

BEGINNING FARMER CONTRACT BOND

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GENERAL INFORMATION

The information herein is subject to rules and regulations established by the Illinois Finance Authority (IFA) as a means of implementing the Beginning Farmer Contract Bond Program.

The purpose of the Beginning Farmer Contract Bond Program is to provide affordable financing to new, low net worth farmers for financing capital purchases made on contract. The program provides tax exempt interest income to sellers whose tax position may allow them to benefit from this type of investment.

The program uses tax exempt financing to encourage contract sales of farm real estate to qualified Beginning Farmer applicants. The contract seller first makes his own loan analysis, determines the necessary collateral and set the interest rate and payment schedule for the contract. The IFA issues a tax exempt bond having the same face amount and terms as the proposed contract. The interest paid on the bond is exempt from federal income tax. When setting the interest rate, contract sellers should give consideration to TEFRA legislation and the Alternative Minimum Tax. In all cases, the loan and the bond are not obligations of the FIA or the State of Illinois, to the complexity of the legal issues concerning transactions which involve tax exempt bonds, contracts sellers are urged to seek legal counsel to assist them in the transactions described below.

INTERNAL REVENUE SERVICE RESTRICTIONS

The tax-exempt interest income on IFA bonds makes low interest rate loans possible. The Internal Revenue Service has imposed rigid requirements on how bond proceeds may be used in a tax-exempt financing. If a Borrower or Seller ignores any of these rules in an IFA financing, there is a substantial danger that interest on the IFA bond will not be tax exempt. It is the ultimate responsibility of the Borrower to see that none of the rules are broken. If a Borrower fails to satisfy any Internal Revenue Service requirement, his loan will be subject to mandatory prepayment in full with a premium. Borrowers are required to sign certificates at closing stating that the rules have been and will be faithfully observed.

APPLICANT ELIGIBILITY

Net worth. The applicant must have net worth of not more than \$500,000 at the time of application. Net worth is defined as total assets less total liabilities of the individual and the individual's spouse and minor children, if any.



Residency. The applicant must be a permanent resident of Illinois when the bond is issued.

Age. The applicant must be at least eighteen (18) years of age when the IFA loan application is submitted.

Individuals. The applicant must be an individual. IFA cannot loan money to corporations, partnerships, trusts, or any other legal entity under the Beginning Farmer Program.

Capital Requirements. The applicant may be required to document to the satisfaction of the Lender and IFA that he will have access to adequate working capital, farm equipment, and livestock, if appropriate.

ELIGIBLE PURCHASES

The maximum loan amount is \$470,100 per person.^(01/2010) Loan proceeds may be used for the following capital purchases only:

- Agricultural Land. Land located in the State of Illinois that is suitable for use in farming and which is or will be operated as a farm.
- Agricultural Improvements. Any improvements, buildings, structures or fixtures suitable for use in farming which are located on Agricultural Land. IFA will finance the purchase of new improvements on Agricultural Land. IFA can finance used Agricultural Improvements only in situations in which:
 - the improvements are purchased in conjunction with Agricultural Land and used in the operation of a farm to be operated on the Agricultural Land being purchased; or
 - a sufficient amount of qualified rehabilitation expenditures are incurred by the Borrower with respect to the Agricultural Improvements within two years from the date of issue of the Bond.
- Depreciable Agricultural Property. Personal property suitable for use in farming for which an income tax deduction for depreciation is allowable in computing federal income tax under the Internal Revenue Code of 1954, as amended. Examples include, but are not limited to, farm machinery and trucks. Feeder livestock, seed, feed, fertilizer, and other types of inventory or supplies do not qualify as Depreciable Agricultural Property. IFA will finance the purchase of any new Depreciable Agricultural Property. IFA can also finance used Depreciable Agricultural Property if it is purchased in conjunction with Agricultural Land and used in the operation of a farm to be operated on the Agricultural Land being purchased. The total loan proceeds allocated to the purchase price of used equipment may

not exceed \$62,500.

No portion of the loan proceeds may be used for the purchase of a residence. If the project includes a residence, the applicant must make a down payment or obtain conventional financing for the value of the residence.

