



California Used Mattress Recovery and Recycling 2018 Program Budget

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Submitted by:

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Submitted to:

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California Used Mattress Recovery and Recycling Plan Budget

Pursuant to Cal. Pub. Res. Code § 42988 and 14 CCR §18963, the Mattress Recycling Council (MRC), a non-profit corporation, is pleased to submit to the California Department of Resources Recycling and Recovery (CalRecycle) its 2018 budget.

1. Introduction

In September 2013, California enacted SB 254, 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 charge collected from consumers and other purchasers on the sale of each mattress and foundation (collectively referred to as “mattresses” or “units,” depending on context) for use in the state.

In 2013, the mattress industry, through its trade association, the International Sleep Products Association (ISPA), formed MRC to design, implement, and administer recycling programs in states that have enacted mattress recycling laws. 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 Cal. Pub. Res. Code § 42987, CalRecycle has certified MRC as a mattress recycling organization.

As required by Cal. Pub. Res. Code § 42987(a)(3)(B), MRC consulted with the Mattress Recycling Advisory Committee appointed by CalRecycle on June 6, 2017, prior to submission of this 2018 budget (and the annual report required by § 42990.1).

In terms of the content of this budget, Cal. Pub. Res. Code § 42988 provides that it must meet the following requirements:

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.

In addition, 14 CCR §18963(b) provides as follows:

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.
- 4) For used mattress recycling program budgets submitted on or by July 1, 2017 all actual expenses incurred to date shall be included. For annual reports submitted thereafter, the previous two years of actual expenses shall be included.

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.”

In preparing this budget, pursuant to 14 CCR §18962(a)(6), MRC has allocated revenues and expenses in accordance with Generally Accepted Accounting Principles.

2. Executive Summary

MRC launched the Program on December 30, 2015. MRC prepared its 2018 budget based on its actual revenue and expense experience in 2016 and year-to-date 2017 (YTD 2017), adjusting for anticipated changes in 2018.

By law, MRC must set the per unit mattress recycling charge that funds its California operations at a level that is sufficient to fund the Program’s budgeted costs and operate the mattress recycling program over a multi-year period in a prudent and responsible manner. MRC’s expenses include collection, transportation and processing, communications, research, CalRecycle oversight, and administrative expenses.

In general, most expense categories were below budget in 2016 and YTD 2017, largely because actual units received were less than MRC had anticipated. This was largely the result of the fact that MRC has successfully negotiated

agreements with many (but not all) municipal and solid waste facilities in California on terms that they and MRC determined were reasonable for accepting, collecting, storing, transporting, and handling used mattresses for processing through the Program. Using 2016 expenses as our baseline, which as our first year of operations were lower than originally expected, MRC anticipates a 30% increase in units received in 2017 and has budgeted for another increase of 15% in 2018.

MRC adjusted collection, transportation and processing expenses for anticipated inflation and fuel cost increases, as well as possible unexpected expenses that the Program may encounter.

MRC budgeted communications, research, and administrative expenses for 2018 by reviewing 2016 and YTD 2017 actuals and adjusting those figures based on anticipated 2018 program activities and annual inflation.

Finally, the 2018 budget contains a contribution to MRC's long-term reserves.

Based on this process, MRC has budgeted that it will require revenues of \$39,973,452 in 2018 to fund the Program's budgeted costs and contribute to the reserves required to operate the Program over a multi-year period in a prudent and responsible manner. Of this amount, MRC has budgeted that it will earn \$250,000 in interest income, with the balance of \$39,723,452 coming from the per unit charge collected on the sale of all mattresses and foundations to California residents and other purchasers in California (such as hotels, dormitories, etc.). MRC calculated the 2018 per unit charge by dividing (A) the above 2018 recycling charge revenue amount by (B) the total number of California units that MRC expects will be sold in 2018. As with its expense budgeting process, MRC's 2018 unit analysis begins with actual 2016 and YTD 2017 experience. Based on that information, as well as national mattress industry sales data and forecasts, MRC anticipates that 2018 California unit sales will be 3,783,186.

Therefore, dividing 2018 budgeted charge revenue of \$39,723,452 by 2018 anticipated unit sales of 3,783,186 units results in a per unit charge (rounded to the nearest 50 cents) of \$10.50. For these reasons, MRC proposes to reduce the charge from \$11 to \$10.50 per mattress or foundation unit in 2018, to be effective on January 1, 2018.

3. Anticipated revenues and costs of implementing the program, including related programs, projects, contracts, and administrative expenses

(Cal. Pub. Res. Code § 42988(a))

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

Revenue

Other than a small amount of interest income earned on reserves, the per unit recycling charge collected on all sales of mattresses and foundations is the Program’s only source of revenue.

