SPOTLIGHT
Savills Research

UK Rural - January 2022

The Farmland Market

savills

Market update ● Regional values ● Farmland forecasts

“Despite the shift in farm sizes, there is not a clear trend among the farm types being brought to the market, suggesting no single sector is undergoing more significant structural change”

The farmland market 2021

Change in sentiment sees farmland values growing strongly throughout the year, while supply continues to remain stubbornly low

Renewed confidence in the farmland market has contributed to an unexpected increase in demand, resulting in land values growing strongly throughout 2021 and gaining a momentum that looks set to continue. This confidence is being led by investors who see that global regulatory accountability for environmental impacts is shifting and that in response farmland presents a real asset investment opportunity that is high in Environmental, Social and Corporate Governance (ESG) values. A growing population and focus on decarbonising the economy means farmland is in demand for a broader range of uses than ever before – it is no longer just about food production.

Farmer buyers, the largest group in the GB farmland market, appear cautiously optimistic. Throughout 2021, successive policy announcements have shone increasing light on the nature and role of the industry once the Common Agricultural Policy’s influence comes to an end. Alongside this, emerging alternative markets have boosted opinion that dynamic farming businesses can navigate this tumultuous time.

SUPPLY AND DEMAND

After the record-breaking lows in 2019 and 2020 for publicly marketed farmland, there was an expectation that farm businesses would use the clarity provided by the raft of policy announcements to make decisions that would lead to a “bounce back” in supply in 2021. While supply increased by 7% on 2020 levels, it has only recovered to the volume seen in 2019 at 122,400 acres. This slower rate of supply increase suggests levels may not return to the 10 year average of 150,000 acres per annum for some time yet.

Nationally supply has increased from the low of 2020, but it varies regionally. Supply in Scotland has increased 63%, which is a significant turnaround, but still falls short of the five year average. Meanwhile 83,500 acres were brought to the market in England, which was slightly less than in 2020.

For farm businesses improved yields and strong commodity prices supported farm profitability in 2021 despite the first cut in subsidy support for farmers in England, while those in Scotland and Wales continued to benefit from their governments’ policies of maintaining support levels. However, average annual agricultural input inflation of 21.9% (according to the AF Agricultural Inflation Index) will impact farm profitability and

7%
The increase in farmland supply on 2020 levels

21.9%
Average annual agricultural input inflation

1%
The average proportion of annual farm sales that are over 1,000 acres in size

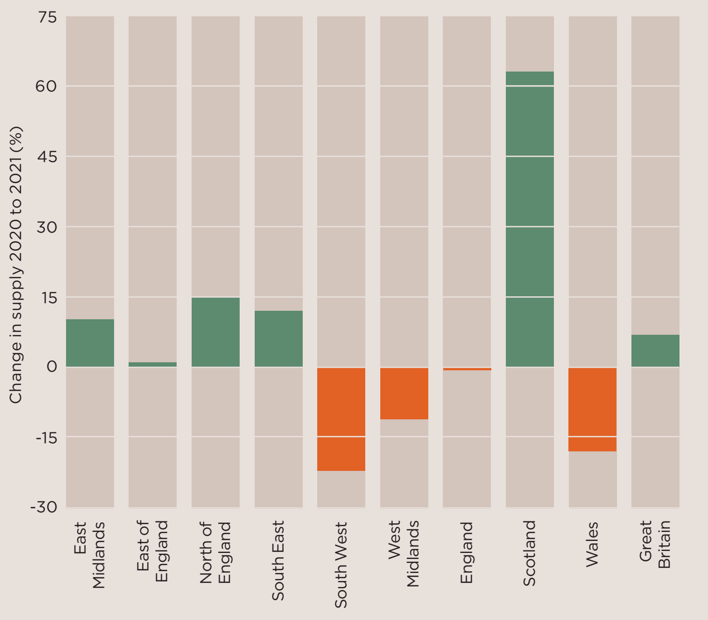
challenge those that will not be sustainable without direct payment subsidy support. This may lead to an increase in the amount of farmland for sale, but the Environmental Land Management scheme (ELM) in England and emergence of other markets offering alternative sources of income will temper the extent to which supply is increased due to retirement or giving up farming.

