

## Getting Started in Farming: Inheriting a Farm

Inheriting a farm can be both exciting and frustrating. Some people know exactly what they would like to do with the farm, but many do not. A number of questions and issues must be addressed before the final decisions are made.

Over the next several years, the question of what to do with inherited farmland will become increasingly important. The average age of farmland owners continues to increase. According to the 2007 Census of Agriculture, the average age of the principal farm operator was 57.1. The fastest growing group of operators is farmers over the age of 65. The average age of landlords has seen a significant increase as well. According to the 2007 Farmland Ownership and Tenure in Iowa study, more than 55 percent of farmland in Iowa was owned by people over the age of 65. Owners over 75 years of age owned 28 percent of farmland in Iowa.

Farmland values have experienced increases in the past year. The 2011 U.S. average farm real estate value was \$2,350 per acre, a 6.8 percent increase from 2010. Today, the agricultural land market is influenced by many factors. A large contributing factor is commodity prices or the income that can be earned from the land. Other key components that influence land value are the amount of debt incurred with land acquisition and government policies, especially policies related to energy, taxes, and input costs. The performance of the U.S. economy and economies throughout the world impact commodity prices, which in turn, influences land values. Government monetary policies are significant factors to observe, as they relate to inflation and interest rates. Weather-related challenges, both here and abroad, continue to have an influence on land values. Urban sprawl, real estate development, and other land use planning issues impact the cost and availability of land.

Individual circumstances dictate the most sensible course of action. In some cases, the land may already

be farmed by the individual who inherited it, and the decision could be relatively simple. In other cases, the land may be inherited by someone who knows little about modern agriculture and has no idea what to do with the farm. Finally, the farm may be jointly inherited and the wishes of all parties may influence the decision of what to do with the farm. Regardless of the circumstances, it is important to assess your situation carefully.

There are two major factors that need to be considered before making any decisions. First, it is important to evaluate the land you inherited and understand the farm. In most cases, this will determine the best course of action. The second major factor to consider is whether the farm was inherited by one individual or a group. The more people involved with the inheritance, the more complicated the decision-making process.

This publication is designed to raise questions that need to be asked and to direct heirs to specific information for their circumstances. This publication is an update of an earlier publication prepared as one of the North Central Regional Extension Publications on Getting Started in Farming. This publication was updated again in 2001 by John Baker and Mike Duffy, the Iowa State University Extension and Outreach. Many of the ideas presented are similar because the basis for good farmland decision making has not changed. Acknowledgement is made in a general sense and will not be made throughout to avoid disrupting the flow of the publication.

What E. G. Stoneberg said in the original piece on inheriting farmland is as true today as it was then: “The first step in making a sound decision (the right one for you) is a systematic, careful appraisal. This evaluation should include three major parts: real estate inherited, current economic conditions, and yourself.”

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## Evaluating the Land

### *Location*

An old saying in real estate appraisal says that the three most important factors in determining the value of a parcel of land are location, location, location. Location is the key to the value of an inherited farm. Location is what determines the land's current, best, and future use. For example, land located near an expanding metropolitan area has potentially greater value for development than similar land located in a rural area. Highly productive land is worth more than lower-grade land for crop production. There are many other factors associated with location that determine the value of the land.

### *Income*

After location, the property's potential income is the most important indicator of value. Figuring the farm's potential income will help in estimating the value as well as provide information to help make the final decision of what to do with the farm.

The current use of the land is a good starting point in estimating the potential income from the land. The present use of the land is determined by many factors; therefore, it is important not to assume that the current use is the best use for the land, especially under new ownership.

Estimating the potential income is not a simple task. The inherent productivity of the soil will help in estimating the expected yield for different crops and cropping systems. Iowa State University Extension and Outreach can provide estimated production costs and potential yields. The USDA's Natural Resources Conservation Service can provide advice on the most appropriate uses for the land, given its natural limitations. NRCS can help develop a soil conservation plan if necessary.

Income from livestock can play an important role in determining the potential income from the property. For instance, land that is in permanent pasture or hay will be used primarily for beef, sheep, or dairy cattle. In this case, livestock income will determine the value of the land.

