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| To: | Dave Donery, Town Manager, San Anselmo |
| From: | Garth Schultz, Principal, R3 Consulting Group |
| Date: | **January 5, 2022** |
| Subject: | Background and Analysis of MSS PPP Loan Forgiveness |

## PPP Loan Program

The Paycheck Protection Program (PPP) is a federal loan program backed by the US Small Business Administration that helped businesses keep their workforces employed during the COVID-19 crisis. Recipients of PPP loans were eligible for forgiveness after all proceeds were expended. Once forgiven, PPP loan proceeds effectively became "grants" that were used for the purposes of continuing to employ workers during the early and extremely uncertain financial times of the COVID-19 pandemic.

## MSS's PPP Loan

Marin Sanitary Service (MSS) applied for and received a $4.575 million PPP loan in 2020 which was spent in continuing to employ 265 workers in 2020. MSS is one of many solid waste companies to receive a PPP loan. MSS has applied for loan forgiveness, which would effectively render proceeds as a "grant" for keeping workers employed during the pandemic. MSS's PPP proceeds were spent employing workers in 2020, meeting the requirements of the program. Of the $4.575 million in proceeds, $2.5 million was used to employ workers in collection operations for the seven solid waste collection franchise agreements MSS holds with public agencies; the remainder was used to employ workers in other MSS divisions (such as the debris box division, maintenance division, Marin Resource Recovery Center, and others.

## PPP Proceeds Benefit MSS Ratepayers

### Continuity of Service Delivery

As was the case for many other solid waste collection operations, MSS saw immediate declines in ratepayer revenues in the early months of the COVID-19 pandemic. Without the $2.5 million in PPP proceeds used to continue to employ collection workers, and because of unprecedented reductions in rate revenues (primarily due to subscription downsizing and/or service cessation in the commercial sector) MSS would likely have had to layoff collection workers in order to cover its other fixed cost capital and fee obligations. Doing so would have negatively affected MSS's ability to provide contracted collection services, resulting in service disruptions, routing changes, and lack of continuity in service delivery (which was the case in some other California communities).

Moreover, service disruptions would likely have been long-lasting even after anticipated recovery in rate revenue collections, due to an extremely challenging driver labor market. Had MSS needed to layoff collection workers, the likelihood that MSS would have been able to re-employ those same collection workers upon revenue recovery is highly unlikely. Instead, MSS would have had to compete with other solid waste companies and other driver focused companies (e.g., Amazon, UPS, trucking, etc.) to recruit, train, and retain new collection workers, which would likely have resulted in a decline in service quality, and may have resulted in an increase in overall labor cost. These impacts were avoided because of continuing to employ workers which was made possible by the PPP proceeds, enabling MSS to retain existing employees and avoid the need to layoff and then re-hire employees including hard-to-hire drivers.

## Voluntary Waiver of 2020 Rate Revenue Reconciliation

Per the Franchise Agreements that the Town of San Anselmo (Town) and the other six public agencies have with MSS, MSS's annual compensation is adjusted in accordance with a "balancing account" of ratepayer revenues owed vs. received. This was established for two reasons:

1) To shield MSS from the revenue reduction impacts of customer "downsizing" to smaller and less costly solid waste collection services, which solidifies MSS's partnership in continuing waste diversion and reduction; and

2) To return surplus rate revenue to ratepayers in the event that MSS collected more ratepayer revenues than needed to achieve a reasonable profit.

Annually, and in accordance with its rights in the Franchise Agreements, MSS may calculate the magnitude of the "balancing account" for the prior rate year and apply that amount to the rate adjustment for the following rate year as a "rate revenue reconciliation" adjustment. Prior to the pandemic, it was expected that the magnitude of such adjustments would be relatively minimal and vary over time. However, as a result of the steep declines in ratepayer revenue in 2020 due to the COVID-19 pandemic, the 2020 rate revenue reconciliation adjustment across the seven MSS public agencies was $1.5 million.

This $1.5 million adjustment would have amounted to an additional 3.56% increase in 2022 rate revenues for the Town, had MSS not voluntarily waived its right to request such an adjustment. MSS was able to waive this contractually allowed adjustment to its compensation, again, because of its relatively secure financial position resulting from PPP monies. The result is a 2022 adjustment to solid waste rates that is less than half of what it would have been had MSS not participated in the PPP program.

## Avoidance of Extraordinary Compensation Adjustments

MSS incurred new expenses in adjusting its operations to continue to provide services during the COVID-19 pandemic, as was the case for essential service businesses (such as PPE and increased cleaning of offices and trucks). MSS could have requested an extraordinary adjustment to its ratepayer compensation to fund the cost of these new expenses. MSS has not made such a request, which is attributable to MSS being in a relatively secure financial position, largely due to the PPP proceeds.

