Discussion of Revisions to the Recycling Market Development Zone (RMDZ)
General Loan Eligibility Criteria

July 7, 2011

INTRODUCTION

At the request of the California Association of Recycling Market Development Zones, this document provides additional background and context about the loan program criteria and the January 2011 stakeholder questionnaire.

Approximately one-third of Zone Administrators responded to the questionnaire, providing valuable and informative feedback. The questionnaire addressed six specific criteria and solicited other comments and suggestions. Below is a summary of responses to each criteria question, along with staff's recommendation. More specific detail for each of the criteria starts on page 5.

Current Criteria	Staff Proposed Criteria	Page
1. Maximum Loan Amount is $2 million	No change	5
2. Maximum Outstanding is $3 million	No change	7
3. Maximum Number of Loans – Unlimited	No change	9
4. Use of Loan Funds (equipment, working capital, leasehold improvements, real estate and refinance of other lender debt)	Equipment Purchase Only	11
5. Primary Single Family Residence as Loan Collateral: Not allowed, but applicant can ask for an exception.	No change	13
6. Start-up businesses: No specific criteria, evaluated the same as an existing business.	• Maximum loan of $1 million or 50% of total project costs, whichever is less. • Owner investment at least 25%.	15

PROGRAM BACKGROUND INFORMATION

<u>RMDZ Program</u>

The RMDZ program was established by Senate Bill 1322 (Bergeson, Statutes of 1989, Chapter 1096) and codified in Public Resources Code (PRC) sections 42010-42024. Program regulations are found in Title 14 of California Code of Regulations sections 17901-17939.5. The purpose of the program is to further local and regional markets for recyclable materials collected by local jurisdictions. In order to accomplish this goal, CalRecycle provides a combination of technical/financial incentives and resources to attract/retain recycling manufacturers. This combination ensures local Zone Administrators are adequately trained, ensures efficient use of limited state resources, and provides RMDZ opportunities to many local jurisdictions.

CalRecycle Zone Liaisons and Loan Officers partner with local Zone Administrators to provide a plethora of RMDZ program services to the business community in designated zones. Their roles are described below:

- *Zone Liaisons*: CalRecycle's Local Assistance and Market Development Branch staff conducts both broad and customized market development activities that strengthen demand for the recyclable material collected by municipalities and private companies. They assist existing local recycling manufacturers expand or establish new processing operations, and help out-of-state and foreign companies to locate within California RMDZs. Specific business services include identifying local waste stream feedstock and markets and coordinating referrals to local permitting, waste management, and economic resources.

- *Loan Officers*: Loan officers are part of CalRecycle's Financial Resources Management Branch. Their core responsibility is to evaluate and process eligible loan applications from RMDZ businesses or businesses seeking to move into an RMDZ from out-of-state. CalRecycle provides direct loans to eligible businesses and non-profit entities. Loan officers also match the business' monetary needs with financing from other public and/or private entities, establish appropriate loan repayment schedules, and negotiate loan modifications.
- *Zone Administrators*: Local jurisdictions must provide staff resources and business incentives to complement CalRecycle's. ZAs implement local RMDZ programs in cooperation with local public works departments or economic development offices. Focused on increasing the beneficial use of locally generated recyclable materials, the ZAs primary function is to promote the RMDZ program to recycling-based manufacturers. Additionally, they work with the business community to introduce the many services offered locally and by CalRecycle. This active assistance provided by the ZA is critical to the success of the local RMDZ program.

These combined activities are expected to increase local diversion, assist jurisdictions to meet the AB 939 mandates, and support RMDZ manufacturers/processors.

Loan Program Sunset Date

Although the RMDZ program as a whole is permanent, the loan program has a statutory sunset date of July 1, 2021. The sunset date has been legislatively extended several times since 1993.

Loan Program Statistics

- Currently, there are 35 RMDZs located throughout the state, comprised of 228 cities and 30 counties (48 percent of all jurisdictions statewide). The RMDZs cover approximately 88,000 square miles and represent almost 21 million Californians.
- Since inception of the loan program in 1993, CalRecycle has approved and funded 161 loans totaling $113 million.
- The Tire Recycling Management Fund has also provided approximately $12 million in loans to RMDZ businesses.
- As of 2009, the funded loans have resulted in an estimated additional 4.2 million tons per year of material being diverted from California landfills. Over 2,036 people are employed by RMDZ loan borrowers.
- As of July 6, 2011, the outstanding loan portfolio consists of 45 loans to 35 businesses, totaling $33 million.