Several government and private organizations offer programs that can affect the income from a farm, depending on the type of farm and its location. The Farm Service Agency can provide information about the current government programs and the farm's eligibility for these programs. In addition, several resource conservation groups, such as the American Farmland Trust, the Nature Conservancy, and Ducks Unlimited, offer programs that might affect the use of the farm. Recreation and hunting leases are popular in many parts of the country, and these uses can add income or value to the land.

It is important to be aware of any contracts, leases, zoning regulations, or other easements connected with the farm. Such arrangements limit the potential uses of the property. If the land is currently leased, it may not be available until the lease expires.

### *Value*

A full appraisal by a certified appraiser is the best way to determine the value of a farm. There are other methods to estimate a value for the property, but they are not as accurate. Whether to use a full appraisal or some other means depends on the desired degree of accuracy. In most situations in which there are multiple people involved, a neutral third party appraisal is the best approach.

The heir must consider any buildings, facilities, and other land improvements when estimating the value of the farm. In some circumstances, buildings can add considerable value to the property and significantly influence how the property will be used. A dwelling on the property can also influence the property's use. The conditions of buildings, dwellings, and improvements should always be identified as they help determine the relative value of the property. In some cases, old rundown facilities may actually decrease the value of the land because they would have to be removed or renovated.

The size of the farm also influences the decision of what to do with it. Size determines the value of inheritance and the feasibility of earning a living only from the farm.

In many cases, the farm will have sentimental value, which will play a role in the decision making. Sentimental value is much harder to quantify. One heir's sentimental attachment to the land will not be the same as the others.

### ***Taxes***

Estate and inheritance taxes at both the state and federal level are important considerations. Minimizing these taxes can increase the value of the inheritance, but simply minimizing the taxes may not produce the best use, given individual circumstances.

The size of the estate, how the assets were owned or leased, the relationship of the heirs, and what is done with the property determine the amount of the taxes. If a high proportion of the inheritance is in land, it might be necessary to sell some of the assets or borrow money just to settle the estate.

In some cases, the inheritance may come under "special use" valuation. In this situation, there may be restrictions on how long the property may be farmed in order to maintain that special use valuation.

In some special cases, the property can be sold and the proceeds reinvested without triggering tax consequences.

If the farm is held as an investment, who farms it and whether material participation occurs can be important in determining the amount of inheritance tax.

It is not possible to examine all of the details and circumstances of taxes in this publication. Farmland heirs should seek sound legal advice regarding the inheritance to determine which of the special provisions it qualifies for and what restrictions there are on the use of the property. In some cases, it will be better to pay the taxes. In other cases, it will be better to alter the uses or disposition of the farm in order to lessen the tax burden.

If taxes are owed, the new owner should be able to borrow funds to pay them by using the property as collateral.

### **Options for the Farm**

Whether farmland is inherited by an individual or a group, there are three basic options available to each heir: farm the land, keep the land as an investment, or sell the farm.

### ***Farming the Land***

Farming the land is a complex decision that will involve a number of considerations. One of the first questions is whether the heir has the necessary skills and resources.

If the heir is already farming, then the next step is determining how the farm fits within their current operation. The heir could decide to add the land to their current operation to form one, larger unit, or they could sell one of the farms and consolidate around the other farm. Several questions should be addressed before deciding whether to farm the inherited property or combine it with an existing operation. How close is the inherited property to the current property? Will the size of the new operation generate an adequate income? Will the heir be able to manage it? Will it require new or different machinery?

If the heir is not currently farming but would like to start, there are numerous family decisions regarding the change in lifestyle that farming would entail. It might be easy to get caught up in the allure of farming or being on the land. But this is a decision that requires careful consideration.

Approximately 60 percent of farms have annual sales of less than \$10,000. A farm this small cannot support a family. In these cases, the farmer needs off-farm employment to supply needed income. On the other hand, off-farm income can supplement a beginning farmer who has an operation with the potential for full-time employment. The question whether the farming operation is large enough or has the potential to support the heir and his or her family to live a lifestyle which they are accustomed to or aspire to needs to be addressed. According to the 2007 Census of Agriculture, 75 percent of principal operators worked off the farm to generate additional income, and 29 percent of principal operators worked 200 or more days off the farm.

The health of the farm operator is an important factor that should not be ignored. Does the heir have ability to do physical labor and be fully exposed to the weather? Many farm activities must be performed in inclement weather.

