

SOUTH DAKOTA
BEGINNING FARMER BOND PROGRAM

PROGRAM SUMMARY

**SD VALUE ADDED FINANCE AUTHORITY
523 EAST CAPITOL AVENUE
FOSS BUILDING
PIERRE, SD 57501
PHONE 605 773-5436
FAX 605 773-3481**

<http://sdda.sd.gov/farming-ranching-agribusiness/financial-assistance-programs/>

TABLE OF CONTENTS

<u>Section</u>	<u>Page</u>	
I	PROGRAM POWERS AND ELIGIBLE ACTIVITIES	2
	1. Agricultural Land	2
	2. Agricultural Improvements	2
	3. Depreciable Agricultural Property	2
II	PROGRAM MAXIMUMS AND MINIMUMS	2
III	NATURE OF INVESTMENT RISK; LIMITED OBLIGATION BONDS	2
IV	APPLICANT ELIGIBILITY	3
	1. Age Limits	3
	2. First-Time Farmer	3
	3. Net Worth	3
	4. Residence	3
	5. Training and Experience	3
	6. Use of Project	3
V	INELIGIBLE PROGRAM ACTIVITIES	3
	1. Refinance Existing Debt	3
	2. Finance Working Capital	3
	3. Finance the Acquisition of Property	3
	4. Finance a Contract Sale Between Beginning Farmer and Grandparent, Parent or Sibling	3
	5. Rural Residence	3
	6. CRP Land	3
VI	APPLICATION AND PROCEDURES	4
	1. Application Forms	4
	2. Application Period	4
	3. Interim Financing	4
	4. Fees	4
	5. Use of Financial and Security Documents	4
	6. Bond Purchaser	4
	7. Public Hearing & Governor's Approval of Bond Issuance	4
	8. State Volume Cap Limitations	4
	9. Modified Accelerated Cost Recovery System Limitations	5
	10. Maximum Loan Maturity	5
	11. Purchases from Related Person	5
VII	DETAILS FOR DIRECT LOANS	5
	1. Loans to Beginning Farmers and Security Arrangements	5
	2. Terms of Loan	5
	3. Repayment of Loan	5
	4. Assignment of Sale of Bonds	5
	5. Timing Requirements for Spending Bond Proceeds	6
VIII	DETAILS FOR SALES CONTRACTS	6
	1. Sales Contract and Security Arrangements	6
	2. Terms of the Sales Contract	6
	3. Payment Under the Sales Contract	7
	4. Closing Documents	7
IX	LOAN CLOSING PROCEDURES	7
	1. Preparation of Legal Notice	7
	2. Receipt of Loan Data Sheets and Paperwork Regarding Each Loan	7
	3. Preparation of Bond Documents	7
	4. Bond Summary	7
	5. Request for Governor's Approval	7
	6. Prepare for Loan Closing	7
	7. Prepare Final Closing Documents	7
	8. Verify Returned Closing Documents are Complete	7
X	TAX EXEMPTION OF AUTHORITY BONDS	7
	1. General Federal Tax Exemption of Bonds	7
	2. Federal Alternative Minimum Tax	8
	3. Deduction for Interest Incurred to Carry Tax-Exempt Bonds	8
XI	MAKING CHANGES AFTER THE BOND IS ISSUED	8
	1. Modifying Interest Rates and Terms	8
	2. Assumption of Loans/Sales Contracts-Substitution of Collateral & Transfer of Property	8
	3. Disposition of Bonds That Have Been Paid Off	8
XII	RIGHT TO AUDIT	9
XIII	DEFINITIONS	9
	CONCLUDING NOTE	10

THE PROGRAM SUMMARY IN BRIEF

The South Dakota Beginning Farmer Bond Program (SDBFBP), is a tax-exempt bond program designed to assist Beginning Farmers in the state of South Dakota to acquire agricultural property at lower interest rates.

The Program enables lenders, individuals, partnerships, corporations, and other entities (herein referred to as the "Bond Purchaser") to receive federally tax-exempt interest with respect to a loan or contract sale made to Beginning Farmers. The Bond Purchaser, after arranging the loan or sales contract, will obtain from the Value Added Finance Authority (the "Authority") a federally tax-exempt Private Activity Bond (PAB) in the amount of the loan or unpaid balance. The loan and its collateral will be assigned to the Bond Purchaser as security for the bond. In the case of a contract sale, the contract will be entered into by the Authority, and the Bond Purchaser will receive the bond to evidence the Authority's obligations under the contract. The Authority's right, title and interest in the contract will then be assigned to the Beginning Farmer who assumes payment obligations of the Authority under the contract.

