The Scottish Government

Testing of the Rent Review System
Report and Recommendations

Scottish Government
Riaghaltas na h-Alba
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Contents

We confirm the report is settled by all parties and reflects our professional opinion.

Signed:

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Hannah Guild

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Executive Summary

Executive Summary

Aim of the Research

The Land Reform (Scotland) Act 2016 sets out the framework for assessing what is a ‘fair rent’ for an agricultural holding. The concept of a ‘fair rent’ underpins the ethos of the Act and therefore drives the recommendations and conclusions reached in this report. It is implicit that a ‘fair rent’ must be a sustainable rent for both landlord and tenant. This dictates a need for codes of practice to outline how this can be produced in a reasonable and proportionate manner.

Overarching Philosophy

The overarching philosophy of creating a ‘fair rent’ should be based on transparency of process. This can largely be achieved though “open” as opposed to “without prejudice” correspondence and agreed statements relating to factual matters and evidence.

A rent review can be settled along the following three different pathways:

1. Litigation and/or Arbitration
2. Alternative methods to dispute resolution
3. Dispute Avoidance

The preference should always be dispute avoidance which we believe is possible if best practice guidance facilitates that the following processes are put in place by both parties to ensure positive engagement:

1. No documentation between parties being labelled as ‘without prejudice’ will encourage correspondence to be open, reasoned and justified.
2. The disclosure of insurance details in terms of litigation cover at the start of rent review negotiations so parties are aware of where they stand and this is not used as a ‘bargaining chip’ later in the negotiation process. There should also be an acceptance of the fact that insurers would be updated on the likelihood of success throughout the process of litigation.

3. A statement of facts on the capability of the holding is produced between the two parties prior to the creation of any budgets. This will employ a level of agreement and range of reasonable figures prior to a proposed rent being put forward. It will therefore ensure boundaries for working and transparency in approach.
4. A 50/50 split of the divisible surplus is used unless it is fully justified why an alternative approach should be put in place.

We believe that a cultural change should underpin the implementation of this Act. In order for the provisions to be workable in practice there needs to be valid and accepted codes of practice which dictate the expected conduct of both parties and the main steps which should be taken to come to a fair rent. The promotion of professional practice is seen to be very important in order to make the new system workable in practice.

Recommendations

Our recommendations can be summarised as follows:

<u>Form & Content of a Rent Review Notice Summary</u>

- Removal of Sub-section 2(d) to ensure a rent review notice does not need to include details of the proposed rent. However, we observe that this would appear to fall outwith the scope of Section 2 (4) of the Act which allows Scottish Ministers by regulations to make “further” provision about the form and content of rent review notices. We do not believe that removing an existing requirement is making further provision and any such change may require primary legislation.

- Best practice guidance should be updated to dictate:
    - A timeframe for a rent review negotiation procedure similar to that which is currently outlined. It is felt dictating a timeframe within statute is too inflexible to cope with circumstantial delays caused by farming operations or unforeseen events;

    - completion of the tenant's amnesty should be encouraged in order to improve records for rent review purposes;
    - completion of a Statement of Facts should be undertaken alongside the Tenant's amnesty procedure prior to a rent review notice being served under the new system.

Productive Capacity Summary

- Clarity is required to ensure that the productive capacity can be calculated using the Gross Output model proposed. Further research into what percentage of Gross Output would reflect the expected Gross Profit of a competent farmer, how this may vary and what factors would allow it to be varied is required;
- a black patch approach to tenant's improvements should be adhered to except where the improvement is required to be considered in order to derive a sensible farming system for the holding;
- non black patched improvements should be accounted for and deducted in terms of the additional rent a tenant would pay for them. This may be done using a relevant cost and deduction method agreed to be reasonable by both parties;
- where an improvement is undertaken using grant aid, the amount that represents the landlord's contribution should be taken into account in the rental assessment. The amount which represents the tenant's contribution should be disregarded from the rental assessment. This approach would be considered as fair to both parties but different to what has been done in the past and what is outlined in the Rent Review Tender document;
- as standard, it is recommended that the divisible surplus is split 50/50 before deductions for improvements and additions for surplus residential accommodation and non-agricultural use. Adjustments to the 50/50 split will only be justified where the result of this is considered to be 'unfair';
- the inclusion of adequate residential accommodation for the holding can either be accounted for by varying the gross profit percentage used in the gross output model

or by considering this in terms of 'all of the circumstances' outwith the three statutory considerations of the Act. Further research is required to ensure a fair means of accounting for non surplus residential accommodation;

- use of comparable sitting tenant rents agreed or set in the previous three years should be allowed as a reasonable sense check for productive capacity;
- guidance should encourage parties to complete a 'Statement of Facts' and record all tenant's improvements and tenant's fixtures within the timeframe of the Tenant's amnesty.

Residential Surplus Summary

- An update of the Standard Labour Requirement (SLR) data contained within the Scottish Agricultural College (SAC) handbook should be undertaken;
- surplus residential accommodation should be defined using the SAC handbook's SLR figures for a holding;
- the open market rent should be calculated on the proportion of residential accommodation over and above what is required for the holding. Regulations and/or Best Practice Guidance must allow this to be calculated using the method outlined in paragraph 7.2.2.1 of this report;
- clarity needs to be added to ensure that compliance with the Housing (Scotland) Act is accounted for when calculating the cost to be deducted from the open market rent;
- tenant's improvements should be black patched wherever possible unless they are considered when analysing comparable evidence to come to the open market rent;
- non black patched improvements should be deducted through assessing the amount of additional rent the improvement warrants through an analysis of comparables then deducting it from the market rent or spreading the cost over the likely lifetime of the improvement and deducting its annualised rate from the market rent. The overall basis for the deduction of non black patched improvements should be to reasonably consider how much the improvement adds to the rent and deduct it on that basis.

Non-Agricultural Use Summary

- Clarity is required to ensure it is possible to cross check the comparable approach with the hypothetical tenant net enterprise income approach in order to promote a reasonable sense check where there is a lack of comparable evidence to allow for the calculation of a ‘fair rent’;
- the ability to both black patch and deduct tenant’s improvements through a cost and deduction method should be clarified in the regulations. The overall basis for the deduction of non black patched improvements should be to reasonably consider how much the improvement adds to the rent and deduct it on that basis.

1. Introduction

Introduction

1.1 The Project

1.1.1 The Scottish Government's recently published economic strategy reaffirms its commitment to delivering increased sustainable economic growth with opportunities for all to flourish. The creation of an agricultural rents system which is fair to both tenant and landlord is an important part of this agenda.

1.1.2 To this end, the Government has appointed Savills in conjunction with Hamish Lean (Shepherd & Wedderburn) and Watson Bell (Watson Bell Consultants Ltd) to test, analyse and make recommendations on the functionality and application of the new rent review system introduced under Part 10, Chapter 5 of the Land Reform (Scotland) Act 2016.

1.1.3 The aim of this project is to help to shape the secondary legislation needed to bring the reforms to fruition. In summary, the requirements of the project are as follows:

- Interpreting schedule 1A of the 2016 Act and identifying further information that may be needed to ensure the new system operates according to definitive rules;

- carrying out a sample of ten rent reviews to analyse both 'fair rent' as defined by the new system and (wherever possible) the 'market rent' under section 13 of the Agricultural Holdings (Scotland) Act 1991. The purpose will be to fully test the new arrangements, ensuring they are fair to both Landlords and Tenants. In each review, productive capacity (as defined by Scottish Government in Annex A of the ITT), should be assessed alongside the assumed terms of the tenancy agreement and a budget prepared. Based on an agricultural holding farmed by a hypothetical tenant farmer, the fair rent should be calculated with reference to a divisible surplus;

- making a separate adjustment for open market rent of any surplus residential accommodation and fixed equipment provided by the landlord and used by the tenant farmer for non-agricultural purposes;

- assessing alternative methods of calculating the productive capacity, consistent with the 2016 Act;

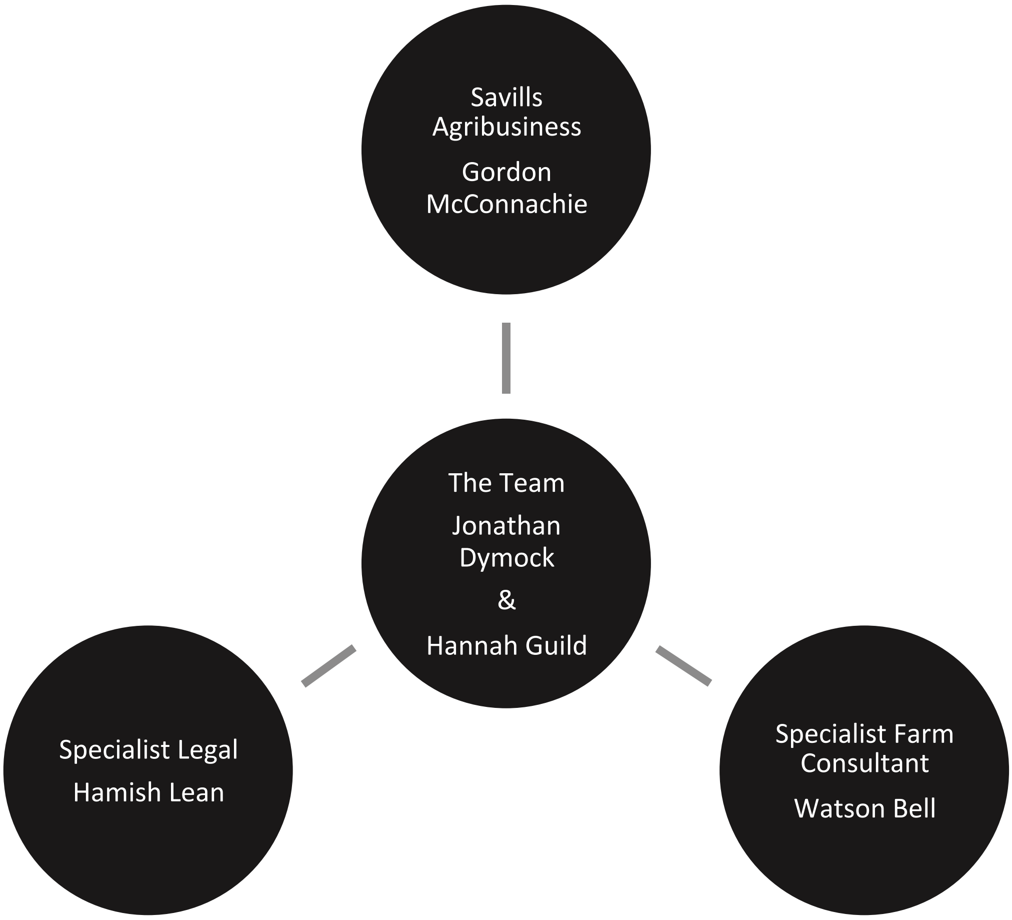
- summarising the findings of the reviews and the issues raised in an interim report, highlighting areas that require further analysis and debate;

- producing a further report which appraises the practicability of implementing the new rent review system; thereby identifying options which will enable the Scottish Government to achieve its objectives in this field;

- delivering two presentations on this later report, enabling the Scottish Government and the Tenant Farming sector main stakeholder organisations to scrutinise the findings and debate the conclusions.

1.2 The Team

1.2.1 The model below outlines how the Team has worked together to achieve this aim. The Team conducted the main research and pulled knowledge and direction from Gordon McConnachie for farm consultancy and budgets, Hamish Lean for legal opinion and Watson Bell for cross checking rationale, farm budget models and rent analysis:



1.2.2 The Team pulls from experience in working for both Landlords and Tenants to ensure a completely robust and objective approach to the research. Through the structured inclusion of meetings and the complete transparency of the research at each stage of the process between Team members, all methodology has been robustly debated and agreed to ensure a joint sign off from all members was achieved.

1.3 Core Team

Jonathan Dymock MRICS

Lead Director

As team leader Jonathan has overall responsibility for delivering the project and for co-ordinating resources. In conjunction with Hannah Guild, he carried out the sample rent reviews. He has been the principal point of contact for the Scottish Government, attending all meetings, delivering the reports and presenting the results.

Jonathan heads Savills' landlord and tenant service line and is used as a source of authoritative advice on agricultural rent reviews by other members of the firm. He regularly carries out agricultural rent reviews across central and north east Scotland acting for both Landlords and Tenants.

Through his involvement in contract-farming 4,000 acres of arable land, Jonathan is well versed in the day-to-day realities of running agricultural businesses and has a close understanding of the issues facing tenants. He has also prepared expert witness reports on agricultural rents, addressing issues such as diversification and sub-letting income.

Hannah Guild MRICS FAAV

Land Agent

Hannah has worked closely with Jonathan in conducting the rent assessments and delivering the research. She has assisted him in collating evidence, producing the reports and co-ordinating the other members of the team.

Hannah joined Savills in June 2016 after four years at Dunecht Estates, where she was the lead rural surveyor. Her responsibilities there included managing commercial properties, let farms and seasonal grazings. Her involvement with tenants included preparing new tenancy documentation, rent reviews, liaising on liabilities for repairs and minimising arrears. Previously Hannah was employed by Buchan Agricultural Consultants where she worked for both landowners and tenant farmers in submitting subsidy claims and land management grant applications.

She has experience in managing mineral interests, residential lets and sporting interests, and has worked on property sales, valuations and the promotion of development opportunities. Her role has included liaising closely with management staff including accountants, solicitors, forestry managers and agricultural consultants.

Currently Hannah is involved in the management of estates and completing rent reviews for a range of other clients. Through her experience in dealing with residential tenants, she has an extensive knowledge of open market rent for residential properties, compliance issues and the costs involved in bringing properties up to standard.
She applied this expertise in assessing the surplus residential units.

1.4 Specialists

Gordon McConachie

Food & Farming Consultant

Gordon has been responsible for cross-checking the budgets drawn up for each farm.

Gordon has spent his lifetime working in agriculture, including with the Scottish Government's various agricultural offices. As an accredited adviser to LANTRA (leading training body for land-based and environmental industries), he has produced many government funded whole farm reviews. These involve analysis of farm and enterprise accounts in the light of market trends and advice on budgeting and profitability. Part of the remit is to produce workable alternatives to current farming enterprises and cost them accordingly. At the Scottish Government Rural Payments and Inspections Directorate, he was involved in all aspects of subsidy entitlements and analysing business applications for funding.

As a whole farm review consultant, Gordon has a detailed knowledge of the farm business environment, market trends and farming best practice – essential requirements in being able to prepare effective budgets for the productive capacity assessments.

In his spare time he helps run the family tenant farm just outside Grantown-on-Spey, breeding pedigree Highland and Aberdeen Angus cattle along with running 600 Blackface sheep.

Watson Bell

Independent Farm Consultant

Watson has worked with Jonathan and Hannah to critically assess their findings and provide input on issues emerging from the research, including potential alternative approaches and solutions.

The Senior Partner of Watson Bell Consultants, Watson is an authority on agricultural issues with 40 years' experience as a consultant in the industry. As a trained mediator he has helped to resolve complex and long-term disputes between Landlords and Tenants. He is on the approved panel of advisers for members of the Scottish Tenant Farmers' Association and represents tenants in a wide range of negotiations including rent reviews, wayleaves, tenant's improvements, termination of tenancies and establishment of SLDT and LDT agreements. Having represented landlords as well as tenants, Watson understands the issues from both perspectives.