Once the heir has chosen to farm the land, he or she must decide whether to raise crops, livestock, or both. ISU Extension and Outreach offers many publications explaining which crops can be grown across the state as well as estimates of the crops' production costs. This information can be used to estimate the potential income from the inherited farm. The choice of crop and livestock enterprises is sometimes complementary. For example, one option is to raise crops that will be fed to livestock.

Production agriculture involves much more than simply owning the land. It includes labor, capital, and management. The amount of capital required in production agriculture varies by the system chosen. Many operations today rely heavily on purchased inputs, which require a significant amount of capital. Many operators must borrow funds for at least part of the expenses. Other operations rely more heavily on labor, management, or marketing skills. Discuss your situation to potential lenders before making a final commitment.

There will be machinery requirements regardless of the operations. Modern farming equipment can be expensive and requires skill to operate it safely and effectively. Owning the machinery is only one option, however. Today, many farmers use leasing or custom hire as a way of machinery management. Leasing or custom hire is particularly beneficial for the higher-priced, seldom-used pieces of equipment.

Good management skills are needed in order to run a profitable farming operation. Management skills in production and operations, financial, general business, personal attitudes, and decision making are similar to other businesses. Computer skills are becoming increasingly important for recordkeeping and business analysis, particularly on large operations. A farmer must effectively search out changes occurring

in the industry and develop strategies to use them for personal gain, develop positive relationships with buyers and sellers, communicate problems, identify the operation's competitive advantages in terms of productivity and technical efficiency, and develop strategies to overcome barriers. Certain risk management techniques used to address vulnerabilities in the operation, such as crop or livestock insurance, are unique to farming.

The decision whether to farm the inherited land should not be made lightly. The major consideration is the estimated income that can be generated from the farm and whether that is sufficient for the heir. Each situation is different.

A farmer's annual income can vary greatly from year to year. Changes in commodity prices, input costs, land values, weather, and yields are just a few of the factors that influence a farmer's income.

### **Holding the Land as Investment**

Holding the land as an investment is another option for heirs. Those who decide to own the land can choose from several different management techniques, each one involving different amounts of time and effort. Some people enjoy being active in running the farm and others prefer not to be involved.

### ***Leasing***

Leasing land to others is a viable and common option today. The Census of Agriculture reported that 54 percent of land was leased in 2007. A number of lease arrangements are available. See the Iowa State University Agricultural Decision Maker website for a complete discussion of the lease arrangements. A typical leasing arrangement involves cash rent or crop share. In a cash situation, the tenant bears most of the risk. In a crop share arrangement, the production and price risk are shared between the tenant and landowner.

Cash renting is one of the least demanding options for the owner. This kind of arrangement involves finding a tenant, paying taxes, and a few other minor ownership duties. A farm may use a whole farm rental rate,

which would include all the land on the farm. Or a farm may be rented for a fixed amount per cropland acre with a different rental rate for pasture or buildings. Typically, whole farm rental rates are lower than cropland rental rates.

Determining a fair rental rate is not easy. The most common method for determining cash rent is to set a rate that is similar to what other people are charging in your area. If you use this method, make sure you are comparing your rates to landowners with similar quality of land. Always compare multiple rates versus just one or two. Comparing rental rates has its downsides because it assumes that others are charging their tenants reasonably and fairly. To assure a fair price, take into consideration average yields, corn suitability ratings (CSR), and share of gross crop value. It is important to try and keep the relationship between the landlord and tenant in a partnership-style environment, as opposed to being adversaries.

In a crop-share lease, the tenant and landlord split some of the expenses and the yield. The exact division is a matter of negotiation. Landowners also have the option of a flexible lease, which can be a combination of both the cash and crop-share features.

Once again, the best rental arrangement depends on each situation. In some cases, other factors outside the rented property may need to be considered, such as snow removal, property upkeep, and maintenance.

### ***Custom Farming***

Custom farming can serve as an alternative to leasing the farm. The owner of the land makes the decisions about the crop, inputs, and marketing, but hires others to perform the actual work. The custom operator handles all machine operations on the owner's land in exchange for a set fee or rate. Custom farming is an option with less risk involved. In a bad year, profits from custom farming will be smaller than under a conventional lease, but that is the trade-off for reducing risk.

