

Agriculture, Food and Rural Communities Directorate
Land Reform and Tenancy Unit

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30 October 2015

Dear Mr Gibson

Land Reform (Scotland) Bill – Update on Rent Review Modelling work

In our letter of 09 September, we agreed that we will be providing you with an update on the agricultural holdings rent-review modelling work carried out on since the Land Reform (Scotland) Bill was introduced earlier this summer.

The attached document is for you and your Committee members consideration ahead of the evidence session on 02 November, and contains the following items:

- Paper on productive capacity and other elements of the new rental process
- Agenda for the stakeholder meeting taking place on 29 October .
- Agreed minutes of 30 July stakeholder meeting
- Agreed minutes of 25 August stakeholder meeting

Please note that a third stakeholder meeting took place on the 1st October. However, the draft minutes are pending approval from the meeting attendees. Another meeting also took place on 29 October to make further progress on the rent review model. We will send you the final paper and agreed minutes in due course. This is likely to be by the end of November.

DEFINITION OF PRODUCTIVE CAPACITY AND OTHER ELEMENTS OF NEW RENTAL PROCESS

Introduction

1. The purpose of this paper is to:
 - agree definition of Productive Capacity (PC) (**see paragraph 12**)
 - agree the non-exhaustive list (**see paragraph 13**)
 - agree a statement on fair rent (**see paragraph 14**)
 - agree a statement on relevant price data to use when assessing potential output (**see paragraph 15**)
 - explore options to address outstanding issues related to rental assessments (**see paragraph 16**)
2. The draft provisions contained at paragraph 12 onwards are intended as a starting point for further exploration with stakeholders. They are not intended as specific legislative drafting as more time will be required to undertake this process in full consultation with stakeholders, allowing them to consult internally.

Background

3. Following the Court of Session's (CofS) decision in the Moonzie case in February 2012, the case was sent back to the Scottish Land Court (SLC) for that court to revise their valuation in light of the CofS guidance that was contained within their decision. The CofS also stated at that time that in determining any rent case in the future the SLC had to follow their guidance.
4. The Moonzie case decision was significant, as this was the only case at that point in which the SLC had determined the appropriate rent level for a holding since the Agricultural Holdings (Scotland) Act 2003 came into force. The CofS decision highlighted that the SLC had placed too much emphasis on a budget approach and in doing so had lost sight of the hypothetical open market evidence. The SLC was wrong to assume that the rent level should not exceed the economic capacity of the holding. The essential question should have been what was a prospective tenant farmer likely to offer for the holding on the open market. The best evidence of this would, in practice, be the rent level paid for a Limited Duration Tenancy (LDT). Another, more direct, indicator of open market value would be evidence of the rent reviews agreed between landlords and their sitting tenant farmers. Valuation based on a budget approach was a method of last resort.
5. This led to allegations that there was too much uncertainty in the sector, which may have damaging impacts on tenants and the sector as a whole.
6. The second agricultural rent review decision made by the SLC was in June 2014 re Capital Investment Corporation of Montreal v Elliot (Roxburgh Mains Farm). In their decision, the SLC concluded that the rent from Whitsunday 2009 should be £48,982 which was an increase of £21,482 from the previous agreed rent of £27,500.

7. Key points to arise from the SLC's decision in this case are:

- following the CofS guidance in the Moonzie case, the SLC fixed the rent by reference to open market of a comparable farm on the Roxburghe Estate that was suitably adjusted and cross-checked against a number of agreed sitting tenant rents
- the SLC held that the rent for the comparable farm had been distorted by scarcity, but, was not persuaded that the extent of the distortion could be measured by a formula that had no statutory foundation. Instead, the SLC made broad judgements based on their expertise as a specialist court and hypothesised what rent the comparable farm would have made in a reasonably balanced market
- on the other hand, the SLC made no deduction for 'marriage value' as most of the offers treated the comparable farm as a standalone holding. They did, however, apply agreed adjustments to reflect the different repairing and replacing obligations for the two holdings, and certain fixed equipment provided by the tenant farmer at the comparable farm
- although the SLC in principle, agreed that a secure 1991 Act tenancy arrangement should be more valuable than a LDT, based on the offers received for the LDT (the comparable farm) the SLC did not find scope for a premium as the majority of bidders had made their best possible offers for the LDT
- the SLC was satisfied that an upward adjustment for SFP was appropriate, on the grounds that, had the Moonzie case been decided when rents of comparables had been negotiated then higher rents would have been obtained.

