Transitions in Agriculture: Implications for Research, Data Development and Policy Analysis

Lessons Learned

Introduction

Farm and Ranch transition planning can be described as a process that involves three equally indispensable parts:

1. **Estate planning**, which involves transition of the business' assets.
2. **Retirement planning**, which involves transition of the business' labor and management as well as a detailed estimate of financial needs and sources
3. **Business Transition/Succession planning process**, which involves a comprehensive long term business plan and an in depth outline of the timing regarding the transition of each part of the farming business.

This paper will focus on "Lessons Learned" and "Observations" from two main sources: The projects funded under the Extension Risk Management Education grant program and experience gained through leadership of the University of Nebraska's Beginning Farmer and Returning to the Farm programs.

Extension Risk Management Education funded projects

The Extension Risk Management Education program has been funded by the USDA since 2001 to provide education to farmers and ranchers in all areas of risk management. Since the beginning of the program, over 100 Farm Transition projects throughout the United States have been completed. Impacts for thousands of producers have been recorded. The Ag Risk Library located at http://www.agrisk.umn.edu houses nearly 4,000 farm management educational documents, curriculums, tools, and power point presentations available at no cost for anyone interested in farm management education. Farm Transition information is located in the "Legal" section of the Ag Risk Library.

While many ERME projects covered more than one of the three areas of Farm Transition, the vast number of funded projects, (over 70%), have focused on the estate planning or the asset transfer area. The demand for education focusing on estate planning has been high, in part, because of uncertainties with the Federal Estate tax law and impending changes in both the Unified Credit Exclusion amounts and the Federal Gift and Estate tax rates. Potential impact for heirs of farm and ranch businesses loomed very high and many project directors focused heavily on this aspect of their educational efforts. The remaining two areas of Farm Transition planning received significantly less project focus. Both areas including Retirement planning and Business Transition/Succession planning were focused areas of educational efforts on about 20% of the projects. It can be concluded that, although estate planning remains a necessary component of Farm and Ranch transition planning, there needs to be an increased focus on both Retirement Planning and Business Transition/Succession Planning.

University of Nebraska's Beginning Farmer and Returning to the Farm Programs

The University of Nebraska began educating farmers and ranchers in the area of farm business succession planning over 25 years ago. Since its' beginning UNL programs have impacted over 1,000 Nebraska farming/ranching businesses. Many have received assistance transferring their farm business from one generation to the next and a few families have decided that they will not attempt to make a generational transfer for various reasons. Early UNL educational efforts focused on the farm financial aspects of the transition process, however, because of demand indicated by participant evaluations, educational efforts have shifted focus to include more **communication skills**, **retirement planning** and in depth hands on instruction of the **business transition/succession planning process.**

Observations

There are many barriers preventing younger people from entering production agriculture in the U.S. including the high capital costs of land, machinery and other farm assets, the increased mechanization of farming, U.S. tax policy, tight profit margins for many sectors of agriculture, ease of operation of modern farm equipment, pride of ownership, love of the land, the "no one can do it as well as I can" attitude of current farm business owners, deficiency in communication skills, lack of retirement planning by the current farm operators, and lack of planning for a successor (Ahearn 2009)   Although barriers do exist, interest from younger "want to be" farmers remains high. Many U.S. states have linking services that match farm owners with prospective successors, e.g. *International Farm Transaction Network: Fostering the next generation of farmers* at: http://www.farmtransition.org/ and the *Center for Rural Affairs Land Link program*. at: http://www.cfra.org/resources/beginning_farmer/land_link. All linking programs indicate the number of younger potential farmers is several times larger than the number of older farm owners willing to participate in the linking programs.

A farm business is more than only the farm assets. The farm business includes people, the assets and liabilities of the farm business finances, the day-to-day operation, the marketing and purchasing as well as the labor, management and decision making aspects. Owners of a farm business make either a conscious or an unconscious decision regarding whether or not to actively pursue a successor for their business. Many farmers do not consciously consider the question, "Do I want my farming business to continue after I am gone?" They simply go on day after day doing their work as best they know how. One day simply turns into the next which turns into a week, and then a month and eventually fifty years have gone by and the question is asked, “Where has all the time gone?” Without thoughtful planning for succession, the unintended consequence is that there are fewer and fewer young farmers entering the business and ownership of land becomes concentrated into fewer and older hands.

