UK Rural - January 2021

SPOTLIGHT

Savills Research

The Farmland Market

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Market update • Farmland forecasts • Agricultural policy

80%
of 2020 farmland supply was launched from June onwards

114k
acres brought to public market during 2020

17.5%
rise in poor livestock land values in Scotland due to forestry planting demand

The farmland market 2020

Farmland supply remains at a record low, but encouraging market activity saw farmland values edge higher

As the market emerged from winter hibernation into the first Covid-19 lockdown, it was May before activity levels gained momentum. A busy summer period saw the market recover surprisingly well as simmering pent-up demand now matched a backlog of supply. This split in activity saw 80% of publicly marketed supply launched from June onwards, as society adjusted to a new way of life and confidence in the market returned.

Despite the late surge, publicly marketed farmland supply set a new record low for the second consecutive year. Ongoing uncertainty relating to Brexit trade negotiations and agricultural subsidy reform, coupled with the Covid-19 lockdown, understandably reduced the confidence of potential sellers, with many continuing to delay major decisions until detail and clarity in the future business environment improves.

Some market sub sectors attracted strong interest. Lifestyle and amenity farmland was particularly sought after as Covid-19 increased the desire for more space and indeed more green space. Rural estates with diversified revenue streams and notable residential components were also in demand. Scotland and northern England saw a growing appetite for greenfield forestry land as the increasing presence of new environmentally-motivated buyers begins to strengthen. In contrast, more commercial lowland farms saw mixed results, with a wide variety of prices achieved based on quality, location and local competition.

VALUES TO DECEMBER 2020

Average farmland values remained remarkably resilient for 2020 showing no impact from the wider economic uncertainty. Results from the Savills Farmland Values Survey showed average values across all land classes

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in Great Britain increased for the 12 months to December 2020, with our average “all land types” indicator finishing up 0.7% at £6,740 per acre.

Average prime arable and Grade 3 arable values were up almost 1% at £8,800 per acre and £7,360 per acre respectively. Prime dairy land was unchanged at £6,770 per acre, with Grade 3 livestock finishing 0.7% higher at £5,420 per acre. Among the lower quality land types, poor arable rose 1.1% to £6,620 per acre with poor livestock up 0.7% to £4,110 per acre. Interest has been building at this end of the market over the last couple of years as environmentally-motivated buyers begin to compete for land with forestry planting potential. This is particularly evident in Scotland where poor livestock land values increased some 17.5% during 2020.

As we have noted in the past, the market continues to see a wide variety of results either side of these averages as property quality, local demand and other special purchaser motivations may have a greater influence on buyer sentiment, particularly where supply is limited.

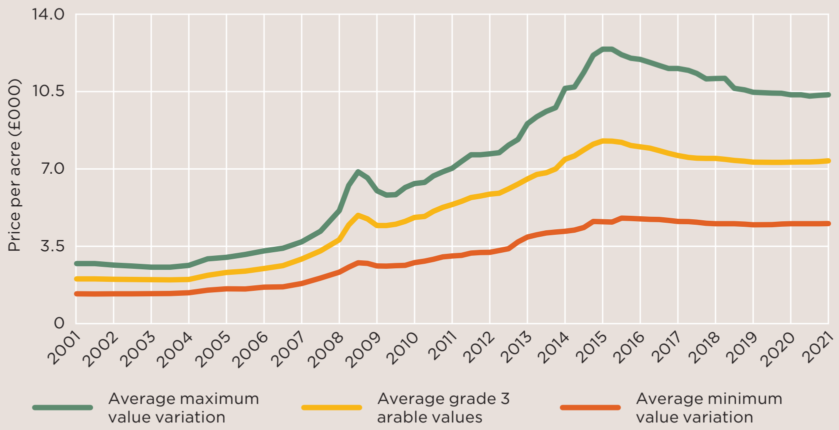
SUPPLY TO DECEMBER 2020

For the second consecutive year farmland supply was at a record low: just 114,000 acres of lowland were bought to the public market for 2020. This undercuts last year’s record of 122,000 acres and is the lowest since Savills started tracking the farmland market in 1993. Last year’s farmland supply was 7% down on 2019 and 31% down on the five year average.

