



# FRESNO MADERA FARM CREDIT

## PATRONAGE PROGRAM OVERVIEW & FREQUENTLY ASKED QUESTIONS

### PROGRAM OVERVIEW

As an FMFC borrower, you are a member-owner of a cooperative. A key element of the cooperative structure is the ability to return earnings to members through patronage distributions.

FMFC concludes its fiscal year each December 31st; after the earnings have been calculated, the board of directors uses their discretion to determine the amount of earnings that will be allocated to the members in the form of Qualified Patronage, which is typically paid in cash.

The portion of our patronage sourced earnings that are not distributed as qualified patronage is allocated to members in the form of a Non-Qualified Written Notice of Allocation, which is not distributed as cash.

These earnings are placed in our retained earnings account, which is an equity account on the cooperative's balance sheet. The FMFC board has no plans to distribute this equity.

### DEFINITIONS & BACKGROUND

#### **Organizational Structure**

Fresno Madera Farm Credit, ACA ("FMFC", or "Association") is a cooperative owned 100% by our member-borrowers ("members"). As a result of our cooperative structure, we enjoy a number of unique advantages that benefit our members.

#### **Cooperatives and Earnings**

Like other companies, cooperatives use earnings to accumulate capital. Increasing capital improves the company's ability to withstand adversity and increases competitiveness in the marketplace.

After cooperatives determine their earnings each year and assess the need for capital, the board of directors determines the amount of its earnings that can be distributed in the form of a patronage distribution.

#### **Patronage Distributions**

A patronage distribution is distributed from a cooperative to a member based on the amount of business done with the member. Patronage distributions can either be in the form of cash, or equity representing an allocation of surplus.

#### **Income Tax Treatment**

In general, cooperatives are not taxed on patronage income to the extent that that income is distributed to members as patronage distributions in a timely manner. As such, in general, patronage income distributed to members is taxed only one time – at the member level. This increases the amount of earnings that can be distributed as they are not reduced by income tax expense at the cooperative level. Members pay income tax on cooperative earnings only if earnings are distributed (generally in the form of cash).

YOU SHOULD CONSULT YOUR TAX ADVISOR IF YOU HAVE ANY QUESTIONS REGARDING THE FEDERAL, STATE, OR LOCAL INCOME TAX CONSEQUENCES OF THE RECEIPT OF PATRONAGE DISTRIBUTIONS.

## FREQUENTLY ASKED QUESTIONS

### **Why doesn't FMFC charge lower rates of interest instead of paying patronage?**

Federal regulations require Farm Credit Associations to charge interest rates that are sufficient to cover all costs, fund provisions to the allowance accounts [potential loan losses], and accumulate capital. The amount of these costs and needs can vary from year to year based on a number of factors. FMFC's pricing philosophy is to charge a market rate, and to pay patronage to reduce our members' cost of borrowing. In addition, there are financial benefits to the Member, and to the Association when patronage is paid.

### **Does FMFC have to raise interest rates to pay patronage?**

No. Our loan pricing decisions are based on the marketplace, and the credit risk associated with individual credit based on the factors that impact each loan. Overall, the interest we earn from our loan portfolio covers our operating expenses, allows us to accumulate new capital, and fund our provision for loan losses. If these financial needs increase in a given year, the board can use their discretion to reduce or not pay patronage.

### **How does paying patronage benefit the members of FMFC?**

Our goal is to provide our members with competitively priced financing as a strong, dependable, farmer-owned cooperative. Cash patronage effectively reduces our members' cost of borrowing money.

### **How does paying patronage benefit your Association [FMFC]?**

Deductions for patronage distributions reduce our income tax liability. This increases the effectiveness of our earnings because they are not 'double taxed' as with many other organizational structures.

### **Under what circumstances would FMFC reduce the amount of patronage distributed in cash?**

We collect net interest income to cover our operating expenses, capitalize growth, and increase our allowance for loan loss (represents potential loss on loans). If any of these needs increase by significant or unexpected amounts, the board of directors would use their discretion to reduce or not pay patronage depending on FMFC's needs each year.

### **Do all loans qualify for patronage?**

Our Bylaws and governing Board resolutions define loans that are eligible for patronage and which loans are made on a non-patronage basis. If patronage is declared by the board of directors, all eligible loans, receive patronage. However, a loan ceases to be eligible for patronage if it is formally restructured, written-off (partially or wholly) or is in non-accrual status at the end of the year, unless such loan is current and contributed to interest income during the fiscal year.

### **How is the amount of my patronage determined?**

The amount of patronage paid to each member is based on the average daily balance ("ADB") of the member's eligible loans, each fiscal year. For example, with a board approved patronage distribution of 1%, and an average loan balance of \$200,000, you would receive a cash distribution of \$2,000.

### **When are patronage payments made to members?**

FMFC's annual financial statements for each year-ended December 31 are audited by an independent public accounting firm. After the audit of our annual financial statements has been concluded, a final determination of patronage is made by FMFC's board of directors. The process is normally concluded sometime in mid-March of each year, and if patronage is approved by the board of directors, payments are made by check in late-March.

### **Will I receive a tax notification regarding my cash patronage distribution?**

Yes. The Association will send each member a FORM 1099-PATR in January of each year showing the amount of cash patronage distributed to the member during the previous year. These qualified patronage payments are taxable to the recipient. A non-qualified written notice of allocation is not taxable to the recipient unless and until it is retired as cash. The board of directors has no plans to redeem equity retained as non-qualified retained earnings.

**We appreciate that you have chosen FMFC as your lender of choice. If you have any questions, please feel free to contact your loan officer at (559) 277-7000, for more information.**