

Agribusiness Law Update

July 2011

Commercial Lending: The “New Normal”

By Jonathan J. Siebers, Attorney

The lending market has changed a lot since the start of the Great Recession a few years ago. Those who have not had to borrow any money in that time may be a bit out of touch with respect to the “new normal” that is commercial lending today. Following are a few tips for the farmer who may need to borrow in the near future.

Tip #1

Don’t wait until the last minute.

Financial horror stories often start like this: A borrower waits until the week before his loan matures to call his banker and ask for a renewal, only to have the banker tell the borrower that the bank is no longer interested in working with him. Often, these stories involve bankers and borrowers who had a long-standing relationship in which it once took little more than a phone call for the borrower to renew his loan.

Unfortunately, things simply don’t work that way anymore. The bank may have too many loans in a particular industry, or it may be getting significant pressure from federal regulators. Whatever the reason, the simple, automatic renewals once received in the past may not be available today. As a safeguard, farmers need to start the renewal process well in advance of their existing maturity dates. Only then will the farmer have the flexibility to look around for alternative financing

if his lender is not willing to renew, or is not willing to renew on terms that are agreeable to the farmer.

Even if the lender is willing to renew, loans seem to take longer to get approved today than they did four years ago. Thus, borrowers need to make sure they leave plenty of time between submitting the renewal application and the maturity date for the existing loan, or they may run up against the maturity date (and the added interest and penalties that result from a missed maturity date).

Tip #2

Do the homework before calling the bank.

Before asking for a renewal, the borrower should try to get a sense of the bargaining power he will have with the bank. This is a three-step process. First, the borrower needs to assess how creditworthy he is. For example, has the borrower been in default during the existing loan term? Is the borrower currently in default? How are the borrower’s projections for the coming years? If the borrower has been in default, is in default today or has poor projections, the borrower may face some difficulty in renewing.

Second, the borrower needs to assess the bank. Is the bank financially unstable? Is the bank being operated or overseen by federal regulators? Is the

bank looking to move agriculture loans out of the bank? If the answer to any of these questions is “yes,” again, the borrower may face some difficulty in renewing.

Third, even if the borrower has been with the same bank for years, the borrower should spend a bit of time looking around to see what other options are available. The lending landscape has changed over the past few years with many banks closing or merging, bankers leaving the industry for other pursuits, and banks and bankers that specialize in certain types of loans. Thus, the wise borrower will see what is available even if the borrower believes he will stay with his current bank.

Tip #3

Anticipate the changed lending climate.

Just a few years ago, even moderately creditworthy borrowers had many options for financing, which resulted in competition among banks and deals for borrowers. That generally is not the case today. What does this mean? It means that borrowers have less bargaining power than they once had. This in turn means that banks are not willing to negotiate many aspects of a financial transaction that they once had no choice but to negotiate.

Further, banks have become very cautious and are demanding collateral levels and guarantees for loans that previously had less collateral and no guarantees. In the past three years, only a very small minority of loans did not require a personal guaranty from the principals of the borrower.

Conclusion

In short, borrowers who have not been to the bank recently may be in for a surprise next time they need to borrow. The smart borrower will begin the loan application process well before the money is needed, will assess his strengths and weaknesses and those of the bank before contacting the bank, and will be prepared for a “new normal” in terms of how loans are approved, what collateral is required and whether and from whom guarantees will be needed.

Farmers and other borrowers with legal questions concerning financing should contact an attorney who is experienced with agricultural financing.

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Hot Topic: Supreme Court Tackles the “Uncapping” Issue

By Robert W. Parker, Attorney

The Michigan Supreme Court recently issued an opinion in a case that significantly impacts property taxes and estate planning. The following is an analysis of how the *Klooster v. City of Charlevoix* decision impacts property tax bills in joint tenant transfers.

Background

All property tax bills contain three values: Taxable Value, Assessed Value and State Equalized Value. Property taxes are calculated by multiplying the millage rate in a community by a property’s Taxable Value. The Assessed Value should

represent 50% of the property's true cash value, but it is not used to determine taxes owed.

In 1994, the citizens of Michigan adopted Proposal A that became effective beginning in 1995. Among other things, Proposal A *capped* increases in a property's taxable value to either the rate of inflation or 5%, whichever was less. It also created the notion of Taxable Value. Prior to 1994, taxes were assessed against a property's Assessed Value, increases of which were unlimited.

