UK Rural - September 2021

SPOTLIGHT
Savills Research

Future of Land Occupation

Drivers for change ● Future models ● Skillset evolution

£100k
In 2022 Defra will offer a lump sum payment of up to £100k to farmers in England who wish to exit the industry

36%
of all farm holders in the UK are over the typical retirement age of 65 years

All change please?

The end of agricultural subsidies is set to shake up the future use and occupation of land at farm and estate level across the UK

Land use in the UK is undergoing a major review and will result in seismic change. This is not just a result of the decision to leave the European Union and define our own agricultural policy for the first time in nearly 50 years. It is also because of a new national and international focus on climate change and biodiversity loss. These external drivers are forcing deep analysis into the future use and occupation of land.

In agricultural policy terms, Scotland and Wales have granted their farmers a period of stability, but change is inevitable after 2024. By contrast, in England Defra is actively seeking to change the structure of the agriculture industry in order to unlock sustainable productivity improvements and increase its competitiveness. This comes at a time when the demands on land and the accountability of its use are also changing profoundly.

An important debate is needed now over strategy to navigate these changes at farm and estate level, in order to prepare for decisions as and when policy details are known and market opportunities crystallise. Landowners need to review what they expect from the land for their own needs, what it is able to deliver to meet the new regulatory landscape and how it will be occupied in the future. In other words, what business structures are going to be needed to ensure required levels of control and viable occupation of their land.

To help bring some insight into this time of change, we tapped into the breadth of expertise within Savills to explore what changes are expected in land management and how it will be occupied. Our Future of Land Occupation Survey results are based on the experience, observations and opinions of 125 rural professionals from across the UK during June 2021.

PRODUCTIVITY PICTURE

Criticism of the Common Agriculture Policy often focused on the financial cushion it gave farmers, sustaining models of land occupation regardless of their true economic viability. Providing an income cushion to farmers was also felt to inhibit the uptake of innovation and research on farms and result in the over capitalisation of businesses. The English government hopes that by removing subsidy it will address these behavioural issues and help increase farm business productivity. Environmental Land Management (ELM) will play a part in driving uptake of new techniques, as the Sustainable Farming Incentive (SFI) pays higher rates for the adoption of precision farming techniques. There are already crops and products, including wheat and milk, where the UK is globally competitive. Developing more globally competitive sectors and businesses is one strategy that will enable UK agriculture to thrive in a more liberalised trading environment.

OUT WITH THE OLD

The UK policy revolution comes at a time when generational change is inevitable. Across the UK, 36% of all farm holders are over the typical retirement age of 65 years and the proportion is growing, up from 31% in 2005. Retiring from farming is not straightforward, nor encouraged by the rules that drive inheritance tax planning. However, the imminent regulatory change will lead to many succession or retirement conversations.

Defra's Farmer Opinion Tracker results from last autumn found that a quarter of England's farmers were not confident that they could respond to the payment changes and the regulations their businesses must follow; among tenants the proportion increased to a third. According to Defra's survey, 5% of farmers could retire within the next three to five years. During this period a further 3% expect to leave farming for other reasons and 6% expect to reduce the size of their business.

To test these findings, we surveyed our professionals on what they expect to happen on the land they manage as a result of the withdrawal of direct payments. As expected, a significant number of them believe owner occupier and tenant retirements will become more common in England (*figure 1*) and for any future withdrawal of direct payments to have a similar impact in Scotland too. The evidence suggests that more land will be coming to the market than in recent years, through both sales and new tenancies, as farmers retire and businesses restructure to meet new market and policy opportunities. Landowners will need to be ready to decide what to do with land that is coming back in-hand by taking a fresh strategic look at optimum farm size, boundaries of holdings and the provision of fixed equipment at estate wide scale.

Defra's survey found that 23% of farmers are planning to expand their businesses, suggesting an appetite for land coming onto the market, and our own understanding is that there are new and active buyers looking for land-based opportunities.

