

MEMORANDUM STATE OF ALASKA
DEPARTMENT OF NATURAL RESOURCES - DIVISION OF AGRICULTURE

TO: Board of Agriculture & Conservation
January 20, 2011 meeting

DATE: January 10, 2011

THRU: Franci Havemeister
Director

FROM: Candy Easley
Loan Officer

SUBJECT: ARLF Loan Interest Rates
Good Borrower Credit Rate

ARLF Loan Interest Rates

11 AAC 39.071. Interest rates on loans. (a) At least annually, the board will review and establish interest rates for new loans that are comparable to the rates charged by other agricultural lending institutions in the state for similar types of loans.

(b) The interest rate that will be charged on a new loan is the rate that is in effect on the date that the new loan is approved by the board or the emergency loan committee.

The ARLF loan interest rate for all loan types had been 8% pursuant to Statute for a number of years. As a result of 2000 legislation, the Board of Agriculture and Conservation (BAC) now sets the ARLF loan interest rates *comparable* to other Alaskan agricultural lenders.

Beginning December 18, 2001 the BAC set the ARLF short term operating loan interest rate at 6% and all other ARLF loan types at 7%. January 16, 2003 all ARLF loan interest rates were set by the BAC at 5%. The BAC reviewed the ARLF loan interest rates and good borrower credit rate February 26, 2009 and set rates at 3.00% short term, 4.00% intermediate term and 4.50% for long term. The BAC reviewed and made no changes to these same rates January 21, 2010 and May 3, 2010.

All the Alaskan agricultural lender programs differ; therefore, it is difficult to make an exact comparison of ARLF interest rates. The applicable Statute does not specifically define "comparable". *Historically, the BAC has considered within 1.00% as being comparable.*

Alaska Rural Rehabilitation Corporation – Variable rate

ARRC offers conservative financing with a focus on moderate operating loans, chattel loans and farm land purchase financing. Their current interest rates are varied 5% - 9% determined by applicant's credit & collateral and no loan fees with terms of up to 20 years. The majority of the loans are closed at the 5%. Their rates are adjustable every two years with no cap.

USDA Farm Services Agency – Fixed rate

FSA offers financing if other credit is unavailable with some program loan funds targeted specifically for Disasters, Beginning Farmers and Socially Disadvantaged Farmers. FSA added a Conservation Loan Program 2010 to be used to finance farm conservation projects that does not require a credit elsewhere determination.

Their chattel loans and real estate loans maximum are \$300,000. Alaska is appropriated approximately \$2 million annually; however, FSA is currently loaning approximately \$1,000,000 annually. FSA also offers a guaranteed loan program to eligible lenders and eligible loan applicants. This program guarantees lender's loans from 80% - 95% based on program requirements.

Their rates change monthly based on Treasury interest rates and are fixed. Their rates are presently 1.750% for short/intermediate term with a maximum of 7-year term and 4.500% for real estate loans with a maximum 40-year term with no loan fees.

Farm Credit Services – Variable rate

Farm Credit Services offers conservative financing with FSA guarantees and has only made a few agricultural loans in Alaska over the years. They do not have an Alaskan office and process Alaskan requests out of Washington or Oregon. Their interest rates are variable rates with a cap and presently range 3.85% - 8.30% and loan fees 0 – 2% with a maximum 20-year term. Borrowers may be eligible for .50% - .70% annual interest refund. There may be prepayment penalties.

Commercial Fishing & Agriculture Bank – Variable rate

CFAB has had no agricultural loan activity in years. Their loan programs are primarily for the fishing and tourism industries. Their variable rates are not competitive for agricultural loans at 7.25% - 8.50% and 1% loan fee with a maximum 20-year term.

Agricultural Revolving Loan Fund – Fixed rate

ARLF is Alaska's major agricultural lender with emphasis on agricultural development. Based on the November 30, 2010 Balance Sheet, the ARLF is valued at approximately \$23 million, which includes \$14 million loan portfolio, \$5 million cash and other assets. The ARLF currently offers 3.00% short term 1 year, 4.00% intermediate term up to 7 years and 4.50% long term up to 30 years.