The difference was greatest in Scotland where supply was 57% down on the five year average. However, the majority of regions saw supply decline by between 20-40% based on this metric. Wales was the one exception. Supply exceeded the five year average by 14%, albeit off a comparatively smaller base.

Analysis of lowland farms above 50 acres brought to the public market suggests that the average farm size sold was 160 acres, approximately 25% smaller than the average farm size of the previous 10 years. The average was low last year too, at 174 acres. The recent reduction in average marketed farm size is likely to be due to a higher proportion of lifestyle and amenity properties being marketed in 2020.

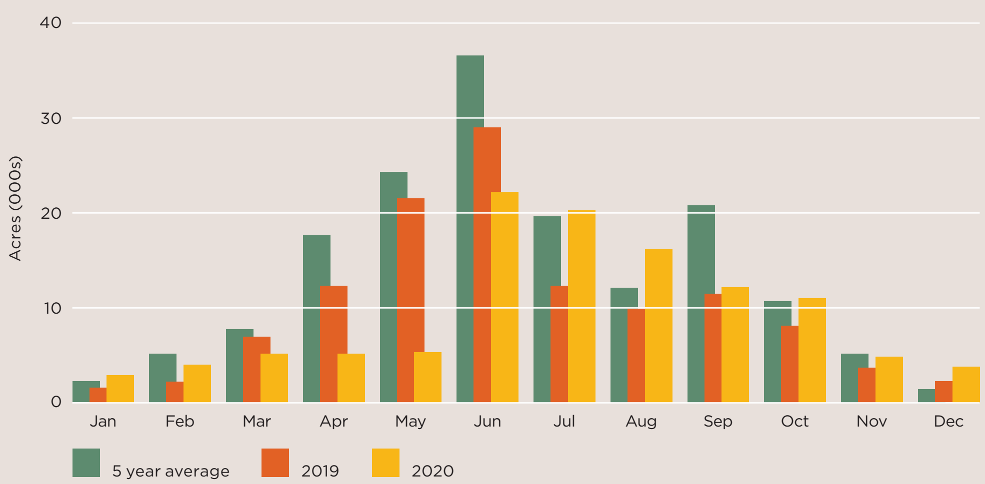
Average Grade 3 arable farmland values for Great Britain



*Average maximum and minimum spreads calculated by averaging the maximum and minimum regional values recorded in the Savills Farmland Values Survey plus or minus one standard deviation.

Source Savills Research

Seasonality of publicly marketed lowland acres across Great Britain



Source Savills Research

BUYER AND SELLER ANALYSIS

Savills transactions show existing farmers made up 49% of purchasers, up from 42% last year with farm expansion being the overwhelming motivator (45% of all transactions). Non-farming buyers were successful in 34% of deals with lifestyle purchasers accounting for over half of this figure for the first time in recent history. Institutions and other corporations accounted for 10% of buyers, up from 5% last year. An active lifestyle and amenity market in 2020, saw non-farmers account for 63% of vendors, an increase from 48% in 2019. Most of this change can be attributed to farmers being less active in the market. As a proportion of sellers their share decreased from 36% in 2019 to 23%, confirming that many were awaiting clarity on the future business environment before making major investment decisions. Institutions and other corporations accounted for 12% of vendors down from 14% last year.

> Quality farms are expected to be in great demand, as are those with strong amenity value and scale

The outlook for farmland values in Great Britain

As changes draw nearer, we expect values to remain steady with some volatility as subsidy reform begins to take effect

At this key turning point in UK agriculture's history, there is growing discussion over the direction of farmland values in light of subsidy reform plans and the post-Brexit trade environment. Market activity has been reduced due to uncertainty about these factors, with farmland supply at record lows and values largely static as many people seek clarity before making major strategic decisions. The underlying sense, however, is that despite the possible short-term disruption, farmland will continue to be an attractive asset, with unique diversifying capabilities across many competing land uses.

