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# RURAL BULLETIN

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## Welcome to this latest issue of the Knight Frank Rural Bulletin

**The past three months have brought mixed news for farmers and landowners. Amendments to the contentious Marine and Coastal Access Bill could benefit those living around the English coast, while fierce industry lobbying has persuaded government not to go ahead with an unpopular proposal to replace set-aside with a new compulsory environmental scheme. Renewed confidence in property has also helped push farmland prices back up after nine months of falling values. Nostalgic readers, however, will rue the passing of the historic Royal Show, which closed its doors for the last time in early July. Weakening commodity prices, particularly in the dairy sector, which has also been hit by the collapse of one of the largest farming co-ops, are of growing concern for farmers. All these issues and more are discussed in this latest instalment of our Rural Bulletin. I hope you find it informative and useful.**

## Headlines

- **Land values recover, according to Knight Frank research**
- **Commodity prices fall**
- **Coastal access reprieve for landowners**
- **Cow victim awarded £1m damages**
- **Prime property recovery**
- **Voluntary set-aside confirmed**
- **Budget summary**
- **Forestry and let land investments shine**

# FARMLAND MARKET SHOWS SIGNS OF RECOVERY

The average price of English farmland increased by just over 3% to £4820/acre in the second quarter of the year, according to the Knight Frank Farmland Index. This partially helped to reverse an almost unprecedented nine-month run of falling values.

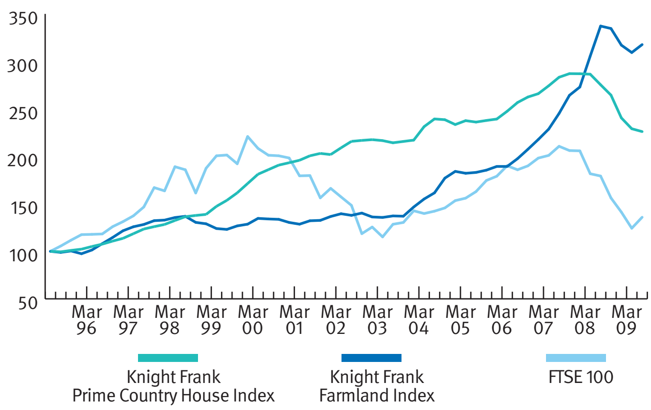
However, as the graph below shows, farmland has suffered far less during the credit crunch than other property sectors or investment classes. Farmland is now worth just 5.5% less than it was a year ago and we expect increased demand from farmers, lifestyle buyers and investors to push up prices further, although not at quite the same pace that saw double-digit increases in consecutive quarters during the first half of 2008 when prices peaked at £5100/acre.

Prices started to fall because many potential buyers, uncertain as to where the market was heading during the credit crunch, withdrew. A continued shortage of supply and the relative willingness of banks to support farming prevented a collapse in prices and acquisitive farmers, hopeful that agriculture in the UK has a viable long-term future, are now looking for good-sized blocks of land again.

Investors are also looking at farmland again, both in the UK and abroad. Their enthusiasm is based on economic models that suggest the current fall in commodity prices is a blip in a longer-term bull run driven by increasing world populations and a potential shortage of farmland. Tentative green shoots in the UK residential market are also encouraging a number of lifestyle buyers to return to the market.

**Comparative performance of farmland**

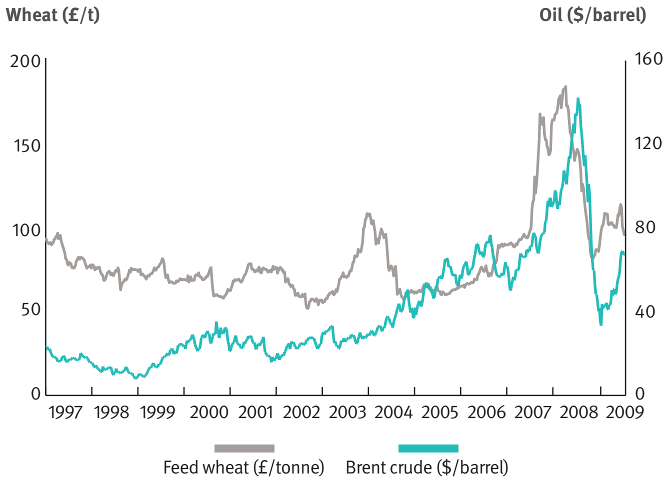
**Country property and FTSE 100 (March 1995 - June 2009)**