BASIC QUALIFICATIONS:

- Net worth of \$400,000 or less (page 10).
- May not have previously owned any substantial amount of farmland (page 10).
- Program may be used to purchase agricultural land, agricultural improvements, and depreciable agricultural property (page 2).
- Property may be purchased from close relatives only through third-party lenders (page 5).
- The loan maximums under existing federal laws are:
 - \$501,100 for agricultural land and improvements
 - \$250,000 for new depreciable agricultural property of which no more than \$62,500 can be for used property. (page 2)

There is no minimum loan amount for the program. The Bond Purchaser will make a credit evaluation of the Beginning Farmer, may require any collateral deemed necessary and, with the Beginning Farmer, must arrange the terms of the loan or contract. Neither the loan, contract, nor bond will be the Authority's obligation, and the bond will be secured solely by the loan or contract and collateral provided by the Beginning Farmer. The Bond Purchaser will be responsible for the creation and perfection of any security interest deemed necessary for the loan or contract.

A loan made under the Program is funded solely from the bond sold to the Bond Purchaser. The Authority has no independent funds to fund a loan. Therefore, a Beginning Farmer must submit an application with the Bond Purchaser (bank, contract seller or individual investor) who is able to purchase the Authority's bond to fund the Beginning Farmer's loan. This Authority shall not be liable or responsible for the failure of a Bond Purchaser to purchase a bond or otherwise perform the functions of a Lender. Nor shall the Authority be liable or responsible for the failure of a Beginning Farmer to locate an alternate Bond Purchaser in the event of a failure of performance by the Beginning Farmer's initial Bond Purchaser.

GENERAL

The South Dakota Legislature created the Value Added Finance Authority in 1995. The Authority's statute is South Dakota Codified Law 1-16E. The purpose of this law is to assist eligible South Dakotans, who engage in farming or wish to engage in farming, to purchase Agricultural Land, Agricultural Improvements, and Depreciable Agricultural Property. The law also allows for the sale of bonds to individuals for contract sales and direct loans.

The Program has been expanded to allow beginning farmer loans to be used for transactions between parents, grandparents and siblings. Such transactions can be financed only through third-party lenders; Internal Revenue Service (IRS) rules prohibit contract sales between close relatives. The new law also will increase the number of acres applicants could own and still be eligible for a Beginning Farmer Loan.

The powers of the Authority are vested in and exercised by a board of seven members. The members are appointed by the Governor. The Secretary of Agriculture is an ex-officio non-voting member.

SECTION I

PROGRAM POWERS AND ELIGIBLE ACTIVITIES

Eligible activities (only for persons who are First Time Farmers) consist of financing of the following:

1. **Agricultural Land** -- The Authority can finance the purchase of land suitable for use in farming (page 9).
2. **Agricultural Improvements** -- The Authority can finance the construction or purchase of improvements located on Agricultural Land (which are suitable for use in farming). Examples: Confinement systems for swine, cattle, or poultry; barns and other out-buildings; grain storage facilities; silos; improvements to land such as tiling and soil conservation practices which could include, but not be limited to, terraces, farm ponds, erosion control structures, waterways, etc. Agricultural Improvements may be new or used, and may include additions to or renovation if existing buildings or other structures. There are restrictions regarding the financing of a personal residence on a farm (page 9).
3. **Depreciable Agricultural Property** -- The Authority can finance the purchase of personal property suitable for use in farming for which an income tax deduction for depreciation is allowed in computing Federal income taxes. Example: Livestock used for breeding or dairy purposes, farm machinery, trucks, etc. (feeder cattle, feeder pigs, or feeder lambs do not qualify as Depreciable Property). Bond proceeds may be used to finance new or used Depreciable Agricultural Property). "Used" livestock are female animals that have produced offspring or are male animals that have been used for breeding purposes. Open or bred heifers, gilts, or lambs would not be considered "used" property under this definition (this class of animals would be considered "new" property). Male animals that have not been used for breeding purposes would also be considered "new" property (page 10).
4. **Purchases from Close Relatives** -- Purchase of land, improvements, or equipment from parents, grandparents, or siblings is allowed so long as the purchase price paid by the Beginning Farmer is fair market value. The Bond Purchaser certifies that the purchase price paid was fair market value, an appraisal is supplied showing the fair market value, and the close relative certifies to the Authority that the close relative will not have a financial interest in the Project after the closing. In addition, financing may not be by the use of a sales contract – a loan from a third party must be used.

SECTION II

PROGRAM MAXIMUMS AND MINIMUMS

Federal and South Dakota law collectively set various maximum amounts which may be financed under the Program.

1. No more than an aggregate amount of \$501,100 may be used for Agricultural Land, Agricultural Improvements and Depreciable Agricultural Property. It is possible to use the program more than once, if the Beginning Farmer still meets eligibility requirements and the grand total of bonds per individual does not exceed the \$250,000 lifetime maximum.
2. Of the possible \$501,100, no more than \$250,000 can be for Depreciable Agricultural Property, of which no more than \$62,500 can be for "used" property.
3. There is no minimum loan amount for the Program.

