

BEGINNING FARMER LOAN PROGRAM

Program Guidelines

**Administered by
MISSOURI AGRICULTURAL AND SMALL BUSINESS
DEVELOPMENT AUTHORITY**



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MISSOURI AGRICULTURAL AND SMALL BUSINESS

DEVELOPMENT AUTHORITY
BEGINNING FARMER LOAN PROGRAM

Table of Contents

<u>Section</u>	<u>Page</u>
I. Definitions.....	3
- Act.....	3
- Agricultural Property.....	3
- Application.....	3
- Authority.....	3
- Beginning Farmer.....	3
- Bonds.....	3
- Borrower.....	4
- Cost of the Project.....	4
- Indirect Land Ownership.....	4
- Low or Moderate Net Worth.....	4
- Net Worth.....	4
- Participating Lender.....	4
- Project.....	4
- Related Person.....	5
- Substantial Farmland.....	5
II. Program Power and Eligible Activities.....	5
1. Agricultural Land.....	5
2. Agricultural Improvements.....	5
3. Depreciable Agricultural Property.....	5
III. Program Maximums and Minimums.....	6
IV. Nature of Investment Risk, Limited Obligation Bonds.....	6
V. Applicant Eligibility.....	7
1. Age Limits.....	7
2. First-Time Farmer.....	7
3. Net Worth.....	7
4. Residence.....	7
5. Training and Experience.....	7
6. Use of Project.....	7

VI.	Ineligible Program Activities	7
	1. Refinance Existing Debt	7
	2. Finance Working Capital	7
	3. Finance the Acquisition of Property For Others	7
	4. Finance the Acquisition of Agricultural Land, Agricultural Improvements or Depreciable Agricultural Property from a “Related Person”	7
VII.	Application and Procedures.....	9
	1. Application Forms	9
	2. Application Period	9
	3. Interim Financing.....	9
	4. Loans to Beginning Farmers and Security Arrangements	10
	5. Terms of Loan.....	10
	6. Repayment of Loans	10
	7. Reoffering of Bonds.....	10
	8. Fees	10
	9. Use of Financial and Security Documents	11
	10. Participating Lender.....	11
	11. Procedures Following Bond Issuance.....	11
	12. Timing Requirements for Spending Bond Proceeds.....	12
	13. Assumption of Loans - Substitution of Collateral & Transfer of Property	12
	14. Public Hearing and Governor’s Approval of Bond Issuance	12
	15. State Volume Cap Limitations.....	13
	16. Modified Accelerated Cost Recovery System Limitations.....	13
	17. Maximum Loan Maturity.....	13
VIII.	Federal Tax Exemption of Authority Bonds.....	13
	1. General Tax Exemption of Bonds.....	13
	2. Other Tax Considerations	13
IX	Right to Audit	14
	Concluding Note.....	14

PROGRAM SUMMARY

Beginning Farmer Loan Program

THE PROGRAM SUMMARY IN BRIEF

The Beginning Farmer Loan Program (the “Program”) is a tax-exempt bond program designed to assist beginning farmers in the state of Missouri to acquire agricultural property at lower interest rates.

The program enables Lenders to exclude from gross income for federal income tax purposes the interest on loans made to beginning farmers. The lender will arrange the loan and purchase from the Missouri Agricultural and Small Business Development Authority (the “Authority”) a revenue bond in the amount of the loan. The proceeds of the bond will be used by the Authority to make a loan to the beginning farmer by the Authority, and that loan and its collateral will be assigned to the lender as security for the bond.

BASIC QUALIFICATIONS:

- ◆ Net worth of \$200,000 or less.
- ◆ May not have previously owned any substantial amount of farmland, of which the individual materially participated.
- ◆ Borrower’s chief occupation must be farming or ranching. After loan closing, gross farm income must exceed off-farm income; spouse’s income is not used in determining eligibility.
- ◆ Property may not be purchased from a related person, unless the acquisition price is for fair market value. After the acquisition the related person may not have a financial interest in the property financed with the loan proceeds.
- ◆ Program may be used to purchase agricultural land, agricultural improvements, and depreciable agricultural property.
- ◆ The maximum loan is \$450,000 for agricultural land, improvements, and depreciable agricultural property, with a limit of \$62,500 on used property.
- ◆ There is no minimum loan amount for the program.

