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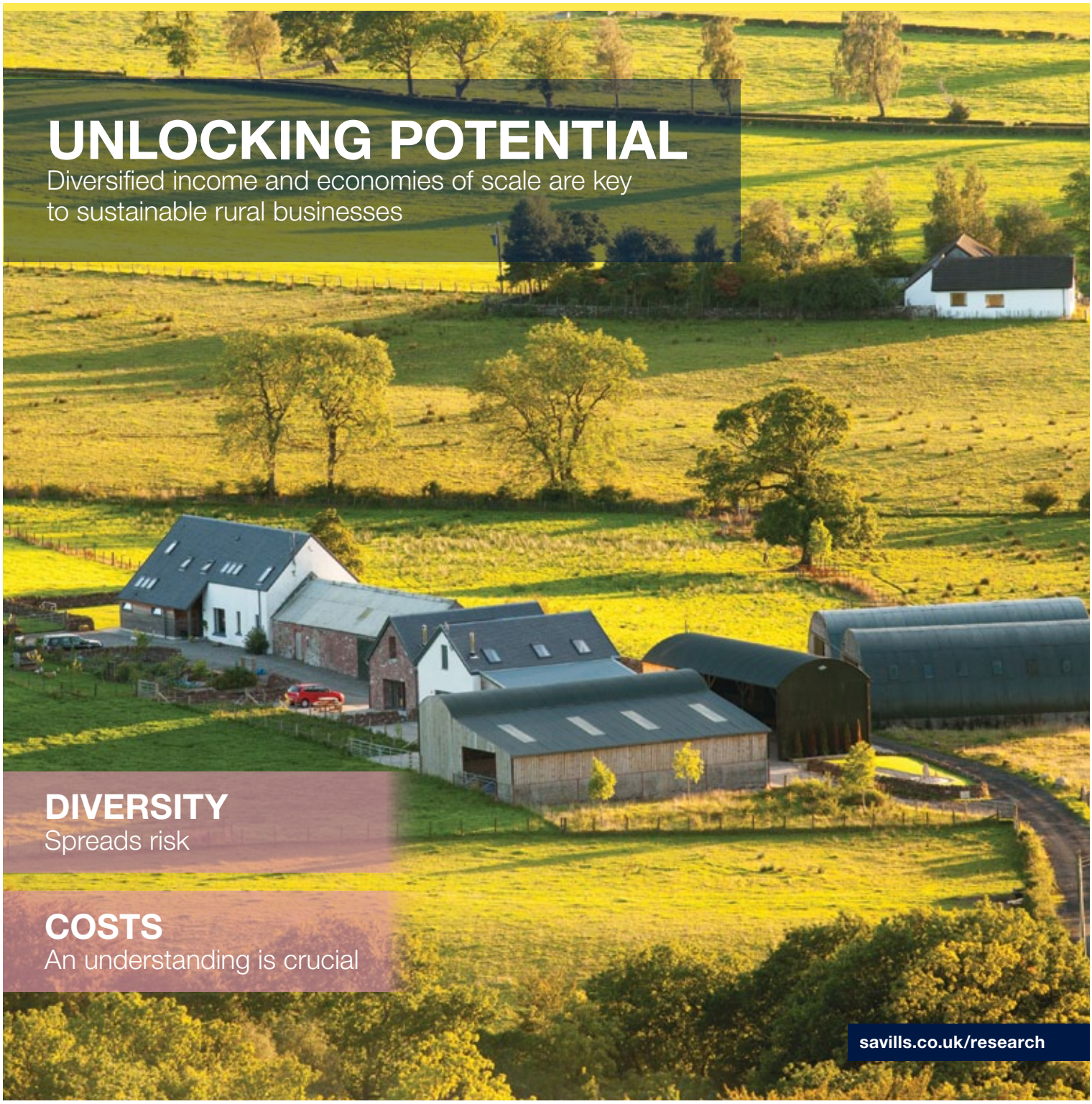
Savills World Research
UK Rural

Scottish Estate Benchmarking Survey 2016

February 2017



UNLOCKING POTENTIAL

Diversified income and economies of scale are key to sustainable rural businesses

DIVERSITY
Spreads risk

COSTS
An understanding is crucial

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EXECUTIVE SUMMARY

Diversified estates providing affordable housing and essential rural employment
See page 03

Diverse business streams lessening reliance on agricultural income
See page 04

Shift from let agricultural land to in-hand/contracting enterprises
See page 04

Income from residential assets on Scottish estates has increased
See page 04

Understanding estate's costs essential as Brexit impacts the sector
See page 7

Welcome to our 8th Scottish Estate Benchmarking report, which reviews the performance of Scottish estates during the 2016 financial year. During the reporting period rural businesses have had to endure incredibly difficult operating conditions. Like other businesses, the Brexit referendum, threat of another independence referendum, coupled with CAP reform and a raft of new legislation, has created uncertainty for owners and managers. Such an environment has prevailed for many years, to the extent that it is perhaps considered the norm, however it has placed considerable pressure on management resource.

