

SESSION OF 2021

SUPPLEMENTAL NOTE ON SENATE BILL NO. 15

As Amended by Senate Committee on Financial
Institutions

Brief*

SB 15, as amended, would enact law to establish the Kansas Economic Recovery Loan Deposit Program (Program); would amend law governing linked deposit programs and related investment procedures; would amend field-of-membership requirements placed on state-chartered credit unions to increase the permissible geographic area for a credit union's field of membership; and would permit national banking associations, state banks, trust companies, and savings and loan associations, for all taxable years commencing after December 31, 2022, to deduct from net income the net interest income received from qualified agricultural real estate loans and the net interest income received from single family residence loans to the extent such interest is included in the Kansas taxable income of a corporation.

The bill would also make technical changes.

Kansas Economic Recovery Loan Deposit Program (New Sections 1-7; Section 9)

Program Citation; Definitions (New Sections 1-2)

The bill would designate sections 1 through 7 of the bill as the Kansas Economic Recovery Loan Deposit Program and would further provide the Program shall be part of and

*Supplemental notes are prepared by the Legislative Research Department and do not express legislative intent. The supplemental note and fiscal note for this bill may be accessed on the Internet at <http://www.kslegislature.org>

supplemental to Article 42, Chapter 75 of the *Kansas Statutes Annotated*.

Definitions (New Section 2)

The bill would define terms including the following:

- “Economic recovery loan deposit” would mean an investment account placed by the Director of Investments under the provisions of Article 42, Chapter 75 of the *Kansas Statutes Annotated* with an eligible lending institution for the purpose of carrying out the intent of the Program;
- “Economic recovery loan deposit loan” or “loan” would mean a loan made by an eligible lending institution to an eligible borrower from the eligible lending institution’s economic recovery loan deposit as part of the Program;
- “Economic recovery loan deposit program” or “program” would mean a state-administered program in which eligible lenders are charged less than the market rate of interest and eligible borrowers receive a reduction in interest charged on a loan in the amount of the deposit;
- “Eligible borrower” would mean any individual or entity operating a business primarily for commercial or agricultural purposes with no more than 100 full-time employees maintaining offices or operating facilities and transacting business in the state of Kansas and is not an individual obtaining a loan primarily for personal, family, or household purposes; and
- “Eligible lending institution” would mean a financial institution that is:

- A bank, as defined in KSA 75-4201, that agrees to participate in the Program and is eligible to be a depository of state funds;
- A credit union, as defined in the State Credit Union Code, that agrees to participate in the Program and provides securities acceptable to the Pooled Money Investment Board (PMIB) pursuant to Article 42, Chapter 75 of the *Kansas Statutes Annotated*; or
- An institution of the Farm Credit System organized under the federal Farm Credit Act of 1971, as amended, having at least one branch in the state of Kansas that agrees to participate in the Program and provides securities acceptable to the PMIB pursuant to Article 42, Chapter 75.

The bill would also define the terms “director of investments” and “economic recovery loan deposit loan package.”

Program Administration and Purpose (New Section 3)

The bill would authorize the State Treasurer to administer the Program and states the Program shall be for the purpose of providing incentives for the making of business loans. The bill would further specify the total aggregate amount of loans made under the Program must not exceed \$60.0 million of unencumbered funds pursuant to Article 42 of Chapter 75 of the *Kansas Statutes Annotated*.

Rules and Regulations

The bill would require the State Treasurer to adopt all rules and regulations necessary to enact and administer the provisions of the Program. Such rules and regulations must be adopted no later than February 1, 2022.

Annual Report; Legislative Review

The bill would require the State Treasurer to submit an annual report to the Legislature and the Governor identifying the eligible lending institutions participating in the Program and the eligible borrowers who have received an economic recovery loan deposit loan. The bill also would require the annual report to 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, 2023, and each January 1 thereafter. The bill would require the Legislature perform a review of the Program as part of the State Treasurer's annual report on or after January 1, 2024.

Program Loan Package Requirements and Loan Information (New Section 4)

The bill would authorize the State Treasurer to disseminate information and to provide economic recovery loan deposit loan packages (loan packages) to the eligible lending institutions.

