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BILL ANALYSIS



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Senate Bill 1497 (Substitute S-1 as reported)
Sponsor: Senator Michelle A. McManus
Committee: Agriculture

Date Completed: 10-28-08

RATIONALE

The Agricultural Development Fund was created under the Julian-Stille Value-Added Act in 2000, to encourage the development of value-added agricultural processing and production in the State. In 2006, amendments were enacted to require the Michigan Department of Agriculture (MDA) to establish a low-interest loan program or loan guarantee program to provide qualified agricultural loans. To date, the MDA has not implemented a program under those provisions, partially over concerns that it would place the State government in competition with commercial lenders. Some still believe, however, that an agricultural loan program would be desirable, especially to small and new farmers and innovative ventures. These ventures often carry a comparatively high degree of perceived risk, and beginning farmers in particular may have difficulty securing loans to fund the capital investment necessary to commercialize their operations. It has been suggested that a loan guarantee program financed through bonds could encourage commercial lenders to extend credit to agricultural operators, spurring additional agricultural innovation in the State.

CONTENT

The bill would enact the "George A. McManus, Jr. Agriculture Innovation Loan Guarantee Act" to do the following:

- Create the Michigan Agriculture Innovation Finance Authority.
- Create within the Authority the agriculture innovation loan

- guarantee programs to promote value-added agricultural processing, commercialization of agriculture technologies, processes, or products, and farming operations.
- Require the Authority to establish an agriculture innovation loan guarantee program that would permit the purchase of real property, improvements, machinery, equipment, and operating needs for up to \$5.0 million per loan guarantee transaction, for established agricultural processing and new ventures.
- Allow the Authority to establish a loan guarantee program for beginning farmers and small farmers that would permit the purchase of real property, improvements, machinery, equipment, and operating needs for up to \$1.0 million per farm unit.
- Require the loan guarantee programs to use participating lenders only.
- Allow the Authority to establish an interest rate assistance program on a farm loan guarantee for beginning farmers, small farmers, and new ventures, and to provide an interest buy-down to participating lenders.
- Limit a loan guarantee to 90% of the participating lender's loss.
- Permit the Authority to issue bonds and notes.
- Limit the aggregate principal amount of the Authority's outstanding bonds or notes, excluding refunding bonds or notes, to \$40.0 million at one time.

-- Require the Authority to issue an annual report to the Governor and the Legislature.

Authority

The bill would create the Michigan Agriculture Innovation Finance Authority as a body corporate within the Michigan Department of Agriculture. The Authority would have to be administered under the supervision of the MDA but would exercise its prescribed statutory powers, duties, and functions independently of the Department. The Authority's budgeting, procurement, and related functions would have to be performed under the direction and supervision of the MDA. Authority funds would have to be handled in the manner and subject to the provisions of law that apply to State funds or in a manner specified in a resolution of the Authority authorizing the issuance of bonds and notes.

The Authority would be governed by a board of directors consisting of the MDA Director, the State Treasurer, and seven members with knowledge, skill, and experience in production agriculture, agri-business, agricultural banking, business, or the financial field. Those seven members would have to be appointed by the Governor with the advice and consent of the Senate. None of the appointed members could be State employees. Two of the appointees would have to represent production agriculture and two would have to represent agricultural banking or the financial field.

The appointed members would have to serve for three-year terms. When the initial appointments were made, however, three members would have to be designated to serve for three years, two for two years, and two for one year. Of the members appointed to serve an original term of three years, one would have to be appointed from a list of two or more nominees of the Speaker of the House of Representatives, and one from a list of two or more nominees of the Senate Majority Leader.

Members of the board and officers and employees of the Authority would be subject to Public Act 317 of 1968, which governs contracts of public employees with public entities. A board member or an Authority officer, employee, or agent would have to discharge the duties of his or her position in

a nonpartisan manner, with good faith, and with that degree of diligence, care, and skill that an ordinarily prudent person would exercise under similar circumstances in a like position.

The board would have to organize and make its own policies and procedures. The board would be subject to the Open Meetings Act.

The Authority would have to elect a chairperson and vice-chairperson from among its members, and could employ legal and technical experts and other officers, agents, or employees paid from Authority funds.

The Authority would have to contract with the MDA for the purpose of maintaining and improving the rights and interests of the Authority.