8. On rents, the AHLRG's recommended the following:

Legislative provisions on rents for secure 1991 Act agricultural tenancies should be amended so that rents are determined on: the basis of the productive capacity of the holding; farmed by a hypothetical tenant (who is an efficient and experienced farmer of adequate resources who will make best use of the land); using the fixed equipment provided by the landlord; taking account of the budget for the holding; and including the contribution from non-agricultural diversified activity

9. Following on from this the Scottish Government have proposed the following in the Land Reform Bill:

In determining the fair rent for the holding, the Land Court must have regard, in particular, to -

- (a) the productive capacity of the holding,
- (b) the open market rent of any surplus residential accommodation on the holding provided by the landlord, and
- (c) the open market rent of—
 - (i) any fixed equipment on the holding provided by the landlord, or
 - (ii) any land forming part of the holding, used for a purpose that is not an agricultural purpose.

The Scottish Ministers may by regulations make provision for the purposes of paragraph 7(4)(a) about the productive capacity of agricultural holdings, including -

(a) how the productive capacity of an agricultural holding is to be determined,
(b) the information to be provided by the landlord and the tenant of a holding to the Land Court to enable the court to have regard to the productive capacity of the holding.

10. Following on from above the Group have been working on a draft definition of productive capacity, and other elements that require some form of statement/guidance to provide increased clarity to the sector where that is possible.

11. Below are set out proposals on how to address the definition of productive capacity, and other factors to take account of.

Proposed legislative provisions for Productive Capacity

12. The provisions developed by the Group, which can be developed further into the required secondary legislation for more detailed consultation, is:

Definition

(1) For the purposes of paragraph 7 of Schedule 1A of the Agricultural Holdings (Scotland) Act 1991 (“the Act”) the “productive capacity of the holding” means the sustainable yield of agricultural products that would reasonably be expected from the holding under a system of farming suitable to it when farmed by a competent, efficient and experienced tenant with adequate resources for that system with such assessment being made as at the effective date and taking account of any factors that might reasonably be thought to vary it before the next rent review.

Determination of the Productive Capacity

(2) The productive capacity of the holding is to be determined:

- (a) taking account of the physical character of the holding relevant to its use for agriculture as a trade or business [including but not limited to those factors listed at **the non-exhaustive schedule of factors**],
 - (b) having disregarded the presence of fixed equipment and any tenant’s improvement so far as:
 - (i) it has been provided wholly or partly at the expense of the tenant (whether or not that expense has been or will be reimbursed by any grant) without equivalent allowance or benefit having been made by the landlord in consideration of its provision
 - (ii) it has not been provided under an obligation imposed on the tenant by the terms of the lease unless it was an item that the landlord was obliged to provide when the lease commenced in the circumstances holding at that date
 - (c) taking account of the fixed equipment provided by the landlord but disregarding such proportion of its cost represented by any grant that the landlord has received or will receive in respect of his providing it
- CAVEAT: paragraph (2)(c) reflects the currently understood position, however views were mixed with some in the group pointing out that it could be seen as odd and unfair to allow a tenant to be compensated for all improvements they made whether grant aided or not, but not the**

landlord. Many were of the view that both should be treated in the same way. This issue will need further discussion and exploration.

- (d) allowing for any land and fixed equipment provided by the landlord that is accepted as being used for a purpose that is not an agricultural purpose relevant to paragraph 7(4) of Schedule 1A
- (e) having disregarded any dilapidation to or deterioration of or damage to fixed equipment or land caused or permitted by the tenant
- (f) taking account of the extent to which the holding may reasonably be farmed with other land
- (g) taking account of the terms of the lease by which the holding is let to the tenant
- (h) taking account of the terms of any other legally enforceable agreement or restriction affecting the use of the holding
- (i) using the yields that would reasonably be expected from the holding for that system of farming conducted by such a tenant.

Information to be provided to Land Court as to Productive Capacity

- (3) The landlord and tenant are to provide the Land Court with the information necessary to that determination of the productive capacity of the holding including but not limited to:
 - (i) the factors affecting the selection of the system of farming suitable to the holding
 - (ii) the land use stocking rotation of crops and other details of that system
 - (iii) the yields of agricultural products that would be expected from that systemwith any other information and factors that may assist the Land Court in assessing the productive capacity of the holding.

DECISION REQUIRED: The group is invited to agree these provisions, in order for them to be shared with the Scottish Parliament and other interests to aid parliamentary scrutiny and debate.

Proposed non-exhaustive list of other factors that may be taken into account when determining the farming system and productive capacity of the holding

13. The non-exhaustive list is proposed as:

- Locality (including proximity to or remoteness from markets and other factors based on general location)
- Topography (including altitude, aspect, inland, coastal, exposed, sheltered, etc)
- Geology and soil types, depth and nature (acid, alkaline, stony, heavy clay, organic content, light sand, free- or slow-draining, etc)
- Climate
- Vulnerability of land to flood, drought, wind blow or erosion
- Presence of contamination, disease infestation, pollution and other limiting factors
- Quality, quantity and compliance with standards of landlord's fixed equipment – not only buildings but also including drainage, fencing, field water supplies, reservoirs and other items

