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PRO-DAIRY

Winding Down Your Farm Operation

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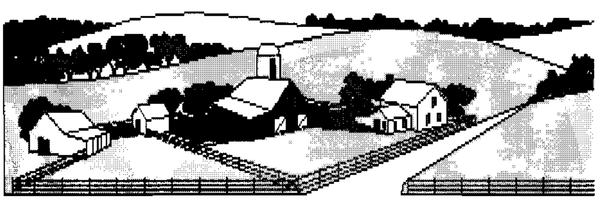

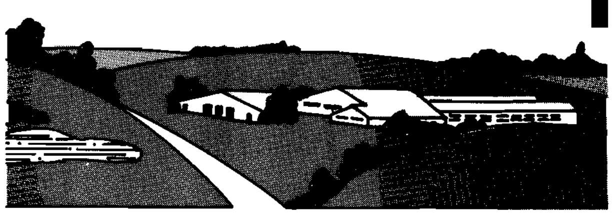

Workbooks in this series include:

- ✎ Your Farm and the Industry
- ✎ A Planning Process for Considering Dairy Farm Expansion
- ✎ Winding Down Your Farm Operation

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Your Dairy in Transition....

Winding Down Your Farm Operation

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Your Dairy in Transition

This series of workbooks have been developed to assist dairy farm operators with making decisions relative to the future of their farm businesses. An interdisciplinary group of Cornell Cooperative Extension faculty, specialists and agents worked together to develop these publications. The team that developed "Winding Down Your Farm Operation" include:

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Additional Your Dairy in Transition Workbooks

"Your Farm and the Industry"

"A Planning Process for Considering Dairy Farm Expansion"

Your Dairy in Transition
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Winding Down Your Farm Operation

Perspective

The winding down phase of the farm operation may be recognized by a number of characteristics. For example, a winding down situation typically results from changes in lifetime and/or family goals. The changes in goals are often related to age. Family members get to a point where they want to cut down on the hours of work, reduce the responsibilities of running the farm, or just don't have the physical stamina to continue the operation.

A second characteristic of a winding down situation is the changed (usually shorter) planning horizon. Rather than a 10-20 year planning horizon, the family begins to plan for a change within one-five, or perhaps as many as six or seven, years ahead. The transition may be to retirement, to new employment outside farming, or it may be just to a substantially different farming operation as a part of the move toward retirement.

Those considering winding down the farm operation may include a rather broad audience because of the wide range in situations. For example, consider those nearing retirement. Some owners will retire gradually while turning the operation over to children, and this may involve an expansion phase in the form of a partnership before the senior generation retires. Others will simply turn the operation over to children and not participate further. In still other retirement situations there are no children to take over the farm operation. The farm may be sold to a non-relative with no further involvement by the owners. Or, there may be a gradual phase-out, even with sale to a non-family member.

There are also situations where the farm operation is not a viable business unit for any new owner--whether in or outside the family. Hence, new farm investments during the winding down phase may not be appropriate. The objective of the present operator will be to wind down, live off depreciation, and save as much of the farm asset value as possible to provide retirement income. A more critical variation of this situation is one in which a major new investment is needed, such as replacement of a barn lost by fire, but the time horizon of the manager or owner is simply not sufficient to justify the investment; there isn't time in the operator's remaining farming career to recover the cost of the investment.

Finally, there are always some situations in which the present owner is forced out of farming by financial or business problems. Debt gets out of control, prices drop, herd health problems develop, drought reduces crop yields, or some poor management decisions are made. Often, if not usually, these problems are caused by factors beyond the manager's control. From time to time, situations develop where there is simply no future for the farm operation; the family wants to reduce its farm labor requirements; or, they want to get out of the business.

