Capital Transfer

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Today's beginning farmers have the same vision, drive and fortitude that were the foundations of rural America during the last two centuries. They are faced with a different set of obstacles, however, and need to pioneer new approaches to start out in farming today.

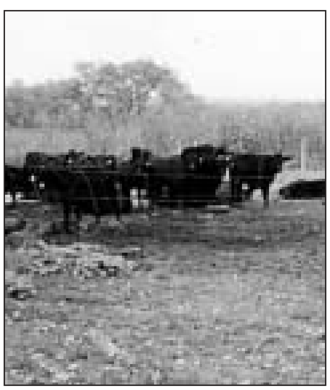
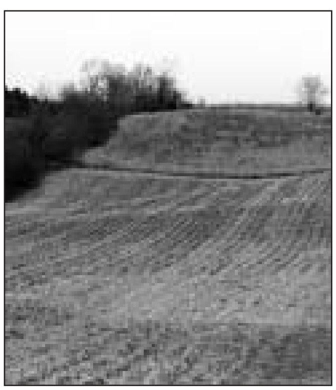
An array of financial strategies and instruments are available to facilitate farm transfer to beginning farmers, including:

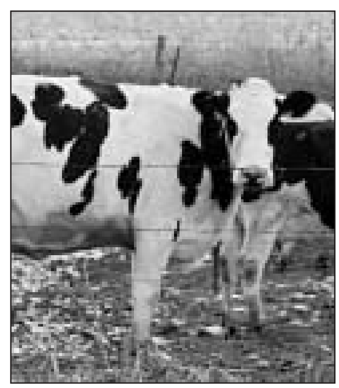
- crop share rental agreements
- lease purchase arrangements
- tax credit programs
- cash financing,
- little or no down payment financing
- seller financing
- purchase of development rights
- aggie bond programs

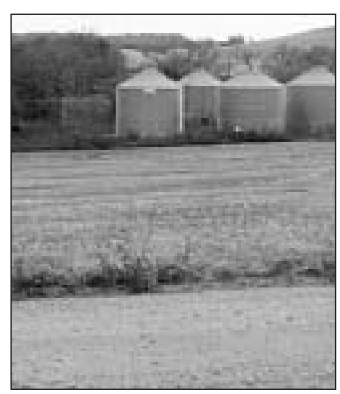
Sole proprietorship, informal partnerships, and corporations are legal structures that can assist the transfer of assets.

As important as formal financial and legal agreements is the cooperation between the new and retiring farmers. Communication and relationship building are an essential part of completing a successful farm ownership transfer.

The following eight case studies demonstrate successful transfers of farm operations to nine beginning farmers from Iowa, Nebraska, New York, Pennsylvania and Wisconsin. The beginning farmers have anywhere from three to 10 years of farming experience. While their goals and the details of their individual agreements vary, they all have some common strategies and characteristics.



With a three-year plan, a ten-year plan and an informal partnership, Dave and Dan Bean are transferring their 1,800-acre, 120-cow farm operation to 30-year-old Mark Groth. Progressive purchases of equipment and cows, and 50-50 crop share rental arrangements are facilitating the transfer of assets.

Growing a Farmer:

Passing on Assets and Experience

This case study was prepared for the North Central Initiative for Small Farm Profitability by Joy Johnson, Farm Transition Specialist and Land Link Realty Broker, Center for Rural Affairs. Written by Rebecca S. Kilde.

Additional information is available through the Center for Applied Rural Innovation and Food Processing Center, University of Nebraska,58 H. C. Filley Hall, Lincoln, NE 68583-0947 or online at ***www.farmprofitability.org***.

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Good Help Wanted

Dave and Dan Bean, brothers, ran a 1,800-acre, 120-cow farm in Garwin, Iowa. As they got older, they realized they wanted to divert some of their energies away from the farm to pursue missionary work, and needed someone to take over some of the farm's operation. They also wanted to maintain more control of the farm's stewardship than is customary with a cash rental arrangement. They started looking for someone to fit the bill.

Mark Groth had returned to the area after completing college. He had worked as an agronomist at the local elevator, but he really wanted to get into active farming. Dan and Dave liked what they saw of this intelligent 30 year old's work at the elevator, and decided this was the right man for the job. They presented him with a plan.

Planning for Success

The brothers carefully developed three-year and 10-year plans that would transfer equipment and livestock to Mark. The percentage of the business that Mark can own is tied to the percentage of crop ground that Mark farms. Labor is shared. Input costs are paid cooperatively for all acres farmed, and crops are marketed cooperatively as well. The plans, and later the strategies to achieve the goals of the partnership, are written out so that expectations and responsibilities are clearly understood.

How did it Work?

During the first year Mark rented 300 of the 1,800 acres owned by Dave and Dan on a 50-50 basis, and rented equipment from Dan and Dave. That 300 acres is 16 percent of the total number of acres Mark and the brothers farmed collectively.

The second year Mark was required to purchase 15 percent of the equipment owned by the brothers through a chapter S corporation. He purchased the equipment rather than shares of the corporation. The bank required that they identify at least one piece of machinery to use as security on this initial investment. He also bought 18 stock cows, which is 15 percent of the 120-animal total. Those percentages are based on the 15 percent of total acres Mark farmed in the previous year.

The third year Mark purchased an additional five percent of both stock cows and equipment, which gave him 20 percent ownership in the farm operation. That year he also rented 22 percent of the total crop acres.