A loan made under the program is funded solely from the proceeds of the bond sold to the lender. The Authority has no independent funds to fund a loan. Therefore, a beginning farmer must submit an application with a lender who is able to purchase the Authority’s bond to fund the beginning farmer’s loan. The Authority shall not be liable or responsible for the failure of a lender to purchase a bond or otherwise perform the functions of a lender. The Authority shall not be liable or responsible for the failure of a beginning farmer to locate an alternate lender in the event of a failure of performance by the beginning farmer’s initial lender. The Authority shall not be responsible to the lender in the event the beginning farmer fails to repay a loan.

GENERAL

The Missouri General Assembly created the Missouri Agricultural and Small Business Development Authority to promote the development of agriculture, small business and small business pollution control facilities through the issuance of bonds.

The powers of the Authority are vested in and exercised by a bipartisan commission of seven members, appointed by the Governor with the consent of the Senate. The members' terms are five years in length.

SECTION I
DEFINITIONS

There are several definitions used in the program that are important to lenders and borrowers contemplating use of the program. These definitions are as follows:

“Act” means Chapter 348 of RSMo. 1986, as amended.

“Agricultural Property” means any land and easements and depreciable real and personal property, including, but not limited to, buildings, structures, improvements, equipment, and livestock, which is used or is to be used in Missouri by Missouri residents for: (a) the operation of a farm or ranch; (b) planting, cultivating, or harvesting cereals, natural fibers, fruits, vegetables, or trees; (c) grazing, feeding, or the care of livestock, poultry, or fish; (d) dairy production; (e) storing, transporting, or processing farm and ranch products including, without limitation, facilities such as grain elevators, cotton gins, shipping heads, livestock pens, warehouse, wharfs, docks, creameries, or feed plants; and (f) supplying and conserving water, draining or irrigating land, collecting, treating, and disposing of liquid and solid waste, or controlling pollution, as needed for the operations set out herein.

“Application” means a completed instrument on a form approved by the Authority which includes among other things a description of the anticipated use of loan proceeds, the amount of the loan, a summary of the proposed loan terms and certain certifications of the borrower and lender.

“Authority” refers to the Missouri Agricultural and Small Business Development Authority organized pursuant to the provisions of the Act.

“Beginning Farmer” is a person who has never had any direct or indirect ownership interest in substantial farmland in the operation of which the person has materially participated. An ownership interest of material participation by a person’s spouse or minor child will be attributed to the person, as well.

However, the federal tax law also provides that a person’s prior ownership interest in farmland will be disregarded if:

1. Such farmland was disposed of while the person was insolvent; and,
2. Section 108 of the Internal Revenue Code applied to indebtedness with respect to such farmland; that is, the person was not required to recognize any income for federal tax purposes from the cancellation of the indebtedness on the farmland.

“Bonds” mean any bonds, notes, debentures, interim certificates, bond, grant, or revenue anticipation notes, or any other evidences of indebtedness.

“Borrower” refers to a beginning farmer.

“Cost of the Project” means the cost of acquisition of all land, rights-of-way, property rights, easements, franchise rights, and interests required for acquisition, construction, or both. It also means the cost of demolishing or removing structures on acquired land, the cost of access roads to private property, including the cost of land or easements, and the cost of all machinery, furnishing, and equipment, and all financing charges. Cost also means the cost of engineering, legal expenses, plans, specifications, surveys, estimates of cost and revenues, as well as other expenses incidental to determining the feasibility or practicability of acquiring or constructing a project. It also means other expenses incidental to the acquisition or construction of the project, the financing of the acquisition or construction, including the amount authorized in the resolution of the Authority providing for the issuance of bonds, and the financing of the placing of a project in operation.

“Indirect Land Ownership” refers to a minimal interest in a family farm corporation, a limited partnership, a trust, or any other sort of indirect entity which in turn owns farmland in an amount which is greater than 30 percent of the median size of a farm in the county and the person materially participates in the operation of such farmland.

