



Agricultural rents

Market overview

In recent months the format of post-Brexit farm support has become clearer, and profitability has improved in the arable sector, which could lead to more rent reviews being triggered this autumn.

The proportion of agricultural tenancies that are being reviewed remains low, and the average outcome whilst still positive, has reduced from the highs seen in 2012 and 2013. These two factors combined mean that rental growth at portfolio level is low.

Part of the explanation is that landlords and tenants have been exercising caution due to the uncertain outcome and potential impact of the Brexit trade negotiations, and the Government's intention to refocus the priorities of farm support when they develop the UK's own agricultural policy. Direct payments will be replaced with a support system which rewards the delivery of public goods, especially environmental enhancements.

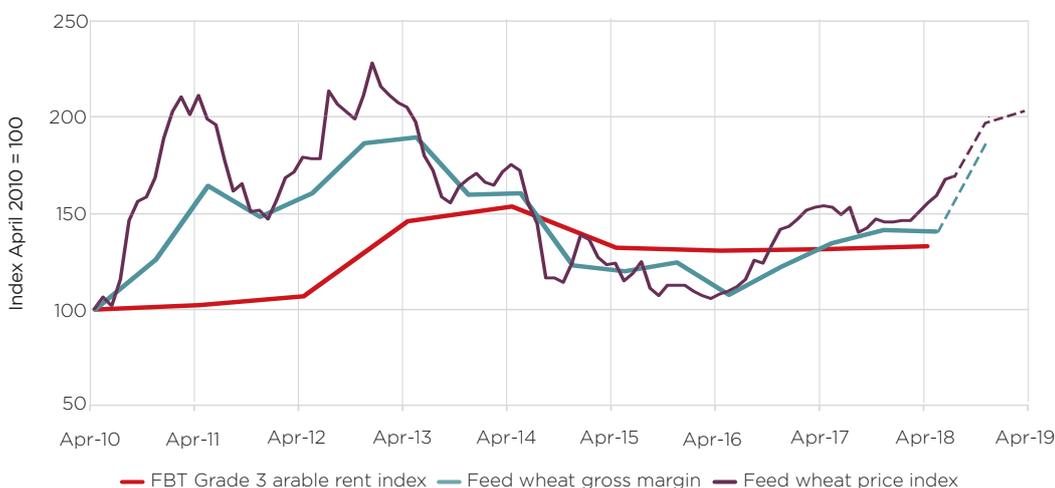
After Brexit in March 2019, the Government intends to continue a BPS like scheme for 2019 and 2020, then in 2021 a seven year transition period will start. During this time direct payments will be phased out,

with the last payments being made in 2027. In 2021, direct payments for all farmers will be reduced, but payments to larger farmers will be reduced by greater proportions.

Considering the significance of Brexit for agriculture, it is understandable that it has encouraged a cautious approach to rent reviews, however agricultural profitability has improved for many, after declining for three years. So the economic case for landlords to consider reviews is becoming stronger. Defra estimates that Total Income From Farming (TIFF) increased by 41% in real terms between 2016 and 2017. Price increases in the arable, livestock and dairy sectors have all contributed towards this. At £5.743 billion, the first estimate of TIFF for 2017 is the highest in real terms since 1996, although it is not unprecedented, 2013 was similar at £5.713 billion.

The reviews which were completed in the year to 30 April 2018 resulted in an average increase of 7% for Agricultural Holdings Act (AHA) tenancies, which is the same outcome as in 2017. For Farm Business Tenancies (FBT) on average the reviews concluded with a 11% increase in rent compared to 12% in 2017.

Figure 1 Relationship between arable rents and the gross margin of wheat crops



Source: Savills Research

Agricultural profitability has improved, after declining for three years

How do wheat prices affect rents?

Where reviewed, arable rents increased by an average of 6% during the year to 30 April 2018. Since then wheat prices have climbed due to lower cereal yields across the globe, and stocks amongst major exporters being at their lowest in a decade. UK November 2018 feed wheat futures reached a peak of £194.65 per tonne on the 8th of August. What impact is this likely to have on arable rents?

In spring 2011 and winter 2012/13 wheat prices also peaked, increasing the crop's

gross margin. Following this, the average FBT rent agreed for arable land increased (Figure 1). There is a clear time lag before the rent climbs due to the notice period required for a rent review. When the gross margin fell during 2014 and 2015 the average rent agreed also reduced, but remained above its 2010 average. At present cereal production is more profitable than in recent years, however current prices are below December 2012's peak of £216 per tonne ex farm, so whilst there

is potential for rent reviews to increase arable rents, the economic stimulus is not as strong as in 2012 and there is the added dimension of Brexit uncertainty.

That said, rents are reviewed on a case-by-case basis so factors such as the current rent, productivity of the land, and for FBTs, the strength of competition in the market, will affect the potential risk and reward of initiating a rent review for both parties.



Outlook

Moving forwards prospects look better for arable rents. On the other hand livestock farmers are currently farming in more challenging circumstances, the late spring lowered their forage and straw stocks, and the summer's drought has prevented them from being built back up. In fact low grass growth has forced some farmers to sell their stock early, which has in turn depressed the market price.

Whilst businesses are preparing for the impact of Brexit, crucial aspects such as our future trading arrangements with the EU remain uncertain. The prospect of departing the EU with no deal in place appears to have become more likely, although the Government remains confident tariff free access will be secured.

If a deal is not struck the UK will default to the World Trade Organisation rules. It is the 'no

deal' scenario which poses the biggest short-term challenges to the UK economy, in agriculture lamb producers are particularly vulnerable.

For agricultural policy we do at least know the direction of travel. Future policy and support schemes will have an increased focus on public money for public goods, especially environmental enhancements. Work developing the Government's new environmental land management scheme continues, it will provide an opportunity for farmers to recoup some of their lost support income.

Defra has recently extended its environmental scheme pilot projects in Wensleydale, Norfolk and Suffolk which pay farmers according to the environmental results they achieve.

Other elements of the proposals would affect land availability and rents, such as the intention that

direct payments during the transition period will be detached from land occupation to encourage retirement. This would be based upon a reference period and could include a lump sum payment rather than annual payments; at this stage we do not have any further detail on how this concept would be implemented.

Regardless, Brexit has already encouraged many to be more analytical about their business. Some farmers are choosing to retire or restructure how they farm, whilst others are expanding, resulting in strong competition when FBTs are tendered on the open market.

For both landlords and tenants the best course of action is to review their business interests and work towards ensuring they are resilient under any trade or support scenario.

Glossary:

AHA - Tenancies originally created before 1 September 1995, they have security of tenure and often have succession rights allowing the tenancy to pass to relatives. Due to their rent formula, rents are lower than for FBTs.

FBT - Tenancies agreed on or after 1 September 1995. Parties have greater freedom to negotiate terms, and the rent is normally open market.

For Brevity the "Year to 30 April 2018" is referred to as "2018" in this document, and "2017" refers to the "Year to 30 April 2017".

Savills team

Please contact us for further information

Rupert Clark
Estate Management
01798 345 999
rclark@savills.com

Johnny Dudgeon
Estate Management
01522 508 952
jdudgeon@savills.com

Andrew Teanby
Rural Research
01522 507 312
ateanby@savills.com

Ian Bailey
Rural Research
020 7299 3099
ibailey@savills.com

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