Fostering a Bright Future

Dave and Dan are committed to improving Mark's management skills, and have given him responsibility for purchases and marketing. Mark develops a plan each fall for marketing the crops, using a combination of strategies: grain is sold out of the field or using forward contracts, or is stored until a target price is available on the cash market. Both types of management decisions are presented to Dave and Dan during business meetings for a consensus before being employed.

Formal meetings were established from the beginning. During the first six months they met monthly. Mark states, "Dave and Dan were up-front on what they liked and didn't like," and adds that, "they were probably more patient with me than with their own kids." They continue to meet formally twice a year after sharing supper. Dan takes notes and shares written copies with both Dave and Mark.

This regular communication has established an honest and constructive communication style, which is a strong foundation for a sound business. Mark places a great deal of value on that business relationship, as well as the informal relationship that has been so helpful in making this a successful transition.

Opportunities to increase profits

The plans are flexible enough to allow Mark to increase his own income. Mark has purchased bottle calves for the last two years, and last year he farmed an additional 140 acres nearby, rented from another farmer, and used the operation's equipment to do the work. He is exploring adding custom spraying next year.

Best of Both Worlds

This arrangement provides Mark with an income and the opportunity to build and expand a business. He's the youngest farmer in the county, and says he may be looking for a partner down the line.

Dan can take extended time away from the farm to pursue missionary work in Kenya, Africa, throughout the year. Dave is able to focus on missionary work closer to home during the winter months. The rental agreement allows risk to be shared while Dan and Dave still retain significant control of stewardship practices.

Trudy and Ronald Buxenbaum pass on their farm, a dairy operation with 180 tillable acres in New York's Cayuga County, to daughter and son-in-law Amy and Terry Torea. An informal purchase agreement, spread out over 15 years, transfers cattle, equipment and land to the next generation.

Going Home: Taking Over the Family Farm

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There's No Place Like Home

Amy and Terry Torea wanted to move back to Amy's home farm to raise their children. The quality of life in that rural setting was a major motivation for them to make the move.

When Amy told her parents, Trudy and Ronald Buxenbaum, that they wanted to take over the family farm, Trudy and Ronald were happy to welcome them home. The younger couple's farming backgrounds gave them a step up starting out, and the Buxenbaums were ready to help. Amy's siblings were also supportive of the move.

Fulfilling their long-time dream, Amy and Terry moved to Cayuga County, New York, in 1990 to raise their family and begin farming. They started the purchase agreement in 1991.

Turning Over the Reigns

The older couple turned the reigns of the farm over to the young family with an informal agreement to purchase the cattle during the first five years, followed by the equipment in the next five years. An independent appraiser established the value of both the cows and the equipment prior to the purchases. The Buxenbaums financed the sales.

The final five-year phase, buying the land, will begin in 2001, the tenth year of the agreement. The amount is based on an appraised sale price, and they plan to finance this with a seller contract as well.

How it Worked

During the first year the dairy was completely run by the younger couple. From the start, all dairy expenses were theirs and have been covered with income from the milk.

They overcame a challenge that first year when the local cheese processor, which had been purchasing the Torea's milk, went out of business. They successfully found a new processor, and were back on track.

> "THE QUALITY OF LIFE IN THAT RURAL SETTING WAS A MAJOR MOTIVATION FOR THEM TO MAKE THE MOVE."

Ronald provided mentoring on a limited, on-call basis in the beginning. He remained active in the crop production during the first two years, providing up to half of the labor while Terry concentrated on animal husbandry.

There have been only minor changes in the farm operation so far. The Toreas invested in a few additional pieces of equipment and have plans to expand the number of acres used for grazing.

Financially Speaking

Farm income to the older couple is from wheat and oat sales on a cropshare basis, and cash rent on the corn and alfalfa acres. The older couple also receives regular income from cattle sales, and charges enough rent on the facilities to cover taxes and insurance on the farm. Amy and Terry reimburse the Buxenbaums for expenses related to crops and equipment repair.

Lately, Ronald has shifted his energy from farming to crop dusting and providing flight instruction services with a small plane that he owns. Trudy continues to teach school on a regular basis and helps out on the farm by caring for her grandchildren when Amy's attention is needed elsewhere.

Amy and Terry's current debt-to-asset ratio, as well as other financial indicators, place them in the top level of farm operations. That's about to change as they move ahead with the land purchase. Maintaining low operating expenses would be a fiscal strength for the young couple during that transition.

In addition, successfully implementing their plans to increase grazing could minimize expenses even more. (For more detailed descriptions of grazing operations, see the case study ***Can Smaller Be Better?*** on page 18 of this publication.)

Amy and Terry Torea are making great strides in building their dairy farm.

Chart #4: Small Family Farm U.S. Averages (1998)

	low sales	high sales	limited resource
Net worth (in dollars)	522,151	654,547	66,838
Solvency—debt to asset ratio	6.8%	15.2%	12.2%
Asset turnover ratio	0.07%	0.22%	0.13%
Operating expense ratio	0.97%	0.77%	1.34%

Chart #5: Amy & Terry Torea financial information for comparison

	2001	2000	1999	1998
Net worth (in dollars)	288,900	278,900	261,900	251,900
Solvency—debt to asset ratio		3%	7%	11%
Asset turnover ratio		44%	46%	38%
Operating expense ratio		67%	67%	7%

Amy and Terry Torea are making great strides in building their dairy farm. Currently their debt to asset, and other ratios fall into the top level of farm operations. However, that picture is on the verge of changing as they follow through with their plans to purchase the farm real estate. Their strength will remain with the operating expense ratio with possible improvements within this area should their vision of improving grazing methods.

