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RURAL BULLETIN

Autumn 2009

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Welcome to this latest issue of the Knight Frank Rural Bulletin

As we head into the autumn, the latest indications suggest that the worst of the credit crunch is behind us in terms of the rural property markets. The value of farmland has increased strongly for the second consecutive quarter and the prime country house market appears to have bottomed out and is even rising in some areas. In this bulletin we reflect on the reasons behind this recovery and try to predict future trends. Commodity markets continue to frustrate or reassure depending on whether you are a livestock, arable or dairy producer, but most farmers will benefit from an increase in their Single Farm Payments following the pound's slide against the euro. As ever, the taxman continues to nibble away at Agricultural Property Relief (page 2), but we can also report a welcome victory for the tax payer (page 4).

I hope you enjoy reading the articles in this bulletin and find them informative and useful. If Knight Frank can be of help in any way you can find contacts for all our rural service lines on the final page.

Headlines

- **Land value recovery continues, according to Knight Frank research**
- **Weakening pound boosts Single Farm Payment**
- **Government planning consultation for heritage assets**
- **Taxman targets disused barns**
- **Confidence returns to prime property market**
- **New coalition to save countryside**
- **Inheritance tax victory**
- **Rural Payments Agency under the microscope**

LAND VALUE RECOVERY CONTINUES

English farmland values continue to recover from their credit crunch dip and are now just £125/acre below the peak they reached last summer.

According to the Knight Frank Farmland Index, prices rose 3.2% in the third quarter of the year and now average £4,973/acre with the best land fetching over £6,000/acre in some cases. The increase follows a 3% rise in the second quarter and suggests confidence has returned to the market once more.

Supply remains tight with about 20% fewer acres than 2008 publicly marketed so far this year. This trend looks set to continue with little sign of lenders becoming less supportive of the industry. At the same time demand is strong, with UK farmers still keen to add to their holdings where it makes business sense.

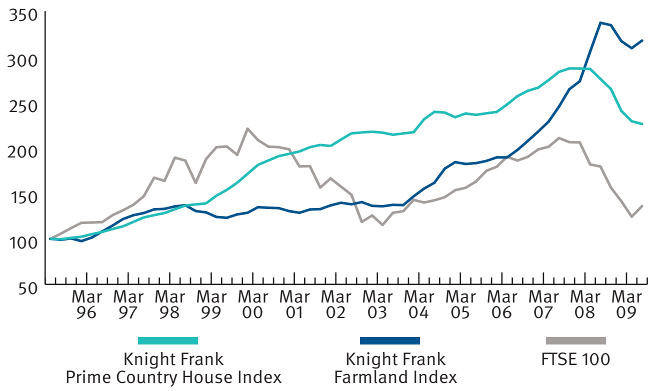
We also expect a number of players active in the market prior to the credit crunch to return soon. The weak pound makes UK farmland a good buy for farmers from the Eurozone, especially those in countries like Denmark where land values are much higher. A number of investment funds are also gearing up to buy farmland in the UK.

Looking forward, we expect values to continue increasing and believe it is not inconceivable that prices will hit £10,000/acre by 2015. Aside from the traditional drivers mentioned above, there is growing global concern, particularly in cash-rich, soil-poor nations, about food security. This has led to a new "land rush" with Gulf states reputedly acquiring large tracts of land in Africa and Asia. Other buyers, however, prefer the transparent and secure land tenure regulations of the developed world.

Pressure from alternative uses, such as biofuels, will also help bolster demand and values.

Comparative performance of farmland

Country property and FTSE 100 (March 1995 - September 2009)



Source: Knight Frank Research

WEAK STERLING COMES TO FARMING'S RESCUE

Wheat prices remain stubbornly below £100/t with a significant UK and global carryover of grain from last season, plus a better-than-expected 2009 harvest in many countries, keeping a lid on markets. Prices, however, have been edging up slightly as the weakness of Sterling makes UK wheat more attractive on world markets.

The pound's slide against the euro in particular has been good news for UK farmers. As well as making our exports more competitive, it has helped to bolster significantly the subsidy payments that UK farmers receive from the EU. These are set in euros and converted into pounds based on the prevailing exchange rate on 30 September, although some farmers who locked into an exchange rate earlier this year may have lost out.

Although using an exchange rate based on just one day could have a severe downside in the future, it has proved extremely beneficial this year as the rate used (90.93p) was the weakest since the Single Farm Payment was introduced in 2005. It compares with a rate of 79p last year and effectively means an increase of 15% in the value of the SFP.