“Low or Moderate Net Worth” means:

1. For an individual, an aggregate net worth of the individual and the individual’s spouse and minor children of less than two hundred thousand dollars (\$200,000);
2. For a partnership, the aggregate net worth of each partner, including the partner’s net capital in the partnership together with that partner’s spouse and minor children, shall not exceed two hundred thousand dollars (\$200,000).

“Net Worth” is total assets minus total liabilities as determined in accordance with generally accepted accounting principles with appropriate exceptions and exemptions reasonably related to an equitable determination of the beginning farmer’s or partnership’s net worth. Assets shall be valued at fair market value.

“Participating Lender” any state or national bank, federal land bank, production credit association, bank for cooperatives, federal or state chartered savings and loan association or building and loan association or small business investment company that is subject to credit examination by an agency of the state or federal government, or any other lending institution approved by the insurer or guarantor of an agricultural development loan, small business development loan, or small pollution control facility loan which undertakes to make or service such a loan.

“Project” refers to the acquisition, construction, improvement or rehabilitation of property owned or to be owned by a beginning farmer.

“Related Person” according to the IRS, includes grandfather, grandmother, father, mother, brother, or sister (whether whole or half blood), child, grandchild, or spouse. It also includes certain corporations and partnerships. (See page 7).

“Substantial Farmland” — any parcel of land is substantial farmland unless; the parcel is smaller than 30 percent of the median size of a farm in the county where the parcel is located, (see attached table “Median Size Farm”).

SECTION II

PROGRAMS POWERS AND ELIGIBLE ACTIVITIES

Eligible activities (only for persons who are first-time farmers) consist of financing purchases of the following:

1. **Agricultural Land** — The Authority can finance the purchase of land suitable for use in farming practices as defined under agricultural property.
2. **Agricultural Improvements** — The Authority can finance the construction or purchase of improvements located on agricultural land (which are suitable for use in farming). Examples: Confinement systems for swine, cattle, or poultry; barns and other out-buildings; grain storage facilities; silos; improvements to land such as tiling and soil conservation practices which could include, but not be limited to, terraces, farm ponds, erosion control structures, waterways, etc. Agricultural improvements may be new or used, and may include additions to or renovation of existing buildings or other structures.

NOTE: There are restrictions regarding the financing of a personal residence on a farm. The ability to finance a personal residence with the program is severely limited due to federal regulations governing the use of the Authority’s bonds; therefore, except in certain circumstances (e.g., when the value of the residence is clearly less than 5% of the amount of the loan or the amount of contract financed), it will be necessary to finance the personal residence separately.

3. **Depreciable Agricultural Property** — The Authority can finance the purchase of personal property suitable for use in farming for which an income tax deduction for depreciation is allowed in computing Federal income taxes. Examples: Livestock used for breeding or dairy purposes, farm machinery, trucks, etc. Feeder cattle, feeder pigs, or feeder lambs do not qualify as depreciable property. Bond proceeds may be used to finance new or used Depreciable Agricultural Property. “Used” livestock are female animals that have produced offspring or are male animals that have been used for breeding purposes. Open or bred heifers, gilts, or lambs would not be considered “used” property under this definition (this class of animals would be considered “new” property). Male animals that have not been used for breeding purposes would also be considered “new” property.

SECTION III

PROGRAM MAXIMUMS AND MINIMUMS

Federal Law sets various maximum amounts which may be financed under the program. The maximums are:

1. No more than an aggregate amount of \$450,000 for agricultural land, agricultural improvements and depreciable agricultural property.
2. Of the \$450,000 limit, the entire amount may be used for new depreciable agricultural property, and up to \$62,500 can be for “used” property.
3. There is no minimum loan amount for the program.

SECTION IV

NATURE OF INVESTMENT RISK: LIMITED OBLIGATION BONDS

THE LENDER MUST MAKE THE CREDIT EVALUATION OF THE LOAN, THE BEGINNING FARMER’S NET WORTH AND ABILITY TO REPAY PRINCIPAL AND INTEREST AND THE SUFFICIENCY OF THE SECURITY FOR THE LOAN. THE AUTHORITY WILL NOT MAKE AN INDEPENDENT EVALUATION OF THE BEGINNING FARMER’S ABILITY TO REPAY THE LOAN, OR DETERMINE THE BEGINNING FARMER’S NET WORTH. THE AUTHORITY AND ITS COUNSEL WILL NOT REVIEW AND WILL MAKE NO WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE LEGAL SUFFICIENCY OR VALIDITY OF THE LOAN.