Demonstrating resilience and fleetness of foot, rural businesses have shown an exceptional ability to adapt to new legislation and to react quickly to economic and policy changes, while continuing to improve business performance. This is remarkable, however we expect these enterprises to come under even more pressure over the next few years. Already we can see these businesses mitigating against risks by reducing their reliance on traditional sources of income. However, moving into diversified business carries its own risk in terms of investment, delays in building income streams and identifying the correct opportunities. In the long-term we anticipate that the most successful businesses will have a portfolio of diversified businesses.

One of the interesting observations from the results is, that during the period of Land Reform, the impact of this process has been the very reverse of what was intended. The quantum of let land has dropped markedly. Savills has advocated a free market as the best way of encouraging the letting of land. Over the coming years, we expect the market to encourage landowners to let land to balance their portfolios between in-hand/contracting and letting on modern tenancies. Ironically, rather than enhancing this trend, the Land Reform Act is constraining it.

During the reporting period, these businesses were cautious about expenditure, however they continued to invest over half of their income back into the fabric of rural communities, particularly into let farming businesses and into the rural housing stock. In terms of corporate social responsibility, rural businesses continue to engage and work closely with local communities, sharing enterprises, opportunities and investment.

There are difficult times ahead; agricultural incomes are going to come under pressure and we may see a market correction in terms of the required scale for sustainable units. Many rural businesses are already pursuing a policy of restructure to take advantage of economies of scale and diversified income. At Savills, we look forward to working with these businesses to develop progressive sustainable enterprises.

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INCOME SUMMARY

The 2016 survey results show that average gross income on 'All Estates' in Scotland increased by a significant 11% to £155 per acre across the whole estate. This performance was stronger than the annualised 5% recorded over the past three years and shows a proactive determination to use all opportunities to generate income, creating a strong business which is not exposed to single enterprises (see 'Diversity of the Rural Estate' below).

Net Incomes (before depreciation, finance, drawings and tax) followed a similar trend and rose by almost 30%, equating to £76 per acre as total costs fell -2.3% on 2015 (see page 6 for more detail on costs).

DIVERSITY OF THE RURAL ESTATE

The diversity of assets (agricultural, residential, commercial and more recently renewable energy) and therefore opportunities to generate income, continues to increase and help spread risk. This has also been a key factor in the recent improved performance.