The outlook for 2010 cereal prices is slightly better with November wheat futures trading at £117/t, but even at these levels many farmers will not make a profit without their SFP and will be hoping the pound continues to languish against the euro.

Longer-term, the view is slightly better as wheat consumption should pick up as the global economy recovers. A new bioethanol plant in Teesside that could eat up over 1m tonnes of wheat each year is also due to open next autumn. This could significantly cut the UK's annual exportable surplus of wheat and reduce our reliance on world markets.

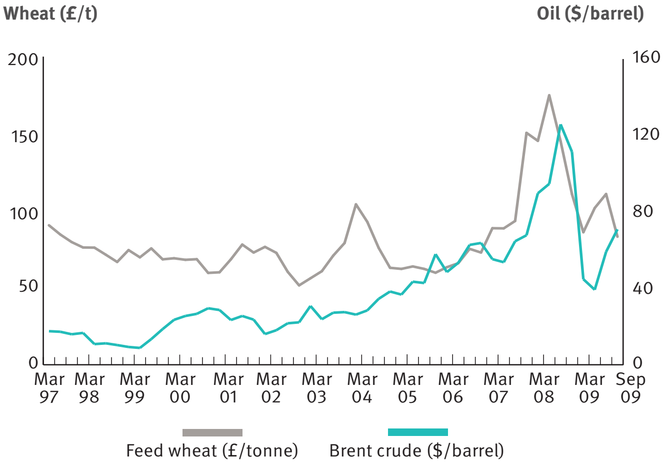
Milk prices are also starting to creep up as world commodity markets pick up slowly, but there is continued widespread discontent not just in the UK, but across Europe, at the levels of payment. In true Gallic fashion, this has culminated in direct action by French dairy farmers who have taken to the streets in their hundreds and even sprayed the police with milk. A number of German milk producers reputedly even went on hunger strike in protest.

Although UK dairy farmers are struggling to remain profitable, the weak pound has helped restrict the annual drop in milk prices to 13%. In the Eurozone the fall has, in some cases, been over twice that.

Agricultural price changes 2008-2009

Commodity prices	Sep 2009	Jun 2009	Sep 2008	Quarterly change (%)	Annual change (%)
Feed wheat (£/t ex-farm)	91	93	95	-2%	-4%
Oilseed Rape (£/t ex-farm)	218	227	277	-4%	-21%
Cattle (R4L steers p/kg dw)	285	288	285	-1%	0%
Sheep (R3L lambs p/kg dw)	323	325	291	-1%	11%
Pigs (DAPP p/kg dw GB av)	150	155	136	-3%	10%
Milk (UK p/litre)	23.3	22.5	27	3.6	-13%
Input prices					
Red Diesel (p/litre)	43	42	58	2%	-26%
Oil ($/barrel Brent Crude)	72	69	93	4%	-23%
Fertiliser (£/t AN 34.5%)	182	175	380	4%	-52%
Soyameal feed (Argentine £/t)	n/a	298	252	n/a	n/a
Economic indicators					
Interest rates (B of E base %)	0.5	0.5	5.0	0%	-90%
Inflation (CPI)	1.1	1.8	4.7	-39%	-77%
£:€ rate	1.10	1.16	1.25	-5%	-12%
£:$ rate	1.60	1.61	1.80	-1%	-11%

Wheat prices v oil



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

TAX THREAT ON BARNS

Landowners with traditional farm buildings on their farm or estate that are no longer suitable for modern farming methods because of size, design or location need to ensure they do not lose valuable tax reliefs.

The taxman is now arguing more strongly that disused buildings should not qualify for 100% agricultural property relief on inheritance tax as they are no longer part of the farming business. This could lead to a potentially large tax bill as some of these buildings could have significant value if converted into dwellings or commercial units.

To avoid this, farmers should ensure they are used for some genuine agricultural use such as storing fertiliser and that this is well documented. According to accountant Old Mill, using them to store sundry "bits and bobs" is unlikely to convince HM Revenue and Customs.

PLANNING CHANGES ON HORIZON FOR OWNERS OF "HERITAGE ASSETS"

A draft government planning policy statement (PPS) could have implications for the owners of historic buildings, sites or landscapes.

PPS 15, *Planning for the Historic Environment,* will replace the current Planning Policy Guidance notes PPG 15 (*Planning and the Historic Environment*) and PPG 16 (*Archaeology and Planning*). It is an attempt to ensure all historic elements of our environment – buildings, archaeology, battlefields, parks, gardens and maritime sites – are dealt with via one policy.