SECTION III

NATURE OF INVESTMENT RISK: LIMITED OBLIGATION BONDS

THE BOND PURCHASER MUST MAKE THE CREDIT EVALUATION OF THE LOAN OR SALES CONTRACT, THE BEGINNING FARMER'S NET WORTH AND ABILITY TO REPAY PRINCIPAL AND INTEREST AND THE SUFFICIENCY OF THE SECURITY FOR THE LOAN OR SALES CONTRACT. THE AUTHORITY WILL NOT MAKE AN INDEPENDENT EVALUATION OF THE BEGINNING FARMER'S ABILITY TO REPAY THE LOAN, PAY THE CONTRACT OR DETERMINE THE BEGINNING FARMER'S NET WORTH. THE AUTHORITY AND ITS COUNSEL WILL NOT REVIEW AND WILL MAKE NO WARRANTIES OR REPRESENTATIONS WITH RESPECT TO THE LEGAL SUFFICIENCY OR VALIDITY OF THE LOAN OR SALES CONTRACT. In setting the terms and drafting the loan or sales contract, the Beginning Farmer and Bond Purchaser are strongly encouraged to consult their legal counsel and tax consultants. The Bond Purchaser will be required to execute a statement at loan closing with respect to his or her understanding of the Authority's limited obligation on the bond and the credit risks inherent in purchasing such a bond.

The principal and interest on the bond are limited obligations, payable solely out of the revenue derived from the debt obligation, or sales contract, collateral, or other security furnished by or on behalf of the Beginning Farmer. A guarantor, letter of credit or alternative credit enhancement on the debt is permissible. A guarantor may be a Related Person. **The Bond, which is issued by the Authority to the bond purchaser, is a non-recourse obligation. The Principal and interest on the Bond do not constitute an indebtedness of the Authority or the State of South Dakota or a charge against their general credit or general funds.** It should also be noted that any recording or filing fees or transfer taxes associated with the loan will be paid by the Beginning Farmer or Lender and not the Authority. **Additionally, the Authority will have no responsibility with respect to the preparation, execution, or filing of any Declaration of Value of Groundwater Hazard Statements.**

SECTION IV

APPLICANT ELIGIBILITY

The basic eligibility requirements for the Program are as follows:

1. **Age Limit** -- Beginning Farmer must be at least age 18, unless he or she is married. There is no upper age limit.
2. **First-Time Farmer** -- All Beginning Farmers must be First-Time Farmers regardless of the purpose of the loan. A First-time Farmer is a person who has never had any direct or indirect ownership interest in Substantial Farmland in the operation of which he/she has materially participated. An ownership interest or material participation by a person's spouse or minor child will be attributed to the person as well.
3. **Net Worth** -- The Beginning Farmer must have a net worth under \$400,000.
4. **Residence** -- The Beginning Farmer must be a resident of South Dakota at the time the bond is issued.
5. **Training and Experience** -- The Beginning Farmer must have documented, to the satisfaction of the Bond Purchaser and the Authority, sufficient training and experience in the type of farming operation for which the bond is requested.
6. **Use of Project** -- Agricultural land, agricultural improvements and depreciable agricultural property shall only be used for farming by the individual, the individual's spouse, the individual's minor children, or any of them.

SECTION V

INELIGIBLE PROGRAM ACTIVITIES

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

1. **Refinance Existing Debt** -that has been incurred by the Beginning Farmer prior to 60 days within the Authority's board approval of a Program application.
2. **Finance Working Capital** -to purchase feed, seed, fertilizer, fuel, etc. (Feeder cattle, feeder pigs or feeder lambs would also fall into this category).
3. **Finance the Acquisition of Property** -for individuals other than for First-Time Farmers (page 4).
4. **Finance a Contract Sale Between Beginning Farmer and Grandparent, Parent or Sibling** -Federal tax law does not allow tax-exempt bonds to be issued to close relatives. The purchase of land, improvements or depreciable agricultural property from close relatives must be financed through third party Lenders in order to be eligible.
5. **Rural Residence** - the purchase of only a house is not permitted. However, if the house is a minor part of a farm or acreage purchase it can be included as a part of the loan. No more than 5 percent of the bond proceeds can be used toward the purchase of the house.
6. **CRP Land** - the purchase of farmland that is entirely enrolled in CRP is not permitted. Depending on whether a portion of bond proceeds are financing a house (not to exceed 5 percent) 20-25% of the bond proceeds may be used to purchase CRP acres.

The Beginning Farmer, or any Related Person, shall not make any expenditures with respect to the acquisition or construction of any part of the Project prior to 60 days of the date the Authority board approves the Application. To do so runs a risk that the IRS would deem the bond transaction a refinancing; tax-exempt bond proceeds may not be used for the purpose of refinancing.

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

SECTION VI

APPLICATION AND PROCEDURES

A Beginning Farmer and Bond Purchaser must prepare and submit an Application jointly to the Authority. The following should be noted:

1. **Application Forms** - Application forms are available from the Authority. **The Application should be completed by the Beginning Farmer and Bond Purchaser and submitted to the Authority.** Applicants and Lenders are encouraged to contact the Authority if they have questions in completing the application.