Funding

- During 1993 to 2005, $49.5 million was transferred to the RMDZ Subaccount from the Integrated Waste Management Account (IWMA). However, the economic decline has significantly reduced landfill tipping fees. As a result, CalRecycle has not made additional allocations into the RMDZ subaccount since 2005.
- In fiscal year (FY) 2011/12, a total of $5 million is available for RMDZ loan projects.
- In FY 2012/13, available loan funding is estimated at $4 million, subject to state budget approval and timely loan repayments.

The table below reflects funding data from the State Budget:

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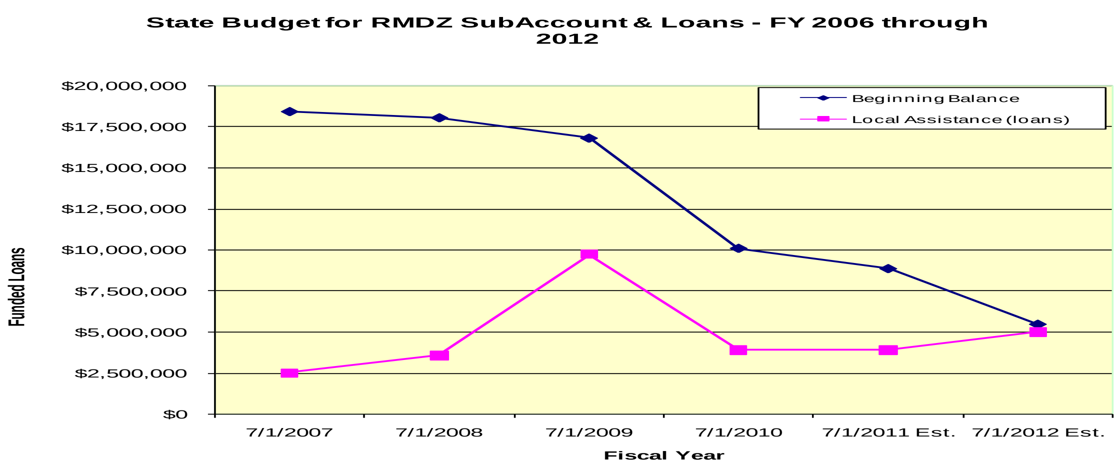
State Budget (ooo's)	2006/07 Actual	2007/08 Actual	2008/09 Actual	2009/10 Actual	2010/11 Estimate	2011/12 Estimate
Beginning Balance	$18,470	$18,091	$16,846	$10,113	$8,871	$5,473
Prior Year Adjustment	$22	$33		$698		
Adjusted Beginning Balance	$18,492	$18,124		$10,811		
Loan interest repayments	$1,948	$1,743	$1,438	$632	$1,122	$2,975
Total Revenue	$20,440	$19,867	$18,284	$11,443	$9,993	$8,448
State Operations	$1,337	$1,041	$1,227	$1,320	$1,320	$1,380
Loans funded	$2,520	$3,578	$9,727	$5,000	$5,000	$5,000
Loan principal repayments	($1,508)	($1,598)	($2,783)	($2,396)	($1,800)	($2,200)
Total Expenditures	$2,349	$3,021	$8,171	$2,572	$4,520	$4,180
Balance	$18,091	$16,846	$10,113	$8,871	$5,473	$4,268

The chart below reflects the state budget's beginning balance of the RMDZ Subaccount and actual loans funded or anticipated to be funded. Beginning in year 2012/13, new loans will be funded solely from repayments. The loan program should then become self-sustaining, without reliance on transfers from the IWMA, but only at a relatively modest level of funding on the order of $3 million.



Often, loan staff recommends other financing sources to prospective loan applicants if the applicant needs additional project funds. Prospective loan applicants are typically referred to the following state financing programs since they offer assistance to recycling-based businesses:

- Treasurer's Office – California Capital Access Program (CalCAP): A bank is encouraged to make direct loans to borrowers. That loan is supported by a loan loss reserve deposit account for the bank, held by the Treasurer's Office. CalRecycle is an independent contributor in the CalCAP program for the purpose of paying the borrower's loan fees. This program recently received additional funding from the federal American Recovery and Reinvestment Act.