MRC began by reviewing the actual quantity of units that retailers and other mattress sellers to California consumers reported to MRC in 2016 and YTD 2017 (California unit sales). MRC then took the following factors into account in calculating anticipated 2018 California unit sales:

- In preparing its 2017 budget two years ago, MRC anticipated 2017 California unit sales would be 4,216,858. At that time, MRC did not have the benefit of knowing what actual 2016 California unit sales would be. Rather than basing its analysis on actual MRC experience, the 2017 budgeted units were based largely on best estimates and forecasts.
- At the time that it prepared its 2018 budget, MRC had actual 2016 and YTD 2017 data (through March 2017), which showed that its 2017 1st Quarter California actual unit sales were 11% below budget.
- By the time that MRC prepared its 2018 budget, ISPA had published industry statistics showing that units sold nationally during 2017 1st Quarter were 4.4% below 2016 1st Quarter national units sold.
- Since MRC now has actual California unit sales data for 2016, MRC conservatively adjusted its 2017 budgeted units sold by reducing it to 4.4% below 2016 actual California units sold, thus having the adjusted 2017 budget projections follow the national data.
- To estimate 2018 Unit sales, MRC increased the adjusted 2017 California unit sales budget projections by 3.0%, which was the expected growth rate in ISPA’s 2016-18 Mattress Industry Forecast (Issued June 2016) for the year 2018.

This analysis can be summarized as follows:

2016 Actual California Units Sold	3,842,046
Adjusted 2017 Budget Forecast for California Units Sold (2016 Actual – 4.4%)	3,672,996
2018 Budgeted California Units Sold (Adjusted 2017 + 3.0%)	3,783,186

Costs

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

- Collection
- Transportation & Processing
- Communications

- Research
- CalRecycle Oversight
- Administration

Following is a description of each of the above cost categories:

Collection:

This cost category covers the following activities:

- Solid waste facility handling fees
- Collection/storage container rental fees and signage (fees will vary depending on the size of the containers used and location of the site)
- Consumer incentive payments
- Illegally Dumped Mattress Collection Initiative

MRC's budget anticipates increased spending in all Collection expense categories as a result of both Program expansion and inflationary pressure (we have assumed inflation of 3% annually). MRC currently contracts with 145 solid waste facilities across the state. As MRC continues to expand the Program in 2017 and 2018, we anticipate contracting with another 50-75 facilities in coming years. Total solid waste facility handling fees and collection/storage container rental fees correlate directly to the number of sites participating.

MRC set the \$3.00 per unit consumer incentive payment following discussions with the Mattress Recycling Advisory Committee during pre-program meetings in 2015. 13% of units collected through the Program in 2016 were through the consumer incentive. The incentive remains at \$3 in 2017, though the incentive collection target has increased to 17%. For the 2018 budget, MRC has again planned for 17% of units to be collected through the consumer incentive.

Following discussions with the Mattress Recycling Advisory Committee, MRC also budgeted \$750,000 to the Illegally Dumped Mattress Collection Initiative in 2016. In that first year of the Program, MRC spent only \$237,940 on the initiative due to lower than anticipated participation (95 entities registered to participate in the initiative, but only 40 entities ultimately qualified for compensation). In 2017, MRC budgeted the same amount and took additional steps to encourage more participation. For the 2018 budget, MRC has again allocated \$750,000 to the initiative. Once we have two years of actual expenditures, MRC will evaluate whether to increase or decrease funding for this activity.

Transportation & Processing:

Both transportation and processing are directly related to the number of units collected. MRC's actual 2016 transportation and processing expenses fell below budget because fewer units were collected than anticipated. MRC in 2016 negotiated agreements with 122 municipal and solid waste facilities in California on terms that they and MRC determined were reasonable for accepting, collecting, storing, transporting and handling used mattresses for processing through the Program. However, other such facilities in the state chose not to enter into such agreements on comparable terms.

Transportation

MRC uses third parties to transport mattresses from collection sites to recyclers for processing. The per unit transport costs vary considerably depending on the transport distance and the quantities transported on a specific load.

MRC has budgeted 2018 transportation costs based on (1) 2016 actual per unit rates, plus a 3% annual increase to cover anticipated fuel cost increases and general inflation between now and 2018, (2) an increase in the number of units to be transported in 2018, and (3) a contingency factor in case the Program incurs unforeseen added costs as the Program expands.

