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SUCCESSION DECISIONS AND RETIREMENT INCOME OF FARM HOUSEHOLDS

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Most farm households control a substantial amount of wealth. In 2001, U.S. farm households had an average net worth of $545,869, compared with $395,500 for nonfarm households. Failure to plan carefully for retirement and transfer of the estate can result in serious problems such as financial insecurity, personal and family dissatisfaction, and unanticipated capital losses. The fact that a large part of farm family wealth tends to be held as illiquid, indivisible assets makes the succession and retirement process particularly difficult, but important for farm families. This is not unique to family farms as the productive assets owned by many self-employed individuals or family businesses have similar characteristics. For family farms, the farm itself constitutes a physical asset that is highly illiquid, indivisible to a large extent, and in most cases constitutes a large fraction of family wealth.

Many studies have shown that even when the farm business cannot provide the family with an adequate standard of living, farmers refrain from selling farm assets and try to supplement their income from other sources, such as off-farm work. Further, the survival of the family farm is highly dependent on successful intergenerational transfer. Entry into farming by the 'next generation' holds a place of central importance in the determination of industry structure and total number of farmers and farm families.

The family farm is more than an income generating enterprise. It is an asset whose productive life expectancy may extend well beyond that of its operator, and whose future value depends crucially on the way it is managed and the degree to which its productive capacity is maintained. It is a place of residence for the farmer in old age, and it is attached to land, whose symbolic importance exceeds its economic value for many landowners, environmentalists, and others. This evidence points to the fact that retirement and succession considerations cannot be disentangled from day-to-day farm management decisions. Synchronizing the growth and decay cycle of the farm business may itself be crucial for the continuance of the farm family business. Clearly, intergenerational succession is one of the important links between these two cycles. This paper provides an understanding of the various farm, operator, household, and financial characteristics that affect an operator's decision to retire and designate a successor to operate the farm. Further, the paper describes the retirement horizon of farm operators and documents sources of retirement income for farm households.

Sources of Retirement-Succession Plan Data

Data for this analysis are from the 2003 Agricultural Resource Management Survey (ARMS). ARMS is conducted annually by the Economic Research Service and the National Agricultural

Statistics Service. The survey collects data to measure the financial condition (farm income, expenses, assets, and debts) and operating characteristics of farm businesses, the cost of producing agricultural commodities, and the well-being of farm operator households.

The target population of the survey is operators associated with farm businesses representing agricultural production in the 48 contiguous states. A farm is defined as an establishment that sold or normally would have sold at least $1,000 of agricultural products during the year. Farms can be organized as proprietorships, partnerships, family corporations, nonfamily corporations, or cooperatives. Data are collected from one operator per farm, the senior farm operator. A senior farm operator is the operator who makes most of the day-to-day management decisions. For the purpose of this study, operator households organized as nonfamily corporations or cooperatives and farms run by hired managers were excluded.

The 2003 ARMS collected information on farm households in addition to farm economic data. For example, it collected detailed information on off-farm hours worked by spouses and farm operators, the amount of income received from off-farm work, net cash income from operating another farm/ranch, net cash income from operating another business, and net income from share renting. Furthermore, income received from other sources, such as disability, social security, and unemployment payments, and gross income from interest and dividends was also counted.

In addition, the 2003 ARMS queried farmers on their anticipated retirement from farm work and plans for the future of the farming operation (rent, sell the farm operation, turn the management and operation of the farm over to another partner and/or family member). Farmers were also queried about whether they had developed a succession plan for their farming operation. These questions were developed to support research focused on the livelihood, savings, and investment choices of farm households. The farm itself is a significant, even dominant, component of the household asset portfolio for most farm households. As such, it is a source of earnings and wealth that help support household expenditures at different stages of the life-cycle.

Respondent Demographics

There are nearly 2.0 million farm families in the U.S that are engaged in farming at some level. Not all of them are actively involved in farming as a primary economic activity of the farm household, since many households dependent on off-farm income choose to reside on farms in rural areas. The average farm operator is about 56 years old and operates an average of 452 acres. The size of operation varies by the commodities produced, location of the farm, and plans for retirement of the farm operator. For example, operators who indicate that they are retired, operate (on average) a 193 acre farm. On the other hand, operators age 65 or older (not retired or retiring anytime soon) have an average of more than 817 acres in their operation. Several things stand out in American agriculture: (1) farms vary extensively in terms of acres operated and commodities produced; (2) farms are located in different regions; and (3) farm households derive income from many sources, including off-farm work.

The 2003 ARMS asked farm operators about labor and employment decisions for farm operators and their spouses. In 2003, 45 percent of operators and 54 percent of spouses reported that a job other than farming was their principal occupation. To obtain information about the employment choices made by farmers and/or their spouses, those who reported a principal occupation other than farming were asked a follow-up question focused on whether that occupation was the operator's or his/her spouse's career choice. Three-fourths of operators and four-fifths of spouses responded that their non-farm occupation was their career choice. Most farm operators who worked off the farm were employed by private companies. Private businesses were also the main employer for spouses, followed by government or schools. The heavy emphasis in employment of operators and spouses by private companies or nonfarm business ownership demonstrates the importance of the general economy to the financial status of farm households.

Farm household income originates from both farm and nonfarm sources. While off-farm wages predominate, income from another business—such as a machinery repair shop, seed dealership, or insurance agency—can also add to farm household income. Income from interest and dividends includes the interest income from savings and investment accounts. Dividends earned by households are from investments in equities such as stocks or mutual funds. Additional sources of nonfarm income include pensions, annuities, military retirement, unemployment, Social Security, veterans' benefits, other public retirement and public assistance programs, and rental income from properties. By combining income from farm and off-farm sources, farm operators received an average household income of $66,190 in 2003, higher than the average for all U.S. households ($59,067). On average, 91 percent of farm operators' household income came from off-farm sources in 2003. Reliance on off-farm income, however, varied widely among different types of farm households. Due to off-farm income, average farm household income was particularly high in metro areas. However, it should be noted that the share of off-farm income varies with region, stage of the farm operators' and their spouses' life-cycle, and work choice of farm households.

Retirement Plans of Farm Operators

The issue of retirement and succession is especially pertinent for farmers who are ready to retire within the next five years. Their retirement will have implications for farm wealth, industry structure, and the supply of food and fiber. Using the 2003 ARMS, farm operators have been classified into four categories based on their reported retirement information. The first category includes farm operators who indicate that they are already retired (about 4 percent of farm households). Second are farm operators who indicate that they will retire in the next five years (about 7 percent of households). Third are farm operators who are age 65 and are not retired nor plan to retire (9 percent of households). Finally, the largest category (80 percent of households), consists of all other principal farm operators. Retiring and retired farm households have a significant presence in the farming community (figure 1).

Information is reported on responses to five major questions concerning these retirement categories: (1) which farmers plan to retire as reflected by age, experience, work time, income levels and sources, and household net worth; (2) where they are located geographically; (3) what commodities they produce; (4) how much land they own and control; and (5) what they plan to do with the farm upon retirement.

Which Operators Plan to Retire? Over 7 percent of principal or primary operators of farm businesses are planning to retire from farm work within the next five years. Of those operators planning to retire from farming the average age is 55, with 60 percent in the age 55 to 64 group. Operators who report that they are retired average 70 years of age and 76 percent are age 65 or older. Farmers who are either retired or are planning retirement tend to have more than twenty years of farming experience. On average, retired operators have farmed for over 19 years, while those who are contemplating retirement have farmed 21 years. Nationally, the average for all farmers is 23 years. The primary occupation of operators who are planning to retire from farm work is divided between farming and off-farm work as it is for operators of farms from all households. For operators who are planning retirement, 56 percent report a nonfarm primary occupation.

Where are Farmers Who Plan Retirement Located Geographically? While farmers who indicate retirement or planned retirement from farm or ranch work are located throughout the country, some regions have a larger than proportionate share of operators at this point in the household and business life cycle. The Eastern Uplands and Fruitful Rim account for over two-fifths of all retired operators and a fourth of operators in total. The Heartland, Eastern Uplands, Northern Crescent, and Fruitful Rim have nearly 68 percent of all operators who report planned retirements. Among regions, about two of five planning to retire operators are located in the Heartland (21.2 percent) and Northern Crescent (19.1 percent), the largest shares among the regions (figure 2).

What Commodities Do They Produce? Operators who plan to retire, on average, produced $82,267 of agricultural output in 2003, compared with $76,788 for all U.S. farmers. Their farms accounted for over 7 percent of the value of agricultural production. Given their disproportionate location in the Heartland, Eastern Uplands, Fruitful Rim, and other grain and oilseed production areas, it is not surprising that farmers planning retirement accounted for over a third of beef cattle farms and nearly 18 percent of other livestock farms. On the other hand, among operators age 65 or older, more than 55 percent specialize in beef cattle, and one-sixth in cash grains and oilseeds (Figure 3).

How Much Land Do They Own and Operate? Households with operators who report retirement plans own 356 acres, on average, compared to 452 owned acres for all households or about 6 percent of total land owned by operator households. In total, land owned by operators who report retirement plans amounts to about 87 million acres. Further, about 40 percent of households with operators who report retirement plans participate in government farm programs, receiving an average payment of $5,657, slightly higher than the average for all farm households ($5,019) (figure 4).