Two brothers rent 620 acres from their father and uncle through a combination of crop share and cash rent arrangements, with a goal of taking over and expanding the farm over time. Cash-based financing and the generational transfer of land, livestock and equipment are the strategies used to make this transfer possible.

Generational Transfer:
A Tale of Four Brothers

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Farming Runs in This Family

The 620-acre Nelsen farm is nestled in the Loess Hills of northeast Nebraska. Scott and Wally Nelsen maintain about 140 acres of pasture, 40 acres of hay and 30 acres of oats. The remaining acres are in a corn and soybean rotation. The crop and livestock diversity of this farm remains typical of the area, although a few larger operators limit themselves to a corn and soybean rotation.

For many years, Scott and Wally's father and uncle ran a successful farm on this land. The partnership between the two younger men emulates their father and uncle's long-time relationship, a successful model for them to follow. Their father retired in 1995. Their uncle John David currently works primarily off the farm, although he continues to maintain a small piece of land which he hires Scott and Wally to custom farm.

Scott and Wally's younger brother is not involved in the farm, but lives nearby. He has expressed an interest in farming, but all agree that the income available from current acreage wouldn't be sufficient to include him in the farm operation. He is pursuing another occupation, at least for now. John David has a son and a daughter, both living in the area. They are not involved in agriculture.

Getting Ready to Succeed

These days, many parents are discouraging their children from coming back to the farm.

Scott and Wally's parents are an exception. Since the boys were young their parents clearly outlined their requirements and expectations for them. The priority was for Scott and Wally to have the education, financing and skills to be successful.

Education beyond high school was expected, and would give them the skills to be either good farm managers or to support themselves with another profession. Mr. and Mrs. Nelsen also felt that it was important for Scott and Wally to experience life away from the farm to help them decide if they really wanted to pursue farming as a career.

Scott and Wally began developing strong farming skills early. They set their goals for farming and began raising some hogs in high school, and pitched in at the home farm.

They both worked at area farms and used wages to begin investing in livestock and building equity in their farm. Profits from their livestock also helped put them through college. The children were encouraged to make as much of an investment in themselves as their parents made in them.

Making the Move

Scott and Wally have been sharing the operation of the farm since 1995, and there's no set time-frame to complete the transfer. Both agree that having a mentor like their father is important, and have adopted his philosophy of working hard and avoiding debt. When their father retired they missed some of the direction he brought to the table. Scott smiles as he says, "Dad still offers advice now and then, that we sometimes do and sometimes don't follow."

The Specifics

The older generation's working relationship is the model for the younger's. An informal partnership has been established that includes a combination of clear, simple and straightforward arrangements.

Part 1. 300 acres owned by their father are rented on a 50/50 crop share basis. In other words, the younger partnership splits expenses and income 50/50 with their father. The remaining 50 percent of total income and expenses are split evenly between the two brothers.

Part 2. 120 acres owned jointly by their father and uncle are rented on a cash basis, and the rent is split 50/50 between the older generation. The income from this parcel is split 50/50 between Scott and Wally.

> **"THE PRIORITY WAS FOR SCOTT AND WALLY TO HAVE THE EDUCATION, FINANCING AND SKILLS TO BE SUCCESSFUL."**

Part 3. 160 acres owned jointly by their father and uncle are rented on a combination of crop share and cash. Uncle John David receives cash rent for his ownership, while their father accepts a 60/40 crop share for his ownership interest.

Part 4. Scott and Wally custom plant and harvest 100 acres for their uncle.

Part 5. Their father owns approximately two-thirds of the cows that are leased to the partnership, with the calf income split 60/40. The boys split the 60 percent and dad gets 40 percent.

Part 6. Facilities for the hog operation and cattle working facilities are rented from their father on a cash basis.

While there are numerous arrangements, they have provided both flexibility and income. Scott and Wally both agreed the arrangements have helped when cash was running short.

A Look at the Numbers

The operating expense ratio, which is determined by dividing total cash operating expenses by gross cash farm income, is within reasonable limits compared to the national average for farms with low sales. The lower the number, the better for operating expense ratios, but with ratios in the 80 to 90 percent range these brothers are certainly competitive with larger more experienced farmers. Low hog prices in late 1998 and 1999 made it difficult to build net worth. Despite low income, they are managing to make some progress.

Turning a Corner

Last year Scott and Wally began the process of purchasing their own equipment through a unique partnership arrangement. When equipment is replaced, the older implement will be traded in—in this case, it was a tractor.

Chart #6: Small Family Farm U.S. Averages (1998)

	low sales	high sales	limited resource
Net worth (in dollars)	522,151	654,547	66,838
Solvency—debt to asset ratio	6.8%	15.2%	12.2%
Asset turnover ratio	0.07%	0.22%	0.13%
Operating expense ratio	0.97%	0.77%	1.34%

Chart #7: Scott Nelson

	2001	2000	1999	1998
Net worth (in dollars)	136,120	136,120		
Solvency—debt to asset ratio	16%	16%		
Asset turnover ratio		34%	263%	
Operating expense ratio		93%	74%	87%

Chart #8: Wally Nelson

	2001	2000	1999	1998
Net worth	137,029	137,029		
Solvency—debt to ssset ratio	14%	14%		
Asset turnover ratio		36%	263%	
Operating expense ratio		92%	87%	86%

Scott and Wally used savings to purchase the new implement, and paid their father the trade-in value stated by the implement dealer.