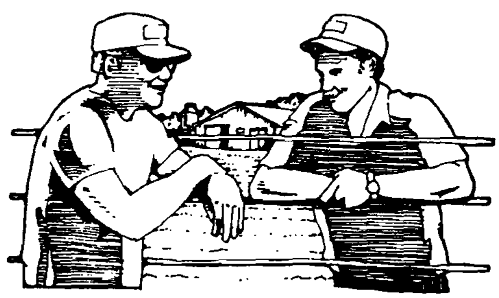

Table 1-1. Factors Affecting Options

1.	Goals
2.	Family's situation
3.	Resources available
4.	Percieved options
5.	Planning horizon
6.	Non-farm savings/investment
7.	Financial situation

Factors Affecting the Options

As with most major decisions, the winding down decision depends on such factors as goals, the family's situation, the resources available, and the various perceived options. A major difference, however, is that the planning horizon typically involves a shorter time period. If one is planning to exit from farming within the next three or four years, then the planning horizon limits the investments and alternatives. Investments that might be profitable in a ten-year planning horizon may not be justified in a three-year horizon.

Goals are probably the most important starting point. And, goals for a winding down situation are likely to be somewhat different than the goals farm families have been used to dealing with. Rather than trying to build a larger, more profitable operation, the goals now turn to preparing for and building a retirement situation or establishing children in farming. Or, the goals may be very short-term and specific in the case of financial or business problems. Survival of the business may be a goal. If that isn't possible, then exit from farming into a new occupation or job may be an intermediate-term goal.

In short, new goals become paramount. What does the family want to accomplish in the remaining years of the farm operation? What changes are required to meet those goals? If a goal is to move from farming into retirement, it becomes important to collect information on expected expenses in retirement and on the sources and amounts of income that will be available. Examining goals and alternative actions to achieve those goals may be a circular process where one first looks at goals and then at sources of income. One may then have to go back and revise goals in line with expected income.

In working toward clarification of the family's values, goals and options, a person outside the family, such as an extension agent, may be of great help. Independent consultants and farm lenders are other help sources. By serving as a sounding board, such outside advisors can often help the family sort out its values, goals, and reletant courses of action.

Individual family circumstances will impact the options for winding down. Clearly, if the family is heavily in debt and being forced out of farming, that will limit the alternatives. For example, if the family is being forced out due to financial problems, then a relatively young operator will likely need to focus on supporting the family. An older operator, in contrast, could think of early retirement. Perhaps it might be possible to move to a retirement situation where Social Security and part-time work would meet family needs.

Other aspects of the family's situation affect retirement possibilities as well. A farm family that has accumulated a substantial net worth by the time they approach retirement clearly faces a wider range of choices compared to a family with less accumulated net worth. Certainly, a farm family nearing retirement will examine different options if they plan to have children take over the farm operation than if there are no heirs to carry on.

One's individual resources are a third critical factor affecting winding down of the farm operation. Resources of particular importance are types and quality of property, financial savings, physical capability, and personal skills. For the family being forced out of farming because of debt or overriding farm problems, the physical and human skills they possess are important in finding new employment or a new business.

If the family is looking to retirement, physical capability and personal skills may limit (or broaden) possibilities for a semi-retirement phase before full retirement. Many families follow a gradual change from full-time work, to part-time work, to eventual full retirement. Particularly if one has several years before full retirement, it's important to contact employment or retraining agencies to help in the transition to a new job or part-time job situation.

It is most important, when considering the move to retirement, to recognize the declining physical stamina that comes with age. There is no uniform age at which one's physical situation requires working less or giving up management or control. At the same time, one should recognize that with advancing age each person's physical stamina does decline. Hence, alternatives need to relate to one's physical situation. One strategy is to follow a flexible plan, making adjustments as physical abilities change.

Finally, a point should be made about the importance of building non-farm savings and investments throughout one's working years. Regular savings invested outside the farm over a number of years can accumulate to significant amounts. These non-farm assets help provide liquidity, flexibility, and financial support when the family looks to retirement. It's not easy, of course, to put money aside in non-farm investments when the farm business seems to need reinvestment of every penny earned. Nor is it easy to keep non-farm savings intact when an expansion is needed to bring in a son or daughter as a partner. Nevertheless, those who can put aside some savings over the years to benefit from compounding of returns will find their options for winding down and for retirement to be considerably enhanced.