The Act also provided, however, that when there was a transfer of a parcel, the parcel's Taxable Value in the year following the year of transfer would be its State Equalized Value (which most often is the Assessed Value). This is what is described as the *uncapping* of a parcel's taxable value and often times results in a significant increase in a parcel's annual property tax bill.

Because of the restrictions on increases in Taxable Value imposed by Proposal A, the Taxable Value for many parcels after 1994 began to significantly lag behind their Assessed Value, where increases were not restricted. By 2010, statewide, the "gap" between Taxable Value and Assessed Value had grown to \$46 billion. In order to avoid significant increases in their property taxes when a transfer occurred, taxpayers and their lawyers examined each transfer to determine if it might qualify as one of the 15 transfers exempt under statute.

**Joint Tenancy Exemption:
*Klooster v. City of Charlevoix***

One transfer that the Legislature identified as exempt was a transfer creating or terminating a joint tenancy. The transfer had to be between two or more persons and at least one of the persons

needed to be an *original owner* of the property before the tenancy was initially created.

In 1959, James and Dona Klooster acquired their home in the City of Charlevoix. In August of 2004, Dona quitclaimed her interest to her husband James, leaving him as the sole owner. On that same day James quitclaimed the property to himself and his son, Nathan Klooster, as joint tenants with full rights of survivorship. On January 11, 2005, James died leaving Nathan as the sole owner. On September 10, 2005 Nathan quitclaimed the property to himself and his brother, Charles Klooster, as joint tenants with full rights of survivorship.

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The assessor uncapped the property's taxable value upon James' death claiming that his death was a transfer. Appeals ensued and the Kloosters ultimately found themselves before the Michigan Supreme Court which issued its decision of March 10, 2011 in *Klooster v. City of Charlevoix*. On March 21, the Executive Director of the Michigan State Tax Commission issued her guidance document to the state's assessors and equalization directors instructing them as to how to implement the Court's decision in *Klooster*.

The Michigan Supreme Court provided the Kloosters with a partial victory. It identified a total of five transfers that the Kloosters had been part of. The first was when the Kloosters acquired the property in 1959. The second was when Dona conveyed to James. The third was when James conveyed to Nathan and himself. The fourth was when James died, and the final transfer was when Nathan conveyed to his brother, Charles. *The Court provided that of those five transfers, only one constituted a transfer resulting in an uncapping of the property's taxable value and that was the last one, from James to his brother.* While

it rejected the Kloosters' argument that James' death was not a transfer, it concluded it was nevertheless an exempt transfer. That's the good news. The bad news is that the Court specifically held that the "creation" of a joint tenancy will not always be an exempt transfer.

Moving Forward: The Decision's Impact

There are a number of significant take-always from the *Klooster* decision:

1. If handled properly, the Supreme Court has provided taxpayers with a least a one-generation reprieve from uncapping. We now know that if mom and dad put the property into their names with their son or daughter, that upon mom and dad's deaths, there will be no uncapping.
2. The more the merrier, meaning that it may make the most sense to put all of the children on the deed. What triggered the Klooster's uncapping was the conveyance by Nathan to his brother. If the elder Klooster had conveyed to Nathan and Charles initially, the property's Taxable Value would still be capped.
3. Real estate and estate planning lawyers will take a hard look at joint tenancy as an estate planning tool and, within the joint tenancy, the parties' common law rights and responsibilities. To the extent property owners do not like those rights or responsibilities or they don't mesh with their needs, joint tenancy agreements must be created to re-define those rights.

...transfers that had previously been determined to be non-exempt, may now be deemed to be exempt or, worse, transfers which were deemed to have been exempt are now non-exempt, resulting in back taxes owed.

4. There is more to come. Given the statute's ambiguity, which even the Supreme Court acknowledged was "not the simplest provision to understand at first reading," interpretations of the joint tenancy exemption have varied amongst assessors and equalization directors throughout the state. With the Court's ruling, we now have a definitive, single interpretation. The State Tax Commission has provided that the decision may necessitate examination by assessors and equalization directors dating back to the beginning of Proposal A in 1995. In other words, transfers that had previously been determined to be non-exempt may now be deemed to be exempt or, worse, transfers which were deemed to have been exempt may now be deemed to be non-exempt, resulting in back taxes owed. How far back assessors may go and if they can go back at all may depend largely upon whether a property transfer affidavit was filed at the time of the non-exempt transfer.
5. The chain of title becomes very important as the term "original owner" was defined by the Court to mean a person who was the owner at the time of the last transfer which resulted in an uncapping. For the Klooster family that was 1959, when they originally acquired the property.
6. There are some very intriguing planning opportunities using joint ownership between unrelated parties which may result in exempt transfers.
7. And finally, the gap between Taxable Value and Assessed Value will continue to swell as

years pass. Any conveyance of real estate, whether part of a sale or purchase of real estate, estate planning, marital settlement, adjustment of boundary line, however simple on its face, could result in significantly adverse property tax consequences if not handled properly. A lawyer with an understanding of real estate and Proposal A should always be involved.