In contemplating retirement from farming, households must consider the future of the farm. Tax laws may encourage older farmers to hold onto their land and rent it out for retirement income. Despite reduced tax rates on capital gains associated with the appreciation in farmland values, the prospect of avoiding capital gains taxes on any appreciation prior to death by transferring the land at death continues to encourage farmland owners retain ownership of their land. Recent changes in Federal estate tax policies that allow larger amounts of property to be transferred at death free of any estate tax further reinforce this incentive. Among operators who plan to retire from farming in the next 5 years, approximately 1 out of 5 indicate that they plan to rent out the farm (22 percent), and another one-fifth plan to sell the farm (20 percent). The remaining operators plan to turn over operations to others or convert their land to other uses.

Succession Decisions of Farm Households

Succession planning is a component of a household's risk management strategy for its farm business in as much as it is aimed at continuity of the business management team. Data on the interrelationship between a household's retirement and succession plans also provides additional information about how farms will be managed as they pass from the current generation of households. Four factors have a large effect on the succession/transfer of farm businesses. The most important is the owner's age (farm operator's age) followed by farm size, net worth, and the successor's ability to farm successfully. Nationally, a relatively small percentage, 27 percent, of farm operators indicated that they had a succession plan (figure 5). Of those, 87 percent reported that they had identified a successor, and in most cases the successor was a family member. When asked if the successor worked or participated in the farm business, 52 percent indicated that the successor participated in the farm business. Further, 38 percent of designated successors were participating in management activities and decisions for the farm (Figure 6). About 34 percent of farm operators who indicated that they will retire in the next 5 years had a succession plan and about 80 percent of these households have a family member taking over the farm.

Succession planning becomes of greater importance to households when wealth is considered. Wealth, as reflected by net worth, can become an estate tax liability and planning can help ease the transfer of farms from one generation to another or to another party interested in entering farming. Maximization of wealth is assumed to be an individual and family objective and bequest motives are well rooted in economic and financial theories. The amount of wealth at stake in agriculture is relatively large, compared with most households. Examining succession planning by different levels of net worth reveals a picture that is consistent with theory. For example, only 16 percent of farm households with net worth between $50,000-$99,999 had succession plans, compared to 31 percent of farm households with net worth between $500,000-$999,999, and 44 percent of farm households with net worth over $1,000,000. Further, among net worth categories with a succession plan, a successor has often been designated and that person is most likely to be a family member small (Figure 7). However, participation in business, management activities, and other decisions on the farm indicate that the involvement of the successor on the whole is relatively.

Retirement Income of Farm Households

Any discussion of income, wealth, and retirement warrants a life cycle perspective. Figure 8 shows that the composition of farm household income varies by retirement age. Households headed by operators planning to retire from farming have the highest income ($85,888) among all farm households. Nearly 76 percent of these households reported working off the farm and earning about 49 percent of their income from off-farm employment in the form of wages and salaries. Farm operator households headed by operators age 65 or older receive a significant amount ($15,635), or about 27 percent, of household income from disability, Social Security, and other income sources (such as military and Veteran's benefits, other public retirement and public assistance). However, all U.S. households headed by persons age 65 or older, received (on average) nearly 62 percent of their total income ($30,437 in 2003) from Social Security, private and government retirement benefits.

An important part of retirement planning is determining how much retirement income is needed to maintain household expenditures. Even though the living standards of farm families have become comparable to nonfarm families, expenditures of farm households differ from nonfarm households. The average expenditure ($37,075) of farm households in 2003 was slightly lower than nonfarm households ($40,817). Generally, nonfarm households spend a higher proportion of their income on rent/mortgage. However, among households of operators age 65 or older and those planning to retire, 20 to 23 percent of the income is spent on food and rent/mortgage. Further, these households spent 13 and 16 percent of their income on medical and health related items, respectively. On average 13 percent of all U.S. farm households are living in poverty (as established by Office of Management and Budget and consists of money income levels that vary by family size and composition, and age of the operator). However, the percentage of farm households living in poverty is highest among those headed by operators age 65 or older (about 18 percent). Nearly 10 percent of households, whose operator indicated planned retirement from farming in the next five years, are living in poverty.

Household wealth may be acquired through savings, inheritance, or appreciation of household assets. Farm household net worth is measured by the value of combined farm and nonfarm assets (minus debt). Farm household assets are dominated by farm real estate (77 percent), while other physical assets (e.g., off-farm business investments, nonfarm real estate, off-farm houses, recreational vehicles) represent the biggest share of nonfarm assets (33 percent). However, the share of farm assets in a household's net worth depends on the age and work status of the farm operator. For example, the average net worth from farm assets of retired farm households were only 50 percent ($474,332) compared to nearly 75 percent ($757,912) for nonretired operators age 65 or older. Households of retired farm operators have a balanced farm and nonfarm wealth portfolio. The average net worth of farm operators planning to retire in the next 5 years is smaller ($714,657) than those of retired operators and operators 65 years or older, but slightly higher than that of all farm households. In some sense farm operators planning to retire in the next 5 years represent the average farm household (figure 9).

More than 50 percent of farm households target current income not used for consumption toward savings and other investment opportunities both on and off the farm. Additionally, 57 percent of farm families reported in 2003 that they are saving for long-term goals such as retirement, education, or investment in financial markets. Sixty percent of farm households whose operators are planning to retire in the next five years save regularly. This is not surprising since off-farm employment provides them with opportunities to save for retirement or own company stocks. Further, over 75 percent of these households save for long-term goals. On the other hand, only 38 percent of household headed by operators age 65 or older save regularly and nearly 46 percent save for long-term goals (figure 10). Savings can be used to finance unexpected future needs, such as financial shortfall in the farm business, or major health care expenditures.

Farm households, like their nonfarm counterparts, have diverse financial portfolios. These include:

- retirement accounts (such as IRA, Keogh Plan, 401(k), and others, excluding Social Security)
- stocks, bonds, and mutual funds
- cash and other liquid accounts like checking and savings, and
- real estate and other assets not part of the farm business.

Farm households of operators indicating retirement in the next five years have 25 percent of their nonfarm assets held in the form of other nonfarm assets--real estate and businesses aside from the farm, off-farm houses, recreational vehicles, and other assets. Over one-sixth of nonfarm assets were distributed in retirement accounts, operators dwelling, and liquid accounts. Households of operators age 65 or older had similar nonfarm asset portfolios, however, the share in retirement accounts was lower and the share of liquid assets was about 26 percent (figure 11). Farm households of retired farm operators have 30 percent of their nonfarm assets in corporate stocks and mutual funds and have 18 percent of nonfarm assets in retirement accounts.

Summary

Nationally, a relatively small percentage, 27 percent, of farm operators indicated that they had a succession plan. Of those, 87 percent reported that they had identified a successor, and in most cases the successor was a family member. When asked if the successor worked or participated in the farm business, 52 percent indicated that the successor participated in the farm business. Further, 38 percent of designated successors were already participating in management activities and decisions for the farm. Retiring and retired farm households have a significant presence in the farming community. Farm households of retiring farm operators are mainly employed off the farm (nearly 75 percent), and about 15 percent of these farm households own off-farm businesses. Further, farming enterprises reported by these households indicate a tendency to specialize in beef cattle, a less labor-intensive enterprise. Farm households of retiring farm operators are less likely to be living in poverty. Households that indicate plans to retire are located principally in the Heartland, Northern Crescent, Eastern Uplands, and Fruitful Rim region with 70 percent of all households indicating plans to retire being located in these four regions.

Farm households of operators age 65 or older are mainly employed on the farm and about 18 percent of these households are living in poverty. Farms of these households are large (an average of 817 operated acres) and also tend to specialize in beef cattle (54 percent) and cash grains and oilseeds (16 percent). Farm households of operator age 65 or older are distributed all across the U.S.

Households headed by operators planning to retire from farming have the highest income among all farm households with the majority of their total household income coming from off-farm employment. Farm operator households headed by operators age 65 or older receive a significant amount of household income from disability, Social Security, and other income sources. Income from farming comprises about 24 percent of their household income. Both categories of households have wealth that is above the average all U.S. households. Farm wealth is a significant proportion of total household wealth. Further, households headed by operators planning to retire have 32 percent of their wealth in nonfarm assets, whereas households headed by operators age 65 or older have a smaller share (about 25 percent) invested in nonfarm assets. Sixty percent of farm households whose operators are planning to retire in the next five years save regularly and over 75 percent of these households save for long-term goals. About 46 percent of these households have retirement investments in the form of IRAs. On the other hand, only 38 percent of households headed by operators age 65 or older save regularly and nearly 46 percent save for long-term goals. Additionally, only 25 percent of these households have retirement investments in the form of IRAs. In general, households of operators with plans to retire within five years and households of operator age 65 or older (not retired and have no plans to retire) have a combination of current income and wealth in the form of financial and farm assets sufficient to meet their projected consumption needs in retirement.

