

Farm Management Update



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Retirement Planning



By Warren Lee

Retirement planning can be approached in three steps: 1) Recognize the planning period, 2) Estimate living costs during retirement, and 3)

Design an investment program to try to cover these living costs.

The Planning Horizon

Estimating the planning horizon is illustrated for the "Joneses" who plan to retire when the husband is 65 and his wife is 60 years old. Based on average life expectancies, the husband can expect to live for another 15 years and his wife about 22 years. However, mean life expectancies are not a reliable basis for retirement planning because about half of all individuals live beyond their mean life expectancy. If the Joneses are willing to assume a 30 percent chance of living beyond their planning horizon, they should plan on another 20 years for the husband and 32 years or more for his spouse. A life expectancy calculator that incorporates your age, general health and lifestyle can be found at <http://www.ces.purdue.edu/retirement/> under the topic "Are You Ready to Retire?"

A realistic estimate of the planning horizon is important because over a 30-year period, living costs will increase significantly due to inflation. If the average inflation rate is 3 percent per year, it will take \$2.43 after 30 years to buy what \$1.00 will buy today. A 5 percent inflation rate will increase that amount to \$4.32. The "Rule of 72" is a useful rule of thumb that will estimate how fast income needs will double due to inflation. Divide the interest (inflation) rate into 72 to estimate the number of years it will take for living costs to double. For example, if the inflation rate is expected to be 4 percent per year, living costs will double approximately every 18 years (72 / 4).

Estimating Living Costs

A general rule of thumb is that living costs during retirement will be 75 to 80 percent of present living costs. Some expenses such as clothing and commuting to work may decline; however, other expenses such as medical care will likely increase. Families who plan on an active living style during retirement should plan on 100 or more percent of present living costs. For retirement income

calculators, please refer to "How Much Will Your Expenses Be in Retirement?" at <http://www.ces.purdue.edu/retirement/>.

Designing an Investment Program

Social Security and employer pensions are the base for retirement income planning. Generally they provide a fixed income for our lifetime and for the surviving spouse. Amounts received may or may not keep up with inflation. For a good overview of Social Security and pensions, please refer to "All about Money: Retirement Planning" at <http://ohioline.osu.edu/mm-fact/index.html>.

The rest of our retirement income must come from IRAs and other tax deferred accounts, securities, our home, life insurance, liquid savings and other investments such as real estate, collectibles, a business, etc. The primary criteria for selecting and managing the investment portfolio over time are returns, risk and liquidity.

The investment portfolio should contain a mix of investments so our eggs should be put into different baskets. For information on selecting

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Agricultural Easement Purchase Program

Over 400 landowners recently vied for the right to sell an agricultural easement on their farm under Ohio's new Agricultural Easement Purchase Program (AEPP). The program provides funding to local governments and non-profit organizations to purchase agricultural easements from willing landowners. The agricultural easement ensures that the farmland will remain permanently in agricultural use.

The response to the first funding round of AEPP was much higher than anticipated. In total, the Office of Farmland Preservation (OFP) received 442 applications covering 63,450 acres of farmland. Applications came from 49 of Ohio's 88 counties.

The OFP has \$6.25 million to spend on agricultural easements this year. OFP received a total of \$25 million from the Clean Ohio Fund to conduct a four-year pilot program for the purchase of agricultural easements. The \$400 million bond issue passed by Ohio voters two years ago as "State Issue One" created the Clean Ohio Fund.

The AEPP might also receive additional monies from the federal government as a result of the recently enacted Farm Bill, which reauthorized the USDA Farmland Protection Program (FPP). The FPP provides matching funds for the purchase of agricultural easements to states that have farmland preservation programs. Ohio has applied for FPP funding for this year. The high number of applications to AEPP increase Ohio's chances of receiving up to \$6.25 million more for the first round of AEPP.

AEPP applications were due to

the OFP at the end of April. The applicant, who is the local government or non-profit organization that will receive the funds from the State, partnered with the landowner to submit information about the farm, the farm operator and the local community. The OFP scored all applications on initial criteria—soils, location to other protected property, development pressure, utilization of best management practices, local planning and zoning, and local or individual matching funds. A working group of citizens from around the state assisted the OFP in developing the scoring criteria.

