RISK MANAGEMENT PROFILES

# Farm Family Confronts Financial Distress Head-on

Brent and Jenny are in their mid-60s and have a farm in Alaska. They grow vegetables for sale at two local markets, sell eggs and harvested chickens, and sell wool, lambs, and meat from their flock of 50 ewes. Over their almost 40 years of marriage, Brent and Jenny have been able to live comfortably on profits from the farm.

During a recent visit by their two sons and families, Brent and Jenny finally talked about retiring. Brent told everyone that they wanted Norm, their eldest son, and his wife to buy the farm. Norm said that they were interested in moving back to Alaska, but he wondered if the farm could generate sufficient income to make any debt payments and provide a reasonable living for his family.

When Jenny shared copies of their balance sheet, both sons and their wives were surprised. They asked if Brent and Jenny knew they had a negative net worth –their debts exceeded the fair market value of their assets. They did not, but wondered if that was why their banker would not give them an operating loan for the coming year.

Jenny explained that two years ago, Brent tore an Anterior Cruciate Ligament (ACL) and was unable to walk for the entire summer, forcing them to hire additional summer help. Last year, they were unable to plant the vegetables due to bad weather and wolves killed half their lambs. They were unable to pay off their operating loans and had to borrow more money to cover living

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expenses. To make things worse, the value of their land had declined by 20 percent.

Norm said he would not take over the farm business until his parents addressed their financial problems. He was willing to help, but they should contact the professionals at RightRisk. They would be able to coach them through the process of developing a plan for reorganization and succession.

Jenny contacted RightRisk to discuss their options. RightRisk agreed to coach Brent and Jenny through the process of developing a better understanding of their financial position and evaluating their options.

RightRisk helped Brent and Jenny develop a detailed balance sheet, making sure to list all their debts, payments, due dates, and all past-due accounts. Then they drafted a 3-year production plan with associated cash flow projections.

The plan demonstrated that the farm could once again be profitable if Brent and Jenny could:

1. Expand the highly profitable poultry enterprise;
2. Sell the flock of sheep;
3. Lock-in prices for their vegetables via a contract with the local grocer; and
4. Sell the tractor, for which there was significant debt.

They hoped they could avoid selling any land, but one option would be to sell the pastureland if necessary.

A final part of the plan was for Norm and his wife to spend the next two summers working on the farm in order to learn more about the business. The farm would pay their travel costs up from the Lower-48 and small salaries to supplement their teachers' wages.


After their financial problems were resolved, Brent and Jenny would again seek help from the professionals at RightRisk to develop a transition plan.

Since their plan involved selling capital assets and possible debt forgiveness, Brent met with their tax preparer to discuss the tax consequences of implementing the plan. She suggested there were sufficient carry-forward operating losses and other strategies for minimizing their tax liability. Their accountant indicated that there would be significant capital gains if they sold the land gifted to Jenny by her parents, but not on the land they purchased a few years ago.

Brent and Jenny then met with their bank's loan officer since the bank held the loans on the land and carry-over operating loans. Although he was

interested in working with them, the bank was not in a position to write-off any debt.

Feeling frustrated, Brent and Jenny decided to seek counsel from a bankruptcy attorney. They shared with her the detailed balance sheet, the reorganization plan, and the results of their conversations with their tax preparer and banker.

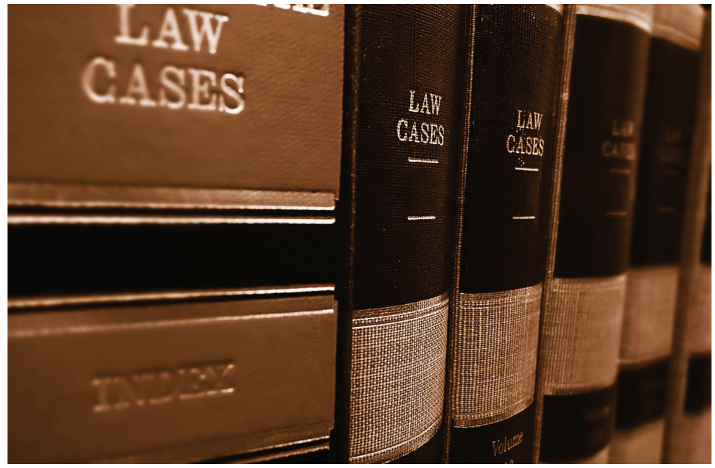
The attorney first verified Brent and Jenny's eligibility for Chapter 12 bankruptcy relief:

1. They are actively engaged in farming;
2. Their total debt (secured and unsecured) is less than $4,031,575;
3. More than 50 percent of their debt is associated with the farming operation; and
4. More than fifty percent of last year's income was from the farm operation.

The attorney also mentioned that they must have regular annual income and that the income must be sufficiently stable and regular. Brent's plan to work part time at the local farm supply store would help satisfy this requirement, as would the vegetable contract.

The attorney filed a Chapter 12 petition with the clerk of the Bankruptcy Court. She also filed a few additional documents needed by the State of Alaska. After making only minor changes to Brent and Jenny's reorganization plan, their attorney filed the plan with the Court and mailed copies to their creditors.

The attorney next hosted a meeting with Brent and Jenny's creditors to discover their acceptance of the reorganization plan and to explore alternative strategies. The creditors liked that Brent and Jenny were




willing to make significant changes to the operation and sell some assets to pay down their debts. In addition, they were reluctant to force Brent and Jenny to move forward with bankruptcy proceedings.

Brent and Jenny agreed to sell the flock of sheep and use the proceeds to service existing loans with the bank. They would rent the pasture to the neighbor, and Brent would visit with the local grocer about a contract to buy their vegetables. Further, Brent's off-farm income could be used to help meet family living expenses.

The bank agreed to combine the carry-over operating loans into a single loan with a 10-year term at a reasonable interest rate, provide them with a loan to cover next year's operating expenses, and loan them the money needed to expand the poultry enterprise. The implement dealer was willing to take back the tractor and consider the debt paid in full, even though the fair market value of the tractor was worth only 70 percent of the debt. The attorney negotiated with the unsecured creditors to settle Brent and Jenny's accounts for fifty-cents-on-the-dollar.

Following the meeting, Brent and Jenny's attorney submitted a final reorganization plan, including the agreement with their creditors, to the Bankruptcy Court. Because all parties were in agreement, the Court dismissed the case.

Brent and Jenny felt a great sense of relief and were once again excited about the business. Their financial future was more secure and they would get to see their son, daughter-in-law, and grandchildren each summer. Also, they were gradually becoming more comfortable with the idea of retirement and turning over the farm to the next generation.

**Additional Resources:**

RightRisk Courses
http://RightRisk.org > Courses

RightRisk Risk Analysis Tools
http://RightRisk.org > Resources

USDA Risk Management Agency
http://www.rma.usda.gov

USDA Farm Service Agency
http://www.fsa.usda.gov