5%
of farmers could retire within the next three to five years, according to Defra survey

Expected impact of direct payment withdrawal on industry exits in England

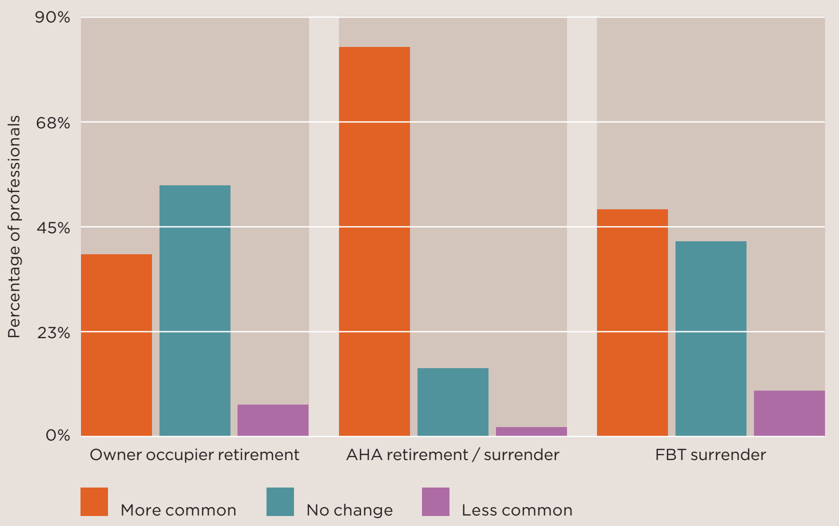


figure 1

Source Savills Research

> **Overall, our survey confirmed that the proposed scheme will benefit farmers who wish to retire, but is unlikely to tempt those who do not have retirement on the radar**

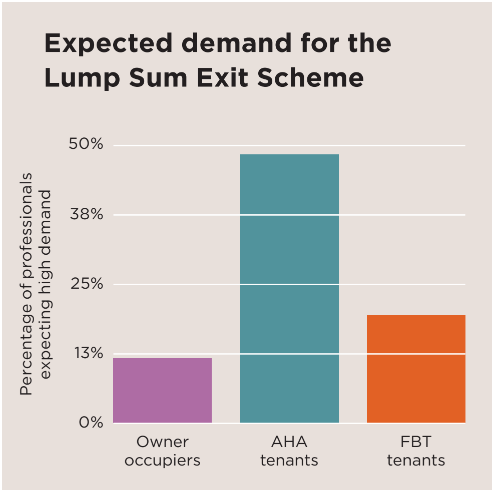


figure 2

Source Savills Research

England: a lumpy exit scheme

LSES will replace any further direct payments to the recipient

In 2022 Defra will offer farmers in England who wish to exit the industry a lump sum payment of up to £100,000. This would replace any further direct payments to the recipient during the remainder of the agricultural transition. It is suggested that the Lump Sum Exit Scheme (LSES) payment could contribute to the costs of moving somewhere new, if combined with funds from the sale of livestock or machinery and, for tenants, any payments they negotiate with their landlord. In a nutshell, farmers would be required to surrender their Basic Payment Scheme entitlements and then owner occupiers would need to either rent out, sell or transfer their land by gift, while tenants would need to surrender their tenancy.

We asked how popular these schemes are likely to be and found that demand for LSES payments will be strongest from Agricultural Holdings Act (AHA) 1986 tenants.

Half of our professionals expect demand within this group to be very high or high. Strong tenant interest is also backed up by a Tenant Farmers Association' (TFA) survey from earlier this year that found three quarters of tenants were seriously interested in the LSES and just over 40% considered it to be their only opportunity to retire from agriculture. Now the proposals have been released, George Dunn, TFA chief executive, has described the LSES as "scaled back but still having merit".

