Distressed Borrower Options

Part 1

September 2, 2026

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Distressed Borrowers Assistance Network Training Series

Today's training is a part of a series offered by the Distressed Borrowers Assistance Network (DBAN).

We hope to see you in person in Virginia Beach for a full day of training on **Thursday, September 24th.**

There's a waitlist, but register here!

Today's Goals

Gain an understanding of the **types of options** that may be available to distressed borrowers, and the **vocabulary** that goes with those options.

Begin learning **how the types of options relate to each other and their pros and cons** in preparation for an additional training on how to navigate the options.

We won't cover every single vocabulary definition we could think of today, but we did put them all **in this glossary**.

…so take notes if it helps your learning process but know you can also use the glossary as a reference!

Disclaimer: unless where indicated, the definitions we are using today are not legal definitions, but our attempt at plain language!

Please drop your questions in the chat!

Vocab Alert

Loan Servicing

In this context, an umbrella term for a number of different options for modifying a loan when the borrower is behind or having trouble making payments.

(some) Types of Lenders

Farm Service Agency (FSA "direct" loans)	Guaranteed Lenders	Commercial Lenders
	Federal government guarantees loans up to 95 percent against possible loss of principal and interest. Makes lending less risky and opens up additional credit options for farmers. **FSA's agreement is with the lender, not the borrower.**	
Interest Rates: Fixed, set by the agency for each type of loan. Low, compared to other lenders.	**Interest Rates:** Negotiated between lender and borrower, up to a maximum limit.	**Interest Rates:** Varies—negotiated between lender and borrower
Loan Limits: Operating: $400,000 Ownership: $600,000	**Loan Limits:** Operating: $2,343,000 Ownership: $2,343,000	**Loan Limits:** Varies
Loan Servicing: extensively regulated; borrowers have a right to be considered for all options, and have appeal rights.	**Loan Servicing:** no appeal rights and— **Standard & Certified**: Are bound by these regulations. **Preferred**: Are bound by their own **lender agreement** with FSA	**Loan Servicing:** whatever they're willing to do

today's focus

more — **BORROWER PROTECTIONS** — fewer

Quiz Time!

1. Who is the beneficiary party with FSA in a guaranteed loan?

   The guaranteed lender is the beneficiary party, according to agency interpretation.

2. True/False? If a farmer thinks their guaranteed lender hasn't followed procedure, they can file an appeal with the National Appeals Division (NAD).

   False. Under current interpretation of the regulations, NAD won't take jurisdiction.

3. True/False? FSA officers may charge different farmers different interest rates on direct operating or ownership loans based on the farmer's credit history.

   False. But they could deny a farmer's application based on credit-worthiness.

4. True/False? Farmers should look for lenders with Preferred Guaranteed Lender status because it is the most protected category for a borrower.

   False. Of all direct and guaranteed loans, loans from Preferred Guaranteed lenders have the fewest regulatory borrower protections.

Today is a **bird's eye view**

Every blue box in the chart could be its own workshop or workshop series.

The fine print matters, and we are not covering it today!

Today is for knowing what the options are and where they all fit.

P.S. we'll be spending less time on the bankruptcy section since Mary Henderson & Annette Hiatt from Land Loss Prevention Project already did a great training on it!

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Quick Guide to Navigating Around a Miro