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Farms that scored highest on the initial criteria proceeded to a second scoring round conducted by the AEPP's 12 member Advisory Board. The board assigned point values for information on farm management, business and conservation plans, local agricultural infrastructure support and community support for farmland preservation. The OFP ranked applications according to the combined totals of the two scoring rounds.

In early July, the OFP announced final scores for all appli-

cations. Top ranking farms have been notified and are now undergoing an appraisal and legal review, which might require several months for completion.

The appraisal process will determine the value of the agricultural easement, which is the difference between the fair market value of the land and the land's agricultural value. For example, where a farm would sell for \$5,000 per acre on the open market or \$3,000 per acre as agricultural land, the value of the agricultural easement is the difference between the two amounts, or \$2,000 per acre.

The AEPP will pay the landowner up to 75% of the value of the agricultural easement, with the remaining 25% coming from the local community, non-profit organization, or by the landowner's donation of the value. This year, the Director of ODA has placed a \$4,000/acre limit on the State's share of the purchase price. A landowner who is dissatisfied with the determined value of the agricultural easement may opt out, and the farm with the next highest score will have the opportunity to enter the program.

The final step in the AEPP process is negotiating the Deed of Agricultural Easement. The deed is the written agreement between the landowner, the Ohio Department of Agriculture, and the local govern-



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ment or non-profit organization. By entering into the deed of agricultural easement, the landowner agrees to maintain the land in agricultural use. The deed of easement outlines uses and activities that are consistent with agricultural use, and also states prohibited uses and activities. As a result of the deed of easement, the ODA and the local government or non-profit organization hold the legal right to require the landowner to abide by the terms of the agreement. Because the agricultural easement is permanent, all successive landowners must also follow its terms.

Selling an agricultural easement is a decision that requires careful consideration by the landowner. The income from the sale is subject to taxation, but may be offset by utilizing like-kind exchange provisions or a charitable conservation contribution deduction. The agricultural easement is a legal agreement that creates rights and obligations for the landowner. The landowner should ensure that those rights and obligations are consistent with long-term plans for the farm and operation. For these reasons, the assistance of tax and legal professionals is a necessity before selling an agricultural easement.

Judging by the surprising interest in AEPP, many Ohio farm owners agree with the commonly cited reasons for selling an agricultural easement: financial benefits to the farm operation, maintaining the family's agricultural heritage, and protecting the land and its resources.

Information on the AEPP and final scores for this year's applications are available on-line at <http://www.state.oh.us/agr/>. ■

Ohio Farm Custom Rates Survey

The 2002 Ohio Farm Custom Rates Survey has recently been completed. Over 500 Ohio producers were surveyed which resulted in over 100 field operations and services being identified. An average and range is provided for each operation/service. A few of the more common operations are included below. A complete survey can be found on-line at: <http://aede.ag.ohio-state.edu/people/moore.301/custompage.htm> or by contacting your local Extension office.

| Operation | Unit | Average | Range |
|-----------------------------------|--------|---------|-----------|
| | | (\$) | |
| Moldboard Plow | acre | 13 | 8-17 |
| Disk Plow | acre | 10 | 6-14 |
| Chisel Plow | acre | 12 | 8-16 |
| Disk | acre | 9 | 6-11 |
| Drag | acre | 7 | 3-11 |
| Disk and Drag | acre | 10 | 5-14 |
| Harrow | acre | 8 | 3-12 |
| Field Cultivator | acre | 9 | 5-12 |
| Land Leveling | acre | 9 | 3-14 |
| Land Leveling | hour | 30 | 12-48 |
| Subsoiling | acre | 13 | 9-18 |
| V-Ripping | acre | 12 | 8-17 |
| Spraying-ground | acre | 5 | 3-7 |
| Spraying-ground (incorporated) | acre | 5 | 3-7 |
| Spraying-aerial | acre | 7 | 6-9 |
| Rope Wick | acre | 5 | 2-7 |
| Combine-Corn | acre | 21 | 18-25 |
| Combine-Soybeans | acre | 21 | 17-25 |
| Combine-Small Grain | acre | 21 | 17-24 |
| Ear Corn Picker | acre | 19 | 11-28 |
| Picker-Sheller | acre | 19 | 14-23 |
| Mowing | acre | 9 | 5-13 |
| Mowing/Conditioning | acre | 10 | 7-13 |
| Raking | acre | 5 | 3-8 |
| Tedding | acre | 5 | 2-7 |
| Baled and Dropped | bale | 0.41 | 0.24-0.57 |
| Baled and Loaded | bale | 0.47 | 0.27-0.66 |
| Charge to Haul and Store | bale | 0.21 | 0.07-0.35 |
| Baled and Left in Field | bale | 6.50 | 5-8 |
| Baled and Hauled | bale | 8.50 | 6-11 |
| Move Stack or Bale | bale | 2.50 | 1-5 |
| Wrapping in Plastic | bale | 6.00 | 3-9 |
| Bush Hogging | acre | 13 | 6-19 |
| Grinding Feed | cwt. | 0.52 | 0.24-0.80 |
| Building Fence | hour | 20 | 8-33 |
| Income Tax Preparation | hour | 78 | 36-120 |
| Income Tax Preparation | return | 192 | 57-327 |
| Farm Account Summary | return | 298 | 118-477 |
| Track Hoe | hour | 76 | 55-96 |
| Snow Removal | | | |
| Loader | hour | 43 | 25-60 |
| Blade | hour | 46 | 27-65 |
| Blower | hour | 52 | 27-78 |
| Hauling Livestock | mile | 1.22 | 0.77-1.67 |
| Bulldozing | hour | 59 | 46-73 |

