

Section Two:
**EVALUATING
YOUR FARM
RESOURCES**



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EVALUATING YOUR FARM AND COMMUNITY RESOURCES

As noted earlier, this workbook is built on the premise that your family wants to retain ownership of your farm in the next generation, or otherwise wishes to see it continue in agriculture or forest use. In developing plans for the future of your farm, it is important to determine what type of production enterprise - if any - the farm, family, and the community surrounding it will support. Alternatively, if you will not actively manage an enterprise on your land, your decisions will nonetheless depend on the opportunities for its use by someone else.

In many cases, the next generation -- someone in the family perhaps -- has plans for what they want to do with the land, whether they will own it outright or with other family members. They may already be farming the land, with their parents or by themselves, and will likely continue to follow the current business model which must expand to support more than one family. In other cases, the next generation will have new ideas, be looking for new markets, or may even be coming back to the farm from another career to make use of the land for income. In either case, an important part of the succession discussion will be an assessment of whether your land and community resources will support present or alternative land uses in the future.

The Quantity and Quality of Land and Water

Land can be looked at from two perspectives, the quality and quantity. First, if you are planning an enterprise, factors such as the soil quality, drainage characteristics, and the quantity and quality of water available, all impact what type of operation you will be able to develop. Different soils are good for different types of production, and different crops may be suitable depending on the amount of water available for irrigation. You should take the time to carefully evaluate both the amount of water that is physically available for irrigation as well as the amount of water that is legally available under the water rights associated with the land. Second, the amount of open land available - what you own or what is available for

rent - will influence your plans for scale of operation.¹

Working Infrastructure and Capital Position

What is the state of your current working assets, such as machinery, buildings, and fencing? In most farm production there is a need for storage for equipment, livestock, feed, fertilizer, fuel, and crops. Likewise, for livestock operations, are the current fencing arrangements adequate? Also, particularly for existing enterprises, what is the capital position of the business in terms of liquidity and solvency? Important also is the availability of credit, which is dependent on the borrower's -- whether the business or individual -- present financial position, the profitability of business alternatives, and credit rating. Financing, of course, depends on one's ability and willingness to manage debt.

Personal Management Capacity

Management capacity is not a given, and will probably be one of the most sensitive discussions the family will undergo. Mom and Dad are making decisions based on love, but even those should take into account whether potential heirs or business successors have the personal wherewithal to manage land and/or a business responsibly (particularly if sharing ownership with siblings). Indeed, many estate plans create a trusteeship over property in one of the heirs, a position of great responsibility.

Where families are looking to gradually transfer a business between generations, an assessment should be made of both generations' abilities, to look for complementary skills and productively identify areas of improvement. When a family will keep but not actively farm the land, someone will still need to manage tenancies and pay taxes. You should assess

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¹ Additional information regarding water rights can be found at the following web sites:

- http://www.ecy.wa.gov/programs/wr/rights/Images/pdf/landownerguide_2009-2ndEd.pdf
- http://www.ecy.wa.gov/programs/wr/rights/find_existing_wr.html

the management capacity of each family member for this purpose.

The Quantity and Quality of Labor and Tenants

If someone in your family plans to operate an enterprise on the land, who will supply the labor? Any enterprise will necessarily depend on family labor, or hired outside labor. Questions to consider include how much time family members will be able to devote to the enterprise, particularly if working an off-farm job, and whether there is an affordable labor pool in the area, one that the enterprise model can support. If you are looking at working with another producer -- as a tenant or a potential partner -- how will you meet like-minded individuals in your area?

In many farming areas, the competition for land is competitive and fairly straightforward, built on relationships and who will pay the highest rent supported by commodity prices. In other areas, finding a suitable tenant can be more of a challenge, depending on their business model and experience, and the factors they require in building an enterprise on your land. At some point, you will need to develop criteria for who you will want farming your land, based on your financial needs and personal values.

Local and Community Support for Farming

It has been said that no one has ever farmed alone.

Commercial food production has always relied on community support. Many of the qualities that make farming attractive -- rural quiet, professional independence -- are nonetheless built on numerous variables that require community support. If someone in your family has a goal to expand production into new markets, it must follow an assessment of the infrastructure to support that business. Examples include proximity of processing, slaughter facilities, and direct market outlets (farmers markets, restaurants, individual consumers). Additionally, there may be developing distribution enterprises in the area in which the farm might participate.

As noted above, if your family wishes to keep land under family ownership but not actively farm it, you will need someone else to farm it. Does your land lie in an area where there is an active tenant market? Is there enough local support to help a tenant grow a business on your land?

The factors identified in the proceeding worksheets are designed to get your family thinking about what is available and what is needed. Ultimately, this assessment will support plans for transfer of the farm.



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HOW DO YOU OWN YOUR PROPERTY?

One crucial part of assessing your resources for farm transfer planning is understanding who has ownership rights in the property -- both real and personal -- that you have at your disposal for personal and farm use. Ownership interests impact how property is passed to heirs, what their rights in it will be, and what decision-making authority you and other potential owners have in the property.