Current Financial Statement - A copy of the Beginning Farmer's current financial statement (taken within 60 days preceding the date of Application) must be submitted with the Application

Background Letter - A letter must be submitted with the Application explaining the Beginning Farmer's background with respect to his or her training and experience in the type of farming operation for which a loan is sought. The letter should also outline the Beginning Farmer's access to machinery, if the loan is for land; or his or her access to land, if the loan is for Agricultural Improvements or Depreciable Agricultural Property. The letter should also state where the Beginning Farmer will obtain operating capital and interim financing if necessary.

2. **Application Period** - To be considered for that month's board meeting, completed applications must be received in the office one week before the board meeting, which is the last Thursday of each month.

3. **Interim Financing (does not apply to contract sales)** - As noted, a Beginning Farmer must not make any expenditure with respect to acquisition or construction of any part of the Project prior to 60 days of the date the Authority board approves the Application; if this were to occur, the bond transaction could be deemed a refinancing. However, once the Application has been approved, the Project may move forward with either construction or possession; if necessary, the Bond Purchaser or another lender may interim finance the loan prior to bond issuance. The interim financing (principal only) will be paid with the proceeds of the bond when issued.

4. **Fees** - The Beginning Farmer or Bond Purchaser must submit to the Authority a non-refundable \$100 application fee (submitted with the Application). A loan fee equal to 1.5 percent of the amount of the bond, but not less than \$500, must be submitted by the Beginning Farmer or Bond Purchaser at loan closing. The loan fee may be financed with bond proceeds, or in the case of a contract sale, the loan fee may be included in the purchase price reflected in the sales contract. *The Authority's bond counsel will review each bond for legality and tax exemption. The Authority will pay its bond counsel from the fees collected from the Beginning Farmer or Bond Purchaser.*

5. **Use of Financial and Security Documents** - The Bond Purchaser should use forms of financial statement and security documents which he/she believes are necessary and appropriate under the particular circumstances for the loan or contract sale. These items should be referenced in the bond documents and their provisions incorporated therein. Any additional requirements not specifically provided for in the bond documents, such as insurance coverage and amounts, should also be added.

6. **Bond Purchasers** - It is the Bond Purchaser's responsibility to ensure that any security agreements, mortgages, guarantees or other security documents, which the Bond Purchaser requires in a transaction, have been completed and signed, and that any financing statements have been filed, mortgages recorded or any other necessary steps taken to protect the Bond Purchaser's interests. The Authority makes no warranties or representations with respect to the effectiveness, validity or priority of any liens or security interests which a Bond Purchaser has, or believes he/she may have, with respect to a particular project. Further, the Authority will have no responsibility with respect to the preparation, execution, or filing of any Declaration of Value statements or Groundwater Hazard statements.

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

Generally, these public hearings will be conducted by the Authority board in conjunction with its monthly board meeting. However, on some occasions the hearing may be conducted by individual board members or members of the Authority's staff. A hearing need not be held prior to an Application being approved, but it must be held before the bond documents are approved. The Governor of South Dakota, after receiving a report on the results of the public hearing, may approve or disapprove the Bond.

8. **State Volume Cap Limitations** - The Federal tax law establishes a limit on the total principal amount of tax-exempt Private Activity Bonds which may be issued within any state during a calendar year. All Authority bonds are subject to the limitation. The procedure for the allocation of Private Activity Bonds is set forth by Executive Order 91-1 dated January 2, 1991. If an allocation from the Volume Cap is not available for a particular bond, the Bond Purchaser and the Beginning Farmer will be so advised.

9. **Modified Accelerated Cost Recovery System Limitations - Bond Purchasers and Beginning Farmers should be aware the Federal law limits the application of the Modified Accelerated Cost Recovery System (MACRS) with respect to facilities with the Authority's Bonds.** If an item is financed with the proceeds of a bond, the Beginning Farmer must use an alternative MACRS methods where deductions are computed by applying the straight line method, the applicable averaging convention, and the applicable longer recovery period for such item (12 years for personal property with no class life, 40 years for real property, and the class life for all other property). Beginning Farmers should contact their tax consultant regarding how MACRS will affect their operation.
10. **Maximum Loan Maturity -** Federal law provides that the weighted average maturity of an Authority bond can be no more than 120% of the average reasonably expected economic life of the project being financed with the proceeds of the bond (except land).
11. **Purchases From Related Person -** Federal tax law does not allow tax-exempt bonds to be issued to close relatives, including parents, grandparents and siblings ("Related Persons"). Therefore, the purchase of land, improvements or depreciable agricultural property from Related Persons may not be financed by the use of a sales contract; it must be financed by a loan from a third-party lender in order to be eligible. In addition, the Project must be sold to the Beginning Farmer for its fair market value. The lender must certify that the Project is being sold for its fair market value and supply an appraisal showing the fair market value of the Project. The Related Person must certify to the Authority that after the sale of the Project to the Beginning Farmer the related person will no longer have a financial interest in the operation of the project.