If a generational transfer of a farm business is to take place it requires effort and planning. Bringing a successor into any business is a process not an event. It requires time, thoughtful discussion, and planning. Transition typically does not happen automatically. To begin the planning process, considering the following questions will help to establish some topics for discussion:

Questions for the owner generation:

- Do you want your farming business to continue beyond your life?
- Is it important to keep the farm in the family?
- Do you want to have a successor?
    - Have you identified a successor?
    - Is the successor one of your heirs?
- Will you retire?
    - If you retire where will you live?
    - How will you spend your time?
    - What kind of lifestyle do you expect in retirement?
    - How much money will you need to support that lifestyle?
    - What will be the source of your income?
        - Rental of farm assets?
        - Non-farm investments?
        - Sale of farm assets?
    - When will you retire?
- What are your expectations regarding:
    - The younger generation’s income?
    - The younger generation’s vacation?
    - The beginning and ending of the work day?
- What assets and liabilities make up the farm business?
- What is the profit history of your farm business?

Questions for the successor generation:

- What are your expectations regarding:

    - Your income?
    - Your vacations?
    - Your lifestyle?
    - Your health insurance?
    - The beginning and ending of the work day?
- What resources do you bring to the business?
    - Skills?
    - Experience?
    - Assets?
    - Desire?
    - Work ethic?
- Which of your skills needs improvement?
    - Analytical expertise?
    - Farm financial management?
    - Risk management?
    - Production/enterprise skills?
    - Communication skills?

The generational transfer plan of a farm business can be thought of as a three legged stool. The three key elements need to be interdependent so they complement each other rather than conflict. The three legs are an estate plan, a retirement plan and a business transition/succession plan. Each leg is needed to support the successful farm business transition from one generation to the next.

Lessons Learned.......Estate Plan

Most farmers and ranchers are not going to become estate planning experts. They can be guided however to be a good consumer of legal services and will be if they go to their attorney equipped with answers to some basic estate planning questions. Their professional can then efficiently help them work through the process resulting in an estate plan that accomplishes their wishes and is compatible with transitioning their farm/ranch business to the next generation. Teaching Estate Planning by discussing four main questions has proven to be a very effective way to organize some rather complicated topics into questions that most producers can answer. What? How? When? Who?

What is the net value (assets-liabilities) of the estate? What type of title has been used to own assets? These are important considerations because of the tax consequences associated with transferring assets from one generation to the next. With some modest effort most farmers/ranchers are very capable of acquiring this information and providing it to their attorney.

How will you transfer your estate? Will you use a will, a trust or titling and deeding? The goal is to help make producers aware of the basics regarding the estate planning tools. Most producers will not be qualified and probably should not make this decision without the advice of a trusted professional.

To **who**m do you want to transfer your estate assets? This is a very difficult question with which many families really struggle. It is not a legal question and as such should not be a question answered by the attorney, but one answered based on a thorough and thoughtful process.

When do you want to transfer assets? Do you want to transfer assets during your lifetime, through gifts or at a time of death transfer through a will, trust, titles or payment on death designations? There are tax consequences that can have significant impact on your heirs based on this decision.

When considering "**who**" to give your assets to, the first question owners of agricultural assets need to consider when doing estate planning is: "Do you want your farming business to continue on beyond your lifetime?" If the answer is no, then simply decide who you want to leave your assets to, when you want to leave it to them, and how long you would like to exert control over those assets. Go to your attorney and draw up your estate plan. If on the other hand the answer to the question is, "Yes, I do want my business to continue on," then you must consider who will be the successor to the business? If the successor is an heir, will that heir be treated differently than the other heirs? Will the farm assets be passed down in a financially viable unit or will they be cut into pieces and divided up like a pie?

Everyone dies eventually, and, in the case of farm owners, at the time of death their farm assets will pass down to their heirs. It is possible for an heir to take over an operation without previous involvement and still become successful, but one can greatly increase the probability of success if the owner plans for a successor.

One of the most difficult decisions for farm families to make is the one regarding asset distribution in their estate plan. Most of us love all our children, but we know that as they were growing up, they were not treated exactly the same. If one child needed to have an appendix operation we didn't rush all the kids to the doctor to keep things even. Each was probably given what they needed, when they needed it, to the best of our abilities. However, many of us have a preconceived notion that if there are five children in the family the estate plan should divide all assets five equal ways.

The following is a recap of an actual conversation with a 68 year old farmer in Nebraska we will call Joe.

After a rather lengthy conversation with an older farmer discussing the importance of the successor generation gaining experience in management and decision making, the 68 year old farmer named Joe asked this question, “You’re the expert; at what age do you think a father should start sharing management duties with his son?” “Well, Joe, how old is your son?” I asked. “Ah, my son is 39 years old, but I wasn’t asking about my son, I was asking about my father.”

