🔍 SPOTLIGHT

Savills Research

UK Rural - January 2020

The Farmland Market

savills

Farmland forecast ● Buyer and seller profiles ● Security and control of ownership

0.8%
increase in dairy farmland values (£6,767 per acre)

£6,687
average value of farmland, per acre, across Great Britain

53%
proportion of purchasers who were non-farmers

Low supply, yet plenty of opportunity

The farmland market looks set to change as new policies and environmental income streams prove their worth

Record low farmland supply headlines the summary of a rather subdued farmland market for 2019. Continued political and economic uncertainty once again weighed on the market as Brexit deadlines and elections made for better viewing than participation. Farmland values remain steady and our analysis of those active in the market suggest new motivators are influencing demand for farm and amenity real estate.

The 2020 farmland forecast was made easier in light of a decisive election result late last year. The election is, however, a small part of the bigger story that is still playing out and we expect landowners to be watching whether announcements of key policy reform are likely to impact on business profitability. The forecast sets out that we are expecting the farmland market to be supported by competing land uses and gradual changes to Government policy rewarding the potential for environmental gains. We also stand back to look at UK farmland investment through a global lens and highlight the political and financial strength backing the freedom of UK land ownership. Many countries around the world do not receive such benefits and while higher returns can be achieved elsewhere, the sustainability of long term, uncorrelated returns remains a key point of difference.

> **"The fundamentals of today's market still remain strong; competing land uses and the ever increasing demand for food, fibre and fuel"**

> **"Commercial farmers with successors showed continued appetite to expand across quality farmland or in locations well suited to complement existing farms"**

The farmland market 2019

The market has been subdued for 2019, largely due to prolonged political and economic uncertainty leading to record low farmland supply

2019 farmland values

Farmland values remained largely flat during 2019, as the market continued to grapple with prolonged uncertainty. The Savills Farmland Value Survey shows that average values have been relatively static with the average for all types of farmland across Great Britain falling 0.2% to £6,687 per acre. At a country level, English farmland lost ground as average values dropped 0.4% on 2018 figures, whereas Scotland and Wales both recorded gains of 0.5% and 1.2% respectively. Northern England recorded the largest value increase of 1.3% in contrast to a 1.2% loss across the East of England.

Across Great Britain, while average prime arable land recorded a 0.5% drop to £8,715 per acre, prime dairy farmland values gained 0.8% to £6,767 per acre.

These fairly static farmland values may partly be due to reduced market activity. However, Savills sales show evidence of a wide range of prices achieved either side of the average, which suggests a continuation of dynamic market forces.

2019 farmland supply

Farmland market supply reached a new record low in 2019 with just 117,000 acres publicly marketed across Great Britain. This eclipses the previous record of 135,000 set in 2012 and is the lowest since Savills starting tracking the farmland market in 1993. Last year's farmland supply was 38% down on 2018 (189,000 acres) and 29% down on the five year average.

Reduced offerings were a common theme across the home nations, with Scotland recording a 44% drop in supply to 25,000 acres, Wales a 32% reduction to 8,231 acres and England a 37% decline to 85,000 acres. The largest reduction in publicly marketed sales occurred in the East of England where only 11,000 acres were marketed, - 67% down on 2018 and approximately half the long-term average.

