Texas Agricultural Finance Authority

Strategic Plan

Texas Department of Agriculture

Commissioner Todd Staples

TEXAS DEPARTMENT OF AGRICULTURE

TODD STAPLES
COMMISSIONER

December 12, 2008

Mr. Joey Longley
Director
Sunset Advisory Commission
P.O. Box 13066
Austin, Texas 78711

Dear Mr. Longley:

In accordance with direction received from the Sunset Advisory Commission following their review of the Texas Agricultural Finance Authority (TAFA), the Texas Department of Agriculture (TDA) has thoroughly reviewed each TAFA program, TAFA's outstanding debt, and TAFA's potential impact on agriculture in our state going forward.

Utilizing input from financial and agricultural industry experts, including Deloitte and Touche, First Southwest Company, agriculture industry groups and the TAFA board of directors, we believe TAFA has great potential to enhance the agriculture industry in Texas and should be continued. Attached is a new strategic plan that addresses the servicing of TAFA's outstanding debt and creates new finance programs.

TDA exhaustively researched opportunities to address TAFA's outstanding debt internally; however, all the financial industry experts have reinforced that without a revenue stream accessible at the onset of the original lending programs, a self sufficient program would not be able to sustain natural losses. As a result there is not a mechanism available that would retire this debt shorter than a thirty-year bond, which would cost twice as much as the original debt.

Financial industry experts concluded the preferred option for retiring TAFA's outstanding debt is to request a one time state appropriation in the amount of $14.7 million. The appropriated funds will be used to reduce the commercial paper liability by $14.7 million, thereby reducing TAFA's debt and significantly reducing annual expenses associated with the program.

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Going forward, TAFA financial assistance programs will be restructured into four programs; the

- Loan Guarantee Program
- Interest Rate Reduction Program
- Young Farmer Interest Rate Reduction Program
- Young Farmer Partner Grant Program

Proposals for each program are included in the following report. Allowances for loan guarantee defaults have been projected to insure the program's projected solvency.

A new portfolio of financial assistance opportunities will provide Texas farmers and ranchers – young, beginning and experienced – with user-friendly, effective financing options to enhance agriculture in Texas.

The Texas Department of Agriculture sincerely appreciates the opportunity we have had to thoroughly examine TAFA and recommend this new agricultural financing strategy that will help ensure stability and growth for this important sector of the Texas economy.

Sincerely yours,

Todd Staples

Todd Staples

Attachment

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Overview

In 2007, the economic impact of agriculture in Texas surpassed $100 billion. Agriculture is the second largest resource industry in Texas following oil and gas. One out of every seven jobs in Texas is related to agriculture.

In accordance with recommendations by the Sunset Advisory Commission (Commission), the Texas Department of Agriculture (TDA) carefully reviewed historical data, current activities and future projections of the Texas Agricultural Finance Authority (TAFA). TDA sought counsel from financial and agriculture industry experts to help determine if TAFA is needed and can be effective in meeting future agricultural needs in Texas.

The findings clearly indicate the need for state-sponsored financial assistance programs designed to help agricultural producers and businesses. TAFA should be continued and the new strategic plan set forth in this report is designed to enhance the stability and growth opportunities for the agriculture industry in Texas.

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A nine-member board of directors (Board) governs TAFA. The following individuals currently serve on the board of directors:

Chair:	Mike Golden	Lake Jackson, TX
Vice Chair:	Darwin (Dal) DeWees	San Angelo, TX
Directors:	Lisa Birkman	Round Rock, TX
	Ted Conover	Tyler, TX
	Stan Ray	Georgetown, TX
	Dr. Victoria Salin	College Station, TX
	Larry Shafer	Granbury, TX
Statutory Members:	Commissioner Todd Staples	Austin, TX
	Deputy Commissioner Drew DeBerry (Designee)	
Secretary-Treasurer:	Dr. Freddie Richards	Prairie View, TX

Program History

TAFA is administered by TDA, and is governed by a nine-member board of directors comprised of the commissioner of agriculture, the director of the Institute for International Agribusiness Studies at Prairie View A&M University and seven members appointed by the governor with the advice and consent of the senate.

The 70th Legislature passed the Texas Agricultural Finance Act, which created TAFA as a public authority within TDA. TAFA provides financial assistance for the expansion, development, and diversification of producing, processing, marketing and exporting Texas agricultural products through various programs.

TAFA provides financial assistance for the expansion, development, and diversification of producing, processing, marketing and exporting Texas agricultural products through various programs.

TAFA is composed of eight (8) programs of which three (3) are currently active. *A chart showing the various TAFA programs is attached hereto as Exhibit A.* Of the active programs, the Interest Rate Reduction Program and the Young Farmer Loan Guarantee Program are the most utilized and offer the most financial benefit to Texas agriculture in today's economy. More information about the continuation of these programs follows later in this report.

In November 2002 the TAFA Board imposed a moratorium on any new extensions of credit to private enterprises in four of the eight programs operating under TAFA (*Exhibit A*). The Participation Purchase Program and Direct Loan Program had some limited use, but had been inactive for quite some time prior to the moratorium. The Rural Development Finance Program-Business was never used. The Loan Guaranty Program (LGP) was the most active of all the programs and was targeted to encourage new value-added projects. Many of the projects assisted by LPG were start-up businesses and resulted in loan defaults and losses. In addition, **there was no appropriation or capital investment set aside to service the debt created by the defaulted loans**. Throughout LGP's history, more than 100 loans totaling over $82 million were guaranteed. Currently, thirteen (13) loans to eight (8) borrowers approved under LGP are still active and outstanding. Also, six (6) Rural Development Finance Program-Municipal (RDFPM) loans continue to perform. Between these two programs, TAFA has outstanding loans totaling $6,835,033.00 of which a reserve for bad debt of $362,752.00 has been established as of August 31, 2008.

The Farm and Ranch Finance Program was used very sparingly and program costs exceeded revenue. Therefore, in 2003 the TAFA Board moved to discontinue the program and used program equity to pay off all debt associated with the Farm and Ranch Finance Program.

None of the programs mentioned above are recommended to re-activate or resume operation.

The funding source for both the LGP and RDFPM was generated through the issuance of short-term commercial paper. As of August 31, 2008, $25 million in commercial paper was outstanding; however, only $6.4 million in loans and $4.1 million in cash are available to service the total debt. Over the history of TAFA, $14.7 million has been lost due to loan defaults and charge-offs. The cost of servicing $25 million in debt with only $10 million in earning assets hinders TAFA's operation and jeopardizes its long-term viability. TDA intends to request a legislative appropriation to eliminate $14.7 million in bad debt accumulated since TAFA's inception.

In accordance with the management actions stated in the Sunset Advisory Commission Report (Sunset), TDA engaged Deloitte & Touché to conduct a performance audit of TAFA.

In accordance with the management actions stated in the Sunset Advisory Commission Report, TDA engaged Deloitte & Touché to conduct a performance audit of TAFA. *A copy of the performance audit is attached hereto as Exhibit B.* The performance audit included an assessment of financial statements going back to 1991 to determine how much of TAFA's current debt is from defaulted loans and a recommendation on what actions will be needed to service the outstanding debt. The executive summary of the performance audit (page 2) states the current debt from defaulted loans is $14.7 million and recommends that the TAFA Board should consider requesting state appropriations to cover the debt. The TAFA Board concurs with that approach over other options including debt-restructuring models prepared by TAFA's financial advisor, First Southwest Company (FSC). *A copy of the models prepared by FSC is attached hereto as Exhibit C.*

The Deloitte & Touché report also includes recommendations for program modifications, funding and administrative cost options, staffing needs, internal controls and the need for a database to collect and retain program data. These recommendations were considered and utilized in the development of the strategic direction of the State's agricultural finance efforts.

Strategic Plan Development

The resources used to develop the strategic plan for TAFA include Commissioner of Agriculture Todd Staples, TDA Executive staff, TDA Rural Economic Development division, Deloitte & Touché, First Southwest Company (FSC), agriculture industry groups and the TAFA Board.

Industry groups clearly indicate there is a continuing need for financial assistance programs geared toward agricultural producers and businesses.

Based on the management actions directed by the Commission, various steps have been taken to carry out their proposed recommendations. First, TDA engaged Deloitte & Touché to conduct a performance audit of TAFA. The audit report included recommendations regarding restructuring TAFA's programs as well as findings concerning the existing debt due to loan defaults.

The audit report was then presented to the TAFA Board. Two strategic planning sessions were held to get Board input on a strategic plan for TAFA's future direction. FSC was engaged to research and make recommendations regarding servicing and eliminating the $14.7 million of defaulted debt carried in the existing commercial paper debt; the company prepared various models to address this debt.

Consultation with agriculture industry groups also provided guidance regarding the ongoing needs in agriculture and areas where assistance is needed. Discussions with those groups clearly indicate there is a continuing need for financial assistance programs geared toward agricultural producers and businesses, particularly in the areas of low cost and stable access to credit. Industry representatives also indicate that any new programs should be made accessible to rural lenders, utilize a streamlined application process, allow proceeds to be used for general costs related to agricultural production and business development, and have reasonable interest rates and funding limits that are in-line with current demands of agriculture financing.

TDA recognizes the shortfalls of some of the existing TAFA programs, and has developed recommendations that will result in more useful, efficient, self-funding programs. TDA recommends the discontinuance of the Rural Development Finance Program/Municipal. This program is funded by short-term commercial paper and the interest rates must remain variable, which is not as desirable as a fixed rate loan for this municipal customer base. Although this program is not recommended to continue TAFA will continue to service the existing loans. TDA also recommends the discontinuance of the Farm and Ranch Finance Program, the Rural Development Finance Program/Business, the Participation Purchase Program, the Direct Loan Program and the original Loan Guaranty Program. The existing Young Farmer Loan Guarantee Program (YFLGP) will be discontinued and replaced with a package of grant and loan programs to better meet today's agricultural needs.

TAFA's Strategic Plan outlines the proposed programs and unlike the former programs, the structure for the funding of these programs will better serve the needs of agricultural producers, businesses and the agriculture industry in general.

TAFA's Strategic Plan outlines the proposed new programs and unlike the former programs, the structure for the funding of these programs will better serve the needs of agricultural producers, businesses and the agriculture industry in general. **The proposed new programs are not based on debt issued funding, which was one of the major factors that contributed to TAFA's current debt situation**. <u>Emphasis will be focused on assisting agricultural production and agriculture related businesses without competitive interference with the lending industry.</u> Funding is based on the Young Farmer Fund balance and the stream of income from collected tag fees, which was recommended by Deloitte & Touché, to ensure the new programs move toward a sustainable and self-supporting funding stream. The proposed programs incorporate loan guarantees to help stabilize access to funding sources; interest rate reduction and rebate tools to assist the industry through cheaper sources of funds for both general agriculture as well as young operators; and, lastly, grants to offer a helping hand to stretch the use of available equity for young agricultural operators. All programs are intended and designed to function in a simple, streamlined and timely process. As recommended by Deloitte & Touché, new staffing resources will enable TDA to establish more internal controls on funding and establish a useful database to better administer these programs.