The decision in *Klooster v. City of Charlevoix*, also lead to a positive result for Smith

Haughey’s client in, *Taylor v. City of Traverse City*. Because it involved the same “uncapping” issue, the *Taylor* case was a companion case to *Klooster* in the Michigan Supreme Court. The Taylors were represented by attorneys Robert Parker and Jon Vander Ploeg

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Immigration: What Warrants?

When, Where, and How?

By Joanna Kloet, Attorney

Most people know that generally a warrant is required to arrest a person. However, as a practical matter, most U.S. citizens, let alone foreign nationals, do not understand the difference between administrative warrants and judicial warrants.

Administrative Warrants in the Immigration Context

In situations involving undocumented individuals, if the individual’s violations are civil in nature, the warrant used is typically an administrative warrant. An administrative warrant grants the immigration authorities the right to arrest the individual, but not necessarily to enter onto his property.

Many, if not most, immigration violations do not involve criminal prosecutions. For example, being present in the U.S. without permission, or working without authorization, are violations of civil laws. Because of the civil nature of most immigration violations, on a day-to-day basis, Immigration and Customs Enforcement (ICE) agents utilize

administrative warrants to arrest non-citizens. The administrative removal warrant used by ICE is not like a criminal warrant in that it is not required to be reviewed and signed by a federal judge (judicial warrant). Instead, the warrant is typically signed by an ICE official and executed by other ICE agents.

The primary difference between an administrative removal warrant and a criminal warrant is that, unlike a criminal warrant issued by a court, a *removal warrant does not authorize the ICE officer to enter an area to arrest a person if the person has a reasonable expectation of privacy in that area.*

In other words, if an ICE officer encounters the subject of the administrative warrant in a public place, such as on the street, he may arrest him. However, without permission, the ICE officer may not gain entry to a place wherein the individual has a reasonable expectation of privacy using an administrative warrant. For example, an ICE agent may not enter the individual’s home using an ICE warrant. Thus, usually an ICE officer

must “wait it out” until the person leaves the home, or until the person gives consent to entry. This is because an administrative warrant does not have the same judicial safeguards as the typical criminal warrant.

Warrants in the Workplace

Typically, a person has a reasonable expectation of privacy in his or her home such that an administrative warrant cannot be used to enter the alien’s property. But what about the workplace? That is, if ICE has an administrative warrant for the unauthorized alien, can ICE enter the alien’s suspected workplace to execute that warrant?

Alarmingly, recent case precedent is not clear. The critical issue would be whether the workplace is a location where the employee (not the employer), as the subject of the warrant, has a reasonable expectation of privacy. While the Supreme Court has recognized that a person has standing to object to a search of his office, there is no reasonable expectation of privacy in an “open field.” Thus it is unlikely that a court would find the employee has any reasonable expectation of privacy in his employer’s orchard, open-air warehouse, or crop field – typical work locations in the agricultural industry.

The Employer’s Obligation

As a practical matter, once an undocumented immigrant is arrested, information gleaned from the employee regarding any unauthorized work theoretically could be used to build a case against the employer. Thus, assuming an employee does not have a reasonable expectation of privacy in his agricultural workplace, a related question is whether an employer can refuse entry of an ICE

official attempting to execute an administrative removal warrant specific to one named individual.

Generally, a search warrant is needed to search the premises of a third party if the third party is *not* named on the search or arrest warrant. However, case law suggests that in some situations, a search warrant may not be necessary to execute an arrest warrant on the premises of a third party when the police have a “reasonable belief” that the *named* suspect on the arrest warrant is on the premises.

