Farm and ranch households are affected by savings and retirement plans differently than most households in the United States. Due to the nature of farm business, farm households have different savings habits and more diverse financial portfolios than typical U.S. households. In general, farm households have more personal savings than the average household and have less dependence on social security income during retirement. Additionally, farm households earn income from both farm and off-farm sources. Commercial farm operators are less likely to have an employer-sponsored pension and more likely to receive a larger share of their retirement income from farm assets.

Retirement planning is especially important for farmers who would like to retire in the next five to fifteen years. Currently, nearly 80% of Nevada's farmers are 45 or older, while 25% are 65 and older (NAS, 2005). Older age-group farm operators and landowners are staying in farming longer than previous generations, due in part to improved health and longevity, and to technological advances that have enabled farmers/ranchers to perform physical tasks longer than previous generations could.

**Develop a Financial/Retirement Plan**

There are four key steps to developing your financial/retirement plan:

*Identify Your Goals:* Determining your financial goals in advance is the best way to ensure that you follow the investment path that best meets those goals. Keep in mind that while long-term goals may not change much over the years (i.e. retirement planning, passing your business to the next generation) your asset allocation strategy will change as you age: as you move closer to retirement, you may want less risky investments. This combined with market fluctuations makes updating your goals and investments an important part of any financial strategy.

*Estimate Your Risk Tolerance:* Risk tolerance is your psychological and financial ability to tolerate market volatility. Your risk tolerance will adjust as you age. For example, young people can afford to be risky with their investments because retirement is far enough away that they can handle potential losses. People approaching retirement should use a more conservative approach.

*Estimate Net Worth, Income, & Expenses:* Your net worth is a comparison of what you own (assets) with what you owe (liabilities). When developing your investment strategy, first estimate your monthly income and expenses to measure your monthly disposable income, or the income that's left over after paying your required expenses. Your monthly disposable income determines the amount you can afford to contribute to your investments each month. If you discover that your monthly expenses exceed your income, you have the opportunity to see which expenditures can be eliminated or postponed, or if additional income can be earned. If your income exceeds your expenses, it is time to determine how your excess income should be allocated to meet your financial goals.
impacts on your investments, it is also unwise to be too conservative with your investments. Taking risks with your investments while you are young may improve your chances of reaching your financial goals, especially if those goals involve creating retirement income.

**Investment Terms**

- **Liquidity**: the speed and ease with which an asset can be converted into cash.
  - High liquidity: cash, savings accounts, mutual funds, stocks
  - Medium liquidity: certificates of deposit (CDs), savings bonds
  - Low liquidity: long-term bonds, real estate

- **Inflation**: a general increase in the price of goods and services that reduces purchasing power.

- **Time Value of Money**: due to inflation, the value of a dollar is greater today than it will be in the future.

- **Return on Investment (ROI)**: a payment made to an investor in return for use of the investor’s money; may be distributed as interest, dividends, or growth in the value of the asset/investment.

- **Risk**: the probability that an investment will perform below expectations.

**Choose an Investment Strategy**: Financial planners suggest that investors "layer" their investments according to the financial pyramid. For a pyramid to be sturdy, it needs a stable foundation. Your financial pyramid should have a stable foundation composed of cash assets, the most liquid type of asset. Although cash assets pay the lowest interest rates, they are liquid, convenient, safe (banks, credit unions, and savings and loans insured by the FDIC offer a high degree of safety for both principle and interest) and are easier to obtain in an emergency than other assets. Cash assets include savings accounts, life insurance, CDs, U.S. Treasury bills (T-bills), U.S. Savings bonds, and money market accounts.

Emergency/opportunity funds are a key element of your stable financial foundation. You should have emergency/opportunity funds on hand to handle emergency situations, or to provide you with the ability to take advantage of a particular situation, such as a special purchase or vacation funding. Personal insurance, such as life insurance, and disability insurance, should also be considered as a part of your foundation, as they protect your dependants from hardship in the event of death or disability.

The next level is wealth building, including assets such as stocks and stock mutual funds. Purchasing a stock is purchasing a small price of the corporation. In effect, the investor becomes part owner of the business. Investors make money from stock ownership in two ways, through capital appreciation or through dividends. A mutual fund is a pool of money, owned by a group of investors, and invested in various stocks and/or bonds under the guidance of a professional portfolio manager. When an investor purchases a mutual fund, he/she becomes part owner in the securities held in that fund.

Moving up the pyramid, the next layer of your investment strategy should be income-generating assets, such as bonds. Bonds are a loan to a government or corporation, where the investor acts like a bank, receiving interest on the loan until the loan is paid off on the maturity date of the bond. Bonds offer a steady income from interest payments and flexible durations for investing, from one to thirty years. Bonds may be issued by corporations, and state, local, and national governments.

