Demographic changes in the United States indicate that the population is aging. By 2030 it is expected that one out of every five Americans will be 65 or older. If tomorrow’s retirees are like past retirees they want a comfortable retirement life. However, given the rising cost of living, increased health care costs, possible changes in Social Security, and declining individual savings rate, they may be forced to accept a decreased standard of living in their retirement years. To avoid this, it is important for individuals to develop realistic investment plans that help them achieve an acceptable standard of living during their retirement years. This is especially important for self-employed people such as farmers and ranchers. A major difference between the self-employed and those employed by others is that the self-employed must initiate their own retirement plans.

Finding the will and means to make the necessary financial commitment to save and invest for retirement is difficult at all ages and income levels. While inflation may certainly take a toll on an individual’s retirement savings, perhaps the biggest reasons for this predicament is that many retirees do not plan correctly nor save enough.

When planning for retirement ask yourself these questions. Do I really want to retire? When do I want to retire? Will I enjoy not working? Can I retire yet continue to work at a slower pace? The answers to these questions are probably different for everyone. That is what makes financial planning for retirement such a challenging undertaking.

Therefore, the purpose of this fact sheet is to present some clear-cut, simple, planning facts that will assist farmers and ranchers to reach their retirement goals.

Financial Planning Considerations for Retirement

Financial Independence
The one constant goal in almost everyone’s retirement planning is usually financial independence. According to financial experts, anyone can become financially independent if they follow these simple principles of financial planning: 1) spend less than you make, 2) budget in order to save, 3) manage your credit wisely, 4) aim to save at least 10% of your net income, 5) pay yourself first, and 6) avoid procrastination!

Procrastination in an enemy for everyone including those engaged in production agriculture. Farmers and ranchers often get so caught-up in the day-to-day activities that they neglect financial planning. An article in the California-Arizona Farm Press looked at three retired South Carolina farmers. They all agreed that discipline and early planning were a necessity for a secure retirement. This is the same message relayed by Stanely and Danko, authors of The Millionaire Next Door: The Surprising Secrets of America’s Wealthy.
After twenty years of experience studying the wealthy in America, they have found that one of the keys to creating wealth was allocating time, energy, and money efficiently in ways conducive to building wealth. They further state “most people have it all wrong about wealth in America. Wealth is not the same as income. If you make a good income each year and you spend it all, you are not getting wealthier. You are just living high. Wealth is what you accumulate, not what you spend.”

How Much Do You Need?
Financial planners normally assume that an individual will need anywhere from 70 to 100 percent of their working income for retirement. Do you know how much in investments you will need for your retirement? In order to answer this question you must first decide what type of retirement is desired. Remember the retirement questions posed earlier? Based upon your answer you can then determine how much you need for your particular retirement. A starting point is to calculate what you presently have. This is called net worth. One study, that did not include farmers or ranchers, found that very few people actually knew what their current net worth was. In many cases, farmers and ranchers may have a very good idea of their net worth due to the close working relationship required to finance most agricultural operations. Net worth is calculated by subtracting all liabilities (what you owe) from all assets (what you own). The difference is your net worth. Once you have calculated your net worth you are then able to determine the additional amount you will need to accumulate for your retirement.

\[ \text{Assets} - \text{Liabilities} = \text{Net Worth} \]

Time
When it comes to building wealth, time is your long-term ally. By starting a regular program of investing as early as possible, you take advantage of the power of compounding. Compounding takes place when your original investment generates interest, dividends or capital gains, which are then reinvested into the principal to further boost, or compound, your earnings.

Understandably, many people just starting out may feel they have little if any "discretionary" income that can be set-aside for retirement. However, the longer one waits before starting an investment portfolio, the more money that will be required to reach the same financial goal.

Risk Factors
In general, risk and rate-of-return are directly related. As the risk level of an investment increases, the potential return usually increases as well. The assumption is made that most farmers and ranchers are seeking profit maximization. However, the goal of profit maximization needs to be tempered by the occurrence of risk and the attitude of the investor toward risk.

Personalizing Your Allocation

Asset allocation is the process of determining how much of your wealth you should invest in different types of investments. Studies show that it is the most important factor impacting the rate of return you receive on your investment portfolio. Asset allocation will account for 90 percent of your return. Market timing and the selection of individual securities will account for the remaining 10 percent or so.