- Services and permissions benefiting the holding
- Quality and suitability of land parcels and their relative mix
- Macaulay land classification
- Layout of the holding
- Field sizes, slopes and shapes, sizes of headlands and margins, ease of working, neighbouring woodland
- Access to holding and fields
- Damage risk by rabbits, game and other animals
- Field drainage and ditches
- Water supply to the holding, including private water supplies, abstraction licences on the land
- Designations including SPAs, SACs, SSSIs, NNRs, National Parks, Scheduled Monuments, Listed Buildings, Battlefields and items listed on the Inventory of Gardens and Designed Landscapes.
- Site specific statutory regulations (eg NVZs)
- Servitudes and wayleaves affecting the holding (including pylons, poles, cables, mobile phone masts and pipes)
- Core paths and rights of way affecting the farm
- Existing uses of the holding for non-agricultural purposes
- Any long term use established on the land that could limit choice or offer opportunities
- The terms of the lease
- Past, current and available future prices of inputs and agricultural products relevant to the holding
- Availability of labour for the holding

DECISION REQUIRED: The group is invited to agree these provisions, in order for them to be shared with the Scottish Parliament and other interests to aid parliamentary scrutiny and debate.

Fixed Equipment Provided by the Tenant – Section inserted to provide further clarification on how to take account of tenants improvements.

Potentially a new Paragraph 7(5) or a rider to paragraph 10 but here drafted as freestanding while recognising the potential overlap with 2(b) above in the definition of productive capacity.

- (1) In determining the fair rent for the holding [assessing the productive capacity under paragraph 8 and the open market rent for paragraph 10] the Land Court shall subject to sub-paragraph (2) disregard the presence of fixed equipment and any tenant's improvement so far as:
 - (i) it has been provided wholly or partly at the expense of the tenant (whether or not that expense has been or will be reimbursed by any grant) without equivalent allowance or benefit having been made by the landlord in consideration of its provision
 - (ii) it has not been provided under an obligation imposed on the tenant by the terms of the lease unless it was an item that the landlord was obliged to provide when the lease commenced in the circumstances holding at that date

- (2) The Land Court may have regard to any item of fixed equipment or tenant's improvements to the extent to which it considers that a tenant could reasonably be expected to have provided it either
 - (a) to meet statutory requirements for a use of the holding permitted by the lease or
 - (b) to secure a beneficial economic return from a use of the holding permitted by the lease that would not be available without that provision.

Where the Land Court takes such account of an item of fixed equipment or a tenant's improvement it shall make allowance for the current cost of providing that item and such other factors as it considers relevant.

DECISION REQUIRED: The group is invited to agree these provisions, in order for them to be shared with the Scottish Parliament and other interests to aid parliamentary scrutiny and debate.

Proposal on fair rent

14. The following provisions set out proposals on how the Land Court should address the issue of setting a fair rent for both parties.

- (1) The principles which the Land Court shall apply in deciding the fair rent for the holding are that –
 - (a) the economic outcome that is reasonably to be expected to be derived from the productive capacity of the holding should be shared fairly between tenant and landlord;
 - (b) it should then take account of the open market rental value of:
 - (i) the right to sub-let surplus residential accommodation
 - (ii) the land and buildings provided by the landlord which are used for purposes other than agriculture
 - (c) it should take account of such other factors as it considers necessary to determine a rent for the holding that would be reasonably seen as fair between a landlord and a tenant
- (2) The economic outcome that is reasonably to be expected to be derived from the productive capacity of the holding is to be determined by reference to:
 - (a) the value of the output from that productive capacity together with all other relevant income and subsidies arising from the occupation and use of the holding
 - (b) the costs of producing that output and income and of complying with the rules of those subsidies including overhead costs but excluding finance, rent and any return for tenant's own labour and management

taking into account as appropriate the extent to which the holding might reasonably be expected to be farmed in conjunction with other land.

(3) In determining the fair division under sub-paragraph 1(a), taking account of the values under sub-paragraph 1(b) and the factors identified under sub-paragraph 1(c) the Land Court shall not take account of the personal circumstances of either landlord or tenant but shall have regard to all relevant factors including:

- (a) any other income available to and costs that would be the liability of a tenant by virtue of occupying the holding under the terms of the lease which the Land Court considers relevant but excluding those that accrue from activity not on the holding solely because the tenant is resident in a dwelling on the holding
CAVEAT – wording added to make clear that the income a tenant secures outwith the holding (e.g. through part-time work elsewhere) is not relevant to the rental calculation, as it is the productive capacity of the farm in question that is relevant (taking account of any diversification income using the land and assets provided by the landlord).
- (b) the tenant's investment in the fixed equipment of the holding
- (c) the working capital and borrowings reasonably required by a tenant of the holding
- (d) the land provided by the landlord
- (e) the investment by the landlord in the fixed equipment of the holding
- (f) the needs of the landlord to fund his obligations to the holding under the law and the lease
- (g) the terms of the lease more generally.

