UK Rural - January 2023

The Farmland Market

SPOTLIGHT
Savills Research

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Supply is significant • Green capital investment • Demand and price forecasts

> **Boosting productivity is a core objective of government plans for adapting Great Britain's agriculture industry to a post Common Agricultural Policy world**

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The farmland market 2022

Supply of farmland has increased modestly and farmers are exiting the industry but in our assessment there won't be a step change in acres available

Relative to historic activity levels, supply for the GB farmland market remains low and continues to have a significant influence on the market's performance. Buyers with local or national requirements compete for the limited opportunities available in a constrained market. Encouragingly supply is increasing from its recent lows, which we have attributed to the uncertainty linked to agricultural policy reform and the impacts of Covid-19. There were 127,900 acres of farmland publicly marketed during 2022, which is the most since 2018.

While the overall national supply has increased, there is considerable regional variation (*figure 1*). On the one hand, in Scotland the farmland market was 16% smaller in 2022 than in 2021 and in the East and West Midlands it was 29% and 7% respectively below the previous year. Over the last few years supply has been particularly constrained in the West Midlands – just 7,100 acres were advertised in 2022 – the lowest area since 2004.

On the other hand, supply levels were exceptional in the East of England, Britain's "breadbasket" where 84% of farmland is mainly used for cereals or root cropping. In the region 67% more acres of land were marketed than in 2021 and 22% more than the 10-year average. There were more larger properties on the market, including 13 properties over 500 acres compared to a 10-year average of seven properties.

EXIT OR ADAPT

Boosting productivity is a core objective of each government's plans for adapting Great Britain's agriculture industry to a post Common Agricultural Policy (CAP) world. In England the agricultural transition with its Farming Investment Fund, Future Farm Resilience Fund, Lump Sum Exit Scheme (LSES) and progressive withdrawal of direct farm support was designed to encourage farmers to review the viability of their businesses and adapt or exit.

This is undoubtedly happening. Applications for the LSES closed in September with over 2,000 received, representing 2.6% of England's farms, with a clear bias towards smaller farmers due to the £100,000 payment cap in place. According to Savills modelling, these applications cover 260,000 acres of land, which is 1.2% of England's agricultural land area, equivalent to 20% of Lincolnshire's agricultural land area or 50% of Hampshire's. Expressed in these terms it does not sound large, but, to put it in context, it is double the area of farmland that was offered for sale on the public market in England in 2022.

To access their tax efficient lump sum, these applicants must sell, let or transfer their land by 31 May 2024. The scheme will consequently lead to more farmland sales in 2023 as it is effectively the only marketing season available.

5% increase in farmland supply on 2021 levels

9.4% of farmers expect to retire within the next three to five years

26% of farmland sales in 2022 were to unlock funds for investing elsewhere

However, we predict that the amount of farmland for sale will not increase significantly because capital taxation policy continues to encourage its long-term retention and in most cases the farm is also the family's long standing family home, so ties are strong.

In our assessment the majority of retirees will meet the scheme rules by surrendering rented land to their landlord or if owned, transferring it to their successors, or renting it out under a Farm Business Tenancy. This is backed up by analysis of farm machinery dispersal sales in 2022 (*figure 2*); sale of the farm is only explicitly stated as a reason for the auction in 15% of cases, far more are due to retirement or a "change in farming policy" and it is often suggested the farm will be let or contract farmed.

A step change in land occupation rather than land ownership will therefore result from Defra's actions. In fact more retirements are expected than the LSES is facilitating; Defra's April 2022 Farmer Opinion Tracker survey found 9.4% of farmers expect to retire, pass on the business to the next generation or leave for other reasons within the next three to five years. The LSES and our farm machinery dispersal sales analysis confirms these intentions are becoming action, and some will no doubt lead to a sale of the farm itself.