The principal and interest on the bond are limited obligations, payable solely out of the revenue derived from the debt obligation, collateral, or other security furnished by or on behalf of the beginning farmer. A guarantor, letter of credit or alternative credit enhancement on the debt is permissible. A guarantor may be a related person. **The Bond, which is issued by the Authority and purchased by the lender, is a non-recourse obligation. The principal and interest on the bond do not constitute an indebtedness of the Authority or the state of Missouri or a charge against their general credit or general funds.** It should also be noted that any recording or filing fees or transfer taxes associated with the loan will be paid by the beginning farmer or lender and not the Authority. **Additionally, the Authority will have no responsibility with respect to the preparation, execution, or filing of any declaration of value or groundwater hazard statements.**

SECTION V

APPLICANT ELIGIBILITY

The basic eligibility requirements for the Program are as follows:

1. **Age Limits** — A beginning farmer must be at least age 18. There is no upper age limit.
2. **First-Time Farmer** — All beginning farmers must be first-time farmers regardless of the purpose of the loan.
3. **Net Worth** — The beginning farmer must meet the net worth requirements.
4. **Residence** — The beginning farmer must be a resident of Missouri at the time the bond is issued.
5. **Training and Experience** — The beginning farmer must have documented, to the satisfaction of the Lender and the Authority, sufficient education, training and experience in the type of farming operation for which the bond is requested. If the beginning farmer is an individual in a partnership, all partners shall have sufficient education, training, or experience in that type of farming operation.
6. **Use of Project** — If the beginning farmer is an individual, the agricultural land and agricultural improvements shall only be used for farming by the individual, the individual's spouse, the individual's minor children, or any of them.

SECTION VI

INELIGIBLE PROGRAM ACTIVITIES

The Internal Revenue Service has promulgated many rules and regulations governing the use and sale of tax-exempt bonds, some of which apply to the Authority's Program. The rules that will affect the Program most are those stating the **tax-exempt bond proceeds cannot be used to:**

1. **Refinance Existing Debt** which has been incurred by the beginning farmer prior to approval by the Authority of a program application.
2. **Finance Working Capital** to purchase feed, seed, fertilizer, fuel, etc. (Feeder cattle, feeder pigs or feeder lambs would also fall into this category.)
3. **Finance the Acquisition of Property** for individuals other than for first-time farmers.
4. **Finance the Acquisition of Agricultural Land, Agricultural Improvements or Depreciable Agricultural Property from a "Related Person" unless the Acquisition price is for Fair Market Value and after the sale the related seller may not have a financial interest in the property financed with the loan proceeds.** (For purposes of this statement, a related seller will not be treated as having a financial interest if the related seller:
 - A. has no more than a ten-percent interest in the capital or profits in a partnership comprising the farm;
 - B. has no more than a ten-percent stock interest in a corporation comprising the farm;
 - C. has no more than a ten-percent of the beneficial interest in a trust comprising the farm;
 - D. is not a principal user of the farm; or
 - E. has no other direct or indirect ownership or use of the farm which has as a principal purpose, the avoidance of this provision.)

The IRS states that the following, among others, are deemed to be a "related person": grandfather, grandmother, father, mother, brother or sister (whether whole or half blood),

child, grandchild, or spouse. “Related person” also includes certain corporations and partnerships where a beginning farmer acquiring land or property from a corporation or partnership, together with any persons having family relationships indicated above, own more than 50% of the stock in a corporation or have more than 50% interest in a partnership would also have to meet “related person” requirements.

NOTE: (Because the estates of any of the persons in the foregoing list may also be considered related persons, purchases from such an estate may be ineligible for financing under the program.) It should be pointed out that the foregoing list is not exclusive. There are certain other entities and individuals who could also be considered “related persons”. However, an uncle, aunt, nephew, niece, or cousin would not be treated as a “related person”.