Click and drag to move around the screen

Zoom in and out with the **mouse SCROLL BAR** or **hold CTRL and hit + or -**

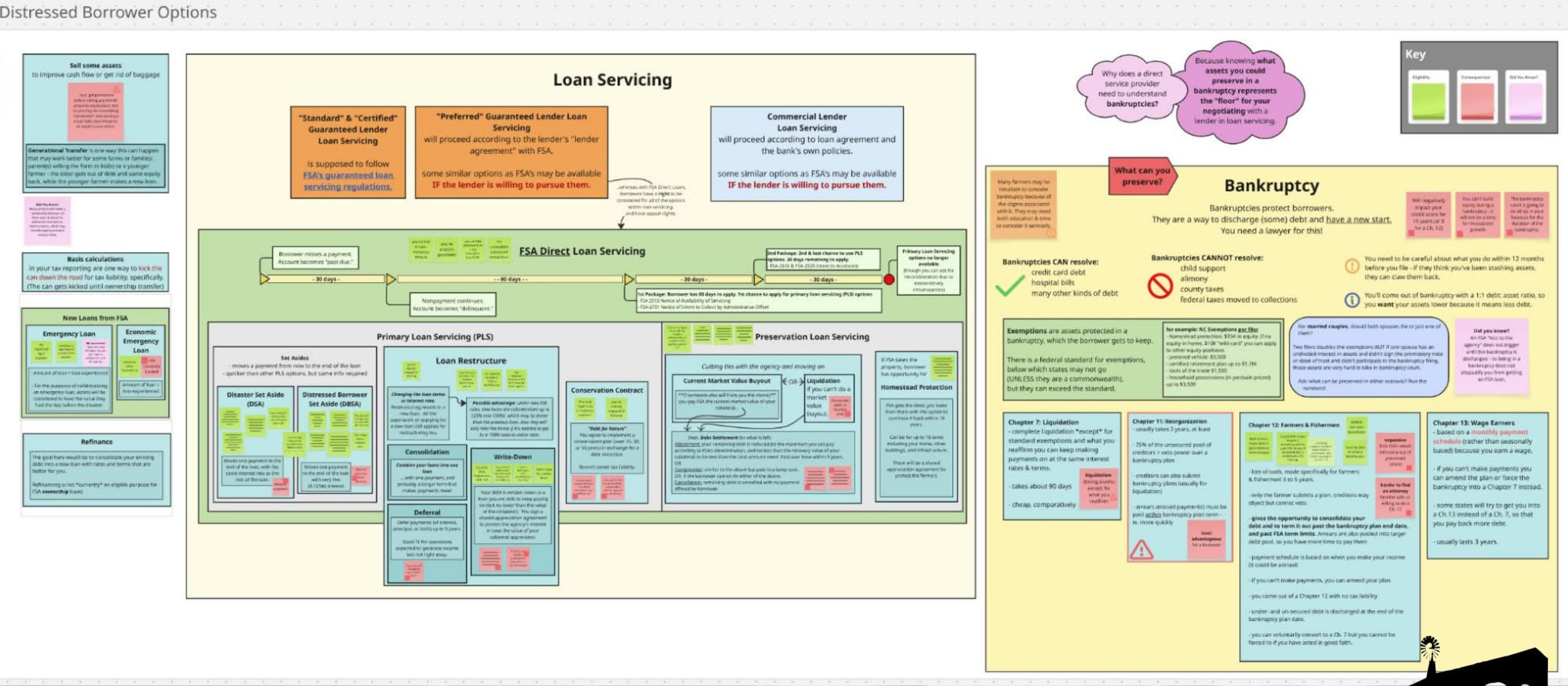
Click on someone's icon in the upper right corner to follow their view of the Miro.

Vocab Alert

Words that get confused, part 1

Bankruptcy	**A tool a debtor can use to protect themselves**, discharge unsecured debt, and restructure / emerge ready for a new start.
Liquidation	When a debtor's assets are sold - converted into cash - in order to satisfy debts.
Foreclosure	The act of selling security either under the power of sale in the security instrument or through judicial proceedings to satisfy debt.

Distressed Borrower Options Concept Map



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Sell some assets

to improve cash flow or get rid of baggage

...but get permission before selling any chattel property (equipment, etc) or you may be committing "conversion" and could get a bad faith determination or result in civil action.

Generational Transfer is one way this can happen that may work better for some farms or families: parent(s) selling the farm to kid(s) or a younger farmer - the elder gets out of debt and some equity back, while the younger farmer makes a new loan.

Basis calculations

in your tax reporting are one way to kick the can down the road for tax liability, specifically. (The can gets kicked until ownership transfer)

Did You Know?

Many lenders will make a "protective advance" of their loan to preserve collateral from loss or deterioration, which may include paying overdue county taxes.

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Vocab Alert

Words related to loans

Collateral

Specific property pledged to a lender to assure repayment of a loan. A lender has a legal right to take possession of collateral if the loan is not repaid.

=

Security

Specific property pledged to a lender to assure repayment of a loan. A lender has a legal right to take possession of security if the loan is not repaid.

Lien

A piece of paper that allows a creditor to come take your stuff if you don't pay them back. First, second, third lien etc means that multiple creditors have "dibs" in a certain order.

Protective Advance

When a lender spends money (ex: paying for overdue county taxes or insurance payments) to protect or preserve collateral from loss or deterioration. The expense is added to the borrower's loan principal.

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Vocab Alert

Words about tricky things

Conversion

When a borrower sells assets that are serving as loan security without permission of the lender. Can result in non-monetary default on a loan, a "bad faith" determination with FSA, and/or civil action.