Source: Knight Frank Research

# ARABLE AND DAIRY SECTORS SUFFER AS PRICES FALL

**Wheat prices v oil**




Sources: Farmer Weekly, DairyCo, DEFRA, Knight Frank Research, HGCA, EIA

**Agricultural price changes 2008-2009**

| Commodity prices | Jun 2008 | Mar 2009 | Jun 2009 | Quarterly change (%) | Annual change (%) |
|---|---|---|---|---|---|
| Feed wheat (£/t ex-farm) | 145 | 102 | 93 | -9.3 | -36 |
| Oilseed Rape (£/t ex-farm) | 341 | 244 | 227 | -7.0 | -33 |
| Cattle (R4L steers p/kg dw) | 282 | 285 | 288 | 1.1 | 2.1 |
| Sheep (R3L lambs p/kg dw) | 361 | 380 | 325 | -14.5 | -10 |
| Pigs (DAPP p/kg dw GB av) | 132 | 143 | 155 | 8.4 | 17 |
| **Input prices** | | | | | |
| Red Diesel (p/litre) | 68 | 40 | 42 | 5.0 | -38 |
| Oil ($/barrel Brent Crude) | 136 | 48 | 69 | 44 | -50 |
| Fertiliser (£/t AN 34.5%) | 340 | 264 | 175 | -34 | -49 |
| Soyameal feed (Argentine £/t) | 292 | 255 | 298 | 17 | 2.1 |
| **Economic indicators** | | | | | |
| Interest rates (B of E base %) | 5 | 0.5 | 0.5 | nc | -90 |
| Inflation (CPI) | 3.8 | 2.9 | 2.2 * | -31 | -42 |
| £:€ rate | 1.26 | 1.08 | 1.16 | 7.4 | -7.9 |
| £:$ rate | 1.99 | 1.43 | 1.61 | 13 | -19 |

*May 2009

Feed wheat prices have fallen back to well below £100/t following a mini rally over the past few months and farmers without sufficient grain storage will be forced to sell this year's harvest for less than the cost of production. Without the single farm payment, an average arable farm could be looking at a loss of £111/ha this year, according to figures from farm business consultant Andersons.

Sterling's relative weakness against the dollar and euro, which makes UK grain more competitive on world markets and boosts the value of the euro-denominated single farm payment, has prevented prices falling further. The pound, however, is gradually regaining some ground, which is not good news for farmers. Fortunately, input costs like fuel and fertiliser are also significantly lower than they were 12 months ago as the recession dampens global demand for oil and other commodities.

Increased world grain stocks following last year's record harvest and upgraded estimates for this year's harvest have helped to pull back prices. Looking further ahead, November feed wheat prices are slightly better at about £105/t and commodity analyst Rabobank says the market is currently at a realistic level taking into account market fundamentals.

There is more room for optimism in the medium term with a report from the Organisation for Economic Development (OECD) predicting that arable crop prices over the next 10 years could be 10-20% higher in real terms than during the past decade.

Milk prices, which have been on the wane since peaking at almost 28p/litre last December, could also be close to the bottom of the price cycle, according to a report from dairy specialist Kite Consulting. It says prices could start to recover from 2010 as global production falls and may even go higher than 30p/litre.

Dairy producers could do with an injection of confidence – a recent survey by levy board DairyCo – found that only 18% were planning to increase production over the next two years, compared with 35% recorded by the same survey a year ago. This would be insufficient to make up for the production lost from the 13% who said they were planning to quit the industry, DairyCo said.

The collapse of farmer-owned co-operative Dairy Farmers of Britain, which went into administration in June owing its 1800 members £150m for their milk, has also cast a shadow over the sector. For some of the members, especially those in locations of little interest to other milk buyers, the future is not bright.

# LOBBYING WINS COASTAL ACCESS REPRIEVE

A welcome amendment to the controversial Marine and Coastal Access Bill, which aims to create a continuous coastal footpath around England, has been secured by lobbying groups led by the Country Land and Business Association.

It was announced in June that affected landowners will now have an independent right of appeal against the right to roam being imposed on their land. The bill's opponents claimed enforcing compulsory access was a contravention of the Human Rights Act.

It has also been confirmed that parks and gardens will be excluded from the bill. The CLA, however, said it was still concerned about government plans to conduct trials in private parks. About 70% of the English coastline is already currently available to walkers.

# INJURED RAMBLER AWARDED £1M DAMAGES

A woman injured after she was attacked by cows while walking her dog across a Cumbrian dairy farm in 2003 has been awarding £1m in damages. The court said farmer John Cameron, who plans to appeal, had not properly considered the risk his cattle posed to walkers.

Concerns have been raised that the decision will set a legal precedent meaning farmers will no longer be able to keep cattle in fields where there is public access.

The National Farmers Union, however, said there was no reason why livestock should not be kept in such fields as long as a proper risk assessment had been carried out and appropriate measures like warning signs or temporary fencing put in place.

There has been a recent spate of attacks on dog walkers with one, a vet, trampled to death. Former home secretary David Plunkett was also injured when walking with his guide dog.