Finally, one's financial situation has major influence on the options available. Clearly a substantial net worth built up from non-farm investments and/or to be realized from sale of the farm allows options that a lower net worth does not. If one is heavily in debt, that may well restrict available options. If the family's financial troubles are forcing exit from farming, then options may be somewhat limited.

One should start thinking about life after retirement many years before facing the winding down stage. But, if longer-term plans haven't been made, then certainly it's time to start planning for the years after sale of the farm along with the winding down of the farm operation. Talk about future plans, part- or full-time job possibilities and other ways of keeping active, with extension, contacts in agricultural supply and input businesses, farm lenders, and job training and rural employment offices.

Options for Winding Down

There are many variations for winding down the farm operation. Some are relatively quick exits and involve a one-time transition. Others are much more gradual and include several phases. Also, some are voluntary and come about from the choice of the farm family;

others are involuntary and force the family to exit because of its financial situation or other factors. Some options may seem inappropriate in specific situations; but there is great diversity in situations, so there is also diversity in best solutions. Brainstorming can be a helpful tool. Some of the more common options are described below.

Quit, Sell Out, and Leave the Farm

Certainly one alternative for winding down the operation is to sell out and leave the farm. A sale gives the family maximum flexibility in deciding when to sell and in finding buyers. If there is debt on any of the assets, arrangements must be made with creditors to release the property before actual sale. After selling the farm assets, settling debt, paying costs of auction, taxes, and other obligations, the owner retains whatever is left. These net proceeds can then be used for retirement, relocation, buying into another business, or whatever other purpose is desired.

When considering selling out, it's important to start with an appraisal. Estimate the farm value, expenses of sale and the net return from the farm after sale. A professional appraisal of the farm's value may be very useful. Remember, prospective buyers may not think the farm is as valuable as the present owner does. Also, remember that there will be expenses of sale and the realized net return will be less than the farm value. Realtor's or auctioneer's commissions and taxes will have to come out of gross sale proceeds. If the farm was purchased many years ago, there may be large taxable gains. Typically, gains from the sale are substantial, and taxes will be due <u>even though debts may be high in relation to assets</u>. A tax consultant is useful in advising on tax effects of alternatives and for estimating net return from the sale. Remember, however, that attorneys, accountants, and farm business analysts are advisors only. Keep control yourself over the final decisions.

A second step when selling out is to estimate financial needs for retirement. For many farm families, this is particularly difficult. Their family living expenses, at present, aren't monitored closely. Further, the relatively large cash flow from the farm business overshadows family living expenses. Cornell Cooperative Extension may be helpful in providing estimates of average family expenses for retirement. Also, as a part of retirement planning, it would be useful to contact the Social Security Administration to estimate Social Security benefits. Form SS-7004-PC is useful for this purpose.

If the family is currently not ready for full-time retirement, finding a job to support the family until retirement is important. One question involves whether the operator wishes to remain in farming or farm-related work. If so, then neighbors, farm groups, or farm related businesses may be sources of information on employment.

Another aspect of the decision concerns where the family will live. Is it possible, or desirable, to remain in the farmhouse even though the farm is being sold? If one must find work between exit from farming and retiring, then it may be helpful to remain in the same general community, if possible. The decision of whether to leave the community is particularly difficult. Moving away means leaving friends, acquaintances, and one's support group built up over the years. In general, there are three alternatives as far as a home: one is to remain in the farm home and sell off the farm except for the house. A second is to sell the farm including the farm home and move into a village or city nearby. The third is to leave the farm and community and move to a completely different locality. If

Often the first step in a gradual winding down is an arrangement to transfer the farm operation, usually, but not necessarily, to a family member. At the winding down stage, such a transfer would not be for the purpose of forming a partnership, but rather as a start toward exiting from the farm operation. One common situation involves renting out the barn. The farmer winding down might then grow feed for the tenant. Or, the retiring farmer may rent or sell the machinery to the new owner. In other words, gradual winding down allows a new operator to take over the business, and capital may be provided to the new operator through rental agreements. A variation is for the real estate as well to be sold or rented out to a new operator.