- Based on recent discussions with CalCAP, loan staff will continue to work with CalCAP staff and refer RMDZ businesses appropriate CalCAP banks after an assessment of the proposed loan project and the business' financing needs. Loan staff will initiate a meeting between the bank(s) and the business.

- Treasurer's Office – California Pollution Control Financing Authority (CPCFA): CPCFA offers bonds to businesses. The borrower's cost to obtain the bond is reimbursed by CPCFA up to a maximum of $250,000.
  - Loan staff will continue to refer qualified businesses to the CPCFA bond program after an initial assessment of the business' financing needs. Loan staff will work closely with a CPCFA bond underwriter to facilitate additional funding for the proposed RMDZ project.
- Housing and Community Development – Small Business Loan Guarantee Program: A bank makes a direct loan to a small business supported by a state guarantee. This program is similar to the federal Small Business Loan Guarantee Program which offers relaxed credit standards and a preference for financing working capital and short-term loans. This program also received additional funds from the federal American Recovery and Reinvestment Act.
  - Loan staff will continue to refer qualified RMDZ businesses to the State Loan Guarantee Program after an assessment of the business' financing needs. Loan staff will contact the local Financial Development Corporation that will perform the loan underwriting to introduce them to the RMDZ business owner.

<u>Current General Loan Eligibility Criteria</u>

The loan eligibility criteria apply to all loan applicants regardless of the type of project; they support the laws governing the RMDZ loan program and enable CalRecycle to fund projects that address priority material diversion. CalRecycle reevaluates loan program criteria every two to three years, with the last update being in September 2008. The current criteria are available on CalRecycle's web site at www.CalRecycle.ca.gov/rmdz/loans . Now is the time to evaluate the loan program criteria to ensure that they satisfy stakeholder needs and CalRecycle's current funding limitations.

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STAKEHOLDER QUESTIONNAIRE
In January 2011, stakeholders were sent a questionnaire. At its April 2011 meeting, the Loan Committee discussed the responses from 11 of the 35 RMDZ Zone Administrators and some CalRecycle staff. Any changes to the loan criteria would be effective for FY 2011/12.

More detail about each question (background history, some data, and options for consideration) is provided:

1. **Maximum Loan Amount**
   Question: The program can fund a maximum of 75% of costs directly attributed to an eligible project up to a maximum of $2 million, whichever is less. Available loan funding for the program as a whole is estimated at approximately $4 million for each of the next two fiscal years, so lowering the maximum loan amount may enable more eligible businesses to access loans. Should the maximum loan amount be reduced?

   Response choices: No; or Yes, change the maximum loan amount to: $500,000, $750,000, $1,000,000, $1,500,000, other.

   Current Criteria: The program can fund a maximum of 75% of costs directly attributed to an eligible project up to a maximum of $2 million whichever is less.

   Background: From 1993 to 1999, the maximum loan was $1,000,000 or 50% of eligible project costs, whichever is less. Assembly Bill 1364 (Migden, Statutes of 1999, Chapter 467), increased the maximum loan amount to $2 million per loan. The increased amount was justified due to the large amount of funds in the RMDZ sub-account and the increased cost of new, technologically improved processing equipment. The increase in the percentage of the project financed was needed because otherwise most borrowers needed bank or investor loans to pay for the match and because CalRecycle desired to decrease the risk of repayment by recording a collateral lien in first position.

   Statistics
   - Average loan amount since FY 1993 is $704,000.
   - Average loan amount since FY 2009 is $1,097,156.
   - In FY 2008/09, a total of $6,927,000 in loans was approved for RMDZ businesses.
   - In FY 2009/10, a total of $3,698,530 in RMDZ loans plus $3,635,000 in Tire Equipment loans was approved for RMDZ businesses.
   - In FY2010/11, a total of $2,951,124 in RMDZ loans plus $640,000 in Tire Equipment loans was approved for RMDZ businesses.
   - Since FY 2008/09, CalRecycle has approved eight loans for the purchase of equipment. Each loan request was for $1,000,000 or more.