The accounts of the Authority would be subject to an annual audit by the State Auditor General or a certified public accountant appointed by the Auditor General.

Loan Guarantee Programs

The agriculture innovation loan guarantee programs would be created within the Authority, and would be one or more of the following:

- An agriculture innovation loan guarantee program.
- A loan guarantee program for beginning and small farmers.
- An interest rate assistance program.

The programs would have to promote value-added agricultural processing, commercialization of agriculture technologies, processes, or products, and farming operations within the State.

The loan guarantee interest rate and payment terms would be negotiated between the participating lender and the eligible participant. Participating lenders could not use a loan guarantee for the sole purpose of refinancing prior debt.

A loan guarantee could not be more than 90% of the participating lender's loss after all alternatives to collect had been exhausted.

All loan guarantee programs established by the Authority would have to include a provision requiring out-of-State business to have a significant existing or proposed business presence in Michigan.

Guaranteed loans would be the property and responsibility of the lenders, which would make the loans and service them to conclusion.

A program authorized by the proposed Act could be combined with any other State or Federal program in order to promote value-added agricultural processing; commercialization of agriculture technologies, processes, or products; and farming operations within Michigan.

"Loan guarantee" would mean a commitment by the Authority to pay part or all of a loan's principal and interest to a lender or the holder of a security in case the borrower defaulted. "Participating lenders" would mean lenders who have experience in agricultural lending, who are approved by the Farm Service Agency (FSA) in the U.S. Department of Agriculture (USDA) as a preferred lender or a certified lender, and who are eligible to participate in the FSA guaranteed farm loan program.

"Eligible participants" would mean people able to receive loan guarantee expenditures, including individuals, farmer-owned cooperatives, partnerships, limited liability companies, private or public corporations, and nonprofit organizations in Michigan. Eligible participants would not include any entity located in a renaissance zone.

"Farming" would mean the cultivation of land for the production and harvest of agricultural crops, and would include the production of the following: grains and feeds, forages and sod, dairy products, fruits and vegetables, seeds and grasses, aquaculture, equines, poultry and poultry products, and livestock and cervidae (e.g., deer), including breeding and grazing. Farming also would include the harvest and production of timber and timber products, and of floriculture.

Loan Guarantee Program

The Authority would be required to establish and administer an agriculture innovation loan guarantee program under which the

Authority would approve loan guarantees only for projects in Michigan designed to establish, retain, expand, attract, or develop new innovation in value-added agricultural processing and related agricultural production operations or the commercialization of agriculture technologies, processes, or products.

The loan guarantee program would have to permit the purchase of real estate, real estate improvements, machinery, equipment, and operating needs not to exceed a total of \$5.0 million for each loan guarantee transaction for established agricultural processing as well as new ventures.

In addition, the loan guarantee program would have to do all of the following:

- Use participating lenders only.
- Require segregation of security and lien priority issues to be documented in the agreement between the Authority and the participating lender.
- Ensure that the loan guarantees were used to finance operations that were viable, productive, and sustainable as determined by the participating lender.

"Loan guarantee transaction" would mean the aggregation of the dollar amount of the existing outstanding principal balance of all loans to the same borrower guaranteed under the proposed Act in addition to the amounts of any new guarantee loan applications to the same applicant.

"Agricultural processing" would mean one or more of the operations that transform, package, sort, or grade livestock or livestock products, agricultural commodities, or plant or plant products into goods that are used for intermediate or final consumption, including goods for nonfood use. "Value-added" would mean the enhancement or improvement of the overall value of an agricultural commodity or of an animal or plant product into a product of higher value. The enhancement or improvement would include but not be limited to marketing, agricultural processing, transforming, or packaging.

"Commercialization" would mean the transition from research to the actions necessary to achieve market entry and general market competitiveness of new

innovative technologies, processes, and products and the services that support, assist, equip, finance, or promote a person or an entity with that transition.

Beginning & Small Farmers; New Ventures

Loan Guarantee Program. The Authority would be permitted to establish and administer a loan guarantee program for beginning farmers and small farmers that would allow the purchase of real estate, real estate improvements, machinery, equipment, and operating needs not to exceed a total of \$1.0 million per farm unit to be included in any loan the program guaranteed. The program would have to do all of the following:

- Limit loan guarantees to a maximum of \$1.0 million per loan guarantee transaction.
- Require the applicant to fund at least 10% of the purchase price.
- Use participating lenders only.