Texas Agricultural Finance Authority
Strategic Plan

Recommendations

I. Overall Program Change

- Add two board members to represent young farmers

II. Main Program Components

- The Loan Guarantee Program (LGP)
- The Interest Rate Reduction Program (IRR)
- Young Farmer Interest Rate Reduction Program (YFIRR)
- The Young Farmer Grant Program (YFG)

A. Loan Guarantee (LGP) Program

1. *New program:* Similar to the current Young Farmer Loan Guarantee with broadened participation criteria and different loan guaranty limits
2. Participants – any agricultural producer or other agricultural business
3. Source of funds – Young Farmer Fund 5683
4. Maximum guarantee
   - $500,001-$750,000 or 70%, whichever is less
   - $250,001-$500,000 or 80%, whichever is less
   - $250,000 or 90%, whichever is less

   Note: The above tier amounts were generated to match closely with current credit policy provisions and to stay within acceptable risk tolerance
5. Interest rebate of 3% of the interest rate not to exceed $10,000 per applicant per year (based on the Young Farmer Loan Guarantee Program)
6. Interest rate must be fixed for long or intermediate term loans
7. Variable rate is permissible for annual operating loans
8. Program limit of 3:1 based on the Young Farmer Fund balance (less that used for the Young Farmer Interest Rate Reduction Program) as of August 31 annually
9. A guarantee fee of 1% of the guaranteed amount of each loan is paid to TAFA to fund program costs
10. Certified Lender Status is available to expedite the TAFA approval process (criteria to be established)

B. Interest Rate Reduction (IRR) Program

1. *Existing Program:* The current Interest Rate Reduction Program with a higher loan limit and less restrictive categories for participants
2. Participants – any agricultural producer or other agricultural business
3. Source of funds - $30 million is available through linked deposits placed by the Comptroller of Public Accounts
4. Maximum loan level - $500,000

5. Expanded eligibility *(May use for any agricultural purpose or agriculture related business)*
6. All other program rules and criteria remain constant

C. **Young Farmer Interest Rate Reduction (YFIRR) Program**

1. *New program:* Similar to the current Interest Rate Reduction Program with more restrictive participation criteria, lower interest rates and a different source of funding
2. Participants – any agricultural producer between the ages of 18 and 45
3. Source of funds – Young Farmer Fund 5683
4. Loan limit - $500,000
5. Lender gets funds through a deposit from the Young Farmer Fund
6. Lender pays interest on the deposit at a rate that is not less than the greater of (i) the current market rate minus three percent (3%); or (ii) one-half percent (.5%)
7. Deposits will be collateralized by 105% of approved securities
8. Deposit is made for a loan term of between 1-5 years
9. Lender may not charge in excess of 4% over the deposit rate
10. Use of funds must be for agricultural purposes
11. Borrower repayments of $1,000 or more will result in a corresponding reduction of the linked deposit

D. **Young Farmer Grant (YFG) Program**

1. *New program:* To be modeled after other producer grant programs such as the Wine Grape Investment Pilot Grant Program administered by TDA in 2008
2. Participants – any agricultural producer between the ages of 18 and 45
3. Source of funds – Young Farmer Fund 5683. Maximum grant - $20,000; Minimum - $5,000
5. Grant based on a minimum of one-to-one cash match from applicant
6. For use in conjunction with or independent of a loan from a private source
7. Applications will be accepted twice a year and will be scored by an objective scoring criteria and a panel of reviewers
8. Annual funding – estimated between $250,000 and $500,000 (Will vary from year-to-year depending on the net income and fund balance for the Young Farmer Fund)

III. Funding

- All of the above programs are intended to operate using the existing Young Farmer Fund that will be renamed the Texas Agricultural Fund. The Young Farmer Fund has a current balance of $16 million and the continuing stream of ongoing funding from the collection of farm vehicle tag fees as the source of revenue. The leverage limit of the fund is recommended to increase to a maximum of 3:1 to allow additional benefits to a larger segment of the agriculture industry. The program activity may be adjusted to stay within the fund capacity at all times to keep risks to the fund in check.

IV. <u>New Program Operations</u>

Program Funding

- Based on Young Farmer Fund 5683 balance (≈$16 million)
- Annual collection of tag fees (Estimated at $900,000 annually)
- Interest and/or investment income of Young Farmer Fund ($12,000,000 @ 3.5%=$420,000)
- Interest on YFIRR ($4,000,000 @ 0.5%=$20,000)

Operating Expenses

Salaries	$209,926
(Program Coordinator; 2 program specialists; 1 support staff) <u>Current:</u> $58,464 *(Program Coordinator)* <u>New:</u> $151,462 *(salary + benefits)* 2 Program Specialists 1 Administrative Staff	
Employee start-up costs	$18,471
Professional fees	$40,000
Travel	$5,000
Other operating costs	<u>$55,000</u>
Total Estimated Costs	$328,397

Staffing to administer the proposed programs includes two additional program specialists and one administrative assistant. Efforts to streamline and simplify the programs will keep the staffing needs at a minimum compared to the staffing required prior to the program moratorium, of eight (8) full time employees at the maximum point.

V. <u>Required Statutory Changes</u>

Statutory amendments to Chapter 44 and 58 of the Agriculture Code, and Chapter 502 of the Transportation Code would be required to accomplish the new programs described above. The most significant and necessary change would be eliminating the restriction on the Young Farmer Fund to enable it to be used in support of a broader section of the agricultural sector.

Chapter 58, subchapter B would require an amendment to section 58.012 expanding the board from nine (9) to eleven (11) members. The additional two members would be added to represent young farmers and their interests. Section 58.012 would also be amended to give the governor's power of appointment of the board of directors to the commissioner. Additionally, section 58.013 would be amended to allow for the commissioner to designate a member of the board as the chairman of the board to serve in that capacity at the pleasure of the commissioner.

Section 58.021 of subchapter C would be amended to allow the board to administer the new young farmer grant program. The statutory requirement to give preference to value-added businesses would be eliminated. Section 58.0211 would be amended to require the board to charge a minimum administration fee not less than one percent of the guaranteed loan.

A new subchapter D would include sections 58.041 through 58.045, and it would provide the structure for the agricultural loan guaranty program. The subchapter would provide for the program's tiered loan limits, an interest rate reduction component not to exceed either three percent or an annual benefit of $10,000, fixed interest rate for loans with terms extending beyond 12 months, the authority to provide a certified lender's program, and the authority to access the lesser of three-fourths (3/4) or $12,000,000 of the young farmer account to fund the program.

Subchapter E would be amended to eliminate the young farmer guarantee program and to replace it with two programs exclusively for young farmers: a grant program and an interest rate reduction program. Section 58.051 would include definitions for "Eligible Lending Institution," "Grant Application" and "Linked Deposit." Section 58.051 would extend the eligibility age to include anyone 45 years of age. Section 58.052 would provide the structure for the young farmer interest rate reduction program including a linked deposit, capped interest rate and an interest rate reduction component. Section 58.053 would provide structure for the young farmer grant program by providing a minimum and maximum grant amount of $5,000 to $20,000 and requiring a minimum of one-to-one ratio of matching funds. Section 58.056 limits the young farmer interest rate reduction program to one-fourth (1/4) of the funds in the young farmer account.

Section 502.174 of the Transportation Code, would be amended to change the reference to the young farmer loan guarantee account to the Texas agricultural fund account.

Chapter 44 would be amended to rename the link deposit program as the interest rate reduction program. In order to expand the overall program, the specific requirements contained in the definition of "Eligible Borrower" in section 44.001 would be eliminated. Additionally, the statutory preference for specific projects in section 44.007 would be eliminated leaving the language more general so that the program is broadened and the board is allowed more flexibility. Section 44.010 would raise the maximum loan amount eligible for participation in the program from $250,000 to $500,000 regardless of the type of project.

VI. Issuance Of Debt Through The Texas Public Finance Authority (TPFA). Sunset Advisory Commission-Recommendation 1.3

Recommends the Texas Agricultural Finance Authority (TAFA) issue debt through the Texas Public Finance Authority (TPFA). Chapter 58 of the Texas Agriculture Code provides TAFA with the authority to issue its own debt. After consultation with TPFA, the Texas Department of Agriculture (TDA) has determined that there would be little or no cost savings to issuing debt through TPFA, and TAFA does not anticipate issuing any new debt. TDA, therefore, recommends that this function remain with TAFA until all existing debt is paid.

VII. Debt Structure Proposal

Texas Agricultural Finance Authority (TAFA)

- Commercial Paper outstanding: $25,000,000
  - Current performing obligations and liquid assets of $10.5 million
  - Charged-off debt: $14.7 million

The interest expense for the commercial paper for FY 08 is $918,056. The interest expense for FY 07 was $1,414,854. The average interest rate dropped from 5.3 percent in 2007 to 3.6 percent during the year. The decrease in interest expense from 2007 of approx $496,000 is due primarily to the decrease in market interest rates and reflects the volatility of funding costs.

The current portfolio of loans will continue to be serviced per existing terms. The furthest maturity date is April 1, 2030.

First Southwest Company (FSC) prepared various models addressing solutions to carrying the $14.7 million of defaulted loans. (*Exhibit C*). The TAFA Board considered all scenarios and concluded the legislative appropriation approach was the most timely and cost-effective solution for the State.

The Texas Department of Agriculture intends to work with the Texas legislature to seek an appropriation to eliminate the charged-off portion of the commercial paper debt. A source of funds is also desired to provide for an estimated reserve fund of 15 percent of the remaining loans, which would be roughly $1 million. This could be done in conjunction with legislative appropriation or through a long-term bond issuance. The report issued by Deloitte & Touché stated that by retiring the debt related to the defaulted loans, TAFA could reduce its commercial paper interest expense by approximately 56 percent or $563,000. Since interest rates continually change, this estimate will change as interest rates fluctuate. Commercial Paper is issued between one and 270 days. TAFA's CP is usually in the 30-90 day range and interest fluctuates with the financial markets and associated short-term rates.

