Scottish Estate Benchmarking Survey 2011

Savills Research

savills.co.uk/research

savills

Our 2011 Estate Benchmarking Survey results demonstrate that gross incomes continued to rise on Scottish rural estates. However, the growth in net income has been dampened by higher costs.

In a year of global economic uncertainty, performance was broadly positive but the challenge, going forward, is to balance the pursuit of growth in turnover with the management of the ever-increasing cost base.

Agriculture and the rural economy have often proved to be relatively recession proof and our outlook, detailed at the end of the bulletin, considers the threat to this position.

Income

The average gross income on 'All Estates' totalled £90 per acre (£222 per ha) in 2011, up 13% on the previous year's figure of £80 per acre (£198 per ha) (see Graph 1).

This report demonstrates that income from the residential and agricultural sectors has grown. Together they contributed 84% of the total income across estates. In 2010 the contribution was 79%. This in part reflects the growth in rents in both sectors but also reflects the downturn in other sources of income such as leisure and commercial, which jointly dropped their contribution from 16% to 11%.

As agricultural commodity prices have become more volatile, estates with a diversified income will be best placed to retain a more balanced annual income flow. On this basis, the commercial and leisure sectors should continue to be encouraged to take advantage of the current trend for UK-based outdoor activities. In the future, an over-reliance on the agricultural sector might be considered a potential risk.

While high commodity prices prevail there is a risk of being lulled into a false sense of security about the performance of estates. With forthcoming CAP reform, eurozone turmoil and a more volatile global climate, the peaks and troughs in these prices will become more pronounced.

Agriculture

In these recessionary times, the agricultural sector, supported by buoyant livestock and crop prices, continues to underpin income on rural estates.

Our research shows that in 2011 agriculture contributed 44% of gross income or £40 per acre (£99 per ha). Our survey records average agricultural rents in 2011 as listed below:

- **Traditional Tenancy:** £47 per acre (£116 per ha), up 1% on 2010.
- **Limited Partnership Tenancy (LPT):** £44 per acre (£108 per ha), up 2% on 2010.
- **Limited Duration Tenancy (LDT):** £53 per acre (£131 per ha), similar to 2010.
- **Short Limited Duration Tenancy (SLDT):** £63 per acre (£156 per ha), up 12% on 2010.

Traditional agricultural tenancy rents continue to increase, albeit at a slow rate, with the average rent at £47 per acre (£116 per ha) up almost 10% since 2009 (in line only with inflation). Many landlords are clearly cautious about undertaking rent reviews, given the current politics associated with secure 1991 Act tenancies.

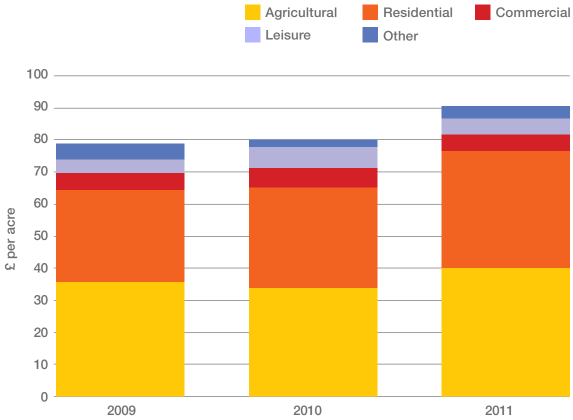
Notwithstanding the above, landlords continue to invest substantial sums into the agricultural portfolio, with the benchmark indicating that 22% of the income from the let agricultural portfolio being ploughed back into these farms.

It is interesting to note that rents for Short and Limited Duration Tenancies, which are agreed under negotiation, on modern terms, have increased by up to 30% over the same period.

This suggests we now have a two-tier rental market akin to the residential sector, with similar disparities to those between short assured market rents and regulated or protected fair rents. However, the Moonzie decision may well result in a narrowing of this disparity in the agricultural sector.

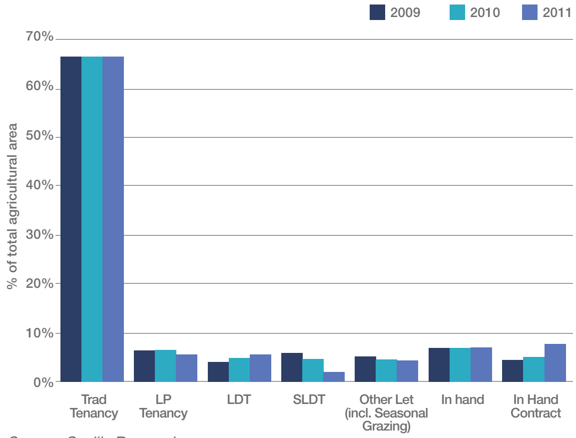
Between 2009 and 2011 the number of Secure Agricultural Tenancies has remained static. There has however been a shift away from the shorter term arrangements such as seasonal grazings and SLDTs towards LDTs and contract farming arrangements. The shorter term lettings have declined, while LDTs and contract farming have increased (see Graph 2).