Succession Decisions and Retirement Income of Farm Households

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Background

- **Population is aging**
  - Concerns about comfortable retirement
  - However, declining individual saving rate, increased cost of health care may result in a lower standard of living.
- **Farm families do little formal planning or investing specifically for retirement.**
  - Amount of wealth at stake is substantial for most farm families.
  - Farm households' average net worth in 2001 was $545,869 compared to $395,500 for nonfarm households.
- **Income for retirement is an issue that is being debated and receives attention from all sectors of the economy.**

Objective

- Given the importance of succession and financial well-being of farm households in later life:

  The purpose of this presentation is to describe selected characteristics of the operators, their households, and their financial status related to:

  - Retirement status and planning
  - Designation of a successor to the farm
  - Selection of a successor who is a family member
  - Involvement of the successor in decisionmaking and management activities.
  - Income and wealth of retiring farm households

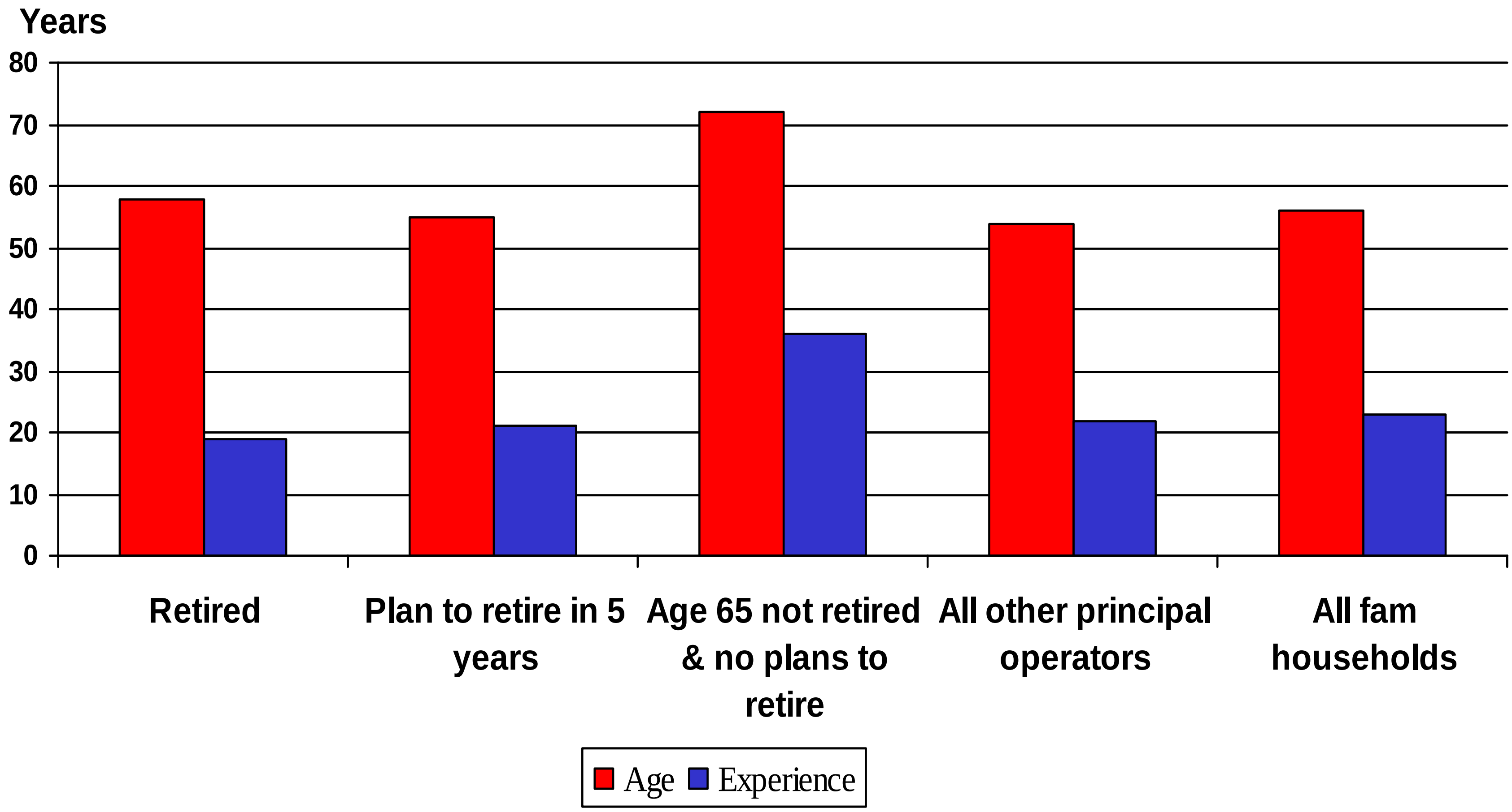
Data

- 2001 and 2003 Agricultural Resource Management Survey (ARMS).
- ARMS is a national farm-level data survey of approximately 10,000 farm households.
- As a special focus on retirement and succession, the 2001and 2003 ARMS queried farm households on their retirement decisions and succession plans.

Using the 2003 ARMS, farm operators have been classified into four categories:

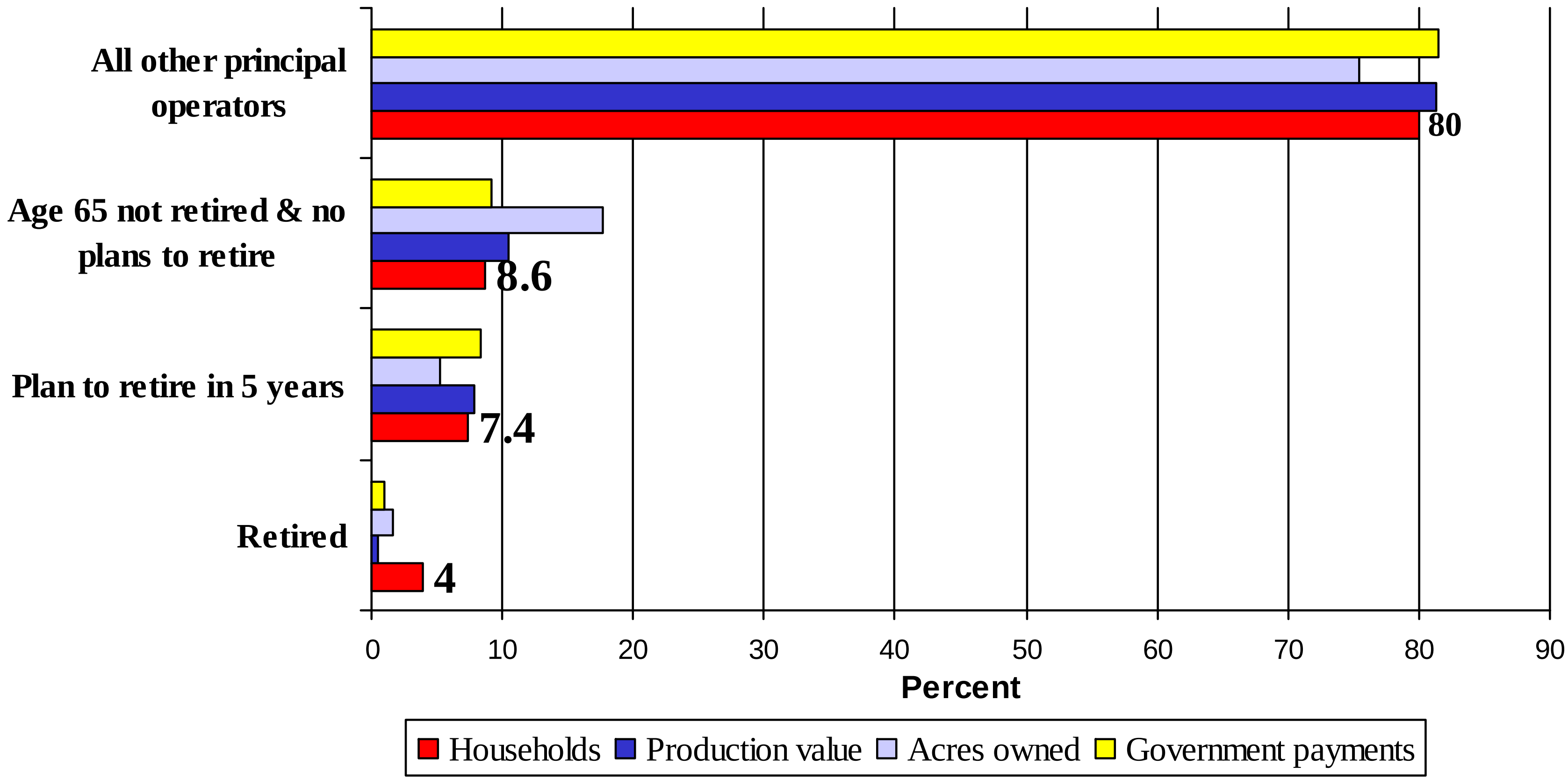
- ➢First-indicate that they are already retired (app. 4%).
- ➢Second-retirement in the next five years (about 7%).
- ➢Third-age 65 or older not retired nor plan to retire (9%).
- ➢Finally, the largest category (80 percent of households), consists of all other principal farm operators.