(4) The landlord and tenant are to provide the Land Court with the information that each considers necessary or that the Land Court may require to assist it in determining the fair rent in accordance with this paragraph.

DECISION REQUIRED: The group is invited to agree these provisions, in order for them to be shared with the Scottish Parliament and other interests to aid parliamentary scrutiny and debate.

Statement on price data

15. The statement developed by the Group is:

- The appropriate price data to use is often specific to the farm itself, and based on individual business choices. However, future prices are the most appropriate starting point to consider potential financial outputs from the products produced.

Other elements of rent process to resolve

16. The issues below have all been raised by stakeholders during discussions within the group (and in other places such as AHLRG and Scottish Parliament). They may also in some way fall within the remit of the TFC and the codes of practice they will develop, depending on decisions taken by the TFC. One of the overarching purposes of the work being taken forward is to increase clarity within the tenancing sector regarding rental negotiations. Given this, the group were asked to consider whether an appropriate level of guidance should be drafted to address the issues below; and whether this guidance should be placed on a statutory basis. Further

consideration would need to be given regarding the relationship with the work of the TFC to ensure there is an effective and appropriate balance between issues addressed in legislation, and issues best left to TFC codes of practice.

17. There are clear risks arising from putting guidance into legislation regarding future lack of flexibility, and unintended consequences on individual businesses. However, there is the benefit of providing certainty to those operating within the sector regarding the elements that should or should not be taken account off when setting rents, and how to go about addressing these.

18. Below, each of the issues raised by the group and others is briefly explored. Further discussion will need to be held in the New year on these issues, based on findings from the pilot work that will be undertaken to test the proposals from the group, and taking account of the Stage 1 report from the Rural Affairs, Climate Change and Environment Committee.

Tenants Improvements

19. The group has agreed as a starting point that tenants improvements should be removed from the calculation of productive capacity. This will see any improvements made by the tenant that impact on productive capacity requiring an adjustment of the productive capacity to remove the output generated by the tenants improvements. This will be a complex system to develop, and guidance on how to do this would be beneficial to remove inconsistency in approach. Work will be undertaken by group members to test the process to ensure any challenges are identified and resolved. This can then inform wider consideration of the issue, potentially to aid drafting of some form of guidance.

Surplus accommodation

20. The SG has legislated to state that when determining the rent, the Land Court must disregard any accommodation all or part of which is occupied by the tenant of the holding. This ensures that rent cannot be charged for a 5 bedroom house supplied to the tenant by the landlord when the Standard Labour Requirement (SLR) for the holding is only 1. It has been suggested by some members of the group that the tenants accommodation is taken account of in the productive capacity/fair rent calculation instead, as part of the assets provided by the landlord. This would see a charge applied to reflect the rental saving to the tenant of having a dwelling (or dwellings) made available on the holding for their use (or for the use of any workers they require).

21. There is debate over this rental charge in the Productive Capacity calculation, regarding the assessment of an appropriate rent. Reference to the local housing market is felt to be appropriate, however discussion centred around the size of the house. Some (numbers unclear) tenant farms will be supplied with a dwelling that is no longer an ideal fit for the size of the farm (due to decisions to reduce the original size, or because modern farming methods no longer require a large workforce). Given this results in a tenant being given a house that is too large for their purposes, but with no other option available to them (beyond moving into a house off-farm which may not be practical), further consideration has to be given to the principle of

charging rent for farmhouses and other dwellings on-farm to house the tenant and his family and any workers required for the holding. One option is to leave this to discussion and negotiation, although there are clear risks this will result in inconsistency of approach and uncertainty within the sector. Alternatively, guidance or legislation could be prepared to set out a process whereby the rental comparisons can only be made against dwellings of the size required to house the SLR of the farm. So if the SLR is 1, this would entail charging rent for a dwelling equivalent to the need of the tenant (for example a 3 bedroom dwelling to house the tenant, their partner and their 2 children).

22. It is unclear what the impact of this would be across all scenarios and it will be important to ensure the system is fair to both the tenant and the landlord.

23. If the tenants accommodation is to be taken account of in the productive capacity calculation, thought will have to be given as to how to take account of tenants improvements and the minimum standards that the majority of dwellings in Scotland must meet. It can be argued that if it is the improvements made by the tenant that mean the accommodation meets the minimum standards then no rent should be due as otherwise the accommodation would not be deemed habitable in a normal rental context. Conversely if a landlord is required to make improvements to the accommodation to ensure it remains habitable, then some level of rent could be merited (e.g. if those improvements mean the accommodation meets the minimum standards). Consideration also needs to be given to how/whether to compensate a tenant at waygo for any improvements to the dwelling.