Sustainable food production is at the core of Welsh and Scottish policy plans. In England, however, the emphasis upon it was weaker until the Sustainable Farming Incentive (SFI) was announced as one component of the ELM "public money for public goods" scheme. In 2022 the SFI will consist of three soil management standards with variable payment rates according to the level of ambition selected. Farmers can now evaluate its compatibility with their existing crop and livestock production systems. There are already some significant changes from the pilot, but it remains true that the scheme does not offer the same income or profit margin as the Basic Payment Scheme (BPS) and cannot be seen as its replacement.

The emphasis is upon creating a scheme that de-links agricultural support from production. Defra argues that there is little correlation between the two; in 2017, almost 60% of agricultural output came from just 8% of farmers operating on a third of land in England. Around half of this output is from the pig, poultry and horticulture sectors, which typically operate on small farms and could face productivity challenges unless a solution to their labour supply issues can be developed.

While specialist smaller farms can thrive, across the wider industry the economies of scale favour larger businesses, meaning industry exits are more common among smaller farmers. Since 1995, smaller farms have become a larger proportion of the properties on the GB farmland market; their share has increased by 10%, reducing the proportion of larger farms on the market, particularly those between 250 and 999 acres. The largest farm sales, over 1,000 acres, remain rare and since 2011 make up on average only 1% annually of publicly marketed sales. Despite the shift in farm sizes, there is not a clear trend among the farm types being brought to the market, suggesting no single sector is undergoing more significant structural change than others.

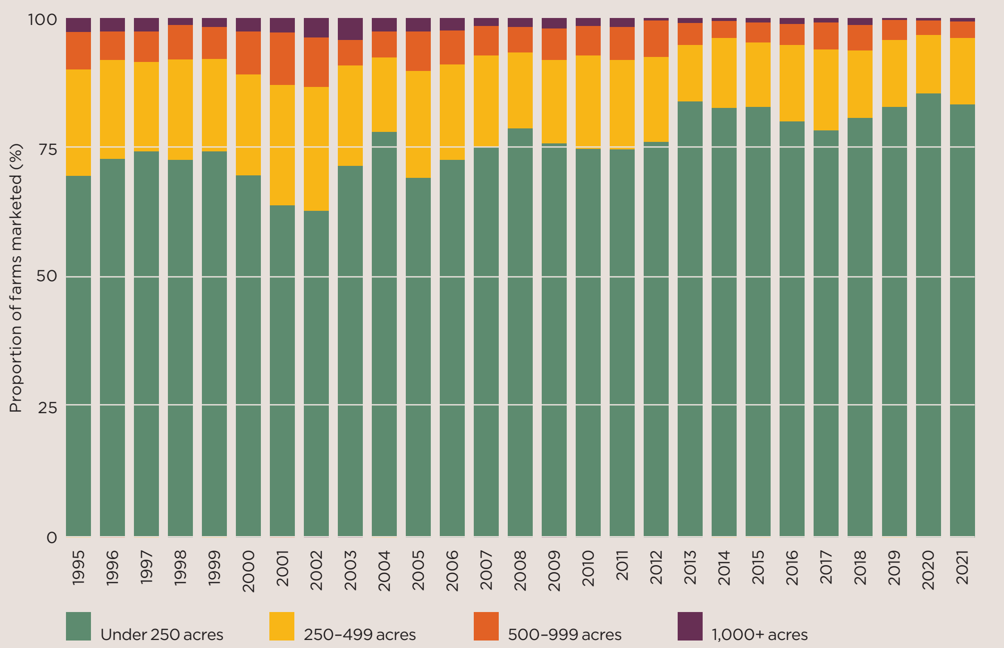
Regional variation in market activity



Source Savills Research

63%
Supply in Scotland has increased 63%, which is a significant turnaround, but still falls short of the five year average