Eligible Borrowers, Applications, Loan Limitations

The bill would provide the following requirements and other criteria for participation in the Program:

- The loan package must be completed by the eligible borrower before being forwarded to the lending institution for consideration;
- An eligible lending institution that agrees to receive an economic recovery loan deposit must accept and review applications for loans from eligible borrowers;
- The lending institution must apply all usual lending standards to determine the credit worthiness of eligible borrowers;

- No single economic recovery loan deposit loan can exceed \$250,000;
- Only one economic recovery loan deposit loan can be made and be outstanding at any one time to any eligible borrower; and
- No loan may be amortized for a period of more than ten years.

Certification and Loan Approval

The bill would require an eligible borrower to certify on the loan application that the reduced rate loan will be used exclusively for the expenses involved in operating the borrower's business in Kansas. The eligible lending institution would be permitted to approve or reject a loan package based on the institution's evaluation of the eligible borrowers included in the package, the amount of the individual loan in the package, and other appropriate considerations. The eligible lending institution would be required to forward to the State Treasurer an approved loan package in the prescribed form and manner. The bill would require the package to include a certification by the applicant that such applicant is an eligible borrower.

Evaluation of the Economic Recovery Loan Deposit Loan Package; Interest and Market Rates; Loan Agreement (New Section 5)

The bill would permit the State Treasurer to either accept or reject the loan package based on the State Treasurer's evaluation of whether the loan meets the Program requirements. The bill would further provide, if sufficient funds are not available for a loan deposit, then the applications may be considered in the order received when funds are once again available, subject to a review by the lending institution.

Upon acceptance of a loan package, the State Treasurer would be required to certify to the Director of Investments (Director) the required amount for the package and the Director would be required to place an economic recovery loan deposit in the amount certified with the eligible lending institution at an interest rate that is 2.0 percent below the market rate provided in KSA 75-4237 (a floating rate). The bill would require such rate to be recalculated on the first business day of January each year using the market rate then in effect. The bill would further specify the minimum interest rate (or floor) would be 0.25 percent if the market rate is below 2.25 percent. When necessary, the bill would permit the State Treasurer to request the Director place an economic recovery loan deposit with the eligible lending institution prior to acceptance of a loan package.

An eligible lending institution would be required to enter into an economic recovery loan deposit agreement with the State Treasurer. Such agreement would include requirements necessary to implement the purposes of the Program. The bill would specify requirements must include an agreement by the eligible lending institution to lend an amount equal to the loan deposit to eligible borrowers at an interest rate that is not more than 3.0 percent greater than the interest rate made available to the lending institution (effectively capping the interest rate spread at 3.0 percent). The borrower's rate must be recalculated on an annual basis. The bill would provide the loan agreement would also include provisions for the loan deposit to be placed for a time not to exceed a period of ten years and that is considered appropriate in coordination with the underlying loan. The bill also would require the agreement to include provisions for the reduction of the loan deposit in an amount equal to any payment of loan principal by the eligible borrower.

Funding of the Loan by the Lending Institution (New Section 6)

The bill would require, upon placement of a loan deposit with an eligible lending institution, the institution to fund the loan to each approved eligible borrower listed in the loan package in accordance with the agreement between the institution and the State Treasurer. The bill would require the loan to be at the rate established in the agreement and established pursuant to requirements of this bill.

Liability for Default or Delay in Payments (New Section 7)

The bill would state the State and the State Treasurer shall not be liable to any eligible lending institution in any manner for payment of the principal or interest on any economic recovery loan deposit loan to an eligible borrower. The bill would also state any delay in payments or default on the part of the eligible borrower does not in any manner affect the economic recovery loan deposit agreement between the eligible lending institution and the State Treasurer.

Amendments to Linked Deposit Loan Program Law (Section 9)

The bill would amend law governing the investment of state moneys, which also includes previously authorized linked deposit programs, to add those loan deposits made under the Program and applicable interest rates established by the bill.

Field of Membership—Credit Unions (Section 8)

The bill would amend one of three criteria (occupation, association, and geographic area) associated with defining field of membership for state-chartered credit unions in the State Credit Union Code (Code). Continuing law requires

credit union members to be linked by one of three fields of membership.

Under current law, a geographic area is permitted to include a single political jurisdiction or multiple contiguous political jurisdictions, until the aggregate total of the population of the geographic area reaches 500,000. The law further provides, however, if the headquarters of the credit union is located within a metropolitan statistical area (MSA) of more than one county, a different maximum population limit would apply. That limit is determined by a formula:

- Multiply the population of the most populous MSA within Kansas (*i.e.*, the population of the Kansas City MSA counties within Kansas) by the fraction having 1.0 million as the numerator and 750,000 as the denominator. [*Note:* Current population numbers are those of the adjusted federal census information presented to the Legislature by the Secretary of State.]

