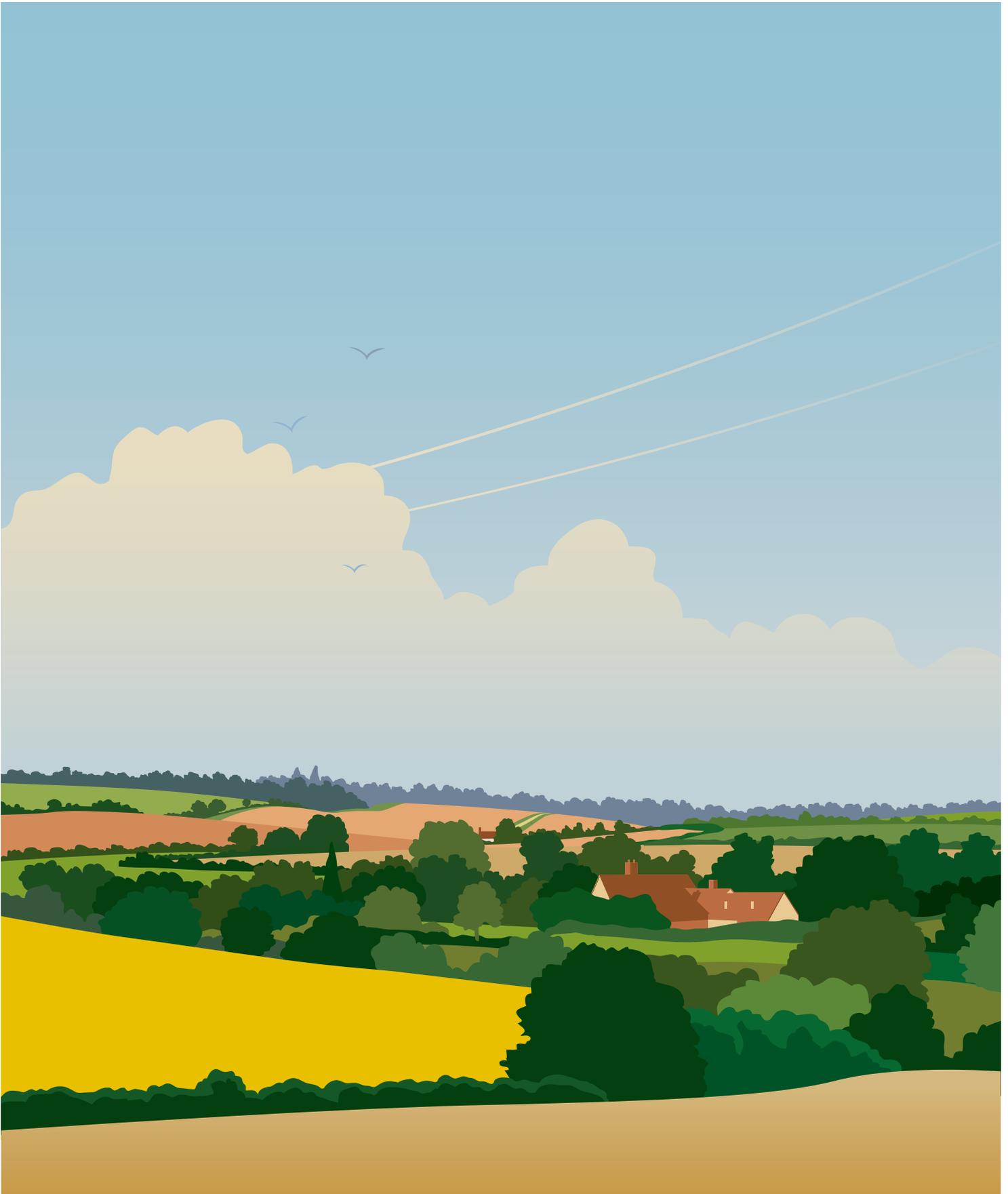


UK Rural - Summer 2019

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**SPOTLIGHT**  
*Savills Research*