Graph 1.
Source of income



Source: Savills Research

Graph 2.
Agricultural tenure



Source: Savills Research

Residential

The let residential sector has seen a considerable improvement in income. As predicted by many forecasters, the residential rental sector continues to benefit from the 'credit crunch', particularly as estates provide high quality property at affordable prices for first time buyers unable to secure finance to purchase a property.

Over 10% of rural estates' housing stock is let on protected tenancies, reflecting the level of subsidised affordable housing for key workers that estates provide to the local rural economy. Income from the residential sector now contributes over 40% of the total estate income or £36 per lowland acre (£89 per ha).

Our survey shows the average Short Assured Tenancy rent increased from £5,216 in 2010 to £5,498 per dwelling in 2011, reflecting 5.4% rental growth in 2011. The results demonstrate that void periods fell in 2011 to between 2% and 3% from the 5% recorded in 2010 – further evidence of strong demand for property to rent. Fair or regulated tenancy rents achieved similar increases of 5.1%, with an average rent of £3,731 per dwelling (see Graph 3). In England, the trend was similar with average annual rental income for Assured Shorthold Tenancies (ASTs) increasing 5% during 2011 to £8,300 per dwelling.

Commercial

Our research shows the recession has hit the commercial and leisure sectors with both, on the average estate, contributing less to gross income in 2011.Rural offices have been resistant to the economic downturn, with rents increasing by 5.9% on the previous year to £6.25 per sq ft. This reflects the benefits of providing cheaper out-of-town office space, where there is still a good latent demand.

Let commercial workspace is relatively sparse on Scottish estates compared with England. While the survey records an average of around 12,000 sq ft of workspace on Scottish estates, almost 90% of this is low cost, industrial type space with average rents of around £1 per sq ft.

Telecoms mast rents fell by 2.1% in the 2011 survey to an average of £7,308 per mast. This figure reflects total income per mast (base rent and site sharing payaways). While landlords continue to take a robust stance against telecom tenants lobbying for base rent decreases, they have no control over tenants agreeing cartel style agreements with other operators, resulting in significantly reduced site share payaways.

Leisure

Many of the leisure activities on estates would be considered luxury items and have struggled as disposable incomes have dropped. However, in 2011 this sector still contributed over 5% of gross income of the average estate income. We would expect leisure income to track fluctuations in disposable income. This trend was similar in England with downward pressure on leisure income.

Sporting

Bearing in mind that the majority of participating estates are mixed or low-ground estates, sporting income is unlikely to make up a significant proportion of the total gross income. In 2011 the income derived from all sporting activity was just over £2 per lowland acre (£5.50 per ha), up 20% on 2010.

Other income sources

Other sources, including woodland and minerals, contributed the remaining 2% of gross income and amounted to £2 per acre (£5 per ha) in 2010. Woodland would appear to be an underutilised asset, especially considering the current interest in biomass and using woodland to offset carbon emissions.

Estates will continue to regularly review all their resources, including property, employees and capital, to identify opportunities to deliver more income. This should be undertaken with appropriate advice. Targeted investment, especially on repairs and improvements to residential property, is fundamental to maximising the future income potential of an estate's property portfolio. The results of our survey illustrate this.

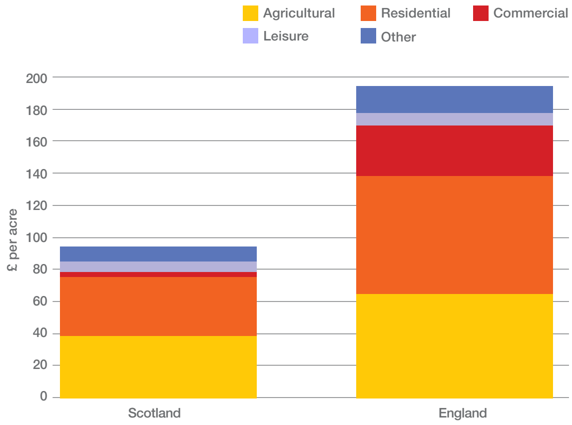
Country analysis

The results of our English survey show a similar pattern of gross income growth, although growth was more constrained at 4% to £197 per acre (£486per ha) (see Graph 4).

Graph 3.
Residential rents

Source: Savills Research

Graph 4.
Source of income by country



Source: Savills Research

Net income

Our 2011 survey results show that the average net income (before depreciation, finance, drawings and tax) increased by 4% to £41 per acre (£99 per ha) while costs, mainly from property repairs, increased, which dampened the increase in gross income (see Graph 5).