The bill would permit a single political jurisdiction (continuing law) but would modify other criteria to:

- Increase the permitted maximum for multiple contiguous political jurisdictions for an aggregate of the total population from 500,000 to 2.5 million, as determined by official state population figures, or any portion thereof, which are identical to the decennial census data from the enumeration conducted by the U.S. Census Bureau (language attributable to the Census data is located in the definition of “population data” in the current field of membership requirements); and
- Remove language that separately applied to credit unions with headquarters located within an MSA of more than one county (allowed for a different maximum population limit).

The bill would also modify a requirement that provides, from and after July 1, 2008, no geographic area shall consist of any congressional district or the entire state of Kansas to instead state no geographic area shall consist of the entire state of Kansas.

The bill would remove definitions within the Code for “MSA,” “population data,” and “overt act.” Some of the requirements within the definitions had been specific to operations of credit unions, including branch locations, construction of new buildings, and membership of occupation or association groups on or before either February 1, 2008, or June 30, 2008.

***Kansas Financial Institutions Privilege Tax—Definitions
(Section 10)***

The bill would permit a deduction from net income, beginning in tax year 2023, for financial institutions subject to the Kansas Financial Institutions Privilege Tax (privilege tax) equal to the net interest income received from qualified agricultural real estate and single family residence loans attributable to Kansas to the extent such interest is included in the Kansas taxable income. The bill would create definitions for the terms “interest,” “qualified agricultural real estate,” and “single family residence” and would also create a calculation methodology for “net interest income received from qualified agricultural real estate loans” and for “net interest income from single family residence loans” as follows:

- “Interest” would mean interest on indebtedness attributed to Kansas and incurred in the ordinary course of the active conduct of any business and interest on indebtedness incurred that is secured by a single family residence;
- “Qualified agricultural real estate loans” would mean loans made on real property that is

substantially used for the production of one of more agricultural products and that:

- Have maturities of not less than 5 years and not more than 40 years;
 - Are secured by a first lien interest in real estate, except that the loans may be secured by a second lien interest if the institution also holds the first lien on the property; and
 - Have an outstanding loan balance when made that is less than 85 percent of the appraised value of the real estate, except that a loan for which private mortgage insurance is obtained may exceed 85 percent of the appraised value of the real estate to the extent the loan amount in excess of 85 percent is covered by such insurance;
- “Net interest income received from qualified agricultural real estate loans attributed to Kansas” would mean the product of the ratio of the interest income earned on qualified agricultural real estate loans over total interest income earned, in relation to the net income of the national banking association, state bank, trust company, or savings and loan association without regard to this deduction;
 - “Net interest income received from single family residence loans attributed to Kansas” would mean the product of the ratio of the interest income earned on single family residence loans over total interest income earned, in relation to the net income of the national banking association, state bank, trust company, or savings and loan association without regard to this deduction; and
 - “Single family residence” would mean a residence that is:
 - The principal residence of its occupant;

- Located in Kansas, in a rural area as defined by the U.S. Department of Agriculture that is not within an MSA and has a population of 2,500 or less as determined by the most recent census for which data is available; and
- Purchased or improved with the proceeds of the loan.

Background

The bill was introduced by the Senate Committee on Financial Institutions at the request of Senator Longbine.

[*Note:* As introduced, SB 15 is identical, absent technical updates to dates and references, to 2020 Senate Sub. for HB 2619. A companion bill, HB 2069, has been introduced in the House Committee on Financial Institutions and Rural Development.]

Senate Committee on Financial Institutions

In the Senate Committee hearing, **proponents** included representatives of the Kansas Bankers Association (KBA) and the Kansas Restaurant & Hospitality Association, officials from the Bank of Tescott and Heartland Tri-State Bank, and an agricultural producer. Written-only **proponent** testimony was provided by representatives of The Belmont, the Kansas Association of Realtors, Kansas Chamber, Kansas Livestock Association, NFIB-Kansas, and Renew Kansas Biofuels Association. Proponents generally addressed the need for longer-term solutions to address the economic impact caused by COVID-19 and the availability of low-cost credit to Kansas businesses. Low-cost credit would be provided through the Program and through a targeted tax exemption that is intended to lower interest rates for agricultural real estate loans and to create an incentive for rural housing development in communities with populations of 2,500 or less.