# Delivering Future Arable Performance



Unlock a productive future • Improving land access • Environmental opportunities

**0.9%**

annual agricultural growth in the UK since 1964

**3.5%**

agricultural growth in the Netherlands since 1964

**79%**

of cereal farms' profit was from direct payments in 2014-17

# Unlocking a productive future

UK agriculture is being restructured to ensure that it has the necessary skills and talent for its future success

The traditional dynamics of UK agriculture are being reshaped through the agricultural policy development work that the Department for the Environment Food and Rural Affairs (Defra) is undertaking as a result of the vote to leave the EU. Whether this will be a completely new policy, or simply tackling elements that sit outside the Common Agricultural Policy (CAP) remains to be seen. One area that can be tackled in any Brexit outcome is the UK industry's low productivity growth, which has been widely discussed as a cause for concern.

Since 1964 productivity growth in UK agriculture has averaged 0.9% per year, lagging behind other developed nations such as the Netherlands (3.5%), France (2.5%) and the USA (3.2%). One aspect of Defra's plan to unlock sustainable productivity improvements is to encourage "structural change" within the industry. This could be triggered by the withdrawal of direct support payments from 2021, but also by Defra's reform proposals for agricultural tenancies in England and Wales. These aim to "facilitate structural change and support new entrants and next generation farmers so the sector has the skills and talent needed to thrive in the future".

Agriculture and Horticulture Development Board (AHDB) research has shown that top

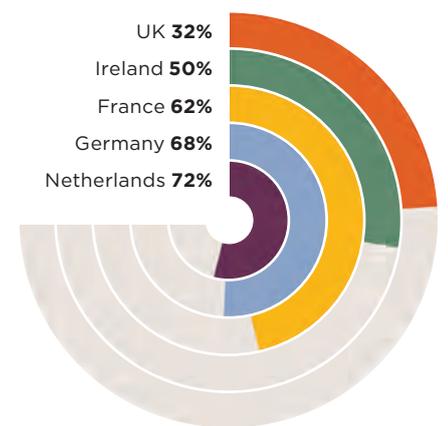
performing farms are differentiated from lower performing farms by the quality of their business management. Successful farms analyse their own performance, plan and are willing to change and improve. These are characteristics that are partly rooted in training and mind-set. A link between productivity and training has been demonstrated by research for the Irish Government which showed that on average the output produced by "trained" farmers was 12% higher than untrained farmers.

The proportion of farm managers in the UK who have undertaken some formal training is much lower than in comparable European countries (see right). Improving productivity through training would be slow to deliver results, which seems to have led Defra to the conclusion that land occupation policy can be used to boost productivity more effectively. Creating an environment that encourages and provides options for less productive farmers to retire and thus will present opportunities for expansion for entrepreneurial businesses that embrace the latest technology and market niches. The Irish Government took a similar approach after its Agri-Taxation Review found "access to land and the low level of land mobility is one of the main challenges facing farmers who want to increase their productivity".



Cover illustration iStock / John Woodcock

## Formal training Farm managers



Source Eurostat, EU Farm Structure Survey 2013

## Improving access to land

A renewed and vibrant tenanted sector could bring innovation and fresh skills

Using the Agriculture Bill, in England the Government intends to remove direct payments over an agricultural transition period between 2021 and 2027. At some point the payments will be "delinked" from the land so the legacy claimant will not need to remain in occupation. The Government may also allow farmers to take their payment stream capitalised into a single lump sum rather than declining annual amounts. These actions will create the opportunity for owner occupiers or tenants to take a lump sum and retire, leading to the occupation of their land changing.

At the beginning of 2019 a survey of Savills professionals, responsible

for managing over 800,000 hectares of land, found that 84% thought that retirement and surrender from Agricultural Holdings Act (AHA) tenancies would become more common due to the withdrawal of direct payments. Increased owner-occupier retirement is expected too, with 55% thinking it would become more common. Use of Contract Farming Agreements (CFAs), share farming, stubble-to-stubble contracting and Farm Business Tenancies (FBTs) were all anticipated to increase in the future. Backing for CFAs was particularly strong, with 78% expecting them to become more common, although they

are growing from a lower base than FBTs.