This arrangement has its pros and cons. On the pro side, Scott and Wally's cash outlay is minimized and stretched out over time, which allows them to save and prepare for large purchases. On the con side, they are acquiring older equipment that will require more frequent repair and maintenance, or early replacement—whether the bank account is ready or not.

Exploring Options for the Future

Scott and Wally want to expand the operation by another 320 acres within five years. One hundred and sixty acres owned by their father will come out of CRP in five years and will help them meet their expansion goal. While they look forward to the loan deficiency payments associated with this additional acreage, they don't depend on them in their cash flow projections.

Where marketing is concerned, Wally explained that they feel a need to stay flexible with their plans and be proactive whenever possible. As an example, he talked about the time hog prices were 11 cents per pound on the open market. They made a few calls and let people know that they would sell market hogs at $75 a head.

They were amazed at the number of people who were willing to drive out to the farm and slaughter their own hogs. The brothers were able to more than double their earnings per animal, and in the process learned a lot about the preferences of different ethnic groups.

After the market rebounded, people wanting more hogs called Scott and Wally, but they were unwilling to pay the market rate. While it probably won't be possible to double the market price often, it sure helped in that case.

With hard work, time and persistence, they plan to double the farm's current size. With support and flexibility from their family and an eye to their goals, they have a good chance of making it.

"WITH HARD WORK, TIME AND PERSISTENCE, THEY PLAN TO DOUBLE THE FARM'S CURRENT SIZE. WITH SUPPORT AND FLEXIBILITY FROM THEIR FAMILY AND AN EYE TO THEIR GOALS, THEY HAVE A GOOD CHANCE OF MAKING IT."

A unique sale agreement takes advantage of two new programs available in Pennsylvania to provide a manageable purchase price for the buyers and an equitable return for the sellers.

A Farm for the Future:
Using Innovative Programs to Pass on the Farm

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A Return to Farming

Patty Huff grew up on a dairy farm in Chester County, Pennsylvania. Although she left the area for a number of years, she maintained ownership of some 4-H dairy cattle with help from her former neighbors, who cared for the animals at their farm.

Patty and her husband, Brian, decided to move from New Jersey to Pennsylvania in 1992. They rented a dairy farm on a turn key lease that included the real estate and equipment. The equipment turned out to be inadequate, and the situation was aggravated by a poor relationship with the owners. "We couldn't get out of there fast enough," says Brian.

While on that farm, the Huffs used USDA Farm Service Agency (FSA) financing for operating expenses. The good relationship they cultivated with the FSA allowed them to move and invest in equipment on a larger dairy.

They ended up taking over a dairy operation from a farmer facing foreclosure, which turned out well for everyone involved.

The Huff's rent payments allowed the owners to make good on outstanding loans, and the stable arrangement allowed Brian and Patty to build equity in cows and equipment while working the farm for the next seven years.

Making Connections

Back in 1992 Patty won a dairy cattle show. Suzanne and George Lamborn saw an article about the event, which mentioned Patty and Brian's interest in getting into farming in the area. Suzanne and George have kids Patty's age, and remembered her as a teenager.

The Lamborns offered to rent their farm, which they had run from 1965-90, to the Huffs. The Huffs decided to decline that offer, but they kept in touch.

In 1999, the Lamborns decided to sell their farm. They had learned about the Pennsylvania Bureau of Farmland Protection program (see box below) that would allow them to get the development value from their land and at the same time ensure that it would continue to be farmed. The Lamborns' three children don't farm, and only one was interested in building on the site. Their current tenants weren't interested in buying the farm. The Lamborns called the Huffs.

Weighing the Options

Brian and Patty carefully weighed their options with the Lamborns' purchase offer. This was an opportunity to finally own their own farm, but the 155 acres with its 32-tie stall barn, was half the size of the one they were currently renting. Despite that, the Huffs decided it would be a good move for them if they could arrange the financing.

The Details of the Deal

Using a mix of farmland protection programs available in Pennsylvania, the Lamborns were able to sell their farm to the Huffs at its farmland value, considerably less than its development value. They figured the selling price by using the appraised value of the land for development, established by the Chester County Agricultural Preserve Board, less the development rights purchase price received from the Pennsylvania Bureau of Farmland Protection program (see box below). The Lamborns financed the remaining amount—the farmland value—on a contract for deed to the Huffs.

With the equity the Huffs had gained over the last eight years in their cows and equipment they secured financing from the Farm Service Agency. This financing allowed them to expand the milking facility from 32 head to 72 head, add a six-month manure storage facility, build a silo and complete soil conservation measures including new streambank fencing.

The Huffs also participated in

Farmland Protection Programs

For more information about **Pennsylvania's Bureau of Farmland Protection**, go to their website: *http://sites.state.pa.us/PA_Exec/Agriculture/bureaus/farmland_protection/* or contact the Pennsylvania Department of Agriculture, 2301 North Cameron Street, Harrisburg, PA 17110-9408; telephone 717-787-4737.

Nationally, two organizations provide in-depth information regarding farmland and conservation trusts for saving open space and farmland. **The Land Trust Alliance** can be reached at 1331 H St. NW, Suite 400, Washington, DC 20005-4734; telephone 202-638-4730; website at *www. lta.org*. Find the **American Farmland Trust** at 120018th St. NW, Suite 800, Washington, DC 20036; telephone 202-331-7300; or go to *www.farmland.org*.

the aggie bond program available in Pennsylvania, which provided an additional return on the interest to the Lamborns. (See the sidebar at right.)

