Key differences between bankrupt churches, small businesses, study finds

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Although they share some important similarities, religious organizations, such as churches, that file for Chapter 11 bankruptcy protection differ from small business debtors in two significant ways – they seek to preserve the "going-concern value" of the organizations themselves, and their members are more integral to their successful reorganizations, says a new study by a University of Illinois law professor.

Between 2006 and 2011, faith-based institutions in the U.S. filed more than 500 petitions under Chapter 11, according to the research of law professor Pamela Foohey.

"Religious organizations filing for bankruptcy are interesting in their own right," she said. "Their operating models are not the same as other businesses, perhaps even other nonprofit entities. Yet when they encounter financial problems, under certain circumstances, they file Chapter 11 and attempt to reorganize."

Before a string of Roman Catholic dioceses sought bankruptcy protection to handle litigation stemming from sexual abuse allegations, the notion of a religious organization filing for bankruptcy seemed somewhat far-fetched, Foohey said.

"The general public might know about the Catholic dioceses cases or the Crystal Cathedral Ministries mega-church bankruptcy, but they're probably unaware of the 100-plus other bankruptcy petitions that are filed every year by religious institutions," she said. "The filing entities are predominately smaller Protestant churches that are seemingly unable to secure financial assistance from their governing bodies in times of trouble, but they're also synagogues, mosques and religious schools."

Religious organizations and small businesses share many similarities. Most notably, they are driven by and dependent on their leaders, Foohey says.

"When leaders make poor business or poor life decisions, or when they move away or die, a sizable portion of congregants lose faith, move with them or abandon the religious community altogether," she said.

Nonetheless, there are distinct differences between religious organizations and small businesses that file for Chapter 11.

"Perhaps the most apparent difference is that the religious organizations have significantly more assets than the typical small business debtor," Foohey said. "These assets are predominantly real property" – the physical church itself, for example – "that may be relatively illiquid. By contrast, small businesses tend to enter bankruptcy with fewer assets that predominantly are not real property, and the assets they own tend to be liquidated easily."

The religious organizations in the study also tended to have roughly the same amount of debt as the small businesses.

"This means that religious organizations generally enter bankruptcy with a solvent balance sheet – that is, the reported value of their assets is greater than the reported amount of their debts," she said. "This solvency indicates that there may be value to be preserved through their cases. Given that religious institutions tend to own real estate, protecting the equity cushion in their real property may be of particular concern to them. Small businesses, on the other hand, generally own less to be preserved, and generally owe more than the value of what they own."

The data show that the vast majority of the religious organizations file under Chapter 11 because of troubles with paying mortgages on their real property.

"They seek to reorganize primarily so that they may restructure their mortgage payments and retain their real property," Foohey said.

Moreover, the religious organizations in the study usually have operated – that is, stayed open and held services – longer than the typical small business debtor.

"They survive about 20 years before filing, which appears to be long enough for a stable congregation to take root," Foohey said. "Indeed, perhaps most unique about religious organization debtors is that the organization's members, along with the leadership, often are the champions of the reorganization. Only with their commitment and support is the reorganization a successful one."

In some ways, the congregants are akin to customers of small businesses, "but these customers are invested in seeing their congregations continue," Foohey says.

"This makes a religious organization's Chapter 11 case partly about saving a financially troubled business and partly about saving a community that has spent time and money to build a place where it can gather and worship."

As evidenced by the successful reorganizations and continued operations of some of the debtors in the study, Foohey says Chapter 11 can provide religious institutions with a productive means to revive their congregations following economic downturns, transitions and failures in leadership, and problems with creditors, thereby allowing members to continue worshiping in the same space they have gathered in for decades.

"For these entities, the results of my study show that reorganization through bankruptcy has the potential to be a viable solution to their financial problems," she said. "In general, the organizations that are successful – that is, they confirm and complete reorganization plans – tend to own real property of significant value; owe less on that real property than it is worth; and commit to the bankruptcy process, such as retaining counsel, filing complete schedules, and remaining current with fees and other obligations."

Successful organizations also, and crucially, often have trusted leaders, such as a pastor and spouse, who guide the church through the bankruptcy and continue to energize the congregation post-bankruptcy, Foohey says.

"Broadly, these reorganizations seem to preserve the physical buildings members have gathered in for years, allowing congregants to continue to worship and meet in the same location going forward, which perhaps is the ultimate goal of their Chapter 11 filings," she said.

The article, "Bankrupting the Faith," is available online.

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