"Beginning farmer" would mean a farmer who had 10 years or less of farming or ranching experience as of the date a loan originally was made. "Small farmer" would mean a farmer who had sustained annual gross sales from agricultural production of less than \$250,000 on the date a loan originally was made. When two or more borrowers signed a promissory note, their annual sales would be aggregated for the purpose of determining whether the loan qualified as a small farmer loan.

Interest Rate Assistance Program. The Authority could establish and administer an interest rate assistance program on a farm loan guarantee through a participating lender to provide interest rate assistance for beginning farmers and small farmers, and for new ventures that would enhance value-added agricultural processing or the commercialization of agricultural technologies, processes, or products.

The Authority could provide an interest buy-down to the participating lender in which the lender received its typical return and the eligible participant benefited from a reduced interest rate.

Authority Requirements & Powers

The Authority could not become an owner of agricultural land, agricultural improvements, or real or personal property, except on a temporary basis if necessary to implement its programs, to protect its investments by means of foreclosure or other means, or to facilitate the transfer of agricultural land, agricultural improvements, or real or personal property.

("Real or personal property" would mean all or any specifically designated real estate, fixtures, or personal property offered as security for a loan, including all forms of property eligible for a security interest as defined in the Uniform Commercial Code.)

The Authority would have to exercise due diligence and care in the selection of projects and apply customary and acceptable business and lending standards in the selection and subsequent implementation of those projects. The Authority could delegate primary responsibility for the determination and implementation of the projects to an agency of the Federal government if the agency assumed an obligation to repay the loan.

The Authority would have all powers necessary or convenient to carry out the proposed Act, including those described below.

In cooperation with other State agencies, State universities, local units of government, and other industry groups, the Authority could conduct studies and analyses of agricultural trends and future economic estimates within Michigan, whose results would have to be made available to the public and the agricultural industry; engage in research; and disseminate information to industry partners.

The Authority also could establish and collect fees and charges in connection with the sale of its loan guarantee commitments and servicing; establish standards and/or inspect records relating to guarantees made under the agriculture innovation loan guarantee programs; and, pursuant to the Administrative Procedures Act, promulgate rules necessary to implement the purposes of the proposed Act.

Annual Report

By January 15 each year, the Authority would have to submit a complete report on its activities to the Governor, the Secretary of the Senate, the Clerk of the House, and the chairpersons of the Senate and House standing committees on agriculture. The report would have to include all of the following:

- A description of the Authority's operations and accomplishments.
- An accounting of its receipts and expenditures during the fiscal year, in accordance with the classifications it established for reporting its operating and capital accounts.
- An accounting of its assets and liabilities at the end of its fiscal year and the status of reserve, special, and other funds.
- A schedule of the bonds and notes outstanding at the end of its fiscal year and a statement of the amounts redeemed and issued during its fiscal year.
- A statement of its proposed and projected activities.
- A list of participating lenders.
- A list of eligible participants that used a loan guarantee under the proposed Act.
- An accounting of administrative expenses.
- Recommendations to the Legislature.

The annual report also would have to identify the Authority's performance goals and clearly indicate the progress made to attain them during the reporting period. If possible, results would have to be expressed in terms of number of loan guarantees, amount of capital investment, and types of value-added and commercialization activities assisted.

Bonds & Notes

The Authority could authorize and issue its bonds or notes payable solely from revenue or funds available to it. Authority bonds and notes would not be a debt or liability of the State, and would not create or constitute any indebtedness, liability, or obligations of the State, or constitute a pledge of the faith and credit of the State.

From time to time, the Authority could issue bonds or notes in principal amounts it considered necessary to provide funds for

any purpose. The bonds or notes would not be a general obligation of the Authority but would be payable solely from the revenue and/or funds pledged to the payment of and interest on them, as provided in the resolution authorizing the bonds or notes. The issuance of these bonds or notes would be subject to the Agency Financing Reporting Act.

The Authority also could provide for the issuance of bonds or notes for the purpose of refunding its outstanding bonds or notes.

The Authority could not have outstanding at any time bonds or notes in an aggregate principal amount exceeding \$40.0 million, excluding bonds or notes issued to refund outstanding bonds or notes. Administrative costs could not exceed 5% over the life of the program.