Watson has also appeared before the Land Court as an expert witness in cases involving penalties for breach of agricultural subsidy rules (SGRPID vs. A & F Grant) and rent determination (Kildrumy Estate vs. Forbes). For 14 years he was the principal lecturer at the University of Aberdeen post graduate land economy course (MLE) specialising in business management agricultural law and rural valuation.

Hamish Lean

Independent Solicitor

Hamish has worked with Jonathan and Hannah to ensure the rent review programme faithfully reflects the requirements and objectives of the 2016 Act, assisting with interpretation where required. He has ensured findings, conclusions and proposed solutions are legally robust and capable of withstanding challenge.

Hamish now heads up the rural team in the Shepherd & Wedderburn Aberdeen Office and is one of Scotland’s leading agricultural lawyers. The Chambers 2017 directory places him in Band 1, describing him as one of Scotland's foremost agricultural law experts with a *"massive reputation"* in the agriculture sector. He is cited in the Legal 500 as a leading figure in the sector and is described as ‘*an all-round professional*’.

He is a frequent practitioner in the Scottish Land Court and writes and speaks regularly on agricultural law topics. He has particular expertise in agricultural tenancies and provides a legal helpline for the Scottish Tenant Farmers’ Association. He was appointed by Scottish Government as a member of the Agricultural Holdings Legislation Review Group in 2013. Many of the recommendations made by the Team have been enacted in Part 10 of the Land Reform (Scotland) Act 2016.

He is a member of the Agricultural Law Association and the Scottish Agricultural Arbiters’ and Valuers’ Association. He sits on the Law Society of Scotland’s Rural Affairs Committee and the NFUS Legal and Technical Committee. He is also a Trustee of RSABI, Scotland’s leading agricultural and rural charity. He lives and practices in Aberdeen.

1.5 Summary

1.5.1 The Team is able to bring:

- in depth experience in carrying out agricultural rent reviews under the current legislation;
- a detailed understanding of the 2016 Act and its full implications for the transition from a market rent to fair rent system;
- an approach to the review programme which is transparent and fully represents the interest of both landowners and tenants;
- continuity in approach with the core team having undertaken all farm inspections with a handful also being attended by Watson Bell and the Scottish Government. The specialists have been consulted throughout the work to date via regular meetings, emails and telephone calls;
- with nine offices and around 120 staff in Scotland, Savills as a company have an ever growing research department which has been fully utilized in order to cross check and further develop models and concepts.

2. Remit & Scope: Testing of the Rent Review System

Chapter 2: Remit & Scope: Testing of the Rent Review System

2.1 Approach

2.1.1 In 2011, the SNP manifesto made a commitment to undertake a legislative review within 18 months of the Agricultural Holdings (Amendment) (Scotland) Act 2012 coming into force.

2.1.2 The ministerial led Agricultural Holdings Legislation Review Group (AHLRG) undertook that review in 2014 and completed their Final Report in early 2015. Evidence gathering work was supported by a Scottish Government research programme that was also undertaken in 2014.

2.1.3 Scottish Government noted in their Invitation to Tender (ITT) that one of the main issues raised within the research related to the regulation of agricultural tenancy arrangements between landlords and tenant farmers. The report highlighted that the research had shown dissatisfaction with the current rent review system in Scotland and a high percentage of applications made to the Land Court under the rent review provisions contained in section 13 of the 1991 Act. It should be noted that the majority of such applications never proceed to a full hearing in the Land Court but are made to allow parties to continue negotiations past the review date. In reality there have only been three rent review cases in the last 14 years which have proceeded to a full evidential hearing before the Court where the Court has then fixed the rent.

2.1.4 In addition to those cases which have gone to the Land Court, the research programme, identified in 2.1.2 above, found that rent reviews were reported as being the most common source of dispute between Landlords and Tenants. When asked, 20% of landlords (50 respondents) and 15% of tenant farmers (150 respondents) stated that they had experienced a major dispute related to a rent review.

2.1.5 The AHLRG concluded that although the under-lying proposition that rent reviews should be fixed on an open market rent may be simple in principle, in practice it can be difficult to apply accurately and fairly in situations where demand exceeds supply. Due to such distortions caused by scarcity, they recommended a means of calculating the rent based on the productive capacity of the holding which should be kept under review in line with the supply and demand pressures within the market.

2.1.6 The AHLRG recommended a new approach to calculating rents, from one based on the concept of an open market, to one which will take account of the productive capacity of the agricultural holding. The Land Reform (Scotland) Act Part 10, Chapter 5 introduces provisions for the new rent review system, moving away from 'the open market' to a 'fair rent', which takes into account the agricultural productivity of the holding, the open market rent of surplus residential accommodation and non-agricultural use.

2.1.7 As the rent review system is significantly changing, the Scottish Government wish to ensure the new approach is tested to determine whether it is fit for purpose and works well in practice over the potential range of different agricultural holding types and sizes across the tenant farming sector in Scotland.

2.2 Definition of Productive Capacity

2.2.1 The proposed definition of Productive Capacity put forward by the Scottish Government in collaboration with the main stakeholder groups is:

2.2.2 The 'productive capacity of the agricultural holding' means the sustainable yield of agricultural products that would reasonably be expected from the agricultural holding under a system of farming suitable to it when farmed by:

- a competent, efficient and experienced tenant farmer;
- with adequate resources for that system;
- with such assessment being made as at the effective date;

- taking account of any factors that might reasonably be thought to vary it before the next rent review.

2.2.3 This definition dictates the form of the models tested within this report.

2.3 Overarching Aims of Rent Testing

2.3.1 The rent review testing work undertaken calculates the rent on a sample of ten different agricultural holdings across Scotland, identified and provided by the Scottish Government. The testing was carried out with reference to the legislative provisions contained within Part 10, Chapter 5 of the Land Reform (Scotland) Act 2016 with a variety of different models used in order to determine the best means of calculating the fair rent.

2.3.2 The provisions of the Land Reform (Scotland) Act 2016 set out the framework for assessing what is a 'fair rent' for the agricultural holding. A 'fair rent' was defined by the Scottish Government in the ITT for this project as 'a rent which will be fair to both the landlord and their tenant farmer.' This definition needs to be further explored to ensure an understanding of what a fair rent represents to both the landlord and tenant.

2.3.3 In determining the fair rent for the agricultural holding, regard must be had, in particular to:

(i) the productive capacity;
(ii) the open market rental value of any surplus residential accommodation;
(iii) the open market rental value of any fixed equipment provided by the landlord or any land and buildings used for a purpose that is not an agricultural purpose.

2.3.4 The Scottish Government has instructed this work in order to gauge how rental valuations would be assessed by reference to the above approach in order that the secondary legislation and regulation can be framed to provide clarity in the methodology. The overarching aim of the testing work is to ensure the creation of a rent review system which is workable and fair to both tenants and landlords. This will involve:

1. Assessing the application of the ‘fair rent’ approach as outlined in Part 10 of the Act through consideration of productive capacity, residential surplus and non-agricultural/diversified use.
2. Considering budgeting models to examine the merits and difficulties with the AHLRG’s recommendation of sharing a divisible surplus.
3. Considering alternative methods within the confines of Chapter 5 of the Land Reform (Scotland) Act 2016 which allow the rent formula to be applied.

2.3.5 The remit can be defined as adopting working models for the best application of the legislation as it stands. We are not tasked with adjusting the legislation in any way and therefore must work within its confines.

2.4 Specific Objectives

2.4.1 In order to meet our aims, rent analysis has been carried out on ten agricultural holdings based on the concept of a ‘fair rent’, taking account of the productive capacity of the agricultural holding as set out in the Land Reform (Scotland) Act 2016 and other considerations contained in Part 10, Chapter 5 of the Land Reform (Scotland) Act 2016.

2.4.2 This work has involved the adoption of the following specific objectives:

- assessing the productive capacity of the agricultural holding in accordance with the definition put forward by Scottish Government;
- consideration of how different tenancy arrangements including post-lease agreements and unusual lease terms would impact the calculations;
- identification of a hypothetical farming system for a holding based on what a competent, efficient farmer would do on the holding using the landlord’s fixed equipment only;
- use of professional expertise and available costing data to prepare budgets for the agricultural holdings based on the hypothetical system identified;
- setting out problems, and proposing solutions and suitable alternatives within the confines of Chapter 5 of the Land Reform (Scotland) Act 2016;
- assessing the open market rent of (a) any surplus residential accommodation on the agricultural holding provided by the landlord, and (b) any land or fixed equipment provided by the landlord for which use is made by the tenant farmer in connection with any diversification activities on the agricultural holding carried out by the tenant farmer;
- considering options available to provide a reality check against the rent identified;
- considering the issues raised by the main stakeholder organisations;
- identifying potential issues with data sources and local/regional issues in relation to the preparation of the budget.

2.5 Timescale

2.5.1 The Rent Testing Team were instructed in May 2017, following which inspections of all sample farms were undertaken and completed by mid July 2017. An Interim Report was submitted to the Scottish Government on the 11 August 2017 following which input was sought from the main stakeholder groups via a meeting organised by Scottish Government and formal written submissions.

2.6 The Report and its Recommendations

2.6.1 This report has been reviewed and signed off by all the members of the Rent Review Testing Team. Its submission should allow officials to complete an analysis of the work and produce a suitable analysis report for Cabinet Secretaries, Ministers and members of the Scottish Parliament's Committees to consider.

3. Methods of Working and Approach

Chapter 3: Methods of Working and Approach

3.1 Methodology

3.1.1 The methodology of the research was agreed with the Scottish Government at the inception meeting. This confirmed that the main aim of the research should be to find a way of assessing the rent in line with the 2016 Act which is fair to both landlord and tenant and will be both objective and transparent in its application.

3.1.2 Protocols for contacting tenant farmers, confidentiality agreements and dealing with the public were also discussed at this meeting. The Team was provided with a list of possible sample farms which had either been volunteered by the stakeholder groups or selected randomly by Scottish Government (blind farms). The project plan enclosed in **Appendix 1** was confirmed and the following protocols agreed:

- Confirmed no conflicts with volunteer sample farms;
- conflicts with blind farms were noted and these were removed from the sample;
- contacting sample farms – Scottish Government contacted the four blind farms in the first instance to explain the process and what documentation we required. This was then followed up with a phone call from Savills and a confirmation letter with the time and date of the farm inspection;
- transparency – Scottish Government confirmed expectations in terms of discussions with sample tenants. It was agreed that we were to adopt a research role rather than an agent role. This meant using the inspections as a means of researching the new process, acting impartially, being completely open with the tenants about conclusions and assumptions to gauge their reactions, understanding why they do what they do and opening up discussions to challenge this rather than just undertaking the reviews;

- documentation – Research would be based on a standard set of general lease regulations rather than analysing the actual tenant's lease documentation. This was in order to prevent the inspection process being seen as intrusive by the sample farms and allow us to test the new system without actually doing a rent review on the farm as an actual rent review would require access to all documentation associated with the lease. In order to cross check different scenarios we considered how a post-lease agreement would impact on the results. It was concluded that a pre–1948 Act tenancy has the effect of removing the landlord's renewal obligations but the repairing obligations are consistent with 1991 Act tenancies. As such no separate consideration is required to deal with these tenancies as renewal by the tenant would be considered to be a fixture or improvement and not included in the rental calculation anyway. This method ensured minimal exposure to conflict, privacy issues and inefficiency or inaccuracy through incomplete documentation. The only documentation sought from the sample farms was a copy of their IACS plan to define the lease boundary;
- communication – For the purpose of this study no evidence or documentation was required to establish tenant's improvements, details of grant funding, sub-letting, diversification, residential property occupancy and any other factor relevant to the rental analysis;
- representation – Limits to the representativeness of the sample farms were discussed. Despite obvious limitations it was agreed that the samples were representative enough to give the research the scope required. In other words the farms selected had a broad enough scope to raise the issues likely to challenge the approach and assessment taken;
- project Plan and timeframe was approved;
- interaction – The procedure for interaction with the Scottish Government, third party advisors and stakeholders was approved and added to the project plan.

3.2 Legal Context – Interpretation of the requirement

3.2.1 A number of areas require secondary legislation and regulation. These include defining how the productive capacity of a farm is to be calculated; the amount of accommodation needed by the farm (i.e. whether cottages are required for agriculture or are surplus); and how the divisible surplus is to be distributed between rent and return to the tenant. We discussed the review process with our legal consultant Hamish Lean prior to the beginning of the fieldwork, to ensure we had fully understood the implications of the legislation and the areas that need to be assessed. The detail of these discussions is outlined in the table in **Appendix 2**.

3.2.2 In summary, the table considered in conjunction with Hamish Lean confirms that the following issues cannot be considered as part of this project as they are already confirmed in terms of the legislation as it stands:

- The hypothetical tenant must be considered so the rent cannot be based on ‘the actual tenant’s’ farming system or business;
- accommodation all or part of which is occupied by ‘the tenant’ must be disregarded when considering whether or not where residential accommodation is deemed as being surplus. It can only be considered in terms of the impact it has on the productive capacity of the farm;
- the actual non-agricultural use cannot be considered. It is what rent would be received on the open market for commercial purposes, based on the same planning use class by any tenant. Importantly this is not restricted to an agricultural tenant;
- standard Labour Requirements (SLR) are set out in the SAC handbook (based on the University of Nottingham Study issued in 2008) based on work done in 2004-2006. We recommend that they be brought up to date;

- dispute Resolution – we recommend guidance is created to encourage alternative methods of dispute resolution. There is not scope to introduce this within the Act itself. Dispute avoidance should be addressed in secondary legislation/regulation. Best Practice Guidance could promote the establishment of a statement of facts at the outset of a review, agreed by both parties on the physical characteristics of the holding;
- grant aid, where the tenant has carried out an improvement with grant aid this must be disregarded from the rent assessment;
- grant aid, where the landlord and tenant make a contribution – the amount of grant aid attributable to the improvement should be entirely disregarded. i.e., if a building was put up with 40% grant, 30% tenant contribution and 30% landlord contribution, 30% of that building could be considered in the analysis of the rent. It should be noted that such a definition only applies to improvements, where fixed equipment has been renewed through a landlord's grant. This can be accounted for in the rent review up to the extent that it is a renewal.

3.2.3 The main areas which can be influenced through further regulation are:

- The form and content of a rent review notice and the information that must or may accompany it;
- the means of calculating productive capacity. Investigation into various models and data sets should be undertaken in order to find a workable model. The definition of productive capacity is linked to the output a competent, efficient and experienced tenant would utilise from the farm;
- the means of disregarding or deducting tenants improvements. A black patch approach has been the preferred approach of the Land Court but we believe the legislation should allow in some circumstances for adjustment by other means, particularly land based improvements;
- consideration of the approach to grant aided improvements where the grant covers 100% of the cost;
- consideration of whether marriage value is appropriate when considering the 'hypothetical tenant';

- consideration of whether finance is relevant as a cost when considering the ‘hypothetical tenant’;
- the application of the divisible surplus between parties and whether it should follow the AHLRG recommendation of 50/50;
- consideration of surplus residential units including when they are seen to be surplus, adjustments for seasonal and retired employees and deduction to make to the market value for tenants improvements, compliance with residential standards and the tenants maintenance obligations;
- consideration of non-agricultural activities, when they can be rentalised, the issues with disregarding tenant’s improvements and the use for commercial purposes.