A Manageable Financial Challenge

Brian and Patty share responsibilities on the farm, with Patty providing a major portion of the herd management. Her background and experience as a licensed veterinary technician helps them maintain a quality herd on a tight budget.

Average figures for small farms in the U.S.* indicate that the Huff's net worth, slightly under $297,000, is between the "limited resource" and "low sales" categories. Their solvency has fluctuated in the last few years, moving from a 25 percent debt to asset ratio in 1998 (prior to their land purchase), to 64 percent in 2001.

Their budget is tight, but the Huffs are able to make their payments, although there isn't room for much else. They try to keep their long-term goals in mind, and keep their perspective by frequently reminding themselves of "how much debt we are paying off."

This arrangement has been so successful that the Lamborns are looking at investing in additional farmland to help another young farm family get a start.

Aggie Bonds
Beginning Farmer Loan Programs

Beginning farmer loans are financed by participating lending institutions or contract sellers with the issuance of federal tax-exempt bonds offered by state authorities. Interest received on contract sales or direct loans by individuals is also exempt from state income taxes in most states.

Aggie bonds provide an effective means for state and federal government and industry partnerships to maximize government funds in order to help first-time farmers purchase land, farm equipment, farm buildings and breeding livestock. The bonds offer limited tax incentives, and local lending institutions still make credit decisions and determine levels of financial risk.

The tax-exempt interest income earned by lenders and contract sellers enables them to charge borrowers a lower interest rate. Beginning farmer loans typically carry interest rates from one to four percentage points below market rates.

Under federal law enacted in August 1996, these beginning farmer loans can be used for transactions between parents, grandparents and siblings. Such transactions can only be financed through third-party lenders, because Internal Revenue Service rules prohibit this type of contract sale between close relatives.

To find out if your state has a program contact your state's Department of Agriculture, or call Joy Johnson at the Center for Rural Affairs (402) 846-5428.

* based on the USDA Economic Research Service's *Structural and Financial Characteristics of U.S. Farms: 2001 Family Farm Report* (ERS Ag Information Bulletin #768 dated May 2001)

Martin Schmidt uses a series of rental agreements to transfer his farm to 25-year-old Ryan Malcom, of Minden, Nebraska. The Schmidt property, augmented by another 80 acres at another location, complements Ryan's investment in cattle.

A Good Start: Investing in a Beginning Farmer

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Good Work and Enthusiasm a Selling Combination

In 1997 Ryan Malcom met Martin Schmidt. "Ryan helped lay irrigation pipe one summer and, unbeknownst to him, he was selling himself to us," says Martin. Ryan shared his desire to farm and demonstrated a remarkable enthusiasm for the occupation.

Martin was so impressed by the combination of good work and enthusiasm that he initiated a transfer deal. That has led to a series of one-year lease agreements on 230 acres to Ryan, and most recently renewed as a three-year lease agreement. The three-year lease allows Schmidt an opportunity to begin slowing down, and also gives him time to assess Ryan's abilities before renting him the entire farm.

Martin knew that Ryan would be able to access equipment from his father's operation during this initial phase. Ryan's father is also helping Ryan build assets by allowing him to invest in 20 percent of the cattle finished on their farm each year. Ryan and his father also began a small cow-calf operation in 2000, consisting of 43 head. Ryan owns 20 percent of that venture as well.

Building on a Good Thing

In 2000 Martin rented another 170 acres to Ryan, and plans to rent the remaining 200 acres to him in 2002. Ryan is investing in one or two pieces of equipment each year, filling the gaps with his father's equipment. After 2002, Ryan will begin to rent and/or purchase various pieces of farm equipment from Martin. This will allow him to build a line of equipment independent of his father.

Maximizing Resources

Ryan Malcom had heard something about the Nebraska Beginning Farmer Tax Credit program (see page 44), a program designed to help beginning farmers get started. During the fall of 2000, he asked his accountant to find out more. Ryan says, "She took it from there and got the forms." They completed the application forms and became the first in the state to receive the credit. Ryan plans to continue to use the tax credit program on the new land rented and on any equipment he rents from Martin.

Fiscally Speaking

Like most new businesses, Ryan's financial status is in an initial state of flux. This should be taken into consideration when reviewing the comparison below.

While the asset turnover ratio appears outstanding when looking at that measure alone, this can be somewhat misleading. Ryan's is a cash-grain and cattle-feeding operationan. Any farm that includes a cow/calf operation requiring more than six

Chart #9: Small Family Farm U.S. Averages (1998)

	low sales	high sales	limited resource
Net worth (in dollars)	522,151	654,547	66,838
Solvency—debt to asset ratio	6.8%	15.2%	12.2%
Asset turnover ratio	0.07%	0.22%	0.13%
Operating expense ratio	0.97%	0.77%	1.34%

Chart #10: Ryan Malcolm's Operation

	2001	2000	1999	1998
Solvency—debt to asset ratio	41%	2%	0%	
Asset turnover ratio		177%	263%	
Operating expense ratio		101%	89%	86%

months to realize a sale would have a lower asset turnover but an increased net worth.

Depressed grain markets might make it a challenge for Ryan to build equity while maintaining cash flow, but a low debt to asset ratio minimizes interest expenses and provides a credit "cushion" if more loans are needed.