In England, the announcement of the Agricultural Transition Plan for 2021-2024 has provided the detail on how Basic Payment Scheme subsidy reductions will take place, while pointing to where new schemes are being developed and trialled, including the Environmental Land Management scheme (ELM).

While there is still detail required on the mechanisms of ELM, the basic principle of environmentally-conscious farming is gradually being accepted as the way forward in the sector and is, in essence, an acceleration of the current trend.

Alongside the headline scheme, there are a number of other provisions designed to incentivise retirement from the sector and encourage new entrants. A question mark hangs over how compatible the new policy is with existing agricultural tenancy law and practice, but we expect a competitive contract farming sector to fill much of this void.

Conversely, Scottish agricultural policy has moved to retain the overarching Basic Payment Scheme legislation until at least 2024, while also enabling improvements to be made from 2021 onwards. Limited information has been provided beyond the 2024 commitment.

However, government and stakeholder groups are expected to deliver policy reform targeted at sustainably increasing rural productivity, profitability and innovation in line with Scotland's more progressive green agenda. Interestingly, in both Scotland and Wales protecting food production is given much higher policy priority than it is in England.

The recent announcement of a free trade deal with the EU, which will provide continued access to the single market, is confidence-boosting for the sector. Although the potential impact of trade on capital values is limited, the outcome does reduce profitability concerns in some major export focused agricultural sectors such as lamb.

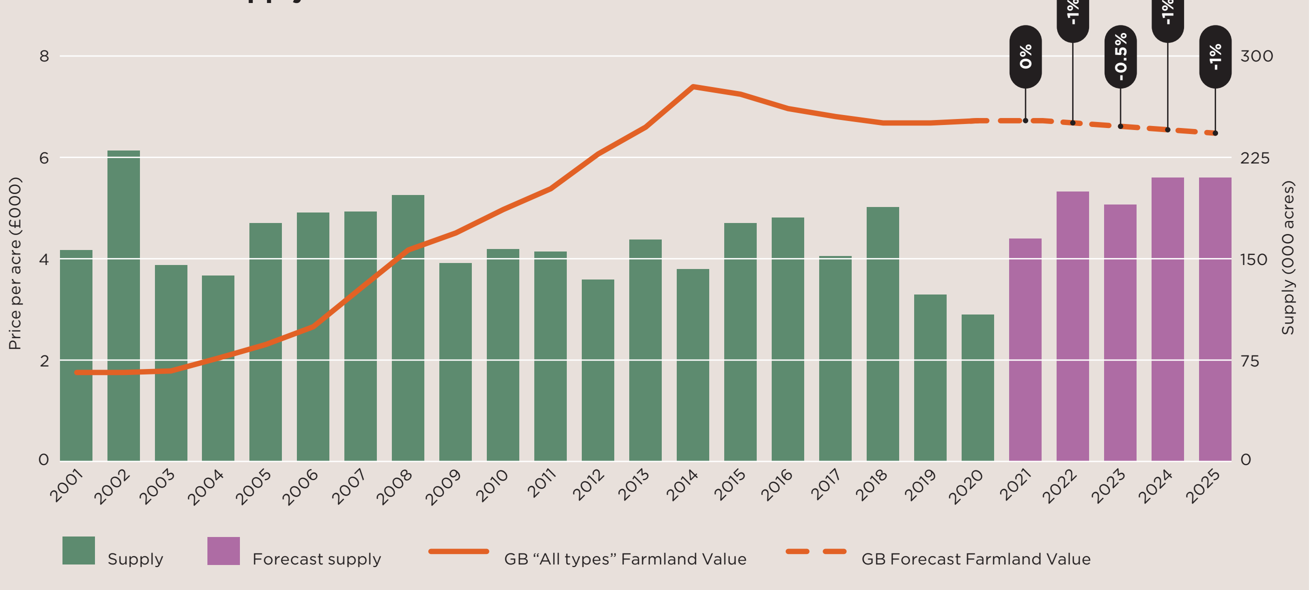
Exchange rate volatility is also expected as the economy reacts to the effect of new trade agreements and the ongoing effects of the Covid-19 pandemic. The pound sterling has been weak by historical standards for some time, but added volatility may present favourable buying conditions for non-sterling denominated buyers.

