



## *Pollution Prevention Fact Sheet*

# Credit Assistance Pilot Project

### **What is the Credit Assistance Project?**

The Maryland Department of the Environment and EPA's Office of Pollution Prevention and Toxics recently conducted a pilot project to determine the extent to which small businesses are able to obtain financing for pollution prevention equipment, and, if they are having difficulties, what type of assistance might be effective in helping them obtain credit. The pilot project focused on dry cleaners in Maryland faced with new Federal and state environmental requirements.

Specifically, a 1993 Federal air toxics rule under the Clean Air Act requires dry cleaners either to purchase "dry-to-dry" machines with a built-in refrigerated condenser (an in-process system for recovering perchloroethylene--"perc"--a toxic chemical used in dry cleaning), or to retrofit with this same type of condenser pre-1991 machines that consume "perc" above a threshold amount.

### **Why Was the Project Undertaken?**

Of some 800 dry cleaners statewide, 77 (about 10 percent) were subject to these equipment modification requirements. For the retrofit (the least costly option), EPA's initial cost estimate was about \$6,300; however, project staff found that the actual cost had escalated dramatically as the rule neared promulgation--to as much as \$15,000 locally. For some dry cleaners, this increase meant that self-financing was no longer possible, and that financing from a bank or other external sources would be necessary.

The project's hypothesis was that banks do not want to make loans to businesses such as these because--according to conventional wisdom--they typically give little credence to claims that pollution prevention investments can reduce operating costs and thereby significantly improve cash-flow. Another negative from the bank's point of view is that most pollution prevention equipment has low resale value, and consequently, limited collateral value.

Moreover, at the time the project began, banks seemed reluctant to lend *anyone* money--in 1993, the more-stringent banking regulations engendered by the "Savings and Loan Crisis" worked in tandem with a recessionary economy to dampen the overall lending climate. Banks' presumed reluctance to get involved in pollution prevention investments was also believed to be linked to fears of "lender liability" resulting from the potential environmental misdeeds or liabilities of the businesses to which they lent money. All of these factors combined to create a dim outlook for access to credit by small businesses required to make pollution prevention investments.

### **What Were the Results?**

The results were unexpected. Project staff met with members of the banking community (including the American Bankers Association, the Maryland Chamber of Commerce, Signet Bank, First Union Bank, and Potomac Valley Bank) to test the hypotheses. The banks confirmed their reluctance to handle small-business loans, but gave different reasons: the amounts of these loans are often too small to allow a bank to recover its costs or make a profit; or the business's cash-flow is insufficient to service the debt.

Contrary to expectations, the banks *were* receptive to potential cost savings flowing from the purchase of new equipment, and were *not* concerned with environmental liabilities associated with the dry cleaning industry. Further, the banks stated that as long as the paperwork for a loan application was complete, and an entity such as Maryland's Small Business Development Center had analyzed the financial status of the business and could show that it would be able to meet the loan payments, the banks would loan money for a purchase as small as \$15,000.

To determine the need for financial assistance, the project staff contacted the 77 dry cleaners required to purchase new equipment. Only 12 of the 77 dry cleaners took advantage of the program to obtain help in seeking bank financing. (Four of the 12 cleaners purchased retrofit units; eight purchased entirely new machines.) The other 65 companies either obtained their own funding (many Korean-owned dry cleaners have access to pooled funds in the Korean community), were able to obtain bank loans on their own, or decided to wait for the retrofit deadline of September 1996 before making any investment.

### **What Lessons Were Learned?**

Four key lessons emerge from this project that are relevant for programs which might impact small businesses in the future. First, banks are not universally "scared off" by potential liabilities associated with environmental lending. It would appear instead that banks are able to discern which industries are likely to give rise to environmental problems and thus are not blindly averse to making environmentally-related loans.

Second, most small businesses, at least in the dry cleaning industry, were able to obtain financing, or were reasonably sure they could. Still, 16% of the 77 firms contacted did take advantage of the assistance and probably would not otherwise have been able to attain compliance.

Third, it should not be assumed that the *mere existence* of a financial assistance program will lead to its *use*. The 12 companies that took advantage of the assistance did so only after an active outreach program identified and encouraged them to pursue the opportunities.

Finally, to make small loans attractive to banks, it helps to have an intermediary attest to the credit-worthiness of the borrower and to reduce transaction costs by handling much of the paperwork. At least in some cases, the only subsidy needed to make a loan "fly" is for processing the loan application paperwork--surely a less expensive proposition for the public than subsidizing the interest rate. As seen in the present instance, the Small Business Development Centers are well suited for this role.

### **For More Information**

For further information on the pilot project, contact Liz Taddeo, Maryland Department of the Environment (410-631-4119). For general information on EPA/OPPT's efforts to enhance the ability of small businesses to obtain financing for pollution prevention projects, contact Ed Weiler (202-260-2996).