Purchase From Related Persons. IFA loan proceeds can be used to purchase property from a Related Person. The IRS states that the following, among others, are deemed to be "Related Persons" of an individual: grandfather, grandmother, father, mother, brother, sister (whether whole or half blood), child, grandchild, or spouse.

In addition, a partnership and each of its partners (and their spouses and minor children) are Related Persons, as are an S corporation and each of its shareholders (and their spouses and minor children.) Related Persons also includes certain related corporations and partnerships. It should be pointed out that the foregoing list is not all-inclusive. There are certain other entities and individuals that could also be considered Related Persons.

It should also be noted that certain individuals are not Related Persons. For example, an uncle, aunt, nephew, niece, brother-in-law or sister-in-law would not be treated as a Related Person.

If IFA proceeds are used to purchase property from a Related Person, the applicant must certify and provide supporting documentation that the purchase price of the project is equal to the market value of the project. The applicant must also certify that the seller will have no continuing financial interest in the project and will not be a principal user of the project, and will have no other direct or indirect ownership or use of the project.

Sixty Day Eligibility Window. In order for a purchase to be eligible, IFA Board of Directors must approve the loan within sixty days of the date that the borrower commences acquisition of the property to be financed. Commencement of acquisition includes acquisition or construction of any part of the Project to be financed with the proceeds of the loan; any contract or purchase agreement, installment or otherwise, in connection with the acquisition or construction of the Project or any part thereof, or the off-site fabrication or acquisition of any part of the Project; and payment of any money by the Applicants for down payment or earnest money.

LOAN PROCESS

Application and Approval. The contract seller first makes its own loan analysis, determines what collateral and guarantees are necessary, and sets the interest rate and payment schedule for the loan. The Contract Seller should consult with its tax accountants to calculate the appropriate interest rate. A Contract Seller who is subject to alternative minimum tax may not benefit from the tax-exempt status of the bond.

The Purchaser and Contract Seller then complete the IFA application form and submit it with the non-refundable \$100.00 application fee. IFA will review the information supplied in the application to determine whether all Internal Revenue Service requirements have been satisfied. For this reason, it is vital that the application be completed with care. The IFA Board of Directors meets the second Tuesday of each month to consider loan requests. An application for a loan



must be received by one month prior to the Board meeting to allow sufficient time for processing prior to the meeting.

Public Hearing and Bond Resolution. At the meeting following the approval of the application, the Board will pass a bond resolution approving the bond sale. Prior to that meeting, IFA is required to hold a public hearing on the proposed project. A notice of public hearing will be published in a newspaper of general circulation in the county in which the project is located. The notice includes the applicant's name, the amount, and a description of the project.

Bond Documents. After IFA has approved the loan application and passed a bond resolution, IFA will send to the Contract Seller a Bond Document Package containing the following documents:

- (I) Loan Agreement between IFA and Borrower
- (AI) Requisition Form
- (II) Seller Loan Agreement between IFA and Seller
- (III) Closing Certificate of Seller
- (IV) Certificate of Participation
- (V) Closing Certificate of Borrower
- (VI) Closing Certificate of IFA
- (VII) Bond Resolution
- (VIII) Arbitrage Certificate
- (IX) Promissory Note of Borrower to IFA
- (X) Agreement as to Terms
- (XI) Guaranty of Promissory Note
- (XII) Sample Bond
- (XIII) Sample Bond Opinion

The documents should be executed by both the Borrower and the Seller and returned to IFA.

Project Fund. IFA will contact the Seller or their closing agent to determine the project closing date. Documents will be released by IFA prior to the closing date. The documents will outline the repayment agreement between the Purchaser and the Contract Seller.

The Project must be closed within six months of the loan date.

Letter of Opinion. IFA's Bond counsel will review each Bond for legality and exemption of interest from federal income tax. Bond counsel will then issue a Letter of Opinion as to the tax-exempt status of the bond.