A sound financial and business plan are essential during the start-up phase of a business, and help make a good case when looking for credit or investors.

As Ryan begins to increase his crop acres, he'll become more independent of his father. The support that Ryan is receiving from his parents now, with the shared use of equipment, will provide him stability to make this operation work on into the future.

Nebraska's Beginning Farmer Tax Credit Program

The Beginning Farmer Tax Credit Act was passed by the Nebraska Legislature and approved by the Governor of Nebraska on May 26, 1999. This act developed a program to encourage present farmers and ranchers to offer beginning farmers and ranchers the needed support to start out in the industry.

When the owner of agricultural assets—such as land, facilities, machinery or livestock—rents or leases an asset for three years to a beginning farmer or rancher, the owner is eligible for a tax credit. The rental arrangement is flexible, and can include cash rent, sharecrop or livestock shares. Beginning January 1, 2001, owners receive a refundable tax credit equal to five percent of the amount of rent received each year, for three years, on each rented asset.

A five-year buyout plan for livestock and a long-term land lease are two of the tools used to accomplish this intergenerational transfer. Bob Warrick and beginner Todd Stewart also used a transitional employment arrangement to make it possible for both to reach their personal goals.

Locally Grown: Neighbors Working Together

This case study was prepared for the North Central Initiative for Small Farm Profitability by Joy Johnson, Farm Transition Specialist and Land Link Realty Broker, Center for Rural Affairs. Written by Rebecca S. Kilde.

Additional information is available through the Center for Applied Rural Innovation and Food Processing Center, University of Nebraska,58 H. C. Filley Hall, Lincoln, NE 68583-0947 or online at ***www.farmprofitability.org***.

This material is based upon work supported by the Cooperative State Research, Education, and Extension Service, U.S. Department of Agriculture. Any opinion, findings, conclusions, or recommendations expressed in this publication are those of the author(s) and do not necessarily reflect the view of the U.S. Department of Agriculture.

The Answer Was Right Down the Road

Todd Stewart had a goal. He wanted to own a ranch or farm, with an emphasis on cattle. After spending time as an agricultural instructor, he took the plunge. He began by farming part-time and working at the local co-op.

He was faced with losing the results of all his hard work, though, when his landlord passed away. Like many beginning farmers, Todd assumed that the only way to get into farming was to rent the land and facilities and buy equipment and livestock. With the death of his landlord, Todd realized he needed to find a different approach.

At the same time, Bob Warrick, who farmed the land that his family homesteaded in the nineteenth century, was dealing with some health issues and began considering options for his retirement. He really wanted to pass on his farm operation to a family farmer who shared his passion for the environment—a person who would appreciate and continue his careful stewardship of the land.

Both Todd and Bob contacted the Center for Rural Affairs' Land Link program, a program that brings together retiring farmers and beginning farmers.

Although Todd and Bob were neighbors, they didn't know that they each had what the other needed. Todd wanted access to land and facilities. Bob wanted labor and someone capable of buying him out within five years. Bob was willing to serve as a mentor to someone wanting guidance. Once they had talked and realized how well their plans and ideals dovetailed, they moved quickly into the transfer process. Todd says, "All it took was two willing people."

Trading Places

To meet Bob's five-year timetable, and provide an income for Todd during the transitional phase, Bob employed Todd full-time for the first year. This provided the additional labor that Bob needed, and provided a chance to set up a baseline for income flow to set the stage for the second year.

In the first year the pair also entered into a written five-year lease/purchase agreement on the cattle, with one-fifth of the ownership transferring each year. The price was based on consultation with the local sale barn.

Both Bob and Todd are interested in organic production, and began the process of organic certification on crop acres in that first year of the partnership.

The second year Todd hired Bob full-time. Todd got an FSA guarantee on the loan he received from his local bank for operating costs and for purchasing gilts from Bob based on the market hog price. Todd leased the farm acres from Bob and his family.

The third year continued much the same as the second. Todd purchased another one-fifth share of the cattle. He'll purchase the rest of the cattle in the fifth year, along with some of the equipment. They used the best equipment from both operations during the first three years, and plan to sell duplicate machinery near the end of the fifth year. They purchased a hay processor together during the third year.

Now in the fourth year of the transfer, Bob is retired, but still likes to help out occasionally. The transfer is running smoothly for both men.

> "ONCE BOB AND TODD REALIZED THEIR IDEALS DOVETAILED, THEY MOVED QUICKLY INTO THE TRANSFER PROCESS. TODD SAYS, 'ALL IT TOOK WAS TWO WILLING PEOPLE.'"

Timing and Finances

Just prior to this arrangement Todd had applied for FSA financing to buy the 320 acres he had been renting, and was waiting for available funding, so timing was definitely a factor as Todd and Bob began their transfer. If Todd took on too much debt as a part of his new arrangement with Bob prior to the FSA loan closing, the shift in his cash flow could have jeopardized his eligibility for the FSA loan.

To Market To Market to Sell a Fat Hog

Low market prices have caused some tension on the financial end for Todd, but the diversification of his operation is beginning to pan out. While he has sold soybeans and some hay through the local elevator, the corn is now being sold on the organic market at a premium.

Because the hogs aren't raised in confinement, Todd is able to market from 85 to 90 percent of them through an environmental marketing group at a premium. Cattle are primarily sold as 700 to 800-pound feeders through a sale barn, but Todd hopes to use the same environmental marketing group to capture a premium on the beef next year.