Exhibit A

TAFA Programs

Texas Agricultural Finance Authority Program

Current Active TAFA Programs:

- Rural Development Finance Program/Municipal
- Interest Rate Reduction Program (Linked Deposit Program)
- Young Farmer Guarantee Program

Current Inactive TAFA Programs:

In November 2002, a moratorium was placed on the following programs:

- Farm & Ranch Finance Program
- Rural Development Finance Program/Business
- Loan Guaranty Program
- Participation Purchase Program
- Direct Loan Program

Recommended TAFA Programs:

- Loan Guarantee Program
- Interest Rate Reduction Program
- Young Farmer Interest Rate Reduction Program
- Young Farmer Grant Program

Texas Agriculture Finance Authority

Current Active Program Summaries

1. **Rural Development Finance Program / Municipal** - Provides financial assistance (loan or bond purchase) to public entities, such as cities, counties, and special purpose districts in rural areas of Texas, for projects that can be identified to improve or assist in the economic development of the rural area.

2. **Interest Rate Reduction Program** (f/n/a Linked Deposit) - Facilitates commercial lending at below market rates to qualified applicants for eligible projects that include: production of an alternative crop; processing and marketing of agricultural crops or livestock; a business that is located in a U.S. Department of Agriculture- or Presidential-declared disaster area; a project using water conservation techniques or purchasing water conservation equipment; and a business loan that will enhance or maintain rural economic development; by providing a lower cost of funds for the lender.

3. **Young Farmer Loan Guarantee Program** - Provides financial assistance through loan guarantees to eligible applicants (ages 18-40) who wish to establish or enhance their farm and/or ranch operation or establish an agricultural-related business.

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Texas Agriculture Finance Authority

Current Inactive Program Summaries

1. **Farm & Ranch Finance Program** - Provides financial assistance (guaranty & participation) to eligible applicants for the purchase of farmland and/or ranch land, which will be in full time agricultural use.

2. **Rural Development Finance Program / Business** - Provides financial assistance (guaranty or participation) through eligible lending institutions to individuals and businesses in rural areas of Texas, for the purchase of real estate, improvements, equipment and working capital.

3. **Loan Guaranty Program** - Provides financial assistance through loan guarantees to agricultural businesses that are, or propose to be, engaged in innovative, diversified, or value-added production, processing, marketing, or exporting of an agricultural product or other agricultural-related rural economic development projects, including projects involved in the development of nature-tourism in Texas.

4. **Participation Purchase Program** - Provides assistance to lending institutions for eligible agricultural projects through the purchase of an undivided interest in a loan made by a lender, that provides significant economic benefits for Texas agricultural products or for rural economic development and shows evidence of creation or retention of employment.

5. **Direct Loan Program** - Provides a direct loan to an eligible applicant in cooperation with the applicant's lender, when the project provides significant economic benefits for Texas agricultural products or for rural economic development and shows evidence of creation or retention of employment.

Texas Agriculture Finance Authority
Recommended Program Summaries

1. **Loan Guarantee Program** - Provides financial assistance through loan guarantees to agricultural producers or agricultural businesses. The program also includes an interest rate rebate component to further assist applicants.

2. **Interest Rate Reduction Program** (f/n/a Linked Deposit) - Facilitates commercial lending at below market rates to qualified applicants for eligible projects. Eligible projects include any agricultural purpose or agriculture related business. This program utilizes funds provided from the Comptroller of Public Accounts. Total program funding limit is $30 million with an individual applicant limit of $500,000. Lenders must be an approved state depository to utilize this program.

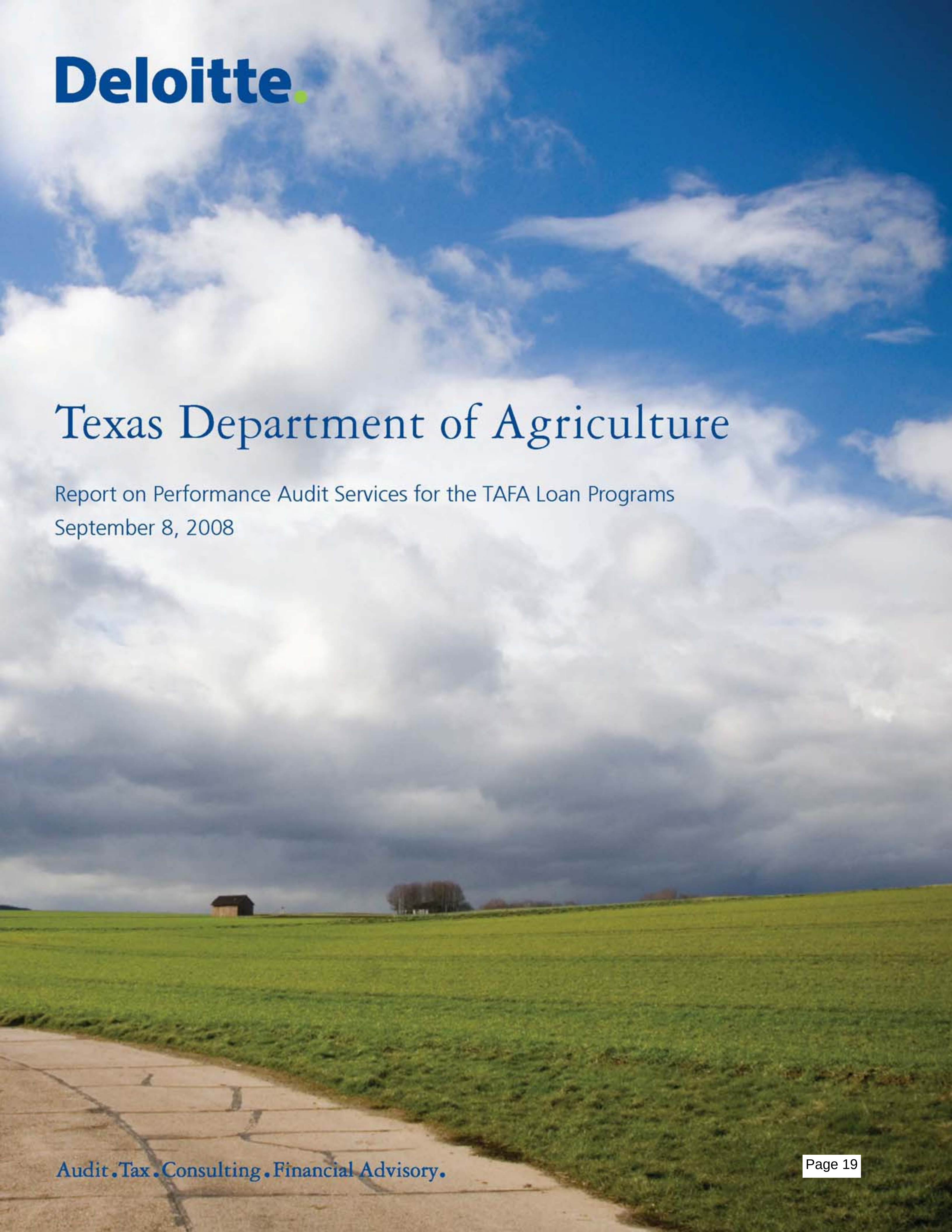
3. **Young Farmer Interest Rate Reduction Program -** Facilitates commercial lending at below market rates to qualified young farmer applicants for eligible projects. The funds must be used for agricultural purposes and the loan limit is $500,000 per applicant. Funds for this program utilize a portion of the Young Farmer Fund. Lenders who wish to utilize this program must be an approved state depository.

4. **Young Farmer Grant Program -** Provides assistance to eligible young farmers and ranchers by leveraging their ability to begin or expand an operation through an equal match grant basis. Applications will be accepted twice per year and will be scored by an objective scoring criteria and a panel of reviewers. Grant amounts will range from a maximum of $20,000 to a minimum of $5,000. Funds for this program utilize a portion of the Young Farmer Fund.

Exhibit B

Deloitte & Touché LLP

Report



Deloitte.

Texas Department of Agriculture

Report on Performance Audit Services for the TAFA Loan Programs

September 8, 2008

Audit. Tax. Consulting. Financial Advisory.

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September 8, 2008

Drew DeBerry
Deputy Commissioner
Texas Department of Agriculture
1700 N. Congress
Stephen F. Austin Building, 10th Floor
Austin, Texas 78701

Dear Deputy Commissioner DeBerry:

Deloitte & Touche LLP ("Deloitte & Touche") conducted performance audit services of the loan programs administered by the Texas Agricultural Finance Authority ("TAFA") a division of the Texas Department of Agriculture ("TDA"). The purpose of this letter is to communicate the results of the performance audit services, the observations we have noted, and to provide management with recommendations for corrective action.

In accordance with the July 11, 2008, Engagement Letter, the objectives of the performance audit services were to gain an understanding of TAFA's loan programs and identify opportunities to enhance and improve the overall viability of the programs; assess the yearly financial schedules and supporting documentation dating back to 1991, when TAFA first began issuing commercial paper, and evaluate how much of TAFA's current debt is the accumulation of losses from defaulted loans.

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards. Those standards require that we plan and perform the performance audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our performance audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our performance audit objectives.

The procedures performed did not constitute an audit, a review, or a compilation of TDA's financial statements or any part thereof, nor an examination of management's assertions concerning the effectiveness of TDA's internal-control systems or an examination of compliance with laws, regulations, or other matters. Accordingly, the performance of the procedures did not result in the expression of an opinion or any other form of assurance on TDA's financial statements or any part thereof, nor an opinion or any other form of assurance on TDA's internal-control systems or its compliance with laws, regulations, or other matters.

This report is intended solely for the information and use of TDA and is not intended to be and should not be use by any other party with the exception of oversight agencies for the performance of their oversight responsibilities. We understand you will present the results of the performance audit services to the TDA Commissioner and TAFA Board of Directors and that the agency will prepare a separate response for consideration by TDA and the TAFA Board of Directors.

We appreciate the cooperation received from management and staff at TDA during the performance of our services. We stand ready to assist TDA in addressing any of the identified issues should you desire such assistance.

Sincerely,

Deloitte & Touche LLP

Deloitte & Touche LLP

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Section I

Executive Summary

Overview of Procedures Performed

In conducting the performance audit services we gained an understanding of the TAFA loan programs by analyzing program policies, procedures, and documents, and conducting interviews of program staff and management. We analyzed and confirmed issues by assessing collected information to include TAFA financial schedules and supporting documentation dating back to 1991 when TAFA began issuing commercial paper and we reviewed supporting ledgers, debt schedules, and other available loan related documents. We evaluated how much of TAFA's current debt is the accumulation of losses from defaulted loans and we benchmarked TAFA's loan programs against similar loan programs of other entities. An overview of the procedures performed and the approach utilized during the performance audit services is provided in Section III - Objectives and Approach Section of this report.