Buyer and seller profiles

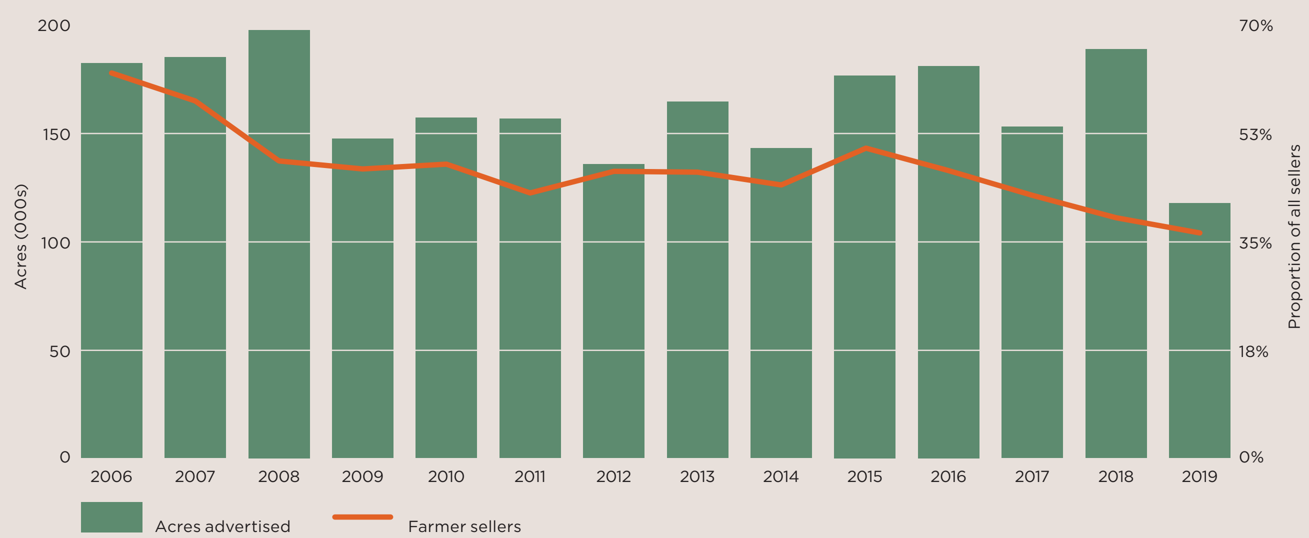
Analysis of transactions during 2019 where Savills acted for either the buyer or seller shows that in a smaller market, new non-farmer buyers represented a higher proportion of buyers in 2019. These represented 23% of all purchasers compared with 16% in 2018, which is the highest proportion for five years. This suggests that current purchasing motivators are more aligned to lifestyle and investment security than commercial farming. Indeed, 55% of new farm buyers cited residential or sporting interests as the key motivation for the purchase, with investment motivating another 21%. Taking existing non-farming buyers into account, non-farmers accounted for 53% of all purchasers. Evidence from our agents around the country shows that non-farming investors continue to show interest in acreage close to regional centres or with the potential for diversified business opportunities.

Farmers represented just 42% of all buyers, which is the lowest level since our records began. Commercial farmers with successors showed continued appetite to expand across quality farmland or in locations well suited to complement existing farms.

Our research of sellers shows a clear link between farming activity and the amount of land being publicly marketed (see graph). Full-time farmers represented just 36% of all sellers – again the lowest level since our records began in 1993. Clearly market uncertainty has overwhelmed decisions to sell for some time. However, those who did sell may have grasped an opportunity as demand for the right properties has remained strong; almost half of farmer sellers cited either retirement (17%) or investment outside of farming (30%) as a reason to sell.

Non-farming landowners represented around half of all sellers. Our research shows that these were selling for a variety of reasons that are similar to selling a private residence, including relocation, downsizing, death and personal reasons and financial restructuring.

Farmer sellers and farmland supply From 2006 to 2019



Source Savills Research

“Agricultural policy reform is likely to favour environmental enhancement objectives, including forestry, which in turn offers opportunities to diversify incomes and support capital values”

Sense and serviceability

Farmland continues to demonstrate a successful history as a vehicle for wealth building and preservation, but some key value drivers are set to change it. How will the market react?

The voice of reason would be cautious entering a market in the midst of ongoing uncertainty. With question marks still hanging over the future trade environment and agricultural policy reform ongoing, many landowners are still playing the waiting game. Farmland attracts investment for different reasons and whether it's business, lifestyle or environmental, the value proposition is influenced by an increasing array of factors.

Our Farmland Forecast is delivered with greater confidence following the decisive election result on 12 December 2019, but the election is part of a bigger story that still needs to be resolved.

A strong Conservative majority implies continuity in the farm business environment, even if a great deal of regulatory change faces the sector over the coming five years. However, our analysis shows many typical market drivers are having less impact in the current market, as influences to buy, sell or transfer land trend more towards local and personal circumstances.

