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QUALIFIED AGRICULTURE LOANS

House Bill 4009 (Substitute H-2)
First Analysis (12-12-01)

Sponsor: Rep. Ron Jelinek
Committee: Appropriations

THE APPARENT PROBLEM:

Inclement weather conditions this year have had a devastating impact on the state's $3.48 agriculture industry, especially the cash crop industry. This spring, farmers were faced with late frosts and excessive rain. This summer, many parts of the state received less than three-quarters of an inch of rain and experienced several days in excess of 100 degree Fahrenheit.

These weather conditions resulted in major crop losses, including corn, soybeans, oats, potatoes, tart cherries, raspberries, grapes, pumpkins, squash, tomatoes, and even Christmas trees. In many parts of the state, corn crop yields were down as much as 30 percent. In the Thumb area, many farmers harvested between zero and 20 percent of their dry bean crops. In Southwest Michigan, some grape growers were left with no harvest whatsoever.

As a result of the widespread destruction of these crops, the United States Department of Agriculture (USDA) recently declared 82 of 83 counties (with the lone exception being Keweenaw County) eligible for emergency farms loans available through the USDA Farm Service Agency (FSA). Legislation has been introduced to offer a state-level agriculture loan program to aid farmers in recovering their production losses as a result from this summer's drought.

THE CONTENT OF THE BILL:

The bill would amend Public Act 105 of 1855, which regulates the disposition of the state's surplus funds, also known as common cash funds, to provide an agricultural loan program. (The language is an updated version of a loan program that was enacted in 1986.) The act authorizes the state treasurer to invest common cash funds in certificates of deposit or other instruments of a financial institution, so the institution can use the investments to make "qualified agricultural loans" to farmers. The bill appropriates an amount sufficient to make these distributions for the 2001-02 fiscal year not exceeding $210 million in loans.

Under the act, there are three types of qualified agricultural loans:

<u>Financial Stress.</u> A loan could be made to a farmer who is engaged as an owner-operator of a farm in the production of agricultural goods, who is experiencing financial stress and difficulty meeting existing debt obligations owed to financial institutions. The bill adds that this would have to be the result of an agricultural disaster as declared by the governor. The loans would be made at rates commensurate with rates charged by financial institutions for comparable loans, and the farmer would have to certify to the financial institution that he or she would not have more than $150,000 in outstanding loans, including the loan for which he or she is applying.

A loan of this type could be made for the operating capital of the farm for such expenses as the rental, lease, and repair of equipment or machinery; crop insurance premiums; and the purchase of seed, feed livestock, breeding stock, fertilizer, fuel, and chemicals. The loan could also be used to refinance all or a portion of a loan for the above reasons entered into before October 1, 2002. A qualified agricultural loan of this type would not be made after October 1, 2007 or with a term extending beyond October 1, 2012.

<u>Crop Disaster.</u> A qualified agricultural loan could also be issued to a farmer that is engaged and intends to remain engaged as an owner-operator of a farm in the production of agricultural goods who has suffered at least a 25 percent loss in major enterprises or at least a 50 percent loss in any one crop due to an agricultural disaster as declared by the governor.

Under the bill, a qualified agricultural loan for crop disaster would have a zero percent interest rate and would be for a term between five and ten years. In addition, the bill states that the loan would have to be accompanied by a proof of loss and ineligibility for federal aid. In addition, this loan would be equal to not more than the value of the crop loss as certified by the USDA FSA, but the loan could not cover more than 65 percent of the proven loss.

Retail Sales. A loan could also be made to a person who is engaged in an agricultural business of buying, exchanging, or selling farm produce or is engaged in the business of making retail sales directly to farmers and has at least 75 percent of the gross retail sales volume exempted from sales tax. Under this loan, the person must have suffered at least a 50 percent loss in volume of one commodity compared to the average volume over the last three years. Under the bill, any loss attributable to a natural disaster would have to occur during 2001, as declared by the USDA. This type of loan would not be made after October 1, 2002, and would not have a term expiring beyond January 1, 2012. A qualified agricultural loan issue for this type of instance would not exceed the lesser of the following:

- $300,000 per facility.

- An amount not exceeding the value of the direct loss, as determined by the Department of Treasury.

- $150,000 per individual.

Other Provisions. A financial institution offering any of the three types of qualified agricultural loans would have the option of making the loans to farmers prior to December 31, 2002, under terms approved by the state treasurer. Under the bill, financial institutions would receive from the state treasurer an amount not exceeding the lesser of the following:

- The interest that would have been earned on the loan if the distribution is not appropriated.

- The interest that would have been earned on the loan if the rate charged for each quarter the loan is outstanding were equal to the average rate earned by the state during that quarter.

Any money for crop disaster loans that has not been invested by the state treasurer by October 1, 2002 would increase the maximum amount available for financial stress loans. In addition, prior to October 1, 2004, the state treasurer would prepare separate reports to the legislature and the House and Senate appropriations agriculture subcommittees pertaining to the disposition of money invested for the purposes of qualified agriculture loans. The report would contain the total number of farmers and agricultural businesses receiving a loan; the total number and amounts of the loans by county; the name of each financial institution participating in the loan program and the amount invested in each institution; the compliance of each financial institution; and information pertaining to the necessary action taken to ensure the successful operation of the act.