We identified a number of opportunities to enhance and improve the overall viability of the TAFA Financial Assistance Programs and to strengthen the internal control environment of TAFA such that the strategic goals of the TAFA programs can be efficiently and effectively met. For each observation, we've developed a corresponding recommendation to provide insight into next steps that should be considered by TDA for addressing the observations.

Our observations and recommendations are organized in the following manner:

- Existing Debt and Cost of Servicing the Debt
- The Loan Guaranty Program
- The Young Farmers Loan Guaranty Program and
- Management and Fiscal Accountability of the Loan Programs.

We have summarized each of the observations and recommendations as well as key strengths below. These observations and recommendations are fully discussed in Section IV- the Detailed Observations and Recommendations Section of this Report.

Key Strengths

The following strengths were identified during the performance audit services:

- TAFA's Financial Assistance programs are reported to have significantly impacted the Texas economy by creating jobs in a cost effective manner. An economic impact study conducted by UNISERV Financial Services entitled "Texas Agricultural Finance Authority Loan Programs; Review Analysis & Cost-Benefit Study" released in December 1996 stated "the Loan Guarantee and Linked Deposit (Interest Rate Reduction Program) were responsible for creating and retaining over 5,000 jobs at an estimated net fiscal cost of $2,264,917 or approximately $412 per job. The report goes on to say that "in fiscal year 1996 the entities in the programs contributed approximately $600 million to economic demand and approximately $130 million to total wage earnings in Texas." Additionally, in an informal study conducted internally by TAFA staff in 1999, it was noted that there was approximately $760M generated for the communities of Texas which created approximately 1,979 jobs from loaning $32.7M from the Loan Guaranty Program.

- TAFA has an experienced Board of Directors with previous Board experience, expertise in banking, and many years of agricultural knowledge.
- The Board of Directors has the power and rule making authority to provide strategic direction to the programs.
- Current members of Board of Directors are cognizant of their responsibilities to carry out the duties of the Board and programs
- Current members of Board of Directors and Program Directors are cognizant of their governance responsibilities and have undertaken a number of steps to review TAFA's programs and enhance program processes to include recently reviewing and updating the Loan Guarantee credit policy and approving these outside performance audit services related to these the programs.
- The Board of Directors, Assistant Commissioner for Rural Economic Development, and Program Director meet routinely to discuss each loan and approve loan activity
- The Board of Directors, Assistant Commissioner for Rural Economic Development, and Program Director are actively working to address recent review comments on TAFA provided by the Texas Sunset Commission.

Summary of Observations and Recommendations

Existing Debt and Cost of Servicing the Debt

Reduce or Eliminate the Debt related to Defaulted Loans

TAFA's Financial Assistance Programs have outstanding debt of $25 million and insufficient funding to pay this debt. The annual cost of operating these programs in 2008 will be approximately $ 1.3 million which includes approximately $1 million in interest costs and $300,000 of salary and other operating costs while total income from open loans and interest earned on reserves is only approximately $1.1 million. Additionally, loan income will continue to decrease as the principal of the open loans is repaid. As such, the cost of operating the programs will continue to outweigh the income generated by the programs.

More than half of TAFA's debt or $14.7 million represents defaulted loans from Loan Guaranty Program which was placed in moratorium by the TAFA Board of Directors in 2002. A 1997 report issued by the State Auditor's Office indicated that loan approving guidelines designed to minimize the risk of defaults were not consistently adhered to resulting in approximately 28.4% of the loans defaulting. Today only eleven guaranteed loans remain open.

TAFA operates another Loan Guaranty Program, the Young Farmer Loan Guarantee Program which is currently active. This program is funded through the collection of certain fees and as of May 31, 2008, has an accumulated fund balance of $15.6 million that is statutorily restricted to use only by the Young Farmer Loan Guarantee Program.

TAFA's Board of Directors should consider reducing or retiring the $14.7 million portion of the debt that is related to the defaulted loans in the Loan Guaranty Program. The Board should consider requesting state appropriations to cover in part or in full the $14.7 million related to the defaulted loans or requesting a statutory change be made to the Young Farmer Loan Guarantee Program provision that addresses the use restriction of the fund balance to allow a portion of the fund balance to be used to pay off the defaulted loan debt or provide for other financial management needs within the Texas Agricultural Fund. By retiring the debt related to the defaulted loans in the Loan Guaranty Program TAFA could reduce its commercial paper interest expense by approximately 56% or $563.000. Since interest rates continually change, this estimate will change as interest rates fluctuate.

Lower the Debt's Liquidity Rate

Part of the cost of servicing the existing debt is liquidity fees. TAFA pays $62,500 per year in liquidity fees or 12.5 basis points of the total liquidity amount. These fees are about 8 basis points or $42,500 higher than the liquidity fees that the State Comptroller of Public Accounts would charge if the debt was serviced by the State.

TAFA should consider reducing its liquidity rate. If TAFA moves the liquidity line of credit from JP Morgan to the Texas Comptroller of Public Accounts, it has the opportunity to lower the liquidity rate by approximately 8 basis points, or approximately $42,500 a year, which will provide an immediate and direct cost savings to TAFA.

Lift the Moratorium on the Loan Guaranty Program

TAFA's Loan Guaranty Program has the opportunity to significantly stimulate the Texas economy by creating new agricultural related jobs and supporting increased market demand for new agricultural related programs such as those for alternative crops, biofuels and other renewable energy sources. However, the Loan Guaranty Program is currently in moratorium. The moratorium would have to be lifted for TAFA to take advantage of these opportunities.

TAFA's Board of Directors should consider lifting the moratorium on the Loan Guaranty Program to continue bringing the economic benefits once realized by this program back to the Citizens of Texas and support investments in the agricultural programs of the future. Before re-establishing the program TAFA's Board of Director should exercise its rulemaking authority to provide strategic direction and oversight over the program by clearly defining new program expectations to include specific strategic objectives and a strong system of internal controls to guide the program.

Develop a Re-implementation Plan for the Loan Guaranty Program

TAFA has not developed a re-implementation plan for the Loan Guaranty Program to assist decision makers in evaluating whether or not to lift the moratorium on the program and re-establish program activities.

To help decision makers in evaluating whether to remove the moratorium on the program and re-establish program activities, TAFA should develop a re-implementation plan which:

- Establishes new program goals, strategies, milestones and specific resource needs
- Enhances policies and procedures that define the specific control objectives and related activities
- Enhances internal loan selection policies and procedures
- Enhances policies and procedures for selecting borrowers
- Enhances policies and procedures for identifying eligible lenders and proactively monitoring lender and loan performance
- Defining program performance measures and metrics
- Establishing reasonable estimates for subsidy and administrative costs to support the reserves and income requirements
- Establishing future revenue mechanisms that can help the program move towards a sustainable and self supporting funding stream.

Estimate Subsidy and Administrative Costs for the Loan Guaranty Program

TAFA has not estimated the subsidy and administrative costs associated with the Loan Guaranty Program. Without these estimates TAFA is unable to adequately determine the reserve requirement of the program, or make a fully informed decision on how best to fund the program.

TAFA should determine the subsidy and administrative costs of the program to properly determine the amount of reserves and income required to cover the costs of the program. Before determining the subsidy and administrative costs, TAFA should develop a methodology for determining these costs utilizing existing federal accounting and loan guarantee guidance which provides guidance to federal and state agencies on preparing subsidy and administrative cost estimates for Loan Guaranty Programs.

Establish Future Funding Mechanisms for the Loan Guaranty Program

The Texas Legislature designed the Loan Guaranty Program to provide financial assistance to inexperienced individuals that required credit enhancement or to individuals who otherwise wouldn't have the opportunity to start up an agricultural based business. While the Texas Legislature appears to have intended the program to be self sustaining, it did not anticipate the potential costs of subsidizing the program and did not provide TAFA a revenue mechanism to generate funds to cover the risks passed on to TAFA from defaulted loans.

Once TAFA determines the reserve amount necessary to support the program, TAFA should determine the amount of funding needed to meet the Loan Guarantee reserves requirements. TAFA should consider requesting state appropriations to fund the reserves of the Loan Guaranty Program as well as requesting a revenue mechanism be established to move towards a sustainable and self supporting funding stream to cover costs of any future program activity.

The Young Farmer Loan Guarantee Program

Increase Participation in the Young Farmer Loan Guarantee Program

The Young Farmer Loan Guarantee Program has limited participation and is not reaching its full potential for the citizens of the State. The low participation rates are likely the result of certain statutory restrictions that limit who may apply for the loans and what level of funding they can expect along with a lack of a focused outreach effort to increase loan participation.

The Young Farmer's Loan Guaranty Program carries a statutory age restriction on who can apply for the loan as well as a statutory limitation of $250,000 per loan. In today's economic environment, a $250,000 loan is unlikely to be sufficient to meet the needs of today's farmers.

TAFA should consider taking a number of actions to increase overall participation in the Young Farmer Loan Guarantee Program. These actions may include revisiting statutory restrictions limiting program participation to include adjusting upwards the age restriction and increasing the $250,000 ceiling to an amount that is more attractive to meeting the needs of today's young farmers. Additionally, TAFA should invest in a marketing campaign to educate young farmers about what is needed in Texas Agriculture and increase awareness of the funding resources available to them through TAFA.

Management and Fiscal Accountability of Loan Programs

Re-Evaluate Staffing Levels Needed To Properly Administer the Loan Programs

TAFA has insufficient resources to effectively administer its loan programs. Currently, the programs are administered by a small handful of people with only one of the individuals having primary responsibility for managing the programs. TAFA program resources were substantially reduced when the Loan Guaranty Program went into moratorium. Remaining staff were left to do what they could with the existing systems and staffing levels they had to work with. Although TAFA is part of the TDA, TAFA has not yet tapped into TDA's broader pool of resources within other divisions to help bolster the administration of the programs.

TAFA should re-evaluate its current staffing levels and determine the appropriate level and number of people needed to enhance its administration of the loan programs. Additional personnel necessary to support the program should either be brought into to the TAFA program group from other areas of TDA or hired externally.

Enhance Internal Controls to Improve Fiscal Accountability of the Loan Programs

TAFA's system of internal controls over the loan programs is insufficient to provide management and the Board of Directors with sufficient information about the effectiveness and efficiency of its operations, the reliability of its financial reporting, and compliance with applicable laws and regulations. We noted the program is administered primarily through manual processes by a handful of people using existing processes that do not appear to be sufficiently controlled.