Todd and his wife, Julie, also raise a few sheep on the farm for meat. A few head of livestock are sold directly to consumers.

Experience + Clear Goals = A Successful Alliance

Todd's eight years of farming experience gave him a maturity that helps in the transfer process. The long-term lease on the Warrick land supplements Todd's 320 acres, making it possible for him to farm full-time. It may even be possible for Julie to join her husband full-time on the farm as well—a working arrangement they would both like.

You could call this transfer an alliance as much as a partnership. Both Bob and Todd continue a nearly daily dialogue that includes sharing ideas for planning, as well as prioritizing the immediate work. This regular communication has been important first as the two merged management of the operation, and then as Bob handed over the reigns of his life's work to a dedicated young farmer.

Chart #11: Small Family Farm U.S. Averages (1998)

	low sales	high sales	limited resource
Net worth (in dollars)	522,151	654,547	66,838
Solvency—debt to asset ratio	6.8%	15.2%	12.2%
Asset turnover ratio	0.07%	0.22%	0.13%
Operating expense ratio	0.97%	0.77%	1.34%

Chart #12: Todd and Julie Stewart

	2001	2000	1999	1998
Net worth (in dollars)	260,000	231,000	47,000	70,000
Solvency—debt to asset ratio	61%	65%	5%	23%
Asset turnover ratio		18%	52%	66%
Operating expense ratio		84%	171%	118%

After looking around for someone to take over his 2,500-acre crop and cattle operation in Nebraska's panhandle, Don Tisdale found the best candidate right on his own farm. A partnership and incorporation are the legal tools that complement good communication and flexible income sharing to achieve Don's 10 to 14-year plan to transfer all but the land to employee Kevin Walker.

Working Dreams:
A Transfer in Progress

This case study was prepared for the North Central Initiative for Small Farm Profitability by Joy Johnson, Farm Transition Specialist and Land Link Realty Broker, Center for Rural Affairs. Written by Rebecca S. Kilde.

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Looking for a Good Farmer

When Don Tisdale was about 60 years old he started thinking about retirement and began looking for someone to take over his 2,500-acre crop and cattle farm near Dix, Nebraska. A family discussion with Dan and Belva's two daughters made it clear that neither of them would be taking over the reigns. He talked with a few other potential candidates, but didn't have any luck. He finally approached his employee, Kevin Walker, with the idea of a partnership arrangement to buy into the farm.

Kevin had lived in the area all his life, and had worked for Don since 1989. Don knew he was a good employee, but had never heard him express an interest in owning his own farm. At age 33, Kevin had equity in a house and little else. He calls this opportunity "a dream that I didn't think could come true." He jumped at the offer.

Taking the First Steps

Because of their long-standing working relationship, start-up requirements for Kevin were pretty straightforward: He had to be willing to accept the risks of farming, take on debt, and increase the amount of time he devoted to the farm. Kevin's practical knowledge and skills learned on the job would serve him well.

Debt included annual operating expenses and livestock purchases. Expenses would be virtually unchanged during this transition.

The original plan allowed for Kevin to gain 50 to 75 percent ownership within five to seven years with no up-front investment. To achieve that goal, the labor contribution would shift right away, with Kevin moving from a 10-hour day six days a week to more like a seven day work week of 10 or more hours each day.

The Implementation

During the first three years the business structure was a partnership. Don had used a line of credit for operating costs on the farm before Kevin became a partner, and that line of credit became available to the partnership. All operating expenses were borrowed each year on that line of credit, including wages and the purchase of feeder cattle.

This arrangement allowed Kevin to draw what was once his salary to cover family living expenses. Any farm income was used to cover the debt from operating expenses first, and then the amount remaining was divided 50/50. Kevin's remaining income, after deducting his wages, was used to purchase pre-identified pieces of equipment at a mutually agreed price.

During the third year of the arrangement they adopted an S-Corporation structure to better serve the transfer process. The S-Corporation offers a means to transfer either shares or assets. Beginning farmers can buy units based on the share value, allowing them to break down high-cost items into manageable pieces.

> **"BECAUSE OF THEIR LONG-STANDING WORKING RELATIONSHIP, START-UP REQUIREMENTS FOR KEVIN WERE PRETTY STRAIGHTFORWARD."**

Current Events

The transfer is now in its sixth year, and both men still draw a wage from the farm, although this is Don's last year. Don's hours are now 50 percent less than he worked at the beginning. The operation needs two full-time workers, however, and Kevin is looking for an employee to replace Don.

Don continues to purchase cattle in the fall. This allows Don to continue something he enjoys, and Kevin can concentrate on the harvest at this busy time of year. They work together on sales. Kevin is now responsible for the management of the farm.

At this time, income is split with two-thirds going to the corporation, and the remaining one-third paid as rent to Don. A binding agreement with the corporation names Kevin as the farm manager, and he will continue to receive a wage. Residual corporate income is split based on the ownership structure, which varies each year. As Kevin

S-Corporation Can Be a Useful Tool

"S-Corporation" is a term that describes a profit-making corporation organized under state law whose shareholders have applied for and received subchapter S-Corporation status from the Internal Revenue Service. Electing to do business as an S-Corporation lets shareholders enjoy limited liability status, as would be true of any corporation, but be taxed like a partnership or sole proprietor. That is, instead of being taxed as a separate entity as would be the case with a regular or C-Corporation, an S-Corporation is a pass-through tax entity. Income taxes are reported and paid by the shareholders, not the S-Corporation. To qualify as an S-Corporation a number of IRS rules must be met, such as a limit of 75 shareholders and citizenship requirements.

invests more in the farm operation, a larger percentage of income will go back to the corporation. Kevin now pays between $20,000 and $25,000 annually to increase his ownership percentage.