BACKGROUND INFORMATION:

1986 Program. The 1986 program allocated $200 million to farm producers and an additional $10 million to agri-business. In addition, lenders were compensated for loan administration by either receiving an additional 20 percent of the loan volume, which could then be loaned to interest paying customers, or through a loan subsidy payment from the state.

As of September 30, 1987, the average loan size was $40,000. There were about 3,500 borrowers receiving approximately $154 million. About 30 percent of the funds were loaned out by 56 banks. Production Credit Associations loaned the remaining 70 percent of the funds out. As of June 30, 1994, 34 banks and all of the PCAs were still in the program. Through the end of the 1993-1994 fiscal year, the cumulative lost opportunity cost to the state was estimated at $44 million.

Common Cash Fund. Under the program, the state does not provide direct loans to farmers. Rather, the state buys CDs from financial institutions and the institutions provide the loans. Funds used to buy CDs come from the state's common cash fund. This is the day-to-day cash flow of the state, similar to that of a checking account. If the state doesn't have the money, it borrows through short-term notes. These short-term notes must be paid back prior to the end of the fiscal year.

Federal Emergency Loan Program. The bill states that the qualified agricultural loan would have to be accompanied by a proof of ineligibility for federal aid. A farmer may be ineligible for a federal farm loan because he or she does not live in a county eligible to receive a loan or may not have suffered damage extensive enough to be eligible. Under the federal emergency loan program, which is administered by the USDA FSA, loans can be utilized to cover production and physical losses in counties declared to be disaster areas by the President or the Agriculture Secretary, and must be applied for within eight months of the disaster declaration.

Loans are available to ranchers and farmers who, among other eligibility requirements, have suffered a qualifying physical loss, or a production loss of at least 30 percent in any essential farm operation or ranch enterprise; cannot obtain commercial credit; can provide collateral to secure an emergency loan; and can demonstrate that the loan can be repaid.

Emergency loans can be used to pay all or part of production costs; restore or replace essential physical property; pay essential family living expenses; or refinance debts. A loan is limited to 80 percent of actual production loss, or 100 percent of the actual physical loss. The maximum indebtedness under the emergency loan program is $500,000.

Loans for crop, livestock, and non-real-estate losses are generally repaid in one to seven years, depending on the purpose of the loan, ability to repay and available collateral. In special instances, terms can be up to 20 years. Loans covering physical losses are generally repaid within 30 years, though may be extended to a maximum of 40 years.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the bill would result in cost increases to the state. The largest cost to the state is the lost opportunity cost, which is difficult to project, as market interest rates fluctuate. The following grid indicates a range of what those lost costs could look like, assuming a zero percent loan.

Market interest rate	5 years	8 years	10 years
5 percent	$6.9 million	$11.9 million	$15.7 million
8 percent	$11.9 million	$21.3 million	$29.0 million
10 percent	$15.3 million	$28.6 million	$39.8 million

Another cost to the state would be to the state treasurer's office for administrative costs, and to the Department of Agriculture for the certification of applicants. These costs are indeterminate at this time.

A potential cost to the state would be incurred if and when the state would need to borrow short-term in order to purchase the CDs from the banks and other lending institutions. A short-term note must be paid back by the end of the fiscal year in which it is borrowed, with interest. There would be no fiscal impact to local governmental units. (12-12-01)

ARGUMENTS:

For:
The drought this summer devastated crops throughout the state. It is believed to be the worst agricultural disaster since 1936. Many farmers were left with little or no crop to harvest. Any crop that remained tended to be smaller than in previous years. The crop disaster from the summer drought came at a time when the number of farmers and farmland has been on a steady decline. In recent years, the costs of a farming operation has increased to due rising fuel costs and other expenses. In addition, increased competition from other states and Canada have also contributed to the decline in the state's agricultural industry. The bill would establish an agricultural loan program, with loans designed to provide quick financial assistance to farmers in need, while also helping farmers return to sound financial ground. In a few short months, farmers will start planting next year's harvest. Many will not be able to continue operation without any financial assistance to make up for actual losses from the summer. In addition, the bill will aid farmers with severe crop losses in the state's counties that were not eligible for federal emergency loans. This loan program is a means to protect the state's agriculture interests. Further declines in the state's agricultural output will adversely impact the state's economy. The short-term costs associated in the program certainly outweigh any potential fiscal risks to the state.

Against:
The bill comes at a terrible time. The state's budget woes have led to millions of dollars in program cuts. Quite simply, the state cannot afford additional budget obligations. According to committee testimony, the state will likely have to get into short-term borrowing to meet the cost obligations of the loan program. Any short-term borrowing must be paid back within the same fiscal year. This may adversely impact the state's AAA bond rating, and will come at the cost of other state programs. In addition, by offering zero-percent interest loans, the state loses millions of dollars over the lifetime of the program.

Against:
In all likelihood, the bill will not help everyone who may need help, as was the case for some farmers under the 1986 program. This bill does not guarantee a loan to all farmers in need of financial assistance. Those in poor financial shape and unable to receive either a commercial loan or a federal loan will likely not be able to receive this loan either. Thus, the bill

will not benefit those farmers in desperate need of financial assistance.

POSITIONS:

The Michigan Agri-Business Association supports the bill. (12-12-01)

The Michigan Farm Bureau supports the bill. (12-12-01)

The Michigan Bankers Association supports the bill. (12-12-01)

The Department of Treasury opposes the bill. (12-12-01)

Analyst: M. Wolf

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.