In addition, the beginning farmer, or any related person, shall not commence acquisition or construction of any part of the Project prior to the date on which the Authority approves the program application. To do so runs a risk that the IRS could deem the bond transaction a refinancing with the interest on the bond being subject to federal income taxation. **Tax-exempt bond proceeds may not be used for the purpose of refinancing.** This means that neither the beginning farmer nor any related person can enter into any contract or purchase agreement, installment or otherwise, in connection with the project or any part thereof more than 60 days prior to the Authority’s approval of the application.

The beginning farmer should make application to and obtain Authority approval before signing a purchase offer or an offer to buy. However, the beginning farmer may sign a purchase offer or other contract prior to obtaining Authority approval, if the following three conditions are met: 1) it clearly states the purchase is subject to approval of the Authority; 2) the risk of loss remains with the seller; and 3) the Authority approval is obtained prior to the beginning farmer taking possession of the property.

Notwithstanding the foregoing, approval of an application does not constitute final bond approval. The Authority reserves the right to cease bond processing at any time or to reduce the permitted bond amount, if, prior to bond closing, it is discovered that the beginning farmer is refinancing an existing loan, or, if due to the application of or changes in federal or state law or regulations, it is determined that the project is ineligible.

SECTION VII

APPLICATION AND PROCEDURES

A beginning farmer and lender must prepare and submit an application jointly to the Authority. The following should be noted:

1. **Application Forms** — Application forms are available from the Authority. **The application should be completed by the beginning farmer and lender and submitted to the Authority.** Applicants and lenders are encouraged to contact the Authority if they have questions in completing the application.

Lenders should use their own form of financial statement and other forms deemed necessary to document the eligibility of the beginning farmer or his or her ability to repay principal and interest payments. A copy of the beginning farmer's financial statement (taken within three months preceding application submission) must be submitted with the application. If a loan is sought with respect to individuals in a partnership, separate applications and financial statements must be submitted by each partner, and an aggregated financial statement covering the partnership and all partners must also be submitted.

NOTE: If the beginning farmer and/or spouse is involved in a business, partnership, corporation, etc., either related or unrelated to his/her farming operation, a financial statement from this entity must also be submitted with the application.

A letter must be submitted by the lender with the application to explain the beginning farmer's background with respect to his or her education and experience in the type of farming operation for which a loan is sought. The letter should also outline the beginning farmer's access to machinery, if the loan is for land; or his or her access to land, if the loan is for agricultural improvements or depreciable agricultural property. The letter should also state where the beginning farmer will obtain operating capital and interim financing if necessary.

2. **Application Period** — There is no formal or defined application period because the program is ongoing, however, applications should be submitted at least one week prior to the board meeting.
3. **Interim Financing** — As noted on page 7, a beginning farmer must not commence acquisition or construction on any part of the project prior to the date the Authority approves the application; if this were to occur, the bond transaction could be deemed a refinancing with the interest on the bond being subject to federal income taxation. However, once the application has been approved, the project may move forward with either construction or possession; if necessary, the lender may interim finance the loan prior to bond issuance. The interim financing (principal only) will be paid with the proceeds of the bond when issued.
4. **Loans to Beginning Farmers and Security Arrangements** — The program involves the lender, beginning farmer, and the Authority. Simultaneously, the Authority will make the loan to the eligible beginning farmer and the lender will purchase the bond as an investment. To facilitate the making of the loan, the lender and Authority will enter into an agency relationship whereby the lender agrees to act as agent or fiduciary for the Authority for all purposes in connection with financing the loan. The lender will make its own credit evaluation of the loan and the beginning farmer's ability to repay principal and interest.

See Section IV, page 6, for nature of investment risk.

5. **Terms of Loan** — The beginning farmer and lender must agree on terms of the loan such as interest rate, length of loan, prepayment options, service fees and repayment schedule. The Authority reserves the right to withhold approval for a loan containing formidable provisions.