"Hereafter acquired" clause

A clause included in many loan agreements which states anything you acquire after the agreement also becomes additional security.

Why Does This Matter?

This is an easy way for a borrower to accidentally commit conversion.

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New Loans from FSA

Emergency Loan

be impacted by a disaster

applying no later than 8 months after disaster

Did you know? This is the only FSA loan you can get if you've caused a loss to the agency.

- Amount of loan = loss experienced

- For the purposes of collateralizing an emergency loan, assets will be considered to have the value they had the day before the disaster.

Economic Emergency Loan

based on price fluctuations

⚠ not currently funded

Amount of loan = loss experienced

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Vocab Alert

Words that get confused, part 2

Refinance

Replacing an old loan with a new one (traditionally implies a new lender)

Restructure

A general term for changing the payment schedule and other terms on one or more loans.

? **Why Does This Matter?** FSA will restructure a loan they have made to a farmer, however refinancing debt from another lender is NOT (currently) an eligible purpose for an FSA **ownership** loan.

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Refinance

The goal here would be to consolidate your existing debt into a new loan with rates and terms that are better for you.

Refinancing is not *currently* an eligible purpose for FSA **ownership** loans.

Quiz Time!

In this context, “conversion” is:

a) Refinancing your guaranteed loan into an FSA direct loan

This is not a thing. Yet.

b) When a creditor agrees to change their lien from first lien to second lien to allow the borrower to use the same security to access credit from a new lender who will take first lien

This happens but it’s called “subordinating” a lien.

c) When a borrower sells securitized assets without permission of the lender.

Correct!

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Vocab Alert

More words related to loans

Interest Rate

Determines how much the credit will cost the borrower.

FSA direct loan rates are comparatively low, and are fixed rate.

Loan Term

Refers to the time over which the loan is repaid (not the interest rate).

FSA direct ownership loans have a maximum term of 40 years.

FSA direct operating loans are typically annual but can go up to 7 years (these are called **Term Loans**)

Vocab Alert

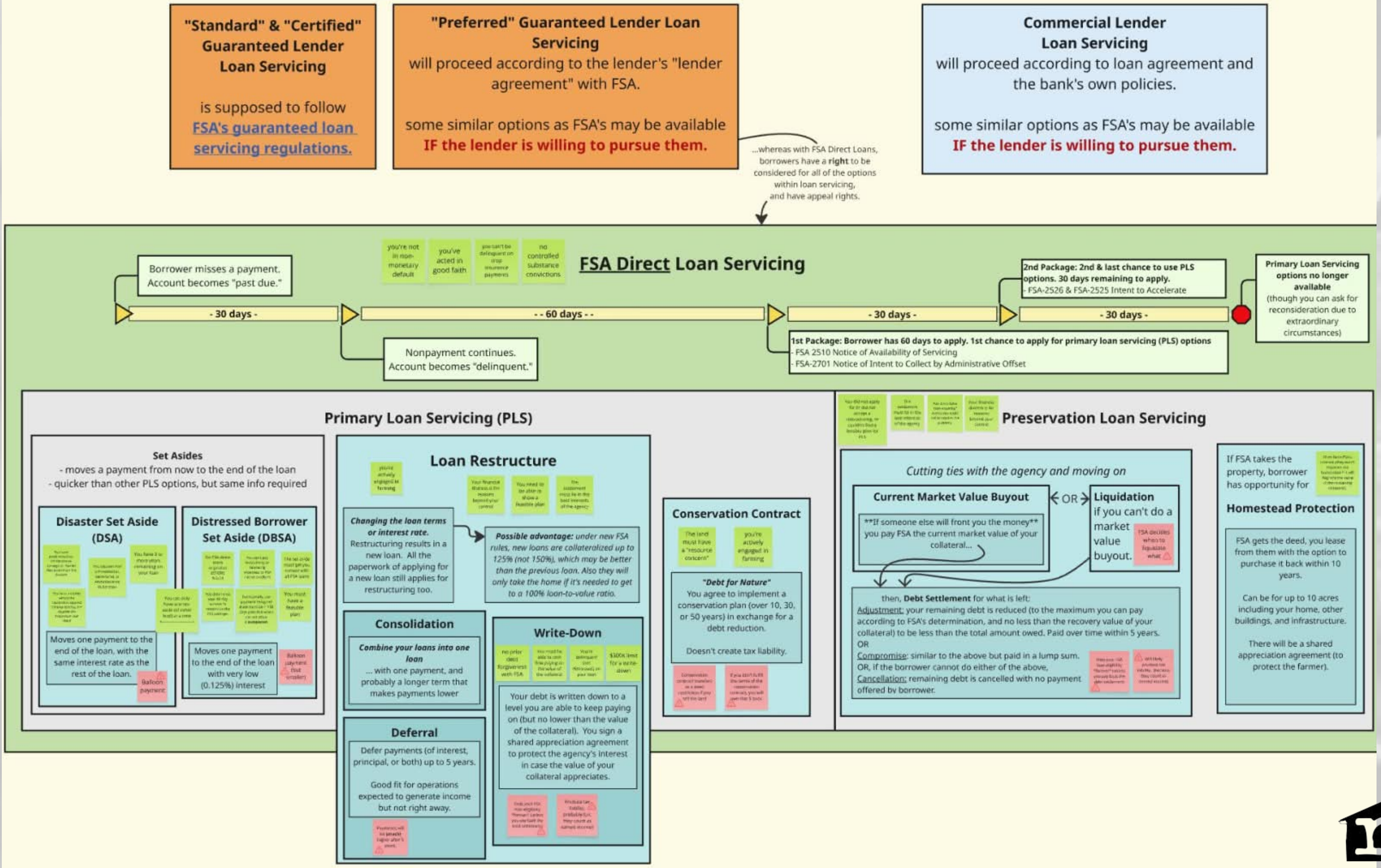
Words for things you can do with debt AKA Words that get confused, part 3