Changes in the number of farms sold in different size bands



Source Savills Research

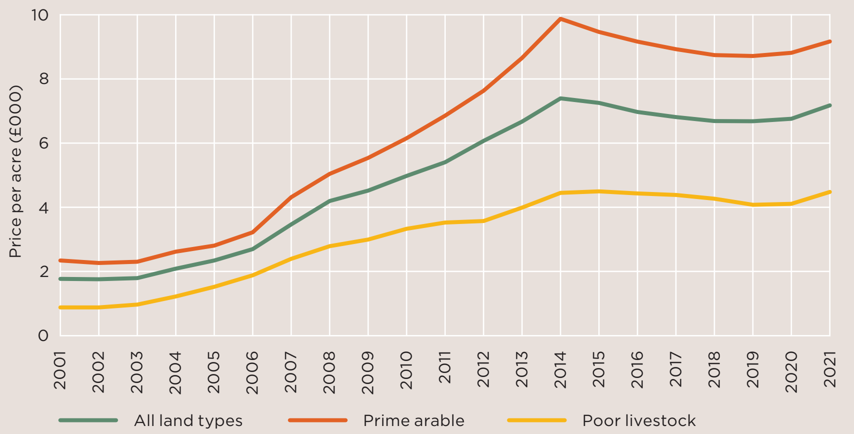
> **"A growing population and focus on decarbonising the economy means farmland is in demand for a broader range of uses than ever before, it is no longer just about food production"**

8.8%
The increase in value of poor livestock land

4%
The increase in value of prime arable land

31.2%
The strongest growth across all land types has been recorded in Scotland this year

Average farmland values for Great Britain



Source Savills Research

Growth across the spectrum

Constrained supply and the increasing demand for rural land brings an end to six years of poor performance

Results from the Savills Farmland Values Survey show values increased by an average of 6.2% during 2021. This is the strongest annual growth since 2014 and is clear evidence of renewed interest in the farmland market. The sustained lack of supply is driving values higher as more active purchasers compete in a crowded market.

Building on the trend that emerged in 2021, it is pasture land that is leading this growth. Poor livestock land and average livestock land have increased 8.8% and 8.7% respectively since December 2020. By comparison, prime arable and Grade 3 arable grew 4% and 5.5%. The average price for poor livestock land has almost equalled its previous peak and has already reached it in some regions.

Regionally, the strongest growth across all land types was recorded in Scotland where values increased by 31.2% during 2021. In part this is as a result of the demand for tree planting land in a buoyant forestry sector, as well as building interest from environmentally-motivated buyers. As a result of these potentially competing interests, these buyers are broadening their search criteria beyond poor livestock land and hill land in order to make purchases, which is causing values across all land types to increase.

The growth in land values across the full spectrum of farm types and qualities is a signal of the change in sentiment towards investing in farmland. The market has been subdued for several years due to prolonged political and economic uncertainty, which started with the EU referendum in 2016. However, UK farmland's history of long-term, stable returns looks appealing against the volatility of other asset classes in recent years.

Looking beyond average values the market continues to exhibit a significant amount of variation. Property quality, local demand and other special purchaser motivations may have a greater influence on buyer sentiment and we have seen that land can remain on the market for some time if sufficient demand does not exist. This highlights the importance of identifying a property's strengths and developing a marketing strategy that targets the key markets for it.

BUYERS AND SELLERS

Analysis of Savills transactions in 2021 shows that existing farmers continue to be the largest proportion of buyers in the market, but they fell from 49% of buyers in 2020 to 46% last year. Non-farming buyers were successful in 38% of deals and there was a second successive strong year for institutional and corporate investment in farmland. Institutional and corporate buyers accounted for 16% of buyers compared to a 10 year average of 10%.

