Retirement Realities for Farm & Ranch Owners

Introduction
It is a unique breed of person who is willing to take on the challenges associated with farming and ranching. It is a difficult and risky business year-in and year-out, and even when it comes to making plans for retirement, farmers and ranchers face unique obstacles. Your expectations may be that the equity accumulated in your land and equipment will ultimately fund your retirement. This could occur through leasing or selling the farm or ranch. Yet, there are significant complications to turning your property into a stream of retirement income.

Many approaching retirement place a priority on trying to sell the property and equipment. While this could result in a sizable nest egg, it means transferring the farm or ranch to the next generation or selling it to other farmers or ranchers. Either scenario comes with its challenges. These types of choices can be emotionally difficult, especially if the land was in the family for generations.

Some key issues farm or ranch owners often consider include:

- The state of a farm or ranch owner’s balance sheet, which likely includes short- and long-term debt
- The degree to which wealth is concentrated in land, buildings and equipment
- The time it will take to fully transition to new ownership
Family succession planning

For the property to remain with the family, the first consideration is whether a family member will continue to operate the farm. Alternatively, if the plan is to maintain ownership of the property but to lease the land, the family should undertake a realistic assessment of its ability to manage the business without triggering any potential conflicts among family members.

The differing priorities of each family member need to be taken into account. Matters often become more sensitive if a decision is made to turn control over to one family member. Business and personal matters can become co-mingled, potentially jeopardizing family harmony.

The key concern ultimately is the fallout if the property is poorly managed or family disagreements become a serious burden. In cases like this, it isn’t unusual for the property to be sold under distressed circumstances.

Keeping the farm or ranch in the family and creating a successful transfer often requires a lengthy transition period with both generations working together to help smooth out the process. As you prepare for a transition, there are many questions that should be addressed.

Key considerations when transitioning the land to family members

Here are questions you will want to consider if family members are looking to take over the land at a future date:

- Are succeeding family members (including spouses) dedicated to farming or ranching?
- Is the current owner ready to share control?
- Do the different generations share a common vision?
- Can family members work side by side?
- Can the farm or ranch realistically support every family member interested in participating in the operation?
- Do you need an agreement to help assure fair treatment of non-participating family members?
- Is there enough liquidity to ease the transition?
- Will the current owners remain in their current home? If so, where will the next generation live?

Generation gaps

70% of first-generation operations do not successfully transition to the next generation.

90% of second-generation operations do not make it to the third generation.

96% of third-generation operations do not survive to a fourth generation.

Source: University of Minnesota, CSREES, USDA 2008 and Farm Journal Legacy Project.

Key considerations when family members do not plan to be hands-on operators

When your family wants to keep the farm but the next generation is not ready or can’t commit to farming, consider these questions:

- What is the plan to transition from an operating farm entity to an income-producing investment?
- Are you willing and able to become the managing landlord or do you need someone else to manage your interests?
- Is there sufficient income and land value to support your family’s overall needs and objectives?
- Can you find a tenant committed to maintaining the farm and stewarding the land, or would you be better served by engaging a professional farm manager?
- Does the earning potential from selling the farm exceed potential income from ongoing ownership and management and related capital expenses?

A desire to maintain family cohesion is one of the reasons to consider the benefits of working with an outside party that can provide expertise and true objectivity while...
soil testing and tillage practices. We manage drainage, irrigation and conservation projects to help assure the farm legacy performs in line with the financial and stewardship goals and parameters established by the owner. Our focus is to ensure that the land provides a fair return based on individual farm qualities and, at the same time, is farmed and managed in a responsible manner.

Support for the family that continues to operate the property

The process of transferring ownership within the family can be daunting. Professional expertise can help potential beneficiaries understand the ownership configuration and the management structure that is to be implemented. You can rely on the expertise of U.S. Bank’s Farm and Ranch services to help oversee all aspects of farm management. This can significantly reduce the burden and responsibility that might fall on others while creating the potential for an enhanced financial payback from the land. Our service offers specialized expertise to work with the unique needs of families that own farmland and wish to retain it to generate ongoing income.

U.S. Bank’s Farm and Ranch services offer superior expertise to assume responsibility for day-to-day management functions of the leasing relationship. We’re prepared to manage all aspects, from routine functions to extraordinary circumstances that may arise.