   Questionnaire Results
   - Five respondents do not want to change the current policy.
   - Nine respondents are amicable to reduce the maximum loan amount on a temporary basis, anticipating that additional loan funds will become available.
   - The Loan Committee indicated that this is really a program decision and is not part of the loan structure, collateral, or repayment ability. They further commented that a lower loan amount

will decrease the loan portfolio repayment risk by lending to a variety of businesses and not having a concentration of loans to a few businesses.

Option #1: Do not change the current policy.

Pros

- Loan staff is not aware of a loan prospect or application that would require a change to the maximum loan amount.
- There are certain projects that involve costly facility and equipment costs generally exceeding $1 million. Businesses are generally able to obtain private investor funds if CalRecycle is willing to lend the first $1,000,000 for a project. The RMDZ loan would be approved subject to the business putting up the required matching funds before loan documents are prepared.
- More funds will be available if other changes are made to the eligibility criteria, e.g. discontinuing the funding of working capital.

Con

- If the maximum loan amount remains at $2,000,000, then only a small number of RMDZ projects will receive funding.

Option #2: Decrease the maximum loan amount to $1 million.

Pros

- CalRecycle would be able to fund more projects, spread the loan repayment risk among more businesses, and decrease the concentration risk of lending to a few businesses.
- The recent average loan amount is about $1,000,000.
- The program must be self-sustainable without transfers from the IWM Account.
- Projects requiring more money have been able to find other sources of funds.
- The maximum amount was increased during robust economic times when over $20 million was available to fund new loans.

Con

- Higher cost projects will require greater funds from the owners, investors, or other financing sources.

Staff Proposes Option #1 because developing manufacturing facilities to handle large amounts of recyclable materials can easily require financing needs that include loans over $1M.

2. Maximum "Outstanding" Loan Amount for Multiple Loans for a Single Borrower

Question: Current policy allows a borrower to have multiple loans as long as the total principal amount owed does not exceed $3 million. To conserve limited loan funds and limit financial risk to CalRecycle, should we reduce this maximum amount?

Response choices: No, continue to allow a borrower to owe up to $3 million; or Yes, change the policy, reduce the total principal amount that a borrower with multiple loans can owe to: $1 million, $1.5 million, $2 million, other.

Current Criteria: A borrower may apply for subsequent loans that result in additional diversion using the same or different type of feedstock, manufacturing process, or end product. A borrower, and all related entities, may not have more than $3,000,000 outstanding on all RMDZ loans.

Background: On July 19, 2005, CalRecycle established a cap on the total loan amount to the same borrower and related entities. This was in response to businesses asking to refinance commercial real estate when the RMDZ loan interest rate was 1.9%.

Statistics

- Since FY 1993, 169 loans have been approved to 130 businesses.
- Of the 130 businesses, 29 have received more than one loan.
- Of the 29 businesses, 21 businesses have received two loans averaging $1,600,000; six businesses received three loans averaging $2,600,000; and two businesses received four loans averaging $3,600,000.

Questionnaire Results

- Three respondents do not want to change the current policy.
- Eight respondents are amicable to reduce the borrowing cap on a temporary basis, anticipating that additional loan funds will become available.
- The Loan Committee commented that this is similar to criteria one above, resulting in a less risky loan portfolio.

<u>Option #1</u>: Do not change the current policy.

Pros

- Allows successful businesses to come back for additional financing, after they have demonstrated performance on their existing RMDZ loan. Return borrowers must also provide one fiscal year of financial statements demonstrating a positive financial trend and adequate cash flow.
- Larger projects will continue to have the ability to obtain more than one RMDZ loan toward additional expansion phases.
- Only a few businesses have reached the $3 million loan limit.

Con

- Limited fund are available and there is a concentration risk of loan funds being given to a few businesses.

<u>Option #2</u>: Decrease the maximum outstanding loan amount for multiple borrowers to $2 million.

Pros

- There are limited program funds.
- Business that are successful and are able to expand should be able to obtain conventional loans from banks and other available loan and guarantee programs. Reduction in the maximum amount outstanding may provide an exit strategy for borrowers to graduate from the RMDZ loan program.
- If the loan portfolio is only concentrated in a few large borrowers and one of these borrowers defaults on their loan obligation, this could result in a significant portion of the existing loan portfolio becoming" non-performing."