Defra's agricultural tenancy reform proposals, published in April, would also help AHA tenants unlock retirement options. If implemented, AHA tenants could accept a payment from a new tenant in return for assigning a 25 year AHA to them; moving forwards the landlord would receive an open market rent for this tenancy. In the first instance the proposals give the landlord the right to buy out their tenant's interest, so that they obtain vacant possession. Either way, this means that the current AHA tenant is able to receive additional capital to help fund their

retirement.

Of course, it remains to be seen whether land occupancy reform attracts the calibre of new entrants that the Government wishes to see leading the industry in the future. Savills predicts that poorly performing tenancies may be consolidated into good ones, rather than re-let to new entrants, but with farmland typically only being sold once every 200 years, and the capital investment needed at an all-time high, the let land sector provides the best entry prospects for new entrants. A vibrant tenanted sector could bring innovation and skills at a time when they are needed more than ever.

🗨️ To ensure the continued viability of their businesses, farmers should explore other opportunities to reduce costs 🗨️



### UNSUPPORTED AGRICULTURE

Between 2014 and 2017, an average of 79% of profit on cereal farms was derived from direct payments. If the agricultural transition period goes ahead as planned, it will be essential that businesses are proactive in taking action to make sure they remain financially secure and can maintain their margin as support is withdrawn. Unprofitable businesses will need to develop a turnaround plan, otherwise trading losses will erode their capital. Savills has developed a subsidy reduction calculator that illustrates how payments could fall (see left). The model is this for a farm currently receiving £50,000 from the Basic Payment Scheme (BPS). There will be a clear gap between payments starting to reduce in 2021 and the new Environmental Land Management scheme (ELMS) opening in 2025. ELMS should not be viewed as a replacement for BPS. Not only is ELMS targeted at different policy outcomes to the BPS, its budget and how it will be targeted are also unknown.

Source Savills Research

## Reducing costs and increasing profit

Businesses need to ensure they remain financially secure as support is withdrawn

Based on Defra's analysis of farm accounts between 2014/15 and 2016/17, removing direct payments would result in 40% of farms making a loss. To reach breakeven, the 10% of farms making the biggest losses would need to reduce their costs by an average of 31%. Half of cereal farms would need to cut their costs by 10% or more.

At present, average wheat and oilseed rape crops generate approximately £1,500 per hectare of income, which includes £225 of BPS support (see right). When BPS is withdrawn, with all else being equal, the crop would lose £105 per hectare. How can a business respond to this and compensate for the lost income?

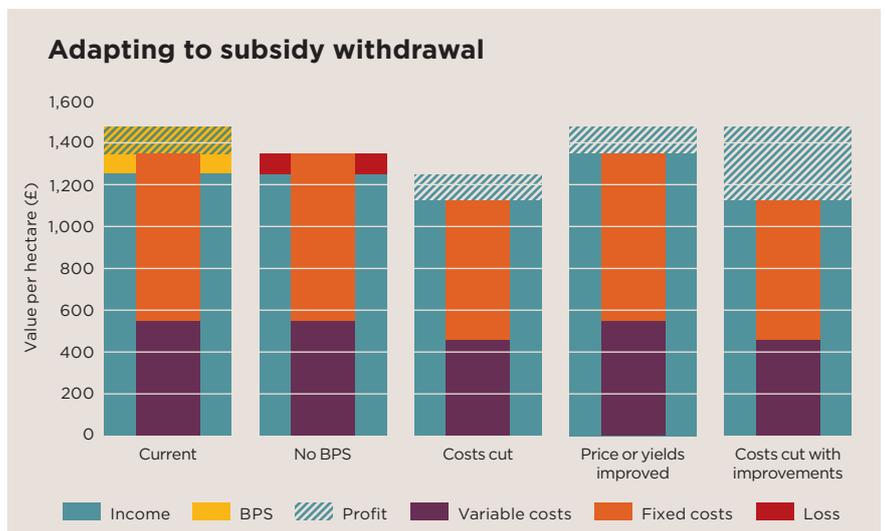
Increasing yields is only part of the solution. The five year average wheat yield is 8.2 tonnes per hectare, which at summer 2018 prices (£162 per tonne) means that an 18% increase in yield would, in theory, replace the lost BPS income. The UK wheat yield record is 101% higher than the average at 16.52 tonnes per hectare, which illustrates the crop's potential under the right management and cropping conditions. However, this does not account for the additional input costs to achieve this: the profit margin is more important than the yield.