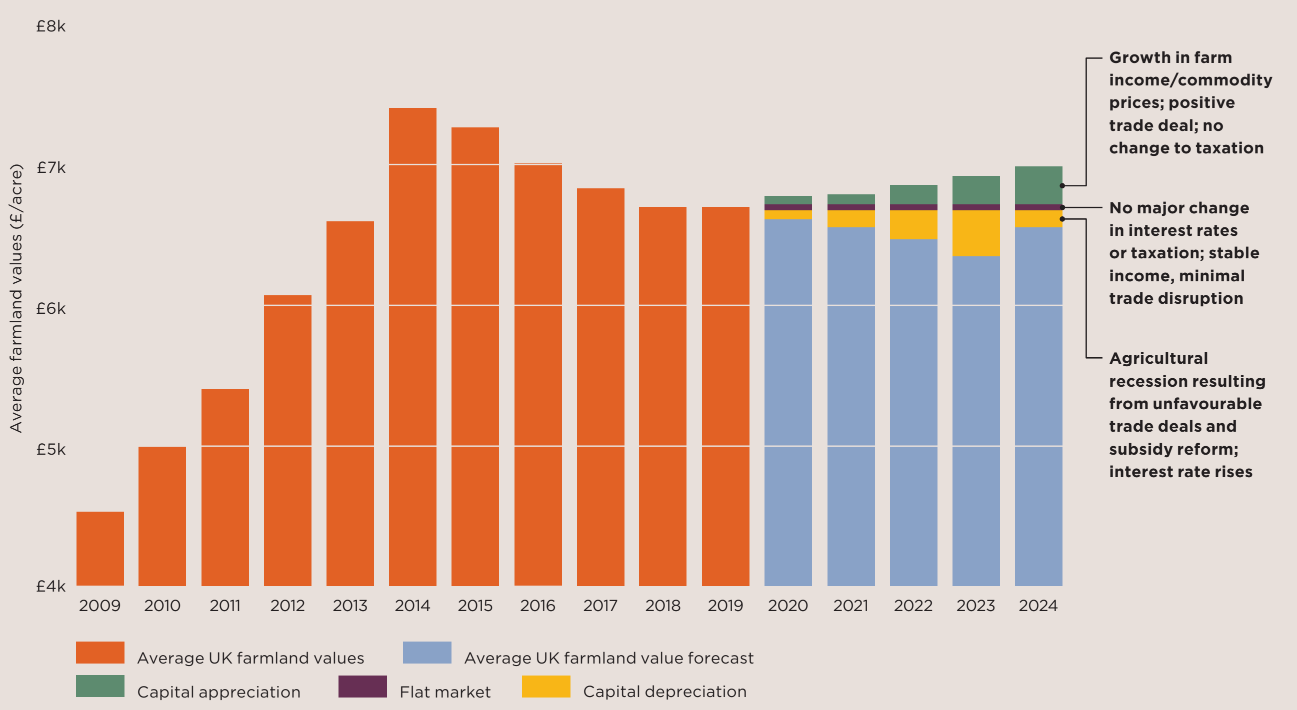
So where is the market heading?

With regulatory uncertainty expected to ease over the short to medium term, landowners will be reassessing business options. The likely restructuring of agricultural payments is expected to put pressure on returns from farming and force the hand of those who are unable or unwilling to invest or restructure. This is expected to bring a variety of land types to market. The prevailing low cost of funds and a volatile global trade market may also attract a greater number of buyers, providing other investment objectives are met. The current weaker pound boosts this sentiment towards inward investment.

In a broader context, the UK population is set to rise 5% over the next decade, adding further demand to food, energy and water systems. Land is a finite resource in the UK and with numerous competing land uses under pressure to grow, we consider any major contraction in land values unlikely.

Our forecast identifies the major influences that, in combination, could create three possible market scenarios over the next five years; an appreciating market, a static market and a depreciating market. The outcome of trade deals is the major macro-economic factor to be determined and more clarity over domestic policy is expected in the coming months. Overall, we predict that the broader economy is more likely to perform positively in the next five years, at least once the first Brexit hurdle is passed. Therefore, we expect the capital appreciation scenario will prevail for land, with local factors remaining the predominant influence on land values. In any event, we predict the upside potential of capital appreciation to be greater than any potential reduction in average values in a capital depreciation scenario, largely due to environmentally oriented demand for land underpinning the lower end of the market.