LSES payments will be less appealing to owner occupiers, with just 12% of our professionals expecting there to be very high or high demand from them. Unlike tenants, owner occupiers already have the option of selling land to generate a substantial windfall gain and have more options to retire while remaining in occupation of the land.

TOP FIVE LSES CONSIDERATIONS FOR TENANTS

1. Value of the payment
2. Total value of the retirement package (including any landlord contribution)
3. Cost of suitable alternative housing
4. Readiness to retire
5. Business viability

TENANT RETIREMENTS: INGREDIENTS FOR SUCCESS

Planning, co-operation and good communication between both parties will be essential for tenants to make successful LSES claims. Landlords and tenants should begin discussions early and be clear about what each party wants to achieve and the funds this will require. Future housing is key to unlocking retirements and an early priority for discussion. It could be feasible for a tenant to remain in a home on the farm at a reasonable rent. Both parties should also ensure they understand the taxation implications of the scheme and tenancy surrender.

Overall, our survey confirmed that the proposed scheme will benefit farmers who wish to retire, but is unlikely to tempt those who do not have retirement on the radar. It will be particularly attractive to smaller farming businesses and those making a trading loss as it can put them in a better exit position overall. After the LSES opportunity has passed, exits from the industry are likely to continue to increase, driven by debt. The LSES is likely to have a greater long-term impact by being the catalyst for retirement discussions even if they do not manifest in 2022 as applications to the scheme itself. See our LSES briefing note for further details, *https://www.savills.co.uk/landing-pages/landscope/ExitScheme.pdf*

SCOTLAND: RELINQUISHMENT RIGHTS

Earlier this year Scottish tenants with a secure Agricultural Holdings (Scotland) Act 1991 tenancy gained the right to relinquish it in return for a payment from their landlord based on a prescribed valuation methodology. If their landlord does not wish to buy the tenancy, the tenant can assign it for a value to a new entrant or a progressing farmer who meets the Scottish government's criteria. The majority of Scottish respondents to our Future of Land Occupation survey think that the relinquishment and assignation rights will increase the retirement rate of 1991 Act tenants.

In most cases, they expect an informal agreement to be reached between the parties that respects the principles set out in the legislation, rather than following the prescribed procedure with its strict deadlines.

Compared to the English exit scheme, the Scottish process formalises the valuation of the tenant's interest and has a built-in mechanism to generate opportunities for young people to enter the industry. In England, Defra has not yet linked its exit and new entrant policies, which could prove to be a wasted opportunity.

> For private landowners, a primary driver in the decision-making process will still be inheritance tax