Developments during the course of 2022 have strengthened the appetite for land ownership. It is now clear that the UK economy is heading into a recession and economic uncertainty tends to lead to the retention of real assets such as farmland. Supply fell 26% across Great Britain during the global financial crisis (December 2007-2009). There is also increased recognition, as a result of the war in Ukraine, that food, fibre and fuel, and the land that they can be produced on, are important resources. These factors potentially deter sales but also build demand. Given the extent to which the market is supply constrained, our agents reported sales for 20% over the guide price were not uncommon in 2022. Those who do decide to sell could benefit from this competition, so it is worth landowners giving serious consideration to whether continued ownership of farmland or perhaps disposal with the benefit of business asset disposal relief and reinvestment elsewhere better meets their objectives. Over a quarter of vendors in 2022 were selling to unlock money for investment into non-farming activities (*figure 3*).

Higher interest rates could also encourage sales. The average value of farmland is at an all-time high, offering an opportunity for investors to cash out profits and secure a fixed return on the capital released. Debt related sales due to poor trading performance or exposure to variable interest rates could become a factor too. For some farmers the growing cost of debt may lead to uncomfortable decisions about their future in the industry. While serviceability may be an issue with cashflow constraints caused by the agricultural transition, the average farm business gearing ratio is just 11%, suggesting most will have scope to accommodate the implications of an increase in their cost of debt, for at least a period of time. The pig and poultry sectors are under most financial stress, but tend to either have a limited land footprint or be part of a wider mixed enterprise that offers a degree of whole business resilience.

There are clearly a diverse range of factors influencing the area of farmland available for sale in the UK. Overall we expect more land to be brought to market than has been the case recently, and while ordinarily you would argue that an increase in supply could adversely affect land values, we consider this is unlikely given the current disparity between supply and demand. On that basis we forecast that farmland market activity will rebuild to 150,000 acres by 2024 and continue at around that volume out to 2027.

Reasons for farm machinery sales in 2022

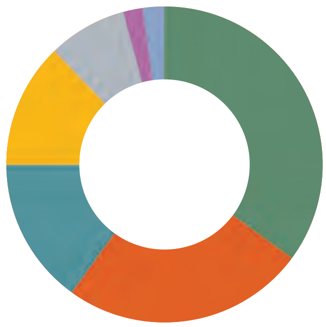

figure 2

Source Savills Research

Reasons for farmland sales in 2022

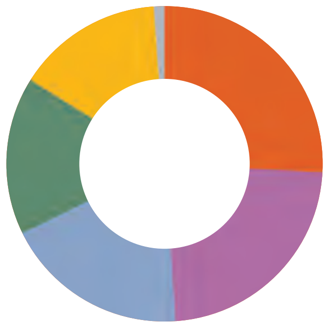

figure 3

Source Savills Research

Regional variation in market activity

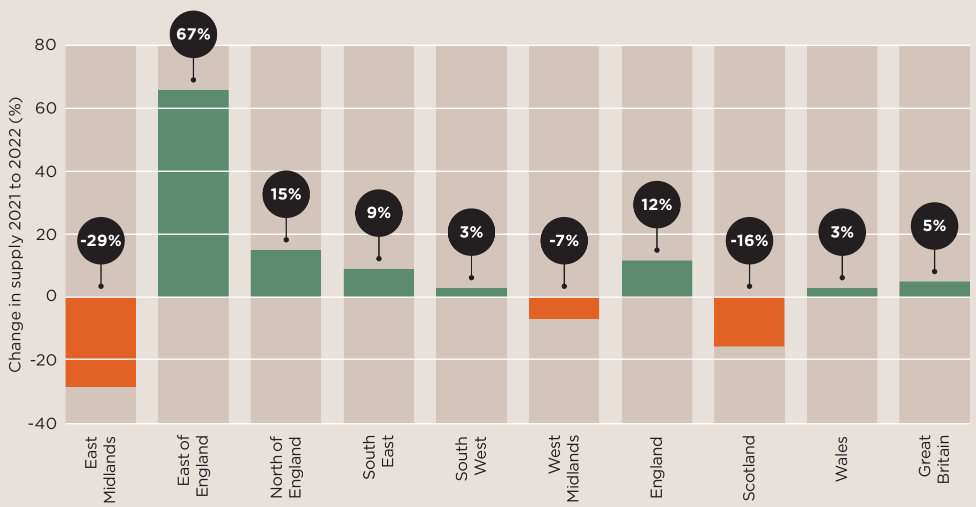

figure 1

Source Savills Research

> "The average value of farmland is at an all-time high, offering an opportunity for investors to cash out profits and secure a fixed return on the capital released"

