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Land Reform (Scotland) Bill: proposed Stage 2 amendment to section 79

Dear Nick

We are currently preparing our response to the RACCE Committee's Stage 1 report on the Land Reform (Scotland) Bill, and will share that with the Committee prior to the Stage 1 debate on 16 December. Before that, though, I wanted to give the Committee early sight of our intentions on section 79, which is an area on which its report requests more detailed information.

At present section 79 of the Bill confers a power on Scottish Ministers to provide for the conversion of 1991 Act agricultural tenancies into modern limited duration tenancies (MLDTs). A tenant would then be able to assign his MLDT to a new tenant on the open market. As the Delegated Powers Memorandum explains, we took this power to allow for further discussion with the sector on developing the proposal. We have noted that both the RACCE Committee and the DPLR Committee have expressed a desire to see more detail included on the face of the Bill, and that there has been debate among stakeholders on how best to implement the principle of supporting outgoing tenants to retire with security and dignity while increasing routes into farming for newer entrants.

We have now more fully developed our proposals to give effect to these principles, and are therefore preparing Stage 2 amendments to replace the delegated power at section 79 with substantive provisions. These will be designed to do two things:

- To allow for 1991 Act tenancies to be converted to MLDTs, with the agreement of the tenant and landlord.
- To create a process under which 1991 Act tenants can assign their tenancy to a new entrant or to a progressing farmer, with the landlord having the option to purchase the tenant's interest during the process. I have attached for the Committee's interest a note we have prepared for stakeholders to explain this process in more detail.

We are continuing to engage with stakeholders on these proposals as we prepare amendments to bring forward at Stage 2.

We would be happy to discuss this with you when we meet on Thursday.

STEVE SADLER

Head of Land Reform and Tenancy Unit

Land Reform (Scotland) Bill: new assignation process to replace Section 79

Introduction

1. As it currently stands, Section 79 of the Land Reform (Scotland) Bill gives Scottish Ministers the power to create regulations that would enable 1991 Act agricultural tenancies to be converted into modern limited duration tenancies (MLDTs), which the tenant could then assign to a new tenant on the open market. The aim behind this Section is twofold:
 - To give farmers with 1991 Act tenancies a route that would enable them to exit their tenancies with dignity and security, without being dependent on a family member succeeding the tenancy.
 - To increase opportunities for newer tenant farmers to establish themselves.
2. We have now developed proposals that we believe will be more effective in realising these principles. In their reports on the Bill, both the RACCE Committee and the DPLR Committee have expressed a desire to see more detail on Section 79 included on the face of the Bill. We are therefore preparing Stage 2 amendments to replace the regulation-making power at section 79 with substantive provisions to implement our new approach.
3. The Bill will still enable 1991 Act tenancies to be converted to MLDTs, with the agreement of the tenant and landlord, to increase flexibility in the sector. However, our amendments will also create a new process under which 1991 Act tenants can assign their tenancy to a new entrant or to a progressing farmer, on the same terms as their existing tenancy (ie as a 1991 Act tenancy). The landlord will have the option to purchase the tenant's interest during the process, as an alternative to the tenancy being assigned.
4. The new process is explained in greater detail over the following pages, and the key differences between the original Section 79 and the new proposal are summarised below:
 - The tenancy now remains a 1991 Act tenancy, rather than being converted to an MLDT.
 - Under the new process there are two stages to waygo. This means that when the tenant gives notice he is not committing himself to leaving the tenancy: an independent valuation is provided which he has the opportunity to consider before making a final decision to leave.
 - The landlord now has the opportunity to buy out the tenancy.
 - The outgoing tenant can now only assign his tenancy to a new entrant or to a farmer progressing in the industry, thereby helping to target those we wish to expand access to tenancies for.

Proposed process (see also the diagram at Annex A)

5. Any tenant of a 1991 Act tenancy may serve a notice on his landlord, letting him know that he intends to relinquish the tenancy.¹ The tenant must send a copy of the notice to the Tenant Farming Commissioner (TFC) at the same time.
6. Once the TFC has received the notice, he must appoint a valuer. The valuer must be someone the TFC believes is suitably qualified and independent. The valuer should also have knowledge and experience of valuing 1991 Act tenancies, of waygo compensation for them, and of the value of agricultural land subject to 1991 Act tenancies.
7. The valuer has six weeks to send the tenant and the landlord estimates of:
 - the value of the land if it were sold with vacant possession;
 - the value of the land if it were sold with the tenant still in occupation; and
 - the sum of the compensation that would be due to the tenant at waygo. This would be estimated as though the tenancy had ended on the date the tenant served his notice to quit.
8. The valuation must take into account any investments, improvements, repairs and maintenance in the holding made by both the tenant and landlord over the period of the lease. It must also be carried out as if s 34(2)-(7) of the Agricultural Holdings (Scotland) Act 2003 applied. Among other things, this means the valuation must take into account when the landlord would otherwise have been likely to recover vacant possession of the land from the tenant.
9. The landlord and the tenant then have 21 days in which either of them may appeal the valuation. If an appeal is made, the valuation is referred to the Lands Tribunal.
10. The tenant may also decide, once he has received the valuation, that he no longer wishes to proceed with ending his tenancy. In that case, he would need to inform his landlord and the process would end.
11. After the appeal window has passed (or, if either party appealed the valuation, once the Lands Tribunal has issued its judgement), the tenant has 14 days in which he can decide he would prefer to continue with his tenancy, and formally notify the landlord that he won't be proceeding with the assignation process. (Note that the tenant also has the option to end the process during the appeal window – see paragraph 10.)
12. If the tenant does not notify his landlord that he wishes to end the process, then once the 14 days have expired the landlord becomes entitled to buy the tenant's interest in the tenancy. To do this, the landlord would need to pay the tenant at least:
 - the sum of the waygo compensation valuation figure, plus
 - 50% of the difference between the estimated value of the land if sold with vacant possession and the estimated value of the land if sold with the tenant still in occupation.