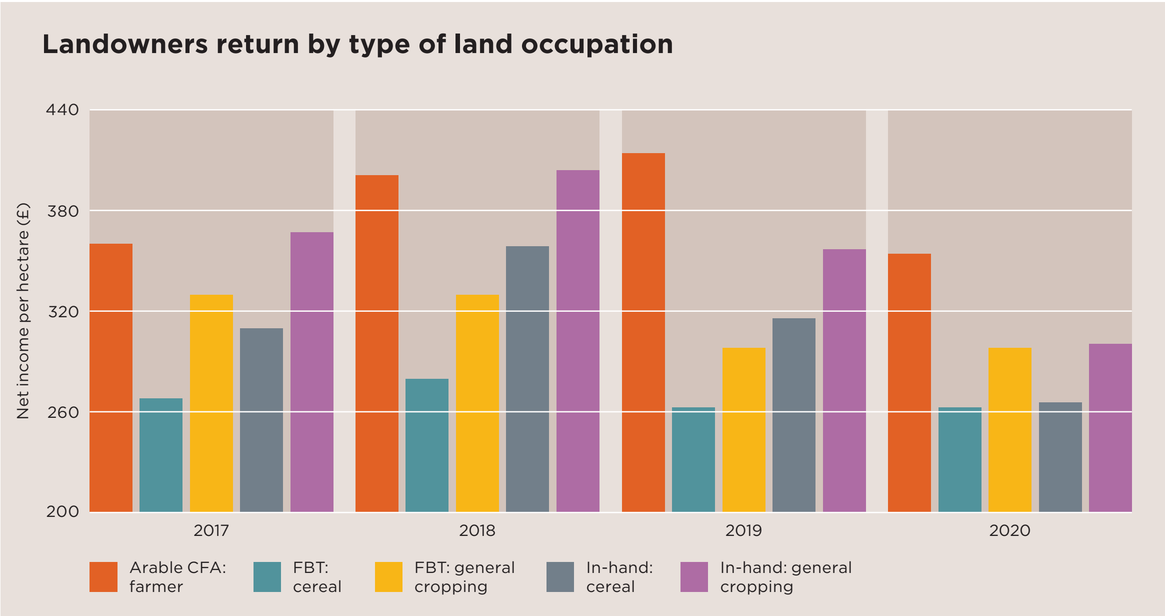


figure 3

Source Savills Research, Defra

In with the new... future models of land occupation

The different factors driving the decision-making of landowners

Considering which model of land occupation best meets a landowner's needs and objectives is an obvious process to go through when a tenancy expires or a farmer retires. But it is a question that should also be asked to challenge the status quo. How is the "in-hand" farm on an estate best managed? Could a new model cut a farm's fixed costs or give it better access to new policy opportunities in land management? How can land occupation decisions support social and environmental objectives as well as secure financial ones?

We asked our professionals about the different factors driving the decision-making of private landowners and institutional/corporate landowners regarding models of land occupation.

PRIVATE LANDOWNERS

For private landowners, a primary driver in the decision-making process will still be inheritance tax. This is understandable as the income return of the asset is low relative to the potential tax exposure at 40% of the capital value, so it is important that the occupation model adopted does not jeopardise eligibility for any reliefs. In addition to the fiscal incentives in Scotland, the programme of Land Reform is also a key influence around future structures. As a result of these underlying drivers, for private landowners in both England and Scotland, our professionals expect their top recommendation to be joint venture agreements, which are likely to be Contract Farming Agreements (CFA), followed by a Farm Business Tenancy (FBT) in England or a Short Limited Duration Tenancy (SLDT) or Modern Limited Duration Tenancy (MLDT) in Scotland.

In most instances, both well-structured CFAs and FBTs will currently qualify for Agricultural Property Relief from inheritance tax on the agricultural value of the property. CFAs offer the additional advantages over FBTs that they generate trading income rather than investment income and any development hope value would be covered by Business Property Relief (BPR) too. Due to these distinctions our professionals continue to expect to recommend joint venture farming agreements such as CFAs and share farming agreements in preference to FBTs. Increasing the proportion of trading income within a rural estate can help strengthen a claim for BPR under the precedent set by the Balfour Case. The use of BPR is an alternative approach for estates and can cover agricultural and some non-agricultural property. The strength of any potential claim can be assessed and monitored using the Savills Balfour Matrix. *For further information please contact Clive Beer, Head of Rural Professional Services, cbeer@savills.com*

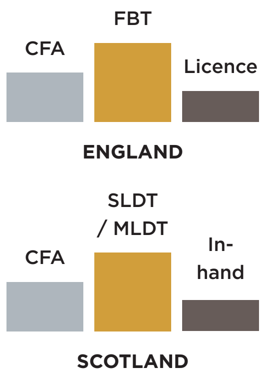
Where a CFA is created it is important that the landowning farmer is actively involved and bearing trading risk. We expect that farmers will lead the development of their ELMs' land management plan to shape and steer the overall environmental delivery work on their holding. They will need to ensure the contractor they select has the precision farming equipment required to match their ambition within the SFI.

