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RURAL BULLETIN

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Andrew Shirley
Head of Rural Property Research
+44 (0)20 7861 5040

Welcome to this latest issue of the Knight Frank Rural Bulletin

Almost three months after the general election we now have some idea of what it is like to be governed by a Conservative Liberal Democrat coalition. The new government has wasted no time in introducing wholesale changes to the way it runs the country and, as expected in this age of enforced austerity, much of this revolves around cutting expenditure. On page 3 we discuss the impact this could have on rural communities. We also take a look at what the coalition's first budget means for landowners and conclude that it could have been much worse.

I hope you enjoy reading the articles in this bulletin and find them informative and useful. If Knight Frank can be of assistance in any way you can find contacts for all our rural service lines on the final page. Further information and the latest rural property news is also available online at www.knightfrank.co.uk/rural

Headlines

- **Farmland values continue to rise, according to Knight Frank Research**
- **Cereal prices on the up**
- **What the coalition government means for landowners**
- **Emergency budget summary**
- **Prime country properties increase further in value**
- **HS2 Exceptional Hardship Scheme introduced**
- **Feed-in tariffs encourage huge rise in renewable interest**

Farmland values rise by 13% in first half of 2010

Anybody who happened to buy English farmland 10 years ago either made a very shrewd investment or was extremely lucky. While the FTSE 100 index of leading shares has fallen in value by over 20% since then, agricultural land has almost trebled in value. According to the Knight Frank Farmland Index it increased by a further 7% in the second quarter of this year, taking total growth for 2010 to 13%.

As the graph below clearly shows even the price of the best residential property in central London has not managed to keep up with farmland.

The average price of English farmland now sits at £5,769/acre. Many sales, of course, realise far more than this and £7,000/acre is not uncommon. Prices in the Cotswolds have performed particularly strongly. The average price achieved by Knight Frank in this area over the past 12 months has been £8,842/acre, with two sales close to Cirencester making over £10,000/acre.

There was nothing in the recent budget likely to impact specifically on the farmland market and the increase in Entrepreneurs' Relief (discussed in more detail on page 4) could actually make farmland an even more tax-efficient asset than it is currently.

The supply of farmland for sale is still significantly down on last year, although the launch of the 23,300-acre Lake Vrynwy Estate in Powys, Wales, by Knight Frank on behalf of water company Severn Trent, will be an interesting test of the market. Available on a 125-long lease for £11m, the estate is the single largest property sale in England and Wales in living memory.

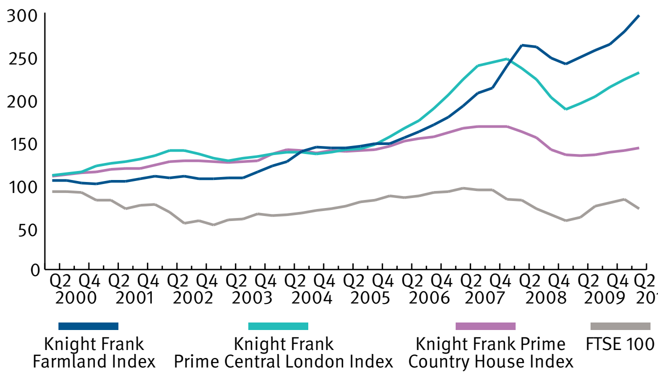
We expect land values to move upwards as demand continues to outstrip supply, but at a slower rate than over the past 12 months.

For the latest information on farmland values please contact andrew.shirley@knightfrank.com

To find out more about the Lake Vrynwy Estate please contact tom.raynham@knightfrank.com

Farmland performance versus other asset classes

Index (Q4 1999=100)



Source: Knight Frank Residential Research

Wheat prices on the rise as speculators enter the market

Wheat prices have finally rallied after languishing below £100/t for over a year. Prices jumped in July so are not reflected in the table opposite, but as this bulletin went to press the average ex-farm UK feed wheat price was almost £115/t. That is a significant increase on the £93/t being paid last year. Oilseed rape prices have also risen to £271/t, up from £217/t last July. Interestingly, those farmers producing bread-making (milling) wheat are actually receiving less on average that they were 12 months ago. This was because the wet weather last harvest affected wheat quality. This pushed up the premiums available for the limited amount of wheat that did make milling grade.