3.3 Research Context

3.3.1 Desk-top research into the issues arising from productive capacity, labour requirements and tenant improvements were carried out before and after the fieldwork.

3.3.2 A comprehensive library of information on which to base calculations has been assembled and includes:

Productive Capacity

- Macaulay (‘The James Hutton Institute’) land classification and soil maps for all farms to be inspected;
- the Scottish Agricultural College Farm Management Handbook (SAC handbook) (yields per enterprise, labour units, pricing data);
- Farm Business Survey (FBS);
- Savills research on up to date pricing and yield data;
- the Law of Agricultural Holdings in Scotland (Greens Practice Library);
- the Scottish Government’s agricultural statistics, including on Scottish farm enterprise performance, harvest summaries and farm business income estimates;
- live data taken from newspapers, the Scottish Farmer, market prices, supplier prices and grain future prices;

- the whole farm reviews target percentages based on Bank Agricultural lending checklist;
- emails from Royal Bank of Scotland, Bank of Scotland and Clydesdale Bank confirming target percentages of gross output for standard costs. These would be the expected percentages for a competent farmer;
- Savills research database of farm rents used to cross check against comparables rents in the areas;
- additional actual costs where known and disclosed by the parties i.e. Farm Management Accounts.

Residential Surplus

- Prime Location, Right Move and other location specific property rental websites;
- contractor quotes analysed to compile standard costs model;
- cross check with Savills buildings surveyors;
- Mortgage Advice Bureau guidance;
- banks advice on percentage for voids and maintenance for buy to let budgets;
- a Practitioner's Guide to Scottish Agricultural Rent Reviews, CAAV, RICS, SAAVA;
- additional actual costs where known and disclosed by the parties i.e. invoices from contractors.

Diversification

- Comparable evidence from commercial agents in the local area;
- comparable evidence from the local Councils;
- Rightmove;
- meeting with commercial agents within Savills;
- analysis of Use Classes;
- Council planning websites;
- additional actual costs where known and disclosed i.e. invoices, accounts;
- analysis of Business Rates criteria.

3.3.3 Following the completion of this report it will be relevant to undertake further research in a number of areas to assist in future rental negotiations. This has been considered and referred to at various times throughout this report.

3.4 Field Work

3.4.1 We carried out a physical inspection of ten sample farms and conducted a rent appraisal for each. The rent appraisal comprised of an assessment of every field and items of fixed equipment, in order to ascertain the most appropriate farming system based on the landlord's fixed equipment. Using this system, farm budgets were then prepared.

3.4.2 The appraisal also identified items of fixed equipment owned by the tenant, and/or erected by the tenant as an improvement or tenant's fixture. These items were then excluded from our farm assessment. In order to compare the findings from each rental appraisal on a consistent basis the following format was used:

Table 1: Appraisal

Introduction — Define the landlord, tenant, address and name of holding, type of lease, entry date, rent review date, last rent review date, current rent, legislation

Introduction	Define the landlord, tenant, address and name of holding, type of lease, entry date, rent review date, last rent review date, current rent, legislation under which the rent will be reviewed
Analysis of lease documentation	The following standard documentation was approved by Hamish Lean and adopted for each of the farms assessed: 1. General Regulations for a 1991 Act tenancy 2. A post-lease agreement Tenants were also questioned about any oddities present within their lease which could give rise to complications in the assessment of their rent.

Farm appraisal	Date of inspection & attendees Field by field description of the land (land classification, quality, topography, soil quality, climate, flood risk, contamination, field size and shape, access, designations, presence of pests, drainage, ditches, services and permissions, current use, fencing, water supply, tenant improvements), description of items of fixed equipment (farm buildings, farmhouse and surplus residential accommodation and their current use and state of repair, identifying any tenant's improvements) Diversification if applicable.
Proposed farming system and budget	To identify what farming system a hypothetical tenant would undertake on the holding. Different models were considered and tested in consultation with our farm management consultants and Watson Bell. Considerations included: labour required for the holding; costs of inputs required for the agricultural holding; restrictions such as NVZ, or other designations specific to the holding; servitudes and wayleaves; public access; standard data versus actual data, costs as a percentage of output or specific to the unit.
Market Commentary	Observation of farming in the general locality to cross-check the proposed farming system.
Comparable evidence	Where available in the locality, analysed as a means of comparing the market rent with a fair rent.
Surplus Accommodation	All residential accommodation was discussed. The SLRs required for the farm were calculated and anything considered to be surplus was assessed on a rental basis except the farmhouse occupied by the tenant.
Non-agricultural Uses	All non-agricultural activity on the farms were discussed. Tenants improvements were identified by the tenant and the commercial use of the area was defined.
Farm Specific Challenges	Farm specific challenges were considered throughout the process and defined as to whether they were specific to the holding or specific to the way 'the tenant' was farming the holding.

3.4.3 The sample farms comprised of 6 volunteer farms supplied by the main stakeholder organisations, and a further group of 4 agricultural holdings supplied by the Scottish Government. The total sample of 10 agricultural holdings represents a fair geographical spread of Scotland including a variety of different types and sizes of farm.

3.4.4 In order to minimise conflict and ensure clarity the sample farms were informed that visits would take 3-4 hours. Each farm visit was documented as soon after the inspection as possible in order to collate the applicable data in a consistent way to ensure budgets could be formed.

3.4.5 The sample farms must remain completely confidential but can be rationalised as follows:

1) A dairy operating in a livestock area
2) A livestock farm
3) A dairy farm
4) An arable farm
5) A mixed arable/livestock farm
6) A pig farm
7) A non-LFA sheep/cattle farm
8) An arable farm with significant non-agricultural/diversified uses
9) A forage farm (small holding)
10) An upland sheep farm (hill farm)

3.4.6 The samples were located from as far north as Inverness to as far south as the Borders. Although they were not considered to be fully representative, they certainly provided the team with examples of different farm types, different sizes of farms, different levels of tenant investment, surplus residential accommodation and various non-agricultural uses.

3.4.7 The main restrictions to the samples can be highlighted as follows:

- No islands were assessed;
- specialist farms were difficult to find and perhaps this indicates that the level of investment for a specialist farm suits an owner occupier model rather than a tenant farm model. Fully functioning fruit farm, pig farm, vegetable farm, pedigree breeding farms were not assessed. Although it was considered that examples of such farms would more than likely be considered as high farming (not what a hypothetical tenant would do) and result in the rent assessment assuming a more general farm type;
- lease documentation was not looked at. Instead standard leases were assumed and the tenant's comments on improvements and landlord consent to activities were relied upon;
- the sample was representative of holdings which were made up of a high level of tenant investment. None of the holdings assessed composed of only landlord fixed equipment so generally rents were based on low intensity farming systems, which was not always the case in practise.

3.4.8 The diversity of farm type, size and location, although not without limitation, was considered to be adequate for the testing of the new system.

3.5 Interim Report

3.5.1 Following the completion of the fieldwork, each rent appraisal and model was analysed in collaboration with Watson Bell. Hamish Lean and Watson Bell independently reviewed the method used, identified where the methodology could be challenged and commented on any further work required including suggesting alternative models. The findings within the Interim Report generally outlined several options which could be refined via stakeholder input prior to the submission of the this Report and Presentations.

3.6 Stakeholder Input

3.6.1 The main stakeholders comprising NFUS, STFA, SL&E, SAAVA, RICS and the Scottish Government were represented at a stakeholders meeting to discuss the Interim Report. Written comments were received on 28 August 2017 and are summarised in Chapter 4.

3.6.2 The main points taken from this meeting related to the need for a Statement of Facts to be encouraged potentially via the amnesty, the need for a budget approach to be assessed, the acceptance that sense checks using an output type model or a Macaulay land classification model was sensible, the need for further justification on valuing out non black patched tenants improvements and the acceptance that the surplus being split 50/50 was the only fair option.

3.6.3 Further research was required into likely variations in output depending on farm type and how the existence of unusual lease terms or post-lease agreements would impact the rent.

3.7 Report & Presentations

3.7.1 This Report and planned presentations take account of the full process from the instruction right through to the stakeholder's feedback. The report makes recommendations based on making the existing legislation workable in practice in order to produce a result which benefits all parties equally in order to meet the main objective of 'fairness'.

3.8 Analysis of Barriers: Challenges & Mitigation

3.8.1 Interpretation of the 2016 Act

A number of challenges and barriers have been identified throughout the course of the research to date. Where possible these barriers have been mitigated through further research or the creation of alternative options. The main challenges which will be expanded on throughout the report can be summarised as follows:

Challenge: Work carried out as part of the research must be based on a sound interpretation of the Act in the absence of case law.

Mitigation: As one of Scotland's leading lawyers specialising in agricultural landlord & tenant issues, Hamish Lean has audited the procedures put in place and the rationale of the models applied to ensure consistency with the 2016 Act. He has been consulted throughout the review process through formal meetings and regular email updates. In order to cross check the research reference, comparisons have also been made with the Agricultural Holdings Act 1986 which added a productive capacity element to the rent review process in England.

3.8.2 Potential for Conflict

Challenge: Potential for conflict arising from calculations based on a hypothetical tenant and the proposed farming system could result in the new system increasing rather than decreasing the number of Land Court applications.

Mitigation: We have monitored tenant farmers' reactions to the assumptions we make about the hypothetical tenant. Several meetings and models have been assessed in conjunction with Watson Bell in order to find a model which is least susceptible to conflict. We anticipate dispute is most likely to relate to the farming system applied, the output possible (i.e. the yield or stocking density possible) and the costs required. A process of coming to agreement on these factors prior to the creation of budgets is the best means of offsetting this issue, although not always possible.

Possible alternatives: Alternatives have also been analysed in order to determine whether or not there is a system which could be adopted using the current legislation as an alternative which could give rise to less conflict.

3.8.3 Budget Issues

Challenge: Creating a hypothetical farm budget has presented the following challenges:

- compiling accurate current, forward and past data;
- finding a model to fit all circumstances, reducing the need for interpretation and minimising complexity;
- agreeing a fair divisible surplus which is acceptable to all stakeholder groups.

Mitigation: Analysis of extensive data on current, forward and past rental values, commodity costs, average yields by location, grain/livestock values, rental trends and other factors relevant to the rental analysis of farms. Various models using various data sets have been tested for the sample farms.

The Team is experienced in representing both landlord and tenants; analysing farm enterprise accounts over a long period; assessing farming alternatives, based on the productive capabilities of the holding; and analysing the economics of farm businesses.

3.8.4 The Transition from Market to Fair Rent

Challenge: The differences between what is considered a 'fair' and 'market' rent. Confirming the arrangement is commercially viable (sustainable) for both landlord and tenant.

Mitigation: We have calculated the fair and (where possible) the market rent for each farm, taking into account the need for both parties to conduct a reasonably competent business from the land asset.

Possible alternatives: The main aim of the project is to produce a workable model under the 2016 Act. We have referred to the current model only to benchmark the effects of the new model and justify conclusions and recommendations.

3.8.5 Labour Units

Challenge: Difficulty in confirming labour units required for a certain farming system and which data source is used for this.

Mitigation: Primarily the SAC handbook has been used to determine the required labour units for the proposed farming system.

Possible alternatives: The SAC handbook model should be updated to reflect modern farming requirements in terms of an appropriate farming system for a hypothetical tenant farmer.

3.8.6 Marriage Value

Challenge: The ability to include marriage value in calculations and whether this is ever appropriate when considering the hypothetical tenant farmer.

Mitigation: We have scrutinised marriage value on a case by case basis to assess whether there are occasions where it should be considered. In terms of how the law is worded, Hamish Lean is of the opinion that it is not applicable. It is also of limited relevance if a focussed approach on Gross Output is taken.

Possible alternatives: The relevance of local practice must be considered. It may be relevant to consider what the hypothetical farmer within the area does, e.g. is it common practice to have a certain size or number of units? Does the tenant have the landlord's permission to sub-let for potatoes?

3.8.7 Tenants' Improvements

Challenge: The range of options available in assessing tenants' improvements is a potential difficulty. Our experience suggests complexities may arise in the analysis of fixed equipment. These relate to the presence of post-lease agreements; improvements which have been undertaken at joint cost; where they have been partly grant funded; whether or not there is landlord consent; and where the tenant owns equipment but the landlord has been insuring and maintaining it or vice versa.

Mitigation: We have assessed this on a case by case basis. Through extensive experience of dealing with issues relating to fixed equipment, the Team are well placed to assess how it affects the functionality of the holding; and whether in view of the lease obligations it should be rentalised. Hamish Lean has been vital in ensuring this is dealt with in line with the Act. We also believe the tenant's amnesty will be an invaluable tool in accounting for tenant's improvements.

3.8.8 Acting Impartially

Challenge: Savills' ability to represent the best interests of all stakeholders may be called into question.

Mitigation: Hamish Lean's involvement throughout the process has ensured all research is carried out in accordance with the correct interpretation of the 2016 Act. This has enabled us to identify any departures from the proposed new system that may be required for practical reasons. Watson Bell as an experienced Agricultural Consultant has ensured all results and models were explored and fully tested.

3.8.9 The Treatment of Surplus Accommodation

Challenge: The difficulty of creating an objective model to determine the level of discount that should apply when taking into account tenants' improvements.

Mitigation: We have drawn upon our knowledge as active residential property letting managers and building surveyors to comment on the additional costs involved in letting houses under the Housing (Scotland) Acts; and the factors to be taken into account when devising an additional rent for surplus residential units.

3.8.10 Timescale for Delivery

Challenge: A tight timetable for completion of the research.

Mitigation: The project plan has been adhered to and regular meetings have been undertaken with Hamish Lean and Watson Bell to ensure the delivery of the research within the timescale.

3.9 Seeking Solutions

3.9.1 There is understandable apprehension that the new method of analysing farm rents could prove to be overly complex, cumbersome or unworkable. Through analysis of the models outlined in this report, input from third party advisors and stakeholders and the implementation of further regulation and best practice guidance we believe a workable, fair solution can be adopted.

3.9.2 It should be stressed that any recommendations made will be subject to the need for further research to improve datasets, further guidance on best practice in terms of communication between parties, procedures to be adopted and the need for alternative methods of dispute resolution to be explored. Workable models need to be based on objectivity and must start from a point where all stakeholders agree on their principals.

4. Stakeholder Feedback

Chapter 4: Stakeholder Feedback

4.1 Summary of Stakeholder Responses

4.1.1 A meeting with the following stakeholder groups was held to discuss findings reported in the Interim Report:

- National Farmers Union Scotland (NFUS);
- Scottish Tenant Farmers Association (STFA);
- Scottish Land and Estates (SL&E);
- Scottish Agricultural Arbiters & Valuers Association (SAAVA);
- Royal Institution of Chartered Surveyors, Scotland (RICS Scotland);
- Scottish Government Rural Payments and Inspections Directorate (SGRPID).