Refinance Replacing an old loan with a new one (traditionally implies a new lender)

Restructure A general term for changing the payment schedule and other terms on one or more loans. **Does** technically count as a new loan.	
Reamortize Revise the payment schedule on a <u>real estate</u> loan. Interest rate may change; loan term usually doesn't.	**Reschedule** Revise the payment schedule of an <u>operating loan</u>, including extending the term. FSA max rescheduling for operating loans = 15 years.

Reaffirm In a bankruptcy, this refers to debt which you are not liquidating assets to resolve, but which you are confirming to the creditor that you can and will continue to pay off, based on the original rates and terms.

Loan Servicing



Loan Servicing

"Standard" & "Certified" Guaranteed Lender Loan Servicing

is supposed to follow [FSA's guaranteed loan servicing regulations.]

"Preferred" Guaranteed Lender Loan Servicing
will proceed according to the lender's "lender agreement" with FSA.

some similar options as FSA's may be available **IF the lender is willing to pursue them.**

See 12 CFR 617.7410 for regulations governing **Farm Credit Association Lenders.

...whereas with FSA Direct Loans, borrowers have a **right** to be considered for all of the options within loan servicing, and have appeal rights.

Commercial Lender Loan Servicing
will proceed according to loan agreement and the bank's own policies.

some similar options as FSA's may be available **IF the lender is willing to pursue them.**

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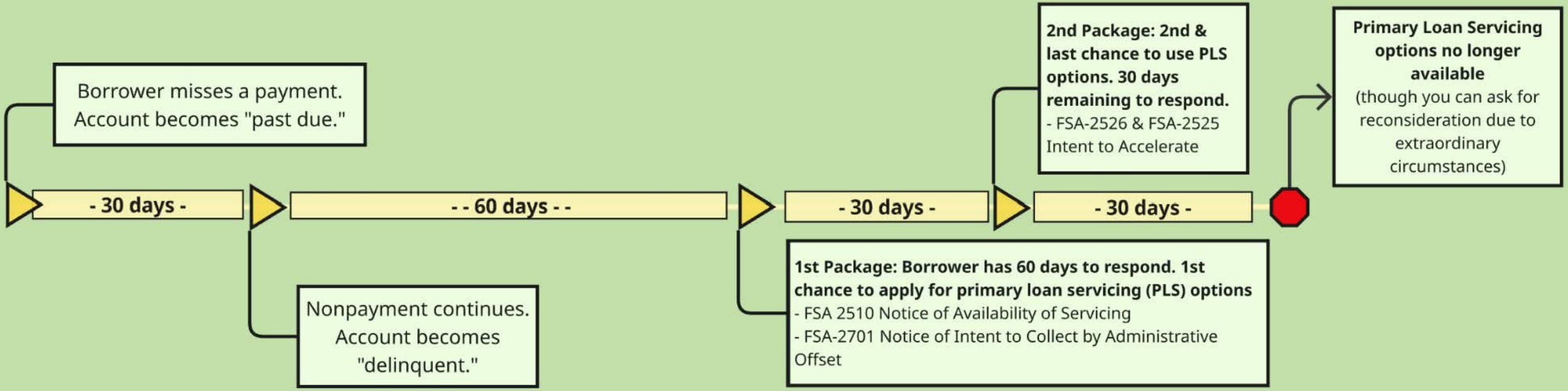
FSA Direct Loan Servicing