According to grain traders, the sharp increase in feed wheat has largely been driven by a surge in interest from investors speculating on the impact of adverse weather conditions across the world. Production estimates have admittedly been cut in Europe and North America, but it is not yet clear if current prices can be sustained by genuine supply and demand fundamentals.

Arable farmers will be hoping the rally continues as recent figures from farm consultant Andersons suggest that the average cereal farm is unlikely to produce a profit in 2010 and 2011 without subsidy and environmental payments.

The prolonged period of dry weather is likely to increase costs for many livestock and dairy producers as forage production has been significantly affected by the lack of rain. In some areas silage yields are down by 40% compared with last year, while hay crops have been reduced by half. This will force farmers to either buy in expensive supplementary feed stocks for the winter or cut back on livestock numbers.

Increasing dairy commodity prices are slowly being passed back to farmers by processors, but any price increases have so far been limited and are unlikely to cover the increased cost of forage. According to figures from DG Agri, the UK now languishes in 19th place in the EU 25 milk price league, with prices 9% below the EU average.

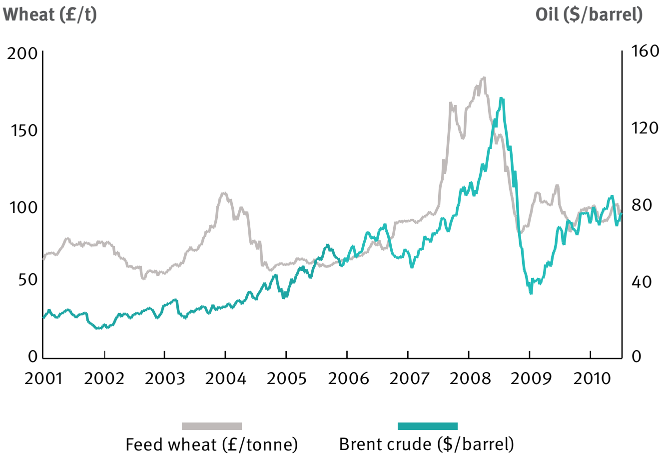
Livestock prices have slipped slightly on the back of an increase in the value of the pound against the euro. A stronger pound makes UK exports more expensive to overseas buyers.

Agricultural price changes 2009-2010

Commodity prices	Jun 2010	Mar 2010	Jun 2009	Quarterly change (%)	Annual change (%)
Feed wheat (£/t ex-farm)	97	92	93	5	4
Oilseed Rape (£/t ex-farm)	245	255	227	-4	8
Cattle (R4L steers p/kg dw)	272	278	288	-2	-6
Sheep (R3L lambs p/kg dw)	369	416	325	-11	14
Pigs (DAPP p/kg dw GB av)	147	143	155	3	-5
Milk (UK p/litre)	23.60*	24.16	22.50	-2	5
Skimmed milk powder (£/t)	2,000	1,850	1,450	8	38
Input prices					
Red Diesel (p/litre)	53	53	42	0	26
Oil ($/barrel OPEC index)	73	77	69	-5	6
Fertiliser (£/t AN 34.5%)	208	225	175	-8	19
Soyameal feed (Argentine £/t)	259	290	298	-11	-13
Economic indicators					
Interest rates (B of E base %)	0.5	0.5	0.5	0	0
Inflation (CPI)	3.2	3.4	1.8	-6	78
£:€ rate	1.22	1.12	1.16	9	5
£:$ rate	1.50	1.52	1.61	-1	-7

*May

Wheat prices v oil



Sources: HGCA, EIA

Coalition government – the story so far

David Cameron and Nick Clegg have defied the sceptics who predicted a Conservative Liberal Democrat pact would never work; for now at least. Lots of new policies and initiatives have been launched over the past few months, many of which impact on rural communities and landowners. Whether this spirit of co-operation can continue for the next five years remains to be seen. In the meantime, we summarise what the coalition has meant for the countryside so far.

