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M|J|B Banking Law Today

IT'S NOT EASY BEING GREEN

A Discussion of the Collateral Challenges Associated with Financing an Industrial Hemp Operation

With the redefintion of industrial hemp as an agricultural commodity in the 2018 Farm Bill and the slow but steady progress of companion legislation such as the SAFE Banking Act, it appears very likely that the regulatory challenges associated with financing industrial hemp operations will be eliminated – or at least greatly ameliorated – by the 2020 growing season.

That said, the biggest challenges associated with financing a hemp operation will not come from the regulators; they will come from the practical difficulties that arise in dealing with the unique, fragile and potentially problematic collateral associated with such an operation. This article provides a discussion of some of these challenges.

Challenge 1 – CNS Financing Statements Do Not Yet Apply to Industrial Hemp.

As it is currently written, the Minnesota CNS-1 Financing Statement Form does not list hemp as an agricultural commodity. The corresponding statutory provision that gives rise to the CNS Financing Statement also does not list industrial hemp as an applicable agricultural commodity. As such, there is currently no surefire way for a bank to ensure that its security interest in hemp can continue after a sale to a commodity buyer.

While banks could try to argue that the "all crops" category in the CNS Financing Statement should cover hemp, there is absolutely no guarantee that a court would uphold the form as it applies to hemp.

Without a CNS Financing Statement in place, the bank would have no recourse against the commodity buyer if the borrower sells the hemp and fails to remit the proceeds to the bank.

Given the above, a best practice may be to send direct written notice of the security interest to all potential buyers – but even that is no guaranty that the bank's lien on the hemp would continue after its sale.

Challenge 2 – The Entire Crop Will Need to Be Burned if the THC Content Exceeds .3%.

While industrial hemp is legal if the THC content is less than .3%, it is illegal and must be burned if the THC content exceeds that amount. Such a scenario would be massively problematic for the financing bank who has a security interest in the hemp. This would cause both a major loss for the borrower and an evisceration of collateral value for the bank, which would likely lead to a direct monetary loss.

Unfortunately, there is no way to reduce this particular risk, other than to ensurr the bank is well secured on other safer types of collateral, such as real property.

Challenge 3 – Crop Insurance Is Not Yet Available for Industrial Hemp.

As of right now and into the forseeable future, industrial hemp is not eligible for traditional crop insurance. As such, in the event of a bad growing season or destructive storms, the value of the crop that functions as the bank's collateral would be reduced or even eliminated altogether.

This makes financing hemp production singificantly riskier than financing other agricultural commodities that are covered by crop insurance.

Challenge 4 – Finding a Repossession Agent Licensed to Handle Industrial Hemp Can be Difficult.

Currently, for a party to either grow or process industrial hemp, they must be licensed through the Minnesota Department of Agriculture. The definition of a "hemp processor" includes a person or business that handles, stores, or sells raw industrial hemp. As such, if the bank wishes to repossess industrial hemp, it must utilize the services of a repossession agent that is specially licensed through the Minnesota Department of Agriculture. Given that the vast majority of repossession companies in the state lack such a license, it may be quite a challenge to find someone who can lawfully repossess and sell the bank's industrial hemp collateral.

Conclusion

Apart from the regulatory concerns, there are a great deal of practical challenges in funding a hemp operation from a collateral perspective. Some of these issues will be mitigated over time as the legal framework continues to evolve (e.g. CNS forms are modified to include hemp as a category) and as more complimentary service providers enter the marketplace (e.g. reposession companies start obtaining hemp handler licenses). Some issues however, such as the risk that entire crops will be lost due to excessive THC content, will remain serious concerns for years to come.

Consequently, the only way to fully mitigate the risk from a collateral perspective is to make sure that there is sufficient non-comodity collateral to make the bank whole in the event that liquidation action becomes necessary.

-Matthew J. Bialick, Esq.