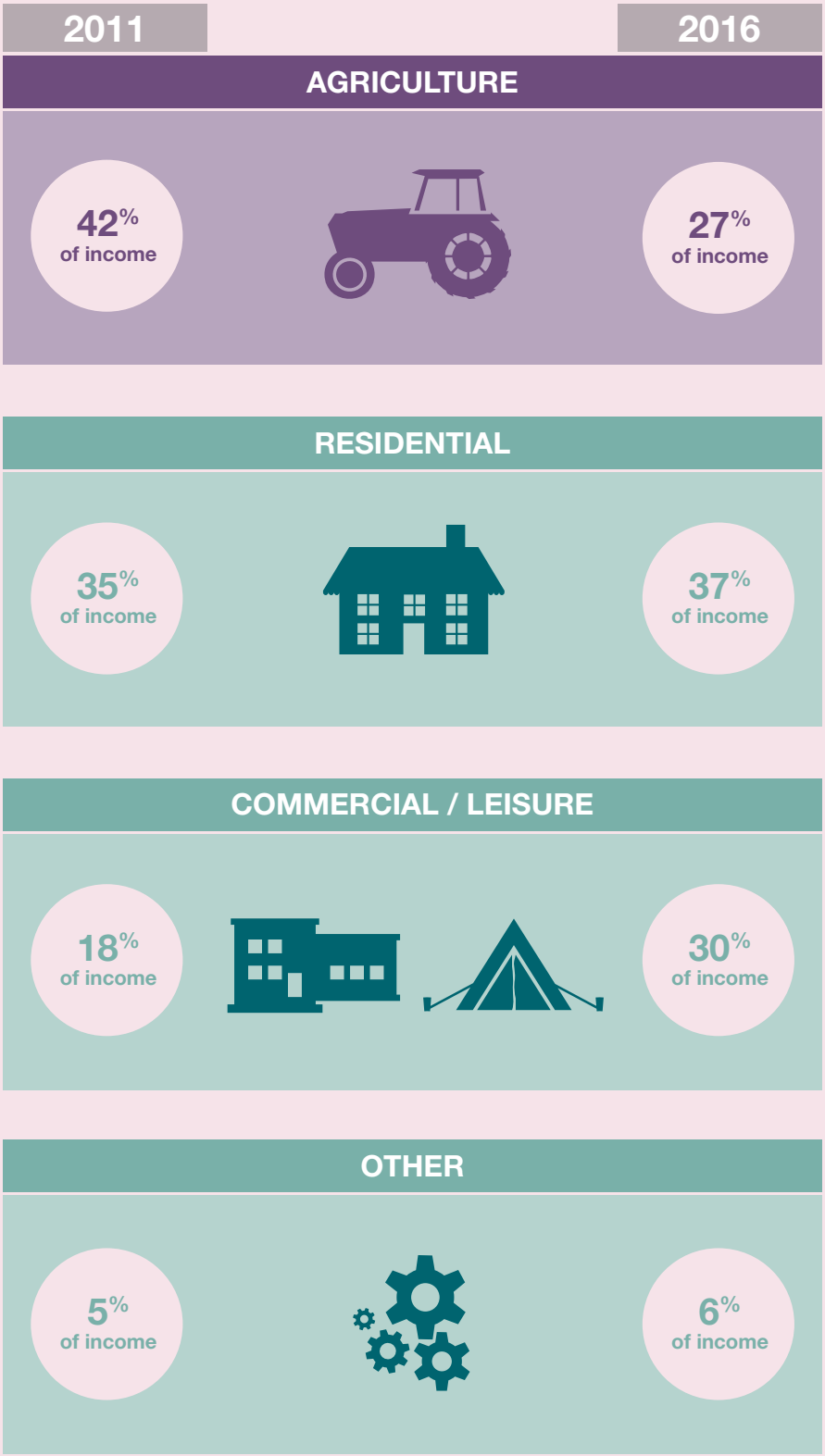
There has, as illustrated in Figure 1, been a greatly reduced reliance on the proportion of gross income generated from agriculture towards other income streams.

Although the contribution from agricultural assets has fallen, together with residential they still provide two thirds of the average estate's income (more details on page 4).

Most estates have a number of other income sources including woodland, shooting, minerals and, in many cases, leisure and commercial trading enterprises. The character and value of these additional income sources is often dependent on location. Notably on their own these 'alternative' income streams can be demonstrated to be very volatile, however as a portfolio the total income derived from them continues to grow.

FIGURE 1

Shift away from agriculture: Gross income increases across other revenue streams



Source: Savills Research

These opportunities have given estates steady positive income growth over the long term. This is in stark contrast to single farm enterprises where exposure to price, exchange rates and weather volatility has created significant swings in financial results from one year to another.

Rural estates remain the foundation of many rural communities, employing and housing specialist in-house tradesmen and also contracting-out to local businesses. Our research demonstrates that, on average over the past five years, over 70% of repairs are undertaken by in-house staff with the remainder undertaken by local builders.

Up to £50,000 is paid to local contractors, from an average estate spend on property repairs of over £150,000 per annum. In addition, on the average estate, around 30% (up to 20 houses) are provided, rent free to staff and former employees. The balance of housing stock (over 200 houses on some estates) is let to local families in the rural community.

The results demonstrate that long-term retention of the business remains the overriding key objective of the owners, providing neighbouring communities and businesses with a stable platform allowing third parties to make assured investments into their own businesses.

Ranked in order, owners' objectives are:

1. long-term retention of the core estate
2. income generation
3. return on capital
4. environmental stewardship.

AGRICULTURAL ASSETS

The increasing diversity is a result of the changing structure of estates, both in the agricultural and residential sectors. Our research shows that there has been a shift from let, notably traditional tenancies, to in-hand farming (including the use of contract farming agreements).