- you're not in non-monetary default
- you've acted in good faith
- no controlled substance convictions
- you can't be delinquent on crop insurance payments



? **Why Does This Matter?** If a farmer does not respond in time to these notices, they lose many options they would otherwise have available. **Determine as quickly as you can where they are in the timeline.**

Vocab Alert

Offsets

When you are delinquent on a federal debt, the government can take payments out of checks you would normally otherwise be getting from them. This is called an **offset.**

Administrative Offset

When money you owe gets taken out of payments to you from USDA (program payments, for example)

Treasury Offset

When money you owe gets taken out of payments to you from other parts of the federal government (your tax return, up to 15% of your social security check, or for federal employees even their paycheck)

In practice, administrative and treasury offsets typically kick in at the same time.

Set Asides

- moves a payment from now to the end of the loan
- quicker than other PLS options, but same info required

Disaster Set Aside (DSA)

- You have production loss, infrastructure damage, or market disruption from the disaster
- The disaster had a Presidential, Secretarial, or Administrative declaration
- You have 2 or more years remaining on your loan
- You're in a county where the declaration applied OR impacted by the disaster the declaration was about

Moves one payment to the end of the loan, with the same interest rate as the rest of the loan.

⚠ Balloon payment

You can only have one set-aside (of either kind) at a time
<------------------------>

Distressed Borrower Set Aside (DBSA)

- For FSA direct loans originated BEFORE 9/5/24
- You can't pay family living or operating expenses, or FSA / other creditors
- The set aside must get you current with all FSA loans
- You didn't miss your 90-day window to respond to the PLS package.
- Functionally, the payment being set aside must be < 150 days past due when the set-aside is **completed.**
- You must have a feasible plan

Moves one payment to the end of the loan with very low (0.125%) interest

⚠ Balloon payment (but smaller)

Primary Loan Servicing (PLS)

Loan Restructure

you're actively engaged in farming

Your financial distress is for reasons beyond your control

You need to be able to show a feasible plan

The settlement must be in the best interests of the agency

Changing the loan terms or interest rate. Restructuring results in a new loan. All the paperwork of applying for a new loan still applies for restructuring too.

Possible advantage: *under new FSA rules, new loans are collateralized up to 125% (not 150%), which may be better than the previous loan. Also they will only take the home if it's needed to get to a 100% loan-to-value ratio.*

Consolidation

Combine your loans into one loan
... with one payment, and probably a longer term that makes payments lower

Deferral

Defer payments (of interest, principal, or both) up to 5 years.

Good fit for operations expected to generate income but not right away.

Payments will be **(much)** higher after 5 years.

Write-Down

- no prior debt forgiveness with FSA
- You must be able to cash flow paying on the value of the collateral
- You're delinquent (not distressed) on your loan
- $300K limit for a write-down

Your debt is written down to a level you are able to keep paying on (but no lower than the value of the collateral). You sign a shared appreciation agreement to protect the agency's interest in case the value of your collateral appreciates.

Ends your FSA loan eligibility *forever* (unless you pay back the debt settlement)

Produce tax liability, probably (b/c they count as earned income)

What **Are** the Best Interests of the Agency?

The FSA Loan Officer, in negotiating what kind of a loan restructure to do, is charged with considering what is in the best interests of the agency, **financially**. The best interests of the agency will change, depending on their prospects for recovering the loan capital and principal.

Ideally, the best interest of the agency is for the borrower to be able to continue paying on their loan as originally planned. When that is not possible, restructuring and/or forgiving some debt may allow the borrower to continue making payments, and therefore be in the best interest of the agency.

When the borrower needs an exit plan, the best interests of the agency depend on the financial result of various paths:

- *Market value* (what a property would sell for) will be higher than *recovery value* (what the agency would net from the sale of the property after their costs foreclosing it and keeping it in inventory, following all the associated regulations). The agent will be thinking about **recovery value** when negotiating a debt settlement, since that is the number that represents the agency's bottom line.
- The agency could lose more of the total loan value if the borrower files for bankruptcy, and so it is in the best interest of the agency to offer the farmer a deal that is better for the farmer than what the farmer could preserve in a bankruptcy.