4.1.2 Formal written responses were requested from the stakeholders by the Scottish Government to inform the this Report. NFUS, STFA, SAAVA in conjunction with CAAV and SL&E all submitted a formal response. A summary of the points raised within each response has been outlined below.

4.2 NFUS Response Summary

4.2.1 General

- Figures should be provided as an Appendix to the next report so recommendations can be cross checked;
- want further detail in the pros and cons of each model;
- gaps in available datasets should be highlighted in the next report.

4.2.2 Form and Content of Rent Review Notice

- No comments were offered.

4.2.3 Means of Calculating Productive Capacity

- Believe if possible a standard approach should be recommended;
- concerned the gross output model does not account for location differentials in terms of cost structures;
- support a budget approach however wants more detail on the pros and cons of past, current and future price data.

4.2.4 Black Patching Tenants Improvements

- Supports the black patch method for accounting for tenants improvements;
- concerned about cost and deduction method for non black patched improvements and believe more information and examples are needed on this if it is to be implemented;
- wary of a system being created which could disincentivise tenants from investing;
- clarification is required to ensure tenants improvements are never written off;
- clarification is required for accounting for tenants improvements which are outwith the scope of the amnesty;
- further research into where interest and depreciation should be considered when dealing with tenants improvements.

4.2.5 Grant Funding

- No comments offered.

4.2.6 Sense Checks

- No comments offered.

4.2.7 Splitting the Divisible Surplus

- No comments offered.

4.2.8 Residential Surplus

- Support the recommendation to update Standard Labour Requirements (SLR) data to reflect modern farming practices.

4.2.9 Non-agricultural Use

- No comments offered.

4.2.10 Dispute Avoidance

- Agreed that a statement of facts was a positive step. Thought this should be encouraged alongside completion of the tenant's amnesty;
- supports proposal that no documents are marked 'without prejudice'.

4.3 CAAV Response Summary

4.3.1 General

- agree that much further work will be needed to develop and implement such approaches to rent review;
- the issues in defining "fair rent";
- what is to be taken into account with the findings on the three statutory factors and other circumstances in then finally arriving at that fair rent;
- the problems of forcing individual farms to fit models with issues over the use of inappropriate, standardised and retrospective data, especially in a time of change;
- the financial assessment under any of the first three models is separate from and consequent to the appraisal of the physical productive capacity rather than fully encapsulating it;
- the need for more thought as how a divisible surplus is to be divided;

- the need to understand the sensitivities in outcomes stemming from variations in the figures and assumptions used. The more links there are in any chain of valuation analysis the more likely the answer is to be wrong;
- desirability of a sense check against actual behaviour by 1991 Act tenants, not further standard figures, if fairness is to be judged;
- that tenant's improvements should be understood more broadly than by the 1991 Act or the Amnesty and then disregarded on the basis of value not cost, whether, as appropriate, by the black patch approach or valuing out;
- the issues around housing which may be resolved by answers within productive capacity or other circumstances;
- the current SLR figures are outdated and will become more so with increasing automation and economic change;
- that more opportunity for final and binding expert determination (Lord Gill suggest this may anyway be possible now) and arbitration would offer the flexibility that businesses need;
- barring the safe space for negotiations offered by "without prejudice" correspondence will create more problems;
- fundamentally, what will best produce the outcome of a "fair rent" that is sought and do so within the wording of the 2016 statute?

4.3.2 Form and Content of Rent Review Notice

- Strongly agree with that specifying a proposed rent over 12 months in advance is impractical and, because of its unreality, more likely to cause problems than reduce them;
- a 4 to 6 month horizon would be much more realistic both on whether a rent review is intended rather being provided for and the economic context for that review;
- approve of the concern to retain practical flexibility over the timetable.

4.3.3 Means of Calculating Productive Capacity

- Do not agree with the use of standardised data used in models 1 & 2;
- believe that the physical data is better drawn from knowledge of the holding and neighbouring units and should be assessed over a period such as a three or five year rolling yield to stabilise it;
- do not think forcing farms into standard farm types is fair;
- issues with identifying all relevant costs to be taken into consideration;
- issues with identifying which data sets are applicable, past, present or future;
- in working directly from the gross output to identify the productive capacity, it allows the whole issue of overheads and marriage value to be bypassed (and also how to judge when to use contractors' costs), so allowing some realism about current farming circumstances and approaches to business adaptability. In that, it also removes the potential for the subsequent calculations to yield a nil or negative rent which is, for some, a potential objection to the budget models;
- prescriptive approaches, such as the conversion ratio used for stocking rates, should not be imposed;
- clarity is required on whether the assessment of the output over a period of years refers solely to the physical output or also to prices;
- further justification of 30% used in the gross output model should be explored and whether this should be set in regulation or open to variance depending on the holding;
- clarification on how to deal with Basic Payment, Greening and agri-environment schemes.

4.3.4 Black Patching Tenants Improvements

- Concern over confusion of cost and value as the cost of the works (even in current terms) may bear little relation to its value to a hypothetical user;
- two accepted ways of dealing with tenant's improvements:
    - the more fundamental "black patch" approach saying that the item of work is not there at all. This allows the productive capacity to be assessed without taking account of the latent value of the opportunity to make the improvement;

- valuing the improvement out for the value it offers as at the rent review date, usually with a deduction of the result from the landlord’s share of the divisible surplus;

- the improvement’s cost is of no relevance and may be only the same as its value by coincidence;
- agree that the black patch approach is more likely to be appropriate for larger improvements made solely by the tenant but that a value based approach may be more relevant to smaller or more incremental improvements;
- agree that the Amnesty offers an opportunity for parties to agree on a full record of fixed equipment whether or not it is compensable but that is not what the Land Reform (Scotland) Act actually provides for.

4.3.5 Grant Funding

- Further clarification from Hamish Lean is required on how to deal with grant funding and if the 2016 Act has changed the procedure from that undertaken under section 13 of the 1991 Act.

4.3.6 Sense Checks

- Do not think the Macaulay land classification model makes sense as a method of valuation. The range of factors relevant to productive capacity point to land classification as being too simplistic to be fair.

4.3.7 Splitting the Divisible Surplus

- When budgets for comparables have been analysed, they often show the rent to be at a significantly varying percentage of the divisible sum with, for example, dairy holdings often being lower;
- relevant issues could be;
  - varying levels of risk
  - varying levels of working capital

- repairing and other obligations of the tenant

- the approaches to the way the divisible sum may be divided need to be more closely considered and argued. A default or prescriptive assumption of an equal split may be ignoring real issues of fairness.

4.3.8 Residential Surplus

- Agree with approach of where the SLRs suggest that 1.2 dwellings are needed, then 80 per cent of the value of the second cottage should be brought into account but suggest clarification is required to conclude this is legally permissible.
- agree where a cottage is being sub-let it should be taken into account. Again clarification is needed on whether this is legally permissible.
- suggest approach to seasonal labour needs further explored.
- consider how the farmhouse occupied by the tenant is assessed when calculating the fair rent.
- we are conscious in looking at this issue of the interaction with the Land Reform Act's proposals for relinquishment and assignation. Where the value of housing is disregarded at rent review, the rent will be lower than otherwise and so reduce the investment value of the holding for the relinquishment calculation. As that would not affect the vacant value, this would increase what the landlord would be asked to pay. That appears to add to the pressures leading to that mechanism becoming a vehicle for selling occupancy rights to housing.
- agree employees and relatives are specific to the actual tenant and should be ignored for the purpose of surplus accommodation.
- agree that the current figures for SLRs, based on work in 2004 to 2006 and issued in 2008 by Nottingham University for FBS and then re-used by SAC are no longer descriptive of farming practice and so are not a fair basis for this assessment.
- prefer industry standard method to more scientific approach.
- believe tenants improvements should be black patched where this is possible.

4.3.9 Non-agricultural Use

- Agree accounts-based approaches may be one way to analyse the rent but are only supporting evidence and assumptions as a sense check to the comparable approach;
- disagree with the proposal that a final divisible surplus be assessed and then split 50/50 to find rent as this does not seem right for business projects only for sub-lettings. Argue the business project may rely so heavily on the tenant's skills, management and endeavours (without which there would be little or no extra value) that they should retain a higher fraction of the surplus where this route is adopted. It will be even more case specific than for farming;
- again the preference is to black patch tenant's improvements where possible.

4.3.10 Dispute Avoidance

- Believe "without prejudice" correspondence offers a means for negotiations to happen in a "safe space" where offers can be tested and positions adjusted without making commitments until the matter is agreed. Therefore do not think it should be removed;
- do not agree that improvements can be limited to those agreed through the amnesty as it does not provide for all improvements to be accounted for;
- preference to expert determination or arbitration;
- agree mediation is useful but entails a further round of what is essentially assisted negotiation with no assurance as to achieving an answer.

4.4 STFA Response Summary

4.4.1 General

- We believe the key is a reasoned forward looking farm budget for the 3 years ahead based;

- believe all tenant's improvements made to the holding should be black patched. Exceptions which may require to be costed out include basic provisions of fixed equipment supplied by the tenant but which should have been supplied by the landlord at the commencement of the lease. These include provision of water, electricity, access and fencing and in some cases drainage works to schemes present at the start of the lease;
- want marriage value to be disregarded;
- want latent value to be disregarded;
- see finance for tenant's working capital and tenant's improvements as a relevant cost to take account of in the rent test;
- agree a Statement of Facts is completed and agreed prior to the serving of a rent review notice.

4.4.2 Form and Content of Rent Review Notice

- Believes that the rent notice should be accompanied with a rent proposal showing transparent workings including Statement of Facts and Expert Statement;
- suggest it is imperative that a Statement of Fact is completed and agreed prior to the serving of a rent review notice.

4.4.3 Means of Calculating Productive Capacity

- Believe future prices should be used rather than past or current price data;
- concerned over the use of a model based on a criteria used by banks to satisfy lending criteria;
- there should not be an assumption that any tenant farmer would carry out improvements to crystallise 'latent value';
- believe the individual enterprise model would be more useful if forward looking gross margins and costs were used instead of historic costs;
- suggest farm labour should not be excluded from fixed costs. Agree there may be an argument for excluding the tenant's individual labour. Hired labour is a genuine cost to be taken into account when determining the divisible surplus;

- believe deductions from the landlord's share of divisible surplus for the annualised value of tenant's improvements not black patch requires some agreed methodology with agreed rates of return for the tenant's investment in fixed equipment;
- adjustments for pre-1948 leases and PLAs will also be significant and require agreed methodology;
- believe the standard data approach does not take account of the significant area differences which are relevant at rent review;
- agree the output model could be used as a sense check but think care is needed as it only relates to years of average prices and average profits;
- argue different farm types show different ratios for rent and interest and a percentage of gross output;
- argues the 30% figure used in the Interim Report may be a banking guideline but it is not representative for actual Scottish farming businesses.

4.4.4 Black Patching Tenant's Improvements

- Believe that the black patch approach should be used for all improvements where possible, being the simplest, fairest, and most transparent method of disregarding improvements;
- agree improvements relating to fencing, water supplies, access roads and provision of electricity could be costed out since without them most Scottish farms would be unable to be farmed.

4.4.5 Grant Funding

- Treatment of grant aided landlord improvements has changed from section 13 of the 1991 Act, which is a significant change. Believe the current situation should prevail and this should be clarified through regulation;
- do not think rent reviews should take account of 100% grant funded improvements done by the landlord.

4.4.6 Sense Checks

- Suggest all models explored as part of the Interim Report, apart from the capital value model, could serve as a good sense check;
- agree the Land Classification Approach could be an excellent sense check if the industry could agree on a range of rental values for different grades of land. There would need to be adjustments for different areas of Scotland, and the extent of fixed equipment attached to the land would need to be specified.

4.4.7 Splitting the Divisible Surplus

- No specific comments offered.

4.4.8 Residential Surplus

- Care should be taken in making any adjustment to SLR figures so as not to disadvantage tenant farmers on more labour intensive and marginal units;
- believes where possible, the principle of black patching all tenants' improvements should prevail;
- agree it is only fair that an allowance for the costs of meeting the repairing standards is also factored into the rent calculation, whether or not the tenant is receiving a rental income from the property;
- clarity is required where the landlord provision of accommodation is insufficient for the SLR of the holding. Should the extra cost to the tenant of providing alternative accommodation be deducted from the landlord's divisible surplus, or should the productive capacity be based of a different farming system with a lower labour requirement?;
- believe that non-surplus accommodation that is let out should not attract additional rent;
- do not agree that specific allowance should not be made for occupation by family members, retired workers or seasonal labour;

- agree proposed formula to annualise certain improvements such as central heating, double glazing or kitchen and bathroom fittings may be acceptable for analysing comparable evidence if such evidence exists. However more basic tenant's improvements such as provision of electricity, water and sanitation, damp-proofing, housing extensions re-roofing, should be black patched to arrive at the original condition of the property.

4.4.9 Non-agricultural Use

- Believe it is important to note that tenant's will usually have landlord's permission to undertake a non-agricultural activity which will probably already be subject to additional rent. Agreed rent levels should be taken into account before applying a "market rent", especially where the "market rent" may remove any return on the tenant's investment;
- believe tenant's improvements must be black patched;
- believe consideration should be given to the treatment of non-physical tenant's improvements that may be required for diversifications including:
    - planning permission or prior notification;
    - listed building consent;
    - a building warrant;
    - water abstraction license;
    - grid connection consent.

4.4.10 Dispute Avoidance

- Agree with the need for a statement of facts and expert statement.

4.5 SL&E Response Summary

4.5.1 General

- Believe it will be difficult to implement the legislation in a workable way which can be undertaken by Landlords and Tenants rather than third party qualified agents.

4.5.2 Form and Content of Rent Review Notice

- Agree that the rent proposal should not be within the notice as this would be unworkable and costly for the party serving the notice;
- believe a timeframe for the rent review proposal could be implemented through primary legislation or regulations in line with current best practice guidance i.e. rent review inspection more than 6 months before review date with written proposal 4 months in advance of review date.

4.5.3 Means of Calculating Productive Capacity

- Believe Gross Output approach would be the best means of minimising dispute;
- some concerns that the rent review process could be brought to a halt if the parties are not able to reach agreement on the farming policy. However, agree there may be scope for a code of practice to encourage reasonable behaviour;
- agree that the “Statement of Fact” to be agreed between the parties should assist in agreeing a realistic farming policy;
- believe that the use of a farm budget is likely to result in dispute due to the number of variables involved.

4.5.4 Black Patching Tenant’s Improvements

- Concerns were raised over annualising tenant’s improvements in a cost and deduction manner and the preference was to black patch tenant’s improvements.

4.5.5 Grant Funding

- Believe an improvement undertaken by the landlord which is 100% grant funded needs to factor into the rent calculation as the landlord will have ongoing repair/renewal obligations.

4.5.6 Sense Checks

- Do not agree a sense check using open market rents is appropriate as a new rent review system could not be gauged by checking against the old system. Believe it may be that a sense check against sitting tenant rents would be more appropriate;
- concerned that a sense check based on land use class would be too complicated. Adjustments would be required for lease terms, landlord’s fixed equipment, tenant’s improvements etc.