Retiring and retired farm households are similar to all farm households in age and farm experience



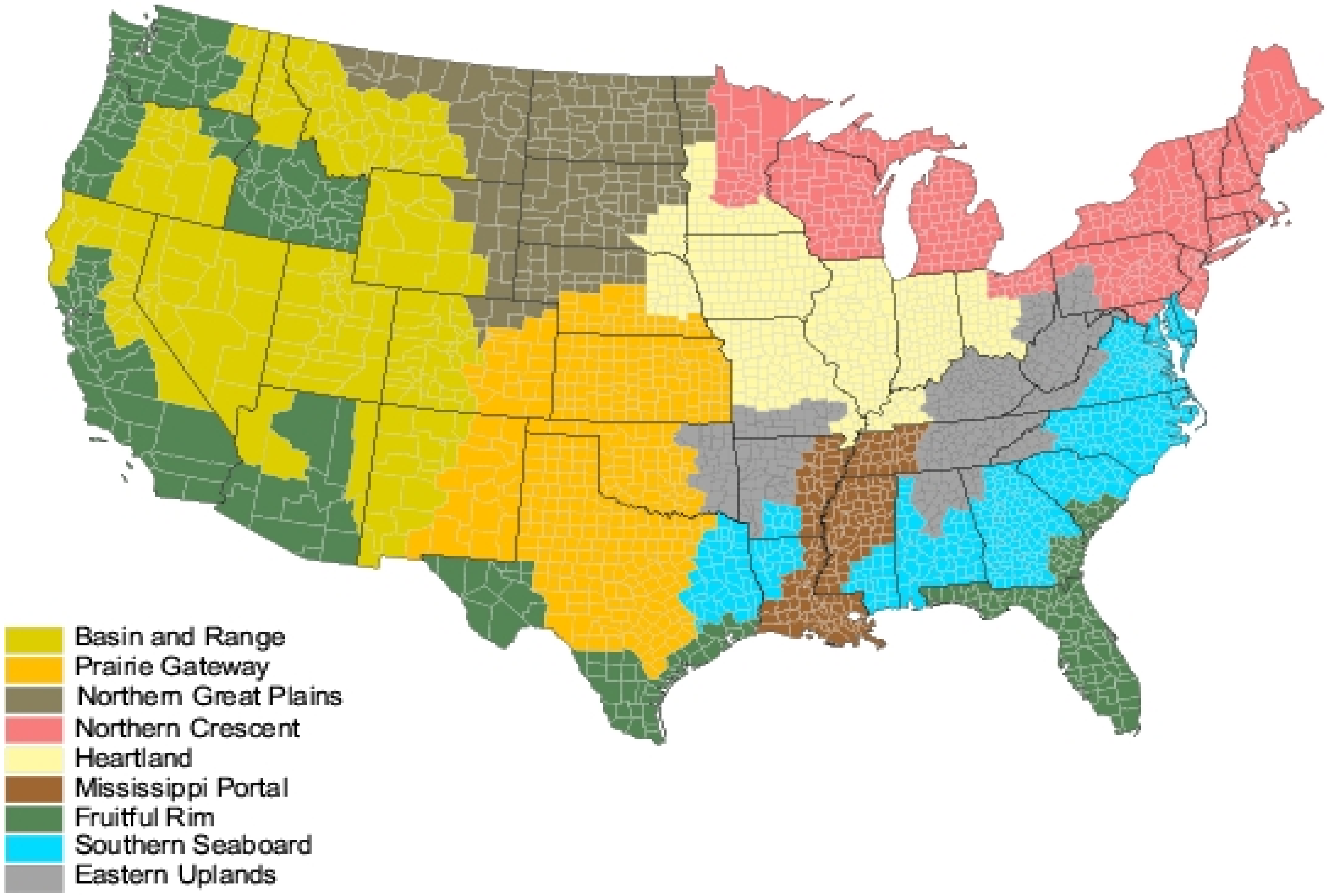
Source: 2003 ARMS/USDA.

Retiring and retired farm households have a significant presence in the farming community

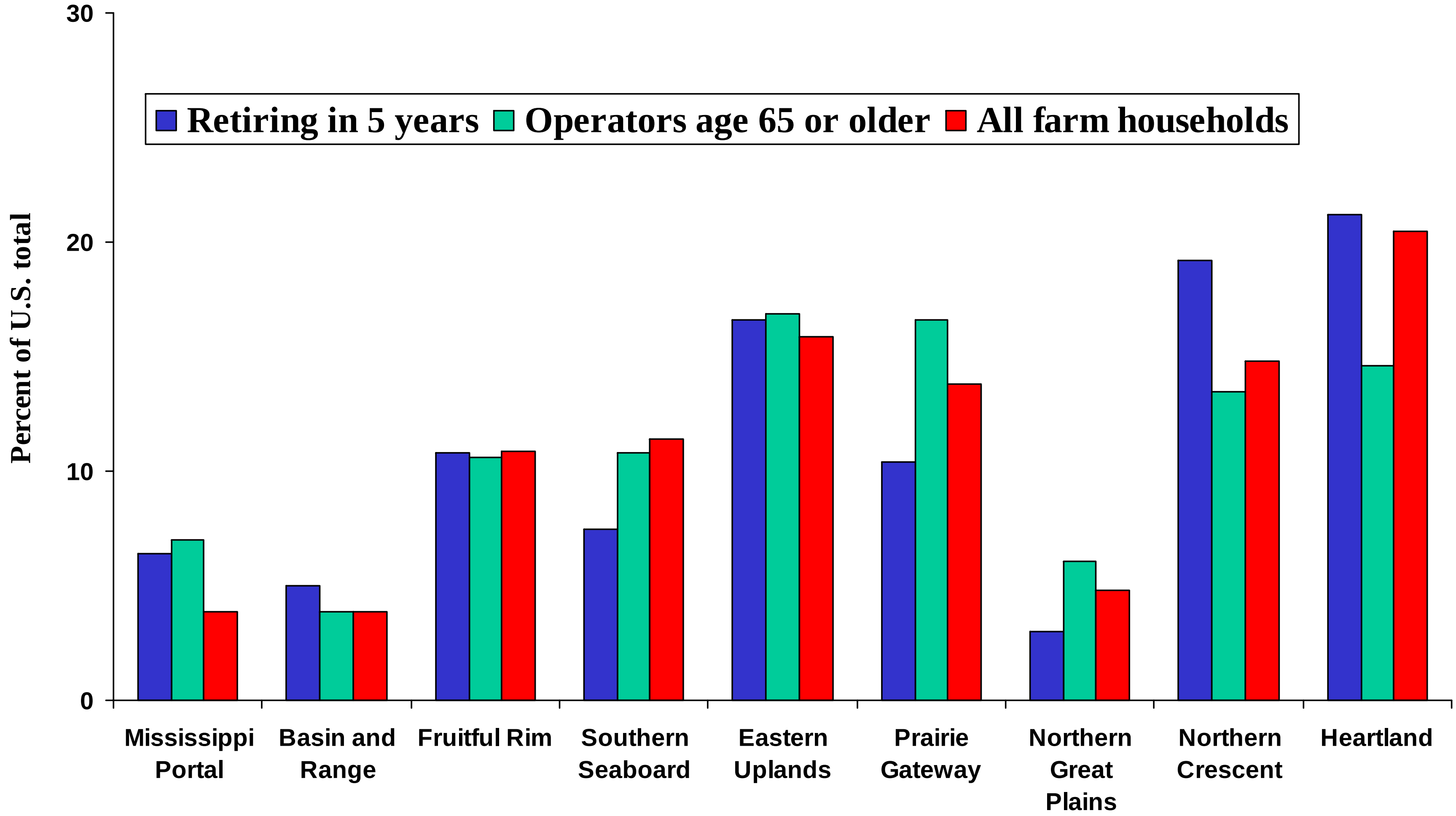


Source: 2003 ARMS/USDA.