x2
Sustainable fund growth is projected to double over the next few years

10%
minimum tree cover required by proposed farm policy in Wales

£44-£97bn
UK 10-year finance gap for nature-related outcomes

Appetite for investment into nature-based solutions

Creating scale, space and a pathway for private capital to invest into nature-based solutions is now essential to reverse land degradation

Environmental Social and Governance (ESG) investors were once considered a niche group. However, today investors are becoming increasingly concerned that extreme weather, climate change and ecosystem breakdown will impact business operations and the planet so they are adapting their portfolios in response. Asset managers globally are expected to increase their ESG-related assets under management to US$33.9 trillion by 2026 (21% of assets under management), which is a 46% increase compared to 2021 (PWC, 2022). This momentum will drive the market for nature-based solutions.

The UN has identified that nature-based solutions are still significantly under-financed. According to its calculations, current finance flows into nature-based solutions must double by 2025 and triple by 2030 if the world wants to halt biodiversity loss, limit climate change to below 1.5°C and achieve land degradation neutrality by 2030.

In the UK there is a funding gap of £44-£97 billion over the next decade to deliver the nation's key nature goals. Public and philanthropic funding alone will not be able to fill this gap, therefore accelerating private finance in nature-based solutions is paramount. However, post-CAP policy is diverging in its approach to private market development, highlighting the role government has to play in delivering for nature recovery.

WHAT IS GOVERNMENT DOING TO DEVELOP MARKETS FOR NATURE-BASED SOLUTIONS?

1 **Market standardisation**
Providing government-backed guidance on data monitoring, reporting and verification reduces market uncertainty – for example, the government-endorsed Woodland Carbon Code and Peatland Carbon Code, and funding the development of the minimum requirements for soil carbon codes. The principles for responsible investment in Scotland are also a type of market standardisation, intended to boost investor confidence. Government also has a critical role to play in establishing the regulatory baseline for land use – a high standard puts additional costs on land managers, but a baseline is needed to create fairness and prevent backsliding.

2 **Create demand drivers**
Direct regulation, for example introducing mandatory biodiversity net gain (BNG) and nutrient neutrality requirements, increases demand for nature-based solutions to unlock development. The Environment Act also introduces new water and waste regulation alongside the polluter pays principle, forcing water companies to consider innovative nature-based solutions. The taskforces on nature and climate related financial disclosures are examples of ways that government can nudge companies into creating environmental targets that increase demand for nature-based offsets.

3 **Controlled public investment**
(*figure 4*) Governments are committing to providing public money for nature-based solutions through a range of support schemes. These payments incentivise and regulate land management actions and outcomes, but poor design can risk undermining private markets.

4 **Government underwrites risk**
There are three key ways government can support emerging environmental markets by de-risking projects for early developers, investors and buyers.

■ *Price guarantees* – for example, the Woodland Carbon Guarantee, which provides a government-guaranteed base price for woodland carbon credits, but with the ability for project developers to sell to the private


Alan Morris / Shutterstock

> **Investors are becoming increasingly concerned that extreme weather, climate change and ecosystem breakdown will impact business operations and the planet so they are adapting their portfolios**

“As more investors are looking to purchase rural land, the demand is highest for land with the greatest nature-based solution income potential”

market instead if open market carbon prices exceed it.

- *Design stage/planning grants* – to improve the viability of a project, often used to support the proof of concept, establish a baseline or monitoring and verification system and develop a pipeline of projects. Examples include Peatland Action funding, the Investment Ready Nature Scotland Grant Scheme and the Natural Environment Investment Readiness Fund and Big Nature Impact Fund in England.
- *Concessional finance* – provided by public entities on more favourable terms in order to mobilise commercial capital. Concessional loans can include subsidised interest rates, first loss guarantees, impact-linked loans or results-based financing.