It Works

Lower commodity prices have slowed the transfer process from the original plan, but otherwise the transfer is working well for both men. Kevin appreciates the opportunity Don afforded him, as well as the on-going mentoring Don provides. They continue to meet daily in the shop to go over details of the daily operation and talk about future plans.

A young couple moves from a rented dairy farm in southern Minnesota to a 250-acre dairy operation in Stratford, Wisconsin. A flexible transfer program and mutual cooperation make this intergenerational transfer a success.

A Thriving Dairy: Cooperating for Success

This case study was prepared for the North Central Initiative for Small Farm Profitability by Kara Heideman, intern, Center for Rural Affairs. Written by Rebecca S. Kilde.

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Finding the Link

In 1996 Lucy and Scott Adank were operating a dairy farm near Rochester, Minnesota, but they were looking for a change. Rent on the land was high, and they wanted to be closer to Scott's parents. A local banker told them about the Wisconsin Farm Link* and they decided to give it a try.

The Wisconsin Farm Link program matches prospective and retiring farmers. The program sends profiles of potential matches to both those looking for land and those looking to pass on a farm. Pursuing the contacts is each individual's responsibility. In this case, the Adanks received 15 applications, among them Eugene Nikolai's.

Eugene Nikolai was looking for someone to take over his 250-acre dairy operation in central Wisconsin. He had tried working with his children to maintain the family operation without success. The land could have been split up and sold to nearby farmers, but Eugene didn't want that to happen. He'd been on that farm for 35 years and wanted it to continue as a dairy.

Eugene also contacted Wisconsin Farm Link, and received 30 applications. The Adanks were among three families that Eugene interviewed, and he decided Scott and Lucy were a good fit.

Making the Numbers Work

After making the decision to move to Wisconsin, the Adanks sold their equipment and all but 27 cows from their Minnesota farm and headed east.

Eugene had the land and equipment appraised and offered them both to the Adanks at the lower end of the appraised value. They purchased the Nikolai's home, 80 acres and 50 cows. They hired custom fieldwork instead of buying the equipment. They rent the remaining 170 acres and have the first option to buy within five to ten years. Eugene maintains a low rate for the rent compared with other farms in the area.

Scott and Lucy are happy to be in a region with a strong emphasis on dairy. They were able to work with the local bank to borrow money for the operation. They also qualified for an FSA guaranteed loan, but haven't used it yet.

The Old and the New

The Adanks have switched to rotational grazing. According to Scott, this is one of the most important factors in the success of the dairy. (For more on grazing, see ***Can Smaller Be Better?*** on page 18 of this publication.)

Eugene maintains a kind of hands-off policy with the Adanks, but is very supportive. He lives close by and often drops in for social visits with Scott and Lucy, but doesn't offer advice on the farm unless it is requested. He's willing to help out around

> "EUGENE'S SUPPORT HAS BEEN A TREMENDOUS HELP TO SCOTT AND LUCY AS THEY TAKE OVER THE OPERATION. SCOTT FEELS THAT THEIR SHARED GOAL—MAINTAINING A THRIVING DAIRY OPERATION ON THIS FARM—IS A LARGE PART OF THE SUCCESS OF THE TRANSFER."

*The Wisconsin Department of Agriculture's Farm Link Services is one of the more successful programs of its kind operating in the U.S. An outstanding program manager coordinates a strong volunteer support network, and the state kicks in financial support for the program. Their publication, ***Farm Transfers in Wisconsin: A Guide for Farmers,*** walks readers through the transfer process from start to finish. Although the tax information is outdated, it's still a good resource for both the beginning and retiring farmer, and it's free of charge. Also free from the Wisconsin Department of Agriculture is a newer publication, ***Retirement and Estate Planning: A Guide for Wisconsin Farmers.*** Call 800-942-2474 for those publications. You can also find out more about the program by visiting http://datcp.state.wi.us, clicking on the Agriculture link, and going to the Farm Center page.

the farm if his help is needed. While it's no longer his farm, he still wants to see it succeed.

Eugene's support has been a tremendous help to Scott and Lucy as they take over the operation. Scott feels that their shared goal—maintaining a thriving dairy operation on this farm—is a large part of the success of the transfer.

The Financial Picture

The Adanks, like many beginning farmers, have dangerously high solvency measures. They're moving in the right direction, though, by building net worth and improving their debt-to-asset ratio. The chart below compares their expenses with those figures in the USDA Economic Research Service's *Structural and Financial Characteristics of U.S. Farms: 2001 Family Farm Report.*

Chart #13: Small Family Farm U.S. Averages (1998)

	low sales	high sales	limited resource
Net worth (in dollars)	522,151	654,547	66,838
Solvency—debt to asset ratio	6.8%	15.2%	12.2%
Asset turnover ratio	0.07%	0.22%	0.13%
Operating expense ratio	0.97%	0.77%	1.34%

Chart #14: Scott & Lucy Adank's financial information for comparison

	2001	2000	1999	1998
Net worth (in dollars)	72,993	54,175	25,571	4,124
Solvency—debt to asset ratio	84%	87%	92%	98%
Asset turnover ratio		42%	60%	59%
Operating expense ratio		79%	81%	82%