ERS Resource Regions

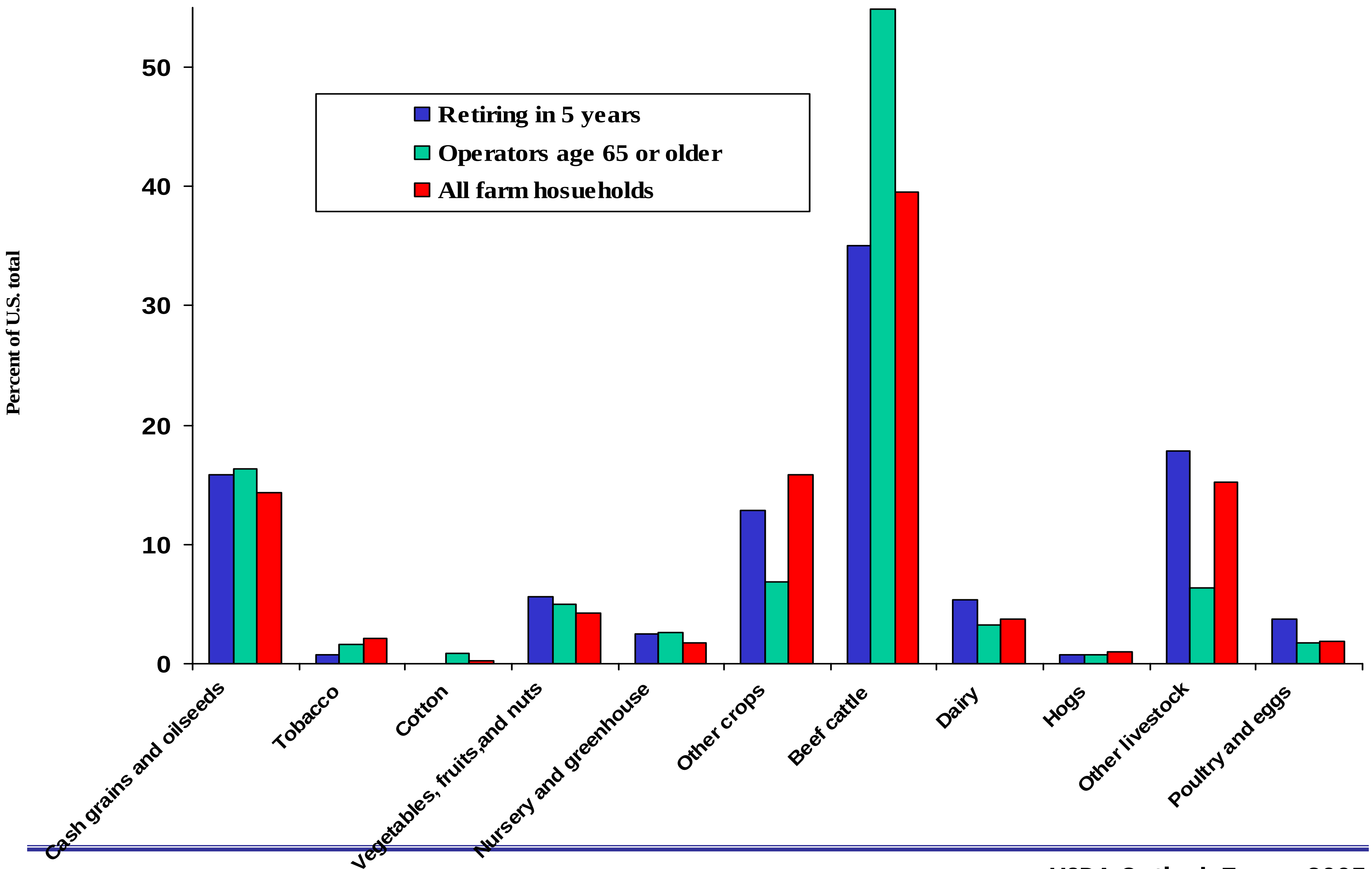


Retiring farm households are located across all regions of the U.S.



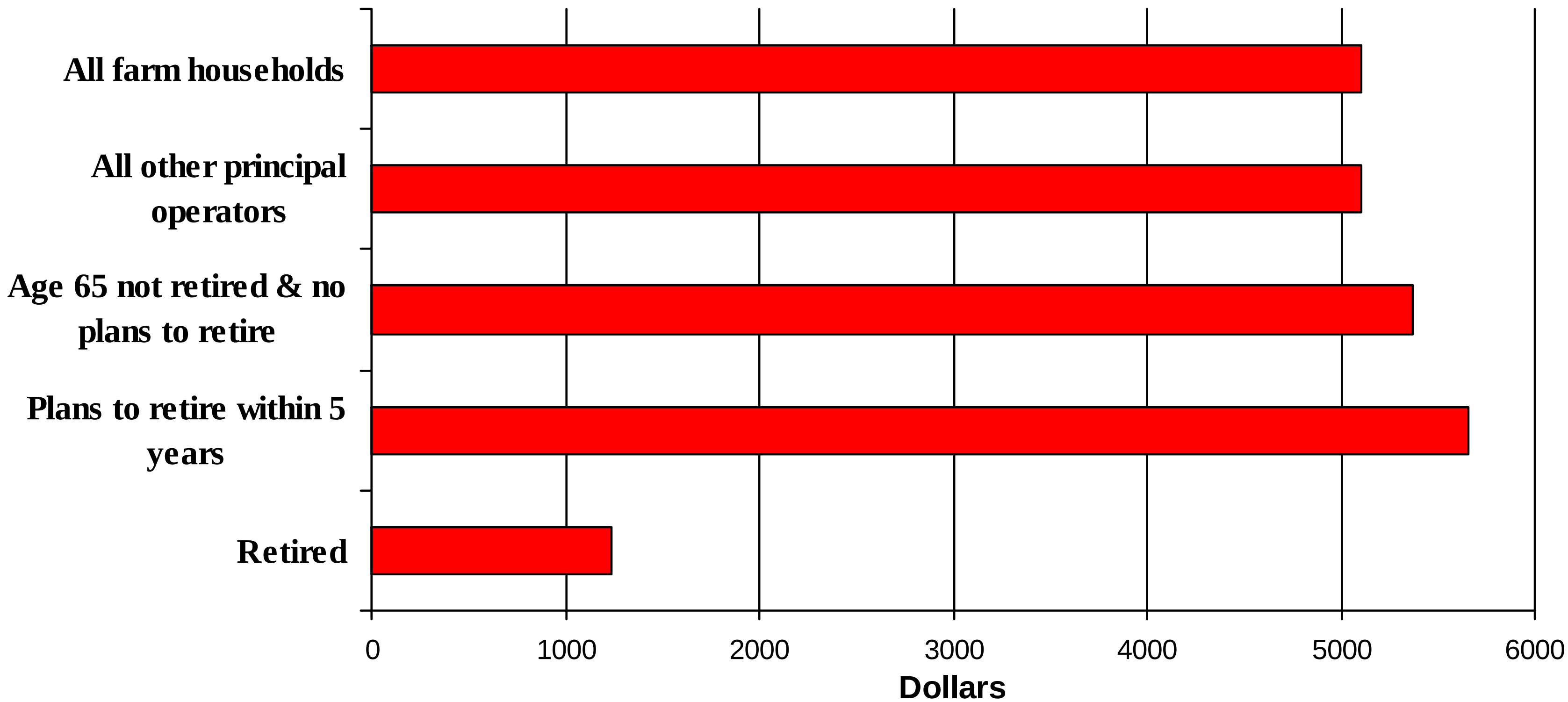
Source: 2003 ARMS/USDA.

Retiring farm households are predominantly engaged in livestock enterprises



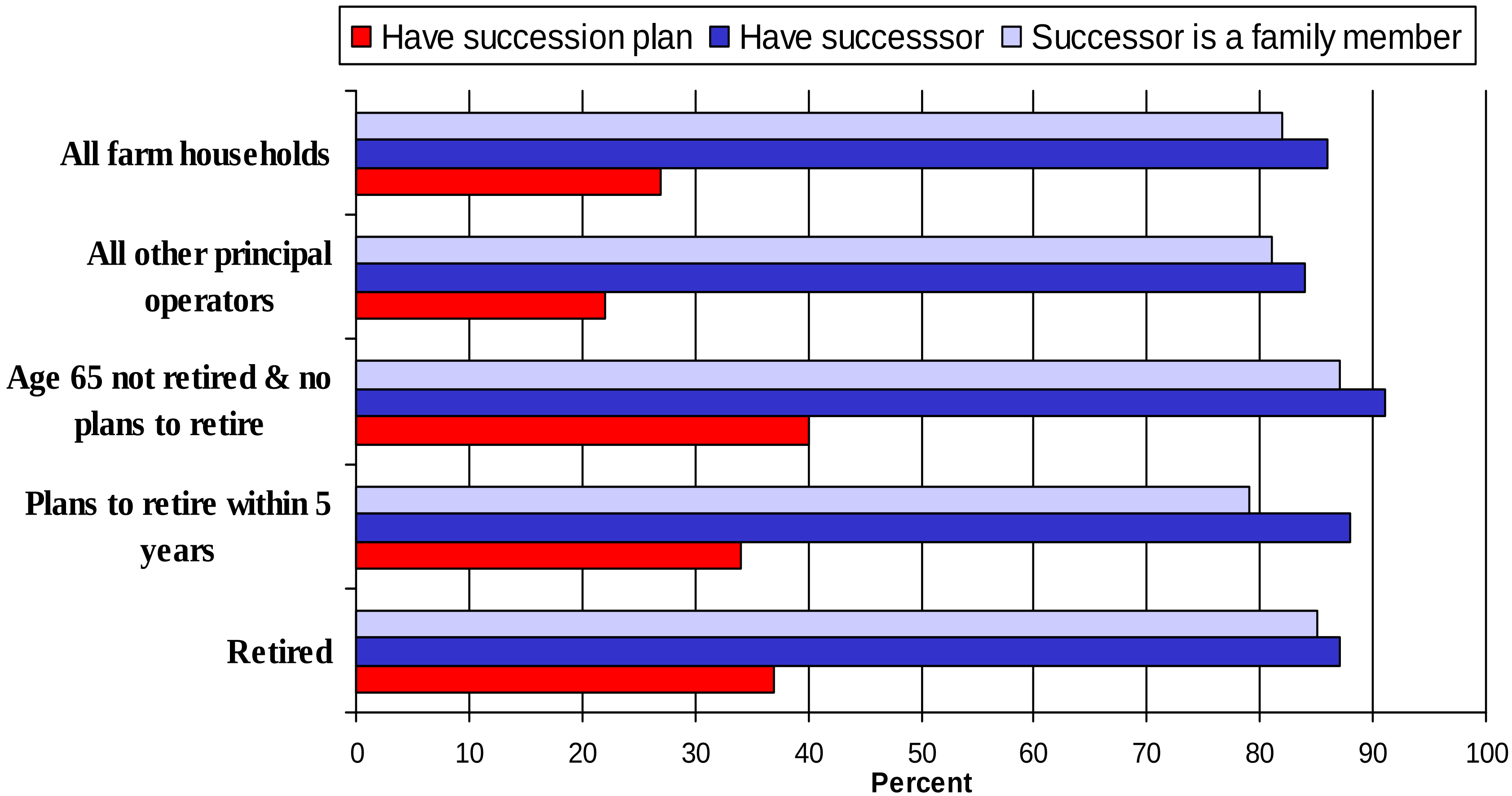
Source: 2003 ARMS/USDA.