More empathy for farmers

Although it is debatable whether the colour of government makes any real difference to farmers (see Rural Bulletin Spring 2010), the Department for Environment, Food and Rural Affairs under Labour seemed more interested in the environment part of its portfolio than anything to do with food production. Encouragingly, the top priority in DEFRA's new draft structural reform plan is to: Support and develop British farming and encourage sustainable food production.

The new DEFRA team (see box), which has been drawn entirely from Tory ranks, also has genuine experience of agriculture. Jim Paice, the minister in charge of farming, has already adopted a more hands on approach than his predecessor by taking a tough stance on reform of the shambolic **Rural Payments Agency** (RPA) and the control of **bovine tuberculosis**.

Mr Paice has taken personal responsibility for reforming the RPA, which is in charge of distributing or, as was often the case, not distributing £2.3bn of annual subsidy payments to English farmers. The RPA has just been slammed by an independent review commissioned by the last government. DEFRA has also been forced to repay £160m to the European Commission following maladministration of subsidy payments by the RPA.

The government has also agreed to launch a consultation paper on whether to allow an industry-funded badger cull in a bid to control bovine TB. Many livestock farmers are convinced that a cull is the best way to control the disease, which has financially crippled many livestock enterprises. Mr Paice says he is personally convinced of the science behind killing badgers.

The new coalition government DEFRA team

Caroline Spelman MP – Secretary of State. Worked in agricultural sector for 15 years

Jim Paice MP – Minister of State for agriculture and food. Former farm manager and shadow farm minister

Richard Benyon MP – Parliamentary under-secretary for natural environment and fisheries. Family owns 14,000-acre Englefield Estate

Lord Henley – Parliamentary under-secretary. Tory peer and landowner

Cost cutting

Cutting the UK's national debt is a key coalition focus and government spending has been slashed across all but a few departments. DEFRA will have to cut its budget by at least 25% and around a third of the ministry's 90 or so agricultural quangos have already been disbanded. The most high-profile victim was the **Agricultural Wages Board**, which set minimum pay levels for farm workers.

The National Farmers' Union welcomed the move, but it was condemned by workers' unions. Knight Frank keeps a database of salary levels for rural workers. **Contact alastair.paul@knightfrank.com for more information.**

Other organisations that have fallen victim to cost cutting are the **Regional Development Agencies**. Local "enterprise partnerships" will take over some of their role. The government has also invoked the ire of the Country Land and Business Association by saying it would no longer be able to meet the **broadband Universal Service Commitment** (USC) of two megabits per second (two Mbps) by 2012, because of insufficient funding. It has set a new target of achieving the USC within the lifetime of this parliament – expected to end in 2015.

Power to the people

One of Prime Minister David Cameron's main drives is to create a new "Big Society" that gives "individuals and communities more control over their destinies". Many are sceptical of how this can really be achieved, especially as some of the proposals to "involve" people look more like persuading them to provide services that most would expect to be covered by their taxes anyway.

Reform of the **planning system** is one area of the "Big Society" that will be of particular interest to rural landowners and communities, especially those businesses that have come up against inflexible local plans and planners. The Infrastructure Planning Commission and Regional Spatial Strategies have already been abolished devolving many planning decisions to a more local level. This sounds good in theory, but does raise concerns about whether any decisions will ever be made, especially if the government goes ahead with its plan to introduce a third-party right of appeal against planning decisions.

Another radical proposal would allow communities to set up local housing trusts that could deliver affordable housing schemes, up to a certain threshold, without the need to get planning consent. A majority of local residents would, however, need to vote in favour of the proposals. Whether local communities are really prepared to offer the levels of altruism or co-operation required for the scheme to work is doubtful. The proposal also seems to offer little incentive for landowners to get involved.

Please contact james.del.mar@knightfrank.com or alastair.paul@knightfrank.com if you think you will be affected by any of the planning issues discussed above.

What the emergency budget means for landowners

The emergency budget on 22 June left very few people in the UK completely unaffected, but it could have been much worse for everyone, including rural property owners. The increase in Capital Gains Tax was lower than many were predicting and although some investment allowances have been reduced there was no attack on Agricultural Property Relief. We believe it to be a reasonable and well-balanced set of proposals – not least considering the parlous state of national finances.