The top layer of your financial pyramid is speculative assets. Speculation is the act of choosing very risky assets, such as emerging market securities or junk bonds, in hopes that they will perform well and turn a high profit. These assets are considered riskier than others because they are highly volatile. It is wise to invest the least amount of money in speculation, because the risk of the asset underperforming is high. Investors approaching retirement should be especially careful with speculation.
What is Asset Allocation?

Each asset type has its own return and risk characteristics, and combining them appropriately within a portfolio can reduce the overall risk of the portfolio. The goal of asset allocation (focusing on the two middle layers of the pyramid) is to mix assets that tend to rise and fall somewhat independently of each other. Investors usually base allocation decisions on four main factors: risk tolerance; personal financial goals; the time horizon for those goals; and the need for liquidity.

A conservative asset allocation is made up of about 80% bonds and 20% stocks. Over the period of 1946-1998, this asset mix had an average annual return of 8% (Russell University (RU), 1999). A conservative allocation is appropriate for investors who will be retiring in the near future.

A moderate asset allocation is comprised of about 60% bonds and 40% stocks. The moderate allocation strategy has had an historical average annual return of 9% (RU, 1999). A moderate investment allocation is ideal for investors who have in the neighborhood of ten years until retirement.

A balanced asset allocation is composed of 40% bonds and 60% stocks. The balanced allocation has had an historical average annual return of 11% (RU, 1999). The balanced allocation is good for investors who have approximately ten years to retirement and who can handle a bit more risk than that of the moderate allocation.

The asset allocation with the greatest amount of return is the equity aggressive allocation strategy, made up entirely of stocks. Stocks have had an average annual return of 14% (RU, 1999). This might be the right asset mix for someone just starting out in the work force, or someone who will not need access to their investments for at least fifteen years.

Choosing the right allocation and making regular monthly investments can help you take advantage of an investment strategy known as dollar cost averaging. Dollar cost averaging is the process of making equal payments into an investment at regular intervals, so that you are buying shares at low prices when the market goes down and at higher prices when the market goes up. Over time, this strategy averages out the per-share cost.

Small Business Retirement Plans

In the past, small business owners including agribusiness owners, and employees had few options for retirement planning. However, over the past decade, more options have become available. The following provides a description of a few of the current available options.
A 401(k) retirement plan allows your employer to contribute a certain amount of your pre-tax income to investment options that you choose from your employer's list. This money is taxed when withdrawn, on both the state and federal levels. Most farm/ranch owners will probably not qualify for 401(k) programs, as they require at least twenty-five employees and can be expensive to administrate.

Nearly every type of asset can be held in an individual retirement account (IRA, also referred to as individual retirement annuity), including stocks, bonds, mutual funds, and real estate (moneycentral.msn.com). Traditional IRA contributions can be tax deductible depending on income and tax status, and are not taxed until you draw down. Upon withdrawal, the account is taxed as ordinary income. Penalty-free withdrawals can be made for qualifying expenses, including education, medical expenses over a certain amount, certain health insurance, a first-time home purchase, disability, and death.

Roth IRA accounts differ from Traditional IRAs in that you are able to grow and cash out your account tax-free. Roth IRAs do have some restrictions. For example, you can only invest money you earned as income from a job. This means you cannot save more money than you earned in a year, and cannot make contributions from leftover student scholarships, gift money, etc. However, benefits of the Roth include the ability to withdraw contributions at any time, tax-free and without penalty, without having to pay it back. Note that you can only withdraw contributions without penalty; there are high taxes applied to the withdrawal of earnings.

The Savings Incentive Match Plans for Employees (SIMPLE) IRA allows small businesses to establish a simplified retirement plan for their employees. To be eligible for a SIMPLE IRA, you must have one hundred or fewer employees. The employer makes tax-deductible contributions, and employees are allowed to defer a percentage of their income into the retirement plan. Employees are allowed to make their own contributions, but the business must match all contributions up to $10,000 annually.

To be eligible for a Simplified Employee Pension (SEP) IRA program, a business only needs to have a handful of employees. SEP IRAs are low cost and low maintenance as business owners do not need to file annual reports with the IRS. SEP IRAs are funded with tax-deductible employer contributions, the amount which can vary from year to year. Employee contributions are not allowed.

Any small business is eligible to set up a defined benefit plan. If you are looking to retire in the next 10 years or so and haven’t built up a nest egg, a defined benefit plan can be a good opportunity to save. Employers make all contributions based on actuarial estimates, with the annual retirement payout not to exceed either $175,000 or the average of the employee's three highest-earning years annually. The downside of defined benefit plans is that they can be expensive, including the cost of required actuarial services. Additionally, there is no employee control over investment options and the plans are not very flexible.

Further Information
Cooperative State Research, Education, and Extension Service (CSREES) maintains a website that features articles about finances and retirement, with an emphasis on later life financial planning. (www.csrees.usda.gov/nea/economics/fsll/cons_planning.html)

References