In these situations, living quarters may be a problem. If the winding down family wishes to remain in the home, then the new operator may not have a place to live. The problem may be resolved with a mobile home; or in other instances, the exiting owner may move out and let the new operator live in the farm home.

Another option in this progression of slow or gradual winding down involves selling the cows or livestock but keeping ownership of the land. Then the operator easing out might choose to raise heifers, youngstock, or a few feeders. In other words, the movement is out of labor-intensive operations into a less labor-intensive operation. Some cash crops might be grown on the farm, but usually some livestock are kept as well. The operator is tied down much less at this stage.

A variation is to sell all the livestock and turn the farm into a cash crop operation. Crops may be marketed directly or the operator might grow feed for a neighbor. Crop farming is a popular way to move gradually toward retirement. Substantially less labor is required than caring for a dairy herd, and there is flexibility for the family to get away from the farm in the winter months. With this alternative, some custom work may have to be hired for specific jobs. Given that the operator is winding down, new purchases of machinery would not be economical since the investment couldn't be recaptured in the time left. The cash crop or feed alternative, however, allows one to stay in farming and in the home community.

Another gradual winding down alternative might be renting out the land to a neighbor. This alternative keeps the family in their home and reduces the need for labor and decision making. Yet it allows them to retain ownership of the land and real estate. A typical next step in the progression, after getting out of all farm decision making and renting, is to sell off the land and stay in the farm house. The family may remain in the home they are used to as well as in the community. This approach also reduces taxes; and with sale of the real estate, there is no need to worry about a tenant's use of the land.

As one reduces the labor required on the farm by switching to cash crops, rental, or sale of the land, it may be possible to increase one's income by working off the farm part-time or full-time. That is, as labor requirements on the home farm diminish or are eliminated, the operator in good physical condition may wish to remain associated with farming and to take on part-time or full-time work for another farmer in the community.

One of the danger points analysts sometimes see in a gradual transition is a final stage in which land has been "worn out," has little value for rental, and is not easily sold. Then, the farm may start to "go to brush" and lose still more of its value. Even then, of course, the family may be able to stay in the farmhouse. If at all possible, keep in mind where the "gradual" winding down may be headed and sell the land off before it goes to brush.

There are pros and cons to a gradual winding down of the farm operation. A gradual process provides maximum flexibility. The specific process can be tailored to the short-term goals of the farm operator. It may also better fit the operator's physical stamina, desire for work, and involvement in the community than a quick sale and a move out of the community. Gradual wind down permits great variation in involvement in the farm operation and in ways of marketing one's labor. There are many sources of help in deciding on the options. Don't overlook extension agents, independent consultants, and farm lending officers as knowledgeable people with whom you could discuss alternatives.

Gradual winding down may be an active choice for many farm operators. It's also true that a gradual winding down may be a "default choice" of operators who are not planning ahead. In short, lack of a long-term plan becomes a "roll with the punch" approach in which one puts off decisions as long as possible. Short-term decisions are made looking only at obvious options available at that moment.

The risk is that the farm property, both personal and real, will deteriorate with lack of use, misuse, or inattention. Then the property may become worth much less at the end of the winding down process than had a sale occurred earlier. Gradual winding down does permit continued association with or involvement in farming as long as the operator is physically and mentally able. Yet, as time goes on, one's options become increasingly limited. Actions and alternatives that could have been considered earlier may not be available later.

