

- SUBJECT:** Revising Texas Agricultural Finance Authority loan programs
- COMMITTEE:** Agriculture and Livestock — committee substitute recommended
- VOTE:** 6 ayes — Swinford, McReynolds, B. Brown, Hardcastle, Hupp, C. Jones
0 nays
3 absent — Christian, Crownover, Green
- WITNESSES:** For — Susan Combs, Texas Department of Agriculture; Ed Dupont, Frost National Bank; Gary Joiner, Texas Farm Bureau; Monty Montgomery, Development Corporation of Haskell, Inc.; Karen Neely, Texas Independent Bankers Association of Texas; James Ekstrom; Stephen Filipowicz; Dennis Jupe; Troy Nedbalek; Stephen Vorwerk
Against — None
On — Jim Butler, Texas A&M System Agriculture Program; Jane Anne Stinnett, Texas Agriculture Finance Authority; Tommy Fondren
- BACKGROUND:** The Texas Agricultural Finance Authority (TAFA) is a \$225 million loan guarantee program created in 1987 by the 70th Legislature. It was set up within the Texas Department of Agriculture as a public authority to provide financial assistance for the development and diversification of Texas agricultural products. TAFA is governed by a six-member board.

Under current law, the board is authorized to provide financial assistance to eligible agricultural businesses seeking to finance the production, processing, marketing, or export of Texas products. In general, local banks make the loans, with TAFA providing loan guarantees of up to 90 percent their value, encouraging lenders to make loans they otherwise would not make.

In a December 1997 report, the State Auditor' Office recommended that in light of a \$5.7 million negative balance in fund equity that the feasibility of TAFA programs should be reassessed if the authority's fund equity position from bad debt continued to deteriorate. The report also noted that the TAFA board was implementing policy changes and corrective measures to

strengthen its position after an earlier state auditor's report had cited concerns about a previous TAFE board's approving loans that did not meet its loan guidelines.

DIGEST:

CSHB 3050 would increase loan limits and expand eligibility requirements for several programs at the Texas Agricultural Finance Authority (TAFE), while also revising creditworthiness requirements. The programs include the Young Farmer Loan Guarantee Program, the Linked Deposit Program, the Microenterprise Loan Program, and the Agricultural Diversification Program.

CSHB 3050 would eliminate a requirement that the TAFE board make loans "that otherwise would not be made." Lending rates no longer would be based on U.S. treasury bills or comparable notes plus 4 percent and instead would be based on the maximum linked deposit rate plus a maximum of up to 4 percent

Microenterprise Program. CSHB 3050 would increase the maximum loan under the Microenterprise Program from \$15,000 to \$25,000 for new microenterprises and from \$30,000 to \$50,000 for established microenterprises or operations.

The TAFE board could make, guarantee, participate in, insure, coinsure, or reinsure loans specifically to rural, agriculture-related businesses. These would include businesses providing recreational activities, such as hiking, fishing, hunting, or other outdoor activities and also would include state agencies or institutions of higher education producing agricultural products.

Any eligible recreational activities that were TAFE-funded would have limited liability coverage as defined in the Civil Practices and Remedies Code, Chapter 75.

CSHB 3050 would define microenterprise as a small business located in a rural area in which the owner operated the enterprise. The bill would delete an existing requirement that the owner's family provide most of the management and labor to operate the business. The bill would delete the requirement that the microenterprises be loan applicants. Instead it would allow an applicant to apply on behalf of a microenterprise.

This bill would transfer the Rural Microenterprise Development Fund from the state treasury to the Comptroller's Office.

Linked Deposit Program. CSHB 3050 would increase the funds available to support Linked Deposit Program Loans from \$15 million to \$25 million.

CSHB 3050 would add that board rules on loan applications include crop information from the Texas Agricultural Statistics Service that may be relevant and natural disaster assistance criteria.

This bill would establish that all linked deposit applications be submitted to the TAFE administrator and not to the board. The comptroller, not the board, would represent the eligible lending institution when entering into a written agreement.