Cons

- In response to the recession, banks have restricted loans to the largest and most creditworthy borrowers.
- Even successful borrowers/large projects may not be able to obtain conventional financing.

<u>Staff Proposes Option #1 because only a few businesses have reached the $3 million loan limit. The few businesses that have requested more than $3 million generally have been able to obtain other sources of financing from a bank or investor funds</u>

3. Number of Loans Per Business

Question: Other than a maximum "outstanding" loan amount (see #2), there is no limit on the number of loans a business can have outstanding at the same time. Should a borrower be allowed to have multiple loans outstanding?

Response Choices: No; or Yes, I recommend the following be established as the maximum number of outstanding loans to the same borrower: one, two, or other.

Current Criteria: There is no current limit on the number of loans a borrower or related entity can have outstanding at any one time.

Background: This is the first time that this issue has been considered.

Statistics

- Since FY 1993, 169 loans have been approved to 130 businesses.
- Of the 130 businesses, 29 have had two or more loans outstanding at one time.
- Of the 29 businesses, 21 have had two loans, six have had three loans, and two have had four loans outstanding at one time.
- Seven businesses have obtained more than $3 million in loans, although the maximum outstanding at any one time has not exceeded the current $3 million cap.

Questionnaire Results

- Five respondents do not want to establish new criteria on the number of loans per business.
- Five respondents are amicable to establishing new criteria that limit businesses to two outstanding loans at any one time. Borrowers should have the ability to ask for waiver of this policy on a case by case basis.
- The Loan Committee commented that at some point, borrowers should graduate from the loan program and not be reliant on state funds.

<u>Option #1:</u> Do not establish criteria to limit the number of loans to repeat borrowers.

Pros

- The number of loans to repeat borrowers is adequately controlled by the separate criteria (#2 above) that limit the dollar amount to repeat borrowers.
- Successful borrowers will continue to have the ability to expand using RMDZ loan funds.

Con

- Repeat borrowers are not motivated to seek conventional financing.

<u>Option #2</u>: Establish criteria to limit the quantity of outstanding loans to two.

Pros

- Lending to a variety of businesses reduces the concentration risk of repayment from a few borrowers.
- Successful businesses should be able to obtain financing from banks, the CalCAP program, the State Loan Guarantee Program, or bond financing.
- Borrowers should eventually graduate and exit the RMDZ loan program.

Con

- Penalizes successful borrowers that are able to expand.

Staff Proposes Option #1 because the $3 million outstanding loan limit adequately addresses loans to repeat borrowers.

4. Use of Loan Funds

Question: Current policy allows RMDZ borrowers to use loan funds in several areas (i.e., purchase real estate, working capital and equipment). However, most borrowers request an RMDZ loan to finance equipment. Changing the use of funds to "equipment only" could potentially expedite loan approvals and improve collateral on the loans. Should we restrict the use of loan funds to equipment purchase only?

Response choices: No; or Yes, restrict the use of loan funds to equipment purchases only.

Current Criteria: Loan funds can be used for the purchase of machinery and equipment, working capital, real estate purchase up to $1 million, real estate improvements, refinance of onerous debt that results in increased diversion, and to finance the loan closing points.

Background: Since inception of the program, the use of loan funds has not changed. The only exception was the cap on the purchase of real estate imposed in 2005, when the loan interest rate was 1.9% and businesses wanted to refinance commercial mortgages, which is not the intent of this program.

Statistics

- Since FY 1993, 71% of loan proceeds funded equipment, 13% funded working capital, and 16% funded other categories. The average equipment cost financed was $1,047,035; and the average working capital was 13% of the loan amount or $205,817.
- Since FY 2009, 95% of loan proceeds funded equipment; 2% funded working capital; and 3% funded other categories. The average equipment cost financed was $560,000; and the average working capital requested was $210,000.
- Loan collateral is a significant consideration to collect from a non-performing borrower. Equipment liquidations result in less than a 20% recovery. There is little to no value in accounts receivable, inventory, and leasehold improvements.