Property is divided into two classes: real property and personal property. Real property consists of land and certain kinds of interests in land. Real property includes structures erected on the land, such as a house, fences or barns. Personal property is everything that is not real property, such as cash, farm equipment, livestock, nursery stock, harvested timber, and household items like cars, jewelry, bank accounts, stocks and bonds.

Evidence of Ownership: Real Property

Ownership or title to real property is normally shown on the deed to that property. However, there are times where you may own an interest in real property where no deed exists, such as when you inherit land through an estate and no deed is drawn up. For real property, the document of title (warranty or other deed) or interest (e.g. easement deed) must be registered according to the state recording act, which determines in what form and where interests in land must be recorded. The state recording act also dictates priorities in land ownership. Deeds to real property must always be recorded in the Recorder's Office for the county where the land is located.

Title to the same parcel of land can be held by one or several people, and in different percentages of ownership depending on how and when the land was transferred. If your name is the only name on the document of title, you are the sole owner of the property. If your name and someone else's name appear on the document of title, your ownership rights are likely limited by the rights of the other owner.

The document of title may create *consecutive* interests in the same property, in other words, when one person's title ends, the other begins as a matter of law. The most common example of this is a life estate deed, where one owner, often a surviving spouse, has

the ownership of property so long as he or she lives, and when he or she dies the ownership is immediately transferred to another person or persons, usually the children of the life tenant. A document of title may create *concurrent* interests, where the rights of each owner occur at the same time. Both consecutive interests and concurrent interests can take various forms, giving different property rights to the owners.

Evidence of Ownership: Personal Property

Ownership of personal property may be shown by automobile titles, receipts, contracts, bills of sale, bank records, stock certificates, etc. Without these documents, ownership of personal property may be difficult to prove. In many cases, particularly for tangible items, possession of personal property may count as proof of ownership, or at least making ownership harder to disprove by another claiming that property.

Personal property can be either tangible or intangible. Tangible personal property is something physical, such as a tractor, a cow, a car, or a gold bar. Cash in dollar bills tucked away in a dresser drawer is tangible personal property, whereas money in a bank account is intangible personal property. Intangible property is something that requires a piece of paper to describe what it is and in what quantity it exists.

Sole ownership

Sole ownership is the simplest form of property ownership, where one person has all present and future power to use, control, sell or otherwise dispose of the property. If you are the sole owner, you may transfer the entire property under the terms of your will, or place your entire interest in a trust. If you do not have a will, your property will be transferred under the state intestacy act (see *Basic Estate Planning Documents: Wills, Trusts and Gifting*, page X).

Consecutive interests

If you are the sole owner of real property, you record a deed that creates consecutive interests in the property. A life estate deed that transfers your interest to another upon your death is the most common example of consecutive interests. If you create a life estate, you are called the life tenant. You have the right to possess and use the property for the life of a specified person.

Usually, a life estate is measured by the life of the life tenant, but it may be measured by the life of someone else. If so, the life tenant's interest ends upon the death of that person. Upon your death (or the death of a specified person), ownership passes to the person or persons who own the remainder. They are called remaindermen.

Usually, the life tenant has the following rights and duties, unless the document creating the life estate shows a contrary intent.

- A life tenant may sell his estate for life. The purchaser buys the right to use and possess the property for the lifetime of the life tenant or specified person.
- The life tenant has the right to plant, harvest and sell annual crops.
- Fee title to the land itself may not be sold unless the life tenant and all the remaindermen join in the sale (though a remainderman may sell his or her interest subject to the life estate). If the property is unproductive, the life tenant may seek permission from a court to sell the land. A court would grant such permission only in unusual cases, however, and the court would require the life tenant to reinvest the funds for the benefit of the life tenant and the remaindermen.
- The life tenant is responsible for taking care of the property and for making ordinary repairs, and must pay property taxes and local assessments. If the property is mortgaged when it comes to the life tenant, the life tenant is responsible for paying the annual interest on the debt, but not the principal.
- The life tenant may not give away the property under the terms of his or her will if his or her life was the measuring life.

An example of words in a will or deed that create a life estate can be "to my wife for so long as she lives, remainder to my nephew, James." The wife has the right to possess and use the property for her lifetime, and upon her death, the property passes to Jane as the sole owner.

Although it is easy to create a life estate, it cannot be undone absent the consent (by new deed) of the remaindermen. Furthermore, it is still part of your

taxable estate for federal estate tax purposes.

Concurrent interests

If you have inherited property (ie. land) along with your siblings or others, you own a concurrent interest in the property along with the others. Concurrent ownership means your rights and the rights of other owners occur at the same time. Your rights in the property depend upon the form of joint ownership, and often how it was acquired. Concurrent joint ownership of property in Washington may take two forms: tenancy in common and joint tenancy with a right of survivorship. Of these two forms of ownership, only tenancy in common permits your interest in the property to pass under the terms of your will. As discussed below, however, ownership by tenancy in common can lead to complicated ownership patterns by multiple parties, making the land more difficult to market and sell.