Forced Out by Finances

Each year, a number of farm operators are forced out due to financial problems. Debt becomes unmanageable or income simply doesn't cover cash flow requirements. In some cases, the farmer sees the problem coming and liquidates the farming operation. More often, perhaps, the issue tends to be forced by creditors because of the farmer's debt situation. When one is forced out by the financial situation, altepnatives are limited and there is often little time in which to make decisions. The severity of the problem demands action and, sometimes, liquidation of the farm operation.

If it's clear that the farm business is not likely to survivg because of the severity of financial problems, it's good advice to get out as soon as possible. Early exit maximizes the equity that can be saved. Struggling to turn things around against "long odds" simply uses up equity that could be better used to relocate, to support the family while looking for new employment, or to get job training for a new position.

To help one consider the options in a serious financial situation, it's useful to find a farm business consultant. The consultant could be a Cooperative Extension farm business management agent, an independent consultant, or a New York FarmNet consultant. Even if the consultant's services involve a fee, the returns are likely to be substantial.

Also, it is worthwhile to contact a legal consultant and a tax practitioner after the business consultant has assembled the financial data on the business. One issue is whether a voluntary liquidation or bankruptcy would be most appropriate for the situation. A legal consultant would be helpful in laying out the pros and cons of the different options. Given the complexity of these considerations, search out a consultant with experience and expertise in farm bankruptcy and farm financial problem situations.

The farm family also needs to be thinking about alternatives after liquidation. Is the family close enough to retirement that they can move from liquidation directly to retirement? If so, what equity can they expect to realize after liquidation, and what Social Security benefits can they expect in retirement?

To deal with the stress of being forced out of farming and to begin to look ahead, it is helpful for the family to work with a counselor. While a professional counselor may be preferred, there are many useful "cost free" counselors, as well. Clergy can be a source of help. Many communities have support groups that can be helpful. New York FarmNet has personal consultants who may be able to help. The operator forced out from financial problems often has feelings of failure. A counselor can help the operator and family deal with such feelings and will be helpful in pointing out the difference between personal and business failure. Many small business operators do not succeed in their first, or even their second, business venture, but they learn from each business mistake. A counselor will help the family set goals, evaluate aptitudes, skills and interests, and recognize options. Such counsel can help the family evaluate new employment or new careers. Most importantly, the support and advice of a trained counselor will help the family undergoing financial problems to look to the future.

Generally, the family forced out by finances will need to find new employment. Again, one issue is whether they wish to remain associated with farming. If so, are there opportunities to market their skills in the locality? Often farmers who are forced out by financial problems feel that they are not employable by neighbors. While this is not necessarily the case, it can be a stumbling block in the willingness of those forced out to search for farm related employment.

If the choice is to find employment outside of farming, the first step is to analyze one's skills and resources. Then comes the job search. New York State Employment Service and other offices such as Private Industry Councils that administer Job Training Partnership Act (JTPA) funds may be helpful with both. Look in the phone book for these agencies and talk to them early in the process. Also, write the New York State Association of Counties, 150 State Street, Albany, NY, 12207 for information on JTPA and other employment help sources in your area. Remember, too, that community colleges and BOCES programs typically have employment counselors and/or vocational training programs that can help one prepare for and find employment.

Still another angle is whether the exiting farm family wants to be self-employed rather than an employee of someone else. Opportunities for self-employment may be limited, but they depend on many factors. If one has the funds, desire, and ability, specialized vocational training or an advanced college degree may be possibilities. Scholarships and fellowships may be available to help with finances. Or, there may be possibilities such as operating a janitorial (cleaning) business, a painting business, or other contracting services. Even if working for someone else, many positions carry a great deal of freedom and flexibility. For example, a sales position, such as a feed sales representative or a farm related service provider, may have room for much flexibility and self direction. Yet, it allows one to remain associated with agriculture.