Retiring farm households receive significant government farm program payments



Source: 2003 ARMS/USDA.

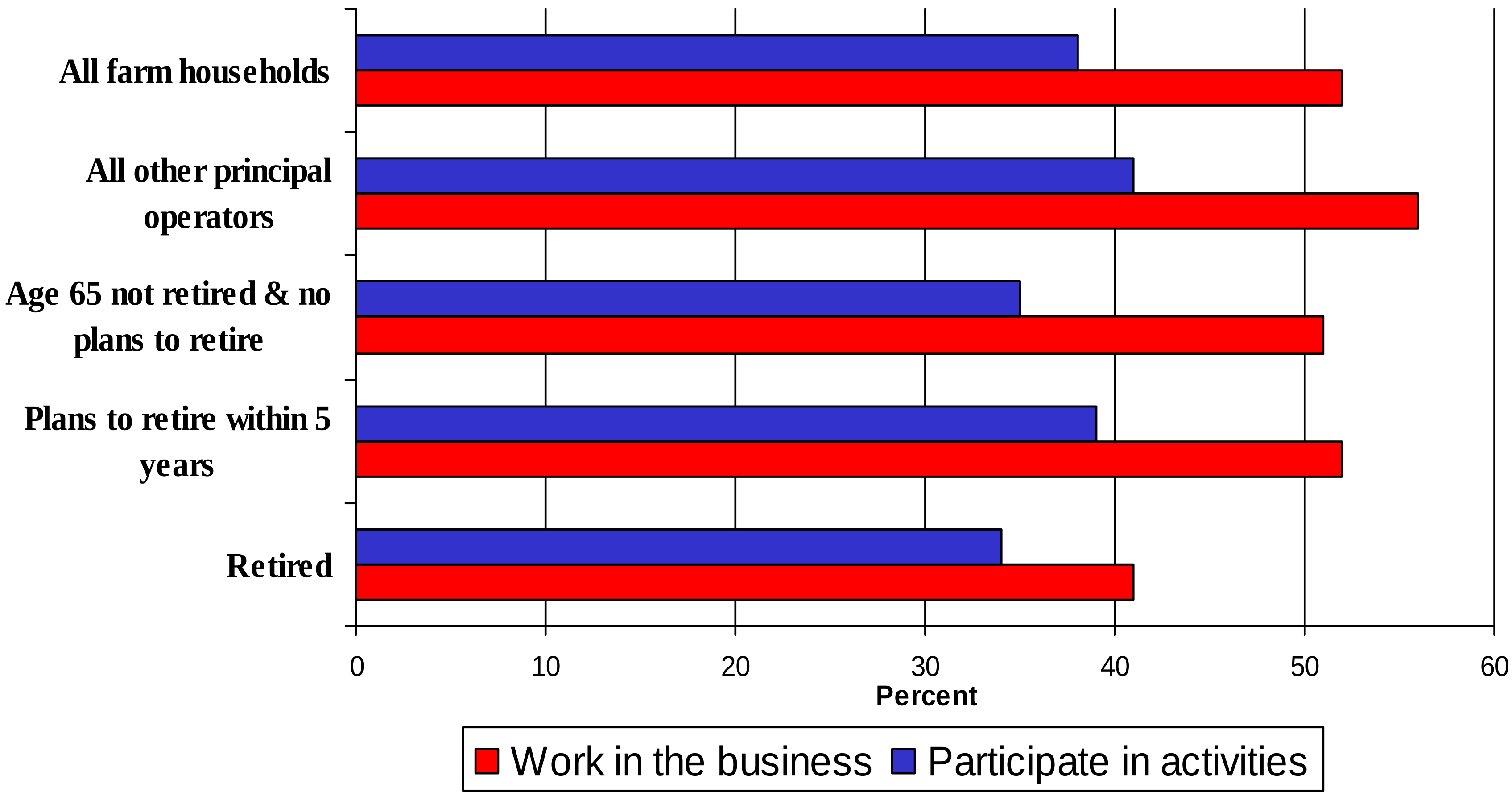
Less than one-third of farm operators have a succession plan, retiring farm households have slightly higher



Of those who have succession plan, the share who have designated a successor and the share of those who are family members.

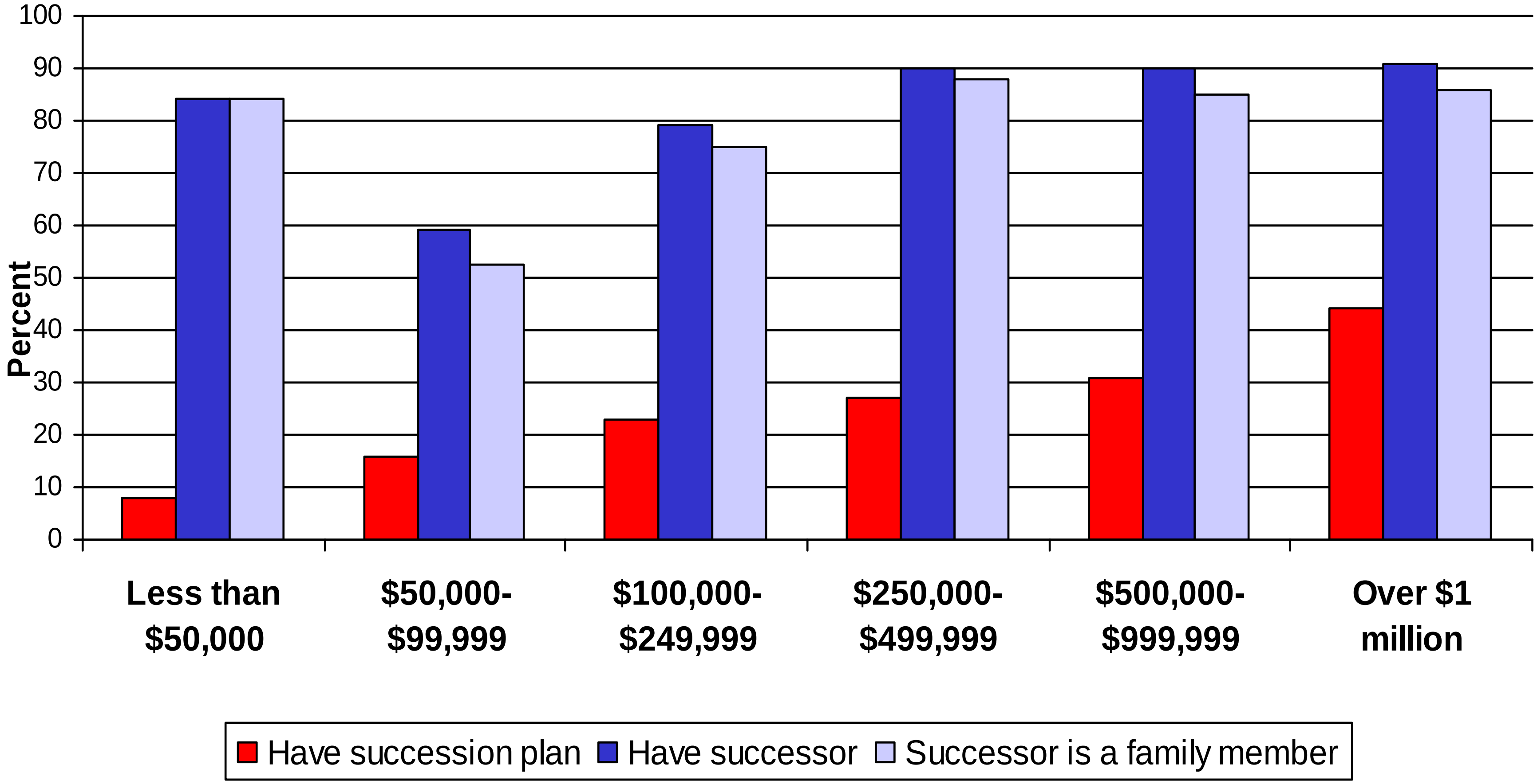
Source: 2003 ARMS/USDA.