Upcoming Seminar through Minnesota Bankers Association

Effectively Navigating Farmer Bankruptcies
August 20, 2019

The troubled agricultural economy has already resulted in a sharp increase in bankruptcy filings, with many more projected in 2020. This seminar will examine the various chapters of bankruptcy that are likely to be filled by farmers and will provide practical insight on how bankers can successfully navigate through the different types of bankruptcy.

Registration Link:
https://www.minnbankers.com/MBA/Education/Event_Display_2.aspx?EventKey=193_3159&WebsiteKey=9116537d-c5ad-4c32-8401-68fb014de7bd

Outside Insights

A Forum for Thoughts and Articles from Sources Outside of the M|J|B Law Firm

Back to Banking Basics

An Article by Mark Warmka of Peoples State Bank of Wells

In these challenging times for the farm economy, the focus is often on regulatory precision and sophisticated analytical tools. While these points of emphasis are certainly critical (and something I carefully adhere to) it is important that we don't forget the fundamentals.

One of the dangers of being married to a teacher (and the father of one as well) is that you can pick up educational lingo. A common refrain regarding education is "getting back to the 3 R's" (reading, 'riting, 'rithmetic) I believe that 3 R's could also apply to agricultural lending.

Relationships—In the end, this business is about people. I have been involved in farming myself since my Dad died when I was in high school, so I have been on the other side of the desk often over the years. This perspective helps me remember what a producer values in a lender. It is important that you truly understand each customer and what is going on with him or her. I try to make a commitment to adding value to my loan servicing by providing educational opportunities and helpful information. Our bank visits each borrower every year on their farm. This is not just an impersonal collateral check, it is an opportunity to meet on their turf, and kick the tires of their operation. A level of trust and comfort between borrower and lender is important when conversations get more difficult. I like to tell my farmer-customers that I hope to build a mutually beneficial and multi-generational relationship between their family farm and our bank.

Realism--- You owe it to the customer and to your financial institution to be realistic when you underwrite and analyze credits. It is your obligation to understand enough about production agriculture and to be skilled enough with an analytical tool like Finpack to make accurate projections and operational analysis reports. Trying to back into a cash flow by over-optimistically tweaking the numbers is not helpful; it allows a problem to grow. The relationship component I mentioned above is essential when you are trying to game plan the upcoming year's cash flow or consider an equipment purchase. A very commonly overlooked area is in collateral evaluation. Are you considering a depreciation component to the machinery value? Are you conservative with land values? Are you tracking grain inventory disposition? Working closely with the farmer and developing a plan that can reasonably succeed is the best way to avoid legal and repayment issues down the road. The discipline of careful, realistic and mutual planning pays dividends over a career for the banker and the farmer.

Remedy---Agriculture is a variable, uncertain business. Sometimes the vagaries of weather and markets can challenge even a strong farming operation. It is then that the banker and farmer who have a strong working relationship, with a good understanding of realistic budgeting, can work on a problem-solving plan in a productive way. Not just rolling over debt continually, but rather trying to intervene while there is time to make a difference. Both parties need to remember that the goal of the farming operation is to build equity for retirement and/or legacy for the next generation. It is imperative that this is kept in mind. Taking small doses of medicine early on is a lot easier than heading to the emergency room (I am the Dad of a medical professional too). Sometimes that may mean the farmer exiting while he still has sustainable equity.

Skill at the 3 R's might just reduce the bad banking 3 R's--Regulation, 'Rite downs, & Remorse.

-Mark Warmka is a Senior Vice President of Peoples State Bank of Wells – client of the MJB Law Firm

Important Legislation Update
Family Farmer Relief Act

On August 1st the Senate passed the Family Farmer Relief Act. This legislation will raise the debt limit for a Chapter 12 family farmer bankruptcy from $4,153,150 to $10,000,000. This change allows much larger farming operations to seek the more streamlined reorganization process of a Chapter 12 bankruptcy, as opposed to the longer, more cumbersome process of a Chapter 11 bankruptcy, which was previously the only option for farmers with total debts between five and ten million dollars.

The legislation now goes on to President Trump for final approval.

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