Ag Business Management

Informing farm families and ag businesses about management issues.

University of Minnesota Extension

Preparing to transfer the farm business

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July 2013

Introduction

Transferring the farm business to the next generation is seldom an abrupt process. The transition generally takes place over a number of years. The entering generation needs to establish a firm financial footing as well as learning to manage the business. The retiring generation has to be willing to turn over control of the business and trust that the successor will do well.

Farming is a capital intensive business. Farms are made up of several classes of assets. Current assets include stored and growing crops as well as feed inventories. Intermediate assets include breeding and market livestock, machinery, and equipment. Farmland and buildings make up the long-term assets. The total of all these assets can equal millions of dollars.

The transition process must be well thought out and implemented prudently, given the potential financial consequences to all involved. The following information will help you with this process.

Factors to consider before transferring the farm business

Your financial security in retirement

Complete a projection of your anticipated income and living expenses during retirement. Will you and your spouse have sufficient annual income to get you through the retirement years? Have you made provisions for higher than normal medical expenses or long-term health care expenses? Remember, people are living longer and this requires more financial planning.

Financial position of the entering generation

Give serious thought and planning to the financial position of the entering generation. Do they have some equity to put into the farm business? Can they afford the payments to you and to other creditors? Will they have a business of sufficient size and efficiency to generate an adequate living? If the answer to these questions is "no", you may want to delay transitioning the business. The entering generation needs to improve their financial position or you need to plan on making major concessions to get them started in the business.

Your Social Security (SS) position

Every individual is different regarding their SS contributions and status. Changes in SS rules may affect your plan to exit from the farm business. Contact your local social security office about your contributions and benefits before making any decisions about when to retire or how to sell or transfer the farm business assets.

Your willingness to let go

Transferring assets and management of the farm to someone else means you no longer will be in control of the farm business. If you cannot let go or stand to see someone else in the decision making role, do not retire until you can accept this change in your role.

Your emotional readiness to transition the farm

If the farm has been the major focus of your whole life and you have spent nearly every day building and working on this farm-expect some challenges. Leaving the farm under these circumstances should be planned for well in advance.

If you can view the following statements positively you may be ready to leave farming.

- *"I have plenty of ways to use my time after I retire. I can golf, fish, travel, socialize and finally get at some of my hobbies."*
- *"I can continue to feel fulfilled as* a *contributing human being by volunteering or helping my children after I retire.* "
- *"Although we will do many things together, I plan to let my spouse have her/his own space. I will establish my own friends and time independently of hers/his at times."*
- *"I am willing to move off the farm and out of my home, so that the younger family can work and live at the center of the farm business."*

Your health

Transferring your farm business to someone else can afford you time to do the things you have always wanted to do. Retiring early while your health is good may give you more time to travel, pursue hobbies, spend more time with family, etc.

Successful retirees are usually committed to good physical and mental health. They *eat* right, exercise regularly and keep mentally fit by reading, thinking and conversing. Are you ready to do the same?

Key questions you need to ask yourself

Transferring the farm to the next generation is a complex and serious undertaking. If not done properly, there can be serious financial and family relationship consequences.

Answer the following questions honestly before you start the transition process:

1. Is the farm, in its current format, generating enough income to support an additional family?
2. If not, are there farm income expansion possibilities or viable off-farm income possibilities available to support the entering family?

3. Is there a way to transfer the farm and keep everyone in the family happy? That includes exiting and entering families as well as non-farm heirs and in-laws.
4. Can the parents afford to give some financial assistance to the entering family while still maintaining an adequate retirement income?
5. Is the exiting manager willing to transition management skills and management decisions to the entering manager?
6. Have the parties involved in the transition had a positive, respectful and considerate attitude toward one another in the years before entering a transfer agreement?
7. Does the entering manager have the ability, desire and willingness to teach the farm management skills needed to manage a high risk, low margin, highly competitive business?
8. Can the involved parties communicate openly and freely with one another?
9. Are all parties involved, willing to develop a written plan of transition and a business agreement prior to starting the transition process?
10. Are housing facilities available which will provide acceptable, yet independent lives for each family involved?
11. Are all participants, including spouses, willing to be involved in decision making regarding work tasks, hours, vacation, finances, and family expectations?
12. Are all parties willing to start with a trial period of working together, through a wage agreement or farming independently while sharing resources, for a year or two before starting a formal arrangement?
13. Are the parents willing to provide security to the entering parties by agreeing to a buy/sell agreement and allowing the entering party the right to purchase assets in the future? The agreement should be binding on other heirs.
14. Are the parents willing to sell, lease, gift or otherwise transfer assets to the entering party at perhaps less than current market values?
15. Are the parents not only willing to transfer farm assets but are they willing to transfer management of those assets to the entering generation?
16. Are the parents willing to eventually move to town or to a residence off the farm to allow the new manager to be nearer the center of farm operations?
17. Can and will both parties put together a tax plan which will be acceptable to everyone as they transfer assets?
18. Are the parents insurable and will they permit the younger generation to carry life insurance on them for financial protection in case of premature death?
19. Are all parties willing to provide protection from premature pay out to off-farm heirs by establishing purchase options with installment terms for sale of assets in their Will or trust?
20. Are all parties willing to pledge that they will not try to control any aspect of the other parties' business and personal lives?
21. Are entering children willing to pay parents adequately for work done on the farm after retirement?
22. Are entering parties willing to sacrifice standard of living and go the "extra mile" with work to get started farming?