NOTE: State Division of Lands agricultural land contract interest rates are based on the prime rate plus 3 percent not to exceed 9.5 percent. The current State ADL contract interest rate is 6.25 % (3.25 prime rate + 3.00 percent).

AS 03.10.010. Declaration of policy. It is the policy of this chapter to promote the more rapid development of agriculture as an industry throughout the state by means of long-term low-interest loans.

The ARLF has received no general funding since 1986, has minimal cash reserves and essentially has no more assets to liquidate. Without new funds to re-capitalize, the ARLF is at risk of not being able to continue to revolve and provide long term lending support to existing agricultural operations or new agricultural development.

AS 03.10.030 Limitations on loans. (4) shall bear interest at a fixed rate comparable to that charged by other agricultural lending institutions in the state for loans similar to those referred to in this subsection.

Adjustments to the ARLF loan interest rates may cause some degree of impact over the long term; however, increasing the interest rates would have very little immediate impact for the ARLF and would not keep up with the short term need to re-capitalize the ARLF.

As an example, increasing all the ARLF loan interest rates to 5.00% would only increase the ARLF annual revenue approximately \$22,500. This really has little impact on the fund; however, it has a significant long term impact on a producer's marginal cash flow.

ARLF FY2010 interest revenue was \$579,507. Attached is a bar chart illustrating examples of the varying results based on interest revenue for one year only.

Most certainly low loan interest rates result in a positive impact for agricultural borrowers by improving their operating cash flows and encouraging new development. However, a balance is necessary to provide low loan interest rates, yet continue to maintain the ARLF as a long term source of funding for existing Alaskan agriculture and for future agricultural development.

ARLF Good Borrower Credit Rate

11 AAC.39.511. Interest credit for borrowers who maintain good financial standing.
(a) At least annually the board will establish an interest rate credit rate to encourage the prompt payment of loans under AS 03.10.50. Unless precluded by AS 03.10.050 (f), the board may approve interest credit on a loan granted under this chapter. The interest credit granted may not reduce the fixed rate to less than five percent a year.

The Good Borrower Credit (GBC) program was instituted as an incentive for borrowers to pay their ARLF loans timely and when ARLF loan interest rates were set at 8% by Statute. Until the Statute changed that gave the authority to the BAC to set ARLF loans interest rates comparable to other Alaskan agricultural lenders, the GBC program was essentially utilized to adjust the interest rate. Good borrowers tend to pay timely; therefore, the effectiveness of the incentive to pay timely is minimal.

The GBC rate can be changed any number of times; however, credit can be no more than a maximum of 2% within a calendar year. GBCs are available to eligible borrowers for existing and new loans. Borrowers that presently have restructured ARLF loans (F-7s), loans with terms extended or have ever had an ADL land contract or AAAC land clearing loan restructured are not eligible for ARLF GBCs. There are “good borrowers” not eligible for good borrower credits.

Interest credit may not reduce the fixed rate to less than 5%. The majority of the ARLF portfolio has been refinanced to 5% interest rate or less. Loans with interest rates greater than 5% may not have refinanced because of standard non-qualifying reasons, low payoff balances or they are unwilling to apply.