What is the ideal asset allocation? Yours will be influenced by the factors already mentioned; how much in investments you will need, your tolerance for risk, the amount of time you have before needing your investments. An aggressive portfolio might contain 75% stocks, 20% bonds, and 5% cash. A conservative allocation might be 30% cash, 35% bonds, and only 35% stocks. A moderate approach falls between aggressive and conservative asset allocation.
Retirement Plan Options for Farmers and Ranchers

Self-employed people must take responsibility for their own retirement planning. The following retirement plan options are examples that were established under IRS regulations for the self-employed. These options may not be appropriate for every self-employed person however, they are used by many and offer the possibility of providing retirement income.

**Individual Retirement Arrangement (IRA)** - is a personal retirement savings plan that is available to those who qualify. There are two types of IRAs for retirement saving, Traditional and Roth. Traditional IRAs allow for before-tax contributions and the Roth after-tax contributions. Husbands and wives may each have an IRA even if one person in the marriage is not working. Legislation in 2001 increased the current annual contribution limit from $2,000 to $5,000 on a phased-in basis beginning in 2002 and ending in 2008. After 2008, the limit will be adjusted for inflation in $500 increments. Also beginning in 2002, workers age 50 and older will be able to make catch-up contributions.

**Keogh Plan** - may let you make the largest contributions. With a *money-purchase defined-contribution Keogh*, you can normally contribute 20 percent of your net self-employed income, up to $30,000 annually. However, you must continue to contribute this same percentage of your income every year. A *profit-sharing defined-contribution Keogh* allows you to put away about 13 percent of your net self-employed income up to $24,000. However, it doesn't require annual contributions. You must establish this type of Keogh plan before December 31 of the year in question, but you have until April 15 of the following year to make the actual contribution. The third type of Keogh, *defined benefit Keogh’s*, are attractive to self-employed workers with relatively few years to go until retirement and who have enough money to fund large annual contributions.

Simplified Employee Pensions (SEPs) – also known as SEP IRAs allow you to contribute 13.0435 percent of your self-employed income up to $25,500. Like an IRA you have until April 15 of the following year to actually make the contribution.

**SIMPLE Plans** – also known as SIMPLE IRAs currently allow you to contribute $6,500 per year up to 100 percent of your self-employed income. In 2002, the contribution increases to $7,000, and on a phased-in basis, contribution amounts will increase to $10,000 in 2005. After 2005, the limit will be adjusted for inflation in $500 increments. If you also work for someone else, they may be able to match up to 3 percent of income, adding as much as another $6,500. Since there is no percentage-of-income requirement, self-employed people who make less than $30,000 annually may be able to contribute more to a SIMPLE than to a SEP or Keogh.

Retirement plans differ in who is eligible to participate, allowable contribution limits, types of investments available in the plan, tax implications, and penalties for early withdrawal. Because the rules governing these retirement options change over time, investors should refer to a current reference source or seek advice from a financial professional. The 2001 Tax Legislation that increased contribution limits contains a “sunset” provision. In the event that no further legislation extends or amends the legislation, the affected provisions will revert to today’s current law in 2010. For additional information, see IRS Publication 560 (Retirement Plans for Small Businesses).
Getting Information

There are many sources of information to help you with planning for your retirement. Just a few include the public library’s investment reference section, the World Wide Web, bookstores, newspapers and personal finance magazines. To find resources that can guide you in making decisions, you’ll need to sort the good information from the bad. Use caution with business-sponsored materials. Familiarize yourself with a few of the investment resources and consult them often to assist with your retirement planning.

As many ranchers and farmers have discovered, the computer, its software and its use for accessing the Internet can be a real benefit in helping plan for retirement. Good financial software can help you with retirement planning tasks and with complex calculations. Also available to help with calculations are sites accessible on the Internet many of which are sponsored/supported by mutual fund companies. The Cooperative Extension System even offers online investment classes such as Investing for Your Future.

Retirement planning for self-employed farmers and ranchers requires careful planning and consideration. As with any retirement plan, the key is to start early, invest continuously, and develop an investment portfolio that is appropriate for your level of risk. Taking responsibility is the first ingredient for success.

Additional Web References

At the time this fact sheet was written one of the more useful Web sites included the following:

http://www.okstate.edu/hes/fci/mbro/frm/links.htm
This site contains links to federal government sites such as the Consumer Information Center, Federal Reserve Board, and the IRS. Other site links include financial management, investing, retirement, and more.

References