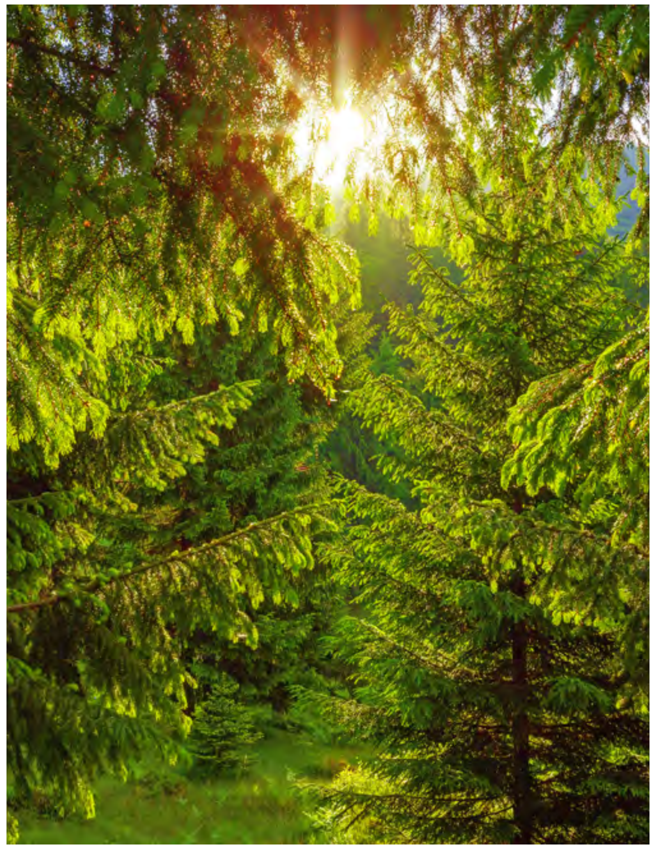
Farmland forecasts Value variation and how different factors may influence future growth

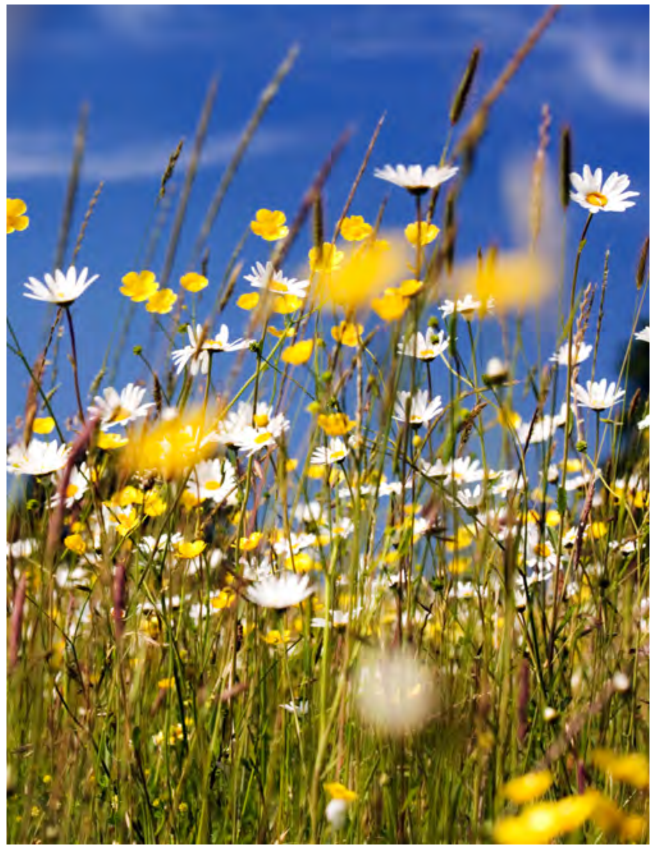


Source Savills Research

70m
UK population by 2030. Expected 5% growth over the next decade (ONS)

6.2%
annualised capital returns forecast for commercial forestry over the next 5 years





A trend that is likely to continue is the disconnect between productive capacity and farmland values. Many factors influence this dynamic, including diversification of farm incomes, expectation of planning gain, buyer sentiment and demand from non-farming buyers, all to varying degrees. The critical element that underpins this is the ability for the landowner to service the debt portion of their land investment.