### ***Hiring a Professional Manager***

Hiring a professional manager is an option for those who want to keep the farm as an investment but do not want to make business decisions regarding the farm. This arrangement varies. In most cases, the owner makes no business decisions and lets the hired professional farm manager run the farm. The owner receives a check, and the farm management firm receives a percent of the gross income. The typical charge for cash rent is 5 percent and a crop-share is 12 percent of the gross income. These percentages will vary depending upon the amount of time and effort involved for the farm manager.

The return to land as an investment is generally thought of in two components. The first is the yearly cash return, which varies according to the use of the land and the type of lease arrangement. It is subject to weather, production, and price risks. In the past, the annual cash return to land has varied considerably, but it usually averages 4 to 8 percent after property taxes and before income taxes.

The second component to the return to land is the increase in value or capital gains. The 2011 average U.S. land value was \$2,350 per acre. This value is up 6.8 percent from 2010. The average value is measured by the value of the land and buildings on the farm. Land values vary greatly throughout the country. Cropland values in the United States increased by 9.4 percent to \$3,030 per acre. Some parts of the country saw increases of 17 percent and others experienced a decrease in value by 1.3 percent.

Regardless the leasing method used, a written contract between the landlord and the tenant is advised so each person has a clear understanding of the agreement.

### ***Selling the Land***

The final option is to sell the farm land. This option is particularly appealing to those who want the proceeds of the inheritance for other uses. This is important not just for the parties involved in the lease but also their heirs.



There are many considerations in the decision to sell the property. Tax consequences from the sale depend on several factors: the amount of the sale, the income tax basis of the property, and sometimes the method of sale. Selling the property under contract can spread out the reportable gain over several years, which lowers the tax burden, but postpones the use of the funds for other purposes. Some states have special programs to provide tax incentives for people selling land to a beginning farmer.

Those who decide to sell the land must consider the method of sale. Most use a licensed real estate broker. Other heirs sell the land to someone who is familiar with the land or through classified advertising.

It is possible to divide a large property into smaller tracts for auction. For example, heirs may decide to sell the building site and keep the cropland, or vice versa.

Another method of selling the farm is to hold a land auction. It is uncertain which method produces the highest price; it depends on the bidder. Setting a minimum price is one option for those who hold land auctions. If the auction produces a higher price than pre-set minimum price, the land is sold. However, if the minimum price is not met, the owner can reassess the sale method or his or her expectations.

Many heirs who decide to sell the land do not know a good selling price. The land market is not well-defined as other more frequently traded commodities. Farmland heirs should obtain a professional appraisal to help establish the value of the land and assist in setting the right selling price. It is also important to remember that an heir's sentimentality for the farm is not translated into value for someone else. It is also important to remember to seek sound legal advice.

#### ***Cash Sale***

A cash sale for deed is one of the most popular ways to sell land. A cash sale immediately produces the proceeds from the sale for other uses. It also minimizes the risk to the seller. However, a cash sale might reduce the number of potential buyers because most

buyers will need some type of financing. Fewer buyers could mean a lower selling price.

#### ***Contract Sale***

A contract sale is an option in which the buyer provides a down payment and then makes payments on the land. The advantage to the buyer is the need for less money up front. The seller's advantages include the option of reporting the gain on an installment basis and lowering the overall tax consequences.

A contract sale does expose the seller to the risk of default from the buyer. However, the increased risk means the seller usually can receive higher interest. The higher interest is additional income for the seller. Again, several states have special beginning farmer programs that allow different tax treatments for this income. Additionally, offering a favorable contract will increase the number of potential buyers and provide the opportunity for a better price.

#### ***Trade***

Trading the property is another option that may be appealing in some circumstances. This is especially true for an heir who is already farming in another area. By trading the property to someone who owns or can buy property closer to an existing farm, the heir can avoid taxes that could be generated from the sale. Trading farmland for other rental property is another possibility.

#### ***Gift***

Giving the property to a non-profit organization as a gift is another alternative to selling it. This usually occurs when the property has unique wildlife or scenic value and is desirable to organizations such as Nature Conservancy, Ducks Unlimited, or Pheasants Forever. This option also allows heirs to avoid tax consequences.

#### ***How the Farm has been Inherited Alone***

Inheriting the farm alone is the easier of the two scenarios. In this case, any decisions will be based upon the individual heir's circumstances without dealing with others' expectations and desires.