24. In addition to the tenants accommodation there is general surplus accommodation, which is that beyond the accommodation required to meet the standard labour requirement of the holding. At present the Land Court can take account of this in the rental calculation, with reference to its condition and location (and other factors such as agreements on retired workers). There may be merit in clarifying what is meant by reference to its condition. For instance should surplus accommodation be disregarded if it is not capable of being let on the open market due to it not meeting minimum standards? Or should it be taken account of only where it is agreed in the lease that the accommodation can be rented out, and the tenant takes up this opportunity? If so, how is it taken account of, is it a straight split of the rent secured?

25. The Group has not settled on a definitive view on this issue in the time available, and further discussion and exploration will be required to resolve.

Marriage value

26. This arises where a tenant uses machinery and other assets to help farm another holding, this machinery etc. may be the tenants or the landlords. In this situation it has been suggested that some form of reduction or increase in rent is due to take account of how this generates an increase in productive capacity. Similar to above, a complex issue that may benefit from clear guidance to ensure consistency. **Further discussion and exploration will be required to set out more detailed thoughts on this issue.**

Billy McKenzie, SG, October 2015

RENT MODELLING STAKEHOLDER MEETING
AT 13.00PM ON THURSDAY 29 OCTOBER 2015
IN CONFERENCE ROOM 2, SASA, RODDINGLAW ROAD,
EDINBURGH, EH11 9JF

Agenda

- *Lunch will be available to Group members prior to the meeting starting at 12.30pm*

Item 1 Introduction

Item 2 Minutes from previous meeting

Item 3 Revised productive capacity paper

Non-exhaustive list of factors bearing on the productive capacity and

Proposal on fair rent

Item 4 Presentation on lessons learned from testing of provisions on real-life scenarios – Tom Oates

Item 4 Next steps for the Group and close of meeting

- *Coffee will be available to Group members after the conclusion of the meeting at 14.30pm*

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Other issues that need to be examined by the Group possibly prior to Stage 2 of Land Reform Bill starting are:

- Rent Modelling Data testing
- application of Tenant's Improvements
- application of Surplus Accommodation and
- application of Marriage Value

MINUTES OF RENT REVIEW MODELLING MEETING ON TUESDAY 25 AUGUST 2015, AT 09.30am, IN ROOM Z1-10, SAUGHTON HOUSE, EDINBURGH

Attendees

Billy McKenzie (SG)
Alan Barclay (SG)
Mal Cooke (SG RESAS)
Andrew Walker (SG RESAS)
Julian Bell (SRUC)
Ken Bowlt (RICS)
Niall Walker (RICS)
Angus McCall (STFA)
Christopher Nicholson (STFA)
Tom Oates (Youngs RPS, with STFA)
James Dick (SAAVA)
Jeremy Moody (CAAV with SAAVA)
Rob Forrest (SAAVA)
Jonnie Hall (NFUS)
Roddy Jackson (SLE)
Andrew Howard (SLE)

Definition of “productive capacity”

1. Billy McKenzie asked Jeremy Moody to outline and explain how he had developed the “productive capacity” paper. Jeremy Moody explained that he used the outcomes from the discussions at the previous meeting considering methodology and identifying tenant farmer’s improvements. Basic points which arose from this approach were: consider the legal position; setting of bench marks, no consideration of current tenant farmers rent, or a poor rent; consider yields expected from the holding; aiming to produce a “fair rent” not just an arithmetic calculation, which might not provide a fair result.
2. Billy McKenzie confirmed the group required to come up with a definition for “productive capacity” which they were content with, as the aim is to have consideration of the definition in the Scottish Parliament as part of the overall process of scrutinising the Bill. He highlighted the need to address the farm house surplus accommodation issue highlighted by the AHLRG.
3. Andrew Howard highlighted that what this group were being tasked to carry out was not what was in the AHLRG’s Final Report. Also, this was not the approach he thought was being undertaken, this was his and SLE members impression from previous meetings and discussion with the Review Group last year. It was agreed the issue of Surplus Accommodation would be explored further as part of the overall work on Productive Capacity and setting rents.

4. A range of influences that should be taken account of when defining “productive capacity” were proposed at the meeting:

- tenants improvements;
- holdings with or without a house;
- labour requirements;
- farm house being calculated as part of fixed equipment; and
- marriage value.

It would be necessary to resolve these as far as possible to ensure more clarity in the process.

5. Billy McKenzie asked if there were any other comments on Jeremy Moody’s draft definition on page 5 of the Agricultural Holdings - Rent Review Clause 82 – Productive Capacity paper. Christopher Nicholson suggested that “improvement” needed to be included in Section 2 (b), to make it:

“having disregarded the presence of fixed equipment and any tenant’s improvements so far as:”

6. After some further discussion the group came to the conclusion that Macaulay maps were a useful guide to use as an indication of the potential cropping/ productivity activity, but not definitively due to the maps not being refined to a detailed enough level.