In England the average net income (before depreciation, finance, drawings and tax) fell by 0.3% to £108 per acre (£267 per ha), mainly from property repairs, increased, wiping out the increase in gross income

Net income was derived from an average gross income of £90 per acre (£222 per ha) and an average expenditure of £49 per acre (£121 per ha). Net income represented 46% of gross income.

Expenditure

Expenditure on the average Scottish estate in 2011 increased by 22%, to £49 per acre (£121 per ha). A significant increase in property expenditure together with smaller increases in legal and insurance costs suggest the economic climate is putting cost pressure on estates.

Property repairs

Property repairs remain the biggest spend and in 2011 amounted to £24 per acre (£59 per ha), as illustrated in Graph 5, representing 27% of gross estate income. An additional £8.74 per acre (£22 per ha) was spent on capital improvements to property – significantly up on the figure recorded in 2010.

Analysis of individual estates shows that much of this increase was attributable to cost-saving in the previous year and damage repairs caused by two severe winters. The general rise in property material and labour costs also contributed to increased repair costs.

Management costs

Our survey shows average management costs across 'All Estates' in Scotland in 2011 were just over £13 per acre (£33 per ha), representing 15% of gross income, exactly the same proportion as last year.

Other costs

All other estate costs followed a similar pattern and in total increased by 13% in 2011 to £12 per acre (£30 per ha). Although expenditure, other than repairs and management, may be relatively small, collectively they add up to an additional 13% of gross income and cannot be overlooked.

Agricultural expenditure

Expenditure on the agricultural portfolio fluctuates considerably, reflecting the scale of renewal and improvements being undertaken by landlords The average estate reinvests 22% of let agricultural income back into these properties, ensuring viable units for their tenants, creating local employment and maintaining the fabric of the countryside. The agricultural surplus of 44% in 2011 is in line with the historic average of 43%.

Residential expenditure

Total expenditure on short assured tenancy property in 2011 was almost £3,000 per dwelling (up 12% on 2010) and as a proportion of the gross SAT rent, the surplus decreased from 50% to 46%.

Regulated tenancies have seen a significant increase in surplus from 31.5% to 53.6%. This reflects many estates referring regulated rents to the Rent Officer, seeking appropriate increases, and suppressing expenditure on the properties.

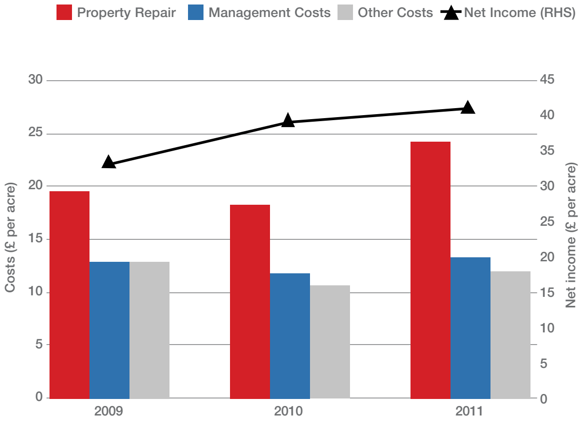
Investment performance

Our research shows rural estates in Scotland continue to perform well from an investment perspective, although restricted in 2011 compared with the previous year. The 2011 survey records an average total return from 'All Let Property' across 'All Estates' of 3.6% (net income 1.2%, capital growth 2.4%), lower than the 7.1% recorded in 2010 (see Graph 6).

However, let agricultural assets recorded a significant 10.4% total return, outperforming the 4.8% recorded in 2010. Overall performance was restrained by reduced capital growth in the residential sector which recorded a total return of 4.4% in 2011 compared with 8.4% in 2010.

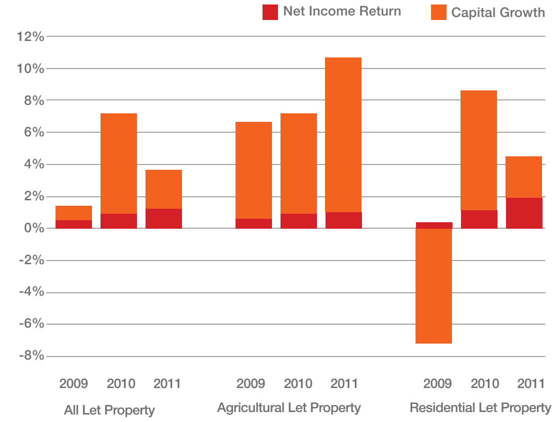
The performance of rural estates remains competitive against alternative investment assets when annualised over three, five and ten year periods, despite the recovery of commercial property, equities and gilts during 2010.