Inheriting the farm as an individual still leaves the same basic options and alternatives: whether to sell the farm, keep it as an investment, or farm the land.

If the heir is currently farming, deciding what to do with the inherited farm is simply a matter of deciding how the farm fits within the current operation and goals. The farm operation can be consolidated by selling the inherited farm and buying one closer to home without triggering tax liabilities.

If the heir is not currently farming, the earlier discussed pitfalls and considerations apply. Heirs must remember to not let the romantic notion of farming or sentimental value of the land cloud their considerations and to estimate the expected income from all sources.

If the heir keeps the land as an investment, he or she must decide how much time and energy to devote to it. Depending on how it is handled, land ownership can involve considerably more time than conventional assets. Farmland heirs also must determine how much and which type of risk they are willing to bear.

Individual tax consequences probably will guide the decisions about selling the land. Many alternatives exist and should be considered carefully. In addition, options exist to postpone or eliminate the tax burden, depending on how the property is sold.

### ***With Others***

Inheriting a farm with other people complicates decision making. Each heir has different goals and needs. However, blindly pursuing what is in one heir's best interest can lower the returns to everyone. Heirs should think as a group and strive for compromises. Open communication is essential.

Ideally, the individual who left the farm to the heirs has made all the considerations for fairness. However, in some cases an equitable distribution was the guiding force. In these cases, fairness becomes an individual consideration.

A complication arises if the farm is currently operated by one of the heirs. It is important to remember that the decisions made by the non-farming heirs can substantially influence the ability of the farming heir to continue. If the heirs want to sell, the farming heir may not have the capital or be in a position to take over the entire farm alone. This may be true if one of the heirs wants to start farming but the others do not.

If the decision is to keep the farm as an investment property, the heirs must agree on how to do so. In many cases, it is easier for a professional farm manager to handle the investment to avoid complications. Regardless of the method chosen, some means of decision making must be established. One heir must not be able to influence the return to the investment without the consent of the others.

### ***Conclusion***

Inheriting a farm can be exciting and rewarding, but at the same time it can be a considerable amount of work.

An accurate professional appraisal will determine the size of the inheritance. ISU Extension and Outreach and other organizations can help with the decisions about the options and alternatives for the inherited farm.

Heirs must remember that there can be significant differences in tax consequences of the various options. Legal counsel should be obtained before deciding what to do with an inherited farm.

Ultimately, you and the others who have inherited the land have to be the ones that make the final decision. The most important factors to consider when deciding what to do with the farm are your values and goals.

**Resources****Iowa State University Extension and Outreach****Ag Decision Maker****Whole Farm - Leasing**

[www.extension.iastate.edu/agdm/wdleasing.html](http://www.extension.iastate.edu/agdm/wdleasing.html)

**Whole Farm - Legal and Taxes - Contracts**

[www.extension.iastate.edu/agdm/wdlegalandtaxes.html#contracts](http://www.extension.iastate.edu/agdm/wdlegalandtaxes.html#contracts)

**Iowa Value Land Survey**

[www.extension.iastate.edu/landvalue/](http://www.extension.iastate.edu/landvalue/)

**Soil and Land Use**

[extension.agron.iastate.edu/soils/](http://extension.agron.iastate.edu/soils/)

**Beginning Farmer Center**

[www.extension.iastate.edu/bfc/](http://www.extension.iastate.edu/bfc/)

**Farmland Ownership and Tenure in Iowa 2007 -**

[www.extension.iastate.edu/Publications/PM1983.pdf](http://www.extension.iastate.edu/Publications/PM1983.pdf)

**USDA National Agricultural Statistics Service**

[www.nass.usda.gov](http://www.nass.usda.gov)

**USDA 2007 Census of Agriculture**

[www.agcensus.usda.gov](http://www.agcensus.usda.gov)

**USDA NASS Land Values Summary**

[usda01.library.cornell.edu/usda/nass/AgriLandVa//2010s/2011/AgriLandVa-08-04-2011.txt](http://usda01.library.cornell.edu/usda/nass/AgriLandVa//2010s/2011/AgriLandVa-08-04-2011.txt)

**USDA NIFA Small Farm Digest, Summer 2012**

[www.csrees.usda.gov/newsroom/newsletters/smallfarmdigest/sfd.html](http://www.csrees.usda.gov/newsroom/newsletters/smallfarmdigest/sfd.html)

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