MSS also saw immediate and steep reductions in ratepayer revenues in mid-2020 during the height of the pandemic. Some solid waste collection providers in other communities made requests for extraordinary adjustments to their ratepayer compensation in response to revenue declines. Had MSS not received PPP proceeds, MSS may have needed to request an extraordinary adjustment to its compensation to continue to maintain operations.

Finally, it should be noted that ongoing and significant reductions in rate revenues are continuing in 2021, and anticipated to continue through 2022, and may continue in 2023 and beyond. Although the "balancing account" mechanism and the associated annual rate revenue reconciliations provide an avenue for MSS to recover from these revenue drops, there is a two-year timing difference between when MSS experiences the shortfall in revenues, and when they are recovered from ratepayers. As a result, MSS is experiencing negative impacts to its income cashflow, which we estimate will be as much as -$1.75 million in 2022, and with negative cashflows (and consequential reductions in income) persisting through 2024. MSS will be eligible for a base year "cost-based" rate review for the 2025 rate year, which will set 2025 rate revenues based on the actual cost of operations (if MSS requests the base year review in lieu of the normal indexed adjustment).



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Table 1 provides a summary of the estimated income and cash flow impacts to MSS from 2020 through 2024, including the PPP proceeds, estimated new expenses related to COVID-19 protocols, and waiver of the 2020 rate revenue reconciliation adjustment. It should be noted that this projection indicates that MSS will, cumulatively over these five years, experience an overall income loss of $750,000, inclusive of the PPP proceeds. Though the rate revenue reconciliation will make up the loss in subsequent rate years, the fact remains that MSS's near term cash flows are – and will remain – negatively impacted by the COVID-19 pandemic despite the PPP proceeds.

**Table 1: Estimate of MSS's Cash Flow Impacts Through 2024**

| | Actual 2020 | Projected 2021 | Estimated 2022 | Estimated 2023 | Estimated 2024 |
|---|---|---|---|---|---|
| Rate Revenue Shortfall | $ (1,500,000) | $ (1,300,000) | $ (1,000,000) | $ (700,000) | $ (500,000) |
| Rate Revenue Reconciliation | $ - | $ - | ***Waived*** | $ 1,300,000 | $ 1,000,000 |
| PPP Proceeds | $ 2,500,000 | $ - | $ - | $ - | $ - |
| New Expenses (PPE and Cleaning) | $ (200,000) | $ (150,000) | $ (100,000) | $ (50,000) | $ (50,000) |
| Impact to Annual Income/Cashflow | $ 800,000 | $ (1,450,000) | $ (1,100,000) | $ 550,000 | $ 450,000 |
| **Cumulative Impact to Income/Cashflow** | **$ 800,000** | **$ (650,000)** | **$ (1,750,000)** | **$ (1,200,000)** | **$ (750,000)** |

It should be noted that the $2,500,000 in PPP Proceeds noted in Table 1 is still subject to forgiveness by the SBA and will not be booked as revenue in MSS's accounting records until forgiveness occurs. This means that the apparent $800,000 positive impact to income/cashflows in 2020 is only indicative of available cashflows for business operations.

## PPP Proceeds are Not Rate Revenues

Collection services provided under the MSS agreements are funded by solid waste rates paid by ratepayers, which are heard and approved annually by the franchising public agencies. Annual adjustments to rates considered by the agencies take into account either a) projections of compensation due to MSS via an "indexed rate adjustment" methodology, or b) projections of MSS's forecasted cost of operations via a "base year rate adjustment" methodology. In both cases, determination of the contractually established annual rate adjustments are predicated only on rate revenues paid to MSS by ratepayers, as those are the sole recurring form of compensation that MSS receives for provision of collection services.

The MSS rate adjustment methodology (and other similar rate adjustment methodologies for most other solid waste agreements in California) does not include one-times grants in the determination of contractually allowed adjustments to rate revenues. Contractually speaking, the Town and its ratepayers have no claim on the PPP proceeds, and MSS is under no obligation to report or include the proceeds in determining annual rate revenue adjustments.

However, and despite having no obligation to do so, MSS notified its franchising agencies about the PPP proceeds, and voluntarily waived a portion of its contractually allowed rate adjustment for 2022, which was to the benefit of ratepayers. Moreover, ratepayers have and will continue to benefit from MSS's receipt of PPP proceeds, while MSS has and will continue to incur near-term revenue shortfalls and cash flow impacts, as described in the following pages.