Our work includes the negotiation and management of lease terms, collection of rent, marketing of grain where applicable and timely distribution of farm income to the owners. We also maintain strong communication with owners and tenants by relaying critical information on a timely basis. As part of our focus on building a strong connection and value with owners, we monitor factors like commodity trends, crop insurance and input prices on an ongoing basis. We also provide an enterprise analysis. All of these factors may have an impact on lease rates and contract terms. We also tap the resources of the Farm Service Agency (FSA) and Natural Resources Conservation Service to identify other opportunities that could potentially augment the income stream.

An important role we play is to serve as responsible stewards of the land, assuring that tenants utilize it in the proper way. We oversee crop rotations, crop inputs,
competitive bid process may also be considered an appropriate strategy. Once the sale process is completed, an offer for the property may be accepted. While U.S. Bank and its representatives do not provide tax or legal advice, we will make arrangements for legal review and assure that all sale terms are met. Our professionals also help to oversee the closing of the sale and proper distribution of proceeds.

Farm and ranch valuation
As with any business, it’s critical to know the value of your farm or ranch in order to plan. The valuation process can be difficult and may require a specialist who understands your geographic marketplace and can make an assessment based on the amount of acreage farmed, the value of machinery or equipment in operation and the crop or livestock the farm is able to produce.

The appreciation of farmland values over the past few years may add to your retirement planning considerations. Estate tax consequences could result, so you may need to identify strategies to help reduce gift and estate taxes.

Estate planning
Another consideration when a farm or ranch makes up a large portion of your estate is having sufficient liquidity to cover estate taxes. If you’ve also leased water or mineral rights, the increased value of your rights may suddenly put your total estate above the threshold for the federal estate tax exemption. Adjustments to your estate plan can help minimize tax liability and ensure sufficient estate liquidity to cover taxes, final expenses and administrative costs.

It’s not always easy to sell all or part of a farm or ranch in order to generate cash, and doing so may be undesirable if you want the farm to remain in the family. Planning can help you identify solutions to liquidity concerns.

The following strategies may help address your estate planning concerns:

- Creating a trust that seeks to provide important benefits that are not available by simply naming beneficiaries in your will. These potential benefits can include:
  - In most cases, assets held in trust avoid probate, which also means that the transfer may remain a private matter.
  - Trusts, if structured correctly, may also provide protection from creditors of beneficiaries.
  - You, as grantor of a revocable trust, may retain control of the assets through trust terms, even after death. This control lets you direct the trust to distribute income from the trust’s assets to your children either now or in the future.
  - When using an irrevocable trust, assets may be removed from your estate, which can help minimize estate taxes.
- Establishing a family limited partnership to help facilitate the transfer process.
- Incorporating life insurance to help provide liquidity.
Nearly 60% of farmers do not have an up-to-date estate plan.

89% of farmers do not have a farm transfer plan.


Family limited partnership strategies

Establishing an entity that qualifies for a gifting discount for gift tax purposes, such as a family limited partnership, is a strategy that can facilitate operational planning and the efficient transfer of family wealth. It also may help reduce gift and estate taxes while accommodating business succession planning.

When a farm owner transfers his/her property into a family limited partnership, the owner receives partnership interests in return. These interests can be divided and transferred to family members, which can eliminate the need to split up the property in order to pass it on to multiple people.

A family limited partnership can also be a vehicle for managing farmland operations and transitioning farm asset ownership from one generation to the next. The older generation retains management control until the younger family members have proven their ability to manage the farm.

Potential advantages:

• With the partnership in place, you can create an operating agreement mechanism that lays out management goals and functions before, during and after the transition. Management control can be designed for any family member who will actively operate and manage the farm.

• Transition ownership to both managing and non-managing family members while providing equitable treatment.

• Ability to discount partnership units for gift tax purposes. Discounts can be applied to non-management/control units to account for their lack of control and marketability. This can help enable the transition of wealth and helps reduce gift and estate tax liability.

• A more efficient gifting mechanism than the gifting of acres and/or fractional acres of farm real estate.