investments see <http://ohioline.osu.edu/mm-fact/index.html>. Here are some sample investment portfolios and expected returns based on past performance:

Lower Risk: 55% Cash, 20% Fixed Income, 25% Stocks – Average Return = 6%.

Medium Risk: 20% Cash, 35% Fixed Income, 45% Stocks – Average Return = 8%.

Higher Risk: 0% Cash, 35% Fixed Income, 65% Stocks – Average Return = 10%.

The Joneses have estimated that they will need \$40,000 per year during retirement. They estimate that their income from Social

security and pensions will be \$30,000 per year, so they will need to generate \$10,000 per year from their investments. They have a "medium risk" investment portfolio that may earn 8 percent per annum; however, they expect that the average annual inflation rate will be 3 percent, so the *real* rate of return on their investments may be 5 percent.

In order to generate an annual income of \$10,000 from earnings alone with a 5 percent real rate of return, they will need a retirement nest egg of \$200,000 ($\$10,000 / .05$). They can generate an income of \$10,000 from a somewhat smaller nest egg if they

plan to gradually liquidate their investment portfolio during retirement. A portfolio of approximately \$154,000 earning 5 percent real return will generate about \$10,000 per year if the principal is used up over a 30-year period.

Clearly, retirement planning should begin well before age 65. The Joneses estimate that they can put aside \$5,000 per year for retirement and that they can earn a 5 percent real rate of return on their investments. If they start saving 10 years before they plan to retire they will have less than \$63,000 saved up when they retire. If they start saving 20 years before they retire, their retirement fund will have grown to over \$165,000. ■

Thank you, Jim Polson

Jim Polson has retired from Ohio State University Extension. Among his most notable accomplishments is serving as "founding father" and editor of the *Farm Management Update*. He encouraged authors, found reviewers, put the final touches on articles and handled most of the behind-the-scenes work. His success is best illustrated by the fact that more than 26,000 copies of the newsletter are now distributed four times per year.



Jim Polson

A New Editor for *Farm Management Update* Newsletter

With the retirement of long-time editor Jim Polson, Robert Moore has taken over as editor of the *Farm Management Update* newsletter. Moore will be responsible for organizing, compiling, and editing the articles for the newsletter. The newsletter is a cooperative effort of state, district, and county Extension personnel with interests in farm management. Moore can be contacted at 614-688-3959 or moore.301@osu.edu.

His vision was a newsletter that helped farm management people look ahead. Titles of a few articles illustrate: Introduction of BST (1989), Computerization of Farm Records—12% of Farms Have Computers (1989), How will NAFTA Affect Ohio Agriculture (1992), Introduction to Pork Contracts (1994), Are You Ready for the Internet (1996), Introduction to the Green Industry (1998) and E-Commerce (2001). In 1993, the newsletter featured a panel of Ohio agricultural leaders looking ahead 10 years. They said the key attributes of Ohio agriculture in 2002 would be diverse, management intensive, urban refinance and encroached upon. That panel earned an A+ for their insights about the future. Jim, we thank you for an exceptional job of helping all of your readers to stay focused on what is ahead rather than lament what has changed. Your grade too is an A+. ■

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