PUBLIC INVESTMENT INTO NATURE-BASED SOLUTION DELIVERY

England, Scotland and Wales are at different stages of post-CAP policy development, adopting varying approaches to supporting farmers and land managers to deliver nature-based solutions through funding support schemes. The governments also take different approaches to enabling blended and private finance to fund nature-based solutions. We analyse the approaches within *figure 4*.

National support strategies for nature-based solutions

Country	10 year finance gap for nature	Policy support for nature-based solutions	Initiatives to crowd in private finance
England	£21-£53 billion according to Financing Nature Recovery UK	Strong levels of public funding for nature-based solutions through Environmental Land Management schemes, Nature for Climate Peatland Grant Scheme and England Woodland Creation Offer.	Natural Environment Investment Readiness Fund, Woodland Carbon Guarantee and Big Nature Impact Fund.
Scotland	£15-£27 billion	Joined up public funding proposed within Scotland’s vision for agriculture to fund food production, climate change mitigation, emissions reduction and nature restoration. Funding schemes for woodland creation and nature and peatland restoration remain strong.	Desire to drive the development of high integrity private markets for nature-based solutions. Initiatives include the Interim Principles for Responsible Investment in Natural Capital and the Investment Ready Nature Scotland Grant Scheme.
Wales	£5-£7 billion	The Sustainable Farming Scheme targets on farm nature-based solutions; all farmers will be required to have 10% tree cover and actively manage 10% of their land to maintain and enhance semi-natural habitats.	A lack of initiatives for large-scale nature-based solutions that crowd in private finance in part due to a desire to deter large-scale afforestation. The government is instead focusing on direct funding.

figure 4 **Source** Savills Research

ADDITIONALITY: A BARRIER TO OVERCOME

When a nature-based project is accredited for the environmental services it delivers, there is a need to ensure that the credits issued represent real environmental improvement. To ensure integrity and efficiency in these markets, the nature-based project that generates the environmental services must be “additional”, in other words was not already being provided. A lack of clarity and consistency around what tests for additionality should be required is creating uncertainty in the marketplace, particularly where more valuable services (such as carbon sequestration) are not deemed to be additional to low value agricultural activity. Fundamentally, one piece of land delivers multiple services, and whether it’s meat, wool and milk from sheep grazing or biodiversity uplift, carbon sequestration and flood mitigation from tree planting, all of these services must be recognised and valued.

WHAT DOES THIS MEAN FOR LAND VALUES?

Despite government action to support the growth of private finance for nature-based solutions, there remains uncertainty around the viability of returns from environmental income streams. Therefore we are seeing a bias towards investors purchasing rural land outright rather than investing in specific nature-based projects. While land values on the whole benefit from this, there is growing evidence of strong competition for the largest properties where institutional-scale capital can be deployed, which has a positive impact on the values achieved for the owners of these properties.

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As more investors are looking to purchase rural land, the demand is highest for land with the greatest nature-based solution income potential. This includes land for afforestation and peatland restoration, as these projects are well supported by existing government schemes. Indicative of this is the rising value of poorer quality pasture land, most suitable for woodland creation, which has increased 12.4% since December 2021 and by more than any other type of farmland. Demand for land that can deliver nutrient neutrality and BNG solutions will be localised due to the mitigation hierarchy and catchment requirements that strengthen landowners’ negotiating positions. Greater clarity on soil carbon standards and the adoption of a pragmatic approach to additionality could unlock new funding into productive farmland.

Further governance and clearly defined first principles are needed to create better functioning nature-based income streams and shift the bias towards investing directly into solutions rather than speculatively into rural assets. No matter how this segment of the market evolves there will always be a role for investors to deliver more resilient, multifunctional and dynamic landscapes that the country requires.