# PRIME COUNTRY PROPERTY SHOWS SIGNS OF RECOVERY

The market for prime residential country property has stabilised with prices falling only fractionally in the second quarter of the year. Average values across the UK dropped by 0.9%, according to the Knight Frank Prime Country House Index, with farmhouses dipping by just 0.3%. Substantial price falls during the previous 12 months, along with low interest rates, have convinced potential purchasers that now could be the time to buy and demand has increased substantially.

London has led the recovery with prime property prices increasing over the past few months. This effect has started to ripple out via the Home Counties, where average prices increased 0.8% last quarter. The market, however, remains very price sensitive and overpriced houses will still struggle to attract interest. We do not anticipate that values will increase substantially while worries remain about the economy and the state of government finances.

**Prime Country Property – price change by sector**

| Property Type | Quarter 2 price change % | Annual price change % | Average value £ |
|---|---|---|---|
| Cottage | -0.4 | -16.7 | 0.44m |
| Farmhouse | -0.3 | -16.1 | 1.1m |
| Manor House | -1.9 | -19.8 | 2.5m |
| Unweighted average | -0.9 | -17.5 | 1.3m |

Source: Knight Frank Residential Research

# DEFRA BACKS DOWN ON SET-ASIDE PLANS

DEFRA has backed down from its threat to impose a new compulsory environmental scheme on farmers to replace set-aside, the EU regulation that required farmers to take a certain amount of their land out of production to avoid production surpluses.

Conservation groups such as the RSPB were concerned that the scrapping of set-aside would have a detrimental impact on wildlife and lobbied the government hard to come up with an obligatory replacement.

Farmers feared this could see an additional 5% of their land forcibly given up to the environment – many already participate in the environmental entry level scheme that provides cash incentives in return for wildlife friendly farming techniques – but counter lobbying from the National Farmers Union and other groups has persuaded agriculture and environmental minster Hilary Benn to accept a voluntary industry-led proposal instead.

Announcing his decision at the final Royal Show Mr Benn said he now expected the industry to deliver on its promises, which included a pledge to get an extra 30,000-50,000 hectares of arable land under environmental management.

# BUDGET ROUND UP

Much has happened at Westminster since the Budget in May, but there are a number of points relevant that deserve a recap.

As mentioned in the last Agricultural Bulletin, there had been worries that the Chancellor would use the budget to scrap Agricultural Property Relief (APR) following a threatened legal challenge from the European Commission. The commission said APR was incompatible with the free movement of capital throughout the union because it only applied to property owned in the UK.

The Chancellor, however, opted to extend APR to cover agricultural property in the EU. APR is a valuable tax relief and particularly benefits the owners of tenanted land that would not qualify for Business Property Relief.

A proposed amendment to the Finance Bill will also remove an anomaly arising from a court case (Mason v Boscawen) that effectively meant any change in the rate of VAT, such as the reduction from 17.5% to 15% last December and a planned increase in 2010, would count as a change to Agricultural Holdings Act tenancy rents where VAT is charged, thereby freezing rents for the next three years. Under AHA legislation, landlords and tenants can only enforce a rent review every three years.

# TREES AND LET LAND TOP INVESTMENTS

Forestry and rural land outperformed the other main investment classes last year, according to new data from property market analyst IPD.

Tenanted farmland delivered a total return of 1.7%, according to IPD's UK Rural Investment Property Index. Income return was 2.1% while capital growth was -0.3%. This was significantly lower than in 2007 when increasing capital values pushed yields to 27%.

A number of rent reviews were settled last year and increases of 20% to 30% on the back of increasing cereal prices were achieved by some landlords. DEFRA, meanwhile, has updated its survey of farm rents – which is now based on results from the government's Farm Business Survey.

In 2007, Agricultural Holding Act tenancies decreased on average by 2.1% to £130/ha. Farm Business Tenancies increased marginally by 0.9%.

| | Total return (%) | Income return (%) | Capital growth (%) | Annualised total return (%) | | |
|---|---|---|---|---|---|---|
| | 1 yr | 1 yr | 1 yr | 3 yrs | 5 yrs | 28 yrs |
| Rural property | 1.7 | 2.1 | -0.3 | 14.3 | 14 | 8.2 |
| Commercial property | -22 | 5.6 | -26.3 | -3.9 | 4.6 | 9.2 |
| Residential property | -15 | 3.2 | -18.0 | 5.0 | 6.6 | - |
| Equities | -30 | - | - | -4.8 | 3.5 | 11.8 |

IPD's latest UK Forestry Index shows that commercial plantations produced a return of 7% in 2008, compared with a loss of 30% for UK equities and a 22% fall for UK commercial property.

This performance, however, was substantially worse than in 2006 and 2007 when forestry yielded 21% and 32%, respectively. A 29% drop in timber prices in the 12 months to March 2008 was behind the fall in performance. Over three years the index has returned 19% per annum with a five-year annual yield of 16%.

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# READY TO HELP –

**Knight Frank offers a wealth of in-depth specialised experience covering the rural property sector. Please get in touch with any of our experts if we can be of any help to you or your business.**

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