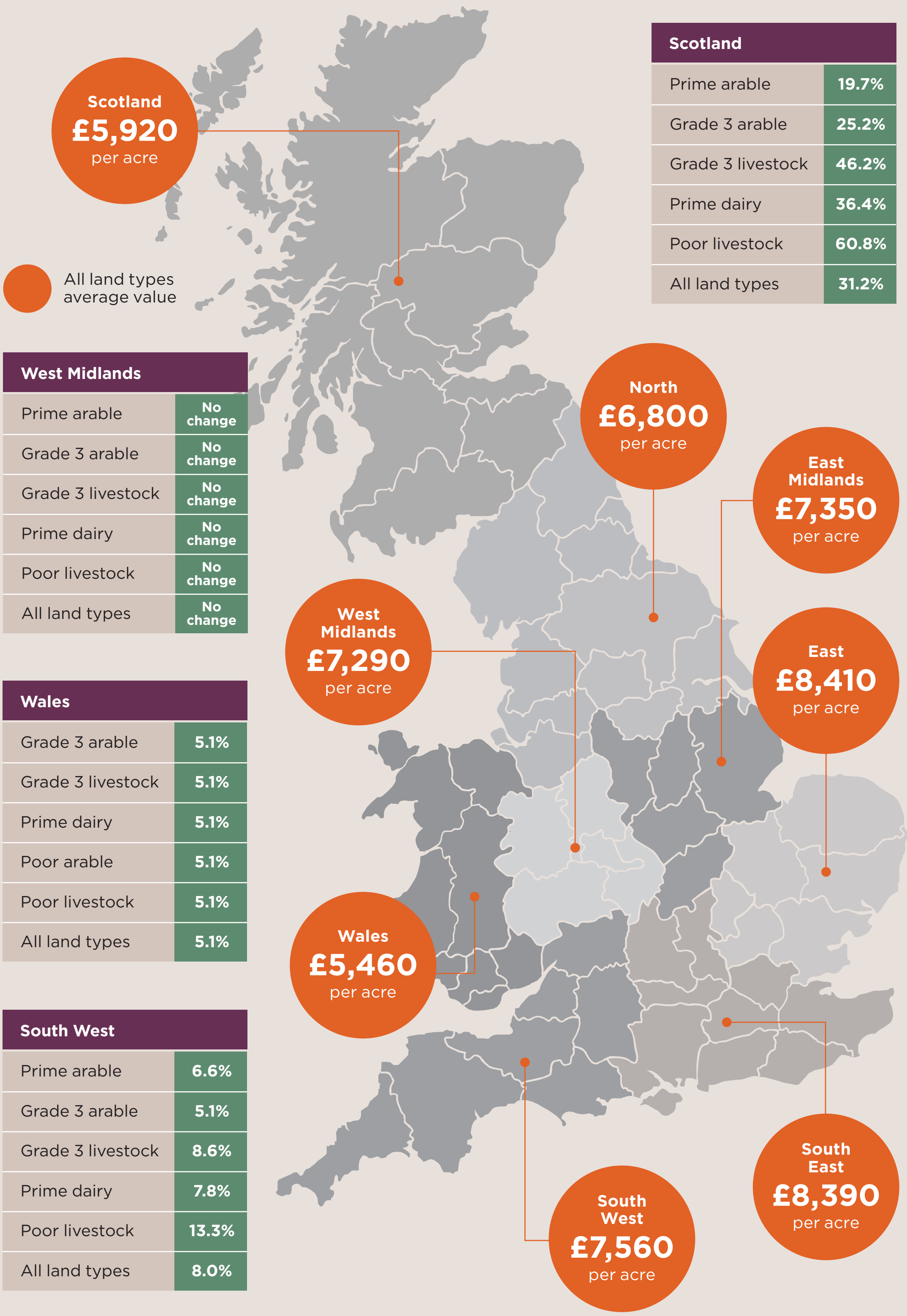
Compared to 2020, farmers were more active as vendors, as a proportion of transactions their share increased from 23% to 29%, but was still below average. Institutions and corporate bodies formed a smaller proportion of vendors than previously, perhaps as a result of net zero targets strengthening their business case for holding rural investments. Overall 68% of sales were due to retirement or personal reasons, a significant increase from the 10 year average of 39%. This suggests that farmers and non-farmers, including retirees or those who have inherited land, are becoming more confident making major investment decisions in the current business environment.