4.5.7 Splitting the Divisible Surplus

- Concerned that the 50/50 split is arbitrary. Consider that the divisible surplus should be calculated (and defined in regulations) and then divided once each party’s costs have been taken into account. The tenant’s labour would also need to be factored in, as well as the landlord’s repairs and reinvestment. The surplus would then be divided between the parties based on the capital they have in the business and the risk associated with that capital;
- appreciate that this may be too complicated to achieve in practice and therefore a 50/50 split with any deviation being justified may be the best alternative.

4.5.8 Residential Surplus

- Support the “recommended approach” and agree that it provides a clear way of calculating what accommodation (or percentage of accommodation) is surplus. It is key that the SLR data produced by the SAC should be updated;

- the legislation provides that the overriding assessment is that of a “fair rent”. The farmhouse occupied by the tenant is only excluded from the assessment of the open market rent of surplus accommodation. This does not seem to preclude it from being taken into account when assessing what is a “fair rent”. Wish for the Team to further consider how this can be applied;
- believe surplus properties occupied by seasonal workers, retired employees and family members should be taken into account in the rent calculation (whether or not the tenant receives a rent). Suggest that voids are not relevant where the property is occupied by seasonal workers, retired employees and family member as there is unlikely to be any voids;
- think tenant’s improvements should be black patched where possible as wary of the cost and deduction method for accounting for these;
- concerned that the scientific approach may be too complicated so the industry standard may be preferable;
- agree that further clarity is required on accounting for tenants improvements and accounting for compliance with the repairing standard.

4.5.9 Non-agricultural Use

- Believe that whilst the definition of diversification should not be solely restricted to the legislative process, it may be useful to highlight that a diversification may be agreed under the 2003 Act;
- believe that given the legislation provides for the “open market rent” of non-agricultural use, agree that comparables are a useful starting point. However, given the potential lack of comparables, agree that a “sense check” is required;
- feel a sense check against the agricultural value would be useful (as a minimum figure);
- concerned about the cost and deduction approach regarding tenant’s improvements;

- disagree with the 50/50 split of divisible surplus methodology here as suggests that the tenant should only pay 50% of the ground rent due to the tenancy being in place (on the basis that there has to be a return for the tenant undertaking a diversification). Believe where the tenant is, for example, carrying out a ground works business, the tenant is obtaining a competitive advantage over competitors because the tenant is not paying a full market rent for the ground.

4.5.10 Dispute Avoidance

- Supports the principle of landlord and tenant agreeing a “Statement of Fact” in respect of a holding but query why some of the information which appears in the “Expert Statement” does not appear in the “Statement of Fact”. For example, the residential property on the farm and any basic details of diversifications will be a question of fact. Also believe tenant’s improvements need added to the templates;
- support the use of alternative dispute resolution but have concerns with a code of practice requiring the parties to go to alternative dispute resolution.

4.6 Areas of Agreement

4.6.1 The following concepts were broadly agreed:

1) There was some acceptance of the Output model if further work is done on the percentages to be implemented. At worst this could be used as a sense check to a budgetary approach.
2) Tenant’s improvements should mainly be black patched unless for farming and housing they are intrinsic to the system being applied i.e. fencing, access, water and elements of drainage for productive capacity and small improvements taken into account in the assessment of comparables along with the cost of meeting the repairing standard for surplus residential accommodation.
3) A methodology is required for valuing out non black patched improvements.
4) Further clarification is required on grant funded improvements.

4.7 Analysis of Disputed Aspects

Table 2: Analysis of Stakeholder Responses

Disputed Aspect	NFUS	CAAV	STFA	SL&E
Remove reference to rent proposal in RR notice	No comment	Agree	Disagree	Agree
Productive Capacity Budget method	Dispute likely	Preference	Preference	Dispute likely
Productive Capacity Output Model method	Preference	Agree but concern over fairness and adaptability to change	As a sense check	Preference
Output model as sense check	Agree	Agree	Agree	Agree
Macaulay model as a sense check	Agree	Disagree	Agree	Disagree
Sitting Tenant rents as a sense check	No comment	Agree	Agree	Agree
Costing out tenant's improvements not black patched	Prefer black patching	Prefer valuing out	Agree if methodology stated	Prefer black patching
Valuing out tenant's improvements not black patched	Prefer black patching	Agree	Prefer costing out	Prefer black patching
Residential Surplus calculation	No comment	Prefer industry standard approach	Prefer scientific approach	Prefer industry standard approach
Ability to charge where evidence of actual surplus but not surplus in terms of SLR	No comment	Agree	Disagree	Agree
No allowance for relatives or retired employees	No comment	Agree	Disagree	Agree
No allowance for seasonal workers	No comment	Unsure	Disagree	Agree
Cost in requirements for meeting repairing standard	No comment	Unsure	Agree	Agree

Disputed Aspect	NFUS	CAAV	STFA	SL&E
Cost and deduction for any improvements taken into account when considering comparable evidence	No comment	Unsure	Agree	Unsure
Ability to charge surplus rent on farmhouse	No comment	Agree this cannot be done on the surplus but feel needs to come into productive capacity	Agree	Agree this cannot be done on the surplus but feel needs to come into productive capacity
Diversification calculation method	No comment	Agree with comparables method	Agree with comparables method	Agree with comparables method
Use of enterprise income method as a sense check	No comment	Agree	Agree	Agree
50/50 split of surplus	No comment	Disagree	No comment	Disagree

4.8 Conclusions drawn from Submissions

4.8.1 From the submissions it was evident further research and justification was required for some of the conclusions drawn in the Interim Report. Very briefly the main areas which were focussed on following the stakeholder submissions can be summarised as follows:

4.8.2 Productive Capacity

- Further work on the Full Budget Model;
- further work on the Output Model in examining how the 30% gross profit which was advised to be split 50/50 could range in terms of farm type and economics;
- further work on how to account for residential accommodation which is not considered to be surplus;
- further work on determining how to disregard non black patched tenant's improvements.

4.8.3 Residential Surplus

- Further work on determining how to deal with actual sub-letting, housing of relatives, seasonal workers and pensioners;
- further work on determining how to disregard tenant's improvements.

4.8.4 Non-agricultural Use

- Further work on determining when something would be a non-agricultural use rather than just sub-letting;
- further work on determining how to disregard non black patched improvements;
- further work on determining where the comparable method would not work and the net enterprise surplus method would be justified.

5. Form and Content of Rent Review Notice

Chapter 5: Form and Content of Rent Review Notice

5.1 Interpretation of the Act

5.1.1 It was confirmed with Hamish Lean that the Act both changes the way the rent is to be assessed and the procedural steps required to initiate a rent review. Section 101 of the Act sets out the procedure which must be followed in relation to reviewing the rent of a 1991 Act tenancy. Sub-section 2 provides that the review notice must be dated and must state the following:

(a) names and designations of the landlord and tenant;
(b) the name, if any, and the address of the holding or such other description of the holding as will identify it;
(c) the rent currently payable in respect of the holding;
(d) the rent that the person serving the notice proposes should be payable;
(e) the date by which the landlord and tenant must reach agreement as to what the rent payable should be (the “rent agreement date”).

5.1.2 The rent review notice must be accompanied by information explaining the basis on which the rent proposed by the person serving the notice has been calculated. The rent agreement date stated in the rent review notice must not fall earlier than 12 months from the date on which the notice is served or later than 2 years from that date. The Scottish Ministers have reserved powers to make regulations which may adjust the form and content of rent review notices and the information that must or may accompany them.

5.1.3 The rent review notice cannot be served if a rent agreement date falls before the end of a period of three years beginning with the latest of the commencement of the tenancy, the date from which the previous variation of rent took effect or the date as from which a previous determination that the rent should continue unchanged took effect. Variations of rent arising out of the operation of Sections 4 & 5 of the 1991 Act which have to do with terms and conditions relating to fixed equipment are ignored, as are variations of rent as a result of the carrying out of certain improvements by the landlord, as is reduction of rent in terms of Section 31 where the tenant has dispossessed the part of the holding or where a variation of rent has arisen because of the exercise of revocation of an option to tax under Schedule 10 of the Value Added Tax 1994 or a change in the rate of Value Added Tax.

5.1.4 A rent review notice once served can only be withdrawn by agreement of the parties and will cease to have effect when the landlord and tenant have reached agreement or where referral is made to the Land Court where agreement has not been reached or where a referral has been made the date on which the Land Court determines the rent to be payable. A referral to the Land Court must be made prior to the expiry of the rent agreement date set out in the notice.

5.2 Issues arising from the Act

5.2.1 The most significant change from the previous procedure is that the rent review notice will require to be frontloaded and the landlord or tenant serving the notice must have a reasoned proposal and be able to set out what those reasons are for fixing a particular rent. Accordingly most of the work required to come up with the rent will have to have been carried out in advance which puts a considerable burden on landlords and tenants, especially those acting without professional advice, and it will be difficult to adequately take into account changing fortunes within agriculture in the lead up to the rent agreement date. Consideration of the practicality of including information on what the rent should be over a year in advance of the effective date is required.

5.2.2 Through consideration of the sensitivity of the productive capacity model for reviewing the rent and how the date of analysis will impact on the result, we believe that it is impractical to set the proposed rent within the rent review notice. The current best practice guidance on timeframes for rent reviews works well with inspections taking place 6 months in advance and written proposals sent to the landlord or tenant 4 months in advance of the rent agreement date. As this is set out in guidance it allows for some flexibility in terms of availability issues due to harvest, lambing, calving or other weather or seasonal activities.

5.2.3 From stakeholder feedback it was clear that the reason for having the notice front-loaded was to allow both parties enough time to agree on the matters required for agreement to be reached. Since this will be most relevant to the first rent review under the new system we recommend this being done through a separate procedure prior to the first rent review being undertaken. A procedure could run alongside the tenant's amnesty procedure which has a three year timescale for completion. This would involve a landlord and tenant agreeing on the main characteristics of the holding which are linked to its productive capacity in terms of a 'statement of facts' (see **Appendix 3**). Provided a statement of facts is agreed prior to a rent review notice being served, we believe the best practice guidance timeframes are long enough and provide the correct level of flexibility to make the system workable in practice. If a statement of facts cannot be agreed prior to the service of a rent review notice it is unlikely that proposing the rent in the notice will assist negotiation.

5.3 Recommendations

- Removal of Sub-section 2(d) to ensure a rent review notice does not need to include details of the proposed rent. However, we observe that this would appear to fall outwith the scope of Section 2.4 of the Act which allows Scottish Ministers by regulations to make “further” provision about the form and content of rent review notices. We do not believe that removing an existing requirement is making further provision and any such change may require primary legislation.

- Best practice guidance should be updated to dictate:
  - A timeframe for a rent review negotiation procedure similar to that which is currently outlined. It is felt dictating a timeframe within statute is too inflexible to cope with circumstantial delays caused by farming operations or unforeseen events;
  - completion of the tenant’s amnesty should be encouraged in order to improve records for rent review purposes;
  - completion of a Statement of Facts should be undertaken alongside the tenant’s amnesty procedure prior to a rent review notice being served under the new system.

6. Productive Capacity

Chapter 6: Productive Capacity

6.1 Interpretation of the Act

6.1.1 Productive capacity is referred to in the Act as one of the factors the Land Court 'must have regard to' when assessing the fair rent for a holding. The Scottish Government has further defined the Productive Capacity as follows:

Table 3: Productive Capacity

"The 'productive capacity of the agricultural holding' means the sustainable yield of agricultural products that would reasonably be expected from the agricultural holding under a system of farming suitable to it when farmed by:

- *a competent, efficient and experienced tenant farmer;*
- *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:

The productive capacity of the agricultural holding is to be determined:

- *taking account of the physical character of the agricultural holding relevant to its use for agriculture as a trade or business, including but not limited to those factors detailed in the non-exhaustive list (see below);*
- *having disregarded the presence of fixed equipment and any tenant farmer's improvement so far as;*
  - *(i) it has been provided wholly or partly at the expense of the tenant farmer (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; and*
  - *(ii) it has not been provided under an obligation imposed on the tenant farmer 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 on the agricultural holding at that date;*
- *taking account of the fixed equipment provided by the landlord;*
- *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;*
- *having disregarded any dilapidation to or deterioration of or damage to fixed equipment or land caused or permitted by the tenant farmer;*
- *taking account of the extent to which the agricultural holding may reasonably be farmed with other land or to the extent an agricultural holding may be farmed with contractors providing machinery services in place of the overhead costs of owning machinery;*
- *taking account of the terms of the lease by which the agricultural holding is let to the tenant farmer;*
- *taking account of the terms of any other legally enforceable agreement or restriction affecting the use of the agricultural holding; and*
- *using the yields that would reasonably be expected from the agricultural holding for that system of farming conducted by such a tenant farmer".*

Source: Invitation To Tender

6.1.2 Through discussions with Hamish Lean we have confirmed that the following points can be derived from the above definition in order to base our working models on:

- Productive capacity is linked to the output, which can be produced from a farm;
- reference to a ‘competent, efficient and experienced tenant farmer’ gives the potential to use a standard percentage of output for costs. This is an appraisal methodology commonly used by banks;
- the inclusion of the assumption that a ‘competent, efficient, experienced tenant farmer’ would have ‘adequate resources for that system’ means that where it would be expected the availability of subsidy is relevant in calculating the productive capacity. In rare circumstances where these would not be taken into account the Land Court could consider this in terms of ‘taking account of all the circumstances’;
- section 1 (2) of the Agricultural Holdings (Scotland) Act 1991 states “agricultural land” means land used for agriculture for the purposes of a trade or business. We can, therefore, assume that ‘a hypothetical competent tenant’ would not continue a business in the long term if it was not profitable over the medium term;
- the ‘hypothetical tenant farmer’ would be expected to make the best use out of the farm’s productive capacity. There is an assumption that a tenant would seek to utilise the potential opportunities the farm provides;
- generally a black patch approach should be adopted for significant tenant’s improvements;
- improvements which need to be included in order to determine a realistic farming system such as fencing, water troughs, access and electricity can be considered as it is reasonable to assume a competent, efficient and experienced tenant would take the opportunities the lease gives him and extract the potential from the farm. A deduction can therefore be made to account for these where it can be proven that they have not been supplied by the landlord. For such improvements this will mean the landlord’s renewal obligations have not been fulfilled as most leases state that holdings are accepted at the beginning of the lease to be in a full state of repair and renewal;

- Grants:
    - where the tenant has completed works with grant aid and no landlord contribution has been made, this must be regarded as a tenant's improvement and disregarded from the rent assessment;
    - where the landlord and tenant make a contribution to works, then both the tenant's contribution and the full amount of grant aid should be disregarded in the rent assessment. i.e. if a building was put up with 40% grant, 30% tenant contribution and 30% landlord contribution, then 30% of that building can be considered in the analysis of rent.
- further regulation may be needed to account for grants where contributions have been made from the landlord. In terms of assessing the fair rent, being unable to include any element of these in the rent assessment does result in disadvantaging the landlord and fully advantaging the tenant in an unproportionate way. It should also be clarified that this is only applicable to improvements therefore allowing grant funded capital to be taken into account when it represents a renewal of fixed equipment;
- fixed equipment used for non-agricultural activities is rentalised using market value not productive capacity. Fixed equipment used for non-agricultural activities which have not been notified under the 2003 Act or consented to as by the landlord should be considered under productive capacity rather than market value, as once rented as non-agricultural activity the landlord's consent will be implied;
- contractor costs may be used. Recognising that they only reflect labour and machinery costs. Although these costs include profit and overheads, many farmers do use them due to the advantages of scale and modernity;
- if a farm is let for a specific purpose this must be considered when defining the farming system;
- a post-lease agreement or unusual lease conditions must be considered in terms of placing a higher cost burden on the tenant which will impact profitability.