Security for the Loan. To facilitate the making of the loan, the Seller Loan Agreement provides that the Seller will act as agent and fiduciary for IFA in connection with the loan. The principal and interest of the Bond are payable solely out of the revenue derived from the Purchaser's Promissory Note, which is secured by collateral furnished by the Purchaser. The Bond that is issued by IFA and purchased by the Seller is a non-recourse obligation. The principal and interest on the Bond do not constitute an indebtedness of IFA or a charge against its general credit or general fund.

If the Seller determines that a Guaranty of the Promissory Note is required, it must use the form of Guaranty included in the Bond Documents Package.

The Seller should use its own security documents, as it deems necessary for each loan. Please note that cash and cash equivalents may not be used as collateral. IFA recommends that security documents clearly state that they are given as additional security for the indebtedness evidenced by the Promissory Note, the Loan Agreement, the Seller Loan Agreement and the IFA Bond and are given to further secure the agreements, covenants, and obligations of the Purchaser contained in the Loan Agreement. The security documents should be directly between the Purchaser and the Seller or the guarantor and the Seller. The Seller may also wish to add a "cross-default" provision to these documents, making an event of default under the Loan Agreement, the Promissory Note or the Seller Loan Agreement an event of default under the security agreements. Any additional requirements not specifically provided for in the Loan Agreement, such as insurance coverage, can be required.

Prepayment of Loans. The Bond Documents and the structure of the financing require any installment payment under the Loan Agreement and Promissory Note to be applied against a like installment payable under the Bond. Under the Loan Agreement and the Lender Loan Agreement, the Loan is subject to mandatory prepayment on the happening of certain events. The Seller agrees that any such prepayments will be applied to the payment of the Bond. The Loan Agreement requires mandatory prepayment in full with a premium if interest on the Bond becomes subject to federal income taxation as a result of any action or failure to act of the Borrowers.

(See discussion of INTERNAL REVENUE SERVICE RESTRICTIONS above). The premium will be equal to the difference between the actual interest payable on the Loan up to the date of prepayment and the amount of interest which would have been payable if the Seller had charged its normal market rate. In addition, the Loan Agreement provides for optional prepayment without premium at the discretion of the Seller in the event of damage, destruction or condemnation of all or any part of the Project. The Loan Agreement also provides for prepayment, in whole or in part, without premium at the option of the eligible Borrower.

Assumption of Loans and Transfer of Property. Loans may not be assumed without the prior approval of IFA, and then only if the assuming party is an eligible applicant. The benefits of the Loan made at the tax-free rate from the proceeds of an IFA Bond must remain with the qualified Borrower, and no person other than the Borrower may obtain the benefits of the IFA Loan.

FEES

IFA charges a non-refundable application fee of \$100 that should be submitted with the application. There is also a closing fee of one and one-half percent of the loan amount, less the \$100 application fee, due when the loan is closed.

The Seller may charge a closing fee of up to one-half of one percent of the loan amount. No other fees may be charged. However, the Seller may pass on to the borrower any recording or filing fees associated with the loan.

RIGHT TO AUDIT

IFA shall have at any time the right to audit records of the Seller and the Borrower relating to a particular bond transaction to insure the bond proceeds were used for qualified purposes by a qualified user.

STATE CAP IN ILLINOIS

The Tax Reform Act of 1986 imposed a limit cap on the amount of Bonds that can be issued in Illinois. Bonds issued by IFA are subject to this limitation.

Questions: If you have any questions regarding the application process, financial records, appraisals, or other terms and conditions, please call the IFA Ag Team at the Mt. Vernon office at 618.244.2424.

About IFA: Illinois Finance Authority is an independent, self-funded state agency offering a variety of loan programs mutually beneficial to farmers and lenders. Contact us for more information on the Beginning Farmer Bond Program, Beginning Farmer Contract Bond Program, Debt Restructuring Loan Guarantee Program, Young Farmer Guarantee Program, Specialized Livestock Guarantee Program, Agri-Industries Loan Guarantee Program, and/or the Value-Added Stock Purchase Loan Guarantee Program.

Serving Illinois Agriculture One Family at a Time Since 1982