6. **Repayment of Loans** — The borrower's prepayment obligations, under the loan agreement and promissory note, are subject to mandatory prepayment in certain events which are set forth in the bond documents. These include the loan agreement becoming void and unenforceable, interest on the bond becoming subject to federal income taxation to the extent any monies remain in the project fund following completion of the acquisition or construction of the project. In addition, the forms may provide for optional or mandatory prepayment (in the discretion of the Lender) in the event of damage, destruction or condemnation of all or any part of the project. Finally the bond documents may provide for optional prepayment of the bond at option of the borrower, the terms and conditions of which are to be agreed upon between the borrower and the lender. The documents and the structure of the financing require installments in amounts to be determined by the lender payable under the bond and the lender agrees that only such prepayments would be applied in inverse order of principal maturity. It should be noted that the bond documents may be prepared to provide for a prepayment at the option of the lender. The terms of this type of prepayment will need to be agreed upon by the beginning farmer and the lender. This prepayment option should be used where a lender may be willing to extend the initial term of a loan, but wants the ability to review the situation at various points in time and to end the loan if the beginning farmer's progress is unsatisfactory (call option).

7. **Reoffering of Bonds** — The bonds may be transferred with the prior approval of the Authority.

8. **Fees** — The beginning farmer or lender must submit to the Authority a non-refundable \$300 application fee (submitted with the application). A participation fee equal to 1 1/2% of the amount of the loan, but not less than \$500, must be submitted by the beginning farmer or lender at loan closing. An issuance fee equal to 1/2% of the loan amount must also be submitted at closing. The participation and issuance fees may be financed with bond proceeds.

The Authority's bond counsel will review each bond for legality and tax exemption. The Authority will pay its bond counsel from the fees collected from the beginning farmer or lender.

9. **Use of Financial and Security Documents** — The lender should obtain from the borrower financial statements and prepare security documents which he/she believes are necessary and appropriate under the particular loan circumstances. These items should be referenced in the bond documents and their provisions incorporated therein. Any additional requirements not specifically provided for in the bond documents, such as insurance coverage and amounts, should also be added.

LENDERS PLEASE NOTE: IT IS THE LENDER'S RESPONSIBILITY TO INSURE THAT

ANY SECURITY AGREEMENTS, MORTGAGES, GUARANTEES OR OTHER SECURITY DOCUMENTS, WHICH THE LENDER REQUIRES IN A TRANSACTION, HAVE BEEN COMPLETED AND SIGNED; AND THAT ANY FINANCING STATEMENTS HAVE BEEN FILED, MORTGAGES RECORDED OR ANY OTHER NECESSARY STEPS TAKEN TO PROTECT THE BOND PURCHASER'S INTERESTS. THE AUTHORITY MAKES NO WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE EFFECTIVENESS, VALIDITY OR PRIORITY OF ANY LIENS OR SECURITY INTERESTS, WHICH A LENDER HAS, OR BELIEVES HE/SHE MAY HAVE, WITH RESPECT TO A PARTICULAR PROJECT.

The Authority strongly recommends that a lender review any existing security documents it may have with the beginning farmer to insure that such security documents are broad enough to cover the loan. Such security documents should be revised if necessary. The Authority also advises that any security documents or guarantees required to be delivered in connection with a loan clearly state that they are given as additional security for the indebtedness, under the loan agreement, as evidenced by the promissory note, under the lender's loan agreement and the Authority's bond and to further secure the agreements, covenants and obligations of the beginning farmer contained in the beginning farmer's loan agreement. The security documents and any guarantees should run directly between the beginning farmer and the lender. The lender should add a "Cross-default" provision to the security documents, making an event of default under the loan agreement an event of default under the security documents or guarantee and vice versa.

10. **Participating Lender** — Any state or national bank, federal or state chartered savings and loan association or building and loan association or small business investment company that is subject to credit examination by an agency of the state or federal government, or any governmental agency, or any other lending institution approved by the insurer or guarantor of an agricultural development loan, beginning farmer loan, or small business pollution control facility loan may be a lender in the program.

11. **Procedures Following Bond Issuance** — No bond proceeds may be used for a non-qualified purpose or by a non-qualified user. Following disbursement of the bond proceeds, the lender and beginning farmer must certify that the proceeds were used by a qualified beginning farmer for a qualified purpose.

