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SFA BILL ANALYSIS

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House Bill 4009 (Substitute H-2 as passed by the House)
Sponsor: Representative Ron Jelinek
House Committee: Appropriations
Senate Committee: Appropriations

Date Completed: 1-28-02

CONTENT

The bill would authorize the State Treasurer to invest up to $210,000,000 of surplus funds in certificates of deposit of financial institutions in order to provide loans (including zero-interest loans) to farmers and agri-businesses adversely affected by this past summer's drought conditions throughout the State. The bill would appropriate up to $210,000,000 for this purpose.

Background Information

During September 1986, the State experienced record-breaking precipitation and widespread flooding throughout much of the central Lower Peninsula, causing severe crop losses. In response to these conditions, the Michigan Legislature crafted an emergency loan program that allocated $200 million to farmers and $10 million to agri-businesses in the form of zero-interest loans. The 1986 program authorized the State to invest surplus funds in banks and production credit associations (PCAs), which then could provide "qualified loans" to eligible applicants. The State did not require principal repayments by the financial institutions until the fourth year.

As of September 30, 1987, 3,500 borrowers had signed up for the program through banks and PCAs. Approximately $154 million in total was loaned out, 30% by banks and 70% by PCAs. The average loan size was $40,000. As of June 30, 1994, 34 banks and all PCAs were still in the program. The cumulative lost "opportunity costs" to the State of this program are estimated at $44 million. Opportunity costs represent the interest earnings that the State would earn if the money were invested in the Common Cash Fund.

Under the 1986 program, the State did not actually lend the money to farmers and businesses. Instead, the State, through the Common Cash Fund, was authorized to buy investments from financial institutions. The institutions then loaned the State's "investment" to eligible applicants. To cover the lenders' administrative costs associated with the program, they were eligible to receive an additional 20% of the loan amount, which could be used for interest-bearing loans.

Federal Emergency Loan Assistance Program

The USDA, Farm Service Agency (FSA) provides low-interest emergency loan assistance to eligible farmers to help cover production and physical losses in counties declared disaster areas by the President or designated by the Secretary of Agriculture. Emergency loans are available to farmers who have suffered a qualifying physical loss, or a production loss of at least 30% in any farm enterprise, and cannot secure commercial credit. The emergency loans must be collateralized and borrowers must demonstrate repayment ability.

The loan limit is up to 80% of actual production loss, or 100% of the physical loss, with a

maximum indebtedness under the program of $500,000. Loans are normally repaid in one to seven years, but may be authorized up to 20 years. The rate of interest is set by the Secretary of Agriculture and currently is 3.75%. Applications for emergency loan relief must be received within eight months of a disaster declaration. At least one group of Michigan farmers has been eligible for emergency loans from the FSA in each of the last nine years.

Federal Emergency Loans to Michigan Farmers

Year	Number	Amount	Ave. Loan Amount
1993	108	$6,184,750	$57,266
1994	24	1,933,400	80,558
1995	31	1,751,770	56,509
1996	4	339,800	84,950
1997	201	18,166,840	90,382
1998	42	4,931,350	117,413
1999	60	4,233,560	70,559
2000	33	2,074,730	62,871
2001	73	5,366,680	73,516

Source: USDA, FSA

The Michigan FSA office reports that a number of applications for emergency loans have been received since the December 2001 disaster designation; however, it is too early to determine the number or amount of loans that will be made in response to the drought conditions of this past summer.

House Bill 4009 (H-2)

In response to the impact on crop production, the House of Representatives passed legislation that would create a loan program to assist farmers in recovering from losses and lower crop yields resulting from the drought of 2001. Specifically, House Bill 4009 (H-2) as passed the House would amend Public Act 105 of 1855, which governs the disposition of the State's surplus funds, to allow the State Treasurer to make deposits in financial institutions in order to provide the institutions with funds to make "qualified agricultural loans" to farmers and agri-businesses. The bill is modeled after the 1986 program by authorizing lending institutions to make three types of State-subsidized qualified agricultural loans.

Under the first type of loan, an institution could make a loan to a farmer who is experiencing financial stress and difficulty meeting existing debt obligations. The stress would have to be the result of an agricultural disaster as declared by the Governor. The rates charged under this loan would be commensurate with rates charged by financial institutions for loans of comparable type and terms. Farmers would have to certify that they would not have more than $150,000 in outstanding qualified agricultural loans. Proceeds from these loans could be used for operating capital expenditures or to refinance previous loans.

The second type of qualified agricultural loan authorized under the bill would be made to a farmer who has suffered a 25% or more loss in major enterprises or a 50% or more production loss in any one crop due to an agricultural disaster declared by the Governor and certified by the FSA. Such a loan would have a 0% interest rate and would be for a term between five and 10 years. The loan amount would be limited to 100% of the proven loss, reduced by crop insurance indemnity payments. Investments by the State to cover loans made by financial institutions under this scenario would not require a principal payment within the first three years after which the investment is made.

The third type of loan would be made to agri-businesses that have at least 75% or more of the gross retail sales volume exempted from sales tax. Under this loan, the person must have suffered a 50% or greater loss in volume of one commodity compared with the average volume over the last three years. The losses would have to be directly attributable to a natural disaster between January 1 and December 31, 2001, as declared by the USDA. The loan amount would be limited to the lesser of: a) $300,000 per facility, b) the value of the direct loss of the applicant, or c) $400,000 per applicant.

Financial institutions would be eligible to use their own funds for making loans, including zero-interest, as opposed to receiving investments in the form of certificates of deposit from the State. Under this scenario, the financial institutions offering the qualified loans would have the option of making loans to farmers/businesses prior to December 31, 2002, under terms approved by the State Treasurer. The institutions would receive from the Treasurer the lesser of: a) 100% or more of the interest that would have been earned on the loan if the distribution were not appropriated, or b) 100% or more of the interest that would have been earned on the loan if the rate charged were equal to the rate earned by the State.

MCL 21.142a

FISCAL IMPACT

There are two methods proposed by the bill to allow financial institutions to provide loans, including zero-interest loans. The bill would appropriate $210 million in fiscal year 2001-02 to cover the maximum amount of distributions to financial institutions for qualified agricultural loans. The fiscal impact of the bill is equivalent to the amount of interest earnings that the State would forgo in order to provide funds to financial institutions to make interest-free loans. Assuming $210 million would be loaned out in the first year for 10 years and no repayments made until the fourth year, the total estimated lost interest income would be $63 million. The interest rate is estimated at 2% for the first year, 3% for the second year, and 5% for the remaining years. If the State does not have sufficient funds in surplus, then it must issue short-term notes, which have to be repaid by the end of the fiscal year.

An alternative method of providing zero interest loans authorized under the bill would allow the State to reimburse financial institutions for the interest and administrative costs associated with making the loans to farmers and agri-businesses. These costs would be contingent on the interest rate that institutions would have received, term of the loans, loan amounts, and the amount of administrative costs that the State would cover. Under the 1986 program, institutions were eligible to receive amounts equal to 120% of the State's short-term interest multiplied by the amount of the outstanding loans issued by the financial institutions. The estimated cost to the State under this scenario would be $57 million over a 10-year term.

The total fiscal impact of the bill would be contingent on how financial institutions decided to provide the loans, including zero-interest loans. In the first year, the State would be required to provide $210 million to financial institutions to make the loans under the first scenario; however, under the second scenario, the State would be responsible only for the interest and administrative costs associated with the institutions' issuance of loans.

In addition to these costs, there would be costs associated with the administration of the program, which would be borne by the Departments of Treasury and Consumer and Industry Services.

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