As a vehicle for preserving and building wealth, farmland has demonstrated a long and successful history. Landowners may leverage returns from other sectors to continue servicing farmland investments, particularly those without farming scale. Agricultural policy reform will stress this serviceability dynamic, as budgets are focused away from income support and towards environmental investment. There remains concern that this policy shift implies that farms with high natural capital will attract lower levels of ongoing public support than poor ones, reducing income from public grants for those who arguably deserve it most. Opportunities to purchase should increase, as the regulatory shift brings forward more business strategy decisions. With new policy likely to favour environmental enhancement objectives, including forestry, opportunities to enhance capital value at the 'bottom' end of the market may surface.

We expect farmland to continue its long-term growth, low volatility and negative correlation to other more conventional assets. While values have fallen back over the past five years, the stability of capital has increased average values 20% (in real terms) over the past decade. The predictable market drivers are arguably softer in today's market, but the fundamentals still remain strong; competing land uses and the ever increasing demand for food, fibre and fuel.

20%
While values have fallen back over the past five years, the stability of capital has increased average values 20% (in real terms) over the past decade

NB: Our forecasts are subject to political and economic forces that are somewhat uncertain at the time of writing. Should any significant change in these factors occur, these forecasts may be revised to consider the result.

“As a vehicle for preserving and building wealth, farmland has demonstrated a long and successful history. Landowners may leverage returns from other sectors to continue servicing farmland investments, particularly those without farming scale”

> **The simple appeal of a tangible asset with secure and transparent ownership laws drove investment following a period of great uncertainty**

Safer than houses?

The UK's farmland market has a history of long-term stable returns, but what are the reasons for this and how do these compare in a global context?

As a globally mature farmland market, the UK boasts a successful history of long-term stable returns. Strong property laws, financial security and plentiful diversification opportunities across energy, infrastructure and tourism have enabled this to continue. However, as competition for land use brings the disconnect between value and earning potential from farmland alone back into focus, it is worth standing back to consider UK farmland investments in a global context.

Political security
Despite all the noise and uncertainty generated from the UK political scene of late, the strength of its developed democracy has not wavered. Political leaders and customs unions may come and go, but the UK, with its robust constitution and court system, continues to be valued by investors.

In the six years following the global financial crisis (GFC), average UK farmland values appreciated 76% in nominal terms (9.9% compound annual growth rate). While there were a number of factors at play, the simple appeal of a tangible asset with secure and transparent ownership laws drove investment following a period of great uncertainty. This is a scenario not many countries around the world can offer.

Take Argentina for example; a world leader in agricultural production and a nation rich in natural resources, yet historically poor at attracting and developing any type of inward investment.

Argentina struggles to manage the risks of a volatile macroeconomic environment, policy instability and an underdeveloped financial sector, making the investment case a particularly hard sell. For those game and with appetite, the risk reward balance holds true. However, with no land title insurance system and an erratic political climate, the grass would seem greener elsewhere.

7.1%
UK debt to equity rate for agricultural land only (Defra)

£216bn
total agricultural land asset value in the UK

1.9%
reduction in average land values across the UK since the Brexit referendum

Financial stability
Financial stability is not the same as market stability and for real estate investments it is important to make that distinction. Materially, the economic risks of Brexit-related market disruption remain, but investors should be comforted by the fact that major UK financial institutions are prepared. Under guidance from the Prudential Regulation Authority (PRA), major banks now hold up to three times the Tier 1 capital coverage they had prior to the GFC (see graph below). Furthermore, stress test modelling by the Bank of England suggests that in the event of another severe recession (or one worse than the GFC), banks would still hold more capital after the event, compared to the coffers before the global market shock of 2008.

