



Legislative Fiscal Bureau

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Joint Committee on Finance

Paper #144

Rural Business Enterprise Loans (Agriculture, Trade and Consumer Protection)

[LFB 2005-07 Budget Summary: Page 63, #11]

CURRENT LAW

DATCP receives rural business enterprise grants from the federal government to make loans to certain small and developing rural businesses. However, under current law, DATCP does not have the statutory authority to make loans, charge interest and origination fees and take security for rural business enterprise loans. As a result, the Department provides "grants" from a federally funded Micro-Enterprise Fund to small and developing rural businesses, and requires the grant recipient to sign a contract with the Department stating the recipient will repay the grant.

GOVERNOR

Provide DATCP the authority to make loans, charge interest and origination fees and take security for those loans, as required to receive federal funding for the development of rural business enterprises or for rural economic development.

In addition, provide an estimated \$250,000 FED annually for loan awards to reflect anticipated federal grants to DATCP for this purpose.

Further, create a loans for rural development continuing appropriation estimated at \$25,000 PR annually to make loans for the development of rural business enterprises or rural economic development. Revenue for these loans would come from fees, repayments of principal, and payments of interest of federal rural business enterprise and economic development loans.

DISCUSSION POINTS

1. To date, DATCP has received federal funding through grants from the United States Department of Agriculture (USDA) that it uses to administer the Wisconsin Value-Added Agricultural Micro-Enterprise Fund. Because DATCP does not have the statutory authority to make loans, charge interest and origination fees and take security for rural business enterprise loans, DATCP uses this fund to provide "grants" to aid small and start-up agricultural businesses. The recipient then agrees to repay the "grant" over a period of time. Under the bill, DATCP could provide direct loans from the fund. Goals of the Micro-Enterprise fund include: (a) creating new enterprises to add value to farm commodity production; (b) enabling small-scale farm and food entrepreneurs to participate and economically benefit from value-added processing of agricultural-based products; (c) creating new opportunities for economic development within Wisconsin's rural areas; and (d) encouraging and leveraging funding from economic development organizations, utilities and others.

2. Terms of the federal grant require that recipients must be located in a rural area, which is defined as not living within a city having a population of 50,000 or more or its adjacent urbanized area with a population density of more than 100 persons per square mile. The state has further prioritized funding to unincorporated areas of the state and cities that have a population of less than 5,000 residents. In order to be eligible for an award under the program, an applicant must: (a) be a small and emerging business that employs 50 or fewer employees and that has less than \$1 million in projected gross revenues; (b) be an individual farmer, small group (less than 10 unrelated farm families) of farmers or private business that purchases all of its primary raw materials from Wisconsin farmers; (c) be a U.S. citizen, or reside in the U.S. after being legally admitted for permanent residence; (d) maintain majority ownership and control of a business supported by the Fund; and (e) not be a DATCP employee or an immediate family member of a DATCP employee.

3. Awards made under the fund may be used for start-up and operating capital, and may not be used to produce commodities or finance planning or existing debt. Micro-Enterprise Fund award recipients must match each dollar of the award with one dollar of private or other public support, and the federal government requires that at least one job will be created or saved for every \$10,000 of award funding. In addition, the applicant must provide a project work-plan and timetable and demonstrate the viability of the project and the business to repay the award for the project.

4. DATCP has set the maximum award amount at \$25,000 per project, or 50% of the total project cost, whichever is less. Currently, DATCP does not have the statutory authority to charge interest on the awards it makes, and instead requires award recipients to sign contracts stating that they will repay the funds. Repayments received by the Department are used to replenish the Fund in order to make additional awards. Terms of the awards are three to five years for operating capital awards, and four to seven years for non-real estate fixed assets awards, with repayment negotiated based on an applicant's project needs. While DATCP may not currently charge interest on awards from the Fund, it charges a processing fee of 2% of the award, due upon execution of the contract, and an administrative oversight fee of 6% of the award, due in equal

monthly installments over the term of the contract. These funds are used by DATCP to replenish the fund so future awards can be made, and to compensate a third party that examines the rural enterprise business awards made by DATCP to make sure the recipient is financially sound, and the award is prudent. Under the bill, the program would be expected to continue as it does currently, except that loans will be made from the fund instead of repayable "grants."

5. In addition to other grounds specified in the contract between the award recipient and DATCP, an award recipient is considered in default when: (1) the business fails to make any payment within 30 days of the payment being due and payable; (2) the business defaults on other loans with private or public lenders; (c) the business ceases operations or moves out of a rural area of the state; or (d) the business is sold. Upon a recipient's entrance into default, DATCP may make all sums due and owing to the state immediately due and payable by preparing a written notice to the company that specifies the default, the action required to cure the default, and a date that the default must be cured by in order to avoid Department action to enforce the repayment contract.