TAFA should enhance their system of internal controls by adopting the COSO framework and improving their system of controls to include the following:

- Enhancing the TAFA control environment to include setting clear control and accountability expectations, establishing and maintaining sufficient policy and procedure documentation and communicating those expectations through the TAFA organization, and holding people a accountable for meeting expectations
- Establishing risk assessment processes over the loan programs to include identification, analysis, and prioritization of risks for the development of risk mitigation strategies and plans
- Enhancing internal controls over the loan program to include establishment of specific control objectives and activities for the safeguarding of assets and the efficient and effective operation of program activities
- Establishing the information systems and communication processes necessary for appropriate management reporting and decision making
- Instituting a sustainable system of program monitoring to determine that program activities are adequately monitored and desired results are achieved.

Implement Spreadsheet Controls to Improve Fiscal Accountability over Loan Programs

TAFA utilizes Excel spreadsheets which contain manual calculations to support many of its accounting and administrative processes over the loan programs. These spreadsheets do not have adequate controls in place prevent data from being intentionally or unintentionally changed. Additionally, spreadsheets provide little to no audit trail for transactions unless they are tied to additional supporting documentation. Without Excel spreadsheet controls, TAFA cannot be sure the information in the spreadsheets is reliable and reflective of actual program activity.

TAFA should be implement spreadsheet controls to help ensure that the financial information contained in the spreadsheets is reliable verifiable, and comes from objective sources. Specific recommendations for controlling spreadsheets include establishing sufficient change controls, version controls, access controls, input/output controls, and security controls.

Develop and Maintain a Loan Repository or Database

TAFA lacks a loan repository or database to support management and the Board of Directors in efficiently and effectively administering the loan programs

TAFA should consider developing and maintaining a loan repository which would ideally include the following:

- Borrowers who have applied for and received loans,
- Borrowers’ demographic information such as Social Security numbers, dates of birth, names, gender, family income,
- Details of each loan such as loan amounts, balances, loan status, collections, claims, cancellation, discharge or other changes, and final disposition
- Collateral information including description of collateral, type, age, and liens
- Lender information such as lender address, lender official managing the loan; reviewers and approvers of original loan and of changes to the original terms of the loan.
- Transactional information on borrowers' loans covering the entire life cycle of the loan from origination through final payment

Section II

About The Texas Agricultural Finance Authority

Background

The 70th Legislature created the Texas Agricultural Finance Authority ("TAFA") in 1987 to provide financial assistance to eligible agricultural businesses and to other rural economic development projects that the Board of the Authority considers to present a reasonable risk and having a sufficient likelihood of repayment. TAFA is a public authority within the Department of Agriculture (Department). The Authority is mandated to support the expansion, development, and diversification of production, processing, marketing, and exporting of Texas agricultural products and to promote the development of rural economic development projects.

TAFA is governed by a Board of directors composed of the Commissioner of Agriculture, the director of the Institute for International Agribusiness Studies at Prairie View A&M University, and seven members appointed by the Governor with the advice and consent of the Senate. The appointed members serve staggered two-year terms. TAFA does not have its own staff, but instead relies on TDA staff to administer the Authority's programs.

The Legislature designed TAFA to provide financial assistance through eligible lending institutions to creditworthy individuals and businesses, with a concentration on individuals and entities that have not traditionally had access to agricultural financial lending, such as value-added agricultural businesses. Under its various financial programs, TAFA can do the following:

- Make or acquire loans to eligible agricultural businesses;
- Make or acquire loans to lenders to enable those lenders to make loans to eligible agricultural businesses;
- Insure, coinsure, and reinsure, in whole or in part, loans to eligible agricultural businesses;
- Guarantee, in whole or in part, loans to eligible agricultural businesses;
- Administer or participate in programs established by another person to provide financial assistance to eligible agricultural businesses;
- Issue general obligation bonds and may use the proceeds from the sale of bonds to acquire or make loans to eligible agricultural businesses;

To implement the programs, TAFA may adopt and enforce bylaws, rules and procedures, and perform other necessary functions, including the establishment of criteria and standards of eligibility and application procedures for businesses or individuals to participate in TAFA's programs.

History of Guarantee Loan Program

After TAFA was established in 1987 the first Board of Directors (the "Authority") was appointed in 1988 by Governor Clements. In 1990, the final draft of the Financial Assistance Programs and Loan Guaranty Program rules were approved for the publication with a maximum guarantee percentage of 90% and a maximum guarantee amount of $2 million per loan, but may go up to $5 million, if the action is approved by a two-thirds vote of the Board.

In 1991, the Board published the rules for public comment. The rules delegate the loan approval authority to the Commissioner of Agriculture. As there were no public comments on the rules, the Loan Guaranty Program was established. During the year, the Board reviewed and approved the proposal for the Loan Guaranty Program to be presented to the Bond Review Board (BRB). A General Obligation (GO) bond approach was approved with $25 million as maximum. Before the rules were published by the Authority, the Credit Review Committee (CRC) approved four loans. However, the Board changed the rules so that the Credit Review Committee will recommend loan applications to the full Board for approval or denial.

During 1992, the Board approved 21 loans. In 1993, The TAFA Board was increased from 6 to 9 members and allows for loan guarantees up to $5 million with a two-thirds vote. Total bonding authority available to TAFA for its programs is $525,000 million. In 1995, Proposition 3, a constitutional amendment authorizing the transfer of $200 million in GO bond authority from the Farm and Ranch Finance Program to the Loan Guaranty Program was approved leaving $300,000 million in authority in the Farm and Ranch Finance Program which is no longer active. The following year the amount of general obligation bonding authority available to the Authority increased from $25 million to $225 million through the transfer of the $200 million of bonding authority from the Farm and Ranch Finance Program. The Bond Review Board subsequently set TAFA's issuance authority for the Loan Guaranty Program to a maximum of $50 million without further approval of the Bond Review Board.

In November 2002 the TAFA Board imposed a moratorium on any new extensions of credit involving private business on four of the eight programs operating under TAFA. In 2003, the TAFA Board discontinued the Farm and Ranch Finance Program as equity was declining in the program. From the inception of the Loan Guaranty Program in 1991 to the moratorium in 2002 there were approximately 100 loans approved and funded.

TAFA Programs Pre-Moratorium of 2002

*Farm & Ranch Finance Program	*Rural Development Business Program	Rural Municipal Finance Program	**Interest Rate Reduction Program	*Loan Guaranty Program	*Participation Purchase Program	*Direct Loan Program	Young Farmer Loan Guarantee Program

*Program currently inactive

**Program previously named Linked Deposit Program

TAFA'S Active Programs as of 2008

Young Farmer Loan Guarantee Program	Interest Rate Reduction Program	Rural Municipal Finance Program

The Young Farmer Loan Guarantee Program provides loan guaranties to lenders at a reduced interest rate for borrowers between the ages of 18 and 39 looking to establish or enhance a farm or ranch operation or agriculture-related business. The program has the capacity to guarantee approximately $31 million, or twice the reserve accumulated from the $5 tag fee, but is currently only guaranteeing $1 million for 13 active loans.

The Interest Rate Reduction Program (formerly called the Linked Deposit Program) facilitates private commercial lending at below market rates to eligible applicants for specific agricultural projects. The program may use up to $30 million to reduce the cost of funds for lenders, but as of May 2008, this program only had 114 active loans, totaling $ 5.9 million. The use of this program is interest rate sensitive and use declines during periods of low interest rates.

The Rural Municipal Finance Program facilitates loans through TAFA's purchase of general obligation bonds from municipalities to fund the economic development of a rural area. In 2008, the program had 6 active loans collectively worth $4.8 million. Many entities that qualify for the Rural Municipal Finance Program loans may qualify for other state grant programs that do not require repayment, such as those offered by TDA's Texas Capital Fund.

Section III

Objectives and Approach

Objectives

The objectives of the performance audit services were as follows:

- Gain an understanding of TAFA's loan programs and identify opportunities to enhance and improve the overall viability of the programs.

- Assess yearly financial schedules and supporting documentation dating back to 1991, when TAFA first began issuing commercial paper, to evaluate how much of TAFA's current debt is the accumulation of losses from defaulted loans. This will include interviewing TAFA personnel and analyzing existing loan documents and payment receipts to determine which loans TAFA has received repayment on, which loans it has written off as uncollectible, and which nonperforming loans it has not yet written off.

- Communicate results in a formal report to include recommendations on reducing or eliminating debt and identifying income producing alternatives.

Approach

In conducting the performance audit services Deloitte & Touche performed the following procedures:

Planning

Step 1 – We developed an understanding of the client environment and expectations for these performance audit services

- Met with TDA and TAFA management

- Identified potential impediments

- Identified reporting strategy

- Identified key client personnel

- Collected organizational materials

- Identified and scheduled interviews

- Reaffirmed approach and detailed work plan

Fieldwork

Step 2 – We gained an understanding of the TAFA loan programs

- Gained a broad understanding of TAFA's loan programs
- Read associated program documents
- Conducted interviews

Step 3 – We analyzed and confirmed the issues

- Assessed collected information to include TAFA financial schedules and supporting documentation dating back to 1991 when TAFA began issuing commercial paper, supporting loan ledgers, debt schedules, and other available loan related documents.
- Evaluated how much of TAFA's current debt is the accumulation of losses from defaulted loans
- Benchmarked TAFA's loan programs against similar loan programs of other entities

Step 4 – We developed potential issues and recommendations

- Identified potential issues and opportunities for improvement
- Shared draft comments with TDA

TDA was responsible for identifying applicable laws, regulations, agreement provisions, and other requirements relevant to the TAFA loan programs. Deloitte & Touche did not provide legal advice or conduct a legal review of any of the organizations documents, records or policies. Deloitte & Touche evaluated how much of TAFA's current debt was from the accumulation of losses from defaulted loans. The evaluation was strictly based on financial information and supporting documentation provided by TAFA.

Reporting

Project management tasks and periodic status reporting was performed during the engagement.

A draft report was prepared in accordance with the Performance Audit Standards set forth in Generally Accepted Government Auditing Standards ("GAGAS") and presented to the Assistant Commissioner for Rural Economic Development for review and comment. Once accepted, the final written report was delivered to the Assistant Commissioner for Rural Economic Development who will then present the results to the TDA Commissioner and TAFA Board of Directors. We understand the agency will prepare a separate response for consideration by TDA and the TAFA Board of Directors.

Section IV

Detailed Observations and Recommendations

The goal of the following observations and recommendations is to identify opportunities to enhance and improve the overall viability of the TAFA Financial Assistance Programs and to strengthen the internal control environment of TAFA such that the strategic goals of the TAFA programs are met. Our observations and recommendations are organized in the following manner:

- Existing Debt and Cost of Servicing the Debt
- The Loan Guaranty Program
- The Young Farmers Loan Guaranty Program and
- Management and Fiscal Accountability of the Loan Programs.

