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Farm Debt and Chapter 12 Bankruptcy Eligibility

March 15, 2019 (IN11073)

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As farm income has declined over multiple years since 2013, the number of reported farm bankruptcies has begun to increase. The Federal Reserve Bank of Minneapolis observed that Chapter 12 farm bankruptcies increased in 2018 across the Midwest and appear to be higher among dairy farms. The American Farm Bureau Federation has compiled farm bankruptcy data from the U.S. Courts at the national level. According to this data, in 2018, 498 U.S. farms filed for Chapter 12 bankruptcy, nearly constant with 501 farm bankruptcies in 2017 (a rate of about 2.5 per 10,000 farms). The continuing steady number of farm bankruptcies at the national level masks an increase in filings across 19 states, particularly in the upper Midwest where a 19% rise in annual Chapter 12 filings has occurred since 2017. Wisconsin had 47 Chapter 12 bankruptcies in 2018, one-third more than the next highest state (Nebraska) and 18% above the number in Wisconsin in 2016.

Chapter 12 of the Bankruptcy Code is reserved for family farmers and family fishermen (11 U.S.C. 1201-1232). It allows financially distressed farmers and fishermen to restructure their debt and remain in operation. Chapter 12 was designed to be less complicated, less expensive, and more appropriate for farmers than other types of bankruptcy, such as Chapter 11, which is better suited to large corporations, or Chapter 13, which is designed for wage earners who typically have smaller debts. To qualify for Chapter 12, family farmers must meet several eligibility requirements (11 U.S.C. 101(18)), including that their total debt is less than $4.153 million (as adjusted for inflation every three years; 11 U.S.C. 104), that at least half of the debt is farm business debt, and that at least half of their gross income is from farming.

A policy concern has arisen over whether the $4.153 million Chapter 12 debt limit should be raised to allow larger farms to qualify for this bankruptcy option in light of recent family farm financial stress, the rise in the number of bankruptcies, and the growth in the average size of farms.

While the U.S. Department of Agriculture (USDA) has published some tables that summarize how farms use debt, those data do not measure combinations of debt at the $4 million Chapter 12 threshold nor include non-farm debt. Additional data obtained from the USDA Economic Research Service allow for the following observations about total household debt per family farm:

- Of the approximately 2 million family farms in the United States, nearly two-thirds have no farm business debt, and about one-third have no household debt (farm or non-farm debt). Hereinafter, this analysis includes both farm and nonfarm debt unless otherwise specified.
- More specifically, of 1,996,000 family farms,
- 592,000 (29.6%) have no debt,

1.32 million (66.3%) have between $1 and $1 million of debt. Farms in this debt range hold 41% of total farm debt.
- 76,000 (3.8%) have between $1 million and $4.153 million of debt. Farms in this range hold 42% of total farm debt.
- 7,700 (0.4%) have debt greater than the $4.153 million, which is above the initial threshold for Chapter 12 bankruptcy. Farms in this debt range hold 17% of total farm debt and account for about 12% of the value of production.

In terms of eligibility for Chapter 12, only a fraction of the farms above would meet the filing requirements that farm debt be at least half of total debt and that farm income be at least half of gross income.

- About 269,000 of the 1.4 million farms above (19%) with total debt between $1 and $4.153 million have ratios of farm-to-nonfarm debt and farm-to-nonfarm income that would allow them to qualify to file under Chapter 12. That only one-fifth of these farms meet the current eligibility standards for Chapter 12 likely highlights the prevalence of non-farm income for many smaller farms in this category.
- To illustrate the hypothetical effect of a higher Chapter 12 debt limit, if the debt limit were raised to $10 million per farm, about an additional 5,000 farms nationwide would become eligible for Chapter 12, based on their total debt and their ratios of farm-to-nonfarm debt and income. Not all of these farms are financially vulnerable, however. About another 800 farms have greater than $10 million of debt and meet the farm-to-nonfarm ratios.

Information is not available to further subdivide these farms by type of enterprise (e.g., crop or livestock) or by location, and still measure the farm and nonfarm components of debt and income.

A question that might arise if the debt limit for Chapter 12 were to be increased: which agricultural lenders would be exposed to additional farms qualifying for this type of bankruptcy? Based on the underlying shares of farm debt held by the various lenders, commercial banks and the Farm Credit System hold about 83% of the farm debt, nearly equally divided. About 6% of that debt is guaranteed for repayment by the Farm Service Agency (FSA) in the case of a default. Loans directly issued by FSA are only about 3% of the total farm debt. Moreover, statutory lending limits on FSA loans ($400,000 per borrower for direct operating loans, $600,000 per borrower for direct farm ownership loans, and $1.75 million per borrower for guaranteed loans) would likely limit FSA exposure to a change that would allow farms with more than $4 million of debt to be eligible to file for bankruptcy under Chapter 12. In the 2018 farm bill, Congress raised these FSA loan limits by about one-quarter to one-third, or double in the case of direct farm ownership loans, in recognition of growing financial stress and the increasing size of family farms.