Exiting farmers find numerous employment situations, and many of them are farm related. A 1985 Cornell University study reported that farmers who had left farming due to financial problems ultimately found many very different employment situations. Several started their own service businesses including janitorial and cleaning businesses. Others worked in occupations from sales to bus drivers to mechanical repair. The interesting point was that those former farmers went into <u>many</u> different types of employment. That result illustrated the wide variety of skills farmers typically possess. Again, it's useful to seek help from appropriate professionals or agencies in assessing one's skills and abilities and in searching for employment.

Finally, those exiting farming involuntarily may also need to consider relocation. While there are sometimes opportunities to remain in the present farm home, finding a new job is of overriding importance. The present location may not be the best place from which to find new opportunities. Whether to stay, of course, may depend on whether one is interested in farm labor, work in a nearby community, or whether one wishes to cut ties and move to a very different kind of employment. If moving to a different location, then again, be sure to check with New York State Employment Service and other agencies to learn where there are jobs available and to make contacts in that locality <u>before</u> firm plans are made to relocate.

Looking Beyond Winding Down

As one contemplates winding down and retirement, attention should focus as well on two additional issues: money management after farming, and future health care. Recognize first that winding down and moving out of farming means entering a new phase of finances. Instead of dealing primarily with farm investments, one has to focus on a whole new array of investments, some of which may be unfamiliar. Should funds from sale of the farm be left in low-interest savings accounts? Invested in bonds? Mutual funds? Or other, non-farm real estate? How much is needed in a highly liquid, readily available fund? Which institutions are sound? How does one balance the risk of inflation eating up low-return savings against the higher risk of loss in higher-return investments?

Perhaps the best advice is to put energy into learning new skills of money and investment management. Read books, attend classes, don't be in too big a hurry to invest until you are ready. And, don't just lean on someone else's advice. Even if you consult a professional financial advisor, you will need to understand investment risks and strategy. You'll need to monitor and evaluate results on your investments. Typically the advisor gets a commission or fee for his or her advice--whether it's good or poor advice. You, on the other hand, will realize any actual gains or losses on the investments. So, get knowledgeable, learn to follow your investments, and take control of your own finances.

Second, get information on and plan for future health care. Evaluate your medical-health insurance coverage as a part of planning the transition to a new situation. Can present insurance be continued? What other options are available for group or individual insurance? Learn about Medicare including what it covers and what it doesn't cover. Give attention especially to the issue of long-term care or nursing home care. In the past, particularly in theheritage of farm families, the family was responsible for long term care of parents and grandparents. That situation is changing. Long-term care or nursing home care is increasingly being covered outside the family. Special insurance policies may be needed to cover such care, or it may be included in your present policies. Find out. Discuss the issue with children or responsible relatives. Include the discussion and the decisions as a necessary part of your transition planning. Don't put it off. It doesn't get any easier to do later.

Conclusion

Most farm families at some point reach a winding down phase for their farm operation. Winding down may be preparation for retirement, a voluntary exit to change employment, or a forced exit due to financial problems. This phase is characterized by a relatively short planning horizon and changed goals.

It's critical that the family give explicit thought to their new goals. Once new goals are understood and decided, an objective analysis of financial, physical, and individual human resources is in order. Finally, the various options for accomplishing the new goals are analyzed in light of the resources the family has or will have available. If goals and resources don't match, it may be necessary to adjust goals or to consider added alternatives, such as new or part-time work, to add to financial resources. That is, balancing goals, resources, and winding down options may take several trials. Remember to utilize appropriate agencies, consultants, and experts in this analytical process. As part of your transition planning, prepare yourself for managing your finances after farming and make the necessary long-term care decisions.

One of the biggest problems many advisors see when families decide to get out of farming is that the family doesn't follow through once they've made the decision to get out . They lose control. Sometimes they hold the auction, pay the auctioneer, and then forget to rent out the land and pay the taxes. It's critical to have a plan for getting out and to maintain control of the process. Remember, it takes just as much planning to get out of farming as to get in.

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