Graph 5.
Net income and expenditure



Source: Savills Research

Graph 6.
Investment performance of rural let property in Scotland



Source: Savills Research

savills

Outlook

The 2011 survey shows that the current economic climate has had some impact on the financial performance of rural estates. Inflationary pressure and increased property expenditure have eaten away at the bottom line.

We expect average gross incomes over the next two years to continue to increase annually, although they may struggle to keep pace with inflation. We anticipate modest average rental income growth across all sectors, along with a continuing shift to market rents in the agricultural and residential sectors.

Tight control of costs and targeted property expenditure will ensure that net incomes remain positive. The current demand in the residential rental markets, especially those in densely populated areas or within sought after locations, may boost incomes from the housing stock, with higher rents, lower void periods and real opportunities to convert more properties to market rents.

We are in uncertain times and there are potential pressures which may impact further on some sectors of the market. These include the continuing difficult economic climate and austerity measures, together with the volatility of farm input and output prices and the current reforms of the CAP.

The current buoyant commodity markets, allied with tax advantages, continue to attract investors. However, the spectre of the absolute 'right to buy' has once again reared its head and may dissuade landlords from letting land. The current political feedback would appear to be a threat to new lettings under Limited Duration Tenancies, which have seen a steady increase since 2009.

> "The current buoyant commodity markets, allied with tax advantages, continue to attract investors."

There is optimism regarding the future of agriculture and the rural economy, as food security, renewable fuels and a realisation that environmental benefits must be rewarded are now firmly on governments' agendas at a national and global level.

Our Benchmarking Survey results show that little income is derived from woodlands, although they potentially offer opportunities including:

- Biodiversity offsetting
- Renewable energy
- Carbon sequestration
- Income generation from leisure and forestry activities

In addition, the opportunity for rural businesses to generate energy and income from renewable energy sources is significant.

Balfour Matrix

This year Savills launched a new service, the Balfour Matrix, which complements the Benchmarking Service. It has been developed with leading tax advisors and cross references the data captured in the Benchmarking Survey, against the key tests identified by HMRC and case law as being as being necessary to extend IHT relief over estate assets. This is highly relevant as let properties and the principal house in the past have often failed to secure relief.

"Having the level of detail required already within our Survey, it seemed obvious to utilise it for some seriously valuable tax planning for our clients," says Hugo Struthers, Head of Rural Professional Services in Scotland.

"The Balfour Matrix, in tandem with our Estate Benchmarking service, will enable landowners to assess whether they meet the tests required to secure Business Property Relief from IHT across their whole estate, or, more importantly, to consider whether it is possible to do so with a little planning or restructuring. We are very proud that our Estate Benchmarking Survey can be used to help our clients plan pro-actively to mitigate future IHT liabilities."

Contact **Ian Bailey** or **Hugo Struthers** for more information about the Balfour Matrix.

savills

Rural Estate Management and Consultancy Services

Savills has one of the largest rural estate management and consultancy teams with more than 200 full-time rural professionals operating out of 30 offices. Together the team is responsible for the management of more than two million acres on a day-to-day or consultancy basis.

This report is produced by the Savills Research department, using extracts from our own research and analysis. For more information on the full range of our rural property and business research and consultancy services, please contact Ian Bailey or browse our website at **www.savills.co.uk/research**

For further information please contact:

Ian Bailey
Head of Rural Research
+44 (0)1797 230156
ibailey@savills.com

Jonathan Henson
Estate Management
+44 (0)1738 477511
jhenson@savills.com

Ewan Berkeley
Estate Management
+44 (0)1356 628605
eberkeley@savills.com

Charles Dudgeon
Estate and Farm Sales
+44 (0)131 247 3702
cdudgeon@savills.com

Roddy d'Anyers Willis
Estate Management
+44 (0)1356 628620
rwillis@savills.com

Kenneth Munn
Head of Scottish Benchmarking
+44 (0)141 222 5870
kmunn@savills.com

Jonathan Dymock
Estate Management
+44 (0)1356 628630
jdymock@savills.com

Hugo Struthers
Estate Management
+44 (0)141 222 4105
hstruthers@savills.com

Nick Green
Renewable Energy
+44 (0)1738 477518
ngreen@savills.com

Anna Thomas
Estate and Farm Sales
+44 (0)131 247 3704
athomas@savills.com

Applied Research: Estate Benchmarking Survey

Estate structure
Within the survey the average estate structure for 'All Estates' is just under 8,000 acres of lowland area including about 84 residential properties and commercial and leisure enterprises.

Estate ownership
27% of the estates in the survey are institutionally owned, with the remainder in private ownership. The owner is resident in about half of the privately owned estates.

Ownership objectives
Estate owners cite income generation and long term retention of the core estate as their key management objectives. Return on capital and environmental stewardship follow closely behind.

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.

A copy of the results of our English survey is available on request.