State Notes
TOPICS OF LEGISLATIVE INTEREST
November/December 2003

Senate Fiscal Agency

Michigan's Farm Disaster Relief Program
by Craig Thiel, Fiscal Analyst

Introduction

In December 2001, 82 of the 83 Michigan counties (Keweenaw excluded) received Federal agricultural disaster designation from the Secretary of the United States Department of Agriculture (USDA) due to crop losses caused by drought in the summer of 2001. This designation initiated the qualification process for emergency loans from the USDA. In response to the severe drought conditions experienced by Michigan farmers and agribusinesses in 2001, the Michigan Legislature enacted the Michigan Farm Disaster Relief Program in order to provide zero-interest loans to farmers and businesses, separate from the Federal loan program. Banks and the Farm Credit Services system made 2,600 zero-interest loans under the program, totaling \$183.3 million. As of September 30, 2003, 51 loans totaling approximately \$13.5 million were repaid, leaving a total of \$169.8 million of the loans still outstanding.

Through fiscal year (FY) 2002-03, the program has cost the State's General Fund/General Purpose budget \$4.0 million in quarterly interest subsidy payments to banks and approximately \$200,000 in lost interest earnings associated with State certificate of deposit investments. The actual future fiscal impact on the State, in total and on an annual basis, will be contingent on the term of each loan issued, the amount of loans repaid each quarter, and the State's rate of return on its short-term investments. Two recent Federal disaster programs made available to Michigan farmers will lower the balances of outstanding zero-interest loans, thereby reducing the cost of the zero-interest loan program to the State.

Michigan Farm Disaster Relief Program

Public Act (P.A.) 16 of 2002 amended P.A. 105 of 1855, which governs the disposition of State surplus funds, to authorize financial institutions to make zero-interest emergency agricultural loans under certain circumstances; established loan criteria and set maximum loan amounts. The total amount of zero-interest loans authorized under the legislation is \$210 million, of which up to \$10 million is earmarked for agribusiness loans. Financial institutions were authorized to issue the zero-interest loans until October 1, 2002, with a maximum term of five years, not to extend beyond October 1, 2007. The legislation provided a "grace period" whereby repayment of each loan is not required until 24 months after the date of the loan. Although 51 loans were repaid in full as of September 30, 2003, all remaining loans will have made their first of four required repayments by October 1, 2004.

Initially, 29 financial institutions issued 2,600 loans totaling \$183.3 million for an average of \$70,512 per loan. Farmers received \$178.8 million in loans, while agribusinesses received \$4.5 million in zero-interest loans. Loans were issued in 70 of the 82 eligible counties. The largest number of loans issued in any single county was 455 in Huron County, where \$28.1 million in zero-interest loans were written.

Public Act 16 of 2002 provided financial institutions with two methods of making the zero-interest loans. First, P.A. 16 required the State Treasurer to deposit up to \$30 million of surplus funds in financial institutions by May 1, 2002, in order to give them the resources necessary to make zero-interest loans to farmers and agribusinesses. Under this scenario, the State purchased certificates of deposit from the institutions, which in turn used the money to provide zero-interest loans. To cover the administrative costs associated with making the loans, financial institutions were authorized under P.A. 16 to receive an additional reserve investment equal to 20% of the investment received for the loans.

In lieu of using State funds to make the loans, P.A. 16 of 2002 allowed financial institutions that are constitutionally prohibited from accepting State deposits to use their own funds to make zero-interest loans and receive an interest subsidy and reimbursement for the administrative costs associated with making the loans. Under this scenario, the institutions receive quarterly subsidy payments from the State equal to 120% of the State's common cash earnings rate on the money lended. The additional 20% is intended to allow lenders to recover costs associated with making zero-interest loans to farmers and agribusinesses. Under both methods, the financial institutions are required to loan funds at 0% interest and are prohibited from charging fees related to the loans.

Zero-interest loans were capped at $200,000 per individual farmer and $400,000 per agribusiness. A provision in P.A. 16 required the maximum loan amount to be reduced for producers that did not purchase crop insurance for the affected crop, if insurance for that crop was available. Loan amounts ranged from $700 to $200,000 for farmers and $15,000 to $400,000 for agribusinesses.