The Authority could hire a person to administer the bonding provisions of the proposed Act.

Bonds or notes issued by the Authority, and the interest on and income from them, would be exempt from all taxation of the State or a political subdivision of the State.

Notwithstanding any restriction contained in any other law, the State and a public officer, a local unit of government, an agency of the State or a local unit, a bank, trust company, savings bank and institution, savings and loan association, investment company, insurance company or association, other person carrying on a banking or insurance business, and an executor, administrator, guardian, trustee, and other fiduciary, could legally invest funds belonging to them or within their control in bonds or notes issued under the proposed Act, and Authority bonds or notes would be authorized security for public deposits.

Authority Property

Property of the Authority would be public property devoted to an essential public and governmental function and purpose. Income of the Authority would be considered to be for a public purpose. Property of the Authority and its income and operation would be exempt from all taxes and special assessments of the State or a political subdivision of the State.

Construction of the Act

The bill would require the proposed Act to be construed liberally to effectuate the legislative intent and purpose as complete and independent for the performance of every act authorized by the statute. The bill also would require that all powers granted be broadly interpreted to effectuate the intent and purposes and not as a limitation of powers.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The agricultural innovation loan guarantee program would serve a purpose similar to that of the Agricultural Development Fund under the Julian-Stille Value-Added Act, helping to encourage greater investment in developing new markets for agricultural products, more efficient technologies, and innovative ways of adding value to commodities produced in the State. Unlike the loan program currently required by the Value-Added Act, which if implemented would place the State government in direct competition with private lenders, a loan guarantee program would place the government in a position of cooperation with the private sector, encouraging private investment with the backing of the State government. That arrangement could be more successful than the Value-Added Act's loan program, which has not been developed. The proposed loan guarantee program would benefit the agricultural community and help the State to foster the new technologies that would allow it to remain competitive and open up new economic activity in Michigan.

Michigan agriculture faces many new and emerging opportunities for growth, including the expanding demand for biofuels, growing markets for value-added agricultural products, and the development of agricultural tourism. To take advantage of those opportunities, entrepreneurs must make significant capital investment, developing or implementing new technologies to meet changing conditions. Many operators, particularly those just entering the agricultural industry, may have difficulty securing the necessary credit to

make these investments. The bill would help to meet that need by guaranteeing loans made by the private sector, reducing the risk for commercial lenders. The program could encourage them to offer credit to entrepreneurs more freely, spurring growth in agricultural innovation across the State. The bill also would maintain incentives for lenders to exercise prudence in offering loans, since the loan guarantee program would guarantee only 90% of a loan. Therefore, lenders still would face some risk if a borrower defaulted, but would be protected from catastrophic losses.

Response: Given the recent financial crisis and the turmoil in the credit markets, it could be unwise to issue bonds at this time. Although the bill specifies that bonds issued by the Agriculture Innovation Finance Authority would not constitute a pledge of the faith and credit of the State, there could be an implied guarantee of those bonds.

Supporting Argument

The bill would complement the existing Federal loan and loan guarantee programs administered by the USDA Farm Service Agency. Those programs offer loans and loan guarantees to promote farm ownership and to assist with operating expenses. While the Federal programs encourage growth in the agricultural sector and help beginning farmers finance their operations, there still is a need for loan guarantees targeted directly to support agricultural innovation, and to help potential applicants who may not meet the qualifications for a Federal loan or loan guarantee. The bill would help to fill in those gaps in the Federal program.

Legislative Analyst: Curtis Walker

FISCAL IMPACT

The bill would have an indeterminate fiscal impact on the State. The Michigan Agriculture Innovation Finance Authority would be charged with creating and administering an agriculture innovation loan guarantee program to promote value-added agricultural processing, commercialization of agriculture technologies, processes, or products, and farming operations. The source of revenue to the Authority primarily would be fees, interest, and collateral on loans that it guaranteed. The members of the board would serve without compensation and operating expenses would be minimal.

The Authority also would have bonding authorization. Any debt obligations of the Authority would not be general obligations of the State nor would the Authority benefit from the full faith and credit of the State. Since the obligations and operations of the Authority would not be paid from existing State funds or revenue streams, existing programs would not be affected.

Fiscal Analyst: Jessica Runnels

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.