6.2 Learning From Other Systems

6.2.1 Agricultural Holdings Act 1986 (AHA)

6.2.1.1 Prior to looking into the various approaches available to calculate the productive capacity of a holding it was considered relevant to look at the pros and cons of the English model which already calculates rents under a similar legislative framework. In England, Agricultural Holdings Act 1986 tenancies, which are similar to that of 1991 Act tenancies in Scotland, rent reviews tend to be approached from two different directions in order to come up with a justified rent. The two procedures used in tandem are comparable evidence and productive capacity via a budgetary approach. The comparables are almost always only drawn from other AHA sitting tenancies, and the values may be adjusted to reflect the terms of the tenancy, and differences in the physical characteristics of the holdings. The budgets are derived from what the hypothetical tenant would be likely to do on the holding, which includes income from sub-let housing, and subsidy receipts. In most cases a valuer would prepare an analysis of comparables and a budget, which ought to produce a similar rental figure in theory and in practice mostly does according to our English counterparts.

6.2.1.2 The legislative basis of the 1986 Act as to how rent is calculated is not dissimilar from how our legislation is now worded under the 2016 Act. Paragraph 1 (1) of Schedule 2 of the 1986 Act defines the rent properly payable in respect of a holding to be:

"the rent at which the holding might reasonably be expected to be let by a prudent and willing landlord to a prudent and willing tenant, taking into account (subject to sub-paragraph (3) and paragraphs 2 and 3 below) all relevant factors, including (in every case) the terms of the tenancy (including those relating to rent), the character and situation of the holding (including the locality in which it is situated), the productive capacity of the holding and its related earning capacity, and the current level of rents for comparable lettings"

6.2.1.3 In practice this system still disregards the tenant’s occupation, scarcity, marriage value, tenant’s improvements, grant-aided landlord’s improvements, dilapidations and high farming.

6.2.1.4 As a contrast to this the Land Reform (Scotland) Act 2016 Part 10, Chapter 5, section 7, sub-section 4 states:

“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.”

6.2.1.5 Through the inclusion of the reference ‘in particular’ it would be possible to undertake a rent review using a similar process to what has been adopted in England for reviewing AHA 1986 tenancies. This would allow comparable rents taken from similar 1991 Act tenancies to be used as a sense check for the productive capacity model. In practice this provides the landlord and tenant with two figures to give them parameters for negotiations. However since the comparable figures would have no relevance to the open market and would be based on sitting tenant rents which are agreed between parties and may have hidden considerations, its application would only be recommended as a sense check provided adjustments were made accordingly. It would also be relevant to add that this sense check should only reference rents agreed or set within the previous 3 year cycle.

6.2.1.6 In practice these rent reviews are done by dealing with the following factors in order:

1. The terms of the tenancy (including those relating to rent); this involves the analysis of terms relating to the repairs, user, subsidy, interest, prohibition of sub-letting and improvement obligations.
2. The character and situation of the holding (including the locality in which it is situated); this involves the consideration of size, soil type, aspect, climate, access, topography, layout, drainage, fixed equipment, access to additional land, markets, public access and available subsidy schemes.
3. The productive capacity of the holding and its related earning capacity; this involves the assessment of the holding as it stands subject to both landlord's and tenant's fixed equipment. The related earning capacity, essentially an assessment of profitability, may be assessed by first undertaking a gross margin budget for each enterprise in the identified system of farming in the circumstances of the subject holding. Having arrived at a total gross margin, the overhead costs (excluding rent) for the holding should then be deducted to establish the surplus before rent – from which a rent needs to be deducted to arrive at the statutorily identified measure of profit. The disregarded rental value of tenant's improvements is commonly deducted from the landlord's portion of the surplus and the remainder of that portion is left as rent for the purposes of this one relevant factor. Alternative approaches may involve different divisions of the present surplus between the parties.
4. The current level of rents for comparable lettings; this involves considering any available evidence of rents determined by arbitration under the 1986 Act.

6.2.1.7 The following contentious factors are apparent within the English model according to the CAAV & RICS guidance on AHA Rent Reviews. Generally these factors have resolved themselves in practice:

- Managerial costs – whilst a very large or intensive unit may require the appointment of a manager, it may be more conventional to regard this as a proper function of profit from the farmer's enterprise;

- typical return on tenant's capital – this requires a capital account to be prepared, including machinery, livestock and working capital but may again often be seen as a use of profit;
- the tenant's own working labour – conventionally the self-employed make profit as a return on their labour as well as their capital. Inclusion of any of these items in calculating the pre-rent surplus may influence the division of that surplus;
- presence of tenant's improvements - The two main approaches considered by valuers to deal with this are: the "black patch" approach and valuing the holding with and without the improvement, assessing the difference, and trying to establish an annual value for the improvement directly, perhaps by writing it down over a period of years. The black patch approach is often criticised for its inability to reflect the latent value provided by the farm in providing the opportunity to implement such an improvement. Writing down on the other hand often means the value of the improvement is overstated as it relates to the cost and the economic write down period rather than the improvements value to the holding.

6.2.1.8 No direct priority is given to earnings-based evidence or market-based evidence. It would seem that generally the practice is to agree a rent somewhere between the two with the preference being towards whichever method relied on the most applicable data i.e. were the comparables fully applicable? Was the costing and output data fully up to date? It therefore provides for the two systems to have their limitations as they are used as a cross check against each other to come to a sensible figure.

6.2.1.9 From the analysis of the English model it is clear that there are a number of workability issues in both determining the productive capacity and excluding or deducting tenant's improvements. In terms of comparable evidence it is also clear that the availability of comparables and the dark art of making adjustments will always prove a limitation when using this method. A sense check to the productive capacity approach seems sensible especially as it would provide a range for debate.

6.3 Calculating the Productive Capacity of a Holding

6.3.1 Working Models

6.3.1.1 The following models have been derived from an analysis of the legislation as being possible methods for considering the productive capacity of the holding:

Model 1: Individual Enterprise Gross Margin Approach (SAC Handbook)
Model 2: Standard Data Approach (Whole Farm Data)
Model 3: Gross Output Approach
Model 4: Alternative Approach 1: Capital Value Approach
Model 5: Alternative Approach 2: Land Use Classification Approach
Model 6: Full Farm Budget

6.3.1.2 Each model has been used to assess the rent on the sample farms inspected with the advantages and disadvantages of the results they produce discussed. The following non-exhaustive list of additional factors should be considered (taken from the Scottish Government's Invitation to Tender) and be taken into account when considering the most appropriate farming system for the holding:

- 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 agricultural holding;

- quality and suitability of land parcels and their relative mix;
- Macaulay land classification of the agricultural holding;
- layout of the agricultural holding;
- field sizes, slopes and shapes, sizes of headlands and margins, ease of working, neighbouring woodland;
- access to agricultural holding and fields;
- damage risk by rabbits, game and other animals;
- field drainage and ditches;
- water supply to the agricultural 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 (e.g. NVZs);
- servitudes and wayleaves affecting the agricultural holding (including pylons, poles, cables, mobile phone masts and pipes);
- core paths and rights of way affecting the farm;
- existing uses of the agricultural holding for non-agricultural purposes;
- any long term use established on the land that could limit choice or offer opportunities;
- the terms of the agricultural tenancy arrangement;
- past, current and available future prices of inputs and agricultural products relevant to the agricultural holding;
- availability of labour for the agricultural holding.

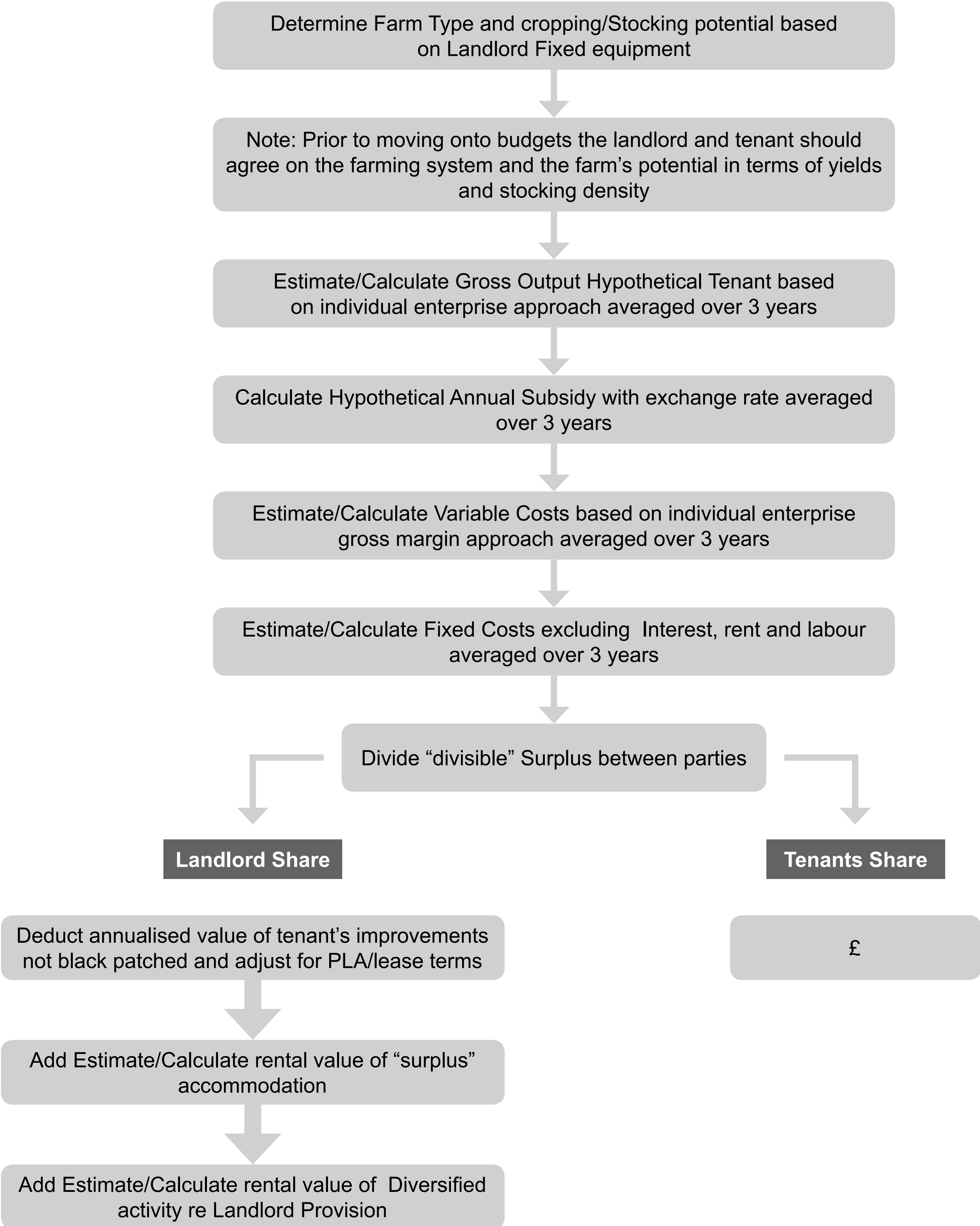
6.3.1.3 Regardless of the model adopted, it will be necessary for the landlord and tenant to agree on certain factors prior to assessing the productive capacity otherwise dispute will be inevitable. The main aspects to be agreed are the farming system most appropriate for the holding, what expected production is likely to be from that system (i.e. yields for crops, stocking densities for livestock) and the status of the fixed equipment present on the holding.

6.3.2 Model 1: Individual Enterprise Gross Margin Approach

6.3.2.1 The gross margin based model begins with the determination of the farming system as all models do. This can be defined through reference to lease documentation, local farming practices, land type, field sizes, fixed equipment provided by the landlord and latent value as well as all the other factors outlined in the list produced by the Scottish Government. A system should be considered by the landlord and tenant as one in which a competent, efficient and experienced tenant would be expected to carry out in order to derive the best, sustainable performance possible.

6.3.2.2 This approach involves both parties working out the productive capacity using gross margins derived from the SAC crop enterprise data and Farm Business Survey Enterprise Data. It assumes a competent tenant would be in receipt of any basic payment, LFASS or other standard subsidy available to them. Following the deduction of all costs the model assumes a 50/50 split of the divisible surplus as is the industry standard. The dataset provides high level information and it is difficult to drill down and analyse. All data would be averaged over a 3 year period in an attempt to account for unstable market conditions. Fixed costs can be obtained from the FBS Cost Centre Analysis Tables. A more detailed extract of this data was provided to the Team by the Scottish Government's Rural and Environmental Science and Analytical Services (RESAS) team to enable costs to be allocated on an area rather than per farm basis.

The sequence is shown below:



6.3.2.3 Advantages

- External data could be seen to be more objective and less arguable.
- In-keeping with the hypothetical tenant farmer.
- Reflects how businesses would make profit projections and plan their accounts.
- Although they would be unlikely to use standard data for this.

6.3.2.4 Disadvantages

- Open to debate between parties with every figure open to scrutiny and the potential for output data and cost data to be analysed in different ways;
- reliance on standardised data which is past data rather than accounting for the current or likely future prices and costs;
- FBS data will include a wide range of data with no ability to check whether the sample only includes competent farmers;
- the lack of consistency within the model could lead to misleading profit/loss figures depending on the angle taken by each party;
- different Scottish Government data sets are difficult to reconcile and ensure all costs are accounted for or make sure there has been no double counting;
- does not achieve the aim of the productive capacity model to decrease conflict in the industry.