Questionnaire Results

- Eight respondents do not want to change the current policy.
- Six respondents are amicable to making this an equipment purchase only program.
- The Loan Committee was more vocal on these criteria, strongly supporting that the loan program should not finance working capital and other short term business expenses on a long term basis. They recommend that this be an equipment purchase only loan program.

<u>Option #1:</u> Do not change the current policy.

Pros

- Outside lenders are still apprehensive to lend to the recycling industry.
- Some current applications are requesting funds other than equipment.

Con

- Staff would continue to receive applications from less creditworthy businesses that do not have sufficient line of credit or owner/ investor funds in the business.

<u>Option #2</u>: Allow the use of loan funds solely for the purchase of new and used equipment.

Pros

- This will expedite the loan approval and funding process.
- It will better match long term loans with long term financing needs, instead of the current policy of financing both short and long term needs only over a long term.
- The collateral value of working capital (accounts receivable and inventory) is short term and does not provide adequate collateral for long term loans.
- CalRecycle does not provide short term working capital lines of credit because we are not a depository institute for a business checking account. Bank lines of credit are tied to automatic deposit and withdrawal with a business checking account.
- Staff will receive more creditworthy applications.
- Equipment purchase only directly ties with increased diversion, as opposed to working capital, real estate, and refinance of onerous debt.
- Considering limited availability of funds, the refinance of onerous debt does not result in increased diversion.
- Other lenders are available and offer competitive terms to lend for real estate purchases and improvements.

Cons

- The business must be adequately capitalized with owner, investor, and other financing.
- Some current pending applications are asking to use loan funds for purposes other than equipment.

<u>Staff Proposes Option #2 for the following reasons: (1) this will greatly streamline and shorten the loan approval process for applicants who have financing needs; (2) business short term cash flow needs should not be financed on a long term basis; and (3) this will better protect CalRecycle's investment in these companies as applicants should be better capitalized with owner and investor funds.</u>

5. Primary Single Family Residence as Loan Collateral

Question: It is common in the commercial banking industry for lenders to allow a primary single-family residence to be taken as collateral on a business loan. Current CalRecycle policy does not allow this; however, loan staff will consider an applicant's request to make an exception to this policy. Should our current policy be changed to allow applicants to offer their primary single-family residences as collateral?

Response choices: No, continue the current policy; or Yes, allow primary single-family residences to be taken as collateral on an RMDZ loan.

Current Criteria: It is CalRecycle's policy not to take a primary single-family residence as collateral. An applicant may request CalRecycle to make an exception to this policy and CalRecycle will consider the request on a case-by-case basis, subject to the standard staff and loan committee recommendation process.

Background: On October 20, 1999, the CIWMB (CalRecycle's predecessor) discontinued the practice of allowing a primary single-family residence to be used as loan collateral. This action was taken due to CalRecycle's reluctance to foreclose on a borrower's primary residence. At subsequent Board meetings in 2003, 2005, and 2008, CalRecycle affirmed this policy. Other types of residential real estate continue to be eligible as collateral, which includes second homes and multi-family dwellings.

The borrower's home is indirectly at risk through the personal loan guarantee requirements.

Statistics

- Between 1993 and 1999, 15 loans had the borrower's residence as collateral.
- Since 1999, loan staff has not received an inquiry or a loan application from a prospect that is dependent upon using their home equity to obtain an RMDZ loan.
- A loan made in 1995 is secured by the borrower's primary residence and this is a key factor in negotiating a repayment plan because the business is not able to make payments.

Questionnaire Results

- Two respondents do not want to change the current policy.
- Twelve respondents are amicable to allowing a borrower to offer their residence as loan collateral if they are willing and able, but it should not be a requirement on all new loans.
- Loan Committee recommends that a borrower be allowed to offer their primary residence as collateral, if there is equity and a current appraisal.

<u>Option #1:</u> Do not change the current policy.

Pros

- Few borrowers have little or no equity in their homes due to the current depressed real estate market.
- No borrower has approached CalRecycle that needs to use home equity to finance a project.
- Borrowers are more likely to file personal bankruptcy before we start the foreclosure process.

- Current policy allows an applicant to request the CalRecycle to make an exception to this policy, and the CalRecycle will consider the request on a case-by-case basis, subject to the standard staff and loan committee recommendation process.