68%
Savills transactions show 68% of sales were due to retirement or personal reasons

> "Results from the Savills Farmland Values Survey show values climbed by an average of 6.2% during 2021. This is the strongest annual growth since 2014"

> **“The sustained lack of supply is driving values higher as more active purchasers compete in a crowded market”**

Farmland market value dynamics across Great Britain 2021



Scotland	
Prime arable	19.7%
Grade 3 arable	25.2%
Grade 3 livestock	46.2%
Prime dairy	36.4%
Poor livestock	60.8%
All land types	31.2%

North	
Prime arable	4.9%
Grade 3 arable	5.2%
Grade 3 livestock	5.1%
Prime dairy	7.6%
Poor livestock	4.8%
All land types	5.6%

West Midlands	
Prime arable	No change
Grade 3 arable	No change
Grade 3 livestock	No change
Prime dairy	No change
Poor livestock	No change
All land types	No change

East Midlands	
Prime arable	2.3%
Grade 3 arable	1.8%
Grade 3 livestock	4.0%
Prime dairy	3.5%
Poor livestock	0.0%
All land types	1.8%

Wales	
Grade 3 arable	5.1%
Grade 3 livestock	5.1%
Prime dairy	5.1%
Poor arable	5.1%
Poor livestock	5.1%
All land types	5.1%

East	
Prime arable	3.3%
Grade 3 arable	2.0%
Grade 3 livestock	5.6%
Poor arable	3.0%
Poor livestock	0.0%
All land types	2.6%

South West	
Prime arable	6.6%
Grade 3 arable	5.1%
Grade 3 livestock	8.6%
Prime dairy	7.8%
Poor livestock	13.3%
All land types	8.0%

South East	
Prime arable	2.5%
Grade 3 arable	2.1%
Grade 3 livestock	3.4%
Prime dairy	1.4%
Poor livestock	1.1%
All land types	2.3%

Source Savills Research

> **Investment in farmland is seen as a hedge against increasing inflation and we may see investors looking to diversify their portfolios with agricultural assets**

The outlook for farmland values in Great Britain

A more dynamic market will develop due to the broader relevance of agricultural land, but scarcity will remain a key market influence

In the run up to COP26 in Glasgow, companies and governments across the world committed to ambitious net zero targets. Land is the only asset class that can be both a source and a solution to climate change. It is this need to provide a solution to the broader economy that will drive a change in use of a quarter of the UK's land over the next 30 years and directly impact farmland values.

This strong sentiment in the farmland market is buoyed by a lack of supply. Our revised forecasts for supply support the improved outlook for farmland values, as the supply and demand imbalance continues to create a scarcity factor for available land.

SUPPLY EXPECTATIONS

On average 160,000 acres have been advertised each year since 2000, but this falls to an average of 150,000 per annum over the last 10 years. While the last few years have been exceptional for limited supply, due to uncertainty over Brexit and then the Covid-19 pandemic, there has been a downward trend in publicly marketed farmland for some time. We expect the next five years to buck this trend as the agricultural transition progresses and deepening BPS income cuts encourage sales. It is anticipated that the area of publicly marketed farmland will increase to the previous 10 year average of 150,000 acres per year.

The government's announcement of the Lump Sum Exit Scheme, designed to assist farmers in England with retirement by capitalising their subsidy payments, has been met with little enthusiasm. Criticisms include that the scheme is too complex and its eligibility conditions are too restrictive. As such, we do not believe it alone will trigger a significant increase in farmland brought to the market. Those who take up the scheme are likely to be intending to retire from the farming industry anyway. However, the agricultural transition plan more generally removes support for farm incomes in England, which will see farmers find new ways of making their businesses viable, through existing markets, diversifications or emerging environmental schemes. While Scottish and Welsh policy looks to be more reminiscent of Common Agricultural Policy schemes, changes in every nation are likely to result in consolidation of farm businesses and an increase in the area of agricultural land traded.