The father/grandfather in this family was 90 years old, and he had maintained complete control of all management and decision making authority. Joe then spoke about their typical day. He said, “Each morning my son and I drive over to my dad’s house and wait in the farm yard in our pickup truck until Dad has finished his breakfast. He then leaves the house and walks over to us and explains what we are to do for the day. For example he looks at me and says, “OK you go feed the cows.” and to my son, “and you go rake hay.” He tells us what to do and when to do it.”

What are the chances that someday when the 90 year old father/grandfather dies that Joe or his 39 year old son will have the management skills required to profitably operate a modern farm business?

After some further discussion, I asked “What is your father’s estate plan?” Joe replied, “Well I really can’t say. We have never really discussed it. I think that someday the farm will all be mine but we don’t talk about stuff like that much.” A few months later on a return visit, the topic of the estate plan came up. He said, “Dave, I have some bad news. I asked my Dad about his estate plan, and he told me that he plans to divide all of his assets equally between my seven brothers and sisters and myself. So I will get 1/8 of the farm just like each of my siblings who have not spent a single day working on this place since they left home.” He had worked on that farm for over 50 years. He was paid a very low wage and given a sub-standard house to live in plus a half a beef per year. His contribution to the success of that business was significantly different than the contributions made by his siblings. His contribution could have been accounted for by paying him a fair wage however that was not the case. It could have been accounted for by providing some sort of “sweetheart” rental rate or use of pasture or farm machinery for a subsidized rate but that was not the case either. The only tool left to help create a compensation for the contribution made by this 68 year old farmer was his father’s will.

This true story does not have a very happy ending. The 39 year old son, who was also being paid a very meager wage and a half a beef per year, left the operation shortly after discovering the facts of the estate plan. He has acquired a good job and is doing quite well however, Joe did inherit only 1/8 of the farm at the death of his father. He tried to acquire financing to buy out his brothers and sisters but was unable to do so. The farm was sold to the highest bidder who happened to be a large landowner in the county. Joe and his wife have unfortunately had to spend most of their inheritance on hospital and doctor bills because of health issues. They currently reside in a low income public housing project in a small Nebraska town and are living on their social security benefits.

Was Joe treated fairly? He was certainly treated equally. It has been said, “The most unfair thing you can do is to treat un-equals, equally.” Shouldn’t the compensation be comparable to the contribution? Should farming heirs who helped build the farming business, contributing 50 years of their lives living on a sub-standard wage, be treated equally with their seven siblings, who only show up for Christmas and the funeral, be treated equally? Is equal fair?

This true account of one family’s situation illustrates the need to develop some way to value the farming heir’s contribution to the business. This concept is “Contribution Should Equal Compensation”.

Let’s take a look at another family. Let’s call this family the Jones. The Jones have three children. The youngest of the three children is Jimmy. He has decided to come back to the farm. The other two siblings chose not to be involved in the family business and have chosen professions outside of agriculture and moved to neighboring states. Jimmy came back into the farming business in 1990. At the time of his return mother and father Jones valued their estate at $300,000. They felt all children had contributed equally throughout their growing years so at the time of Jimmy’s return to the farming business, Dad and Mom feel equal would have been fair. If they had passed away in 1990 each child would have received $100,000. Twenty some years later much has changed. Jimmy has been compensated with a somewhat low wage, but, because his wife works away from the farm, they have been able to get by. His contributions have been significant. Jimmy encouraged Dad to buy the neighboring farm across the road when it came up for sale. If Jimmy had not come back to farm, Dad would not have been able to handle the additional work. Because of Jimmy, Dad purchased the additional farm. It has appreciated in value significantly since that time. Jimmy was also responsible for introducing a beef cow enterprise to the farm and has been largely responsible for the genetic selection that has lead to improved profits for the beef herd. Jimmy has taken over much of the management and decision making the past several years. Dad and Mom still receive significant income from the farming business and will need to continue to do so as they have not developed other retirement strategies.

Today Mr. and Mrs. Jones are considering how to structure their estate plan. Their estate has grown from $300,000 to $3,300,000. The business growth since Jimmy’s return is $3,000,000. The question they are considering is, “How much of that appreciation, reinvestment of profits, growth and success has been due to the fact that Jimmy came back to the farm in 1990?” Mrs. Jones reminds her husband that they probably would not have purchased the additional land had Jimmy not returned to the business. In fact, they may have needed to sell some of the original land to help support income needs in their older years. Jimmy has also had a huge impact on the beef enterprise. It has contributed significantly to the overall profitability of the business. Without Jimmy's input in both labor and, more recently, management of the farming business, the current size of Mr. and Mrs. Jones' estate would undoubtedly be much less. After careful thought and consideration Dad and Mom decided that Jimmy was responsible for 50% of the business growth, and Dad and Mom were responsible for 50%.