> **Competition for commercial farmland was extremely strong last year and the season offered the prospect of high profits to arable farmers in particular**

The outlook for demand and farmland values

Constrained supply and competing demands provide resilience in the face of wider economic challenges and ensure that average farmland values remain high

One of the strengths of the farmland market is the diversity of types of buyer and investment motives in the market. At present, the main groups could be broadly classified as farmers, investors, rollover relief driven, environmental and lifestyle buyers, although many cut across these rather than belonging to a single group. While the relative strength of demand and rate of success in transactions from each group varies over time (*figure 5*) due to economic conditions and policy drivers, the market's supply and demand imbalance means demand remains dominant.

FARMERS

Competition for commercial farmland was extremely strong last year and the season also offered the prospect of high profits to arable farmers in particular. Good yields coincided with high margins: harvest 2022 crops had a relatively low cost base and commodity prices increased due to the war in Ukraine. Moving forwards, short-term prospects are more mixed and depend upon when key decisions were taken to fix the price of fertiliser and energy, or received for the grain. Despite the 57% elevated cost base, a budget prepared in May 2022 for a harvest 2023 winter feed wheat crop showed that a margin comparable to harvest 2021 was achievable (*figure 6*). Seven months later and feed wheat futures have fallen more than fertiliser prices so the projected margin is 60% lower.

Well-managed businesses will have more confidence in their financial resilience and ability to expand, for which there is a clear appetite. Defra's April 2022 Farmer Opinion Tracker survey found 15% of farmers want to expand their businesses and that the ambition was more than twice as likely among larger-scale farms than small ones (26% and 10% respectively). For many farmers bare land that can be bolted on to an existing farm is ideal because it avoids tying capital up in a house that may not be required, or farm buildings that are unsuitable for modern agriculture.

INVESTORS

Historically, rising interest rates reduce demand for farmland. During the 2008 financial crisis demand boomed after interest rates were cut to 0.5% in March 2009. Farmland then became more attractive to investors, offering a way to diversify portfolios with an income return unlike cash, which was eroding in value.

With interest rates expected to rise until the latter half of 2024, it is unlikely we will see a similar impact from the looming recession. In high interest rate scenarios, cash-funded investors can rely on interest rates for capital growth as opposed to alternative investments, resulting in a drop in demand for farmland.

Exchange rates, however, can strengthen demand from overseas investors; the pound hit a record low against the dollar after the sweeping tax cuts that preceded the end of Liz Truss' government. It has started to recover but still offers dollar-denominated buyers enhanced purchasing power. This could be most relevant in Scotland where American buyers often compete for sporting and amenity estates.

ROLLOVER BUYERS

House prices fell by 1.4% in November according to Nationwide, the greatest monthly fall since June 2020. Transaction levels are dropping and values are likely to continue to weaken until pressures on household finances start to ease. Developers are adjusting to reduced demand, which is likely to slow the rate of development land sales leading to fewer new "rollover relief" motivated buyers. Despite this, rollover buyers will continue to be a major force in the farmland market.