From the perspective of property owners and their advisors, bringing all the various policies under one banner should simplify the planning process. An emphasis on pre-application planning and discussion to collaboratively resolve consent issues as early as possible also seems sensible.

Some of the wording of the draft document, however, suggests there could be more onus on the landowner to ensure any new development enhances existing heritage assets. There is also acknowledgement that heritage assets can include those not already designated under existing legislation – suggesting that the net of protection could be extended.

The draft consultation process closes on October 30. Details of how to respond are included at the beginning of the proposal.

PRIME COUNTRY PROPERTY MARKET BUILDS MOMENTUM

The average price of prime country property has risen for the first time since autumn 2007, according to the Knight Frank Prime Country House Index. Prices rose by almost 1% in the third quarter of the year with farmhouse-style properties showing the strongest growth.

There are, however, regional variations. The Home Counties, benefiting from the knock-on effect of the sharp rebound in London – some areas have recorded almost double-digit growth in the past six months – saw average values increase by 2.1%. But in Scotland there was still a slight weakening.

Prime Country Property – price change by sector

Property Type	Quarter 3 price change %	Annual price change %	Average value £
Cottage	0.7	-12.0	0.44m
Farmhouse	1.4	-10.9	1.1m
Manor House	0.3	-17.2	2.5m
Unweighted average	0.8	-13.4	1.3m

Source: Knight Frank Residential Research

Many commentators are predicting that the current resurgence in house prices is unsustainable and prices will fall back by as much as 10% next year. Knight Frank, however, believes that the current severe imbalance between supply and demand in the prime country house market – far fewer houses then normal are being put up for sale – will continue into 2010.

Combined with predictions that interest rates are set to remain ultra low for much of next year, this will help to support prices and ensure any further falls will be minimal. A significant recovery in prices, however, is not likely until 2011 or even 2012.

RURAL COALITION AIMS TO RESCUE THE COUNTRYSIDE

Six of England's most important rural organisations have just joined forces to create the Rural Coalition, a pressure group that will campaign for a new vision for rural communities.

The group, which includes the Country Land and Business Association and the Campaign to Protect Rural England, claims that government policy has undervalued the countryside and failed to meet the needs of rural communities for the past 50 years. It says much of the countryside is in danger of becoming part dormitory, part theme park and part retirement home.

Chaired by Liberal Democrat MP Matthew Taylor, author of last year's report to government on rural housing and employment, the Rural Coalition will set out its detailed proposals for policy and practical changes after the next election. In the meantime, those interested in finding out more can view its prospectus or get in touch online.

BALFOUR TAX WIN FOR LANDED ESTATES

The recent decision by a Scottish tax tribunal to reverse a decision by HM Revenue and Customs to deny business property relief (BPR) on the estate of the late Earl of Balfour could have favourable BPR implications for other landed estates, according to Tom Hewitt of lawyer Burges Salmon.

The basic rule is that non-agricultural let property is not eligible for any inheritance tax (IHT) relief – so estates with surplus cottages, let commercial units and land let for non-agricultural uses run the risk of a future IHT charge. But where there is a single estate business combining letting and trading activities (typically farming) then BPR on the whole business can be available provided the trading activity is larger than the letting activity.

Needless to say, the details of this case, which revolved around trusts and partnerships, are too complex to describe fully here, but the key point was that it was found that there was a single business with both farming and letting activities and it qualified for full BPR because the trading element predominated. HMRC, however, is appealing Balfour and the result will be watched with interest.

The victory of the taxpayer follows a number of other successful BPR cases including Nelson Dance. Here it was ruled that 100% BPR could be claimed on the transfer of a business asset into a trust. Formerly it was thought that for BPR to apply on the transfer of property into a trust, it needed to be a business or an interest in a business.

Knight Frank can advise on all aspects of strategic estate planning. Please contact Sandy Douglas for more details.

RURAL PAYMENTS AGENCY REVIEWED

The government is investigating the performance of the unloved Rural Payments Agency, which is in charge of distributing, or not as the case often seems to be, the £2bn of subsidy and environmental payments received by English farmers each year.

The review, which commenced in September and is due to report by March 2010, could result in widespread changes to an agency that has lurched from one disaster to another following its formation in 2001. The National Audit Office has just issued a damning report estimating the RPA has wasted £680m of public money. Subsidy payments have often been delayed and hundreds of farmers received the wrong information during a recent mapping exercise.

If you require help with any mapping issues please contact Michael McCullough of our digital mapping team.

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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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