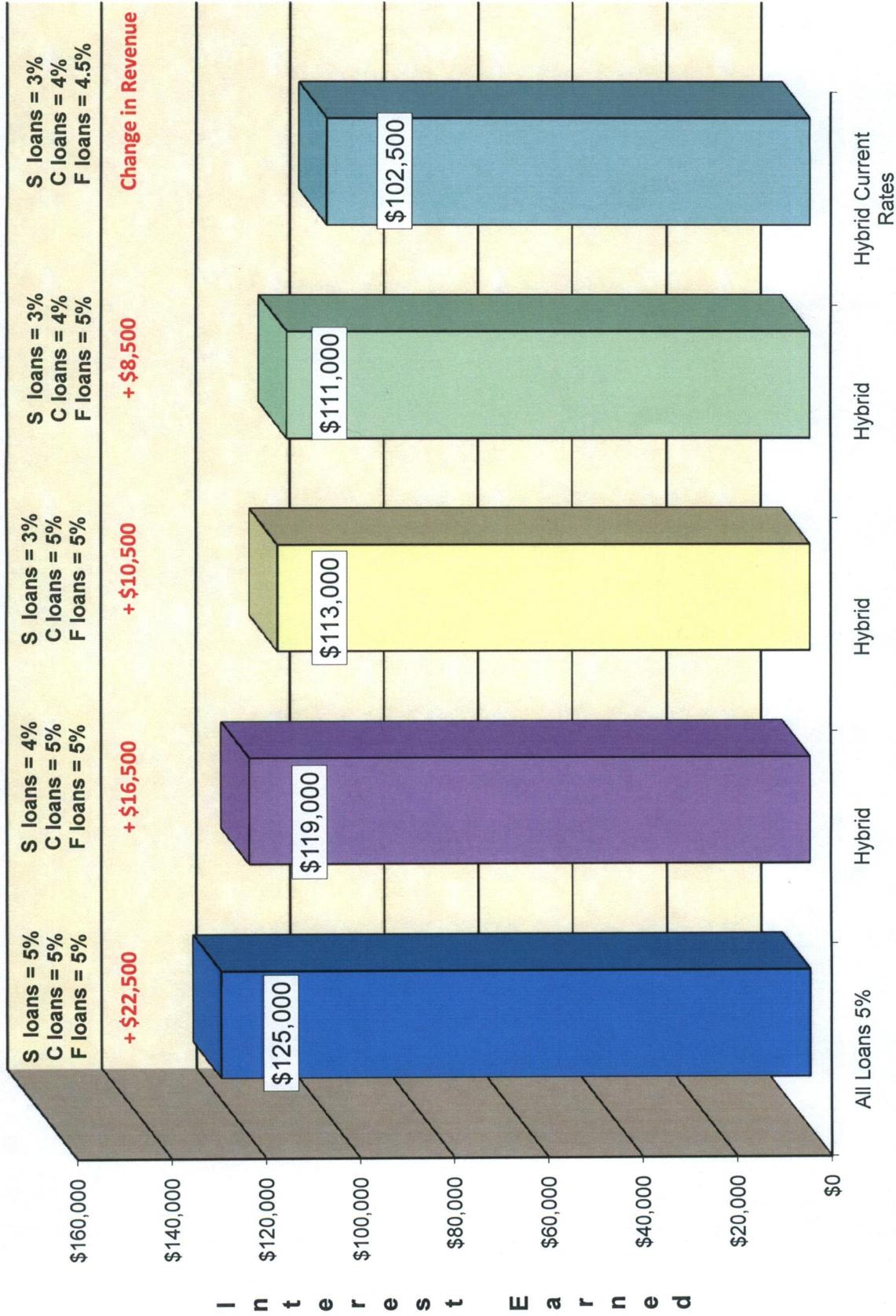
The BAC has approved “zero” GBCs since 2004, though interest credit may not reduce the fixed rate to less than 5% per year anyway. We estimate that a 2% good borrower credit rate for 2011 would result in ARLF interest revenue reduction for one ARLF borrower of approximately \$100, plus administrative costs to service. The one applicable borrower could apply to refinance at a lower rate but has chosen not to.

Recommended “0 %” Good Borrower Credits be approved for 2011.