From a global context, while lending reform and regulation has been a focus over the last decade, there are regions and sectors where this has been harder to achieve. Romania is one of Europe's leading emerging markets, yet 12 years following its official entry into the EU, it ranks as the lowest EU state for access and usage of funds from banks and lending institutions. Some 90% of agricultural holdings struggle to find credit at competitive rates, despite an 8% annualised growth farmland prices over the past decade. Signs are improving with agricultural debt up 180% since 2015 and non-performing loan ratios decreasing, but with 40% of agricultural land directly foreign owned, opportunity to control the balance sheet may well be lost.

In comparison, UK lenders are competing for opportunities to leverage their loan books against farmland, particularly as natural capital reserves show potential to consolidate in monetary and social value. This developing value proposition is a unique string to the bow of the rural sector and it's clear the government intends to drive it.

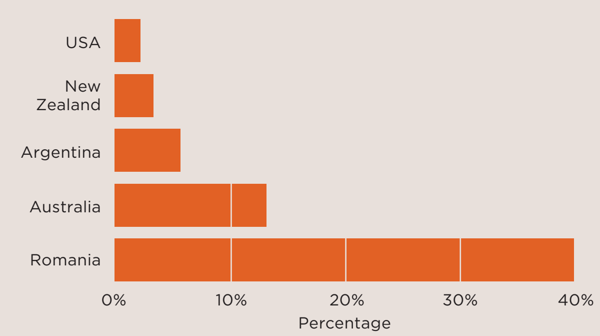
Foreign ownership
Regulation of foreign investment is a careful balance of protectionism and national security with economic growth and prosperity. With farmland, it is no different as issues of food and resource security add further layers of complexity.

Barriers to entry for foreign buyers in the UK remain low, with the only notable impediment being a 3% stamp duty surcharge on residential property. Overseas buyers of land in the UK also do not receive the inheritance tax breaks that benefit UK citizens, but by and large, the market is free, competitive and transparent.

In comparison, countries such as Australia and New Zealand subject varying levels of foreign investment to government approval. Australia's Foreign Investment Review Board judge proposals to buy farmland on a range of criteria, with the purchaser required to pass a national interest test and prove a transparent sale process. Similarly, New Zealand's Overseas Investment Office determines whether applications for foreign ownership of sensitive assets satisfy beneficial national interest conditions and add significant long-term value to the sector and economy. The criteria are regularly under review, often leaving landowners and investors to question exit positions should investment capital be constrained.

For all of the internal discontent and frustration at delayed policy intervention, the global attractiveness of UK rural property remains a core driver of demand. While neighbours can often compete aggressively for once-in-a-lifetime land sales, pushing up prices, potential sellers can look a little further than over the hedge when planning a land sale. The market for UK farmland remains a global one.

Percentage of foreign ownership in major farmland markets by total farmland area



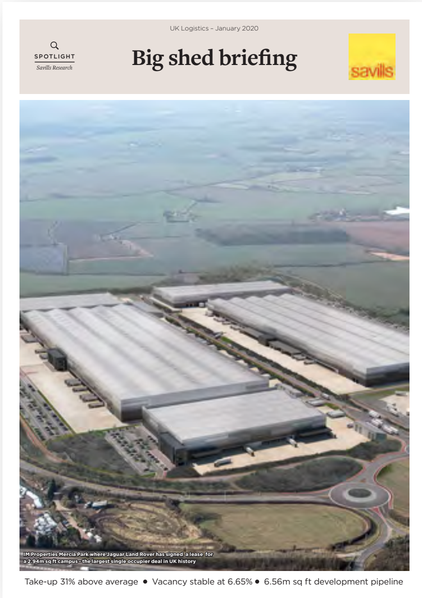
As there is no reliable data available on foreign farmland ownership in the UK it has not been included in this series. However, we estimate this percentage would be low in comparison to the above countries

Source Savills Research

Aggregate tier 1 capital ratio of major UK banks From end of 2007 to 2019

Source Bank of England

4.6%
annual growth in arable farmland values over the last decade



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