Cons

- The borrower's home is indirectly at risk through the personal loan guarantee requirements.
- By not directly taking a home a collateral, business are better able to obtain working capital lines of credit from outside lenders. Home equity becomes available to other lenders.

Option #2: Resume allowing a loan applicant to offer their personal residence as loan collateral, if an applicant offers it and there is a reasonable amount of equity based on current appraisals.

Pros

- Residential real estate values are expected to improve during the next seven to 15 years.
- Most bank and other conventional financing sources require the borrower's primary residence to be taken as loan collateral, so the business owners have more risk in the project and will work harder to make the business succeed. It is taken as an abundance of caution.
- Loan Committee Members have long supported taking the business owners personal residence.
- Borrowers will be more motivated to pay, considering that the owner's home is at risk.
- Statutes do allow RMDZ loan term up to 15 years when partially or wholly collateralized by real estate.

Cons

- Single family residential value has continually declined since 2008.
- Foreclosure is a difficult and lengthy process.
- CalRecycle may have to pay off a senior mortgage and may not have available funds in the RMDZ subaccount.
- Additional documentation is required to take a residence as collateral, such as a current appraisal, which will delay the loan funding.

Staff Proposes Option #1 because most applicants have used their home equity to fund the business or don't have equity in today's depressed economy. In addition, applicants can request that CalRecycle consider this on a case-by-case basis.

6. Start-Up Businesses

Question: Currently, the general loan criteria for start-up and expanding businesses are the same. Since start-up businesses can tend to be "more risky", should loan staff apply a different set of criteria for these types of businesses – one that would reduce financial risk to CalRecycle? For example, criteria could require a larger amount of matching funds for start-ups; or establish a maximum loan amount that is lower than an amount for an established business (i.e., $500,000).

Response choices: No; or Yes (if yes, please explain below how criteria could be different).

Current Criteria: There are no specific criteria for start-up businesses.

Background: New start-up businesses are evaluated in the same manner as existing business. However, a start-up requires more analysis and documentation to validate the financial projections and assumptions. Loan funds cannot be used for collecting, baling, or research and development.

Definition: Start-up projects are defined as businesses that do not have a similar existing facility in the United States and/or the equipment is not being used by other companies in the United States. Additionally, start-up businesses are defined as being in operation less than three full years.

Statistics

- Since 1993, 47 of 169 loans were approved for start-up businesses.
- Since 1993, start-up businesses represent more than 50% of CalRecycle's problem loans.
- Since 2009, seven of 17 loans were to start-up businesses. Two of these businesses have since applied for additional funds. Of these seven, one was unsuccessful in getting operational and ultimately closed.
- Since 2009, the majority of problem loans are directly tied to declining sales and operational cash flow issues due to the global economic recession.
- Currently there are 18 problem loans. Ten of the problem loans were to start-up businesses.

Questionnaire Results

- Five respondents do not want to change the current policy.
- Nine respondents are amicable to establishing new, more conservative criteria for start-up businesses.
- The Loan Committee commented that loans to start-up businesses should be more conservative. The owners/investors should have personal funds at risk.

Option #1: Do not change the current policy.

Pro

- CalRecycle supports start-up projects because they can offer an alternative to landfilling recyclable materials.

Cons

- Some start-ups are not adequately capitalized and the management team may lack sufficient experience. If a business encounters problems due to one of these issues, there is a potential for the business to fail.
- Historical financials are not available and it is difficult to document financial projections.

Option #2: Establish more conservative criteria specific to new start-up businesses.

Proposed start-up business criteria:

- Consider a lower loan amount, such as $1 million.
- Consider an increased matching funds requirement, such as 50%.
- Consider that the owner personally have 25% invested in the business.
- Consider that the equipment collateral lien be in a first position, not subordinated or junior to other lenders or investors.
- Subsequent loan can be considered after the first project is successful and the fiscal year-end financial statements show positive trends and adequate cash flow.

Pros

- Start-up businesses are more risky to lend to because they do not have a proven track record.
- Their debt level is higher and the owners have less investment.

Con

- Fewer startup businesses would be eligible to apply for an RMDZ loan.

Staff Proposes Option #2 because this will better protect CalRecycle's investment to RMDZ businesses and reduce the risk of non-repayments.