Existing Debt and Cost of Servicing the Debt

Reduce or Eliminate the Debt related to Defaulted Loans

Observation

Based on the work performed, we determined that TAFA's Financial Assistance Programs have outstanding debt of approximately $25 million and insufficient funding to pay this debt. The annual cost of operating these programs in 2008 will be approximately $ 1.3 million which includes approximately $1M in interest costs and $300,000 of salary and other operating costs while total income from open loans and interest earned on reserves is only approximately $1.1 million. Additionally, loan income will continue to decrease as the principal of the open loans is repaid. As such, the cost of operating the programs will continue to outweigh the income generated by the programs.

More than half of TAFA's debt or $14.7 million represents defaulted loans while only $6.8 million represents open loans. The remaining $4.4 million represents TAFA's cash position used to pay TAFA's operating expenses which includes interest costs on the $25 million debt, TAFA staff salaries, and various professional fees.

The defaulted loans are from the Loan Guaranty Program which were placed in moratorium by the TAFA Board of Directors in 2002. Based on a 1997 report issued by the State Auditor's Office, loan approving guidelines that were designed to minimize the risk of defaults were not always adhered to. Specifically, loans were approved for individuals with high debt to equity ratios or weak or insufficient collateral to support the loans. A total of 29 out of 102 or 28.4% of the guaranteed loans defaulted. Today only eleven guaranteed loans remain open and are scheduled to be repaid by 2030.

TAFA operates another Loan Guaranty Program, the Young Farmer Loan Guarantee Program which is currently active. This program is funded through the collection of certain fees. This program has annual fee revenue of approximately $900,000 and as of May 31, 2008, has an accumulated fund balance of $15.6 million that is statutorily restricted to use only by the Young Farmer Loan Guarantee Program.

Criteria

TAFA has the responsibility for administering its Financial Assistance Programs in a prudent and cost effective manner for the benefit of Texas citizens. With one program in moratorium and strict statutory restrictions on the other, they must work the Texas Legislature if statutory changes are needed to enhance viability of the programs.

Recommendation

TAFA's Board of Directors should consider reducing or retiring the $14.7 million portion of the debt that is related to the defaulted loans in the Loan Guaranty Program. To reduce the debt the Board should consider requesting a state appropriation to cover in part or in full the $14.7 million related to the defaulted loans or requesting a statutory change be made to the Young Farmer Loan Guarantee Program provision that addresses the use restriction of the fund balance to allow a portion of the fund balance to be used to pay off the defaulted loan debt or provide for other financial management needs within the Texas Agricultural Fund. It is critical that TAFA first determine the subsidy and administrative costs of the Young Farmer program to determine the amount of fund balance it requires. The portion of funds utilized from the Young Farmer fund balance should not decrease the Young Farmer fund balance below its required level to support anticipated future use. By retiring the debt related to the defaulted loans in the Loan Guaranty Program TAFA could reduce its commercial paper interest expense by approximately 56% or $563,000. Since interest rates continually change, this estimate will change as interest rates fluctuate.

Lower The Debt's Liquidity Rate

Observation

A cost of servicing the existing loan debt is liquidity fees. TAFA pays $62,500 per year in liquidity fees or 12.5 basis points of the total liquidity amount. These fees are about 8 basis points or $42,500 higher than the liquidity fees that the State Comptroller of Public Accounts would charge if the debt was serviced by the State.

Criteria

TAFA has authority to enter into agreements with any state agency for the furtherance of any of any of its purposes.

Recommendation

TAFA should consider reducing its liquidity rate. If TAFA moves the liquidity line of credit from JP Morgan to the Texas Comptroller of Public Accounts, it has the opportunity to lower the liquidity rate by approximately 8 basis points, or approximately $42,500 a year, which will provide an immediate and direct cost savings to TAFA.

The Loan Guaranty Program

Lift the Moratorium on the Loan Guaranty Program

Observation

TAFA's Loan Guaranty Program has the opportunity to help significantly stimulate the Texas economy by creating new agricultural related jobs and supporting increased market demand for new agricultural related programs such as those for alternative crops, biofuels and other renewable energy sources. However, the Loan Guaranty Program is currently in moratorium. The moratorium would have to be lifted for TAFA to take advantage of these opportunities.

Criteria

According to UNISERV Financial Services' December 1996 Review Analysis & Cost-Benefit Study on the Texas Agricultural Finance Authority Loan Programs; "the Loan Guaranty and Linked Deposit programs were responsible for creating or retaining over 5,000 jobs at an estimated net fiscal cost of $2,264,917 or approximately $412 per job. In fiscal year 1996 the entities in the programs contributed approximately $600 million to economic demand and approximately $130 million to total wage earnings. In 1999 TAFA conducted an informal economic impact study of the Loan Guaranty Program, that showed that by loaning $32.7M approximately 1,979 jobs were created that contributed $760.2M back to Texas communities.

Recommendation

TAFA's Board of Directors should consider lifting the moratorium on the Loan Guaranty Program to continue bringing the economic benefits once realized by this program back to the Citizens of Texas and support investments in the agricultural programs of the future. Before re-establishing the program TAFA's Board of Director should exercise its rulemaking authority to provide strategic direction and oversight over the program by clearly defining new program expectations to include specific strategic objectives and a strong system of internal controls to guide the program.

Develop a Re-Implementation Plan for the Loan Guaranty Program

Observation

TAFA has not developed a re-implementation plan for the Loan Guaranty Program to assist decision makers in evaluating whether or not to lift the moratorium on the program and re-establish program activities.

Criteria

Office of Management and Budget (OMB) Circular A-129 Policies for Federal Credit Programs and Non Tax Receivables provides guidance for federal and state entities in developing appropriate policies and procedures to reduce the risk of excessive and/or unnecessary losses that result from Loan Guaranty Programs.

Recommendation

To help State decision makers in evaluating whether to remove the moratorium on the program and re-establish program activities, TAFA should develop a re-implementation plan. This plan should include the following:

- New program goals, strategies, milestones and specific resource needs to clearly set forth new expectations and guide the re-implementation of the program.
- Enhanced policies and procedures that define the specific control objectives and related activities that help determine the effectiveness and efficiency of the program's operations and resources, and safeguards the integrity of the program.

- Enhanced internal loan selection policies and procedures to clearly lay out roles and responsibilities for each program administrator, the criteria and requirements for conducting and documenting their analyses, and the decision making processes that are to be used for making and approving loans.

- Enhanced policies and procedures for selecting borrowers to include appropriate screening standards for determining eligibility, creditworthiness, and assessing overall project feasibility through a review of cost and resource estimates.

- Enhanced policies and procedures for identifying eligible lenders and proactively monitoring lender and loan performance.

- Defined performance measures and metrics to monitor and evaluate efficiency, effectiveness, and outcomes of the program.

- Reasonable estimates for subsidy and administrative costs to support the reserves and income requirements necessary to fully cover the operating costs of this program (see issue 3 that follows)

- Future revenue mechanisms that can help the program move towards a sustainable and self supporting funding stream to cover program related costs and activities (see issue 4 that follows).

Estimate Subsidy and Administrative Costs for the Loan Guaranty Program

Observation

TAFA has not estimated the subsidy and administrative costs associated with the Loan Guaranty Program. In order to properly determine the amount of reserves and income required to fully cover the operating costs of this program, total subsidy and administrative cost requirements must be determined. The size of the reserves will depend upon the estimated subsidy and administrative costs. Without these estimates TAFA will not be able to adequately determine the reserve requirement of the program, or make a fully informed decision on how best to fund the program.

Criteria

A sound methodology for estimating subsidy costs should include a cash flow analysis, documentation of the cash flow assumptions, and a review and approval process of costs estimates. Having a sound methodology to estimate program subsidy costs is critical to determining the amount of funds needed to cover any anticipated shortfall and determining the effort necessary to generate and identify funding to cover the anticipated shortfall.

A sound methodology for estimating program administrative costs should take into consideration the cost of reviewing applications, as well as offering, negotiating and, closing the applications and monitoring the guarantees. The procedures should be designed to determine that sufficient fees are charged and collected from the borrowers to fully cover administrative costs.

Recommendation

TAFA should determine the subsidy and administrative costs of the program to properly determine the amount of reserves and income required to cover the costs of the program. The size of the reserves will depend upon the estimated subsidy and administrative costs. Once TAFA determines the reserve requirements of the program it can make a decision on how best to fund the program.

Before determining the subsidy and administrative costs, TAFA should develop the methodologies for determining these costs.

In January 2004, the Federal Accounting Standards Advisory Board's Accounting and Auditing Policy Committee issued Technical Release 6, Preparing Estimates for Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act

Amendments to Technical Release 3: Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act, which provides guidance to agencies on preparing subsidy cost estimates. The Federal Accounting Standards Advisory Board's accounting and Auditing Policy Committee also provides guidance to the agencies on how to prepare subsidy costs estimates. TAFA should use this guidance when establishing their methodology for determining subsidy and administrative costs for their loan program.

The Statement of Federal Financial Accounting Standard No. 4, Managerial Cost Accounting Concepts and Standards for the Federal Government, provides guidance on how to estimate administrative program costs. Administrative cost should include the cost of evaluating applications, as well as offering, negotiating, and closing the applications and monitoring the guarantees.

Establish Future Funding Mechanisms for the Loan Guaranty Program

Observation

The Texas Legislature designed the Loan Guaranty Program to provide financial assistance to inexperienced individuals that required credit enhancement or to individuals who otherwise wouldn't have the opportunity to start up an agricultural based business. While the Texas Legislature appears to have intended the program to be self sustaining, it did not anticipate the potential costs of subsidizing the program and did not provide TAFA a revenue mechanism to generate funds to cover the risks passed on to TAFA from defaulted loans.

Criteria

A review of other State's Financial Assistance Loan Guaranty Programs found that a some are dependent on state appropriations to support the costs of the program while others have become self sustaining over time due to built in revenue mechanisms that support their cost structure. Many of the programs that have built in revenue mechanisms no longer require additional appropriations to support the costs of the program. (See Attachment A, where we compiled a list of Loan Guaranty Programs by State and their sources of revenue).

Recommendation

Once TAFA determines the reserve amount necessary to support the program, TAFA should determine the amount of funding needed to meet the Loan Guarantee reserves requirements. TAFA should consider requesting state appropriations to fund the reserves of the Loan Guaranty Program as well as requesting a revenue mechanism be established to move towards a sustainable and self supporting funding stream to cover costs of any future program activity.