Potential disadvantages:

• The loss of the potential tax benefits of a step up in cost basis, when assets are gifted prior to the death of the owner. With a family limited partnership, assets may be gifted prior to death, and the original cost basis that applied to the owner carries over to the person receiving the assets. This can be an issue if there are plans to sell some or all of the farmland in the near term. We work with you to analyze the savings in gift/estate taxes versus the potential capital gains tax savings if assets are passed on at the owner’s death.

• The administrative challenges and requirements of creating another entity, including filing income tax returns and maintaining other paperwork.
Life insurance options

Another tool to help pay estate tax and/or to facilitate the equitable distribution of a farm or ranch to non-participating family members is the use of life insurance.

A properly structured life insurance strategy allows for the potential of income tax-free death benefits that can be used to help offset final expenses and/or provide for wealth transfer to non-participating family members.

Care must be taken to ensure that the value of the estate is not increased by insurance proceeds received after the death of the owner.

Guarantees are backed by the claims-paying ability of the issuing insurance company.

Legacy preservation

If your goal is to transition your farm or ranch to the next generation, you need to plan ahead for the process of transferring ownership, income and management responsibilities. Topics to discuss with your family and your financial, tax and legal professionals should include:

- Transferring the farm or ranch as a gift: Gifts using annual gift tax exclusions and/or lifetime gift tax exemptions may be a means of gradually giving the farm or ranch over to succeeding family members while you continue to work alongside them and pass on your expertise.

- Selling the farm or ranch on an installment basis: One way to support the income or cash flow of both generations is to have succeeding family members pay yearly installments to the current owners in exchange for future ownership. Assets such as equipment may also be sold on an installment basis.

- Utilizing buy-sell agreements: In the case of the unexpected departure of an active owner, a previously drafted and funded buy-sell agreement may be a way to provide a source of income for succeeding family members to continue to purchase the farm or ranch from the estate of the insured. The proceeds from the sale may also be a source of income for a surviving spouse.

- Setting up a wealth equalization strategy: While you may want to benefit all your heirs, it may not be practical to distribute all farm or ranch assets equally.

You may want to consider setting up an Irrevocable Life Insurance Trust (ILIT) to help provide a death benefit equal in value to the farm or ranch inheritance for nonparticipating children.

- Professional management of your property: When the farm or ranch functions as a legacy, and the next generation cannot commit to the demands of running it, it may be wise to consider professional management services.

With proper planning you can help ensure that your farm or ranch is transferred to interested children and their families with enough remaining for you to be financially secure in your retirement.

Stastically, farm and ranch families who fail to plan for succession are more likely to go out of business, resulting in having their property absorbed into neighboring farms and ranches, or converted to non-farm use.

U.S. Bank Specialty Asset Management, Farm and Ranch group

U.S. Bank’s Farm and Ranch group works with families, individuals and ownership entities through the transition process of retirement.

Our staff has experience in guiding a variety of farm management circumstances. That experience can come to bear on our ability to foresee potential challenges and present alternative considerations to owners. We can offer “what if” scenarios with a reasonable ability to predict likely outcomes. Owners will be in a position to make well-informed decisions.
We offer proactive management and specialized resources for all farm and ranch assets, while helping you work towards your short- and long-term financial goals. Each farm or ranch situation is unique, and our professionals strive to help meet the requirements of your particular ownership situation.

Our team members are strategically located around the country, with each combining his/her formal education in agricultural-related fields with hands-on farm and ranch management experience. They use their understanding of the industry to provide guidance on:

- Crop and land management stewardship
- Lease negotiations and lease management
- Government and environmental regulations
- Crop marketing
- Government programs, enrollment and management

The Farm and Ranch group seeks to provide management services, resources, and technology to help maximize the value of your unique farm or ranch operation while helping protect the quality of your land including:

- A personal farm or ranch manager to help plan and oversee operations
- Choosing an appropriate farm operator
- Planning and managing conservation and capital improvement projects
- Developing and monitoring a crop plan and soil tests
- Marketing the crop

After the close of each year, our team members will provide you with a comprehensive summary of your farm or ranch operations, detailing the locations, acreage and yield of each crop, itemized expenditures and income. They also review opportunities to potentially improve performance in the future. Proactive management to meet short- and long-term financial goals can help lift the stress of day-to-day management from family members, while potentially generating market value for your land investment.

At this critical time of life, a supportive financial professional team can help facilitate a smooth transition to retirement, managing the real challenges presented by retirement today.