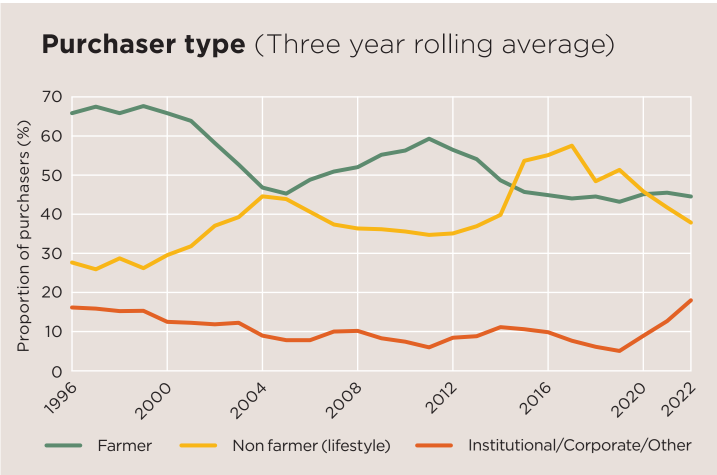


figure 5 **Source** Savills Research

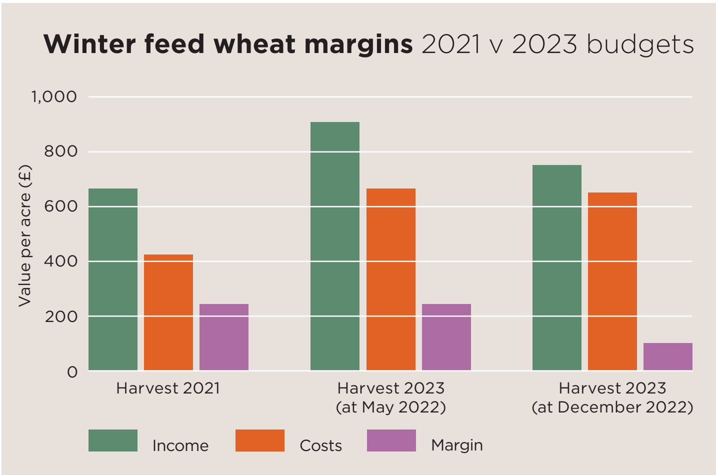


figure 6 **Source** Savills Research

> **With BNG in England becoming mandatory in November 2023, this is likely to be an increasing factor in values over the next five years, particularly for poorer quality pasture land**

12.4%
increase in the value of poorer quality pasture land during 2022

60%
fall in projected harvest 2023 wheat margin since May

6%
rise in grassland values per annum expected in the short term

Business asset rollover relief requires the new asset to be purchased within three years of selling or disposing of the old one (or up to one year before), which coupled with low farmland availability recently means there likely remains a pool of motivated buyers seeking to reinvest capital before their rollover deadlines pass.

ENVIRONMENT

Natural capital still provides a buzz around farmland, with tree planting, BNG, carbon markets and regenerative farming all increasing interest in the farmland market and policy actively welcoming the development of these sectors. Deep-pocketed investors, motivated by environmental and carbon outcomes, continue to chase scarce assets.

With BNG in England becoming mandatory in November 2023, this is likely to be an increasing factor in values over the next five years, particularly for poorer quality pasture land. Additionally, the markets for carbon sequestration in soil are building. While trees and hedges for carbon offsetting remain easier to monitor, the ability to stack funding on the same land parcels will be a real benefit as subsidy payments fall. Development of a Hedgerow Carbon Code is well advanced and a recent Campaign to Protect Rural England survey found 59% of farmers have planted hedgerows in the last 10 years and are likely to plant more in the next five years.

LIFESTYLE BUYERS

The activity of lifestyle or amenity buyers is correlated with the wider housing market, albeit influenced by additional trends such as the desire to move to the countryside prompted by Covid-19 lockdowns and increased flexibility over working location. As the housing market cools, demand from this group will do so too, making the quality, location and asking price of a property increasingly important to secure interest and buyers.

FORECAST VALUES

The most important factor in determining value is the relationship between supply and demand. While we anticipate supply to rise modestly, the demand for farmland remains high, with environmental motivations becoming more prevalent as the climate crisis deepens. Alongside this we expect the taxation benefits and long-term outperformance of inflation to remain significant factors, with pent-up demand insulating farmland values from the impact of the economic downturn.

Given this imbalance, it is no surprise that the average value of GB farmland increased by 8.9% in 2022 to £7,800 per acre – its highest since our research began. Nationally, prime arable land values increased by 8.7% to £10,000 per acre. The value of poorer quality pasture land experienced the largest increase in value during 2022, climbing by 12.4% to a record of £5,000 per acre. Regionally, the largest growth was recorded in Wales, the East of England, the South West and Scotland, all increasing by over 10%, demonstrating that natural capital and commercial agriculture focused opportunities are both in high demand. Prime arable land in the East of England is now on average worth over £10,000 per acre, having increased in value by 15.5% in 2022. This increase highlights the supply and demand imbalance, as supply was also high in the East of England, indicating that there is capacity for more supply without influencing prices.