On the same average wheat crop, reducing costs by 17% would restore profitability to current levels. While it is possible that input costs, including agro-chemicals and

machinery, could soften due to the more constrained purchasing power of farmers, this cannot be quantified and built into business plans.

To ensure the continued viability of their businesses, farmers should explore other opportunities to reduce costs such as collaboration, reduced cultivations, basic fuel and engine efficiency, or precision farming

technology and techniques to improve input use efficiency. Ultimately, the successful strategy will be to both cut costs and increase income, which in both these scenarios would deliver a profit of £385 per hectare, 188% higher than the current profitability, and more than compensating for the loss in BPS support. The challenge is, of course, to achieve these levels of profit whether or not BPS is received.



Source Savills Research

“ Contract Farming Agreements more naturally encourage a collaborative relationship between the farmer and contractor and could allow the farmer to focus on monetising environmental public goods ”



**CHARACTERISTICS OF TOP PERFORMING FARMS**

- 1 Minimise overhead costs
- 2 Set goals and budgets
- 3 Compare yourself with others and gather information
- 4 Understand the market
- 5 Focus on detail
- 6 Have a mind-set for change and innovation
- 7 Continually improve people management
- 8 Specialise

Source AHDB

## Return to the land

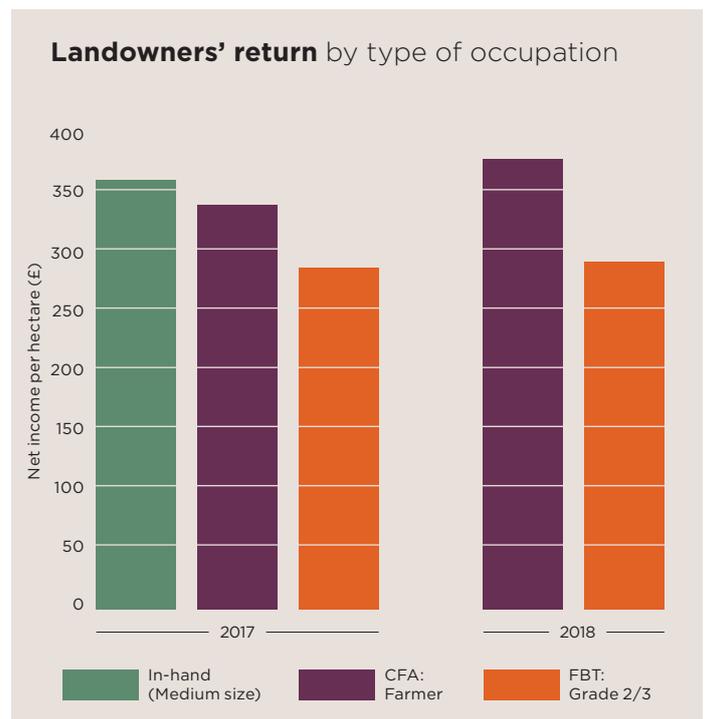
Contract Farming Agreements are providing landowners with higher than average returns

Contrasting the 2018 returns achieved from different methods of land occupation reveals a classic story of risk versus reward. The most suitable option for a landowner will continue to vary according to their circumstances and objectives. Considerations include whether they wish to remain resident on the farm, the degree of influence and involvement they wish to have, and of course taxation. CFAs encourage a collaborative relationship between the farmer and contractor and allow the farmer to focus on monetising environmental public goods, while a contractor assumes responsibility for carrying out fieldwork.

For the last two harvests (see right) a landowner's profit, including BPS from land farmed using a CFA, has exceeded average grade 2/3 FBT rents,

but from an income perspective letting the land has lower risk. Landowners' average returns under the CFAs were 18% higher in 2017 and 29% in 2018, while in-hand returns for medium-sized cereal farms were 25% higher than FBT rents in 2017, according to Defra's Farm Business Survey. Assuming a traditional rent review clause is in use, rents are typically fixed for three years and so rental income is likely to be less volatile than income from in-hand farming or a CFA.