INSTITUTIONS, CORPORATES AND CHARITIES

For institutional and corporate landowners, financial factors remain important even as social and environmental factors rise up the landownership agenda: our survey found the level and stability of return is still the most important factor. Nine out

TOP THREE MODELS FOR PRIVATE LANDOWNERS

TOP THREE MODELS FOR INSTITUTIONAL AND CORPORATE LANDOWNERS



£382

Farmers' average net income per hectare from arable CFAs between 2017 and 2020

8.7

Tenancies publicly marketed between 2016 and 2020 were offered with an average term of 8.7 years

86%

of our professionals reported that landlords are seeking more influence over tenants' environmental management within new lettings

of 10 of our professionals think that tenancies will continue to be the leading recommendation to institutional and corporate landowners. Investment objectives vary, but will usually require income to be at full commercial rates and favour predictable income streams from property to meet their own financial commitments. Of the options available, rental income is most stable and predictable (*figure 3*), but average rents are typically lower compared to CFAs and in-hand farming, which carry more risk and require skills that the owner may not be willing to invest in.

WHAT ARE THE KEY FACTORS INFLUENCING MODEL OR AGREEMENT SELECTION?

PRIVATE LANDOWNERS	INSTITUTIONAL AND CORPORATE LANDOWNERS
1 Inheritance taxation	1 Level and stability of return
2 Trading income needed	2 Degree of risk
3 Level and stability of return	3 Access to natural capital income streams
4 Access to natural capital income streams	4 Lower direct involvement
5 Seeking influence on land management	5 Seeking influence on land management

TIME FOR LONGER TENANCIES?

Ireland has successfully used tiered income tax breaks to expand its tenanted sector and encourage longer tenancy term lengths. This has led to calls for similar intervention in the UK. The factors that deter longer tenancies in England, Scotland and Wales have been well covered and persist. They include taxation, registration requirements and the impact on property values. Equipped holdings will typically form the base of a business, so logically term lengths are longer; tenancies publicly marketed between 2016 and 2020 were offered with an average term of 8.7 years. For bare land, the term offered was shorter, averaging 3.8 years. As the industry increasingly recognises the importance of good soil health, there are compelling arguments for increasing term lengths to ensure the long-term stewardship of the asset. Conversely, in order to have liquidity in the let land market, a clear structure of short starter farms (up to 5 years), longer progression tenancies (10-15 years) and longer term full-time tenancies (up to 25 years) may be the optimum solution to allow new entrants and successful farmers to thrive.

A future for environmental tenancies?

The motivations for holding land as an asset are changing as a result of land ownership accountability, agricultural policy reform and net zero agendas. For some landowners, their inability to influence tenants' behaviour is frustrating; in other situations, a tenant's desire to improve their holding through environmental management or diversification is limited by the terms of their tenancies. To capture this changing picture, we surveyed our professionals on how land is being let to influence or control environmental management.

Overall, 86% of our professionals reported that landlords are seeking more influence over tenants' environmental management within new lettings, but there is evidence of a split between ownership types. Of our professionals, 60% said that environmental concerns of private landowners are influencing their rural asset management, with the core challenge being how to balance these with financial performance. A proportionate approach to tax reliefs is inhibiting environmental delivery, due to the need to ensure sufficient trading or agricultural activity to qualify for the reliefs. Based on the current rules, eligibility will become more challenging where outcomes are purely environmental. To overcome this, urgent clarity is needed from government on the extent that land use and management can evolve in line with government environment and net zero policy without undermining eligibility for these important reliefs.

In comparison, 90% said the ESG policies of institutional/corporate landowners are influencing their rural asset management. The central conflict in improving environmental outcomes for these owners is the tension between a traditionally hands-off approach and the need to show land use change or receive land management data that meets their investment disclosure requirements, while others hope to satisfy their embedded corporate carbon offsetting demands from within their portfolio. Reconciling ambition from within portfolios of AHA tenancies is one of the biggest issues, as these protected tenancies are the most resistant to influence and change.