This shift is in part driven by tenants renouncing their tenancies and part by landlords' anxiety to let land, in the shadow of the uncertainty generated by Land Reform legislation.

Figure 2 shows that over the past five years the area occupied on the average estate by traditional tenancies has fallen from 44% to 22% of the lowland area. Conversely, the area occupied by in hand farming enterprises has increased from 15% to 43%. In addition, land let on modern tenancies has dropped from 41% to 35% - a depressing consequence of the land reform process.

> "Rural estates remain the foundation of many rural communities"
>
> **Ian Bailey, Savills Research**

Our survey records average agricultural rents in 2016 as:

- **Traditional Tenancy:** £65 per acre, up 4.0% on 2015
- **Limited Duration Tenancy (LDT):** £93 per acre, up 7.3% on 2015
- **Short Limited Duration Tenancy (SLDT):** £67 per acre, up 14% on 2015
- By comparison, the average Farm Business Tenancy (FBT) across England in 2016 was £118 per acre, up 2.2% on 2015 and on Traditional tenancies £84, up 4.9% on 2015.

Our research indicates that the average net income (after deduction of property repairs, insurance, third party rents and interest on borrowed working capital) recorded for in-hand farming, including contract farming, enterprises over the past five years was around £30 per acre. It ranged from -£26 per acre to £80 per acre as incomes were exposed to input and output volatility.

Reviewing the results of our rents survey demonstrates that SLDTs are most closely linked to commodity prices and productivity. It would also indicate that rents on traditional tenancies are closing the gap on modern tenancies.

It will be interesting to observe the impact of the Land Reform legislation on rental levels. The results also demonstrate the volatility of in-hand and contract farming; both are critically exposed to commodity prices and ongoing delays to subsidy payments.

RESIDENTIAL ASSETS

Residential assets on Scottish estates on average contributed £57 per acre to gross income, an increase of 7.2%. This represented 37% of gross income. Average annual rental income from Short Assured Tenancies (SATs) on 'All Estates' fell by -3.8% during 2016 to just over £7,000 per dwelling. Despite an overall increase in residential income, the annualised growth for SATs has stalled (0.6%) over the past three years and this is explained below.

As with the agricultural sector, our survey records some fundamental changes in the occupancy of the housing stock on rural estates. Figure 3 shows that over the past five years the proportion of housing stock on the average estate let as Short Assured Tenancies (SATs) has increased from 45% to 63%.

Conversely, those held in traditional agricultural tenancies has fallen from 34% to 14%, releasing housing to be let at market rents: this a result of negotiated resumptions of farm cottages from traditional tenancies.

The consequence is an overall increase in residential income, but of lower value cottages diluting the average SAT rental figures. Many of these are likely to be let at lower rents until full repairs and improvements have been completed.

COMMERCIAL/OTHER/ TELECOM ASSETS

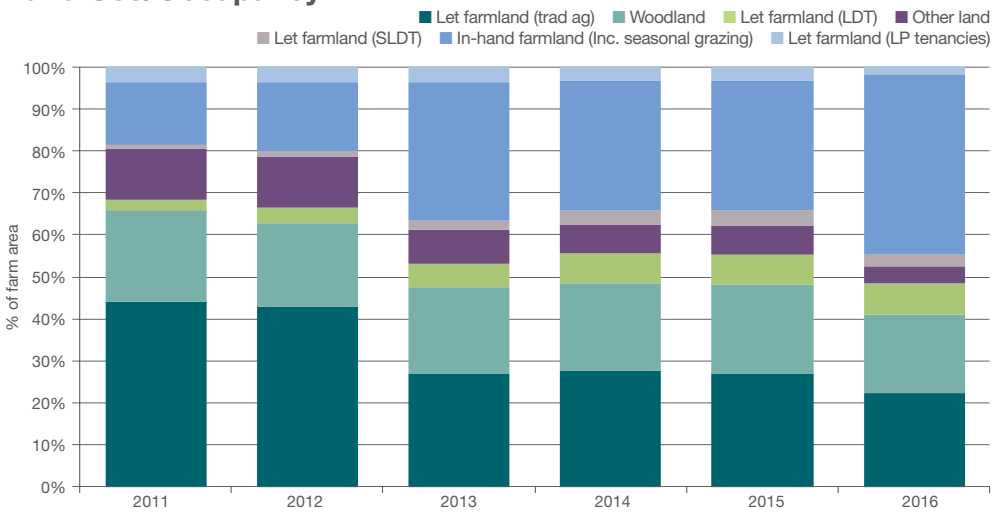
In 2016 commercial and leisure assets and enterprises on 'All Estates' contributed almost £47 per acre to gross income and represented 30% of gross income. This was significantly above the 18% recorded in 2011. The success of commercial enterprises is often location driven.