SHORT TERM (0-5 YEARS)

Over the near term, we are expecting average values to remain steady as pent-up demand filters through the market. Quality farms are expected to be in great demand, as are those with strong amenity value and scale.

Beyond this, we may see some localised volatility in areas most vulnerable to subsidy reform and trade adjustments. Location, land type, sector exposure and

GB Farmland supply and value forecast 2021 to 2025



Source Savills Research

0.7%
forecast annualised decrease in values over 5 years

£14.1bn
Value of UK agricultural exports to the EU in 2019

1%p.a
long-term real capital growth rate for UK farmland

local market dynamics are expected to strengthen as market drivers over the coming years and will continue to result in a large range of prices achieved either side of average indicators.

From a commodity perspective, global cereal prices are forecast to strengthen, which is likely to translate to domestic pricing. The new Brexit UK-EU trade deal should largely see trade continue as normal for the majority of sectors, albeit with some disruption for importers and exporters due to the introduction of new non-tariff trade measures. Farm gate prices are unlikely to be affected to any significant extent. Furthermore, talks are also ongoing to expand trade agreements with new trading partners beyond the EU. Some of these have already opened up, allowing for new market opportunities.

Current thinking on taxation is business asset rollover relief (formerly capital gain rollover relief) is less likely to be reformed as the government has already signaled its intention to "build" its way out of recession and promote development, investment and enterprise. Exactly where the balance lies on tax is difficult to surmise in the absence of any meaningful announcement. For this reason we have not included the effect of any tax changes in the forecast period.

Taking all these factors into account we are forecasting a 0.7% annualised decrease in average values over our five-year forecast period, but expect that supply will start to recover back to levels largely in line with 10 year averages that predated the Brexit vote. To put this in context, the area of land traded annually equates to approximately 0.5% of the total farmland area.

Our forecasts account for what is known from a policy and trade perspective as at early January 2021. Assumptions have been weighted to predict the impact at GB level, noting some differences in policy across the three countries considered. Should any major change in these assumptions arise, this forecast may be updated.

MEDIUM TO LONG TERM OUTLOOK (6+ YEARS)

In the longer term, we expect caution to give way to renewed investor confidence after the initial shock of subsidy reform and Brexit abates. The fundamentals that have historically underpinned the sector's performance should strengthen – shortage of

supply, demand from competing uses and a thriving consolidated rural sector.

Further to this, we anticipate new value offerings of environmental and ecosystem services to be proven income-generating ventures layered on top of and alongside existing land uses and operations. These developing markets will enhance the multifunctional nature of rural land and the diversity of factors that influence value.

The UK is among the first developed countries to recognise these services from a national policy level, and we expect increasing interest from the private sector as accountability grows in favour of considered Environmental, Social, and Corporate Governance (ESG) objectives.

Overall, while we are not anticipating a repeat of the significant price increase recorded in the decade to 2014, we would expect the market to return to its long-term historical real-term growth of around over 1% per annum (i.e. 1% above inflation).

Farmland has a long history as a safe, secure and inflation-hedged investment class, particularly during times of economic uncertainty. The strength and balance of key market drivers may bring about some individual sector or localised volatility, but we see no reason why farmland would not retain its status of long-term security.

Low supply, very low interest rates and strong amenity appeal should support values as the sector deals with interim volatility related to subsidy reform and trading adjustments. Strong fundamentals, an array of competing land uses and increasing interest in the environmental value of land support long-term growth prospects.

KEY DRIVERS LIKELY TO INFLUENCE THE FARMLAND MARKET

STRONG MACROECONOMIC DRIVERS
Low interest rates, reduced bond yields, higher risks of inflation all increase the appeal of asset types such as farmland.