Processing

MRC's 2018 budget for mattress recycling expenses includes an annual increase in per unit processing costs over 2016 actuals to take anticipated inflation into account. In addition, it reflects the fact that we have budgeted for MRC-contracted recyclers to process larger volumes of mattresses in 2018, plus a contingency factor in case the Program incurs unforeseen added costs as it expands.

These services are provided by third parties. No MRC staff are directly involved in processing discarded mattresses, so no direct MRC staff expenses are charged to these activities.

Communication Expenses:

MRC uses comprehensive communication and consumer education and outreach efforts to inform the industry and consumers about the Program and opportunities for mattress recycling. Many of these costs are shared with MRC's other state programs, with the shared costs allocated to each state's program in proportion to each state's population. The California-allocated portion of those costs covers the following activities:

- PR agency services
- Advertising/media buys
- Marketing outreach

- Annual report preparation
- Website & online
- Conferences & events
- Point of sale materials
- Customer service/CRM
- MRC marketing and communication staff
- Community collection events

In 2016, MRC spent nearly \$1.4 million in marketing and communications expenses. This included consumer and industry advertising, online and social media marketing, and exhibiting or sponsoring public and industry events. In 2017, MRC increased the budget by over 40% to \$2 million to fund an expanded advertising strategy, website and locator improvements and development of multilingual communications. MRC also launched an interactive educational booth used at large-scale community events across the state. In 2018, the budget increases another 65% to \$3.3 million and will include continued statewide advertising, awareness studies, target market research and rebranded point of sale materials and training for retailers to better communicate the Program to consumers. In addition, MRC is developing a comprehensive CRM to further enhance customer service, which we plan to complete in 2018.

Research Expenses

MRC seeks to improve the sustainability of mattress recycling through efforts focused on advancing the efficient collection, transport and recycling of discarded mattresses and identifying new and better uses for extracted mattress components. MRC supports applied research and development efforts intended to achieve one or more of the following objectives:

- Identify new or better uses for recycled mattress materials
- Reduce the costs and improve the efficiencies of collecting, transporting and recycling discarded mattresses
- Identify and promote mattress recycling best practices
- Foster innovation, cooperation and communication between suppliers, manufacturers, dismantlers and end-market commodity buyers

MRC research expenses support the goals outlined above.

In early 2017, MRC commissioned research with a major university to investigate potential uses for mattress materials for which limited recycling options are currently available, including post-consumer foam, fiber, quilt pads and wood. The potential opportunities identified by the research included such diverse categories as geotextiles, insulation, sporting goods

and play surfaces, packaging materials, and additives to concrete and other building materials. The 2018 budget includes funding which MRC intends to use to build on this research, as well as for new projects yet to be determined.

In addition, MRC has budgeted funds:

- to conduct a study to examine how the unit handling and dismantling efficiency can be improved as well as whether tracking by units or weights is a more effective method for the program, thereby improving the Program's efficiency and sustainability
- to travel to and investigate best practices of other companies and programs, both domestic and overseas
- for staff and consultants to oversee the above programs, as well as travel to various industry events to speak and network with professionals in the secondary markets to further our goal of finding uses for materials

Administration Expenses:

This cost category reflects MRC's costs to administer the Program, including overhead, staff and consultants, travel and other administrative costs. This cost category covers the following:

- Staffing and management
- Travel/field visits
- Legal fees
- Recycler and seller compliance activity (including audits)
- Annual financial audit of MRC and tax filing preparation
- Finance charges

Staffing and management includes the salaries and associated overheads of MRC staff and shared ISPA-MRC staff that administer the Program. Travel/field visits covers travel costs for staff to visit solid waste sites, recyclers, other operational service providers, and other business-related travel.

Legal costs cover fees for outside counsel that negotiate MRC contracts, advise MRC regarding necessary corporate compliance functions, etc.

MRC uses both in-house and outsourced providers to confirm whether vendors providing mattress processing services to MRC are complying with their contractual and other legal obligations and that retailers are properly registered with MRC and are collecting and remitting the charges they collect to MRC.

Separately, MRC's financial records are audited annually by an

independent certified public accountant, and MRC incurs costs in preparing and filing necessary tax documents.

Finance charges covers bank fees.

MRC administrative expenses represented 11% of 2016 expenses. We expect to maintain expenses in the range of 9-11% for the foreseeable future. MRC will be adding staff in 2017 and has budgeted for these administration expenses in 2018.

CalRecycle Oversight:

Cal. Pub. Res. Code § 42988.2 requires that MRC reimburse CalRecycle for its direct costs incurred to implement and enforce the Act. The costs identified on this line item reflect estimates of these reimbursements for 2018 that CalRecycle has provided to MRC.