Vocab Alert

Words that get confused, part 4

Debt Forgiveness: blanket term which includes both debt settlement and debt write-downs, and potentially, depending on the circumstances, bankruptcy filings.

Debt Write-Down: when the borrower needs to modify their loan to continue making payments on it, and those modifications involve partial debt forgiveness

Debt Settlement: debt forgiveness that happens as part of parting ways with the agency, because the agency determines the forgiveness is in its best interest.

Debt Cancellation: the final resolution of a debt without receiving payment in full. May be part of a debt settlement.

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Conservation Contract

The land must have a "resource concern"

you're actively engaged in farming

"Debt for Nature"

You agree to implement a conservation plan (over 10, 30, or 50 years) in exchange for a debt reduction.

Doesn't create tax liability.

Conservation contract transfers as a deed restriction if you sell the land

If you don't fulfill the terms of the conservation contract, you will owe that $ back.

Conservation Contract

The land must have a "resource concern"

you're actively engaged in farming

"Debt for Nature"

You agree to implement a conservation plan (over 10, 30, or 50 years) in exchange for a debt reduction.

Doesn't create tax liability.

Conservation contract transfers as a deed restriction if you sell the land

If you don't fulfill the terms of the conservation contract, you will owe that $ back.

You did not apply for or did not accept a restructuring, or couldn't find a feasible plan for PLS

The settlement must be in the best interests of the agency

You don't have "non-essential" assets you could sell to resolve the problem.

Your financial distress is for reasons beyond your control

Preservation Loan Servicing

Cutting ties with the agency and moving on

Current Market Value Buyout

If someone else will front you the money you pay FSA the current market value of your collateral...

OR

Liquidation

if you can't do a market value buyout.

FSA decides when to liquidate what

then, **Debt Settlement** for what is left:

Adjustment: your remaining debt is reduced (to the maximum you can pay according to FSA's determination, and no less than the recovery value of your collateral) to be less than the total amount owed. Paid over time within 5 years.

OR

Compromise: similar to the above but paid in a lump sum.

OR, if the borrower cannot do either of the above,

Cancellation: remaining debt is cancelled with no payment offered by borrower.

Ends your FSA loan eligibility *forever* (unless you pay back the debt settlement)

Will likely produce tax liability, (because they count as earned income)

If FSA takes the property, borrower has opportunity for

Must be in FSA's interest (they won't separate the homestead if it will degrade the value of the remaining collateral).

Homestead Protection

FSA gets the deed, you lease from them with the option to purchase it back within 10 years.

Can be for up to 10 acres including your home, other buildings, and infrastructure.

There will be a shared appreciation agreement (to protect the farmer).

Quiz Time!

How many days does a borrower have after their first notice of availability of servicing to respond before they lose access to Primary Loan Servicing Options?

60

What are some consequences to be aware of with different FSA loan servicing options?

Balloon payments
(set asides)

Loss of future lending eligibility
(debt forgiveness)

Much higher payments in future
(deferral)

Tax liability
(debt forgiveness)

Conservation contract transfers with deed
(debt for nature)

Pre-Quiz Time!

