1-6-1999

Legal Aspects of Financial Distress: Refinancing Issues

J. David Aiken
University of Nebraska-Lincoln, daiken@unl.edu

January 6, 1999

Cornhusker Economics

Cooperative Extension

Institute of Agriculture & Natural Resources
Department of Agricultural Economics
University of Nebraska – Lincoln

Legal Aspects of Financial Distress: Refinancing Issues

Market Report	Yr Ago	4 Wks Ago	12/30/98
Livestock and Products, Average Prices for Week Ending			
Slaughter Steers, SE/CH 65-80%, 1100-1300 lb, Omaha/Nebraska Feedlots, cwt.	$65.25	$60.38	$58.30
Feeder Steers, Med. Frame, 600-650 lb., Dodge City, KS, cwt.	*	72.25	69.28
Feeder Steers, Med. Frame, 600-650 lb., Nebraska Auction Weighted Ave., cwt. .	**	**	**
Carcass Price, Ch. 1-3, 550-700 lb Cent. US, Equiv. Index Value, cwt.	95.98	93.60	90.25
Hogs, US 1-2, 230-250 lb., Omaha/Sioux City, IA, cwt.	36.25	19.43	19.50
Feeder Pigs, US 1-2, 40-45 lb., Omaha/ Sioux City, IA, hd.	*	*	13.25
Vacuum Packed Pork Loins, Wholesale, 13-19 lb, 1/4" Trim, Cent. US, cwt.	76.17	80.10	80.63
Slaughter Lambs, Ch. & Pr., 115-125 lb Sioux Falls, SD, cwt.	79.80	*	67.50
Carcass Lambs, Ch. & Pr., 1-4, 55-65 lb FOB Midwest, cwt.	154.50	135.00	145.00
Crops, Cash Truck Prices for Date Shown			
Wheat, No. 1, H.W. Omaha/Kansas City, MO, bu..	3.48	3.31	3.26
Corn, No. 2, Yellow, Omaha/Sioux City, IA, bu.	2.40	1.97	2.06
Soybeans, No. 1, Yellow Chicago/Sioux City, IA,, bu.	6.64	5.73	5.25
Grain Sorghum, No. 2, Yellow Kansas City, cwt.	4.10	3.41	3.33
Oats, No. 2, Heavy Omaha/Kansas City, MO, bu..	*	*	*
Hay, First Day of Week Pile Prices			
Alfalfa, Sm. Square, RFV 150 or better Platte Valley, ton.	*	100.00	*
Alfalfa, Lg. Round, Good Northeast Nebraska, ton.	*	45.00	*
Prairie, Sm. Square, Good Northeast Nebraska, ton.	*	70.00	70.00

* No market.
** New Category - no market reported this week.
Please note that some prices quoted this week are from different sources due to the Omaha Terminal closing. (First source is year ago and 4 wks ago prices/second source is 12/30/98 prices.

Nebraska hog producers are currently facing prices that have reached historic lows. Some producers may be discussing financing options with their lenders and other creditors. This newsletter identifies some issues to consider when refinancing operating (and other) agricultural loans. ***Always*** consult an attorney before signing or negotiating legal documents, such as loan agreements.

Loan guarantees. Parents often co-sign or guarantee loans made to their children to help the child to start farming. This loan guarantee obligates the parents to pay the child's loan under certain circumstances. There are two types of loan guarantees in Nebraska: payment guarantees and collection guarantees. With a ***payment guarantee***, if the child misses a loan payment, the parent must make the missed payment–the lender does not need to foreclose on the child's loan before seeking payment from the parents (the "guarantors"). With a ***collection guarantee***, the lender must foreclose on the loan before it can seek payment of any unpaid loan deficiency from the parents. Of course, the parents can make the payments for the child under a collection guarantee to avoid foreclosure.

Loan guarantees and bankruptcy. If the child takes bankruptcy and gets the loan amount reduced (debt writedown), the guarantors are still liable for the full loan amount. For example, if an $80,000 debt is reduced to $10,000 in bankruptcy, the parents are liable to the lender for the $70,000 in debt writedown (unless the parents also take bankruptcy and themselves qualify for bankruptcy debt writedown).

Assets listed on balance sheet. During the farm financial crisis of the 1980s, producers wished to know if assets that were simply listed on the farm balance sheet were loan security, even though the lender had not taken a security interest in that property. The answer to this question is no, unless the lender has taken the necessary steps to include the listed property as loan collateral. For personal property (crops, livestock, machinery, etc.), this would include the producer's signing a ***security agreement**,* pledging the personal property as loan collateral, and (optionally) the lender's filing a ***financing statement*** (a summary of the security agreement) with the Nebraska Secretary of State. (Before April 18, 1998, most agricultural financing statements were filed with the county clerk). If the producer has not signed a security agreement pledging the crop as loan collateral, the property does not become loan collateral by simply being listed on the producer's balance sheet.

Providing additional collateral. However, lenders do have the right under the Nebraska Uniform Commercial Code (the laws governing using personal property as loan collateral) to request that additional property be pledged as loan collateral to avoid loan foreclosure. In other words, if a lender feels that the loan is in trouble, the lender may give the producer the choice of (1) providing additional loan collateral, or (2) foreclosing on the loan. This would involve the security agreement-financing statement process described above for the new loan collateral.

Providing a lender with additional loan collateral is a significant step. Assume the current collateral is worth $100,000 and the lender requests an additional $50,000 of collateral. In some cases the producer may be better off having the lender foreclose on the $100,000 collateral than the producer would be if the additional $50,000 worth of collateral were pledged and then foreclosed on a year later. Pledging additional collateral is worthwhile only if it allows the producer to turn the corner financially and stay in business. Producers should obtain legal and financial counseling (available through the Nebraska Department of Agriculture Farm Mediation Program, (800) 446-4071 or (800) 364-4296), to help determine whether they can turn the corner financially before deciding whether to pledge additional loan collateral.

Lender paperwork defects. Similar considerations apply when the loan has been signed only by one spouse and the collateral is jointly owned by both spouses. Legally, if the lender forecloses they can only foreclose on the husband's share of the property if both husband and wife did not sign the security agreement (or real estate mortgage or trust deed). Lenders in this situation may request that both spouses sign new loan papers as a condition for continued financing. Again, legal and financial counseling may be required to determine whether the family is better off losing the husband's share to foreclosure but protecting the wife's share.

Security interests in crops. Assume the producer has his production loan from Local Bank and is unable to obtain financing for the 1999 crop year. The producer goes to the local co-op which agrees to provide financing for the 1999 crop if the co-op gets the first security interest on the 1999 crop. In fact, the producer may be unable to give the co-op the first security interest on the 1999 crop if (1) Local Bank inserted an "after-acquired property clause" in its security agreement, (2) Local Bank properly filed its financing statement, and (3) Local Bank's loan is not six months overdue when the 1999 crop is planted. Rarely will the third condition (loan 6 months overdue at planting) be satisfied, which means Local Bank will have the first rights to the 1999 crop even though the crop was financed by the co-op. In this case, co-op should consider negotiating with Local Bank to have the bank's rights in the 1999 crop subordinated to the co-op (in whole or in part), before the co-op (or any new lender) agrees to finance the 1999 crop.

J. David Aiken, (402) 472-1848
Water & Agricultural Law Specialist
Email: daiken@unl.edu