In-hand farming and CFA returns both have more immediate exposure to global commodity prices and weather events impacting yields, although forward selling and other risk mitigation options are available for use.



Source Savills Research, Defra

**£72bn**

collective turnover of France's co-ops

**6%**

market share for UK's agricultural co-ops

**400+**

agricultural co-ops in the UK compared to 2,850 in France

## Responding to the challenge in collaboration

UK farmers working together smartly can improve productivity and profitability

In a marketplace where buyers and suppliers are consolidating, farmers need to give serious consideration to improving their productivity and profitability. Collaboration to build economies of scale, access new technology, add value to crops or increase negotiating strength are options that should be on the table.

Machinery depreciation accounts for 20% of the fixed costs of an average arable farm (Defra, Farm Accounts in England 2017/18), and many machines are not used to their full capacity. Significant savings can be achieved by sharing a piece of machinery such as a seed drill with a neighbour; but the success of this depends upon the relationship between the individuals and being prepared to accept it will demand a little planning and communication each season. Sharing doesn't necessarily have to be with neighbours either: for instance a farm in the north could share a combine harvester with a farm in the south where traditionally the harvest is earlier.

Deeper collaboration can deliver more significant savings. There are successful whole farm sharing agreements and groups of farmers who have formed a joint venture farming company to undertake the field operations on their farms. Planning and structuring these joint

ventures is just as important as implementing them.

Farmers can also work together to trial and develop establishment and husbandry practices suited to their soil and conditions for "new" or novel crops. The area of oilseed rape grown in the UK has declined by 19% since 2012 (AHDB Planting Survey), leaving many farmers looking for an alternative break crop. Soya is a possible option, but UK farmers have limited experience growing the crop. Sharing knowledge locally could help farmers maximise its performance quicker and the risks are lower than if each farmer planted a small area of the crop independently.

At a larger scale farmers can join co-operatives or farmer-owned companies, such as buying groups, to benefit from collective negotiation or add value to their produce. While there are over 400 agricultural co-operatives operating in the UK, including some very significant businesses, they have not been embraced to the extent seen elsewhere in Europe. France is home to 2,850 agricultural co-operatives with a collective turnover of £72 billion, compared to £7.7 billion in the UK during 2018. Co-Operatives UK calculates that the UK's agricultural co-operatives have a 6% market share, compared to 55% in France.

### SUSTAINABLE SOYA BEANS

**3.2m**

tonnes of soya bean equivalent consumed in the UK

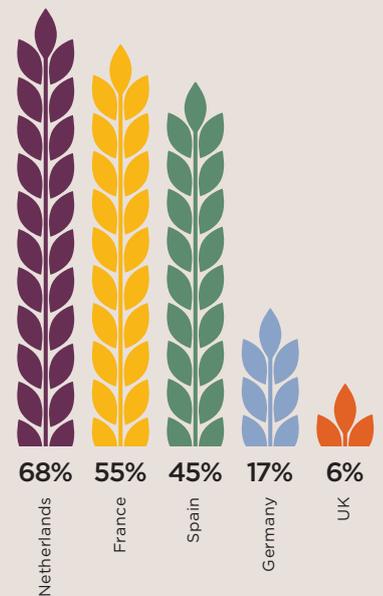
**0.25%**

0.25% of our soya bean demand is currently supplied by UK farmers. Growth potential is significant: the UK crop can be guaranteed to be GM free, and its sustainability credentials more easily monitored too. A report for the UK Roundtable on Sustainable Soya calculated that in 2017 just 20-30% of soya meal consumed in the UK was purchased to a certified or verified standard with a "sustainable" or "responsible" claim. The crop offers farmers rotational and weed control advantages too, because it is a break crop with an early harvest and short cropping window.