- 4. 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**
(Cal. Pub. Res. Code § 42988(b))

Cal. Pub. Res. Code § 42988 requires that MRC maintain sufficient funds to operate the Program over a multiyear period in a fiscally prudent and responsible manner. Unforeseen circumstances, such as operational failures, changes in market dynamics for recycle components, and changes in sales volumes, can significantly affect the Program and its budget. For example, mattress sales unexpectedly decreased by over 4% in the first quarter of 2017.

To meet our statutory obligation to act in a fiscally prudent and responsible manner, and to protect the long-term viability of the Program, MRC has budgeted to gradually build a reasonable financial reserve, which is also reflected in the 2018 budget.

Therefore, to meet the requirements of Cal. Pub. Res. Code § 42988(b), MRC's goal over the first several years of operations is to build (and then maintain) a reserve equal to approximately 9-12 months of operating expenses. The dollar value of the reserve will increase (or decrease) as projected Program expenses increase or decrease over time. Based on this target, MRC proposes a 2018 funding level of \$39,973,452, which includes \$6,894,154 that will be added to MRC's long-term reserve. MRC's reserves through 2016 are \$22,782,839.

5. The amount of the mattress recycling charge and itemization of costs that each charge covers

(Cal. Pub. Res. Code § 42988(c))

Determination of Two Separate Charges

Cal. Pub. Res. Code § 42989(b)(2) gives MRC the discretion to either (1) set a single recycling charge that applies to all sizes and types of mattresses and foundations, or (2) set up to two different charges “to accommodate mattress size differentials.” MRC considered whether to exercise its authority to set two charges when it submitted its Plan in 2015, but decided to set a single charge for all sizes and types of mattresses and foundations. Likewise, MRC has set a single state-specific recycling charge for mattresses and foundations sold in the other two states in which it administers similar mattress recycling programs: Connecticut and Rhode Island. In its September 2016 approval of MRC’s 2017 budget, CalRecycle requested that MRC consider two separate charges when it prepared its 2018 budget and discussed this issue with the Mattress Recycling Advisory Committee.

MRC has considered whether to set two separate charges for calendar year 2018. For the following reasons, MRC has concluded that a single charge for all mattresses and foundations, regardless of size, is appropriate:

To date, MRC has received no complaints about applying the same charge to mattresses of all sizes.

- The single charge is clear and simple to communicate to consumers, retailers and other stakeholders.
- The single charge has simplified the reporting process and minimized remittance compliance errors by retailers. Conversely, different charges would complicate the collection process and would require longer and more elaborate audits of retailers to confirm that the charge has been properly collected and remitted.
- The Program likely experiences no cost savings when smaller mattress units are processed. In fact, the net cost to recycle a smaller mattress is likely more than the cost to recycle larger units. This is because the per unit cost for transporting and handling a mattress is approximately the same regardless of size. At the same time, the scrap value of the recycled mattress components reclaimed from smaller mattresses is less than the value of comparable materials from larger mattresses. Therefore, if anything, charges that “accommodate” a net cost-justified approach to “mattress size differentials” would likely result in MRC charging a higher charge on smaller units because they are more costly (on a net basis) to recycle.
- Industry sales statistics published by ISPA indicate that nearly 80% of mattress sales are sized full, queen or king (including California king). Therefore, if MRC were to set a lower charge for twin size mattresses and

a higher rate for other sizes, MRC could achieve its revenue target only by raising the charge for 80% of the mattresses sold in California (even though net recycling costs would dictate the opposite result). In addition, MRC would need to educate retailers about how to apply, collect and report the two charges. This would require retailers to reprogram their sales reporting data infrastructure as well, forcing them to incur added costs.

- MRC sets the charge at a rate necessary to fund the current recycling of discarded mattresses of all sizes, as well as all other aspects of the Program. The size of mattresses purchased is often different from the size of mattresses discarded by consumers.

MRC discussed with the Mattress Recycling Advisory Committee the potential impact of two different charges based on mattress size during their June 6, 2017 meeting. The committee did not express a consensus opinion on this issue. For the reasons detailed above, MRC is retaining the single charge for calendar year 2018.

Itemization of the Mattress Recycling Charge

Cal. Pub. Res. Code § 42988(c) and 14 CCR §18963(b)(3) requires that MRC itemize the costs that the charge covers.