SECTION VII

DETAILS FOR DIRECT LOANS

NOTE: This section applies to transactions involving a direct loan made by the Bond Purchaser to the Beginning Farmer. If the Beginning Farmer is purchasing the project on a sales contract from the Bond Purchaser, Section VII should be disregarded and Section VIII should be followed. IN ALL CASES, ALSO FOLLOW SECTION VI.

1. **Loans to Beginning Farmers and Security Arrangements --** The Program involves the Bond Purchaser, Beginning Farmer, and the Authority. The financing is accomplished as follows: in simultaneous transactions the Bond Purchaser purchases the bond from the Authority; the Authority makes the loan to the Beginning Farmer from the proceeds of the bond sale; and then assigns the promissory note it receives from the Beginning Farmer to the Bond Purchaser as security for the bond.
2. **Terms of Loan -** The Beginning Farmer and Bond Purchaser must agree on terms of the loan such as interest rate, purchase price, length of loan, prepayment options, service fees, down payment, insurance coverage, security, payment of taxes, repayment schedule, and defaults and remedies on default.
3. **Repayment of Loans -** Under the Authority's bond documents, the Beginning Farmer's payment obligations are subject to mandatory prepayment in the event the interest income on the bond becomes includable in gross income for purposes of federal income taxation, in the event that the loan agreement entered into by the Beginning Farmer becomes void or enforceable, and to the extent any bond proceeds remain following completion of the acquisition or construction of the Project. In addition, the documents provide for optional prepayment from insurance or condemnation proceeds at the discretion of the Bond Purchaser in the event of damage, destruction or condemnation of any part of the project.
 The documents also provide for prepayment at the option of the Beginning Farmer, the terms and conditions of which are to be agreed upon between the Beginning Farmer and the Bond Purchaser. It should be noted that the bond documents may be amended to provide for a prepayment at the option of the Bond Purchaser. The terms of this type of prepayment (called a call option) will need to be agreed upon by the Beginning Farmer and the Bond Purchaser. This prepayment (call) option should be used where a Bond Purchaser may be willing to extend the initial term of a loan, but wants the ability to review the loan at various points in time and to end the loan if the Beginning Farmer's progress is unsatisfactory. This alternative is preferred over a balloon which would automatically terminate the bond and end the tax exemption. Examples of call options are as follows:
 (1) Call option every five years beginning March 1, 2004 upon 90 days prior written notice to the Beginning Farmer. (2) Call option on the dates 1-1-2005, 1-1-2008, 1-1-2013 and 1-1-2014 upon 90 days prior written notice to the Beginning Farmer.
4. **Assignment or Sale of Bonds --** The Authority does not place any restrictions on a Bond Purchaser's ability to participate out, assign or sell a bond issued under the Program. Generally, the Bond Purchaser, participating in the Program, purchases the bonds for his/her own investment and does not anticipate assigning the bond to another investor. It should be noted there are laws that prevent certain sales and participations, or at least seriously

restrict them. For example, the South Dakota Securities Law may impose certain restrictions or requirements if the bonds are sold to investors other than financial institutions. In addition, there are adverse federal tax consequences if the bond is assigned, participated out or sold to a "Related Person" of the Beginning Farmer. Therefore, a Bond Purchaser should consult with legal counsel to determine if any of these laws or regulations will be violated before selling, assigning, or participating out a bond.

The Authority's rules provide that a Bond Purchaser may assign a loan in whole or in part to any person, as defined in SDCL 2-14-2(18). Servicing of the loan in a bank transaction may also be assigned but the Authority must be notified in writing prior to assignment or servicing of the loan.

5. **Timing Requirements for Spending Bond Proceeds** -- Federal tax law restrictions generally do not permit the investment of bond proceeds in securities which bear a higher interest rate than the bond. Under the current rules the period of time during which bond proceeds may be invested in an unrestricted yield is eighteen months. The "Gross Proceeds" of a tax-exempt bond must be spent on the project being financed in accordance with the following schedule: (i) 15 percent within 6 months, (ii) 60 percent within 12 months, and (iii) 100 percent within 18 months. If the Bond proceeds are not spent in accordance with such schedule, the parties to the bond issue will be subject to some very onerous federal reporting requirements and will be required to pay any profits earned on bond proceeds to the federal government.

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

To avoid subjecting any of the Authority's bonds to these reporting and payment requirements, it is the policy of the Authority not to issue a bond for a Project until the Authority can be assured that all bond proceeds will be expended on the Project in accordance with the foregoing schedule. In the closing documents the Beginning Farmer and Bond Purchaser are required to certify that the use of the proceeds will comply with this policy.

SECTION VIII

DETAILS FOR SALES CONTRACTS

NOTE: This section applies specifically to transactions involving a sales contract from the contract seller to the Beginning Farmer. This section should be disregarded if the Bond Purchaser is making a direct loan to the Beginning Farmer and Section VII should be followed. In all cases, also follow Section VI.

