC of documented costs incurred in modifying existing accounting and related systems to collect the fee of up to \$1,500, if it:

- Registers with MRC,
- Has reported and remitted charges to MRC in a timely manner for at least 3 consecutive months,
- Is current on all outstanding invoices,
- Documents the costs for which it seeks reimbursement in a format specified by MRC, including receipts or invoices or other proof of expense, and
- Requests reimbursement by no later than August 1, 2016.

Reserves

Section 42988 of the Act requires that MRC maintain sufficient funds to operate the program over a multi-year period in a fiscally prudent and responsible manner. MRC is embarking on an aggressive expansion of mattress recycling activity in California. Furthermore, the revenues for this program are based on the total number of mattresses sold in California. In addition, the mattress market is a highly pro-cyclical industry. That is, when the economy performs poorly, so too does the mattress industry. For example, during the last recession, the number of mattress units sold dropped by over 25%.

Given that mattress recycling at this scale has not been done in the state before, and substantial unknowns associated with the launch of this program and its rapid growth can have an important impact on both the MRC's annual revenues and costs, which in turn could imperil the Program's long-term viability, it is critical that MRC establish reserves quickly in case it should encounter one or more substantial problems that could otherwise jeopardize the enterprise. In order to act in a fiscally prudent and responsible manner, as directed by the Act, MRC has budgeted to gradually build a financial reserve from 2016 to 2018 that should be sufficient to fund at least three and up to six months of normal MRC operating expenses.

The Amount of the Mattress Recycling Charge

To calculate the per unit mattress recycling fee, MRC has divided the total Expenses plus Reserves for the period 2016-2018 (\$135,823,367) by the total unit quantity for the same three-year period calculated as described in Step 6 of the Revenues calculation (12,347,579 units). That quotient equals \$11/unit.

Section 42988(c) of the Act also requires that MRC itemize the costs that the charge covers. Likewise, §18963(b)(3) of the Regulations provides that the Plan respond to 42988(c). The different cost categories discussed above that make up MRC’s budget represent the percentages of the total budget and the portion of the proposed \$11 charge as follows (based on budgeted and forecasted costs for the period 2016-2018):

Cost Category	Percent of Total Costs	Portion of \$11 Charge
Collection Costs	10.2%	\$ 1.12
Transportation & Processing	72.8%	\$ 8.00
Communications & Consumer Education	3.1%	\$ 0.34
California Government Oversight Expenses	2.5%	\$ 0.28
Administration, Research & Advisory	11.5%	\$ 1.26
Total	100%	\$11.00

* * * *

For the foregoing reasons, MRC proposes a mattress recycling charge of \$11/unit.

**Mattress Recycling Council
California Budget**

	2016	2017 (Projected)	2018 (Projected)	Total	%
Revenue	40,138,535	46,385,438	49,299,394	135,823,367	
Expenses					
Collection Costs	2,992,765	4,121,612	4,592,266	11,706,643	10.2%
Transportation & Processing	23,778,927	27,812,785	32,158,123	83,749,835	72.8%
Communication & Consumer Education	1,303,906	1,085,473	1,122,409	3,511,788	3.1%
California Government Oversight Expenses	1,698,000	600,000	600,000	2,898,000	2.5%
Administration, Research & Advisory	6,815,932	3,145,240	3,246,868	13,208,040	11.5%
Total Expenses	<u>36,589,530</u>	<u>36,765,110</u>	<u>41,719,667</u>	<u>115,074,307</u>	100.0%
 Net	3,549,055	9,620,329	7,579,727	20,749,061	
<i>Accumulated Reserves</i>	3,549,005	13,169,333	20,749,061	50%	
 <i># of Units on Which Charge is Collected</i>	3,648,958	4,216,858	4,481,763	12,347,579	
<i>Charge/Unit</i>	\$11				