However, it is still well worth taking professional advice on a number of the measures announced by the Chancellor to ensure every rural estate or farm is structured correctly to make best use of the tax reliefs and incentives still available to them. We have summarised the key issues below. If you require further advice on any of them please contact james.del.mar@knightfrank.com or sandy.douglas@knightfrank.com

Capital Gains Tax and Entrepreneurs' Relief

The increase in CGT from 18% to 28% for higher-rate taxpayers was not as bad as some people feared – a rate of 50% was not out of the question – but nevertheless it does raise some important issues for anybody thinking of selling property in the future. What was surprising was that the increase came into force on midnight on the day of the budget. This left little opportunity for anybody to sell their assets quickly and take advantage of the existing rate of CGT.

One of the easiest ways for rural property owners to mitigate against the CGT increase is to use Entrepreneurs' Relief, which is available on the sale of an eligible business. Any gains from the sale of a qualifying business up to a specified limit attract a CGT rate of just 10%.

In a rare moment of generosity in an otherwise parsimonious budget, the Chancellor raised the ceiling for Entrepreneurs' Relief from £2m to £5m. This means many farm or land sales could effectively be exempt from the new higher rate of CGT.

Landowners need to make sure they are in a position to make best use of Entrepreneurs' Relief if the need to claim it ever arises.

The amount of gain on which relief is available can effectively be doubled from £5m to £10m if a business run by a husband and wife (or those in a civil partnership) is structured correctly. If both parties are genuine partners in the business each can claim the relief.

Entrepreneurs' Relief, however, cannot be claimed on the sale of let land and farms; there needs to have been active involvement in the actual farming. This does not mean the property in question has to be registered as a business, but there must be some evidence of trading being conducted on the owner's tax returns.

Owners of let land thinking of selling sometime in the future may want to take advice on how they can bring themselves back into the fold of Entrepreneurs' Relief by looking at the structure of their business. Employing a tenant as a contractor could be a possible option to explore.

It is also worth noting that Entrepreneurs' Relief is a lifetime allowance so cannot be used once the maximum gain has been claimed against at 10%.

Corporation tax

As part of his bid to ensure the private sector helps drive the UK's economic recovery the Chancellor cut corporation tax from 28% to 27% from 1 April 2011. There will be a further 1% cut each year until the rate hits 24% for the 2014 financial year.

The small companies rate of tax will also fall from 21% to 20% on 1 April 2011.

Any farms or estates not paying tax as a corporation may now want to consider restructuring to take advantage of the lower rates of tax.

Capital allowances

The valuable Annual Investment Allowance was slashed from £100,000 to just £25,000. This could be a big blow to many farms and estates, which have to make irregular investments in items with a high capital value like combines and tractors.

The new reduced allowance will not come into effect until April 2012 so anybody who is considering a large capital purchase over the next few years would be advised to bear this in mind. The write-down allowance for plant and machinery also falls from 20% to 18%.

Furnished holiday lets

As expected, the Chancellor scrapped Labour's proposals to remove the tax exemptions for Furnished Holiday Lettings (FHLs) for the 2010-2011 tax year. FHLs provide a good income stream on many rural estates so this move is welcome. The government, however, has recently launched its FHL consultation document which proposes to increase the number of days a property should be available for rent from 140 to 210 days and the number of days it is actually let from 70 to 105 days, in order to qualify for tax reliefs. Anyone who could be affected should stay in close contact with their property advisor.

Inheritance tax on trusts

No specific measures were announced in the budget, but the government will consult on bringing IHT within the Disclosure of Tax Avoidance Scheme. Those likely to be affected by this should seek expert advice.

Country house market continues to gain ground

The average price of prime country property rose by 2.5% in the second quarter of the year taking total growth for 2010 to 4.6%, according to the Knight Frank Prime Country House Index. The latest quarterly increase means prices have now been rising for 12 months, but they are still almost 15% down from the peak of the market in autumn 2007.

A continued shortage of property for sale and a resurgence in demand is helping to boost prices in most parts of the UK, but the austerity measures proposed by the Chancellor in his emergency budget means prices are unlikely to rise at the same pace during the rest of the year – some of our offices are reporting that values have already started to flatten out.