23. Are entering parties appreciative of the farming opportunity given to them by their parents? Are they willing to "give and take" to make the transfer process successful?
24. Do the entrants wish to farm because they have prepared for it educationally and feel it is their chosen field? This is in contrast to those who enter farming because they can't find anything else to do, or nothing else worked out, or it is an expectation of their parents.
25. Do the entering parties have a realistic grasp of current agriculture and what it takes to put together a profitable, competitive business?

If you can answer "Yes" to nearly all of these questions, you have a good chance for a successful transition of the farm. If you answered "No" to any question, you may wish to evaluate the situation before you proceed.

Establishing goals

Essential to the business transfer process is the establishment of individual, family, business, and retirement goals. These goals guide the transfer process and help validate decisions that are made. Without being clear and firm about these goals, the transfer process will not succeed.

When developing your goals, think about all the issues listed earlier in this document-parent's willingness to turn over control and management of the business, the ability of the business to support multiple generations, the ability of the entering generation to manage the business, etc.

Think of goals as being what you want to have happen to your business and personal assets or perhaps more importantly what you do not want to have happen to your business and personal assets.

Goals need to be in writing in order to bring life and meaning to them. Research supports the fact that if goals are in writing, the probability of achieving them increases by 1,100 percent.

Goals should list specific actions and specific results of those actions. Goals need to have a timeline. Goals need to be attainable and realistic while also being flexible.

To help begin this process, think about the following questions:

1. What do you want from or for your farm or ranch business?
2. What do you *not* want from or for your farm or ranch business?
3. What do you want for your family?
4. What do you *not* want for your family?
5. What do you want for yourself?
6. What do you *not* want for yourself?
7. What do you want in your retirement?
8. What do you *not* want in your retirement?

One approach to establishing goals is to utilize a three step process outlined below:

Step #1: Each person involved in the business should list their individual short-term goals (3 years or less) and their long-term goals (4 years or more) for three areas. The three areas include your individual or personal goals (what do you want for yourself), family goals, and business/career goals (entering

generation) or retirement goals (retiring generation). This process is done as an individual, by you, with no one else involved.

Step #2: Each generation (retiring generation alone and entering generation alone) comes together and using their individual goals list, prioritize those goals onto one list for their generation, within the three areas (individual, family, business/career or retirement goals).

Step #3: Both generations involved in the business come together and using their Step #2 lists, prioritize their goals under the three areas-individual, family, and business/career-retirement goals. To help with this final process, there are a few questions that may be useful. Those questions are:

1. Which goals are most important for family well-being, business success, and or retirement success?
2. Which short-term goals, if attained, would help us achieve our long-term goals?
3. Which short-term goals conflict with or may impede our long-term goals?
4. Which goals are so important that they should be attained even if it prevents us from reaching other goals?

Once your final list of priority goals is established, it becomes your road map for the transfer process. This list of goals becomes the foundation for your written business transfer and personal estate plan. It should include all the things you want to have happen to your personal and business assets, while alive and after your death. It should also include what you *do not* want to have happen to your personal and business assets, while you are alive and after your death. Each action you take, each decision you make, you do so based upon your list of goals. Check it every time you make a decision. Does your decision help to fulfill your goals or does your decision violate your goals.

Once this list of goals is complete, take it to your transition and personal estate planning team of professionals (attorney, accountant, financial planner, banker, insurance agent, etc.). Their responsibility is to put into place what it is you want, based upon the list of goals. These actions, on your part, will complete the development and implementation of your business transfer and personal estate plan.

HINT: There are many things to think about in the business transition and personal estate planning process. The key to success is to develop your goals list and then take that list to your transition and estate planning team. DO NOT get involved in thinking about all the stuff there is to think about in the transition and estate planning process: Do I need a Will or a trust? Do I need a partnership or LLC? How do I prevent assets from being lost to divorce? Focusing on how to solve all these issues will confuse, frustrate and eventually paralyze you and prevent you from moving forward. All that stuff is nice to know information. Being familiar with the terms when your team talks about them is great. However, your responsibility and task in the process is to complete your goals list-period! It is the responsibility of your team to put your goals into action and address all those other questions and concerns you have.

For more information, see Transferring the farm series #9: Preparing to meet with your transition and estate planning team.

This publication is offered as educational information. It does not offer legal advice. If you have questions on this information, contact an attorney.