1. **Sales Contract and Security Arrangements** -- The Program involves the Bond Purchaser, Beginning Farmer, and the Authority. After an Application has been submitted and approved, the Bond Purchaser and the Authority will enter into a sales contract and the Bond Purchaser will receive a bond to evidence the Authority's obligations under the contract. The Authority's right, title, and interest in the contract will then be assigned to the Beginning Farmer, who will assume the payments and other obligations of the authority under the contract.
2. **Terms of the Sales Contract** -- It must be clearly stated in the sales contract as to the portion of the payments constituting principal and the portion constituting interest. In addition to other terms the Beginning Farmer and Bond Purchaser may include in the sales contract, **the following terms must be included.**
 - (1) This contract will be assigned by the Buyer (Value Added Finance Authority) to _____ (Beginning Farmer) and may not be reassigned by Beginning Farmer(s) without the written consent of Seller(s) and the Value Added Finance Authority which consent, if given, shall not operate as a waiver of the requirement of written consent on any subsequent assignment. Any attempt by Beginning Farmer(s) to reassign this contract without written consent shall entitle Seller(s) to declare all amounts due hereunder immediately due and payable.
 - (2) To evidence its payment obligations under this contract, the Value Added Finance Authority will issue its tax-exempt bond (the "Bond") in an amount equal to the unpaid balance of the purchase price contained herein and bearing interest at the rate of _____ per annum (the "Tax-Exempt Rate") with payment terms identical to those contained herein. Beginning Farmer(s) have expressly warranted to Seller(s) that the interest payments received pursuant to the terms contained herein will come to the Seller(s) in the form that will make it not includable in gross income for federal income tax purposes. Seller(s) are relying on the representations made by the Beginning Farmer(s) in this regard and in the event the interest payments are determined to be includable in gross income for federal income tax purposes, then all interest payments will be computed on the basis of interest at the rate of _____ per annum (the "Taxable Rate") and Beginning Farmer(s) shall be responsible to make payment to the Seller(s) for the difference between interest paid at the Tax-Exempt Rate and the amount calculated on the basis of interest at the Taxable Rate. This provision shall not apply in the event the Bond is held by a Related Person (as defined by the *Internal Revenue Code*) to the Beginning Farmer(s). (Note: This paragraph may be modified if a variable rate is used.)

- (3) The Seller(s) acknowledges that this contract will be assigned by the Value Added Finance Authority by separate instrument, the Guarantee, Assignment and Assumption Agreement (the "Guarantee") to the Beginning Farmer(s) who will assume the rights, duties, obligations and liabilities of the Value Added Finance Authority hereunder and guarantee the payment of principal and interest on the Bond. Seller(s) approves such assignment and assumption and acknowledges that the principal of, redemption premium, if any, and interest on the Bond, the installment payments under this contract and other amounts due and owing to the Seller(s) as holder of the Bond and seller under this contract are special limited obligations of the Value Added Finance Authority and payable solely and only from the obligations of the Beginning Farmer(s) under the Guarantee and are not general obligations of the State of South Dakota or any political subdivision or agency thereof, including the Value Added Finance Authority, within the meaning of any constitutional or statutory limitation and do not constitute or give rise to a pecuniary liability of the State of South Dakota or any political subdivision or agency thereof, including the Value Added Finance Authority, or a charge against their general credit or general funds.
3. **Payments Under the Sales Contract** - The Beginning Farmer's payment obligations and rights and obligations to prepay principal and interest under the sales contract shall be determined by the Beginning Farmer and Bond Purchaser and included in the sales contract.
4. **Closing Documents** - The Authority will have no responsibility with respect to the preparation, execution, or filing of any declaration of value statements, groundwater hazard statements, or any other forms or documents as may be required to finalize the transaction.

SECTION IX

LOAN CLOSING PROCEDURES

After the Application receives board approval, the following steps are needed to complete the loan closing process:

1. **Preparation of Legal Notice** - The Authority is required by federal law to publish a legal notice listing each project for which a bond will be issued. This requires consultation with the lender of each project to obtain approval for publication of the project listing the amount of the bond, name of applicant, description of project being financed, and exact location of the project, including road identification.
2. **Receive Loan Data Sheet and Paperwork Regarding each Loan** - The Loan/Contract Data Sheet and attachments, as well as appraisals, valuations, and other documents are needed to complete the loan process. Beginning Farmers and Bond Purchasers need to allow a minimum of six weeks from the time this information is received in the Authority's office to finalize the loan and issue the bond.
3. **Preparation of Bond Documents** - A double set of bond documents must be prepared for each loan. These documents will need signatures by the Bond Purchaser and Beginning Farmer at the loan closing.
4. **Bond Summary** - This report is needed for each board meeting so applications/projects can be given final board approval in order that bonds can be issued and loans can be closed. This detailed summary includes all the vital information on each loan, including applicant's name and address, bank name and address, previous approval and publication dates, identification of the project plans, exact location of the project, specific loan terms, and length of loan. This information is obtained from the Loan/Contract Data Sheet submitted.
5. **Request for Governor's Approval** - The Governor needs to approve the issuance of these Private Activity Bonds before they can be issued. These papers then become part of the loan closing documents.
6. **Prepare for Loan Closing** - When final loan documents are returned from the bond attorney's office, the Bond Purchaser or other appropriate individuals are contacted regarding the loan closing date.
7. **Prepare Final Closing Documents** - When the closing date is known, the double set of bond documents and closing papers are dated and finalized. If a contract sale is being done, preparation of a Quit Claim Deed and finalizing of the Sales Contract are also needed. The documents are then sent promptly so the documents are received prior to the closing date.
8. **Verify Returned Closing Documents are Complete** - After loan closing, certain documents need to be returned to the Authority's office. Each packet of materials is reviewed when returned to verify all signatures were obtained and bank seals are affixed where needed.