As the Jones calculate how to make a plan that accounts for Jimmy's contribution they first consider the 1/3 of the asset value of their estate when Jimmy came into the farming business; 1/3 of $300,000 is $100,000. They then consider Jimmy's 50% contribution to the growth, appreciation and profit reinvestment of the business since his return; 50% of $3,000,000 is $1,500,000. Finally, they consider 1/3 of the 50% contributed to the business by Dad and Mom; 1/3 of $1,500,000 equals $500,000. Thus, Jimmy will receive an inheritance of $100,000 + $1,500,000 + $500,000 = $2,100,000, while his siblings will receive $100,000 + $500,000 = $600,000. This is certainly not equal, but, based on their situation, the Jones feel it is fair.

Contribution can be compensated through wages to the one making the contribution at the time those contributions are made, compensation could also be paid in the form of some sort of "sweetheart" rental rate or use of business assets at reduced charges or contribution could be accounted for in the estate plan if not done previously. Does Contribution equal Compensation?

A farming estate plan must also account for the fact that the returned earnings of U.S. farm assets are not traditionally very attractive to non-farming heirs. Because asset values, especially farm land, have increased rather dramatically in the last 20 years, the value of many farm estates is relatively high. The earnings those farm assets can produce, however, is modest. The problem arises when non-farming heirs try to stay in business with farming heirs. The income return non-farming heirs will receive on their farming inheritance will not be comparable to many non-farm investments without capturing asset appreciation through the sale of the farm assets. If possible, it may be better to provide an inheritance for non-farming heirs from assets that are not crucial to the continued success of the farm business. Leaving non-farming heirs non-farm assets such as life insurance, houses, stocks, bonds or other non-farm investments will not jeopardize the continuation of the farming business.

Lessons Learned…….Retirement Plan

Lack of good retirement planning has become a major barrier to farm business succession. For many small business owners, and especially for farmers, the business is the key source for retirement income when or if retirement occurs (Lobley and Errington, 2002). The land in essence becomes the 401K plan with farmers using the land as an investment portfolio to be sold upon retirement. Further, the reliance on the farm assets creates an uncertainty regarding the adequacy of retirement income. No one knows the answer to the question, how long will we live? It is very tempting for farmers to just keep on farming. Most enjoy their work and, with modern farm equipment, it has become very comfortable for most farmers to simply farm for one more year. Certainly no one should tell farmers they must retire. It is their business. They have worked hard for it, and they should do as they see fit. There are consequences, though, if a farmer continues farming until death; the likelihood of a younger operator stepping in and continuing the farm business is not high. Odds are at the death or disability of the older farmer, if a successor has not been identified, the family will either rent or sell the property to the highest bidder. Most of the time the highest bidder will be a large established farmer that will likely absorb this farm into their own. The unintended consequence of not planning to retire is there will be one less family living in the community, one less family attending churches and sending children to the local schools, and one less family buying goods and services from the local business. The unintended consequence is a less vital and vibrant community. A good retirement plan should address the retiring families' value of the community, as well as the approximate date for retirement, sources of retirement income and retirement activities.

Lessons Learned…….The Transition/Business Succession Planning Process

Good communication skills are vital to creating and executing a viable farm business transition/succession plan. Transitioning a farm business from one generation to another involves much more than simply transferring ownership of the farm assets. It involves passing on the skills and knowledge the owner has acquired over time and the ability to manage the farm business profitably. A crucial skill that many farmers lack is the skill of communication. The process of developing a successor requires many hours of discussion between the generations. It should include all actively involved parties, especially spouses. A key element that needs to be established is the expectations of each generation. If expectations are not revealed and discussed, future problems are very likely to erupt. All parties to the farm business succession, including spouses, should discuss their expectations. Where expectations differ, the ensuing discussion can provide an opportunity to develop joint problem solving and communication skills that will be essential to an effective generational farm business transition. If disagreements can be resolved civilly to the satisfaction of both parties, the development of agreements can begin.

A proven business succession planning model is available at http://www.extension.iastate.edu/agdm/wholefarm/html/c4-10.html, Don Hofstrand. This was developed over the past two decades by Iowa State University and the University of Nebraska, and it considers the typical farm business to be composed of labor, income, management and asset ownership. Each of these business components will need to be transferred from one generation to the next. Because the transferring of business components may be difficult to reverse, it is suggested transferring occur in phases. This model involves four phases of transition: the testing phase, the commitment phase, the established phase, and the withdrawal phase. Each phase should be discussed and a timeline needs to be identified that indicates the length of each phase. When thoroughly discussed, the farm transition/succession plan becomes the blue print for the transition process.