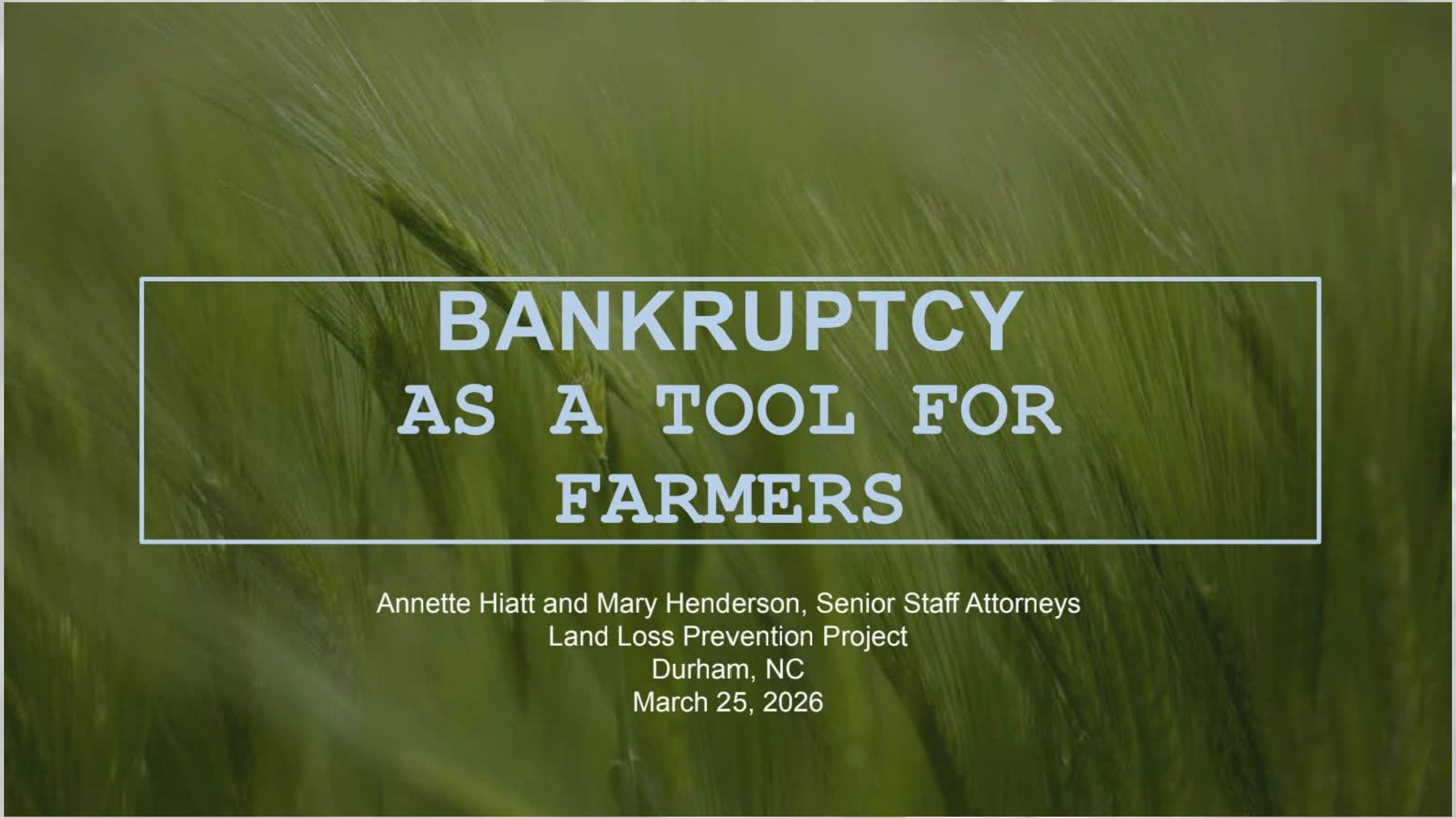
True/False:

Bankruptcies are bad.

Many farmers may be reluctant to consider bankruptcy because of the stigma associated with it. They may need both education & time to consider it seriously.

False. Bankruptcies are a potentially useful tool for a borrower in a **situation** that is, yes, bad. Bankruptcies have pros and cons!

https://www.farmaid.org/dban/bankruptcy-as-a-tool-for-farmers-training/



Bankruptcies protect borrowers.

They are a way to discharge (some) debt and <u>have a new start.</u>

A borrower **needs a lawyer** to file a bankruptcy.

A Direct Service Provider should be able to help a farmer navigate:

What **kinds of debt** a bankruptcy can or cannot resolve

Which **types of bankruptcy** a farmer may be eligible for, and which might be the right fit

What a farmer could **preserve** by filing a bankruptcy

What are the **consequences** of a bankruptcy filing

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What **kinds of debt** a bankruptcy can or cannot resolve?

Bankruptcies CAN resolve:

- credit card debt
- hospital bills
- many other kinds of debt

Bankruptcies CANNOT resolve:

- child support
- alimony
- county taxes
- federal taxes moved to collections

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What **kinds of debt** a bankruptcy can or cannot resolve?

Guaranteed Loans and Bankruptcies

What a farmer could **preserve** by filing a bankruptcy?

Bankruptcies also halt foreclosure sales.

Exemptions are assets protected in a bankruptcy, which the borrower gets to keep.

There is a federal standard for exemptions, below which states may not go (UNLESS they are a commonwealth), but they can exceed the standard.

for example: NC Exemptions <u>per filer</u>
- homestead protection: $35K in equity. If no equity in home, $10K "wild card" you can apply to other equity positions.
- personal vehicle: $3,500
- certified retirement plan up to $1.7M
- tools of the trade $1,500
- household possessions (in yardsale prices!) up to $3,500

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What are the **consequences** of a bankruptcy filing?