The Young Farmer Loan Guarantee Program

Increase Participation in the Young Farmer Loan Guarantee Program

Observation

The Young Farmer Loan Guarantee Program has limited participation and is not reaching its full potential for the citizens of the State. The low participation rates are likely the result of certain statutory restrictions that limit who may apply for the loans and what level of funding they can expect along with a lack of a focused outreach effort to increase loan participation.

The Young Farmer's Loan Guaranty Program carries a statutory age restriction on who can apply for the loan as well as a statutory limitation of $250,000 per loan. In today's economic environment, a $250,000 loan is unlikely to be sufficient to meet the needs of today's farmers.

Criteria

The purpose of the Young Farmer's Loan Guaranty Program is to support the expansion, development, and diversification of production, processing, marketing, and exportation of Texas agricultural products and to promote the development of rural economic development projects. This program is a catalyst for rural economic growth and should be heavily promoted to its target population to reach its full potential.

Recommendation

TAFA should consider taking a number of actions to increase overall participation in the Young Farmer Loan Guarantee Program. These actions may include revisiting statutory restrictions limiting program participation to include adjusting upwards the age restriction and increasing the $250,000 ceiling to an amount that is more attractive to meeting the needs of today's young farmers. Additionally, TAFA should invest in a marketing campaign to educate young farmers about what is needed in Texas Agriculture and increase awareness of the funding resources available to them through TAFA.

Management and Fiscal Accountability of Loan Programs

Re-Evaluate Staffing Levels Needed to Properly Administer the Loan Programs

Observation

TAFA has insufficient resources to effectively administer its loan programs. Currently, the programs are administered by a small handful of people with only one of the individuals having primary responsibility for managing the programs. TAFA program resources were substantially reduced when the Loan Guaranty Program went into moratorium. Remaining staff were left to do what they could with the existing systems and staffing levels they had to work with. Although TAFA is part of the TDA, TAFA has not yet tapped into TDA's broader pool of resources within other divisions to help bolster the administration of the programs.

Criteria

Effective program administration requires sufficient staffing to support the various program related activities that must be performed. Sufficient staffing must be present to perform the various activities in a well controlled manner such that no one individual has control over a transaction from end to end and that all required activities are consistently and routinely performed.

Recommendation

TAFA should re-evaluate its current staffing levels and determine the appropriate level and number of people needed to enhance its administration of the loan programs. Additional personnel necessary to support the program should either be brought into to the TAFA program group from other areas of TDA or hired externally.

Enhance Internal Controls to Improve Fiscal Accountability of the Loan Programs

Observation

TAFA system of internal controls over the loan programs is insufficient to provide management and the Board of Directors with sufficient information about the effectiveness and efficiency of its operations, the reliability of its financial reporting, and compliance with applicable laws and regulations. We noted the program is administered primarily through manual processes by a handful of people using existing processes that do not appear to be sufficiently controlled. Specific observations include:

- Insufficient documentation exists to support and communicate program policies, procedures, controls, and activities
- Program risks are not being routinely identified, analyzed, and prioritized for the purposes of developing mitigation strategies and plans
- Sufficient control activities do not exist to mitigate the risk caused by the lack of proper segregation of duties among the few individuals that administer the program
- Methodologies for estimating programs costs have not been developed to properly determine the funding resources needed to support the program
- Methodologies for allocating common program costs have not been established to appropriately determine these costs represent the actual costs of the individual programs
- Key program milestones and measures are insufficient to help management and the Board evaluate program results

- Key information requirements have not been identified and management reports have not been developed for communication and decision making purposes
- A systematic approach for monitoring program activity and results has not been established

Criteria

An effective system of internal controls will provide management and the Board of Directors with sufficient information about the effectiveness and efficiency of its operations, the reliability of financial reporting, and compliance with applicable laws and regulations. The Committee of Sponsoring Organizations ("COSO") Internal Control Framework is the most widely accepted internal control framework in the country and is the Internal Control standard adopted by the U.S. Government. This framework establishes the expectations for controls over operations, financial reporting and regulatory compliance and can be used by TDA as the criteria by which they enhance TAFA's system of controls.

Recommendation

TAFA should enhance their system of internal controls to provide management and the Board of Directors with sufficient information about the effectiveness and efficiency of its operations, the reliability of financial reporting, and compliance with applicable laws and regulations. TAFA should consider adopting the COSO framework as their controls framework to guide the enhancement of their system of controls to address the key elements of the framework to include the following:

- Enhancing the TAFA control environment to include setting clear control and accountability expectations, establishing and maintaining sufficient policy and procedure documentation and communicating those expectations through the TAFA organization , and holding people a accountable for meeting expectations
- Establishing risk assessment processes over the loan programs to include identification, analysis, and prioritization of risks for the development of risk mitigation strategies and plans
- Enhancing internal controls over the loan program to include establishment of specific control objectives and activities for the safeguarding of assets and the efficient and effective operation of program activities
- Establishing the information systems and communication processes necessary for appropriate management reporting and decision making
- Instituting a sustainable system of program monitoring to determine that program activities are adequately monitored and desired results are achieved.

Implement Spreadsheet Controls to Improve Fiscal Accountability over Loan Programs

Observation

TAFA utilizes Excel spreadsheets which contain manual calculations to support many of its accounting and administrative processes over the loan programs. These spreadsheets do not have controls in place to prevent data from being intentionally or unintentionally changed. Additionally, spreadsheets provide little to no audit trail for transactions unless they are tied to additional supporting documentation. Without Excel spreadsheet controls, TAFA cannot be sure the information in the spreadsheets is reliable and reflective of actual program activity. `

Criteria

Excel spreadsheet controls are designed to help mitigate the risk of invalid and inaccurate financial information. Typical Excel spreadsheet controls include change management controls, version control, access control, input/output controls, and security controls.

Recommendation

Since TAFA must utilize Excel spreadsheets to perform financial calculations and track program activity, spreadsheet controls should be implement to help determine that the financial information contained in the spreadsheets is reliable verifiable, and comes from objective sources. Specific recommendations for controlling spreadsheets include:

- Establishing change controls requiring the user to obtain approval from TAFA management prior to requesting a change to a formula or computation. All changes should be tested prior to using the spreadsheet and evidence of approval and testing must be retained for audit trail purposes.

- Establishing version controls requiring the use of naming conventions. Naming conventions can be defined in the name of the file or desktop tool be utilized or by naming the directories and or folders and sub-directories or sub-folders to be utilized.

- Establishing access controls to directories or folders restricting access to only certain personnel.

- Establishing input/output controls requiring comparisons, reconciliations or check figures for inputs and or outputs, against other sources of valid data such as the General Ledger. Evidence of the reconciliations and checks should be documented or referenced with a key indicating source of the reconciliation.

- Establishing security controls for securing the information against unauthorized access.

Develop and Maintain a Loan Repository or Database

Observation

TAFA lacks a loan repository or database to support management and the Board of Directors in efficiently and effectively administering its loan programs

Criteria

Historical loan information is critical to provide the basis for making policy decisions that are aligned to the needs of the loan population. Also, historical loan information is vital in developing default rate calculations, collecting on defaults; and performing the budget analysis and development. Having ready access to this information in a repository or database which allows user query and management reporting provides for a more efficient and effective means of loan administration.

Recommendation

TAFA should consider developing and maintaining a loan repository or database to facilitate the efficient and effective administration of its loan programs. The repository or database would ideally include the following:

- Borrowers who have applied for and received loans,
- Borrowers' demographic information such as Social Security numbers, dates of birth, names, gender, family income,
- Details of each loan such as loan amounts, balances, loan status, collections, claims, cancellation, discharge or other changes, and final disposition
- Collateral information including description of collateral, type, age, and liens
- Lender information such as lender address, lender official managing the loan; reviewers and approvers of original loan and of changes to the original terms of the loan.
- Transactional information on borrowers' loans covering the entire life cycle of the loan from origination through final payment

Appendix A – Information on Various States' Agricultural Loan Programs

STATES LOAN GUARANTEE PROGRAMS
For more information go to http://www.stateagfinance.org/types.html#guaranteeloan

State Agency	Program Name	Description	Max Guarantee	Max Term	Max Loan	Fees	Funding
Arkansas Development Finance Authority	Beginning Farmer Loan Program	Uses individual small-issue private activity bonds for beginning farmer projects.	100%	Various	$250,000	None	Private Activity Bonds
Arkansas Development Finance Authority	Disadvantaged Business Enterprise Program	Arkansas Development Finance Authority in cooperation with Levi Strauss Foundation and the Winthrop Rockefeller Foundation as has created a program to provide working loan guarantees capital to minority contractors who cannot otherwise finance their working capital needs.	100%	Various	Determined by the bank	None	Private Activity Bonds
Arkansas Development Finance Authority	Bond Guarantee Program	For businesses that have a financial history but are unable to sell industrial revenue bonds to the public, the Arkansas Department of Economic Development can assure bondholders of repayment by guaranteeing up to $5 million of the bond issue. The state's guaranty allows the bonds to be sold at a higher credit rating, therefore lowering the effective interest rate for the business. The Department charges a 5 percent fee for guaranteeing issues of this type. The Arkansas Development Finance Authority (ADFA) also provides a bond guaranty program that enables a company to obtain competitive, fixed interest rates. The total amount ADFA can guarantee is up to $6 million per borrower; therefore, a business could obtain up to $11 million per project,	100%	Long Term	$6 million	5% Guarantee fee	Private Activity Bonds

STATES LOAN GUARANTEE PROGRAMS For more information go to http://www.stateagfinance.org/types.html#guaranteeloan							
State Agency	**Program Name**	**Description**	**Max Guarantee**	**Max Term**	**Max Loan**	**Fees**	**Funding**
		combining the programs of ADFA and the Department of Economic Development. ADFA has the capacity to issue bonds for a single project or for several projects on a pooled basis. The pooled or composite issue allows small businesses needing financing for fixed assets to take advantage of low interest financing and to share the costs for issuing bonds, an option which gives more financing opportunities which otherwise would not be available. ADFA can also provide short-term financing to a company before bond proceeds are available. Contact: Arkansas Department of Economic Development, 1-800-ARKANSAS, (501)682-1121, www.1800arkansas.com/incentives/index.cfm?page=bond_guarantee Bond guaranty program that enables a company to obtain competitive, fixed interest rates. The total amount ADFA can guarantee is up to $6 million per borrower; therefore, a business could obtain up to $11 million per project, combining the programs of ADFA and the Economic Development Commission. ADFA has the capacity to issue bonds for a single project or for several projects on a pooled basis.					
California Coastal Development Corporation	Loan Guaranty Program	The Small Business Loan Guarantee Program allows a business to not only acquire a loan it could not otherwise obtain, but to establish a favorable credit history with a lender so that the business may obtain future financing on its own. The guaranteed percentage varies and subject to negotiation between the FDC and the lender.	90%	The term of the loan guarantee may extend up to seven years.	$500,000	2% to 3% Guarantee fee $250 Documentation fee	State Appropriations