SECTION X

TAX EXEMPTION OF AUTHORITY BONDS

1. **General Federal Tax Exemption of Bonds** - Under federal tax law an Authority bond is classified as a Qualified Small Issue Bond. Therefore, if all the provisions of the state and federal law continue to be complied with by the Beginning Farmer and Bond Purchaser, the interest on an Authority bond will not be included in the Bond Purchaser's gross income for federal income tax purposes.
2. **Federal Alternative Minimum Tax** - Notwithstanding the preceding paragraph, interest on Authority bonds, which is otherwise tax-exempt, shall be directly includable in the calculation of a bondholder's "alternative minimum taxable income" under Section 57(a)(5) of the *Internal Revenue Code* of 1986.

3. **Deduction for Interest Incurred to Carry Tax-Exempt Bonds** - The Authority bonds are not “qualified tax-exempt obligations” within the meaning of Section 265(c)(3) of the *Internal Revenue Code* of 1986. Accordingly, financial institutions will not be allowed any deduction for that portion of the financial institution’s interest expense which is allocable by law to the purchasing or carrying of the Authority’s bond.

For purposes of the alternative minimum tax, the deduction for *interest expense*, which is allocated to purchasing or carrying tax-exempt obligations and which is otherwise disallowed, shall be used to reduce the amount of tax-exempt interest included pursuant to Section 57(a)(5) in the calculation of alternative minimum taxable income.

NOTE: The effects of the taxes and deductions discussed above will vary from Bond Purchaser(s) to Bond Purchaser(s) and, as to a given Bond Purchaser, from year to year. Bond Purchaser(s) should consult their regular tax consultants as to the specific effects of these provisions in the Bond Purchaser’s tax consequences. The discussion in points (1) and (3) above is for the information and convenience of the Bond Purchaser(s). In no event shall the Authority or its counsel be deemed to have rendered any advice or opinion as to the application of any of the provisions discussed above in a given transaction or to a given Bond Purchaser.

SECTION XI

MAKING CHANGES AFTER THE BOND IS ISSUED

1. **Modifying Interest Rates and Terms** - Interest rates and terms on previously closed loans can be changed or modified. A fee of \$100 will be charged for any change to the Bond. The Authority board must approve these changes at a monthly board meeting on a form provided by the Authority and issue a resolution reflecting the board action. The following information is needed by the Authority before modifications can be made:
- a. Project number and borrower(s) name(s).
 - b. Principal balance remaining on the loan.
 - c. New terms - interest rate, payment schedule, etc.
 - d. Effective date of changes.
 - e. The base index rate (not tax-exempt rate) the bank will be using at the time the change will be made.
 - f. The original maturity date of the loan cannot be extended unless a full refunding of the bond takes place. In the case of full refunding, a new bond is written, the old bond is paid off with the proceeds of the new bond, and new terms including maturity date become effective.
 - g. There is a charge for a full refunding but not for a rate change or change of payment dates in which the maturity date is not extended.
2. **Assumption of Loans/Sales Contracts -- Substitution of Collateral & Transfer of Property** -- Loans or sales contracts may not be assumed without the prior approval of the Authority, and then only if the new purchaser of the property will qualify as a First-Time Farmer. Equipment and other depreciable property may be exchanged or traded on similar property, and other property such as breeding livestock may be added or substituted as collateral at the discretion of the Bond Purchaser without the prior approval of the Authority. The benefits of the Authority bond must remain with a qualified First-Time Farmer, and no person to whom property is traded or otherwise transferred may obtain the benefits of the bond.
3. **Disposition of Bonds That Have Been Paid Off** -- When a bond matures and the loan is paid off, the following information is needed:
- a. The original bond issued by the Authority to fund the loan (on green check paper) needs to be returned to the Authority marked “paid” and the date it was paid off. A copy of the bond marked “paid” should be given to the Beginning Farmer.
 - b. If it is a bank loan, a copy of the Promissory Note marked “paid” and date paid should be sent to the Authority with the original given to the Beginning Farmer.
 - c. Bond Purchasers should make copies of these documents for file if they wish to retain them for a record.
 - d. Other than the bond, the Authority does not want the bond documents returned that were issued for the loan. The Bond Purchaser should retain these for record purposes.

SECTION XII

RIGHT TO AUDIT

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

SECTION XIII

DEFINITIONS

The definitions used in the Program are important to Bond Purchasers and Beginning Farmers contemplating using the Program.