Within new tenancies careful thought should be given to the ownership, rights and benefits of carbon. We need to consider how it can be generated, what guarantees the market requires and how these can be met within the context of a tenancy. High quality carbon offsets require sequestration to be permanent and tenants are often unable to guarantee this. If the tenancy agreement allows the tenant to sell credits then this income stream could be partially rentalised, and where the landlord requires credits a right of pre-emption may be an option. Interactions with supply chains is another factor, as buyers are increasingly asking farmers for carbon information.

KEY CRITERIA OF A QUALITY CARBON OFFSET

- Real
- Additional
- Quantifiable
- Permanent
- Verifiable
- Enforceable

Landowners need to have a clear strategy on this. For example, if an estate has a let dairy farm, this farm may now need additional land to achieve net zero milk production. If the estate does not structure the let farm accordingly, its viability may be undermined. Alternatively, if the landowner wishes to be able to claim the value of any carbon sequestered in the land, any tenancy occupation needs to reflect this.

The Tenancy Reform Industry Group's new Code of Good Practice for England and Wales and guidance published by the Tenant Farming Commissioner in Scotland are welcome resources to help the tenanted sector adapt to the new policy and economic environment.

6 in 10
of our professionals expect the agricultural transition to generate more opportunities for new entrants

88%
of our professionals believe they will look for new and different types of tenants and business partners in the future

Occupiers of the future

There is an urgent need for innovation, as well as new thinkers and doers

The future of farming and rural land is facing era-defining changes. In order to fully prepare for this, the sector will need new skills, ideas, business models, thinkers and doers. Rural land has always been valued for its multiplicity of uses, but as these uses evolve to meet new agendas, businesses will require different and new skillsets. This creates an opportunity to diversify and grow the UK's rural workforce and develop innovative models of occupation. Of our professionals, 88% believe they will look for new and different types of tenants and business partners in the future on behalf of their landowning clients. In particular, our survey found six in 10 professionals expect the agricultural transition to generate more opportunities for new entrants to farming.

THE GROWING SKILLS GAP

Farmers in the 21st century need to be practical, tech savvy and business minded. They have to be hard workers and able to withstand climate, policy and market unknowns. Savills rural professionals were asked what type of tenant or business partner they will be looking for in the future, their responses identified several key themes. First, future rural business partners will need to be flexible, entrepreneurial, innovative and forward thinking. They will need a broader skills base than traditional farmers, be able to think outside the box, willing to drive change with diversified and alternative income streams and, crucially, be commercially minded.

Another key theme is that future tenants or partners will need to be open to working closely with landowners in a collaborative approach. Respondents agreed that those who can see the bigger picture and adopt a more holistic approach to land management will be important. Finally, many respondents highlighted the need for business partners with environmental skills, able to leverage natural capital opportunities and drive forward on-farm sustainability, tapping into new ESG markets.

Encouraging new entrants with new perspectives and skillsets into the rural sector is an obvious way to fill this growing skills gap. The fact that farming is often understood as a family-based livelihood that people grow up within and eventually take on, and that UK farmland is so rarely exchanged (over the past 10 years, on average 0.4% of UK agricultural land was publicly traded annually), means that access for new entrants into the rural sector has not been easy. Addressing this is critical for the long-term success of the agricultural industry.

BARRIERS TO ENTRY

The main barriers for new entrants are access to land, finance, and relevant training. The capital required to start a rural business is a significant hurdle to overcome. When land becomes available, landowners often favour tenants who have a track record of agricultural experience and an established business in order to de-risk their side of the relationship. Aspiring new entrants should look to gain as much experience as possible prior to applying for a full tenancy opportunity. At the same time, landlords should review their appetite for risk and then determine a broadminded strategy as a result.