CSHB 3050 would allow linked deposit loans to be used for agriculture-related operating expenses, purchase or lease of land, or fixed assets acquisition, or improvement, as they are identified in the application. Linked deposit loans could be used for existing debt. This bill would no longer require the loan to be applied towards equipment, seed, fertilizer, direct marketing facilities, processing facilities or professional services payment.

Young Farmer Loan Guarantee Program. CSHB 3050 would place the Young Farmer Loan Guarantee Program under Chapter 58 of the Agricultural Code and repeal Chapter 253 where this loan program is currently located. The TAFE board would continue to administer this loan program to help applicants establish or enhance a farming, ranching, or an agriculture-related business. A loan guarantee could not exceed \$250,000 or 90 percent, which ever was the lesser amount, of the commercial lender loan amount.

CSHB 3050 no longer would require an eligible applicant to have four years of practical experience. The applicant's plan no longer would require approval by a teacher or extension agency. The extension economist no longer would have to review the application.

The loan guarantee recipient would be able to use the loan for lease of equipment or other working capital for operating a farm or ranch, and purchase of real estate or any agriculture-related business purpose.

If the loan guarantee had to be honored because the recipient defaulted on the loan, the guarantee authority could bring suit against the defaulting party only in Travis County.

The account for this program would be placed in the Texas agricultural fund, not in general revenue, and could only be used for this specific program.

Other provisions. Under current law, a lending institution is not prevented from participating in the linked deposit program even if a member of the TAFE board is an officer, director, or employee of the lending institution. CSHB 3050 would require that a TAFE board member be recused from taking any action on such an application.

CSHB 3050 would add insect eradication and suppression programs to the list of activities for which the board could provide financial assistance.

Loan eligibility would be expanded to include loans for natural disaster relief at a maximum amount of \$250,000. A crop eligible for natural disaster relief would be identified by a decline, not a marked decline, in production.

The agricultural diversification grant program and all language referring specifically to this program, its grants, or its board in Chapter 44 of the Agriculture code would be deleted. CSHB 3050 would repeal current Agriculture Code section 44.004, 44.005 and 44.006 having to do with crop diversification grants, business assistance grants and small business incubator grants, respectively.

The bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house.

**SUPPORTERS
SAY:**

CSHB 3050 would greatly increase the effectiveness of the Texas Agricultural Finance Authority, providing millions of dollars more in loans to Texas farmers for a variety of important agribusiness enterprises while also tightening creditworthiness requirements.

TAFE had its problems in the past, but the changes in CSHB 3050 would considerably improve this important state agriculture loan program and build on the corrective changes that the board already has implemented successfully to prevent bad loans. As Texas enters another year of drought,

agricultural loans to help farmers survive become even more important. Financing must be made more accessible, not less, and this bill would do that.

Diversification is extremely important for Texas. Setting up enterprises to process Texas food and fiber products creates more jobs. So does starting new recreational and outdoor enterprises. For example, North Carolina has a total of 16,700 residents employed in cotton processing jobs with a payroll of \$397.5 million per year. Texas, which processes only 15 percent of the cotton it produces, has created only about 1,700 processing jobs.

CSHB 3050 is the answer to earlier criticisms of the program. The bill would broaden loan applicant eligibility guidelines that were too narrow, and raise loan cap amounts that were too low to be useful. Changes in the bill would mean TAFSA would no longer act as a lender of last resort.

With creditworthiness requirements strengthened by the bill, TAFSA would be making loans to individuals less at risk. TAFSA's loan default rate has steadily declined since 1996, when internal reforms were instituted. No recipients of loan guarantees have defaulted since that period.

CSHB 3050 would allow loans to be made to such entities as the Texas Boll Weevil Eradication Program and the Texas Forest Service, which may need financing from TAFSA as a result of the drought. Agricultural enterprises provided by state institutions of higher education and state agencies need the support of this important lending program.

Under the bill, the Texas Department of Agriculture would have the authority to decrease loan interest rates, which would greatly minimize the ultimate cost to a borrower. For example, if the Boll Weevil Eradication Foundation received a loan from TAFSA and TDA lowered the interest rate, this decrease in overall loan repayment costs would trickle down, ultimately helping the cotton farmers in the foundation.