In one such case, the person named on an arrest warrant, Demetrius Pruitt, was arrested in his girlfriend’s home. Prior to the arrest, an informant had contacted the police to tell them that Pruitt

...any information gleaned from the employee about his unauthorized work theoretically could be used to build a case against the employer.

was staying with his girlfriend, and so police obtained an arrest warrant (not a search warrant) for Pruitt. The Sixth Circuit Court of Appeals decided that the arrest of Pruitt in *his girlfriend’s* home, executed without a search warrant for that home, did not violate Pruitt’s Fourth

Amendment rights. Additionally, the court held that all of the tips and information collected prior to the arrest that suggested Pruitt’s whereabouts formed a basis for reasonable belief that Pruitt was on the premises.

Notably, the warrant at issue in that case was a “judicial” arrest warrant, not administrative warrant. Thus, it is unclear whether this case would apply to the execution of an administrative arrest warrant. However, if it does, then authorities with a “reasonable belief” that the individual named on the arrest warrant is on the premises may permissibly enter the individual’s workplace to apprehend him. Correspondingly, an employer’s attempt to interfere may constitute obstruction of the officer in the discharge of his duties, and possibly give rise to further liability.

Warrant Regulations in the Agricultural Context

Certain federal immigration statutes and regulations require either a warrant or consent or other lawful exceptions to the warrant requirement in order to enter an agricultural operation. However, an agricultural employer should not be lulled into false comfort by the language of these regulations. The statute and regulation only clearly provide protection when the immigration officer's purpose is to question or interrogate a

person with respect to their right to be in the United States. In other words, if ICE is not seeking *only* to question or interrogate a person, but rather has a valid administrative warrant that specifically names an individual suspected of immigration violations, which in turn allows him to *arrest* said individual, these protections may not apply.

Joanna focuses her practice on immigration law. She can be reached directly at jkloet@shrr.com or 231-486-4515.

Agricultural Tax Assessments May Now be Appealed Through the Courts

By Robert W. Parker, Attorney

Each spring, the local tax assessor sends out the Notice of Assessment (NOA). One of the bits of information contained on the NOA is a description of the property's classification. It's expressed as a number. Typically, classifications are:

- 401 – residential property
- 301 – industrial property
- 101 – agricultural real property

According to the State Tax Commission, a property's classification should reflect its *current use*, not its highest and best use.

A property's tax classification should not be confused with how it is zoned. Zoning restricts use whereas property classification should reflect the use. For example, a classification of residential does not prohibit an agricultural use.

In total, there are 13 different types of classifications. A parcel's classification is critically important and can be conclusive as to a property's eligibility for certain tax exemptions

and credits. For example, industrial personal property (#351) was exempt from the state's 6 mill education tax and commercial personal property (#251) from up to 12 mills of the local school operating tax.

The most significant exemption is that for property classified as agricultural real property (#101) which is entirely exempt from the 18 mills for school operations. (In addition *qualified agricultural property* is exempt from uncapping upon a transfer, provided that the grantee confirms that the property will continue to be used for agricultural purpose.) Property that is classified as agricultural is automatically exempt, whereas property that is classified as other than agricultural may obtain the exemption *but* it is required that at least 50% of the property's acreage must be exclusively devoted to agricultural use.

Like assessments, property classifications can be appealed to the Board of Review. But, unlike appeals of assessments, property tax

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classifications are appealed from the Board of Review to the State Tax Commission, not the Michigan Tax Tribunal. Until recently, that was the end of the line. Unlike matters before the Tax Tribunal, where there was a right of appeal to the Michigan Court of Appeals, there was no appeal available from a classification determination made by the State Tax Commission.

That all changed in May of this year when the Michigan Supreme Court determined that property classifications made by the State Tax Commission were essentially administrative decisions and as

such there exists a right of appeal to Circuit Court.

Property owners should pay close attention to their property's agricultural classification. When pursuing an appeal of the loss of an agricultural exemption, owners have the comfort of knowing that they will now have the right of a judicial review of that loss.

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SHRR Agribusiness Team News & Successes

Jon Siebers recently assisted agricultural clients in the sale of a 100 acre farm, with issues related to the Land Division Act, and with issues concerning agricultural loans.

Janis Adams, Chuck Judson, and Jon Siebers recently presented a seminar to business owners in Traverse City. Topics included non-compete

agreements, the SBA loan refinancing program, and the benefits of negotiation.

Joe Belsito, Jon Siebers, and Steve Stawski will be presenting a seminar to business owners in Grand Rapids on August 9. The seminar will cover the topics of entity formation and operating agreements. For more information, visit <http://tinyurl.com/SH-business-seminar>.

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