¹ Note: this process is not open to tenants in circumstances where there are outstanding demands to remedy or notices to quit against the tenant.

13. The landlord will have a period of several months to exercise this right to buy out the tenant and settle the acquisition – we have not yet reached a decision on exactly how long this period should be, and would be interested in stakeholders' views.
14. If the landlord does not exercise his right to buy out the tenancy, then the tenant may proceed to assign his lease to a new tenant. To do this, he must notify the landlord of the details of the person to whom he proposes to assign the lease, the terms of the assignation and the date on which it is to take effect. However, the tenant may only assign his lease to a new entrant (someone setting up as head of an agricultural holding for the first time), or to a tenant farmer who is progressing in the industry and seeking to establish themselves further (in practice, this will mean someone who has not already held a 1991 Act tenancy).
15. The landlord has 30 days in which he may object to the incoming tenant.

Why have we chosen this approach?

16. In determining how best to proceed, we have been mindful of the need to balance the following factors:
 - Providing 1991 Act tenants with a secure way of exiting their tenancies even if they do not have an eligible successor to whom they plan to assign their lease.
 - Addressing the current disincentive for 1991 Act tenants to retire at an appropriate point, thereby enabling holdings to pass to newer or younger tenants who are likely to be able to farm the land more productively, and to modernise.
 - Transparency and fairness for both the landlord and the tenant on the amount to be paid at the end of the tenancy.
 - Increasing access to land for new entrants to farming.
 - The importance of making holdings available on a basis long-term enough to enable farmers to plan effectively and maximise the productive potential of the land.
 - Protecting landlords' rights to their property.
17. We consider that the new proposals strike an appropriate balance between tenants' and landlords' rights, while helping to create a more vibrant and fluid tenanted sector, which is in the wider public interest.
18. We appreciate that landlords and their representatives have expressed some concerns that the new approach undermines landlords' rights to their property, because it perpetuates indefinite 1991 Act tenancies. However, we would note that:
 - This assignation process only applies to existing 1991 Act tenancies. Under the terms of such leases the landlord is not currently guaranteed to regain control of the land at a fixed point in time: even in instances where a landlord might *expect* to regain control shortly (for example, because the tenant is nearing retirement age, single and without successors), the tenant's circumstances could change: he could (re)marry; have children later in life; or an eligible successor who has not previously shown an interest in taking on the tenancy could change his or her mind. By allowing the incoming

tenant to take on the lease as a 1991 Act tenancy, the new policy therefore preserves the position the landlord was already in.

- The new process creates an opportunity for the landlord to buy out the tenant, ending the 1991 Act tenancy. We see this as an important counterbalance to the increased assignation opportunities afforded to the tenant.
- It is also worth noting that the cost to the landlord of recovering possession will be directly linked to the extent to which his prospects of regaining control of the land are impacted by the new process. In circumstances where landlords may feel they are most disadvantaged – in other words, where they may have expected to regain control of the land in the near future – the cost to the landlord of recovering possession will be relatively low. This is because the independent valuation of the land will take into account when the landlord would otherwise have been likely to recover vacant possession of the land from the tenant. If the tenant is nearing retirement and has no successor, the value of the land with the sitting tenant and the value of the land if vacant will be closer to each other, and the cost the landlord pays (50% of the difference) in addition to waygo compensation will be lower. Conversely, in circumstances where the landlord would not have been likely to recover possession of the land in any event, the impact on him of this new process is more limited. The difference in value between the land with the sitting tenant and the land if vacant would be higher, and therefore the 50% of the difference paid by the landlord would be a larger sum.
- If a landlord does not buy out the tenant's interest, he will still be entitled to receive a fair rent for the holding from the new tenant. He will also be able to object to an incoming tenant, and to re-take possession of the holding in the event of any circumstances in which he is currently entitled to terminate a 1991 Act tenancy.
- Under the new approach, the categories of person to whom the tenancy can be assigned are more tightly focussed than they were under the original proposals. The incoming tenant must now be a new entrant or a farmer progressing in the industry, whereas under the original approach the new tenant could have been anyone. We have taken this approach in order to help maximise the wider public benefit of a vibrant and productive tenanted sector, by increasing opportunities for those who have much to offer yet currently encounter significant barriers to securely establishing themselves in farming.