7. After further discussion on what could and could not be included in the draft definition, Billy McKenzie asked Jeremy Moody to amend the draft “productive capacity” definition to take account of the views of the meeting.

Action Point 1 – Jeremy Moody to amend the draft “productive capacity” definition and forward to Scottish Government for circulating to group.

Non-exhaustive check list of factors bearing on the “productive capacity”

8. The meeting then considered the non-executive check list of factors bearing on productive capacity. Billy McKenzie asked the group whether there is anything that needed to be added to the list.

9. Jeremy Moody had developed the list as a possible draft schedule for an SSI. Billy McKenzie confirmed that would be considered by the Scottish Government.

10. Jonnie Hall asked about the inclusion or access to subsidy payments. Jeremy Moody said that “decoupled” subsidy payments, other than any income foregone element, are outside the calculation of “productive capacity”.

11. The meeting discussed how the following items would have a bearing on the “productive capacity” of the holding: the effect of a bed and breakfast operating from the farm house; stocking levels of the holding; black patch approach, varying labour costs; adjustments taking account of local circumstance; and if there are implications for landlord who is the next step in the chain. All of this will be addressed through the testing process, with the aim of developing clear guidance.

12. Billy McKenzie asked Jeremy Moody to amend the draft “non-exhaustive check list of factors bearing on the productive capacity” definition following the discussion.

Action Point 2 – Jeremy Moody to amend the non-exhaustive check list of factors bearing on the “productive capacity” and forward to Scottish Government for circulating to other group members.

Price data

13. The discussion then turned to price data, Billy McKenzie felt there were three ways to consider price data: should past data be used; should current data be used; or is there a need for consideration of future data. Tom Oates considered that it was necessary to consider all three. Ken Bowlit thought there was a need to look at what has happened in the three years since the last rent review on the holding. Then taking account of the real data for the holding and current market prices this could then be used to determine a rent. If future costs vary significantly from estimates, another review would be done in three years’ time so adjustments could be made.

14. The meeting then discussed various issues that would affect/ influence price data given the position, and identified a wide range of factors including individual business decisions. It was agreed that a statement could be given on price data to use, but no more than this due to wide variety of specific factors involved.

Divisible Surplus

15. Billy McKenzie introduced the discussion on divisible surplus and suggested there were three options for divisible surplus: issue guidance; setting a figure; or leaving to negotiation. Angus McCall remarked that the key point was how you define a “fair rent” to ensure both the landlord and tenant farmer a return on their investments/labour. Tom Oates suggested there was a need to take account of the RICS definition for “fair value”.

16. Members of the group suggested that the Scottish Land Court is contacted to ask about their meaning of fair rent.

Action Point 3 – Scottish Government to ask Scottish Land Court what do they mean by a “fair rent”.

17. Ken Bowlt said that a practitioner would consider the surplus produced by the figures available to them but the issue would be how to split it between both parties. He highlighted that this was not a straight forward calculation as you would need to account for the capital invested by the tenant farmer and the landlord; you would also need to consider what each party brings to the tenancy arrangement; if the rent known; how the rent figure compares with any comparable; if its right and finally if there is anything missing.

18. Others members of the group commented that there was a need to follow some form of guidance and the process for a reasonable test and what should be taken account of.

19. Billy McKenzie asked Ken Bowlt to draft a paper to define potential guidance for the setting of a fair rent.

Action Point 4 – Ken Bowlt to put together a draft guidance paper/statement for fair rent and forward to Scottish Government for circulating to other group members for discussion at next meeting.

Revised rent model

20. Julian Bell mentioned that SRUC hadn't reworked the whole model from previous meeting, instead they considered the issues around the “productive capacity” element. SRUC had focused on what the typical land use would be for that regional area.

21. The members of the group felt it was too rigid for holdings given the great difference that the figures show for different areas. The average yield data was considered useful, albeit on a limited basis due to the lack of more precise detail. The Scottish Government explained that it would be extremely difficult if not impossible to gather more precise data given the wide variety of farms in each parish and the need to survey thousands to get a highly accurate picture. What the data can do is provide an indication of average yields. It was agreed that further work could be done to explore whether we can refine the data further, but as a starting point average yield data is useful. Other elements of the model, although useful as a business tool, were deemed unnecessary and could be set aside.

Next Steps

22. As there are a number of action points from this meeting that require individuals to prepare discussion papers for the whole group to consider, Billy McKenzie suggested that another meeting would be arranged with the group members possibly near the end of September or at the start of October.

To Note:

Following the meeting Tom Oates, Roddy Jackson and Rob Forrest agreed to meet and go through a test negotiation using tools produced by the group, to identify issues to refine, improve, and replace. This will be used to develop guidance, prior to wider testing with volunteer tenants.