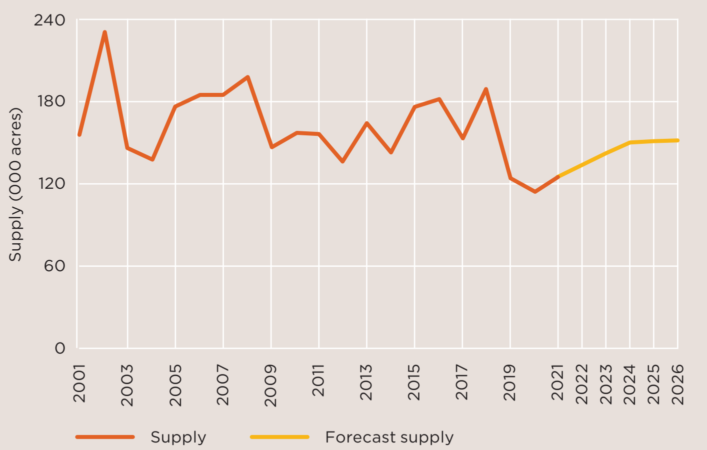
160,000

On average 160,000 acres of farmland have been advertised each year since 2000

As the UK is learning to live with the Covid-19 pandemic, the dust is beginning to settle on the economic fallout. The Bank of England base rate was kept low in 2021, until the announcement in December to increase it to 0.25%. With inflation at 5.1% and agricultural inflation at 21.9%, there is increasing pressure on farm finances. However, the other side of the same coin is that investment in farmland is seen as a hedge against increasing inflation and we may see investors looking to diversify their portfolios with agricultural assets.

The economic recovery looks set to focus on taxing income through the new Health and Social Care Levy for now, and the risk of damaging capital taxation reform has reduced. In November, the Treasury confirmed that it would not be proceeding with any changes to inheritance tax or its important reliefs and will only be making minor changes to the capital gains tax regime. The status quo will continue to support the retention of farmland by keeping farms intact, but also increase demand as rollover buyers seek eligible assets.

GB farmland supply forecast

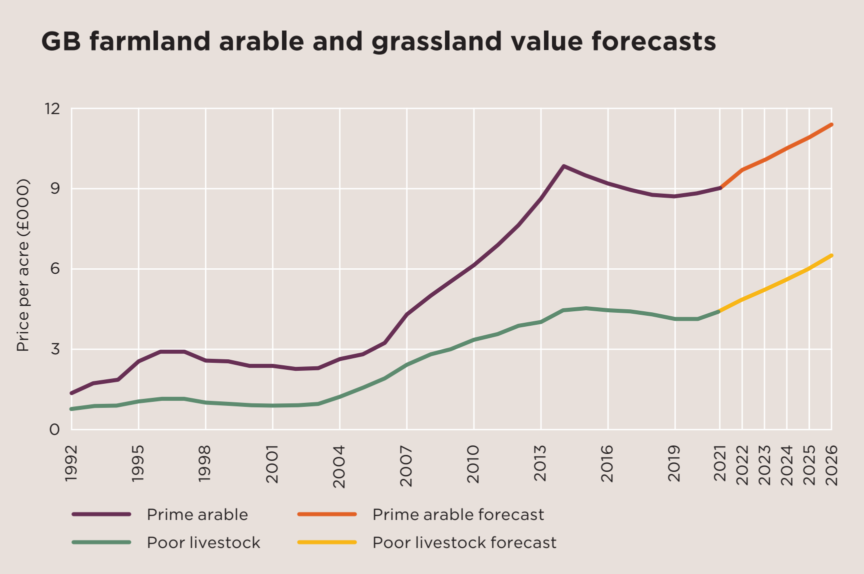


Source Savills Research

12%
Rise in real terms for barley prices forecast in next decade

13%
Drop in beef prices forecast in next decade

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



Source Savills Research

Forecast values

Environmental concerns are likely to be a key driver in the highest levels of growth

Food production is a fundamental function of farmland and returns from the sale of agricultural produce contribute strongly to farmland values. In the next decade, global demand for food will increase due to population growth. The World Bank forecasts an increase in food commodity prices, such as wheat (1%), barley (12%) and chicken (3%) over this period, while the price of beef will fall (13%). This is likely to translate to domestic pricing, which supports farm returns and farmland values by extension.