Tenancy in common: A tenancy in common means that two or more people own an undivided fractional interest in the same piece of property. This is probably the most form of land ownership for inherited land in families with more than one child. For example, if three children inherited property from a parent "to share and share alike," they own the property equally as tenants in common, each owns an undivided one-third interest in the entire property, not a specific portion of it. Each co-owner has the right to use and possess the whole property, but each co-owner cannot exclude another co-owner.

None of the owners in co-tenancy may take any action with respect to the whole property without the written permission of the others. The agreement of all three is required to sell, lease, gift, or mortgage. Absent an agreement to the contrary, all co-tenants share equally in the income and rents produced by the property. For example, a deed signed by one owner does not transfer interest in the entire property, only their percentage ownership (and again, not to a specific part of the property). The new owner owns it along side the other tenants. Likewise, a lease to the entire property signed by one owner is likely unenforceable if the other owners do not also sign it.

Any co-tenant can ask a court to order a partition to the property. The court may be able to divide the property and give each co-owner a proportionate interest. On the otherhand, if the property is not easily partitioned

- usually the case with land of varying attributes such as crop land, water, woodlands and road frontage - the court can order a sale of the whole property. The proceeds of the sale are divided according to each co-tenant's interest.

Ownership shares in a tenancy in common can be unequal. This can happen when one of the co-owners dies and his or her heirs inherit their interest.

Example: Brothers, Richard and James, inherited a farm from their mother who owned it as sole owner. Each owns a fifty percent undivided interest. Richard dies with a will that leaves his property to his five children to "share and share alike" whereupon his share is bequeathed equally to his five children. James still owns a fifty percent undivided interest, but now his nieces and nephews are his new co-owners, who each own a ten percent undivided interest in the property.

Then James dies, leaving his undivided interest to his two children. Each of his children owns a twenty-five percent undivided interest, but there are now seven owners to the farm. To sell the entire farm, or even lease it to another farmer (absent an agreement otherwise) the seven cousins must agree to the sale. James' children have no greater authority simply because they own a larger interest. Further, any cousin may choose to sell his or her individual interest to a willing purchaser. If any one of the cousins dies, his or her interest will continue to pass to his or her heirs, and there may be more co-owners, now of differing generations.

The value of a co-owner's undivided interest is included in his or her gross estate for federal estate tax purposes and may be subject to federal and state estate taxes. The value of the interest is measured by the fair market value of the property multiplied by their percentage interest, although a discount may be allowed if there are more than a few owners.

Joint tenancy with right of survivorship: Two or more persons may own property as joint tenants with right of survivorship. This is common for bank accounts, certificates of deposit and stock certificates, particularly where an elderly parent wishes these interests to pass outside of probate, or they wish to have their money - in the case of a bank account - readily accessible by a chosen child to immediately handle matters following their death. Real property may also be owned jointly with a right of survivorship. To create a joint tenancy with right of survivorship, the document of title - say a deed - must expressly say the property is held with the survivorship right (the absence of such language simply creates a co-tenancy). However, this is no longer common outside of marriage (see below).

Upon the death of a joint tenant, in a joint tenancy with right of survivorship, the entire property automatically passes to the surviving joint tenant or tenants, and does not pass in the deceased owner's will or by intestacy.

Example: Laura is a widow with two children, Caroline and Elizabeth. Laura is getting older and becoming concerned that she may forget to pay her bills. Laura goes to the bank with her youngest



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daughter, Caroline, and converts her account to a joint survivorship account, thus giving legal authority to Caroline to write checks and make deposits on her account.

The creator of a joint bank account should be careful to consider his or her other wishes as to the distribution of other property. Continuing the above example:

Laura had inherited two separate farms from her father, and in her will she has directed that one farm go to Caroline, the other to Elizabeth. Laura is made an attractive offer by the tenant on the farm designated for Elizabeth, and decides to sell it to him. She then deposits the sale proceeds in the joint bank account. When Laura dies, Caroline becomes sole owner of the sale proceeds, and still inherits the other farm through the will. Caroline likely has no legal obligation to share the money with Elizabeth. Such a situation could likely spawn litigation between Caroline and Elizabeth, which is probably not what Laura would want.

Conclusion

As you can see, the way you own your property affects your rights to use, manage, sell or direct its distribution after your death. Automatic survivorship takes precedence over what is written in your will, and a carefully designed estate plan can be defeated if you fail to consider how your property is owned when you make certain decisions about its disposition. There may be times in your planning process that it is advisable to change the form of ownership to achieve farm transfer planning goals. Your lawyer will be able to determine how you own your property by looking up the deeds or otherwise knowing how and when you inherited it. It is not necessary to go into the lawyers office with deeds in hand. It is usually enough to inform him or her the counties where you *think* you own land, and he or she can do the rest. Hopefully, your lawyer will follow the wisdom of Dr. Neil Harl of Iowa State University, who cautions in his multi-tome treatment of agricultural law: You should never take your client's word that the farm is in their name alone.