Where estates have commercial workspace our research suggests that rental growth, from offices to storage, was positive in 2016.

Average rental income from telecom masts increased by 20% to average £12,500 per mast. This figure includes site sharing payments and accordingly this income source is at considerable risk from the Digital Economy Bill. Protecting this income through new negotiated leases is imperative prior to the new legislation.

FIGURE 2

Land Use/Occupancy



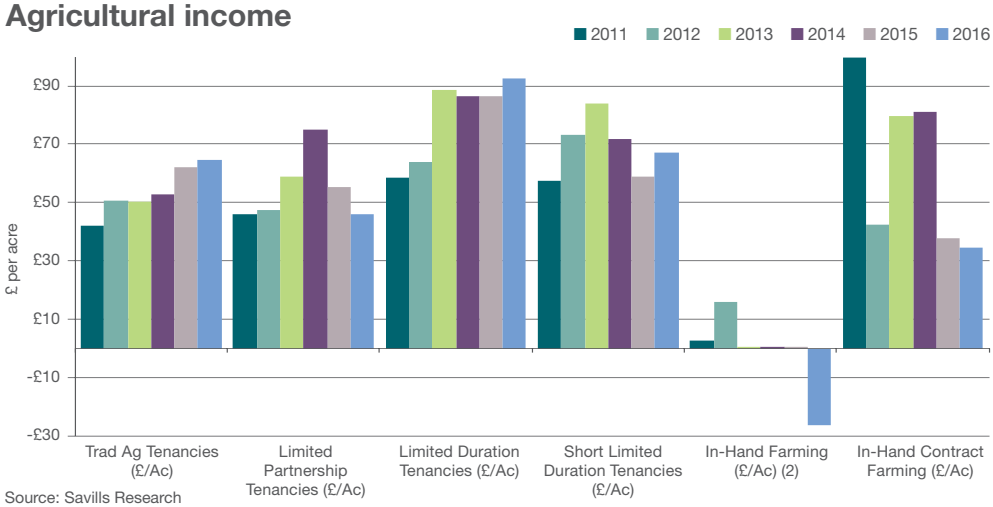
Source: Savills Research

43%

Proportion of land farmed in-hand

FIGURE 3

Agricultural income



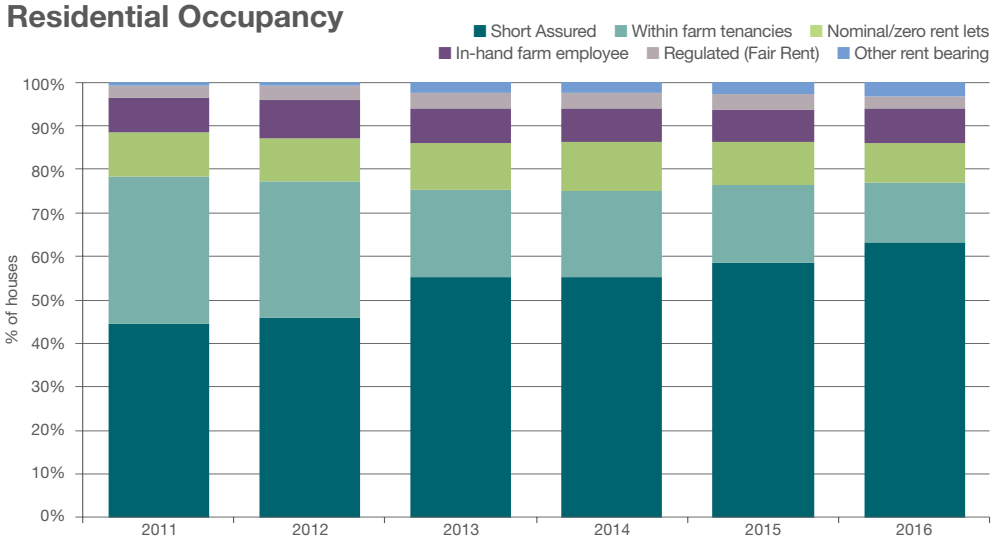
Source: Savills Research

22%

Traditional tenancies occupy of estate lowland acres

FIGURE 4

Residential Occupancy



Source: Savills Research

63%

SATs as proportion of all housing stock

COSTS CONTROLLED

Total estate expenditure fell by -2.3% in 2016 compared with 2015 and amounted to £79 per acre. In 2016 this represented 50% of gross income, which was below the average of the past five years of 57%.