Share of successors working in the business and handling management responsibilities varies



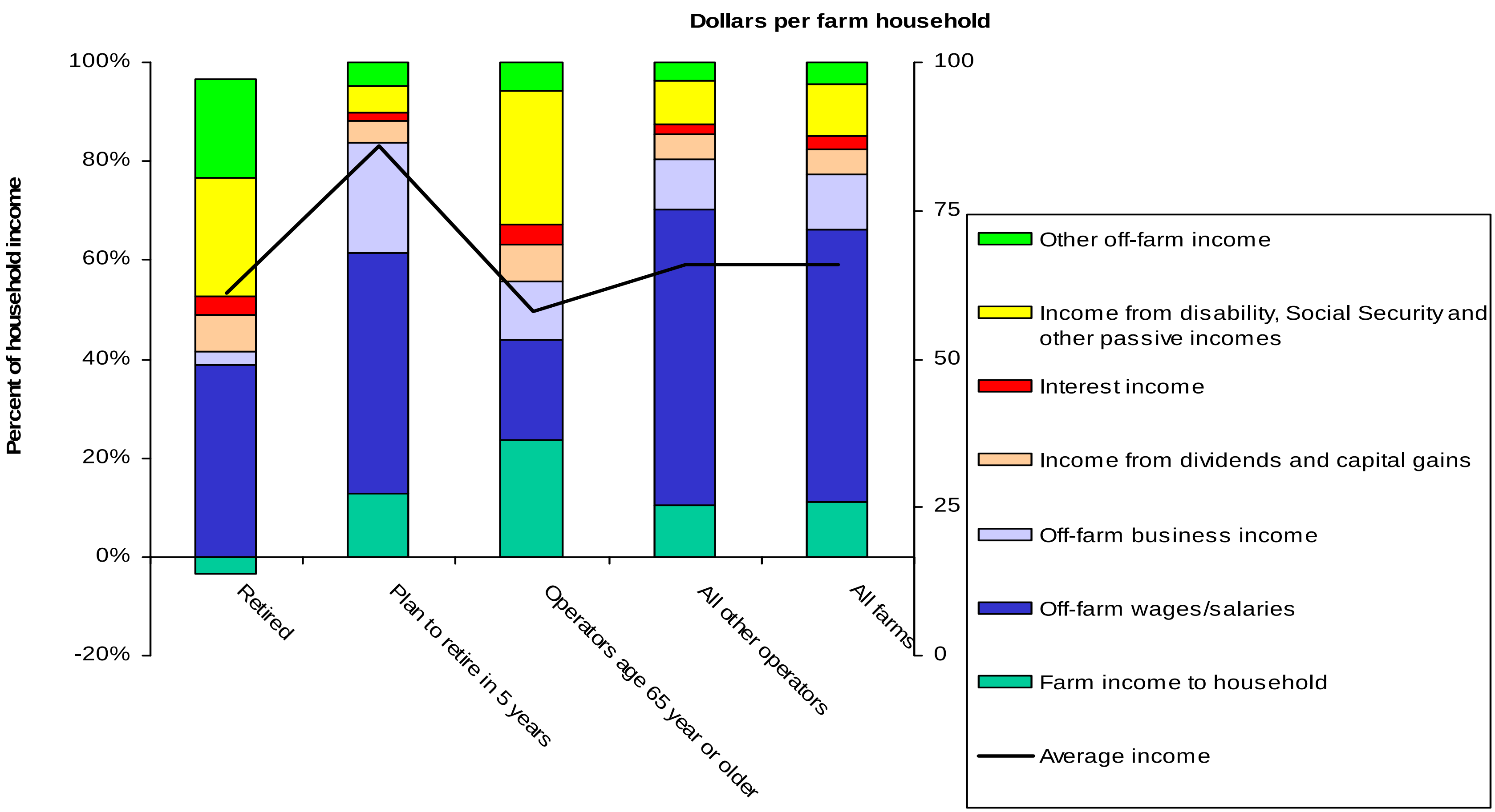
Source: 2003 ARMS/USDA.

Succession plans vary with the net worth of the household



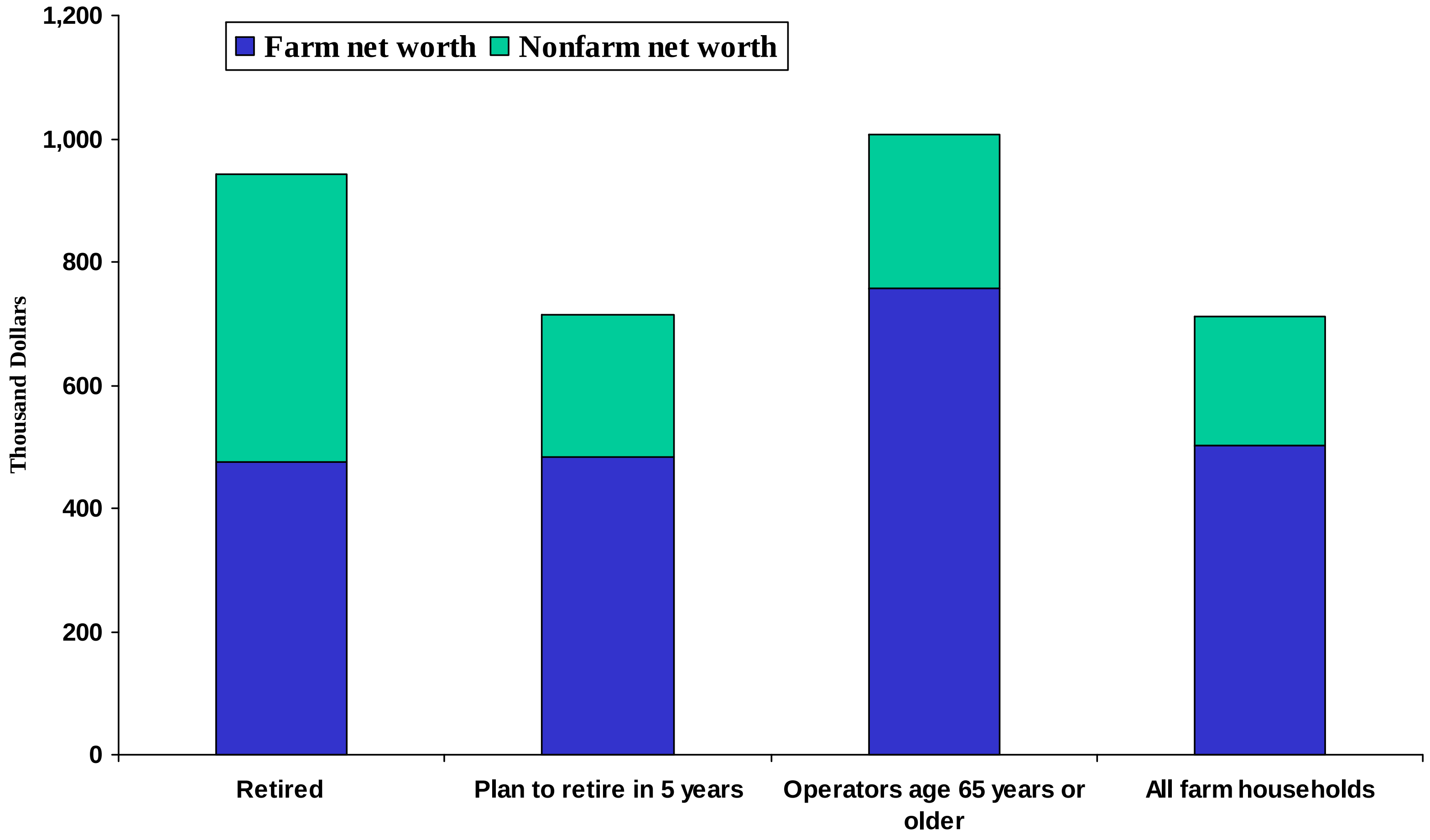
Source: 2003 ARMS/USDA.