CREATING A BUSINESS CASE

In order to increase accessibility for new entrants, positive support is needed, but it is not always available. Of our professionals, 37% said it's common or very common for land managers to support new entrants or younger farmers when selecting tenants, whereas 20% said it's rare or very rare. Understanding the motives of the landowner is, therefore, essential to whether a new entrant is given a fair opportunity. Our professionals advise that while passion, flexibility and entrepreneurial flair are important, to compete against established players, a well presented, knowledgeable, competitive and realistic business plan is also essential.

PRIORITY SKILLS FOR NEW ENTRANTS

1. Business management skills
2. Agricultural skills and knowledge
3. Financial management
4. Practical agricultural experience
5. Innovation and entrepreneurial drive
6. Environmental skills and knowledge
7. Marketing skills

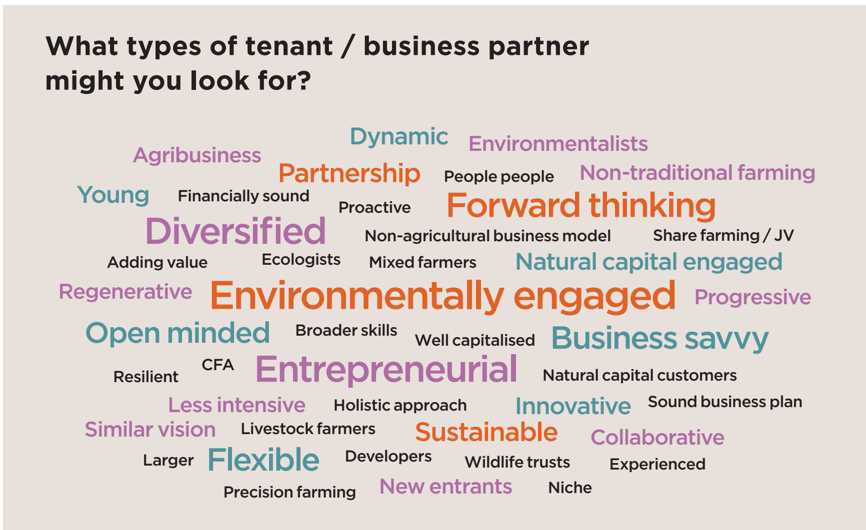


figure 4 **Source** Savills Research

> **“If the skills, business models and enterprises adopted within a landowner’s portfolio are not diverse, there may be more exposure to market or policy failure”**

The solutions

Support and incentivised schemes are key to attracting new entrants

Defra will launch a New Entrant Support Scheme in 2022, which is expected to focus on building entrepreneurial skills in new entrants. Our professionals suggested some other ways the government could incentivise and support new entrants. Common proposals included offering capital grants, financial assistance, loan support and guarantor schemes. Education, training and mentoring were key suggestions, as well as a national apprenticeship scheme and tax incentives for landowners to take on new entrants too. Existing sector-based schemes such as Yorkshire Water’s Next Generation Farming Programme and Fresh Start Land Enterprise could also be candidates for support and expansion.

Encouraging new entrants into the sector also relies on a mind-set change from landowners. As one Savills manager explained, “If objectives are to maximise return or to take the ‘safe option’ new entrants will always be second on the list. If objectives are to encourage new entrants, fresh ideas and innovation it may encourage new entrants but it would likely result in a higher risk and potentially a lower income.” Risk exists on both sides of this equation though. If the skills, business models and enterprises adopted within a landowner’s portfolio are not diverse, there may be more exposure to market or policy failure. Value may be gained by ensuring new ideas and skills are brought into the mix. Starter units, training and apprenticeships were suggested solutions as to how landowners can increase access to the rural sector.

Innovative occupation structures such as share farming or joint bids are viewed as possible solutions for new entrants to join the industry without the need for significant capital expenditure. However, our survey found that share farming is often considered too complicated due to the administration and collaboration it requires, compared to the contractual simplicity of a CFA. The Welsh government has set up Venture, a scheme designed to match new entrants with farming retirees, offering mentoring, business planning and legal advice to provide guidance in establishing joint ventures. More examples of successful share farming, blended occupation and joint ventures are needed in order to help the industry transition to a more vibrant land occupation future.