The Young Farmer Loan Guarantee Program, for persons ages 18 to 40, would be used more effectively than before because of a streamlined loan application, increased maximum loan amounts and an expanded eligibility definition. Texas should help its young people start and continue farming and ranching. This program is critically needed in Texas, since the average age of

a farmer is near 60. CSHB 3050 would pull the Young Farmer Loan Guarantee Program under the TAFE statute, for the purposes of consolidation.

Broadening the types of businesses eligible for loans would help farmers and ranchers diversify and cushion themselves against economic fluctuations caused by drought and shifting commodity prices. For example, a rancher could develop a bird sanctuary with nature trails on a parcel of land, or even branch into the feed store business. Demand for nature or ecotourism is on the rise, and this loan program would help agriculture related businesses expand and diversify their markets. CSHB 3050 would establish increased loan amounts giving new enterprises start-up or expansion capabilities. Currently, the program is inactive because of the existing loan restrictions.

The Linked Deposit Program has been a highly utilized TAFE program. This bill would increase available program funds from \$15 million to \$25 million. The funding increase will ensure that more Texas agricultural businesses may participate. A language change will allow loan eligibility to include disaster relief through refinancing of existing debt.

All of these loan program changes make the programs more accessible to those who need them through expanded loan amounts and eligibility requirements.

**OPPONENTS
SAY:**

As the state auditor has pointed out, TAFE has made numerous poor lending decisions in the past. Broadening the scope of this troubled program to include a wide variety of agricultural business enterprises and increasing the funds available could only compound the problem of the state government's subsidizing loans to shaky enterprises that private financial institutions otherwise would find too risky.

Serious questions remain about whether state agriculture officials should be in the business of making or guaranteeing loans in the first place. TAFE's poor track record would seem to underline these questions. These loans have been aimed at helping higher-risk applicants whom banks already have turned down. It does not make good business sense for the state to encourage borrowing by individuals who could not get financial assistance through traditional banking channels.

TAFAs should be required to use stricter selection criteria for loan applicants, not looser criteria, as this bill would allow. Until the program gets on track, it would be unwise to authorize it to issue even bigger loans. This would be opening the door for TAFAs to make even costlier mistakes. While changes in the bill would mean TAFAs would no longer serve as a lender of last resort, the agency still could make loans to individuals for projects that banks have rejected

Out of 65 TAFAs-backed projects, 18 percent (12 projects) have defaulted on their loans. Some \$3.9 million has been written off as uncollectible out of \$42.3 million in loans the authority has guaranteed, with another \$3.2 million in loan money considered to be at risk. More than \$200 million in TAFAs funds remains uncommitted to any project.

Expanding the eligible applicants to include state agencies and universities would dilute TAFAs funding resources, diverting them from the applicants for whom these loans were really intended, Texas farmers and ranchers. If state agencies and universities want more money for their programs, they should justify them as part of the appropriations process. Tax-supported entities should not be allowed to borrow even more tax dollars.

NOTES:

The committee substitute changed the original bill in several ways, including: removing the transfer of the Office of Rural Affairs; deleting “small business incubator” definition and adding “eligible lending institution”, “alternative agriculture crops”, “rural area” and “board” definitions; deleting language that would bar a loan from being used to refinance; allowing the board to delegate to the commissioner the authority to approve or disapprove applications; moving the microenterprise fund from the general revenue fund to the Comptroller’s Office; authorizing lending to a state agency or higher education institution; authorizing recreational limited liability coverage; deleting a net worth value eligibility requirement from the Young Farmer Program; and changing the effective date from September 1, 1999, to immediate effect upon passage.

The fiscal note shows a negative impact of \$160,000 in general revenue funds resulting from lower loan interest rates.

The companion bill, SB 1430 by Duncan, was reported favorably by the

Senate Natural Resources Committee on April 9 and recommended for the Local and Uncontested Calendar.