

FINANCIAL VIABILITY AND FARM SUCCESSION PLANNING-

*Farm Succession Training for Legal and
Financial Professionals*

September 21, 2021

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WHAT IS FINANCIAL VIABILITY?



- Why is it important?
- How do you measure it?
- How do you improve financial viability?
- What if finances are still inadequate for the next generation?



WHY IS IT IMPORTANT?

- As simple as beer and pizza!
- “Adequate” earnings provide:
 - ✓ Living Needs
 - ✓ Debt Service
 - ✓ Capital Investment
 - ✓ Return on Equity
 - ✓ Room for aAdversity



FARM FINANCIAL STATEMENTS – MEASURING VIABILITY

**Balance Sheet
1/1/20**

**Balance Sheet
12/31/20**

**Cash Flow
Statement**

**Income
Statement**

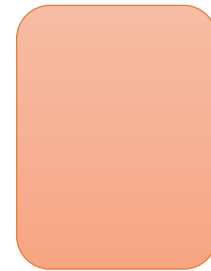
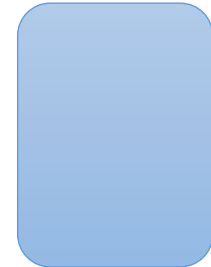
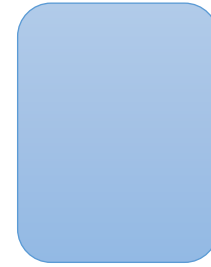
(Accrual Adjusted
or Production-
Based)



FARM EXAMPLES

Dairy Dreamin'

- Owner Ages: 64 and 61
- 60 milking cows
- 25+years
- 285 acres owned



High Ridge Produce

- Owner Ages: 52 and 53
- 12 acre mixed produce/plant sales
- 20 years farming



NET WORTH OR EQUITY

Key Concept:

Solvency- *the ability of the business entity to meet its long term debts and obligations.*

Definition:

Net Worth: *The total financial wealth of the company or individuals taking into account all owned assets minus liabilities.*



NET WORTH OR EQUITY

Where to Find It: Balance Sheet

What to Look For: Magnitude in relation to business stage, Trends ↑↓

<i>Farm Net Worth</i>	2017	2018	2019
Dairy D.	\$1,564,814	\$1,468,814	\$1,474,814
High Ridge			



NET WORTH OR EQUITY

Where to Find It: Balance Sheet

What to Look For: Magnitude in relation to business stage, Trends ↑↓

<i>Farm Net Worth</i>	2017	2018	2019
Dairy D.	\$1,564,814	\$1,468,814	\$1,474,814
High Ridge	\$247,000	\$268,000	\$281,000



DEBT-TO-ASSET

Definition: *A leverage ratio that defines the total debts in relation to the value of assets owned by the company ($Debt \div Assets$)*

Where to Find It: Financial Ratio Scorecard, Data is on the Balance Sheet



DEBT-TO-ASSET

What to Look For:

- Trends ↑↓
- The % moving below 30% and toward zero in later business stages

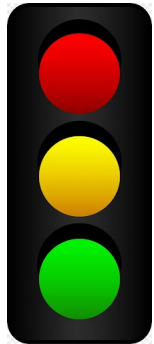
<i>Debt-to-Asset Ratio</i>	2017	2018	2019
Dairy D.	17%	22%	22%
High Ridge	42%	38%	35%



NET WORTH CHALLENGES

- Net Worth (Equity)- to- Asset Ratio

$$= \text{Net Worth} \div \text{Total Assets}$$



Risky: Less than 50%

Caution: 50% - 70%

Strong: 70% and over

- Room for Adversity
- Financing Challenges
- Borrowing your Last Dollar



GROSS FARM “SALES”

Definition: *Cash sales transacted and payments received within the annual period.*

Where to Find It: Cash Flow Statement

What to Look For: Magnitude, Trends ↑↓, Volatility

<i>Gross Sales</i>	2017	2018	2019
Dairy D.	\$270,234	\$232,897	\$256,745
High Ridge			



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<i>Gross Sales</i>	2017	2018	2019
Dairy D.	\$270,234	\$232,897	\$256,745
High Ridge	\$144,591	\$142,385	\$136,936

GROSS FARM “INCOME OR REVENUE”

Definition: *Cash Sales plus/minus inventory changes plus/minus payables or receivables*

Where to Find It: Income Statement

What to Look For: Magnitude, Trends $\uparrow\downarrow$, Volatility, over productive capacity of the farm

<i>Gross Income</i>	2017	2018	2019
Dairy D.	\$282,000	\$219,678	\$261,050
High Ridge	\$144,591	\$144,500	\$136,936



NET FARM INCOME (Return to unpaid labor, management and capital)

Definition: *Farm Revenues minus: operating expenses, interest, depreciation.*
The calculation does not include owner draws or principal payments to debt.

Where to Find It: Income Statement

What to Look For: Family living coverage for Sole Prop. Trends ↑↓

<i>Net Farm Income</i>	2017	2018	2019
Dairy D.	\$38,765	\$27,987	\$32,500
High Ridge			



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Where to Find It: Income Statement

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<i>Net Farm Income</i>	2017	2018	2019
Dairy D.	\$38,765	\$27,987	\$32,500
High Ridge	\$2,200	\$1,850	\$2,073



HOW DO YOU IMPROVE FINANCIAL VIABILITY

- Additional income opportunities?
- Potential cost cuts?
- “Right size” the business?



HOW DO YOU IMPROVE FINANCIAL VIABILITY

- Change the type of business?
- What else needs to change?
- Is adequate profit possible?