COMPETING LAND USES
Lifestyle, tourism, energy infrastructure and development are all increasing their share of land. Ecosystems services are likely to add further competition to this.

AMENITY/LIFESTYLE ATTRACTION
Covid-19 has accentuated a desire for green space and heightened the appeal of the countryside. The right property in the right location can achieve premium prices.

NATURAL CAPITAL
New value opportunities that recognise the role of considered environmental stewardship are on the horizon. Both public and private money is expected to offer new ways to value and earn from land assets.

SUBSIDY REFORM – BPS
Although the total UK subsidy budget has been maintained until 2024, in England BPS is being progressively phased out in favour of a new scheme that will require demonstrable investment. This will inevitably reveal those willing and unwilling to make the change.

A MAJOR SUPPLY INCREASE
We anticipate supply to increase to levels more in line with the pre-Brexit vote 10-year average. Beyond this there could be downward pressure on values.

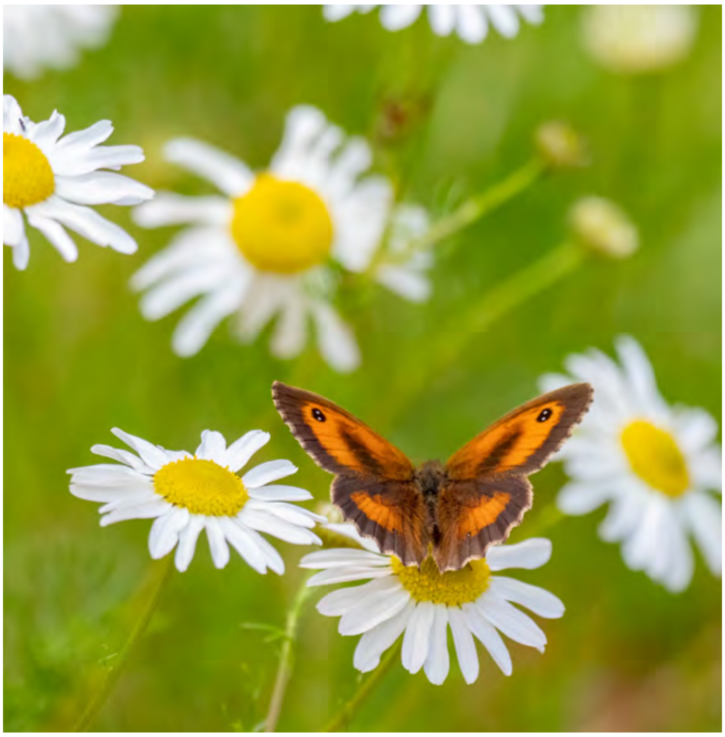
POTENTIAL TAX CHANGES
Speculation continues to surround the tax treatment of farmland particularly in light of the Covid-19 induced debt burden. Any significant change could negatively impact values.

"The strength and balance of key market drivers may bring about some individual sector or localised volatility, but we see no reason why farmland would not retain its status of long term security"

50%
BPS cut for all English farmers by 2024

£1trn
ONS value of UK natural capital

25%
estimated land use change in the UK to achieve net zero ambitions



Future farm policy

Targets on net zero emissions and enhancing the natural environment are the leading influences of agricultural policy, but what about food production?

The decision to leave the EU has triggered an agricultural policy revolution. This policy shift switches the raison d'etre of public support from area or production-based income support payments to payments for environmentally-focused public goods – at least in England. However, it is arguable that centralised government land management policy is no longer the driving force within any of the devolved nations. Each country's targets on net zero emissions and reversing biodiversity decline are now the leading influences, with other elements such as food, rural productivity and social cohesion competing for policy attention.

National agri-environmental policies will seek to provide a range of benefits that will contribute to the wellbeing of society as a whole by responding to the climate emergency, reversing biodiversity decline, ensuring high animal health and welfare standards and protecting our natural resources. Linking these national policies with private demand for nature-based solutions could unlock transformational investment in land management outcomes.