Neutral testimony was provided by the State Treasurer and representatives of the Farm Credit Associations of Kansas (Farm Credit) and the Heartland Credit Union Association (HCUA). The State Treasurer highlighted existing linked deposit programs administered by the Office of the Treasurer, indicating the new Program would provide another avenue of assistance. The State Treasurer suggested amendments to the bill to address a residency requirement, alignment of Program requirements for Farm Credit institutions, additional definition to eligible businesses, and a sunset for the Program. The Farm Credit representative stated concerns regarding the privilege tax deduction in the bill and suggested an amendment to better align the privilege tax exemption with provisions in the federal Farm Credit Act (“qualified agricultural real estate loans”). The HCUA representative stated support for both the Program and modifications to the field-of-membership requirements and concern for the taxation provisions contained in the bill.

A representative of the Kansas Cooperative Council (KCC) provided **opponent** testimony in the Senate Committee hearing. Written-only opponent testimony was provided by representatives of Pride Ag Resources and Skyland Co-op, Inc. The opponents stated concern with the taxation provisions in the bill, which would set a new precedent in Kansas tax policy by providing for-profit companies access to the same benefits as cooperatives without requiring those entities to adhere to the same standards as not-for-profit entities. According to the KCC conferee, the bill would not provide assurance that the exemption would be passed directly to borrowers in the manner cooperatives currently provide (e.g., cash patronage, equity, lower interest rates, or a combination of benefits).

The Senate Committee amended the bill to:

- Modify the definition of “eligible borrower” to limit the eligible businesses to those with no more than 100 full-time employees transacting business in Kansas and require certification on an eligible

borrower's loan application that the loan will be used exclusively for expenses involved in operating the business in Kansas;

- Specify eligible Farm Credit System institutions, as "eligible lending institutions," must have at least one branch in Kansas;
- Provide, in addition to the required annual reporting requirements, the Legislature must perform a review of the Program as part of the annual report on and after January 1, 2024;
- Remove a requirement governing the economic recovery loan deposit agreement requiring the deposit to be placed for annually renewable one-year maturity up to ten years to instead specify to be placed for a period of time not to exceed ten years and that is considered appropriate with the underlying loan [this amendment and the three previously described amendments were requested by the State Treasurer]; and
- Update the term and references in the privilege tax deduction from "qualified agricultural real estate" to "qualified agricultural real estate loan" and provide criteria for these loans [requested by Farm Credit]

Fiscal Information

The fiscal note prepared by the Division of the Budget provides estimates for provisions of the bill, as introduced, as follows.

Privilege Tax

The Department of Revenue (Department) estimates the bill would decrease State General Fund revenues by \$2.0 million in FY 2023, \$3.9 million in FY 2024, and \$3.9 million in FY 2025.

To formulate estimates specific to the income tax deduction, the Department reviewed data on state-chartered banks from the KBA. Data indicates 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 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 2023. 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 2023 includes the first half of tax year 2023 tax liability. For FY 2024, the estimate includes the last half of tax year 2023 tax liability and the first half of tax year 2024 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 the bill would require \$48,078 from the State General Fund in FY 2023 to implement the bill and to modify the automated tax system. The required programming for this bill by itself would be performed by existing Department staff. 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.

Linked Deposit Program

The bill would require the State Treasurer to administer the new Kansas Economic Recovery Loan Deposit Program and indicates the same processes and procedures in place for the existing Agricultural Production Loan Deposit Program would be used to administer this new program. The security of idle fund balances deposited at eligible lending institutions would be maintained by requiring the lending institution to underwrite the business loans and requiring the State deposits to be collateralized to offset any default risk. The State Treasurer indicates the bill would require \$53,000 from the State Treasurer Operating Fund in FY 2022 to hire 1.00 new FTE position to manage this new program.

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 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. The fiscal note continues, rates that the PMIB could earn in that market fell to near zero after actions from the Federal Reserve in 2020 (and are likely to stay low for the foreseeable future according to the November 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's 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 sufficient idle fund cash balances would fund this new program; however, future balances that would be used to

support this program over the course of the next ten years are unknown. The PMIB indicates 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.

Financial Institutions (Regulatory Agencies)

The Office of the State Bank Commissioner and the Department of Credit Unions both state enactment of the bill would not have a fiscal effect on agency operating expenditures.

Any fiscal effect associated with the bill is not reflected in *The FY 2022 Governor's Budget Report*.

Financial Institutions; taxation; economic recovery; linked deposit program; field of membership; privilege tax