Will negatively impact your credit score for 10 years (or 8 for a Ch. 12)

You can't build equity during a bankruptcy - it will not be a time for innovation/ growth

The bankruptcy court is going to be all up in your finances for the duration of the bankruptcy.

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Chapter 7:
- complete liquidation *except* what you reaffirm you can keep making payments on at the same interest rates & terms.

- takes about 90 days

- cheap, comparatively

liquidation (losing assets) except for what you reaffirm

Chapter 11:
- takes 3 years, at least

- 75% of the unsecured pool of creditors = veto power over a bankruptcy plan

- creditors can also submit bankruptcy plans (usually for liquidation)

- arrears (missed payments must be paid <u>within</u> bankruptcy plan term - ie, more quickly

least advantageous for a borrower

Chapter 12: Farmers & Fishermen

debt is not over $3 million

80% of non-home debt is agriculture or fisher/related

at least 50% of your income in preceding taxable year (OR the avg of the preceeding 3 taxable years) is from ag

...so timing matters! you don't want a $0 farm income year right before you need to file a Ch. 12

must be able to show a feasible plan

expensive $10-15K+ which will come out of preserved assets

harder to find an attorney familiar with or willing to do a Ch. 12

- lots of tools, made specifically for farmers & fishermen!

- only the farmer submits a plan. creditors may object but cannot veto.

- **gives the opportunity to consolidate your debt and to term it out past the bankruptcy plan end date, and past FSA term limits**. Arrears are also pooled into larger debt pool, so you have more time to pay them

- payment schedule is based on when you make your income (it could be annual)

- if you can't make payments, you can amend your plan

- you come out of a Chapter 12 with no tax liability

- under- and un-secured debt is discharged at the end of the bankruptcy plan date.

- you can voluntarily convert to a Ch. 7 but you cannot be forced to if you have acted in good faith.

Chapter 13: Wage Earners
- based on a **monthly payment schedule** (rather than seasonally based) because you earn a wage.

- if you can't make payments you can amend the plan or force the bankruptcy into a Chapter 7 instead.

- some states will try to get you into a Ch.13 instead of a Ch. 7, so that you pay back more debt.

Which **types of bankruptcy** a farmer may be eligible for, and which might be the right fit

Chapter 7: Liquidation

- complete liquidation *except* for standard exemptions and what you reaffirm you can keep making payments on at the same interest rates & terms.

- takes about 90 days

- cheap, comparatively

liquidation (losing assets) except for what you reaffirm

Chapter 11: Reorganization

- usually takes 3 years, at least

- 75% of the unsecured pool of creditors = veto power over a bankruptcy plan

- creditors can also submit bankruptcy plans (usually for liquidation)

- arrears (missed payments) must be paid <u>within</u> bankruptcy plan term - ie, more quickly

least advantageous for a borrower

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Quiz Time!

What are some reasons a farmer would not be able to file a Chapter 12 bankruptcy?

- More than 50% of their income is off-farm
- Debt is over $3 million
- Can't show a feasible plan
- Less than 80% of non-home debt is related to farm
- Can't afford a Ch. 12 bankruptcy lawyer
- Can't find an attorney who does Ch. 12 bankruptcies

Quiz Time!

What are some ways you could learn more about these topics?

a. Review the slides, concept map, and glossary for this presentation
b. Come to the in-person training at Farm Aid on September 24th
c. Review the DBAN Bankruptcy or Direct Loan Servicing training videos
d. Join the DBAN network for peer support, resource sharing, and future trainings
e. Read FLAG's Farmers Guide to Minnesota Lending Law
f. All of the above!

Questions?

Thank you for coming!

Vocab Alert

Documents

Promissory Note - ties you as the individual to the debt. Some include the hereafter acquired clause here.

Deed of Trust - ties the real estate to the debt. Incorporates the descriptions of the property. Uses a survey if you've had one.

Mortgage - a term that people use that's synonymous with the deed of trust and the loan agreement

Loan Agreement - includes terms/conditions (ie what happens if you miss a payment, etc). Explains what the lender has to do to foreclose. Hereafter acquired clause is usually here.

Lender's Agreement - this is the agreement between the guaranteed lender and FSA. (case law is mixed on whether the farmer/applicant is the intended beneficiary)

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Vocab Alert

Words related to bankruptcies

Family Living and Farm Operating Expenses

Disposable Income

Essential Assets

Non-essential Assets

Discharge (a debt)

Discharge (a bankruptcy)

Vocab Alert

Words about passing on the farm

Generational transfer

Transfer & assumption

Protective Advance (where does this go?)

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