With the exception of poorer quality pasture, national average land values unsurprisingly did not quite keep up with shock inflation during 2022, however farmland has a strong record of outperforming inflation over the medium and long term. With inflation anticipated to fall in 2023, we forecast real values for prime GB arable land will increase by an average of 2.5% per year and poorer quality pasture land by an average of 6% per year over the next five years (*figure 8*).

Current factors encouraging farmland sales and purchases

	Sell	Buy
Encourage	■ Strong competition for limited land ■ Opportunity to invest in other asset classes while their values are depressed ■ Lump Sum Exit Scheme ■ Agricultural Transition ■ Debt pressures ■ Commodity price outlook falling in real terms, higher costs, margins challenged	■ Expansion for economies of scale ■ Continued capital tax benefits ■ Demand for nature-based solutions ■ Biodiversity Net Gain ■ Nutrient neutrality ■ Lifestyle appeal ■ Backlog of rollover funds to reinvest
Neutral	■ Higher trading risk ■ Scottish and Welsh policy stability	
Discourage	■ Continued capital tax benefits ■ High short-term profitability ■ Guaranteed agricultural support budget	■ Improved interest on cash deposits ■ Higher cost of borrowing ■ Development land demand slowing ■ Falling residential values

figure 7

Source Savills Research

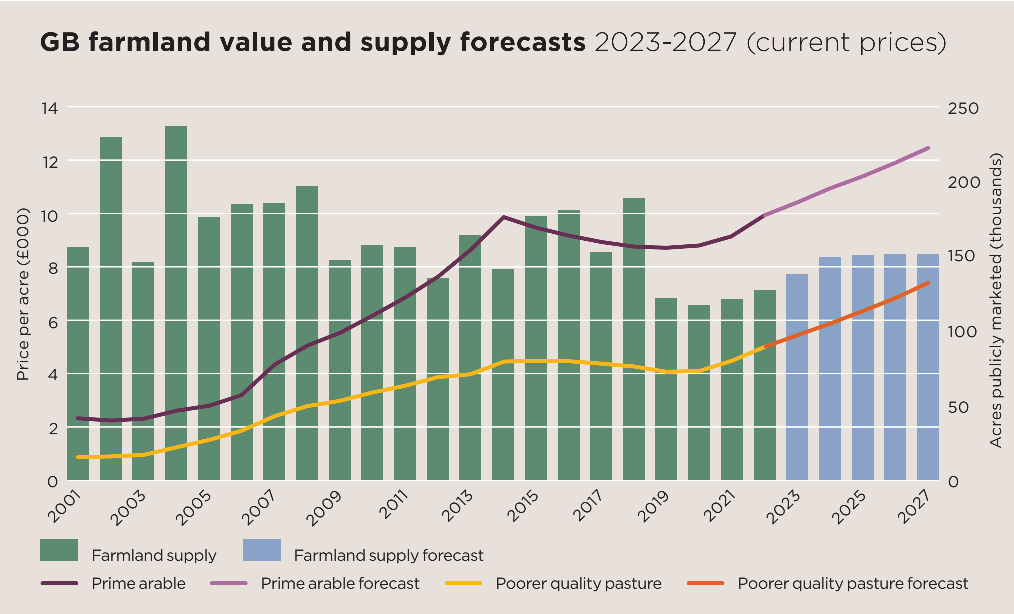
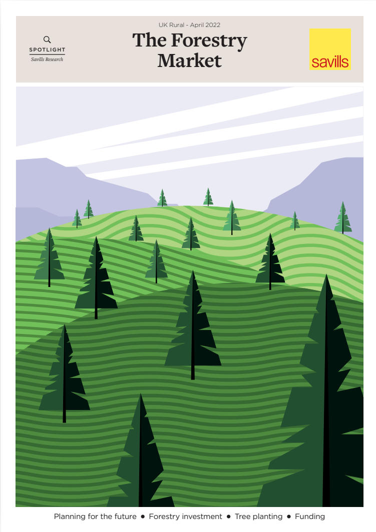


figure 8

Source Savills Research



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