**8k**

tonnes of soya beans grown in the UK

Market share of farming co-ops by country



Source Co-Operatives UK

Producer Organisations formed in the horticulture sector work together to add value to their crops, shorten supply chains and crucially strengthen their negotiating position relative to the small number of large buyers for their produce. With the support of the EU Fruit and Vegetables Regime they have successfully boosted productivity through investment in the latest technology and targeted crop breeding on a match funding basis. UK strawberry production is the stand-out success story: strawberry yields increased by 170% over 20 years and self-sufficiency climbed from 49% to 69%. The Government is supportive of the Producer Organisation concept and plans to introduce an improved scheme after the UK leaves the EU. This should create an opportunity for arable farmers to collaborate in a new way, because the Government intends to open up the regime to a much wider range of agricultural products, including cereals, seeds and sugar.

**170%**

Increase in strawberry yields over 20 years under the co-op concept

**75%**

of CAP spend is direct payments to active farmers

**£122bn**

value of the agri-food supply chain in the UK

**£3.5bn**

CAP direct payment and rural development budget in the UK

# Why waiting for ELMS is not the right thing to do

Removing BPS could be the difference between profit and loss for many, so it is important to understand the full implications of the transition from BPS to ELMS

There have been voices calling for reform of the CAP for many years. Many of them have focused on the supposed impact that subsidy has on land values, arguing that removing it would reduce values and improve access to land for new entrants. For those operating farm businesses, the BPS bears no relation to the value of land, and instead acts as an annual lifeline – a guaranteed income regardless of management skill, trade arrangements or market performance.

At this time of broader trading uncertainty, public investment through the CAP helps to cushion the industry against volatility and offers a welcome degree of security. Farmers have planted seeds and planned for the next generation of livestock this year just like any other year, even though the end market for much of that produce may still change. However, AHDB research shows that removing BPS from farm accounts would be the difference between profit and loss for many. Equally, its research indicates that only the top 25% performing farm businesses will fare well under any Brexit scenario. On this analysis, removing BPS could be devastating.

The Agriculture Bill 2018 announced a transition away from the BPS and also announced a new system of financial assistance for publicly valuable activities to be purchased via a new Environmental Land Management scheme (ELMS). For many around the industry, adopting a “wait and see” approach to accessing ELMS has seemed the logical thing to do. For businesses exposed to BPS to cover operating costs, this even may feel like the only viable course of action. However, there are at least three major reasons why “wait and see” is not the right approach.

**1** First of all, we know that ELMS will be fundamentally different from the CAP in its policy intentions. Article 39 of the Treaty on the Functioning of the European Union sets out the five core policy objectives for the CAP, which include to “ensure a fair standard of living for

the agricultural community, in particular by increasing the individual earnings of persons engaged in agriculture”.

So, at the moment, one of the key reasons the industry receives BPS is to support farm incomes. Direct payments to active farmers still account for around 75% of all CAP spend. It is crucial to note that in comparison, the Agriculture Bill contains no mention of income support at all. It simply sets out seven categories of public good for which financial assistance may be given. The removal of income support for farmers is the first necessary adjustment, as ELMS will be measured against environmental improvements, not farm income levels.

**2** The second key reason why waiting for ELMS is not the right thing to do is because there is no clear idea over what the funding levels will be. So even if financial assistance under the Agriculture Bill is available, it might not be at the same level, and it is unlikely to be simply paid on an area basis. It will be conditional on environmental delivery, which will need to be supported by evidence that the money is actually achieving improvements in resource management.



**3** Finally, ELMS as currently described is not conditional upon active farming, which opens up whole swathes of the country to environmental investment that have not previously accessed public money. Based on a simplistic assessment of “public goods”, it could be expected that upland and non-farmed areas are capable of delivering higher levels of biodiversity, water and carbon storage outcomes than lowland areas, potentially attracting higher levels of investment under ELMS. This is particularly the case as Defra has indicated that soil health is a private good that farmers should be delivering in their own best interests. On the other hand, public goods will be worth more if delivered near centres of population, which may benefit lowland environments more.

It is clear that ELMS is not a direct or even indirect replacement for the BPS. It is an evolution of current countryside stewardship schemes and needs to be approached as such. Every farm needs to have a much greater focus on other means of mitigating volatility, including revisiting contracts, looking for collaboration and analysing costings. But also it is necessary that the adjustment is not borne by farms alone: market forces have already forced margins to be tight and market prices both upstream and downstream of farms will need to adjust to a new lack of liquidity at farm level. In the context of £24 billion agricultural spend in the UK and a £122 billion agri-food supply chain, the loss of £3 billion of BPS represents a not insignificant 2.1% of annual revenue. Shared through the supply chain, and with investments in productivity enabled by better contracts and supply chain security, the pain should be short-lived.

