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Cooperative Extension Service

Farm Update

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AGRICULTURE & NATURAL RESOURCES EDUCATION
Clint Hardy
Daviess County Extension Office

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Preparing to Transfer Your Farm to the Next Generation:

There are many factors to consider when deciding to transfer your farm business to the next generation. Open communication between generations is key for a successful transition process. Topics of profitability and income generation should be addressed, for both the retiring and new generations. If the farm business does not have the ability to provide the income and asset needs of both generations, the likelihood of success is greatly reduced.

Households often struggle to estimate current living expenses, which makes planning for the future difficult. Both the retiring and new generations need to calculate the amount of income they will need to generate from the farm. This should be done separately, as each generation will have a different set of needs.

The first step for the retiring generation is to determine your retirement income needs. Start a spending diary by writing down all of your expenses for a one-month period. Bigger expenses are normally easy to identify such as mortgage payments, insurance, taxes, and utility bills. The everyday expenses such as eating out, trips to the store, or even snacks at the ballfield, are much more difficult to track. It is important that you write down all expenses for one month, because even the smallest expense adds up over time. Multiply your monthly spending estimate by twelve. As you review your expenses, identify the expenses that may not occur monthly, such as your property tax bill or holiday spending. Estimate your occasional expenses such as home improvements, medical expenses, federal and state income taxes, recreation/vacations, and automobile expenses including license, registration, insurance, and repairs. Add together the total monthly expenses and occasional expenses; this number should give you a realistic idea of your spending needs. Next, consider each item that you listed in your spending diary as an occasional expense. Do you anticipate any of these expenses increasing or decreasing when you enter retirement? Many families are able to pay off their home mortgage prior to entering retirement, so this may be a reduced expense. However, many couples anticipate traveling more, so this expense category may actually increase. It is also important to recognize that your expenses may change during retirement. For example, as you age your medical bills may increase. Nonetheless, with a little planning you should be able to determine a realistic income that will maintain your desired standard of living. Most retiring couples will not need to rely on the farm as their only source of retirement income. Total your estimated retirement income from other sources, which may include social security, investments, or employer retirement from off-farm work. After you subtract the total amount of other income sources from your estimated retirement needs, you will have a realistic figure for the amount of income that you need to generate from the farm.

Similar to the retiring generation, the younger generation needs to develop a realistic estimate of yearly family living expenses. Follow the same steps as the retiring generation for creating a spending diary and estimating occasional expenses. As you review your anticipated yearly expenses, determine if there are expenses that may adjust up or down over the next several years. Are you planning on having a child or another child? Will your daycare costs increase? Or maybe your children will be moving into public school and your daycare expenses will decrease. Do you have a child that will be driving soon? You will not be able to anticipate all your future living expenses, however, you can develop a realistic estimate. Determine your sources of other income. Do you or your spouse have off-farm employment? Do you have rental property or other investments that generate income? Subtract your total off-farm income from your estimated expenses; the remainder represents the amount of income you would need to generate from the farm operation. As a reminder, the younger generation should be certain to include savings and investment in retirement accounts in their expense estimates.

Once you have determined the income needs for both generations, you will have a realistic projection of the amount of income needed to cover your current standard of living.