12. **Timing Requirements for Spending Bond Proceeds** — Federal tax law restrictions generally do not permit the investment of bond proceeds in securities which earn money at rates greater than the yield on the bond.

Under the current rules, the period of time during which bond proceeds may be invested in an unrestricted yield has been effectively shortened to six months. Unless all "Gross Proceeds" of a tax-exempt bond are spent on the project being financed within six months after the date the bond is issued, the parties to the bond issue will be subject to some very onerous Federal reporting requirements and will be required to pay any profits earned on bond proceeds to the

Federal government.

It should be noted the proceeds of a bond include more than the original principal proceeds. Also included are any amounts earned on the investment of bond proceeds; funds, securities, or other obligations (such as a certificate of deposit) which are pledged as security for the payment of the bond.

To avoid subjecting any of the Authority's bonds to federal reporting and payment requirements, it is the policy of the Authority not to issue a bond for a Project until the Authority can be assured that all bond proceeds will be expended for the Project within six months of the bond issuance. In the closing documents the beginning farmer and lender are required to certify that the use of the proceeds will comply with this policy.

13. **Assumption of Loans - Substitution of collateral and Transfer of Property** — Loans may not be assumed without the prior approval of the Authority, and then only if the purchaser of the property will qualify as a first time farmer. Equipment and other depreciable property may be exchanged or traded in on similar property, and other property such as breeding livestock may be added or substituted as collateral at the discretion of the lender without the prior approval of the Authority. The benefits of the Authority bond must remain with a qualified first-time farmer, and no person to whom property is traded or otherwise transferred may obtain the benefits of the bond.

14. **Public Hearing and Governor's Approval of Bond Issuance** — Federal law requires that a public hearing must be held before any Authority bond is issued. A legal notice will be published by the Authority in a newspaper of general circulation at least 14 days prior to the hearing. In addition, any individual may file a written request with the Authority at or prior to the scheduled hearing requesting that a local hearing be held in the area where the project is located.

Generally, these public hearings will be conducted by the Authority board in conjunction with its monthly board meetings. However, on some occasions the hearings may be conducted by individual board members or members of the Authority's staff. A hearing need not be held prior to an application being approved, but it must be held before the bond documents are approved.

The Governor of Missouri, after receiving a report on the results of the public hearing, may then approve or disapprove the loan. An allocation of the state's volume cap must then be received for the loan. Once the final approval for the Governor and the bonding allocation are received, the loan may proceed to closing with disbursement of the funds.

15. **State Volume Cap Limitations** — The federal tax law establishes a limit on the total principal amount of tax-exempt private activity bonds which may be issued within any state during a calendar year. If an allocation from the volume cap is not available for a particular bond, the

lender and the beginning farmer will be so advised.

16. **Modified Accelerated Cost Recovery System Limitations** — **Lenders and beginning farmers should be aware that federal law limits the application of the Modified Accelerated Cost Recovery System (MACRS) with respect to facilities financed with the Authority's Bonds.**

If an item is financed with the proceeds of a bond, the beginning farmer must use an alternative MACRS method where deductions are computed by applying the straight line method, the applicable averaging convention, and the applicable longer recovery period for such item (12 years for personal property with no class life, 40 years for real property, and the class life for all other property).

NOTE: Beginning farmers should contact their tax consultant regarding the specific effect this change in the MACRS will have on their operations or Project.

17. **Maximum Loan Maturity** — Federal law provides that the weighted average maturity of an Authority bond can be no more than 120% of the average reasonably expected economic life of the project being financed with the proceeds of the bond (except land).

SECTION VIII

FEDERAL TAX EXEMPTION OF AUTHORITY BONDS

1. **General Tax Exemption of Bonds** — Under federal and state tax law, an Authority bond is classified as a Qualified Small Issue Bond. Therefore, if all the provisions of the state and federal law continue to be complied with by the beginning farmer and lender, the interest on an Authority bond will not be included in the bondholder's gross income for federal and Missouri income tax purposes.