All loans must be repaid by October 1, 2007. The first loan repayment will be due the last working day of the month in which the loan was made, beginning 24 months after the loan was issued. For example, for loans made in September 2002, the first repayment of 25% of the original loan amount will be due on the last working day of September 2004, with subsequent payments of 25% of the original amount due in September 2005, 2006, and 2007. Public Act 16 of 2002 requires the recipient of a zero-interest loan to pledge any Federal disaster grant toward the repayment of the loan. Zero-interest loan repayments will be affected by two recently enacted Federal disaster programs that provide grants to farmers who experienced crop losses in either 2001 or 2002.

Federal Agricultural Disaster Programs

Responding to agricultural production losses throughout the country in 2001 and 2002, Congress passed, and the President signed on February 20, 2003, the Agricultural Assistance Act of 2003 (Public Law 108-7), authorizing into law two disaster grant programs in which Michigan farmers are eligible to participate. The 2003 Crop Disaster Program (CDP) reimburses producers for crop losses due to damaging weather or related conditions in either 2001 or 2002. This program specifically excludes sugar beet producers, a commodity that Michigan ranks fourth in nationally. To address production losses incurred by sugar beet farmers due to adverse weather in 2001 or 2002, the Agricultural Assistance Act of 2003 also authorized the Sugar Beet Disaster Program. Both programs, administered by the USDA, provide direct grants of up to $80,000 based on crop production losses for either 2001 or 2002, but not both.

Sign-up for the Sugar Beet Disaster Program ended October 31, 2003. A total of $1.7 million was paid out to Michigan producers statewide under this program, with the largest amount ($403,000) distributed in Gratiot County. Under the CDP, sign-up began June 6, 2003, and will extend until January 30, 2004. As of December 4, 2003, the USDA had paid out $41.4 million in grants. Huron County has received the largest amount of grants to date, totaling $4.6 million. It is estimated that CDP grant payments could total between $50 million and $60 million when enrollment is complete.

In general, qualification for the Federal grant programs was more stringent than qualification for Michigan's zero-interest loan program. It is reasonable to assume that a large proportion of zero-interest loan recipients also received a grant from the USDA. As a result of language in P.A. 16 of 2002 requiring assignment of Federal disaster assistance grants toward repayment of existing zero-interest loans, receipt of the USDA payments will reduce the amount of outstanding zero-interest loans and therefore the amount of quarterly interest subsidy payments required of the State. Farmers and agribusinesses will continue to have until October 1, 2007, to repay their loans in full as the Federal grants will be applied to the outstanding balances of the loans as opposed to early repayment.

Fiscal Impact

The fiscal impact of the provision requiring the State Treasurer to deposit up to $30 million in surplus funds with financial institutions will be equivalent to the amount of interest earnings that the State will forgo in order to make this money available for zero-interest loans. These interest earnings would have been revenue credited to the General Fund. According to the Department of Treasury, only three institutions requested State deposits for loans and administrative costs, totaling $6.8 million. As of September 30, 2003, this aspect of the program has cost the State about $200,000 in lost interest earnings. The estimated cost to the State of these deposits is about $600,000 over the five-year loan period.

The other method of providing zero-interest loans allows the State to reimburse financial institutions for the interest and administrative costs associated with making the loans. Under this method, institutions, using their own funds to make the loans, are eligible to receive a payment equal to 120% of the State's earnings on its short-term investments multiplied by the amount of the outstanding loans issued by the financial institutions. As of September 30, 2003, this portion of the program had cost the State $4.0 million in quarterly interest subsidy payments. The actual total cost to the State of both methods for issuing zero-interest loans will be contingent on the length and repayment schedule of the loans issued and the future direction of short-term interest rates. The total cost of the zero-interest loan program also will be reduced as a result of the Federal disaster grants and the requirement to use these payments for loan repayments.

Without the Federal disaster grants, the estimated total cost of Michigan's zero-interest loan program is $19.5 million over the five-year loan period. Factoring in the estimated impact that the Federal grants will have on Michigan's program, the total cost is projected to be between $13.6 million and $15.1 million over the same period, depending on the total amount of Federal grants received by Michigan producers that also participate in the zero-interest loan program. Future Federal agricultural disaster grant programs will reduce further the cost of the zero-interest loan program as a result of the requirements of P.A. 16 of 2002.