“Agricultural Improvements” - Any improvements, buildings, structures or fixtures suitable for use in farming which are located on Agricultural Land. Agricultural Improvements as defined in chapter 12:21:01:01 of the Administrative Rules of South Dakota include a single family dwelling located on Agricultural Land which is or will be occupied by the Beginning Farmer and structures attached to or incidental to the use of the dwelling.

Note: The ability to finance a personal residence with the Program is severely limited due to federal regulations governing the use of the Authority's bonds; therefore, except in certain circumstances (e.g., when the value of the residence is clearly less than 5% of the amount of the loan or the amount of contract financed), it will be necessary to finance the personal residence separately.

“Agricultural Land” - Land suitable for use in farming and which is or will be operated as a farm.

“Application” - A completed instrument on a form approved by the Authority. Each Application must include the following: Beginning Farmer's name, address, financial data, description of anticipated use of loan proceeds, amount of loan or contract sale to be financed, down payment amount (if any), statement of Beginning Farmer's net worth determined in accordance with Authority rules, a summary of proposed loan or contract terms and certifications of the Beginning Farmer and Bond Purchaser. Each Application must be accompanied by the Beginning Farmer's financial statement (taken within 60 days of Application submission).

“Beginning Farmer” - An individual with a low or moderate net worth who engages in farming or ranching or wishes to engage in farming or ranching.

“Bond Purchaser” - Any individual, lender, corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, or any other legal entity that obtains an Authority bond under the Program in connection with a contract sale or loan to a Beginning Farmer.

“Depreciable Agricultural Property” - means 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 1986.

“Farm” - means a farming enterprise which is recognized in the community as a farm rather than a rural residence.

“Farming” - means the cultivation of land for the production of agricultural crops, the raising of poultry, the production of eggs, the production of milk, the production of fruit and other horticultural crops, grazing, the production of livestock, aquaculture, hydroponics, the production of forest products, or other activities designated by the Authority's rules.

* **“First-Time Farmer”** - A person who has never had any direct or indirect ownership interest in “Substantial Farmland” in the operation of which he or she has materially participated. An ownership interest or material participation by a person's spouse or minor child will be attributed to the person as well.

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

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

* **“Indirect Land Ownership”** - If a person holds a minimal interest in a family farm corporation, a limited partnership, a trust, or any other type of entity which in turn owns farmland in an amount which is greater than 30 percent of the median size of a farm in the county and the person materially participates in the operation of such farmland, then the person will not qualify as a First-Time Farmer.

“Low or Moderate Net Worth” - an aggregate net worth of the individual and the individual's spouse and minor children of less than four hundred thousand dollars (\$400,000);

“Net Worth” - Total assets minus total liabilities as determined in accordance with generally accepted accounting principals with appropriate exceptions and exemptions reasonably related to an equitable determination of the Beginning Farmer's net worth. Assets shall be valued at fair market value.

* **“Related Persons”** - according to the IRS, includes grandfather, grandmother, father, mother, brother or sister (whether whole or half blood), child, grandchild or spouse. (see page 5)

* **“Substantial Farmland”** - Any parcel of land is Substantial Farmland unless the parcel is smaller than 30 percent of the median size of a farm in the county where the parcel is located.

“Total Assets” -- as defined by Authority Rule 12:21:01:02 “Total assets shall include, but not be limited to, the following: cash crops or feed on hand; livestock held for sale; breeding stock; marketable bonds and securities; securities (not readily marketable); accounts receivable; notes receivable; cash invested in growing crops; net cash value of life insurance; machinery and equipment; cars and trucks; farm and other real estate including life estates and personal residence; value of a beneficial interest in a trust; government payments or grants; and other assets.”

Authority Rule 12:21:01:02 states the following:

- a) Total assets shall not include items used for personal, family or household purposes by the applicant, but in no event shall such property be excluded to the extent a deduction for depreciation is allowable for Federal income tax purposes. All assets shall be valued at fair market value by the participating lender. Such value

shall be what a willing buyer would pay a willing seller in the locality. A deduction of ten percent may be made from fair market value of farm and other real estate.

"Total Liabilities" - are defined by Authority Rule 12:21:01:02: "Total liabilities shall include, but not be limited to, the following: Accounts payable, notes or other indebtedness owed to any source, taxes, rent, amount owed on a real estate contract or real estate mortgages, judgments, accrued interest payable, any other liabilities." Authority Rule 12:21:01:02 states the following:

- a) Liabilities shall be determined on the basis of generally accepted accounting principles.

*** = These are Federal tax law definitions.**

CONCLUDING NOTE: The Authority recognizes some of the provisions in this Program Summary may be confusing to the Beginning Farmer or Lender. The Authority will provide any assistance it can in answering questions or completing documents. Beginning Farmer and Lenders are encouraged to visit with the Authority staff early in the application process to make the entire transaction as simple as possible. The Authority's telephone number is (605) 773-5436.

Revised: January 2013