STATES LOAN GUARANTEE PROGRAMS For more information go to http://www.stateagfinance.org/types.html#guaranteeloan							
State Agency	**Program Name**	**Description**	**Max Guarantee**	**Max Term**	**Max Loan**	**Fees**	**Funding**
Georgia Development Authority	Insured Farm Loan	Loans are issued to stable Georgia farmers and small agribusiness. The Authority has an active insured loan program for agricultural capitol purposes. These loans, which are made for a term as long as 20 years, are at a variable rate determined by prime plus 1/2 percent and LIBOR plus 2 percent adjusted annually and some fixed rate loans for as long as 10 years	90%	40 years	$730,000	Small fee base on loan amount	Assets originated with a Federal transfer of funds in 1954
Illinois Finance Authority *	State Guarantee Program for Restructuring Ag Debt	A loss reserve fund has been established by the state. Lenders use this loan guarantee program to refinance and restructure an applicant's existing debt. Debt held by one or more lenders is consolidated and guaranteed through this program. The guarantee provides credit enhancement, and provides more favorable terms including lower interest rates and smaller principal payments. Guarantees are backed by the full faith and credit of the state. They are exempt from banks' legal lending limits.	85%	30 years	$500,000	Borrower pays .75% to 1%, and Closing fee .75% to 1 % Lender pays a .25 % administrative fee annually.	Private Activity Bonds
Illinois Finance Authority *	Young Farmer Guarantee Program	This program is for young farmers purchasing capital assets. Applicants work with local lenders to arrange financing for such things as land, buildings, breeding livestock, machinery and equipment. The guarantee provides credit enhancement, resulting in more favorable terms and more financing opportunities for young farmers. Guarantees are backed by the full faith and credit of the state. They are exempt from banks' legal lending limits.	85%	15 years	$500,000	Borrower pas closing fee of 1% Lender pays a .25% administrative fee annually.	Private Activity Bonds
Illinois Finance Authority *	Specialized Livestock Guarantee	For farmers who are acquiring, constructing or remodeling specialized livestock facilities, including but not limited to, swine, dairy and beef operations. May be contract or independent producers. Also allows the lender an opportunity to finance new types of relationships among producers, vendors and suppliers in various livestock industries. Guarantees are backed by the full faith and credit of the state. They are exempt from banks' legal lending limits.	85%	15 years	$1,000,000	Borrower pays closing fee of 1% of loan. Lender pays a .25% administrative fee annually	Private Activity Bonds

STATES LOAN GUARANTEE PROGRAMS For more information go to http://www.stateagfinance.org/types.html#guaranteeloan							
State Agency	**Program Name**	**Description**	**Max Guarantee**	**Max Term**	**Max Loan**	**Fees**	**Funding**
Illinois Finance Authority *	Value-Added Stock Purchase	For farmers who are buying stock in value-added entities that further process Illinois farm commodities. Recent examples include ethanol plants and meat processing facilities. Stock in the value-added entity may be pledged as collateral to secure these loans. Additional collateral may be required. Loans are scheduled with a 10 year repayment with an "interest only" payment in the first year.	85%	10 years	$100,000	Application fee $300 Borrower pays 1 % of loan minus application fee Lender pays X% for administrative fees annually	Private Activity Bonds
Illinois Finance Authority *	Agri-Industry Guarantee	For entities that are processing or otherwise adding value to Illinois farm commodities. Also, farmers that are producing commodities not commonly produced in Illinois. Examples include poultry, fruit and vegetable production and processing, livestock processing and retail meat, viticulture, and wineries.	85%		$1,000,000	Borrower pays 1% closing fee Lender pays X% for administrative fees annually	Private Activity Bonds
Indiana Development Finance Authority	Agricultural Loan and Rural Development Project Guaranty Program	Value-added agricultural projects and rural development projects. Provides guaranties of loans to finance value-added agricultural projects and rural development projects that result in the creation of new jobs in the state of Indiana.	70-90 % for large projects $300,000 max for small projects		$300,000		
Missouri Agricultural and Small Business Development Authority	Beginning Farmer Program	Loans for beginning farmers. Participation guidelines for this program include the borrower's net worth of less than $200,000 and a minimum age requirement of 18 years.			$450,000	Non-refundable application fee of $300 Borrower Pays: Participation fee of 1½ % not less than $500 Bond issuance fee of .50%	Private Activity Bonds
Missouri Agricultural and Small Business Development Authority	Animal Waste System Loan Program	Loans for livestock/poultry producers. The loans are for financing animal waste treatment systems that have been approved by the Department of Natural Resources.		10 years	No dollar limit	Non-refundable application fee of $50 Borrower pays 1% loan participation fee no less than $250	State Appropriations $10 million

STATES LOAN GUARANTEE PROGRAMS For more information go to http://www.stateagfinance.org/types.html#guaranteeloan							
State Agency	**Program Name**	**Description**	**Max Guarantee**	**Max Term**	**Max Loan**	**Fees**	**Funding**
Missouri Agricultural and Small Business Development Authority	Single-Purpose Animal Facilities Loan Guarantee Program	This program provides a 50 percent first loss guarantee to lenders making loans for single-purpose livestock facilities or expansion of existing livestock operations.	50% of first loss guarantee	10 years	$250,000	Borrower pays 1% loan participation fee Borrower pays .50% guarantee fee and annually thereafter	State Appropriations $40 million
Missouri Agricultural and Small Business Development Authority	Missouri Value Added Program (MoVAP)--Loan Guarantee and Grant Programs	Loans for value-added agriculture projects. provided to lenders making loans for value added agricultural projects including loans for land, building, equipment or stock loans to cooperatives. Grant: A grant for up to $200,000 for projects that add value to agricultural products and impact rural communities. Grants are intended for pre-business startup expenses such as feasibility studies or business plans.	25% of first loss guarantee	10 years	$250,000	Borrower pays 1% loan participation fee Lender one-time loan participation fee of 1% Borrower pays .50% of the guarantee amount annually	State Appropriations $10 million
Ohio Rural Development Partnership	Family Farm Loan Guarantee Program	Ohio farmers who want to start, expand, or begin ag enterprise. Funds may be used for the purchase of fixed assets including land, building construction/renovation and stationary equipment. The bank can charge the borrower no more than 5 percent interest on the guaranteed portion of the loan. Improved or purchased land assisted by this program must stay in agricultural use.	40%	10 years	500,000	Borrower pays 10% or not les than 25,0000	State Appropriations $10 million
Wisconsin Housing and Economic Development Authority	Credit Relief Outreach Program Guarantee	Wisconsin residents who are actively engaged in the farm operation. May be used by partnerships, associations and corporations if legally registered in Wisconsin. Loan proceeds can only be used to pay for services or consumable goods necessary to produce an agricultural commodity. The commodity must be planted and harvested for consumption within the term of the loan. Livestock is eligible if purchased, fed and sold within the term of the loan.	80%	Annually	$60,000	Nonrefundable application fee of $300 on loan amounts of less than $40,000; or $500 on loan amounts of $40,000 or more.	State Appropriations

STATES LOAN GUARANTEE PROGRAMS For more information go to http://www.stateagfinance.org/types.html#guaranteeloan							
State Agency	**Program Name**	**Description**	**Max Guarantee**	**Max Term**	**Max Loan**	**Fees**	**Funding**
Wisconsin Housing and Economic Development Authority	Farm Asset Reinvestment Management Guarantee	Wisconsin residents who are currently operating farm premises. May be used by partnerships, associations, and corporations legally registered in Wisconsin. Provides loan guarantee based on amount of FARM loan, borrower's net worth, or program maximum of $200,000. Guarantee is limited to $100,000	85%	10 years	No Max	$150 nonrefundable application fee 1.00% of the guarantee amount due upon closing	State Appropriations
Wisconsin Housing and Economic Development Authority	Agribusiness Guarantee	Businesses that create products using raw ag commodities. Create a product new to the business or expand production of an existing product that will increase the use of a raw agricultural commodity; or enhance the efficiency of the business. Business must be located in a Wisconsin municipality having a population of under 50,000 and must demonstrate it has made a notable effort to purchase a substantial percentage of its raw agricultural commodities from Wisconsin suppliers.	80%		$750,000	1.5% guarantees fee for loans of $150,000 or less; or 2.5% of guarantees greater than $150,000 Annual servicing fee of 0.25% of guarantee	State Appropriations

Exhibit C

First Southwest Company

Report

Texas Agricultural Finance Authority

November 7, 2008 Meeting

Overview

- Existing TAFA Loan Program
  - $25 Million Outstanding on Existing CP Program
  - FY 2008 interest expense: approximately $918,056
    - Average rate was 3.6% in FY 2008; 5.3% in FY 2007
    - $10.3 million relates to performing loans
    - $14.7 million relates to non-performing or defaulted loans
- TAFA potential sources of revenue
  - Income from Young Farmers Fund
    - Assume 3.125% on $16 million ≈ $500,000 / year
  - Ag Vehicle Tag Fees ≈ $900,000 / year
    - Assume $600,000 / year available
  - Corpus of Young Farmers Fund
  - State Appropriation
  - Earnings from Loan Activity
    - FY 2008 ≈ $600,000
    - Assumed to cover interest cost on the $10.3 million of CP Program related to performing loans

What Amount of CP Could Potentially Be Refunded?

Assuming $1.1 Million
Annually Available

Amortization of Refunding Bonds	CP to Be Refunded
10 Years	$7.33
15 Years	$9.48
20 Years	$10.97

Assuming $500,000
Annually Available

Amortization of Refunding Bonds	CP to Be Refunded
10 Years	$3.25
15 Years	$4.21
20 Years	$4.89

Reflects estimated amount of CP refunding, in millions, that could be supported by the indicated cash flow streams, based on October 9, 2008 market rates.

What Annual Cash Flow Would Be Required to Refund (on a fixed rate basis) Certain Amounts of CP Over Time?

		Length of Refunding Bonds Amortization		
		20 Years	15 Years	10 Years
Amount of CP to Be Refunded	$14.7 million	$1.46	$1.68	$2.16
	$10 million	$0.99	$1.15	$1.48
	$8 million	$0.80	$0.92	$1.19

Reflects estimated annual debt service requirement, in millions, based on October 9, 2008 market rates.

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