Management of the business is critical during all phases but it can be particularly tricky to pass the management from one generation to the next. Transition of management usually begins to occur during the established phase. It can be very difficult for owners as they watch their successors lead the business in a direction that may be different than they would have chosen. Typically, as people age they become more risk averse (Bucciol, 2007). If the successor makes management decisions that have the potential to expose farm assets to an increased level of risk, care should be taken to minimize exposure of the owner's assets. Taking risk may earn rewards. Likewise if rewards have been earned they should be a reward to the party exposed to the risks. Certainly the successors will make mistakes and, likely, different mistakes than the owner would have made. Owners need to be supportive, patient and encouraging when problems arise. Second guessing and "I told you so" comments will produce an unconfident successor who will be insecure in their abilities. The skills required to become a successful modern farm business manager include analytical expertise, shrewdness, persistence, competitiveness, production knowledge and a relentless work ethic. Some or all of these skills have been effectively developed by many farm business owners over the years. These same skills, however, can be very detrimental as the owner begins to relinquish management authority to the next generation. Throughout this phase, it will be important for the owner generation to keep their final goal in mind, their farming operation continuing successfully.

Conclusion

The U.S. agricultural trend of greater numbers of older farmers owning increased amounts of farm land and assets, coupled with fewer younger farmers owning decreasing amounts of farm land and assets has occurred as a result of interaction between several factors. Many of those factors will not be changed. Although several states have legislated Beginning Farmer Tax Credit programs that encourage landlords to rent agricultural assets to beginners, the U.S. Federal Tax Code discourages the sale of capital assets by the older generation.

Education has made and will continue to make a difference. Educational factors that can make an impact are:

1. Teaching owners of farming businesses the importance of retirement planning and the unintended consequence of failure to plan for retirement.
2. Informing farm business owners of the importance of planning for a farm business successor.
3. Educating farmers regarding the farm business succession planning process.
4. Educating farmers to create communication opportunities and encourage efforts to enhance communication skills.

Farm business succession planning is a process not an event. It takes time, effort, thought, calculations and communication. The process is critically dependent on each generation's ability to communicate. Educators have the opportunity to have a significant impact on farm businesses that are willing to participate in the farm business transition/succession planning process.

Submitted by:

Dave Goeller

Deputy Director North Central Risk Management Education Center

Ag Economics Department

University of Nebraska

dgoeller@unl.edu

Bibliography

Ahearn, Mary and Newton, Doris. *Beginning Farmers and Ranchers*. EIB-53. USDA. Economic Research Service. United States. May 2009.

Baker. *International Farm Transition Network: Fostering the next generation of farmers* [Online]. Available at: http://www.farmtransition.org/ [accessed: 20 January 2011].

Baker, John and Duffy, Mike. 2000. "Farm Succession in Iowans." [Online]. Available at: http://www.extension.iastate.edu/bfc/pubs/FarmSuccession.pdf [accessed: 20 January 2011].

Bucciol, Alessandro and Miniaci, Raffaele. 2007. “Risk Aversion and Portfolio Choice.” [Online]. Available at http://economia.unipv.it/eco-pol/PaperSeminari/Bucciol_Miniaci.pdf [accessed: 20 January 2011].

Center for Rural Affairs. [Online]. Available at: http://www.cfra.org/resources/beginning_farmer/land_link [accessed: 20 January 2011].

Center Programs: Beginning Farmer Center – Resources to help our next generation of farmers [Online]. Available at: http://www.extension.iastate.edu/bfc/programs.html#Farm On [accessed: 20 January 2011].

Errington, A., and Lobley, M. *Handing Over the Reins: A comparative study of intergenerational farm transfers in England, France, Canada and the USA*, presented at the Agricultural Economics Society Annual Conference, Aberystwyth, April 2002.

South Dakota Department of Agriculture: Farm Link Program [Online]. Available at: http://sdda.sd.gov/AgDevelopment/FarmLink/default.aspx [accessed: 20 January 2011].

United States Department of Agriculture: The Census of Agriculture. 2009. United States: United States Department of Agriculture [Online]. Available at: http://www.agcensus.usda.gov/Publications/2007/Full_ Report/index.asp [accessed: 20 January 2011].

University of Nebraska-Lincoln Women in Agriculture: Returning To the Farm [On-line]. Available at: http://wia.unl.edu/ReturningtotheFarm [accessed: 20 January 2011].