ENGLAND

English policy has developed the fastest. The government has already legislated for a transition period away from the Basic Payment Scheme (BPS), from 2021-2027, whereas in Scotland and Wales recent legislation allows a simplified version of their respective BPS to be delivered nationally while future policy plans are finalised.

In England, the phase out of the BPS will begin in 2021 with a 5% cut for the majority of farmers. By 2024 this will have increased to 50% and reach 70% for the largest farmers. Over this period farmers will be encouraged to join the existing Countryside Stewardship Scheme and the new Sustainable Farming Incentive component of Environmental Land Management (ELM). This will launch in order to increase the uptake of environmental management activities and prepare farmers for environmental delivery becoming increasingly ambitious and mainstream. ELM will become the focus of future agri-environment policy and all elements will be launched by the end of 2024.

Assuming all other factors are equal, 38% of farms in England make a loss without direct payment support. To tackle this, additional transition-period schemes will focus on building productivity and long-term competitiveness. For example, schemes will support capital investment in new technology or encourage improved herd health.

WALES

A recent Welsh government White Paper proposes the introduction of a Sustainable Farming Scheme (SFS). In contrast to Defra's approach for England, the Welsh government

> **“In England, Environmental Land Management (ELM) will become the focus of future agri-environment policy and all elements will be launched by the end of 2024”**

> Ultimately, significant evolution is needed in the way land is farmed and in some cases a change in the use of that land

sees the SFS as a business improvement programme that integrates support for farmers in delivering public goods with economic resilience support and advice. Strong emphasis is placed on sustainable food production coexisting alongside environmental delivery, but it is clear that food production should be rewarded by the market only.

On entry into the SFS a farm sustainability assessment will establish the farm's carbon footprint and potential for change, leading to advice on how sustainable land management can be most successfully implemented on the farm. The evidence base required to demonstrate the sustainability of products from farms within the scheme will be built through monitoring and reporting. This approach suggests that the SFS will both seek to improve the sustainability of farm products and allow their sustainability credentials to become a strength in the identity and marketing of Welsh produce. Plans for ELM give the impression that English interventions will be focused on the sustainability of farm practices rather than monitoring or driving performance at a product level.

To take the proposals forward an Agriculture (Wales) Bill is expected to be introduced into the Welsh parliament before summer 2022. A launch date for SFS has not been proposed, the Welsh government's view is that the environmental challenge requires decisive action so any transition is likely to be short.

SCOTLAND

The strategy adopted in Scotland sees a period of simplicity for agricultural support between 2021 and 2024. Over this time the legacy BPS will be streamlined, while potential new schemes for longer term policy are piloted. Development of farming and rural support policy beyond 2024 is the responsibility of the Farming and Food Production Future Policy Group, which is currently establishing a series of sector specific farmer-led expert groups to advise it on policy development.

The Suckler Beef Climate Group has already recommended that a future scheme must be flexible and able to deliver environmental outcomes through specific activities that provide value for money to the farmer and a return on taxpayer investment, benefit the local economy and incentivise upskilling. Unsurprisingly, as an industry-led group there is stronger focus on productivity and business improvement than natural capital or environmental outcomes that are not linked to food production. The group's vision would lead to actions to improve and verify the sustainability of Scottish beef, leaving England as the apparent outlier in terms of produce sustainability forming part of the government's strategy.

Despite the post 2024 support structure being less defined than England's, pilot projects are underway to support capital investment in equipment, which would improve the sustainability of agriculture and to incentivise farmers to invest in their natural capital.

