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QUALIFIED AGRICULTURE LOANS

House Bill 4009 as enrolled
Public Act 16 of 2002
Third Analysis (4-23-02)

Sponsor: Rep. Ron Jelinek
House Committee: Appropriations
Senate Committee: Appropriations

THE APPARENT PROBLEM:

Inclement weather conditions this year have had a devastating impact on the state's $3.48 billion 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 degrees 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 states that the state treasurer would deposit before May 1, 2002 up to $30 million in surplus funds with the financial institutions participating in making those qualified agricultural loans. Of this $30 million, not more than $10 would be allocated for loans to a person engaged in an agricultural business or making retail sales directly to farmers. In all, 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, a qualified agricultural loan could be made due to financial stress, crop disaster, or a drop in the volume of a commodity or a loss in gross retail sales. Each type of loan would have to be made prior to October 1, 2002 and could not have a term extending beyond October 1, 2007. In addition, the first payment received by the recipient would have to be made not later than two years after the date of the loan. If the recipient of a qualified agricultural loan receives a federal grant after the receipt of the loan, any federal grant money that remains after all federal obligations are met would have to be allocated by the recipient to be used pay the balance of any outstanding loan made under the program.

Financial Stress. 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 requested 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. If crop insurance were available, and not purchased, the loan would be reduced by the lesser of 30 percent or $50,000.

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.

Crop Disaster. 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 requested by the governor and certified by the producer through an affidavit demonstrating an accurate and valid production loss.

Under the bill, a qualified agricultural loan for crop disaster would not exceed the lesser of $200,000 or the value of the certified crop loss less the amount of a federal grant or crop insurance, if applicable. However, if crop insurance was available for a particular crop and was not purchased, the amount of the loan would be reduced by the lesser of 30 percent or $50,000.

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 claimed by the business would have to be directly attributable to a natural disaster that occurred after January 1, 2001, as requested by the governor and certified by the agricultural business through an affidavit demonstrating an accurate and valid loss. 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.
- $400,000 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 or an agricultural business prior to October 1, 2002, under terms approved by the state treasurer. Under the bill, financial institutions would make a qualified agricultural loan available to farmers or agricultural businesses by using their existing deposits for loans and receiving from the state an interest rate subsidy equal to 120 percent of the state's common cash earnings rate. The state's reimbursement to financial institutions participating in the loan program would not be made prior to October 1, 2002.

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, 2003, 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.

FISCAL IMPLICATIONS:

According to the House Fiscal Agency, the bill would result in cost increases to the state. In addition to the lost opportunity costs due to zero-interest loans, the bill would cost the state $30 million in general fund/general purpose dollars for the fiscal year 2001-02. Short-term borrowing could be used to finance the loans until the end of the fiscal year. The entire amount borrowed, plus interest, would have to be repaid by September 30, 2002. It should be noted that repayment of the principal by lending institutions to the state would not be required until three years after the program has begun.

For the $180 million interest subsidy to lending institutions, the institutions would be eligible to receive 120 percent of the state's earning on its short-term investments. This would result in additional costs to the state.

Other state costs would include administrative costs to the state treasurer, costs to the Department of Agriculture for the certification of applicants, and to the attorney general's office for approving the legal documents and contracts. These costs are indeterminate at this time.

There would be no fiscal impact on local units of government. (4-23-02)

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 problems 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.

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.