Action Point 5 – Scottish Government to arrange another meeting for group members near the end of September or at the start of October depending on peoples availability.

List of action points from meeting held on 25 August 2015

- **Action Point 1 – Jeremy Moody to amended the draft “productive capacity” definition and forward to Scottish Government for circulating to group.**
- **Action Point 2 – Jeremy Moody to amended the non-exhaustive check list of factors bearing on the “productive capacity” and forward to Scottish Government for circulating to other group members.**
- **Action Point 3 – Scottish Government to ask Scottish Land Court what do they mean by a “fair rent”.**
- **Action Point 4 – Ken Bowlt to put together a draft guidance paper/statement for fair rent and forward to Scottish Government for circulating to other group members for discussion at next meeting.**
- **Action Point 5 – Scottish Government to arrange another meeting for group members near the end of September or at the start of October depending on peoples availability.**
- **Another Action Point – Tom Oates/ Roddy Jackson/ Rob Forrest agreed to meet and go through a test negotiation using tools produced by the group, to identify issues to refine, improve, and replace. Then put together a information paper on price data and forward to Scottish Government for circulating to other group members.**

Minutes of the rent review template stakeholder meeting on Thursday 30 July 2015, at 09:30am at SASA, Roddinglaw Road, Edinburgh EH12 9JF.

Attendees:

- Julian Bell, Paul Heyhoe, Douglas Bell (SRUC)
- Andrew Howard, Roddy Jackson (SLE)
- Christopher Nicholson, Angus McCall, Mike Halliday (STFA), Tom Oates (Youngs RPS),
- Allan Bowie, Gemma Thomson, Malcolm McCall (NFUS)
- James Dick, Rob Forrest (SAAVA), Jeremy Moody (CAAV)
- Hew Edgar, Sarah Speirs, Ken Bowlit (RICS)
- Richard Murray, Neil White, Billy McKenzie, Fiona Buchanan, Alan Barclay and Laura Merenciano (Scottish Government)

i) Introduction

1. Billy McKenzie chaired the meeting. He welcomed participants and thanked them for attending. He outlined the purpose of the meeting, which was to introduce the new draft rent review template to stakeholders; and agree on any amendments or improvements they would like to suggest in taking the template forward.
2. Richard Murray updated on progress made to date by SRUC in designing a draft rent template, which was based on Appendix D of the AHLRG Final Report. The objective of the meeting was to identify income and expenditure elements that needed to be reflected in the template. This would then enable SRUC to take amendments on board prior to testing the template with a number of tenant farmer that had volunteered: six provided by stakeholder organisations and another six from the Farms Account Survey.
3. Fiona Buchanan provided an update on the rent review provisions within the Land Reform (Scotland) Bill, highlighting areas where provisions differed from the Review Group recommendations. She also explained how provisions relating to the form and content of rent review notices and other relevant information will be developed through the use of a negative SSI to enable future flexibility.

ii) Discussion on the rent review model

4. SRUC presented the template by providing instructions on how it should be used.
5. The first reactions and comments on the template were as follows:
 - The widespread view among stakeholders was that the template did not fully reflect the AHLRG recommendations. In particular, it was considered that the template did not capture the assumption that estimation of productive capacity is based purely on what would be possible for a hypothetical tenant using only the fixed equipment provided by the landlord. This would mean that no actual data from the farm/tenant would be used, which it is hoped would avoid some dispute. As part of this it was considered that any improvement provided by the tenant should be disregarded from the start of the rent review ('black patch' approach). The Scottish

Government advised that lack of reference to tenants improvements in the model was an error and this would be changed to ensure these type of improvements were removed from any estimation of productive capacity, to ensure that estimates were based purely on assets the landlord provided to the tenant.

Conclusion: Group agreed unanimously that the model should be changed to remove actual data and focus purely on hypothetical, this change will be made for the next meeting.

It was noted that under this type of rent calculation, careful thought needed to be given to situations where a 91 Act tenancy for a holding is being let as bare land but the fixed equipment is provided in a different lease on another holding by the landlord or even a different landlord. It was also noted that we should address the issue of marriage value.

6. Participants were then encouraged to think about the data and methodology that should be used to measure the productive capacity of the holding:

Productive output:

- Angus McCall (STFA) noted that terms of some leases limited what the enterprise could do and this needed to be taken account off, **the group agreed with this approach.**
- Andrew Howard (SLE) noted that the use of the farm should be prescribed by what a farm of that type would be used for by a prudent occupant in that area. The example used was that you wouldn't assume the production of wheat in the far north of Scotland (regardless of land quality) because of short season etc.
- Douglas Bell (SRUC) considered that a starting point to measure productive capacity should be the land capability and quality of the land. This could be provided by the Land Capability for Agriculture (LCA) classification. However, he acknowledged that this indicator by itself was not enough to measure productive capacity as local circumstances also came into play.
- Jeremy Moody (CAAV) followed by suggesting that it was possible to get a non-exhaustive list of factors to assess the physical nature of the holding using the Agricultural Holdings 1986 Act as starting point. He agreed to develop the list further and circulate it.
- The group suggested that coupled subsidy such as VCS and LFA should be taken account of as part of the productive capacity, as these payments were linked to production so formed a part of the whole. There was discussion on whether to use hypothetical data or actual, **with most stating you would have to use actual to get a reasonably accurate picture.**
- Andrew Howard (SLE) considered that extending the list of data/indicators beyond local/physical characteristics would create more problems and room for dispute. He also stressed that the change in the rent review calculation would make tenant farmers more reliant on land agents.

Price data:

- Christopher Nicholson (STFA) stated that using historical data to calculate rents was counter-productive, as the tenant farmer would be paying rents based on market conditions that could potentially be very different from the conditions at the moment of calculating the rent. He provided the price fluctuations in dairy output as an illustration why historical data was not appropriate to calculate rents. Instead, the STFA proposed that data on the Farm Management Handbook could provide more accurate data about the current market conditions at the moment of conducting the rent.

Similarly, data using future projections was fraught with risks as it was fairly certain any estimates of costs in the future would turn out to be wrong.

- Roddy Jackson (SLE) considered that it would be better to calculate the productive capacity of the holding using current data. However, he recognised that there should be a framework or method whereby volatility is removed or properly considered to ensure that rents were not disproportionately low or high.

Conclusion:

7. Following this discussion, SG RESAS will draft a revised model to address stakeholders concern.

8. Farms Account Survey data will be used to attach values to predominant regional activities based on the LCA data, the ultimate goal being to produce a 'benchmark' consisting of a volume of output per hectare range taking into account regional variations.

9. Participants agreed that the proposed approach was the way forward. It was agreed that the use of historical data was adequate to measure output but it should not include price information.

The following agreement was reached:

- **The rent review template should be based on the assumption of the hypothetical tenant using only the fixed equipment provided by the landlord.**
- **The definition of productive capacity should be part of regulations; and the flowchart/list of factors to be considered in assessing productive capacity to be part of guidance.**
- **Group will discuss and agree both the definition of productive capacity and the non-exhaustive list which will form a part of the estimation of rent, based on papers to be circulated by Jeremy moody.**

iii) Discussion on the Divisible surplus

10. The meeting moved on to discussing the surplus split. Billy McKenzie asked participants whether the 50/50 split recommended by the Review Group should be the reference to divide the surplus; or whether they had in mind a different reference point that should be in guidance.

11. The following comments were made:

- Roddy Jackson (SLE) said that there was a Scottish Land Court case that had already defined 'economic rent' (Crown Estate v Gunn).
- Allan Bowie (NFUS) noted that he had to give more careful thoughts to this issue but believed that it was important to avoid a too prescriptive approach. He stressed the need to come up for a system that was transparent and provided basis for negotiation.
- Douglas Bell (SRUC) explained that practitioners had 'rule of thumbs' to calculate the split using financial comparisons and real world comparables.
- Jeremy Moody noted that the split would fluctuate based on what elements you exclude from the surplus calculation.
- Christopher Nicholson (STFA) stated that the capital provided by the tenant should be taken into account in calculating the split.
- Andrew Howard (SLE) stated that the split would depend on what the ultimate aim in calculating rent was. There is the real possibility that on top of all the other new things to agree – productive capacity, output, price etc. – having to split on a negotiated basis would not result in smooth non-contentious negotiations. The fact that mechanisms were being considered to prevent volatility seemed to demonstrate one of the main failings of the proposed approach. It was unclear whether the aim was to accept volatility, preventing disputes or making the rent review process more straightforward. He added that the current rent formula removed volatility from the system.
- Tom Oates (STFA) stressed it was crucial to remove volatility from the rent review calculation.
- Jeremy Moody (CAAV) noted that the Joint Rent Review Initiative had offered a mechanism to remove volatility, as it limited rent increase to a certain level. It was also said that rent review provisions within the Land Reform Bill included a similar mechanism to deal with significant rent increases.

Conclusion: Participants did not reach an agreement about the divisible surplus but agreed to reflect further on potential options.

ACTION POINTS 30 July 2015

AP1: SRUC to develop the template in line with agreed changes and send to Scottish Government for circulation prior to next meeting of group.

AP2: SRUC will test the model using data supplied by SG.

AP3: Scottish Government to organise a meeting with stakeholders at the end of August. SRUC to bring worked examples to illustrate how the model works in practice and receive further feedback.

AP4: Jeremy Moody (CAAV) to circulate the definition of productive capacity and a list of physical/natural factors to be part of the productive capacity definition.

AP5: Participants to reflect further on potential options on divisible surplus.