The two principal costs are property repairs and management which, over the past five years on average, represent 23.6% and 15.2% of gross income respectively or 70% of 'All Estate' costs.

A useful Key Performance Indicator (KPI) is cost relative to gross income. Figure 5 below gives a snapshot, but understanding the relationship between costs to the individual enterprises and resources available on an individual estate is crucial.

"Understanding the relationship between costs to the individual enterprises and resources available on an individual estate is crucial."

Ian Bailey, Savills Research

50%

2016 costs as % gross income

70%

of all costs are property and management

FIGURE 5

Scottish data: % of gross Income (five year average 2012-2016)

Source: Savills Research

LOOKING FORWARD

What are the implications of Brexit?

Looking forward, there are key concerns in relation to Brexit, regarding both changes to support payments and the international trade negotiations. However, in the short term the weak pound may bring some benefits to rural businesses.

These include:

- a more positive environment for exports and commodity prices
- a substantial increase in subsidy payments in 2017
- an increase in domestic tourism as more people choose to holiday at home to avoid unfavourable currency exchange rates, this includes rural tourism
- a boost in the number of overseas visitors to the UK, which will have a positive impact on rural tourism

In the longer term the outlook is less clear. Our analysis of agricultural profitability post Brexit suggests that the impact of changes to trade agreements on arable units could be far more significant than changes to agricultural subsidy. On livestock units, the impact of the new subsidy regime has yet to take full effect and again future trade agreements will impact significantly.

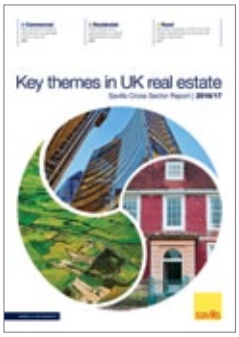
We are regularly providing updates via our Brexit Briefings which can be accessed at **www.savills.co.uk/research/uk/brexit-research.aspx**
This report highlights the diverse income base potentially available to rural estates, where the shift in reliance on agricultural income has already diluted the impact of future legislation and changes to agricultural support.

The key to a profitable and sustainable business in the future will be maximising the opportunities offered by the range of assets, economies of scale, and working in partnership with communities and neighbours. To do this, a full analysis of the current position, including benchmarking to challenge current performance, will be needed to provide the foundation for future strategy.

Looking forward, the options, in addition to developing the core income streams, might include:

- diversifying into niche markets, for example alternative food products
- portfolio restructure
- liquidating capital through sales should not be ignored
- diversifying into assets outside the core business, including commercial property portfolios, hotels and commercial forestry.

Additional Rural Research



Estate structure
The average estate structure for those estates participating in the survey is:

- 3,500 acres
- 40 residential properties with an average density of 8.3 houses per 1,000 acres
- 14,700 sq ft of commercial workspace with an average density of 2,400 sq ft per 1,000 acres

Estates range in size from below 1,000 acres to above 20,000 acres.

Estate ownership
Institutionally owned estates represent around 20% of the estates in the survey with the remainder in private ownership. The owner is resident on three-quarters of the privately owned estates.

Ownership objectives
Long-term retention of the core estate is the key objective followed closely by income generation, return on capital and environmental stewardship.

Sources are included for all the charts. We have used a standard set of notes and abbreviations throughout the document. The most commonly used abbreviations are:

Glossary of terms
- **LDT:** Limited Duration Tenancy
- **SLDT:** Short Limited Duration Tenancy
- **SAT:** Short Assured Tenancy
- **EBS:** Estate Benchmarking Survey

Footnotes
We regularly review our survey data which means the data published each year may not exactly match that published in the previous year's survey. Separate results are published for English estates.

Additional services
In addition to this report, we can provide further analysis, such as the provision of supplementary benchmark comparisons, portfolio analysis and/or interpretation and presentation of results. For estates using Key Accounts and/or Key Property software from LANDMARK Systems there is now a manual to help download data for the Savills Benchmarking Survey.

This publication
This document was published in February 2017. The data used in the charts and tables is the latest available at the time of going to press.

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