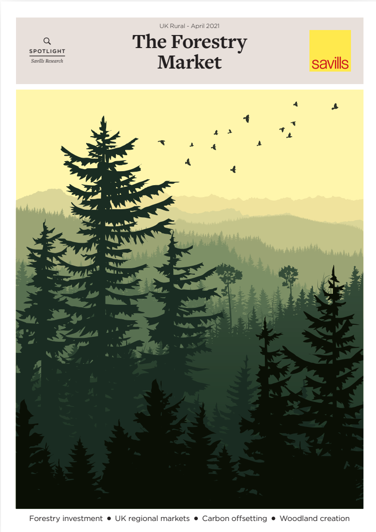
CHALLENGING THE STATUS QUO

Kingsclere Estates in north Hampshire is creating innovative solutions and business models to challenge the status quo of traditional land occupation. The owners want to build a circular community of growers, farmers, producers, start-ups and established businesses to make the most of its 2,500 acres of mixed-use land. Their vision is to regenerate the estate for a fertile future by improving its health and wellbeing, increasing the quality of produce and reconnecting with local people. Kingsclere is a pioneer of enterprise stacking, with a group of partners who run different businesses on the same land – sheep farming, a roaming dairy, pasture-raised chickens, mountain bike adventures, a counselling service that focuses on nature, and a site for woodland burials. The next venture from Kingsclere is called Pitch Up! which is running in November 2021 and will provide an opportunity for people with innovative sustainable business ideas to join the estate as a partner. Those selected will be offered a range of support including land, industrial space, raw ingredients, by-products and waste, low overheads and shared running costs, as well as business advice, administrative and marketing support. Through this initiative Kingsclere hopes to disrupt the norms of commodity-focused farming and encourage innovative and more diverse approaches. We can expect to see other entrepreneurial landowners follow suit with innovative ways of matching environmental and biodiversity improvements with a changing approach to the way in which their land is occupied and by whom; creating a healthy and mutually beneficial relationship for all, to ensure that they are fit to meet the future challenges that lie ahead.

Kingsclere ESTATES GROWING POTENTIAL

ENVIRONMENTAL PARTNERS

Of our professionals, 50% believe that environmental skills and knowledge will be very important attributes when selecting a new tenant. Land managers are increasingly wanting to leverage land’s natural capital through income from nature-based carbon sequestration, biodiversity uplift and water catchment management, among other natural capital opportunities. These environmental-based income streams can be layered on top of food and fibre production (for example, through regenerative agriculture). However, using tenancies to enable environmental management is tricky. The long term nature of environmental uplift is not conducive to short term tenancies, and deciding who owns the value uplift can be difficult. There needs to be innovation in how environmental services might be provided – licences, contracts or collaborative enterprises may be a better solution than a traditional tenancy. There is no doubt that landowners have the ability to bring together a wide range of stakeholders and this will be essential in order to deliver joined-up, effective environmental provision.



Savills Research

We're a dedicated team with an unrivalled reputation for producing well-informed and accurate analysis, research and commentary across all sectors of the UK property market.
To view copies of our previous Spotlight publications, go to **www.savills.co.uk/insight-and-opinion/**

Andrew Teanby
Rural Research
+44 (0) 7835 445 458
ateanby@savills.com

Rupert Clark
National, Estate Management
+44 (0) 7768 708 227
rclark@savills.com

Andrew Wraith
National, Food and Farming
+44 (0) 7801 277 376
awraith@savills.com

Emily Norton
Head of Rural Research
+44 (0) 7807 999 204
emily.norton@savills.com

Mark Fogden
Scotland, Estate Management
+44 (0) 7768 708 279
mfogden@savills.com

Andrew Macdonald
Scotland, Food and Farming
+44 (0) 7970 033 583
andrew.macdonald@savills.com