The per unit charge can be distributed over the different cost categories discussed above that comprise the expense items in MRC’s 2018 budget using the following percentages:

Cost Category	Percent of Total Costs
Collection	13%
Transportation & Processing	65%
Communication Expenses	10%
Research Expenses	1%
Administration Expenses	9%
California Oversight	2%
Total	100%

Amount of the 2018 Charge

MRC has gained valuable experience from its first year of operations in California regarding how best to structure the Program for continued growth and improved efficiency. MRC has made substantial progress in implementing the requirements of the Used Mattress Recovery and Recycling Act and its 2018

budget is sufficient to fund further expansion of the Program. Among other things, MRC is implementing efforts to collect mattress discards “upstream,” before they arrive at solid waste facilities or are illegally discarded. Furthermore, MRC is on track to build a sufficient reserve covering 9-12 months of operating expenses.

For these reasons, MRC thinks it is prudent not to leave the per unit recycling charge at the current \$11 level in 2018 because it will generate a surplus that is larger than is needed to meet the requirements of Cal. Pub. Res. Code § 42988. As a result, MRC proposes to reduce the mattress recycling charge to \$10.50/unit beginning January 1, 2018.

6. Contact information. Identify the corporate officer of the mattress recycling organization responsible for annual used mattress program budget submittal (14 CCR §18963(b)(1))

The MRC Budget is submitted by:

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7. Anticipated revenues and costs. Describe anticipated revenues and costs of implementing the program, including related programs, projects, contracts, and administrative expenses (14 CCR §18963(b)(2))

See Part 3 above.

8. Mattress recycling charge and itemization. Identify the amount of the mattress recycling charge, including an itemization of costs that each charge covers (14 CCR §18963(b)(3))

See Part 5 above.

9. For used mattress recycling program budgets submitted on or by July 1, 2017 all actual expenses incurred to date shall be included. For annual reports submitted thereafter, the previous two years of actual expenses shall be included (14 CCR §18963(b)(4))

Expense Categories	2013/2014	2015	2016	YTD 2017	Total
Operations	\$ -	\$ 5,474	\$ 12,117,303	\$ 7,619,458	\$ 19,742,235
Cal-Recycle Oversight			\$ 1,853,965	\$ 145,975	\$ 1,999,940
Legal	\$ 39,735	\$ 114,957	\$ 84,567	\$ 24,746	\$ 264,005
Marketing	\$ 70,747	\$ 171,364	\$ 1,394,990	\$ 1,287,424	\$ 2,924,525
Administration	\$ 542,253	\$ 1,209,716	\$ 1,919,878	\$ 922,514	\$ 4,594,361
Total	\$ 652,735	\$ 1,501,511	\$ 17,370,703	\$ 10,000,117	\$ 29,525,066

**MRC California
2018 Budget**

	2018 Budget
Revenue	
Charge Revenue (\$10.50/unit)	\$ 39,723,452
Interest Income	\$ 250,000
Total Revenue	\$ 39,973,452
Expenses	
<u>Collection</u>	
Solid Waste Facility - Handling Fee	\$ 1,985,792
Consumer Incentive Payment	\$ 702,317
Collection Containers and Storage	\$ 827,735
Illegal Dumped Mattress Collection Initiative	\$ 750,000
Total Collection Expenses	\$ 4,265,844
<u>Transportation & Processing</u>	
Transportation	\$ 4,234,825
Recycling	\$ 17,359,967
Total Transportation and Processing Expenses	\$ 21,594,792
Total Operational Expenses (Collection/Trans & Processing)	\$ 25,860,636
<u>Administration</u>	
Staffing and Management	\$ 1,989,075
Travel / Field Visits	\$ 90,082
Legal	\$ 112,874
Compliance Audits	\$ 625,000
Annual Financial Audit and Tax Filing Preparation	\$ 89,250
Bank Charges	\$ 26,400
Total Administration and Legal Expenses	\$ 2,932,681
<u>CalRecycle Oversight</u>	
State Regulatory Oversight Fees	\$ 695,000
Cal Recycle Staff Travel	\$ 5,000
Total CalRecycle Oversight Fees	\$ 700,000

Communications

PR Agency	\$	225,000
Advertising/Media Buys	\$	1,800,000
Marketing Outreach	\$	316,412
Annual Report	\$	35,000
Website & Online	\$	60,000
Conferences & Events	\$	72,075
Community Collection Events	\$	77,440
Point of Sales Materials	\$	220,000
Customer Service / CRM	\$	90,000
Marketing and Communications Staff	\$	412,054
Total Communications Expenses	\$	3,307,981

Research

Research Studies	\$	278,000
Total Research and Advisory Expenses	\$	278,000

Total Expenses	\$	33,079,299
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Net Income (Reserve)	\$	6,894,154
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