

May 19, 2020

The Honorable Robert Olson
Statehouse, Room 236-E
Topeka, Kansas 66612

Dear Senator Olson:

SUBJECT: Fiscal Note for HB 2619, as Amended

In accordance with your request, the following fiscal note concerning HB 2619, as amended, is respectfully submitted.

HB 2619, as substituted by the Senate Committee on Financial Institutions and Insurance, would allow national banking associations, state banks, trust companies, and savings and loan associations to deduct the interest income received from qualified agricultural real estate loans and single-family residence loans attributed to Kansas from net income, if the interest is included in the Kansas taxable income of a corporation. The bill includes specific definitions for interest, qualified agricultural real estate, single family residence, net interest income received from qualified agricultural real estate loans attributed to Kansas, and net interest income received from single family residence loans attributed to Kansas. The new tax deduction would go into effect beginning in tax year 2022.

The bill would create the Kansas Economic Recovery Loan Deposit Program that would be administered by the State Treasurer. The program would provide an incentive for banks, credit unions, and farm credit institutions to make commercial or agricultural loans. The State Treasurer would direct the Pooled Money Investment Board (PMIB) to deposit up to \$60.0 million in idle funds at eligible lending institutions that would earn the state interest that is 2.0 percent below the market rate with a minimum interest rate of 0.25 percent. The interest rate on the deposit would be recalculated on the first business day of January of each year. Eligible lenders would then make commercial or agricultural loans with an interest rate that cannot be greater than 3.0 percent above the interest rate earned on the state's deposit of funds. Each eligible borrower would be able to receive a business loan of up to \$250,000. The interest rate on the loan would also be recalculated on the first business day of January of each year and the term of the loan cannot exceed ten years. The eligible lender would be required to apply all usual lending standards to determine the credit worthiness of eligible borrowers. Eligible borrowers would be required to certify on the economic recovery loan application that the reduced rate loan will be used exclusively for the expenses involved in operating their business. Prior to completing the loan request, the State Treasurer would evaluate each economic recovery loan to determine if they qualify for this new program. If

sufficient funds are not available for this program, then the applications would be considered in the order received when funds are once again available. The State of Kansas and the State Treasurer would not be liable to any eligible lending institution in any manner for payment of the principal or interest on any economic recovery loan. All eligible lenders would be required to execute a security agreement with the PMIB to ensure that the state deposits are collateralized.

The State Treasurer would be required to adopt rules and regulations on the Kansas Economic Recovery Loan Deposit Program no later than February 1, 2021. The State Treasurer would be required to submit an annual report to the Governor and the Legislature identifying the eligible lending institutions that are participating in the program and the eligible borrowers who have received an economic recovery loan. The annual report would provide the aggregate amount of moneys loaned and the amount of moneys still available for loan, if any. The report would be due on or before January 1, 2022, and each January 1 thereafter.

Under current law, credit union field memberships are limited to a geographical population of 500,000 in non-metropolitan statistical areas and 1.0 million in metropolitan statistical areas within Kansas. The bill would increase geographical population from 500,000 to up to 2.5 million without any restrictions based on non-metropolitan statistical areas or metropolitan statistical areas. The bill would also eliminate several criteria that impact the calculation of population within a geographical area.

The Department of Revenue estimates that HB 2619, as substituted by the Senate Committee on Financial Institutions and Insurance, would decrease State General Fund revenues by \$2.0 million in FY 2022, \$3.9 million in FY 2023, and \$3.9 million in FY 2024.

To formulate estimates specific to the income tax deduction, the Department of Revenue reviewed data on state-chartered banks from the Kansas Bankers Association. Data indicates that there are 223 state-chartered banks in Kansas and 16.4 percent of total interest income for banks is attributed to interest income from agricultural loans (farmland/real estate loans and agricultural operating loans). Data also indicates that 53.4 percent of total agricultural loans is attributed to real estate loans. Under current law, the state is estimated to receive approximately \$44.0 million in financial institutions privilege taxes in FY 2022. Applying these ratios, the bill would reduce financial institutions privilege taxes by approximately \$3.9 million each year. The financial institutions privilege tax estimate for FY 2022 includes the first half of tax year 2022 tax liability. For FY 2023, the estimate includes the last half of tax year 2022 tax liability and the first half of tax year 2023 tax liability. Any fiscal effect regarding interest income from single family residence loans in rural areas is not accounted for in the fiscal effect of this bill because the Department does not have data on this specific income source.

The Department indicates that the bill would require \$48,078 from the State General Fund in FY 2022 to implement the bill and to modify the automated tax system. The required programming for this bill by itself would be performed by existing staff of the Department of Revenue. In addition, if the combined effect of implementing this bill and other enacted legislation exceeds the Department's programming resources, or if the time for implementing the changes is too short, additional expenditures for outside contract programmer services beyond the Department's current budget may be required.

The bill would require the State Treasurer to administer the new Kansas Economic Recovery Loan Deposit Program and indicates that the same processes and procedures that are currently in place for the existing Agricultural Production Loan Deposit Program would be used to administer this new program. The State Treasurer indicates that this new program would provide low cost loans to Kansas businesses that will aid in the recovery from the economic effects of the novel coronavirus disease outbreak (COVID-19). The security of idle fund balances deposited at eligible lending institutions would be maintained by requiring that the lending institution underwrite the business loans and requiring that the state deposits are collateralized to offset any default risk. In addition, the State of Kansas and the State Treasurer would not be liable if any borrower defaults on an economic recovery loan. The State Treasurer indicates that the costs to create forms and instructions, update its internal software program, and process paperwork would be negligible and could be absorbed within existing resources and staff levels.

The bill would require the PMIB, at the direction of the State Treasurer, to make deposits of up to \$60.0 million of idle funds at eligible lending institutions to fund the Kansas Economic Recovery Loan Deposit Program. The PMIB is authorized to make investments in U.S. Treasury and federal agency securities, highly rated commercial paper and corporate bonds, and repurchase agreements and certificates of deposit at Kansas banks. Declining balances have required the PMIB to maintain a highly liquid portfolio, which reduces the amount of return available to the pool. The PMIB maintains a significant portion of its investments in overnight repurchasing agreements. Rates that the PMIB could earn in that market fell to near zero after the recent actions from the Federal Reserve (and are likely to stay low for the foreseeable future according to the April 2020 Consensus Revenue Estimate Memo). Recalculating the rate on the state's deposits one time each year has the potential to lock in a lower or higher interest rate that can be earned in the market; however, without knowing the timing of future interest rate changes, it is not possible to estimate the bill impact on interest earnings from requiring the deposit of up to \$60.0 million of idle funds at eligible lending institutions compared to other investments that the PMIB might make. The PMIB and the State Treasurer indicate that sufficient idle fund cash balances exist to fully fund this new program. The PMIB indicates that the costs to administer the deposit of idle funds at eligible lending institutions would be negligible and could be absorbed within existing resources and staff levels.

The Office of the State Bank Commissioner and the Department of Credit Unions both state that passage of the bill would not have a fiscal effect on agency operating expenditures. Any fiscal effect associated with HB 2619, as substituted by the Senate Committee on Financial Institutions and Insurance, is not reflected in *The FY 2021 Governor's Budget Report*

Sincerely,

A handwritten signature in black ink, appearing to read "L. Campbell", written in a cursive style.

Larry L. Campbell
Director of the Budget