2. **Other Tax Considerations** — Prospective purchasers of the Bonds should be aware that there may be tax consequences of purchasing the Bonds including the following:

- (1) Section 265 of the Code denies a deduction for interest on indebtedness incurred or continued to purchase or carry the Bonds or, in the case of a financial institution, that portion of such institution's interest expense allocable to interest on the Bonds.
- (2) With respect to insurance companies subject to the tax imposed by Section 831 of the Code, Section 832(b)(5)(B)(i) reduces the deduction for loss reserves by 15

percent of the sum of certain items, including interest on the Bonds.

- (3) Interest on the Bonds earned by certain foreign corporations doing business in the United States could be subject to a branch profits tax imposed by Section 884 of the Code.
- (4) Passive investment income, including interest on the Bonds, may be subject to federal income taxation under Section 1375 of the code for Subchapter S corporations that have Subchapter C earning and profits at the close of the taxable year, if greater than 25% of the gross receipts of such Subchapter S corporation is passive investment income.
- (5) Section 86 of the Code requires recipients of certain Social Security and certain Railroad Retirement benefits to take into account, in determining gross income, receipts or accruals of interest on the Bonds.

Purchasers of Bonds should consult their own tax advisors as to the applicability of these tax consequences.

SECTION IX

RIGHT TO AUDIT

The Authority shall, at any time, have the right to audit or monitor records of the lender and the beginning farmer relating to a loan and bond to insure the bond proceeds were used for qualified purposes by a qualified user.

CONCLUDING NOTE: This program summary is for convenience, and is not an exhaustive or complete analysis of certain legal requirements pertaining to the program. In the event of any disputes between this summary and applicable law, regulation, or interpretations of counsel, this summary will not be controlling. The Authority recognizes some of the provisions in this Program Summary may be confusing to the beginning farmer or lender. The Authority will provide whatever assistance it can in answering questions or completing documents. Beginning farmers and lenders are encouraged to visit with the Authority staff early in the application process to make the entire transaction as simple as possible. The Authority's telephone number is (573) 751-2129.

MISSOURI AGRICULTURAL and SMALL BUSINESS DEVELOPMENT AUTHORITY

Beginning Farmer Loan Program Bank Deductibility for Tax Exempt Bonds

In talking with lenders one question that often comes up is how the purchase of a tax-exempt bond will affect the financial institution's profitability. The interest paid to a financial institution by the borrower is both state and federal tax exempt. However, it is also important to understand that interest paid to the financial institution on the bond will probably have the effect of reducing the financial institution's interest deduction that would have otherwise been available for

income tax purposes.

In 1986 Congress changed the tax law so that a financial institution's purchase of tax exempt bonds is impacted by the ratio of the amount of tax exempt bonds you purchase to all of your other assets.

Example:

Financial Institution Total Assets: \$1,000,000

Beginning Farmer Bond: \$100,000

Total Interest Deduction 10% (\$100,000 / \$1,000,000)

To determine your financial institution's equivalent taxable rate you factor in the ratio of tax exempt holdings to all assets (B below) and multiply this by the total dollar interest deduction the financial institution would have available based upon its normal borrowing rate (D below). These factors will vary by loan and by financial institution and will likely need to be calculated by the financial institution's accountant. The formula used to approximate taxable rate is:

$$(A-BxCxD) / (1-C) = E$$

A = Annual Payment Based on Tax Exempt Rate

B = Financial Institution's Percent of Tax Exempt Loans to Assets

C = Financial Institution's Federal Marginal Tax Rate

D = Dollar Amount Paid for All Borrowed Money

E = Equivalent Taxable Rate

If we assume that your financial institution offers a tax exempt rate of 7% yielding \$7,000/year (A); a tax exempt to all assets ratio of .10 (\$100,000/\$1,000,000 = B); a marginal tax rate of 34%; and the financial institution pays 4% for all borrowed money or \$40,000 (D) for \$1,000,000 in assets; the equivalent taxable rate equals 8.54% (e.g. (\$7,000-(.10) (.34) (\$40,000)/ (1-.34) = 8545).

This example does not take into account that the beginning farmer loans are also state tax exempt. Additionally, these bonds qualify under the Community Redevelopment Act and can be very effective in bringing new customers into your financial institution. We certainly hope that for all of these reasons you will use this program since it is of tremendous value to the beginning farmers and ranchers in our state.

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