CONCLUSION

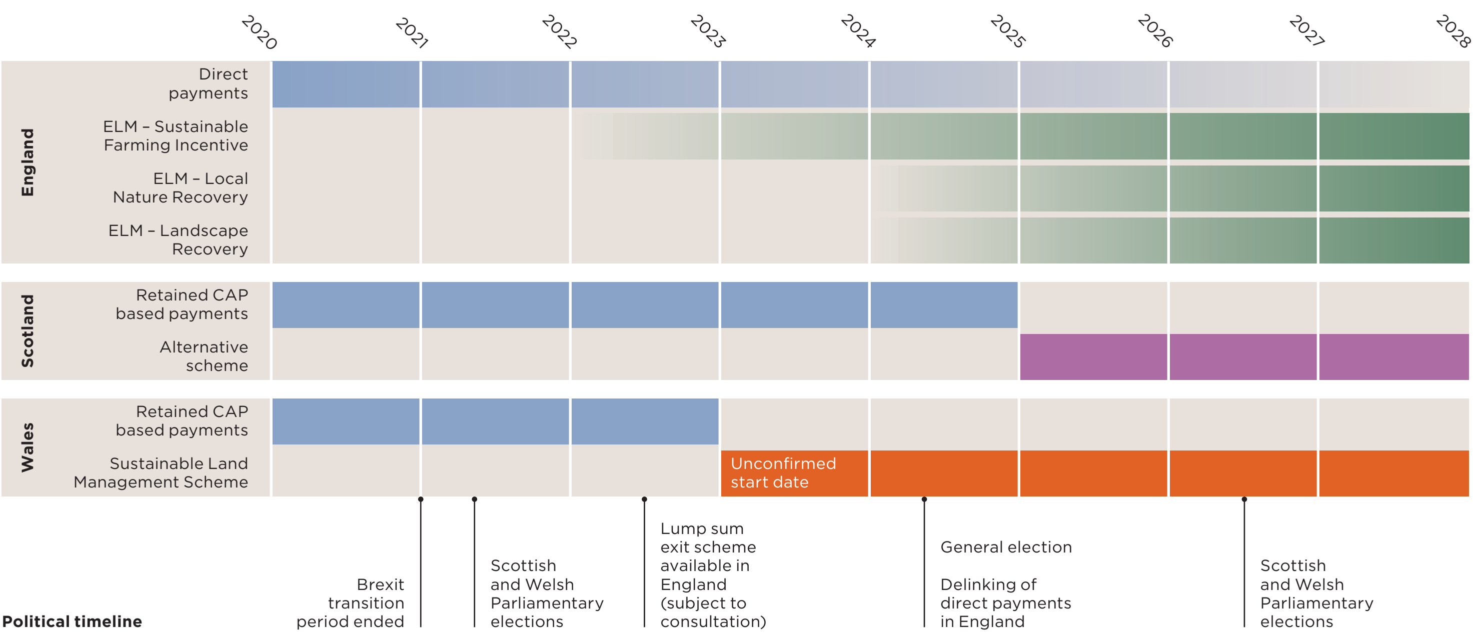
The magnitude of the climate emergency means that despite devolution, rural policy goals are broadly aligned – sustainable land management is the future, although there are nuances between the nations in terms of their paths and specific priorities. Emerging policy in Scotland and Wales more clearly integrates sustainable food production into their vision of agriculture's future, although a national food strategy white paper is due to be published in England.

Ultimately, significant evolution is needed in the way land is farmed and in some cases a change in the use of that land. Government policy, corporate obligations and corporate social responsibility policies mean real value is beginning to be attached to the additional services that agriculture and land management can provide. Demand is building: for agriculture the priority now is to identify and validate these services so that they can be marketed successfully and become an additional income stream into the agricultural sector.

30%

increase in the average price of nature-based offsets in 2019

Agricultural policy tracker timeline



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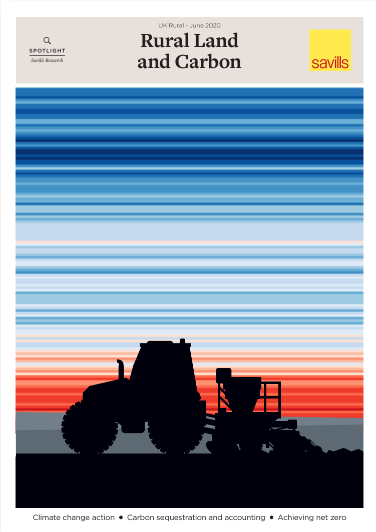

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