What we are also noticing is an increasing polarisation between the really good houses and those that are over priced or not quite scoring top marks for location and quality. Knight Frank recently sold two wonderful houses in the Cotswolds for a 20% premium, while others have struggled to make their guide prices.

Prime Country Property – price change by region Q2 2010

Region	Three-month % change	Six-month % change	12-month % change
Home Counties	2.3	5.2	10.7
South West	3.3	5.6	9.2
Central England	2.8	4.6	7.7
North	0.6	2.3	4.7

Source: Knight Frank Residential Research

HS2 Exceptional Hardship Scheme includes farmland

After a period of public consultation the transport secretary Philip Hammond has agreed to introduce an Exceptional Hardship Scheme for property owners affected by the proposed route for the London to Birmingham high-speed rail link (HS2). The scheme will compensate people who have to sell, but have seen the value of their property fall since the proposed HS2 route was announced earlier this year.

Compensation will only be available where owners can demonstrate a pressing need to sell and would otherwise experience exceptional hardship – a desire to move house is not enough. The scheme will include commercial and agricultural property with a rateable value below £34,800. It also covers properties recently inherited following a bereavement and repossessed properties that the original owner requires a bank or lender to sell. Properties above the tunnelled sections of the proposed route will not be covered.

The scheme will open for applications on 20 August. Mr Hammond has also conceded that some additional provision over and above the statutory blight regime will be needed. It is his intention that "this should be put in place, if and when a decision is taken to safeguard a route".

Knight Frank has created a specialist HS2 team to help those affected by the scheme. **Please contact james.del.mar@knightfrank.com for a free initial consultation.**

Feed-in tariffs generate huge interest in renewable energy

Over 90% of rural landowners are considering some kind of renewable energy, according to the results of a Knight Frank survey conducted at this year's CLA Game Fair. Eighty percent of survey respondents said the introduction of feed-in tariffs (FITs) last April was behind their enthusiasm. FITs are available to anybody producing electricity (up to a limit of 5MW) from renewable sources including wind, hydro, solar, photovolatiac and anaerobic digestion, even if they use the electricity produced themselves.

FIT payment rates, which are index-linked and guaranteed for up to 25 years, vary depending on the scheme type and size. More details are available in The Rural Report, Knight Frank's dedicated magazine for rural landowners. **If you are thinking of a setting up a scheme on your land please contact Christopher Smith, Knight Frank's head of Renewables and Energy, for an initial site appraisal.**

KnightFrank.co.uk/rural

READY TO HELP

Knight Frank can advise on all aspects of rural property ownership. Its principal service lines and the relevant contacts are listed below. Further details are available on our website at knightfrank.co.uk/rural


Michael Bapty


Tom Barrow


James Del Mar


Sandy Douglas


Robert Fanshawe


Claire Glover


Angus Harley


Clive Hopkins


Michael McCullough


Andrew Shirley


Christopher Smith


Andrew Waller

Knight Frank's clients include traditional estates, institutional landowners, country house owners, farmers, charities, local government, energy and utility companies, rural businesses, private investors and funds.

Agricultural Valuations
Tom Barrow
01179 452 641
tom.barrow@knightfrank.com

Building Consultancy
Andrew Waller
01488 688 512
andrew.waller@knightfrank.com

Country House Consultancy
Angus Harley
01488 688 511
angus.harley@knightfrank.com

Equestrian Property Sales
Robert Fanshawe
020 7861 1373
robert.fanshawe@knightfrank.com

Estate Sales
Clive Hopkins
020 7861 1064
clive.hopkins@knightfrank.com

Farms and Land Sales
Claire Glover
020 7861 1069
claire.glover@knightfrank.com

Mapping and GIS
Michael McCullough
01488 688 508
michael.mccullough@knightfrank.com

Marine Consultancy
Michael Bapty
01179 452 635
michael.bapty@knightfrank.com

Renewable Energy
Christopher Smith
01179 452 630
christopher.smith@knightfrank.com

Rural Consultancy
James Del Mar
01488 688 507
james.del.mar@knightfrank.com

Rural Property Research
Andrew Shirley
020 7861 5040
andrew.shirley@knightfrank.com

Strategic Estate Planning
Sandy Douglas
01488 688 502
sandy.douglas@knightfrank.com