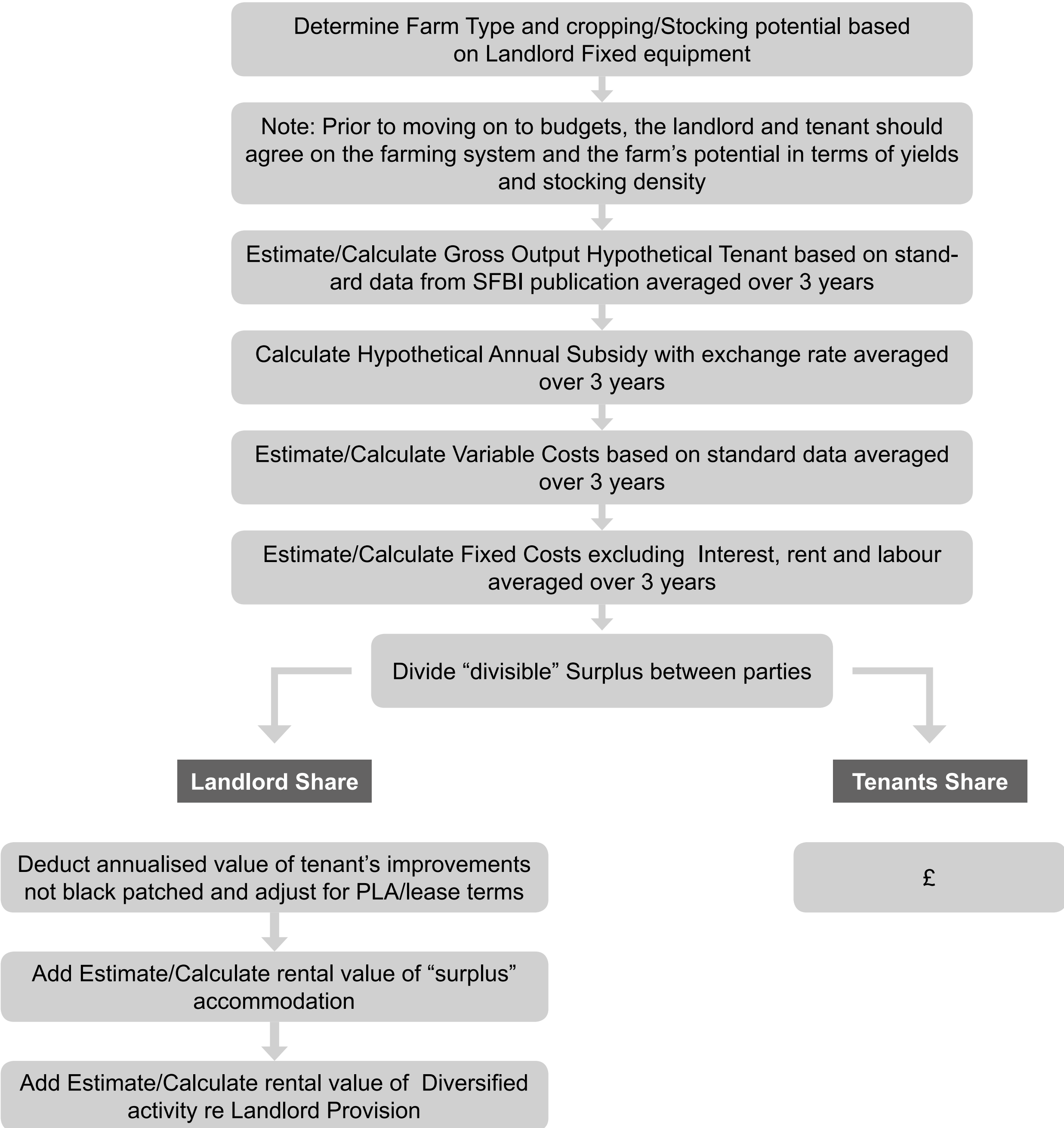
6.3.2.5 Although there are obvious benefits to using a definitive standard data source, the overall issue is that the data is already out of date before it is published and therefore does not reflect markets accurately. With a lack of general detail in terms of what is included within the fixed costs and an inability to account for actual prices and costs, the model lacks accountability and would therefore not be recommended.

6.3.3 Model 2: Standard Data Approach

6.3.3.1 The standard data based model begins with the determination of the farming system based on the standard farm types from the Scottish Farm Business Income (FBI) publication RESAS online publication – Detailed Tables **http://www.gov.scot/Topics/Statistics/Browse/Agriculture-Fisheries/Publications/FASdata**. The selection of the most relevant farm type to the holding from the list of Specialist Sheep (LFA), Specialist Beef (LFA), Cattle and Sheep (LFA), Cereals, General cropping, Dairy, lowland cattle and sheep and mixed should be agreed between the landlord and tenant on the farm inspection as well as agreeing the likely best possible production from the land.

6.3.3.2 This approach involves both parties working out the productive capacity using the FBS farm scale data. This differs from model 1 as the information for each enterprise comes from one of eight farm types. It assumes a competent tenant would be in receipt of any basic payment, LFASS or other standard subsidy available to them. It again bases fixed costs on those expected of that farm type and assumes a 50/50 split of the divisible surplus as is the industry standard. The dataset provides high level information and it is difficult to drill down and analyse.

The sequence is shown below:



6.3.3.3 Advantages

- Provides for a higher level of consistency within datasets via fixed farm types;
- fixes input and cost data, by defining the data source, leaving less opportunity for dispute.

6.3.3.4 Disadvantages

- Limited to only 8 farm types which is unrealistic in practice;
- leads to trying to make the holding match the model rather than matching the model to the holding;
- could be seen as a way of starting with the answer and working back to the farm;
- limited in some respects due to missing data for some farm types;
- variability of the cost data;
- lack of information available in terms of what is included in fixed cost calculations could lead to double counting or missing important elements;
- the concept of a simplified model in which standard data is used appeals as it limits the opportunity for dispute. However in this model the lack of transparency would prove difficult in terms of parties being able to fully justify where rent has come from.

6.3.3.5 Again, although there is an appeal to this model in terms of providing a simplistic means of calculating the productive capacity, it again lacks accountability due to its inability to react to market circumstances, its restrictive nature in terms of farm type and the fact the data is out of date before it is published.

6.3.3.6 It should also be noted that when analysing results from models 1 and 2 there was potential for huge variance depending on which model was used.

6.3.4 Model 3: Gross Output Approach

6.3.4.1 The Gross Output based model begins with an analysis of the farm and the determination of the farming policy. This farming policy is informed by the local farming practices, the landlord's fixed equipment and the physical characteristics of the farm.

6.3.4.2 The farming system is then analysed into arable and grassland based enterprises and a rotation prepared. Data can be gathered from reliable data sources for past, current and future prices available to the parties and should reflect a 3 year average to ensure stability. Ideally one year past, one year current and one year future data should be used where possible with the source for the data remaining as consistent as possible.

6.3.4.3 This approach involves both parties working out the productive capacity based purely on the likely output of the agreed farming system. This removes the need to agree on variable cost and fixed cost data.

6.3.4.4 The following percentage was found through reference to the whole farm review data and then discussed with accountants and banks to determine what percentage of output a farmer would be expected to make in profit. It is considered by banks to be a realistic profit figure and has been used for over 20 years to analyse business performance:

- Profit before Rent & Interest & Personal Drawings (30%).

6.3.4.5 As such it was agreed with three banks that the above percentage is currently used to analyse whether a business is viable or not. There are rules of thumb which the banks use to assess farm businesses. Rent could then be calculated at approximately 12-18% of gross output i.e. 50% of the gross profit (surplus split 50/50). Evidence from banks suggests competent farm rents sit somewhere between 10 and 18% of gross output. When queried on the relevance of these percentages to all farm types, the banks were clear that adjustments were rarely made except where a particularly specialised or intensive farm was analysed. In these cases variable costs would likely be at the higher end of the 30-40% range. It was clear that banks considered businesses with a gross profit below 30% as struggling.

Following the Stakeholders meeting we were guided to consider ‘The John Nix Pocketbook’. It notes a number of common ratios, using normalised output prices (i.e. those in an average year) which it states can be used as guidelines:

Table 4: John Nix Output Table

% of Gross Output	Arable	Dairy	Mixed	Upland	Intensive Stock
Labour inc drawings	12	15	21	17	12
Rent & Interest	12	13	9	8	4
Profit (to cover tax, capital repayments, reinvestment	14	5	14	19	2

(Source: John Nix Pocketbook 2018)

The John Nix Pocketbook also looks at farm survey ratios in England. The analysis looks at rent as a percentage of gross output. It notes that rent as a percentage of gross output on surveyed farms in 2014 and 2015 was 15% and 16% respectively.

6.3.4.6 DEFRA has also published documentation on expected percentages of farming businesses in their paper ‘Figures for a Farming Future’ (2004). The table below shows the expected percentages for variable costs, fixed costs and Rent and Finance which would leave a likely gross profit of approximately 30%. Once again these are defined as ‘expected’ percentages not ‘target’ percentages so it would seem fair to make 30% the base rate for ranges to start from depending on the specific circumstances of the holding.

Table 5: DEFRA Output Table

<table>
<tr><th rowspan="2"></th><th colspan="2">Your Farm</th><th rowspan="2" colspan="2">Expected percentage of output</th></tr>
<tr><th>£</th><th>Percentage output</th></tr>
<tr><td>Gross output</td><td></td><td>100%</td><td colspan="2"></td></tr>
<tr><td>Labour (not including the value of unpaid family labour)</td><td></td><td></td><td>under 15%*</td><td rowspan="2">Under 40%*</td></tr>
<tr><td>Power and machinery</td><td></td><td></td><td>under 25%*</td></tr>
<tr><td>Miscellaneous fixed costs (property expenses and general overheads)</td><td></td><td></td><td colspan="2">Under 15%</td></tr>
<tr><td>Rent and finance costs</td><td></td><td></td><td colspan="2">Under 15%**</td></tr>
</table>

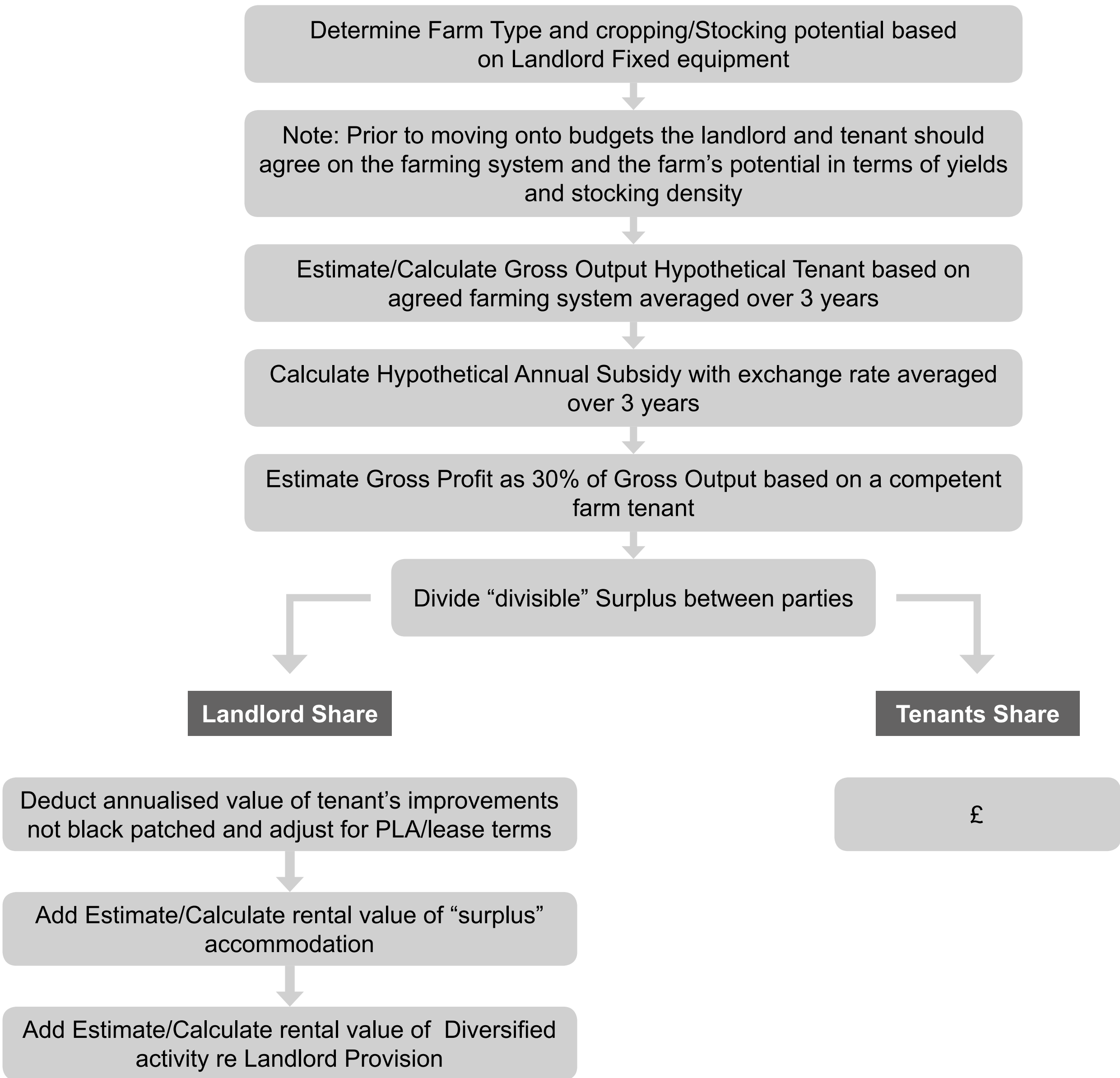
(Source: DEFRA 2014)

6.3.4.7 Although a useful cross reference, it should be noted that data sets such as John Nix and DEFRA are based on farms in England which limits the relevance of its application. However, in principal the data does provide for interesting comparisons and shows that it may be relevant to adjust the 30% profit figure to account for certain aspects of the holding. For example the following would perhaps be relevant when setting the profit percentage:

- The existence or lack of non-surplus residential accommodation;
- the ability to benefit from economies of scale;
- remoteness of markets (although this should be mainly adjusted through prices achieved);
- higher or lower fixed costs;
- the presence of restrictive lease clauses or farm types.

6.3.4.8 Based on the above, 30% as an average could be adjusted up or down depending on the specifics of the holding. In order to ensure relevant ranges are adopted we would recommend further research is undertaken to define what ‘a fair’ profit expectation would look like and what would be ‘fair’ in terms of appropriate ranges at either end of this figure to account for varying factors within a holding.

The sequence is shown below:



6.3.4.9 Advantages

- This model allows the specific farming system to be appraised;
- it is considered, alongside a full budget, to be the best means of producing an accurate assessment of the output for the holding;
- by only dealing with output it significantly reduces the potential areas of dispute;
- in working directly with gross output it allows both fixed costs and marriage value to be bypassed;
- removes the potential for calculations to conclude a nil or de-minimus rent;
- ensures the farm is considered as a business with account to the actual profit the farm is capable of, rather than reference to cost which is generally business specific and often includes an element of individual preference and reference to actual circumstances. For example, a full budget is used by a business to account for their actual circumstances with cost data often altered from the beginning to account for an individual's preferences rather than the most efficient means of running the business in order to ensure profit is maximised.

6.3.4.10 Disadvantages

- Over simplifies the assessment of costs which means it is less able to react to changes in the economy/market;
- still has the difficulties involved in agreeing a farming system, stocking densities, yields etc.

6.3.4.11 Although this model still has restrictions and limitations, it is considered to be a means of simplifying the calculation of the productive capacity of a holding. We appreciate that research is required in order to set relevant profit percentage ranges and a sense check would be relevant in order to prevent the potential for 'unfair' results. However the output model is potentially the most robust option available.