6. DATCP officials state that small value-added agricultural enterprises often find it difficult to find working capital for start-up costs and expansion. In addition, conventional lenders usually prefer to lend against tangible assets and are wary of small or start-up companies that typically do not have significant assets. As a result, because start-up enterprises may have limited initial cash flows and often must spend down equity, Department officials believe rural business enterprise funds are an effective complement to research and development grants and conventional funding that can provide small and start-up value-added agricultural enterprises access to working capital to help the with initial operations.

7. Through March, 2005, DATCP has been awarded a total of \$247,400 in federal grants for loans from the Micro-Enterprise fund. Of this funding, \$147,400 was from the rural enterprise business grant received by the Department in 2002. These federal grants were awarded to the state by the federal government, and the state is reimbursed for the costs after the awards have been made. The additional \$100,000 was awarded from a federal dairy initiative grant. However, DATCP has yet to make any awards and receive any reimbursements from this funding. These funds, which will also be loaned out from the Micro-Enterprise Fund, must be used for loans to small or start-up dairy related enterprises. However, the less stringent requirements attached to these funds do not require DATCP to heavily target rural areas or require potential award recipients to show that at least one job will be created or saved for every \$10,000 in loans received under the program.

8. Through March, 2005, DATCP has made three awards from the Micro-Enterprise Fund, each for \$25,000. The first was made in September, 2003, to an organic dairy for working capital for business start-up of an on-farm organic dairy plant. A second award was made to a creamery for working capital to implement a marketing plan for its on-farm dairy yogurt facility. The final award was made in October, 2004, to a winery for business expansion and implementation of a marketing plan for mead-wines and fruit spritzers.

9. DATCP officials are uncertain about the potential for future receipt of federal rural

business enterprise grant funding. However, were the Committee to adopt the statutory changes recommended by the Governor, DATCP would be able to operate the Micro Enterprise Fund as a revolving loan fund, thereby allowing it the potential to increase the number of loans it makes as the fund grows over time. Given the uncertainty of funding in the future, the Committee could consider reestimating federal funding to \$100,000 in 2006-07.

10. The Governor also recommends creating a loans for rural development continuing appropriation, from which loans would be made for the development of rural business enterprises or rural economic development. Revenue for these loans would come from the fees, repayments of principal, and payments of interest of federal rural business enterprise and economic development loans DATCP could collect under the bill. Currently, any repayments of grants made from the Micro-Enterprise Fund, along with administrative fees associated with any "grants," are deposited to DATCP's administrative services gifts and grants appropriation account. The terms of the federal grant require that these funds be used to issue more rural business enterprise loans. To date, DATCP has received about \$2,300 in repayments associated with the rural business enterprise awards it has made. Under the bill, expenditures for this new loan appropriation would be estimated at \$25,000 PR annually.

11. Based on an average of a five-year loan term and an interest rate of 5% on loans made from the program, revenues could be estimated at \$62,500 beginning in 2006-07, provided DATCP loans out the entire \$250,000 in federal grants it has received. As a result, the Committee could consider reestimating expenditures from the PR loans for rural development appropriation to \$62,500 beginning in 2006-07 to coincide with the amount of estimated revenues to be deposited to the appropriation. As stated earlier, this funding must be used for future rural business enterprise loans (or dairy loans), and may not be used to pay for staffing costs.

ALTERNATIVES

1. Approve the Governor's recommendations to: (a) provide DATCP the statutory authority to make loans, charge interest and origination fees and take security for rural business enterprise loans, (b) provide \$250,000 FED annually to reflect anticipated loan awards from the federal government; and (c) create a loans for rural development continuing appropriation, with estimated expenditures of \$25,000 PR annually to make loans for the development of rural business enterprises or rural economic development.

2. Adopt the Governor's recommendations. However, reestimate expenditures from DATCP's loans for rural development appropriation at \$62,500 PR beginning in 2006-07 and federal grants at \$100,000 in 2006-07.

<u>Alternative 2</u>	<u>FED</u>	<u>PR</u>	<u>TOTAL</u>
2005-07 FUNDING (Change to Bill)	- \$150,000	\$37,500	- \$112,500

3. Maintain current law.

<u>Alternative 3</u>	<u>FED</u>	<u>PR</u>	<u>TOTAL</u>
2005-07 FUNDING (Change to Bill)	- \$500,000	- \$50,000	- \$550,000

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