Transferring £3 billion or more of public investment to environmental delivery could be transformational for the UK countryside, but the whole farming industry, including the agricultural and food supply chain, needs to accept that the annual income support payment to farmers will be going first. The last approach that anyone should be doing is that of to “wait and see”.

👉 At this time of broader trading uncertainty, public investment through the CAP helps to cushion the industry against volatility and offers a welcome degree of security 🍷

“ For landowners interested in NEG opportunities, the first step is to consider what biodiversity is present on the farm and what improvements could be delivered by changing the management of the land ”



Offsetting scenarios proposed by Defra



**SCENARIO A**  
The developer is able to avoid harm, mitigate and enhance on site.



**SCENARIO B**  
The developer is unable to avoid, mitigate and compensate all impacts on site, but is able to secure local compensatory habitat creation.



**SCENARIO C**  
The developer is unable to avoid, mitigate and compensate on site, and unable to find local compensatory habitat to invest in. The tariff is therefore used to fund cost-effective habitat creation projects according to local and national conservation and natural capital priorities.

Source Defra

## New land use opportunities

The key to successful offsetting is the effective application of a “mitigation hierarchy”

The principle of delivering a net environmental gain (NEG) on all new development was included in the 25 Year Environment Plan published last year. NEG is an adaptation to the planning system that seeks to ensure that new developments do not negatively impact on the environment, but also seeks to utilise planning gain to finance investments in environmental improvement. The Chancellor confirmed in the Spring Statement in March 2019 that plans for making NEG compulsory would be brought forward for inclusion in the 2019 Environment Bill.

Currently, NEG is optional for planning authorities, with approximately 77 out of 340 committed to delivering the concept. Defra consulted in December 2018 on the broader application and operation of NEG for all residential, commercial and infrastructure developments. The Defra consultation describes how the NEG process should work. Any planning site should first be subject

to a habitat survey, and the data from this used to populate a biodiversity metric. This metric illustrates how biodiversity impact can be first avoided, and then creates a credit for net gain that can be delivered on the same development site or close by. Delivering on-site maintains habitat connectivity and ensures that communities impacted by development do not lose green space. Early pilots of NEG highlighted that the key to the success of offsetting was the effective application of this “mitigation hierarchy”.

Defra’s vision, as shown above right, is for three different offsetting scenarios depending on the level of avoidance and mitigation deliverable on site or nearby. Under Scenario C, a tariff to pay for habitat creation elsewhere is created to compensate for a lack of local opportunities. It is off-site mitigation that may present an opportunity for landowners looking for private opportunities to deliver environmental goods.

Defra is trialling a more accessible version of the NEG metric that will be launched later this year. The metric enables both the impact of the development and proposed improvements to a landscape to be quantified. A private contract between the developer and the landowner sets up a long-term agreement (25-30 years) for the management of land that delivers the required NEG. There is a bias in the metric to this being delivered locally to the development, but given the scale of development predicted in some areas this is likely to create high levels of demand and push the offsets needed further afield from the original site.

The accountability of the offsetting contract is key to the successful delivery of NEG, both in terms of ensuring that the predicted environmental gain is delivered, and in preventing the same site from being endowed for the same environmental improvements more than once. The concept of environmental services,

however, means that there could be multiple buyers for multiple services from the same piece of land, and therefore careful drafting of the NEG contract is crucial to prevent other uses being excluded.

For landowners interested in NEG opportunities, the first step is to consider what biodiversity is present on the farm and what improvements could be delivered by changing the management of the land. This could be as straightforward as converting bare arable land to semi-improved grassland, or more complex habitat restoration schemes. Working with local ecology or wildlife experts is necessary to create an environmental gain plan that creates and quantifies the “units” that are recognised under the Defra metric. Careful brokerage of these units into the developers is then needed to ensure that the best price and contract terms are received for the landowner in a manner that delivers maximum advantage to the developer and planning authorities.



### **Savills Research**

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