KEY EXPENSE ITEMS

Where to Find It: Cash Flow Statement, Bookkeeping Records

What to Look For:

- ☐ Rental payments
- ☐ Land-related debt service
- ☐ Owner draws, salaries and distributions
- ☐ Personal living buried in operating expenses



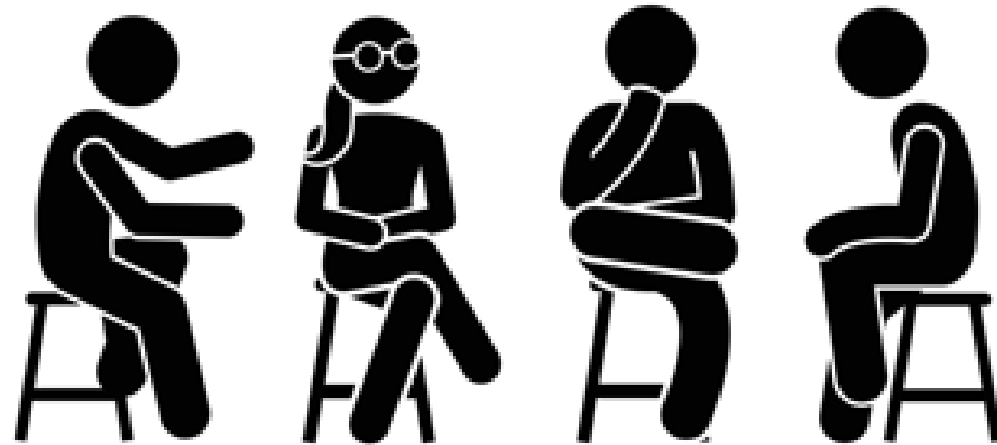
WHEN THE SITUATION IS INADEQUATE FOR THE NEXT GENERATION

- Hold until conditions change.
- Sell for non-farming use.
- Search for a farm buyer not reliant on adequate farm earnings (i.e. hobby farm).
- Sale of development rights or “non-farm” assets (a house lot) to reduce asset value and enhance non-farm assets.



DEVELOP A TEAM

- An advisory team to guide the farming family in the transfer process
- Includes
 - ✓ Attorney
 - ✓ Accountant, Tax Advisor
 - ✓ Financial Planner
 - ✓ Insurance Agent
 - ✓ Extension Service
 - ✓ Appraiser



OUTGOING GENERATION FINANCIAL NEEDS

- 1st Need to understand annual income needs in retirement*.
- 2nd Need to understand what is available from SS, retirement and other existing income sources.
- 3rd Need to cover #1 minus #2 shortfall



OUTGOING FINANCIAL GENERATION FINANCIAL NEEDS

- Plan for the unexpected financial needs
- See the personal budget spreadsheet



Retirement Budgeting Worksheet

A budget is one of the most important tools you can use to manage your money and save for retirement. Limiting your spending and living within your means can have a huge impact on your financial security throughout your life, since you generally have more control over your spending than on your income from work or investments. As seen below, even small changes can add up in the long run. Cutting spending can be a great way to contribute extra money to a retirement account, build up an emergency fund, or reduce your debt. (Text and Savings chart from AARP.)

Weekly savings	1 Year	5 Years	10 Years	20 years
\$10	\$520	\$2,600	\$5,200	\$10,400
\$20	\$1,040	\$5,200	\$10,400	\$20,800
\$30	\$2,600	\$13,000	\$26,000	\$52,000

Instructions: Use the following worksheet to examine how much income comes into your household on a monthly basis. Be sure to include all sources of income you receive, as well as spouse or partner income if applicable. Then look at all your current expenses. Next, try to project all expected retirement income and expenses. Lastly, do the math!

PART I: INCOME	CURRENT	EXPECTED	EXPENSES, CONT'D	CURRENT	EXPECTED
Wages			B. Living/Medical		
Social Security			Health insurance		
Net farm income			Prescriptions		
Other business income			Medical: out-of-pocket		
Rent/lease income			Fitness programs		
Taxable interest			Food/groceries		
Tax-exempt interest			Clothing		
Stock dividends			Auto loan/lease		
Annuity payments			Auto insurance		
Other (e.g., alimony)			Gasoline		
TOTAL GROSS INCOME			Public transportation		
Federal taxes			C. Discretionary		
State taxes			Charitable contrib.		
Medicare/Social Security			Entertainment/dining		
Total taxes			Recreation/vacation		
TOTAL NET INCOME			Gifts (birthday/holiday)		
			Pet/veterinary		
PART II: EXPENSES			Other discretionary		
A. Housing			TOTAL EXPENSES		
Real estate taxes					
Mortgage payments					
Homeowners insurance					
Rent					
Heat					
Water/sewer/trash			TOTAL NET INCOME		
Phone/Internet/cable			(less)		
Maintenance/repairs			TOTAL EXPENSES		
Lawn care/cleaning			(equals)		
Misc. household			TOTAL DISCRETIONARY INCOME		

NEXT GENERATION FINANCIAL CONSIDERATIONS



- What can they afford to pay for the farm without significant changes to the current operation?
- What farm operation changes are needed to improve financial viability – What will these changes cost and how much will they improve net earnings?
- How much does price need to decrease to match better farm business alternatives available?



NEXT GENERATION FINANCIAL CONSIDERATIONS

- How much can they borrow (conventional or seller financing) to acquire the business?
- Down payment required?



MONITOR THE CHANGES

- The transfer plan evolves over time
- Important for ongoing family meetings
 - ✓ Include farming and non-farming heirs
- Every plan is different, no one-size-fits-all approach
- Farming members, along with advisory team members look at Strengths, Weaknesses, Opportunities and Threats
 - ✓ Continuous process- Goals change over time
 - ✓ New farm members or those who leave



DISCUSSION

- Questions
- Real Life Examples