In addition, commodities (including grains, oils and grasses) will likely experience a strengthening market for biofuels to help reach the government's 2050 net zero target. This market has the potential to compete with food and the increased demand for crops could push prices up.

However, it is the natural capital markets that are generating the "buzz" in the farmland market. Net zero and biodiversity targets from the government as well as industry will result in land being used for renewable energy, tree planting and rewilding, which will continue to result in a supply and demand imbalance that will strengthen farmland values.

The royal assent of the Environment Act in November 2021 has confirmed the requirement for developments to achieve 10% Biodiversity Net Gain (BNG) in England. Developers can obtain additional biodiversity units through habitat enhancement and creation onsite, offsite, or through the purchase of statutory biodiversity credits. As a legislated mechanism, BNG is likely to be among the first substantial drivers of natural capital based income streams for farmland and the requirement for offsetting to be local means regions across Great Britain will benefit from this emerging market.

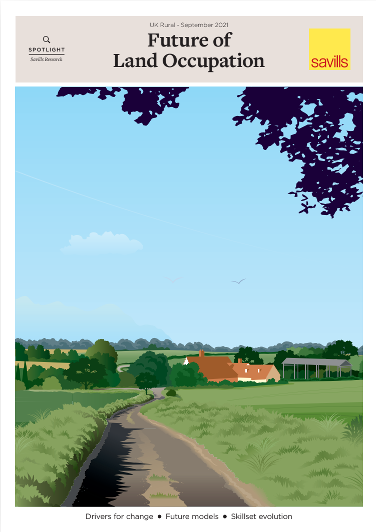
The ability for pasture land to provide valuable carbon and water management services is strengthening demand for it over other land types. For example, woodland planting projects for carbon offsets are targeting grassland due to the constraints of planting on more productive arable land, including the constraint of the price of land. Furthermore, the rules surrounding carbon offsetting and additionality means companies may opt for ownership models over purchasing credits, as land that is already sequestering carbon can represent a negative value on their carbon balance sheet.

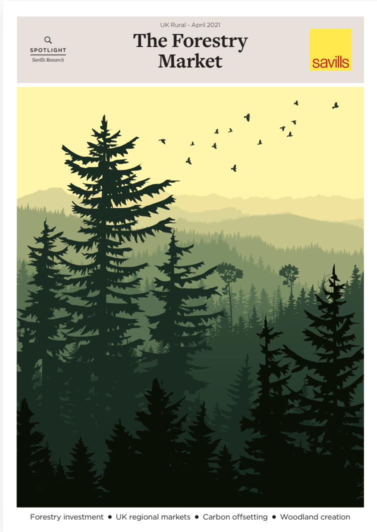
While afforestation and peatland restoration are the best-known nature-based carbon storage solutions in the UK, the less mature soil carbon sequestration market is attracting significant interest and is of potential relevance to all farmland. The announcement that the Sustainable Farming Incentive (SFI) scheme will not rule out private financing for soil carbon may be a welcome relief to land managers who can potentially stack ecosystem services and funding on the same land parcels to increase profitability. We would expect policy in Scotland and Wales to follow suit.

At the other end of the scale, demand for lifestyle farms is expected to remain as a result of the pandemic's long lasting impact on working practices and recognised importance of one's health and wellbeing.

Combining these factors, we anticipate real values for poorer quality grassland will climb, on average, 6% per annum in the short term although, as with every asset class, location and specific environmental characteristics are likely to be key drivers in achieving the highest levels of growth. For prime arable land, commodity prices in the short term look set to hold firm and an increasing interest in energy crops and renewables may continue to support profit from production. We expect this to support growth, forecasted at 2.5% annually excluding inflation.

> **"While afforestation and peatland restoration are the best-known nature-based carbon storage solutions in the UK, the less mature soil carbon sequestration market is attracting significant interest"**





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