Alaska Agricultural Loan Interest Rates January 1, 2011

Lender	Short Term	Chattel	Development/ Construction	Irrigation System	Product Processing	Land Clearing	Real Estate	Comments
ARLF								
Interest - Fixed	3%	4%	4.50%	4.50%	4.50%	4.50%	4.50%	Fees - \$50
Term	1 year	7 years	30 years	30 years	30 years	20 years	30 years	Loans limited to 75% CLTV Alaskan residents only
Good Borrower Credit may not reduce rate to less than 5%								
ARRC								
Interest - Variable	5.00-9.00%	5.00-9.00%	5.00-9.00%	5.00-9.00%	5.00-9.00%	5.00-9.00%	5.00-9.00%	Fees - \$100 new borrower, \$50 existing borrower
Term	1 year	7 years	20 years	20 years	20 years	20 years	20 years	Loans limited to 70% CLTV Rate & Terms determined by collateral & credit
Interest rate adjustment every 2 years with no interest rate cap								
FSA								
Interest - Fixed	1.750%	1.750%	4.500%	4.500%	4.500%	4.500%	4.500%	Credit Report \$13.50 individual & \$20.25 joint, \$75 Entity
Term	1.5 years	7 years	40 years	40 years	40 years	40 years	40 years	Loans limited to 100% CLTV Terms available 'up to' maximum period listed Other credit must not be available
Farm Credit								
Interest - Variable	4.20-7.95%	4.20-7.95%	3.85-8.30%	3.85-8.30%	3.85-8.30%	3.85-8.30%	3.85-8.30%	Fees - 0 to 2%
Term	1.5 years	15 years	20 years	20 years	20 years	20 years	20 years	Loans limited to 75% CLTV Rate & terms determined by collateral & credit Ag Vision Program - Young, beginning, small, minority
Interest rate adjustment varies with interest rate cap. May have prepayment fees. Fixed & ARM rates are also available. May be eligible for .50% - .70% annual interest refund								
CFAB								
Interest - Variable	7.25-8.50%	7.25-8.50%	7.25-8.50%	7.25-8.50%	7.25-8.50%	7.25-8.50%	7.25-8.50%	Fees-1% loan fee + \$200 - \$400 expenses
Term	1 year	7 years	12 years	12 years	12 years	12 years	20 years	Loans limited to 100% CLTV, 70% to 80% standard Rate & LTV determined by collateral & credit Alaskan residents only

ARLF One Year Interest Rate Earnings Analysis



Interest Rate

- All Loans 5%
- Hybrid
- Hybrid
- Hybrid
- Hybrid Current Rates
- Hybrid Current Rates

\$2,500,000 Estimated Loan amounts:
 C - \$200,000 F - \$1,700,000 S - \$600,000
 Note: This chart represents one Fiscal Year estimated earnings only

AGRICULTURAL REVOLVING LOAN FUND

Good Borrower Credits



Alaska Department of
**NATURAL
RESOURCES**
Division of Agriculture

Criteria

The Board of Agriculture and Conservation (BAC) will, prior to the applicable year, establish a list of those Agricultural Revolving Loan Fund (ARLF) borrowers who meet good borrower credit eligibility and may approve the granting of credits on eligible ARLF loans. New ARLF borrowers, unless otherwise disqualified, may be eligible for good borrower credits the current applicable year.

Loans in moratorium would not affect good borrower credit eligibility. Interest would continue to accrue at its contracted rate and credits would be made only after payments were made.

A qualifying borrower is a borrower who maintains good financial standing and

(A) has no ARLF loan that

- is in default;
- has been rewritten;
- has been restructured
- has been rolled over;
- has had its term extended;
- has had interest rate reduction; and

(B) has never had a Department of Natural Resources (DNR) land payment or Alaska Agricultural Action Council (AAC) land-clearing loan restructured.

A borrower who assumes an ARLF loan may be granted a credit if otherwise qualified.

A borrower maintains good financial standing by complying with the terms of all ARLF agreements and has no payments owed under any agreements that are more than 30 days past the payment due date.

Credits

- The maximum credit that will be granted is two percentage points of the annual interest rate. Interest credit may not reduce the fixed rate to less than five percent per year.
- The credit will be applied each time a payment is made in at least the full amount due and if paid on or before 30 days after the date the payment is due.
- A credit will only apply to the amount of interest due on a loan and will not reduce the amount of the payments.
- A borrower shall receive no refunds except upon overpayment of the total outstanding balance on the qualifying loan.
- Credits may not be transferred between loans or calendar years.
- If a borrower fails to maintain good financial standing or ceases to be a qualifying borrower, the borrower shall be ineligible for any further credits during that calendar year.

Authority: AS 03.10.020
AS 03.10.030
AS 03.10.050
11 AAC 39.511