Other options considered

19. Before arriving at our preferred approach, we looked carefully at two conversion options: conversion to an MLDT with a 25 year lease term, and conversion to an MLDT with a 35 year lease term. We also explored the option of the approach described at paragraphs 5-15, but allowing for open assignation.
20. A 25 year MLDT was strongly felt to be too short to enable the land to be farmed as productively as possible, and to give an incoming tenant sufficient security to plan

effectively. As an illustration of the significant difference in potential between a 25 year and a 35 year term:

- A 25 year tenancy would allow a farmer to plan for 3 grassland, vegetable and potato rotations; 4.5 cereal rotations; 3 generations of cattle and 4 generations of sheep.
- A 35 year tenancy would enable a farmer to plan for 4.5 grassland, vegetable and potato rotations; 8 cereal rotations; 4.5 generations of cattle and 6 generations of sheep.

(Note that these estimates assume the farmer will not be able to start immediately on assuming the tenancy, and that his business will change as the end of his tenancy approaches and he prepares to quit.)

21. We were also concerned that a term of only 25 years could deter farmers from investing as much in their holdings as they might otherwise have done, potentially limiting productivity and hindering modernisation. Furthermore, the incentive for tenants to retire could be decreased, as they would secure less value on exiting the tenancy. This would in turn hinder the creation of opportunities for holdings to be passed on to newer or younger farmers able to farm the land more productively.
22. The AHLRG recommended a term of at least 35 years, and for the reasons outlined above we believe a 35 year MLDT would be preferable to a 25 year term. However, there would nonetheless be drawbacks to enabling all tenants to unilaterally convert their 1991 Act tenancies to MLDTs, potentially imposing new lease terms on their landlords against their will. We are therefore of the view that continuing the tenancy as a 1991 Act tenancy is a better approach, as it retains the terms of the lease the landlord is already subject to. We do plan to bring forward Stage 2 amendments to the Bill which would allow 1991 Act tenants to convert their tenancies to MLDTs, but, crucially, only if both the tenant and landlord agree this approach.
23. Having decided to enable tenants to assign their tenancy as a 1991 Act tenancy (rather than converting it to an MLDT), we felt that combining this with open assignation would be too broad an approach, not sufficiently focussed on the policy objective of increasing opportunities for new and progressing farmers. New entrants and those progressing in the industry will typically have less access to capital than well-established farmers, and would be likely to struggle to compete for tenancies if all farmers were eligible. In order to serve the wider public and economic interest of enhancing agricultural productivity and modernisation, it is important that we remove barriers to newer entrants establishing themselves sustainably in the sector.

Summary

24. The proposed policy is designed to:
- Provide an incentive for 1991 Act tenants to retire at an appropriate point, without being dependent on an eligible relative succeeding the tenancy.
 - Create a transparent waygo process, clear and fair to both tenant and landlord.

- Maintain the current lease terms and conditions, but with a new tenant likely to be better-placed to modernise and invest in the holding over the longer term.
- Provide the incoming tenant with the full potential to maximise his opportunity to secure a reasonable return from his investment.
- Increase routes into farming for new entrants and those progressing.
- Give the landlord an opportunity to secure the holding under his full control by paying an appropriate level of compensation.

**ANNEX A:
ASSIGNATION
PROCESS TO
REPLACE
SECTION 79**

The tenant serves a notice on the landlord of his intention to relinquish the tenancy. He also sends a copy of the notice to the TFC.

The TFC must appoint a valuer.

Within 6 weeks of being appointed, the valuer provides the tenant, landlord and TFC with his estimate of the value of the land (both if sold vacant and if sold occupied), and the likely sum due to the tenant at waygo.

Either the tenant or the landlord may appeal the valuation to the Lands Tribunal within 21 days. During this period the tenant may also choose to end the whole process, if he wishes. and if sold occupied), and the likely sum due to the tenant at waygo.

If there is no appeal, the tenant then has 14 days from the end of the appeal window to decide whether to end the process.

If either party appeals, the Lands Tribunal considers the valuation and issues its judgement. The tenant then has 14 days from the judgement to decide whether to end the process.

If the tenant does not end the process, the landlord then has X months in which he is entitled to buy out the tenant's interest in the holding. He must pay no less than the sum the tenant would be entitled to at waygo, plus 50% of the difference between the value of the land with vacant possession and the value of the land with the tenant in occupation.

If the landlord doesn't exercise that right, the tenant may give notice to the landlord that he intends to assign his tenancy to a new tenant, who must be a new entrant or someone progressing in the industry.

The landlord has 30 days in which he can object to the proposed new tenant on "reasonable grounds".