Off-farm income is important to retired and retiring farm households



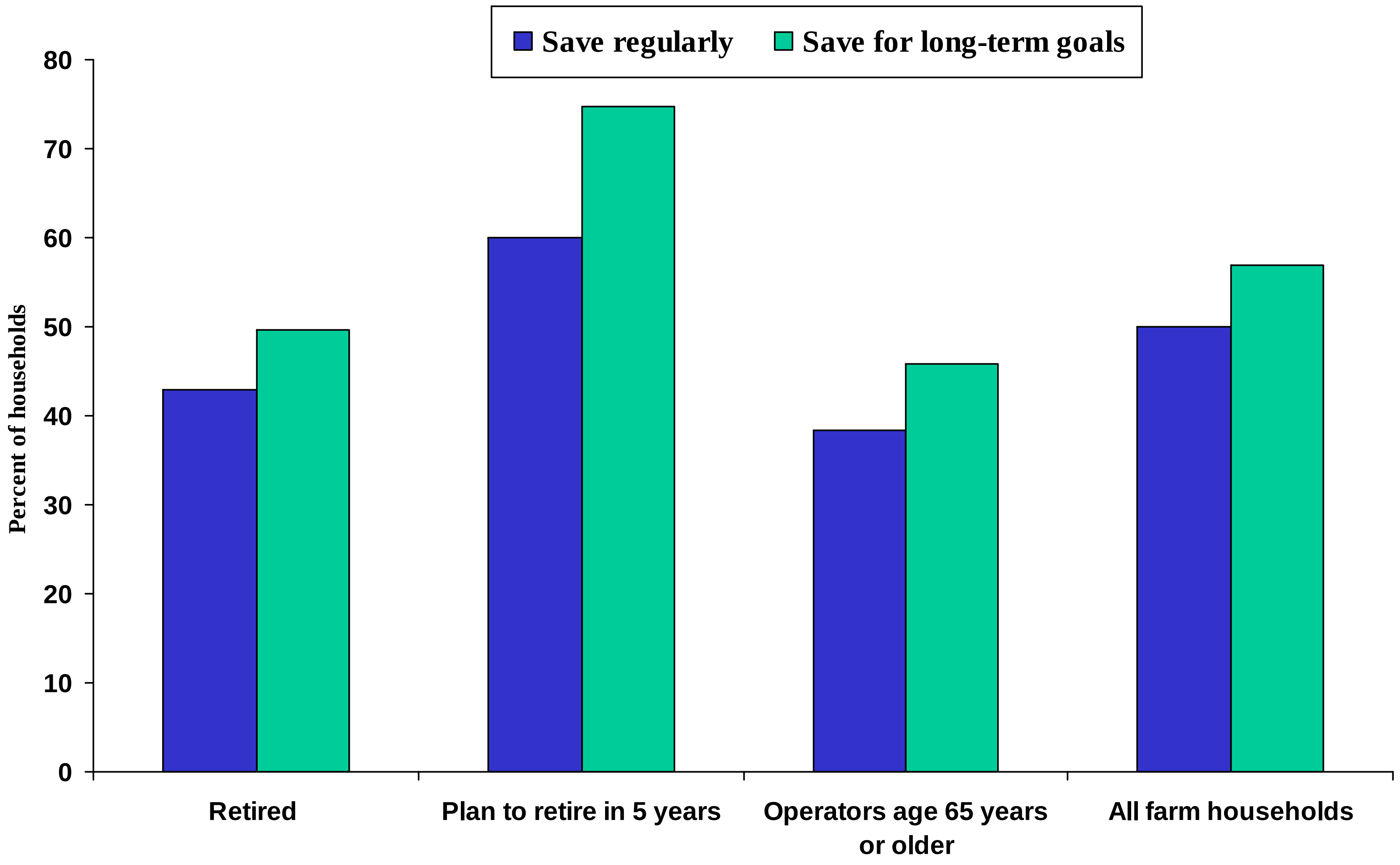
Source: 2003 ARMS/USDA.

Retired and retiring farm households have significant nonfarm wealth



Source: 2003 ARMS/USDA.

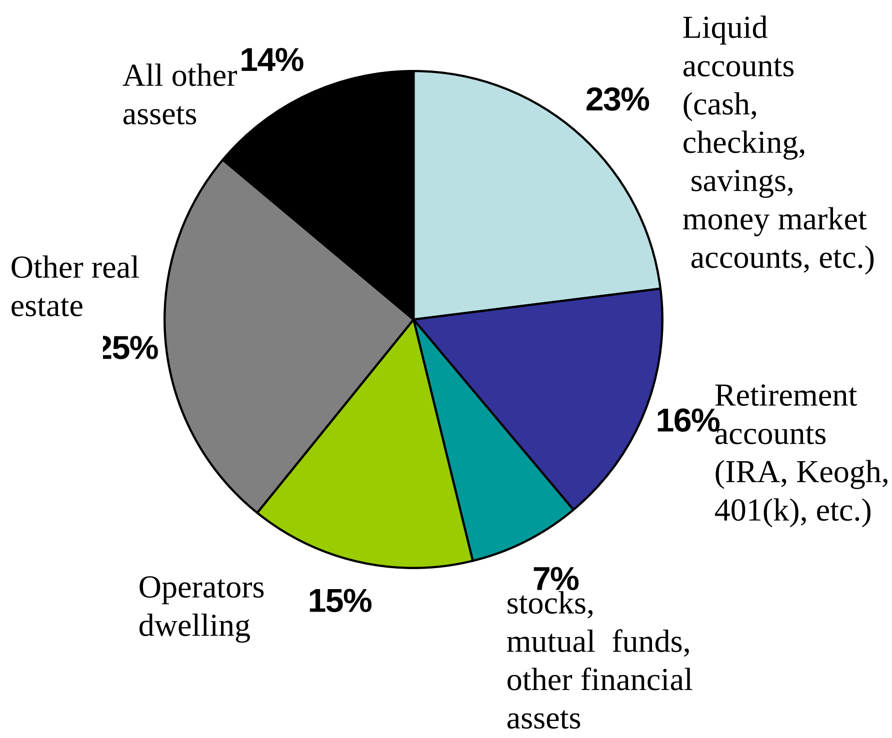
Farm households and particularly retiring farm households save regularly or for long-term goals



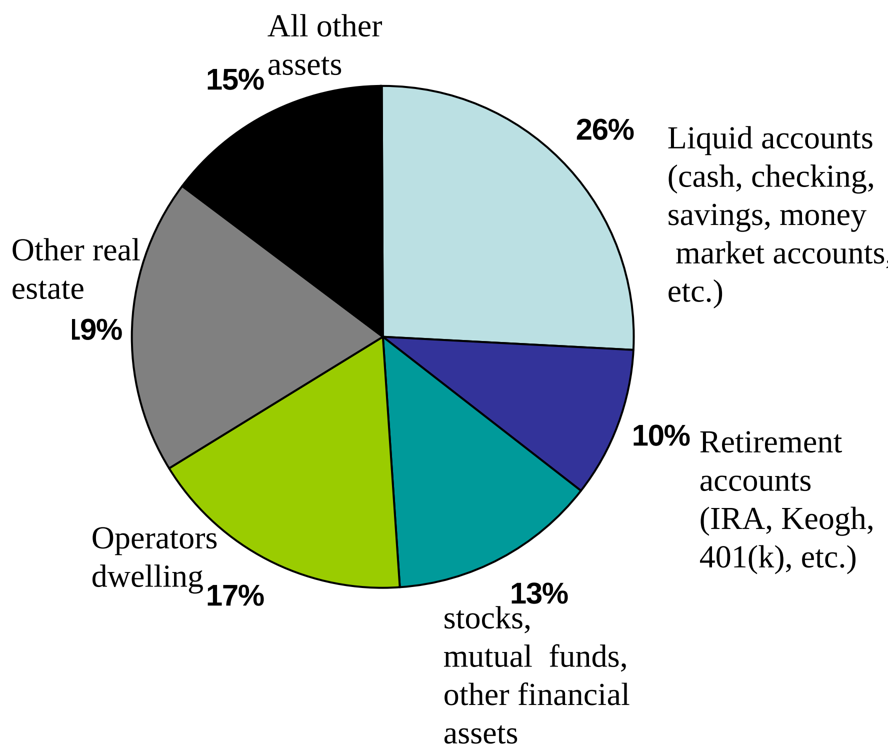
Source: 2003 ARMS/USDA.

Retiring and older farm households have diverse off-farm financial portfolios

Farm households whose operator plans to retire in 5 years
(average nonfarm net worth $231,255)



Farm households whose operator is age 65 and no plans to retire
(average nonfarm net worth $250,331)



Source: 2003 ARMS/USDA

Summary

- Nationally about 7 percent of farm households indicate that they will retire in the next 5 years.
- Households with head who are retired, plan to retire or others age 65 or older represent about 20 percent of farm families.
- Relatively small percentage, 27 percent, of all farm operators indicated that they had a succession plan.
- Only one-third of the retiring farm households have succession plans.
- In most cases a successor is designated and most likely happens to be a family member.

Summary

- Farm households with operators planning to retire in the next 5 years:
  - are younger and derive majority of their income from off-farm sources and have the highest average income.
  - about 15 percent of these farm households own off-farm businesses.
  - specialize in beef cattle, a less labor-intensive enterprise.
  - are located principally in the Heartland, Northern Crescent, Eastern Uplands, and Fruitful Rim regions.
  - less likely to be living in poverty (nearly 10%) than the average farm household (13%).
  - have 32 percent of their wealth in nonfarm assets.
  - 60 percent of these save regularly and 75 percent save for long-term goals.
  - 46 percent of these households have IRAs.

Summary

- Farm households with operators age 65 year or older:
  - are older and more experienced in farming.
  - derive their income from disability and social security (27%), farming (23%), off-farm sources (20%), and total household income is lower than the average farm household.
  - about 11 percent of these farm households own off-farm businesses.
  - specialize in beef cattle (55%), a less labor-intensive enterprise.
  - more likely to be living in poverty (18%) than the average farm or U.S. household (13%).
  - have 25 percent of their wealth in nonfarm assets.
  - 38 percent of these households save regularly and 46 percent save for long-term goals.
  - 25 percent of these households have IRAs.

Conclusions

- The average household income of retiring (higher) operators age 65 or older (slightly lower) than the average U.S. household ($59,067)
  - Further, the average wealth of retiring and operators age 65 or older is higher than the average of all U.S. households ($396,000).
  - While the percentage of retiring farm families that have an IRA is smaller than all U.S. households they have farm wealth to support consumption in later life.
- With the combination of current income and wealth (farm and financial) they are in a position to meet their projected consumption needs in retirement.