6.3.5 Model 4: Alternative Approach 1: Capital Value Approach

6.3.5.1 Model 4 was investigated as an alternative way of calculating the productive capacity rather than dealing with the divisible surplus as per the conventional 50/50 split. It derives a 'fair rent' from the established theory of economic activity being made up of the four factors of production being:

- Land
- Labour
- Capital
- Management

6.3.5.2 The economic return to each is shown below:

Table 6: Economic Return

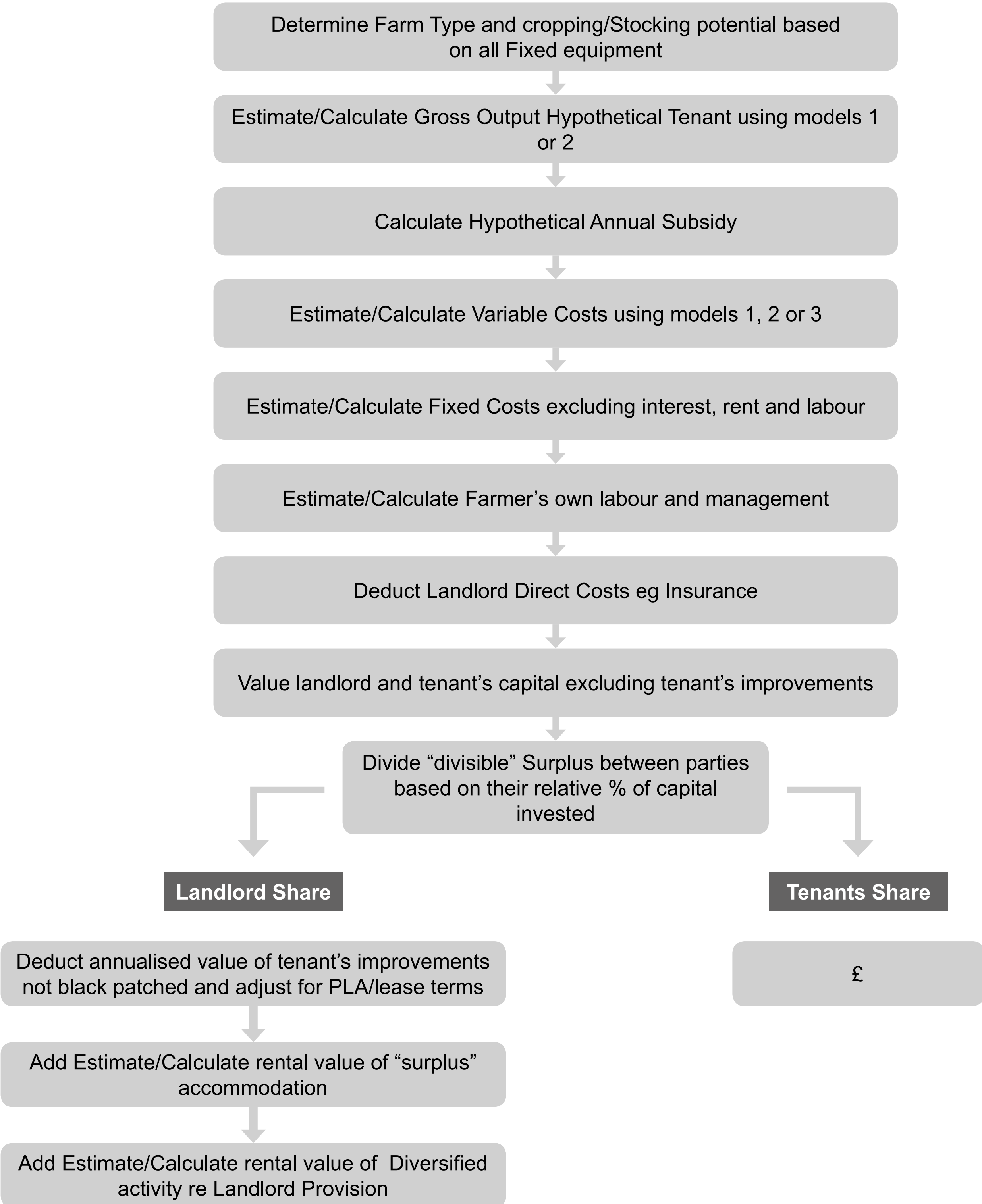
Factor of Production	Component
Land	Rent
Labour	Wages and Salaries
Capital	Interest Payment
Management	Consultancy and wages

6.3.5.3 Rent, from a landlord's perspective, is simply a return on the capital tied up in the holding, and to the tenant it is the cost of acquiring the use of that capital asset. In a system based on the economics of a hypothetical farmer where a "divisible surplus" is to be shared between the parties, that surplus must represent the same thing to both landlord and tenant. To achieve that from a conventional accounting or budgeting perspective, you must take the output (production) and deduct from it all the cost of achieving it except the one you are trying to "Divide".

6.3.5.4 We should therefore deduct from output all variable costs (i.e. seed, feed, fertiliser), all fixed costs (i.e. labour, machinery, insurance) to account for working tenant’s. The fixed costs must include the tenant's own labour and a component for management but exclude any interest costs. On the landlord’s side, we must also deduct landlord’s insurance and admin costs (landlord’s management) leaving a figure which represents the return on capital of both Landlord and Tenant.

6.3.5.5 To be “fair”, we should then divide that “surplus” between the parties in the ratio of the capital they have each contributed to the economic system. For example, the landlord’s capital would be the value of the holding subject to tenancy whilst the tenant’s capital would be the working capital, stock, machinery and the value of any tenant’s improvements.

The sequence is shown below:



6.3.5.6 In theory this represents a “fair” way of determining the rent. However, if you apply that system in practice by accounting for all the costs involved in a farming system, it almost always leaves a negative margin and therefore in theory no surplus to be divided.

6.3.5.7 Watson Bell believes that in agriculture you can afford to pay the market value of only two of the four factors of production. If you are an owner occupier and the farm is fully paid up you can borrow money for stock and machinery and employ paid labour but you are not paying the market price for land or able to employ management.

6.3.5.8 For a tenant paying rent and paying interest they must receive less than the market price for labour and management. This scenario is reflected in reality where many working farmers will receive less per hour for their labour and management than even the minimum wage.

6.3.5.9 The divisible surplus must represent labour and management and any return on tenant’s capital for the Tenant and Ownership costs and return on capital for the landlord. There is no way of reconciling this division or providing a “fair” split in which case it is difficult to envisage an alternative to the accepted “norm” of 50%-50%.

6.3.6 Model 5: Alternative Approach 2: Land Use Classification Approach

6.3.6.1 Although not a budgetary approach, the Macaulay considers the land use capability not its current use and therefore takes its potential into account and excludes reference to the actual tenant, meaning it could be used as a means of calculating the productive capacity of a holding. Used as a main model or a sense check annual pre-determined ranges of rent would need to be produced for each Macaulay land use class or agreed land type. These could be produced through stakeholder agreement and published annually. For example Grade 2 land could be set at £X- £Y/acre, grade 3 at £A-£B/acre etc. The variance within the range would take into account different levels of fixed equipment supplied by the landlord and any limitations within a particular holding in terms of the ‘additional factors to be considered’ which were outlined previously. It is important to note that agreement between the landlord and tenant onsite as to the class of the land would be required as there are obvious restrictions to the accuracy of the Macaulay data in certain parts of holdings. For example a particularly wet area of grade 3 land could be agreed to be classified as grade 4 or 5 in reality provided its condition was not due to a lack of maintenance.

The sequence is shown below:

Determine Land Type Grade and agree adjustments from Macaulay where required

↓

Apply Standard £/acre rate to land type (Ranges for each land class to be defined by the main stakeholder groups)

↓

Consider factors specific to the holding when deciphering which rent within the range is most applicable e.g. Level of fixed equipment, terms of lease etc.

↓

Estimate/Calculate value of “surplus” accommodation

↓

Estimate/Calculate value of Diversified activity re Landlord Provision

6.3.6.2 There would of course still need to be adjustments for region, landlord’s provision of fixed equipment and tenant’s improvements, but it would root the final outcome within a sensible framework and could be used to provide a useful cross check to a budget based approach to allow for reasoned negotiation. This would need to be annually updated to reflect a rolling average of economic conditions, regional and local rental patterns and changing agricultural regulations.

6.3.6.3 Advantages

- Offers a useful sense check to a budgetary approach;
- is based entirely on the productive capacity of the land;
- completely black patches tenant's improvements;
- is simple in its application so less open to debate between parties.

6.3.6.4 Disadvantages

- Considered to be over simplistic in its ability to cope with differences in location, fixed equipment, current price data, likely costs, infrastructure and investment in the holding from either party;
- adjustments would need to be made for the specifics of the holding, without a structure for such adjustments debate could occur;
- relies on the stakeholders being able to agree on ranges with a methodology in place to determine such ranges. Likely to relate to sitting tenant rents which leads us to believe that the ability to use relevant sitting tenant rents in terms of comparables as a sense check would be a better option.

6.3.7 <u>Model 6: Full Farm Budget</u>

6.3.7.1 Models 1 & 2 utilise financial data from either FBS or the SAC Handbook. Both information sources gather farm account data from sample farms across farm types.

6.3.7.2 There are a number of challenges associated with using this survey information which have been discussed. However having identified these challenges and in response to feedback from the stakeholders meeting, it was important to consider a further option, a farm budget, which would get round the issues of using historic data recorded in a rigid format. The farm budget could describe either the actual farming system or the hypothetical farming system. The legislation guides us to the latter after disregarding tenant's improvements.

6.3.7.3 The process is therefore straightforward and does not require a detailed description other than to layout principles. The budget could look at the current agricultural conditions and look forward with a realistic approach to commodity prices, yields and variable costs based on the hypothetical farming system.

6.3.7.4 The budget also has the ability to consider fixed costs in detail. The equipment present on the farm today reflects the tenant's actual farming system, represents the choices the tenant has made and may relate to a wider farming business or contracting enterprise. The budget will therefore need to build up a register of fixed equipment which facilitates the hypothetical farming system. The equipment required would be appropriate in size and value to the holding. In some cases ownership of a machine would not be proportionate. So just as the output and variable costs need to be justified, so must the fixed costs.

6.3.7.5 The presence of a post-lease agreement or unusual lease conditions could be reflected within the annualised costs before the divisible surplus is then split 50-50 as with the other models.

6.3.7.6 Although favoured by some of the stakeholders, there are a significant number of difficulties in arriving at what can be agreed between the parties. In a whole farm budget even for a simple all cereal farming system, there are up to 30 component figures for each gross margin, potentially four or five gross margins and a further 20 costs to agree in order to arrive at total fixed costs. In total between 120 and 150 physical estimates and prices have to be determined in order to arrive at even a simple budget. Where more complex livestock or mixed farming systems are involved the numbers increase significantly.

6.3.7.7 What must be remembered is that even with the best will in the world these figures are only estimates based on the parties respective professional judgements or based on external experts professional advice. There is no "sense check" within the figures and each side will seek to vigorously defend their own position.

6.3.7.8 The use of “standard” gross margin figures as seen in Model 1 could reduce, to an extent, the areas for disagreement, but “standard” figures are precisely that and need to be adjusted for regional, local and individual farm circumstances. It is within the fixed costs particularly that there is scope for significant debate about what is and is not appropriate for a hypothetical farming system. When to hire a tractor or buy, to contract an operation or not are some of the other variables for debate.

6.3.7.9 Whilst variable costs are precisely what they say, fixed costs in general do not fluctuate as much with price or output nor do they follow a linear pattern based on scale. Thus, a 100 acre farm does not have half the fixed costs of a 200 acre farm even where the farming system itself is identical. There is little reliable published data analysed to farming system and scale and therefore widely varying opinions about what should and should not be included. At one extreme it can be argued that where economies of scale are not achievable due to the small scale of, for example arable enterprises, then contractor’s rates should be used in place of machinery costs. The recently published report by Savills 2016 Arable benchmarking illustrates the difficulties with this showing a difference of over £100/Ha in costs comparing in hand farming with contract farming.

6.3.7.10 It has already been pointed out in Model 4 that a model which tries to fully budget a proposed farming system including the tenant’s labour, capital and management doesn’t work. In many cases this leads to a negative divisible surplus. To get meaningful results therefore these costs need to be excluded from the budgeted figures in order to arrive at a positive surplus. The split of the divisible surplus is therefore further open to argument and cannot be objectively defined in terms of “fairness”.

6.3.7.11 Advantages

- It is the most accurate way of looking at costs and prices through finding the most relevant data source for each and not being restricted to standard data sources;
- ability to look at past, present and future price data reflects how businesses would make profit projections and plan their accounts;
- assures a reactive model which can adapt comfortably to changing circumstances like the loss of farm subsidy or significant rises in variable costs;
- all employment costs can be identified in the budget. This means that the accommodation of the farm can be reflected in the divisible surplus.

6.3.7.12 Disadvantages

- Allows for a huge number of variables which can be altered slightly and have a huge impact on the final figures. Although the number of factors allows this model to adapt easily to market changes it also increases the ability for varying results;
- greater scope for partisan behaviour with both sides favouring circumstances which support their position of either increasing or decreasing output or cost;
- with such a wide range of data sources available, the two parties involved can use completely different data sources and come to completely different answers with no means to justify which data source is correct;
- fixed costs required are extremely open to debate with the amount of machinery, labour and housing required being business specific. Standard labour units can be used but if they are not mirrored in practice then the question of 'fairness' is raised;
- housing requirements are also subjective and the treatment of housing costs can be difficult. Is it fair to apply all the costs involved in housing an employee without accounting for the benefit the house provides? If there is no housing provided should costs be put in to reflect renting in from elsewhere or greater travel expenses?;
- assumptions on interest and ownership of machinery are also widely open for debate;

- costs of running a business have the ability to be widely inflated or deflated depending on which party is arguing;
- although not as contentious, output and prices alone can be difficult to agree on with yield capability and carrying capacity in terms of livestock also open to debate;
- the ability to account for the tenant's own labour is also an area of contention;
- this model becomes generally very personal and encourages conflict within the tenant farming sector generally.

6.4 Adjustments to be made for Tenants Improvements

6.4.1 As discussed previously, the primary method for dealing with tenants improvements is to black patch them wherever this is possible. There are difficulties in "black patching" tenants' improvements where in their absence there would be no viable farming system on which to determine productive capacity. An example would be an upland livestock unit on which the tenant has provided all the fencing including march fencing, the water and the internal road system. Without such items it becomes very difficult to adopt a viable farming system. There are therefore certain items which it must be assumed are present to determine the productive capacity but it is recommended that these are limited to land improvements such as fencing, water troughs, electricity supplies and access.

6.4.2 Due to the fact that these improvements are often situation specific, we do not propose implementing a stringent method by which to deal with them but instead have provided a number of ways by which they could be dealt with depending on the situation that presents itself. This should provide parties with a framework under which to form a reasonable basis for a deduction to account for non black patched improvements.

6.4.3 The methods account for these improvements through either an analysis of their likely impact on the rent a competent tenant would pay for the holding or the annual cost, of the improvement spread over its lifetime, deducted from the landlord’s share of divisible surplus. Treatment of improvements may vary depending on whether they are considered to be permanent improvements such as installation of an electricity supply or depreciating improvements such as fencing.

6.4.4 A permanent improvement where, once undertaken, there is no further input from the tenant such as stone removal or reclamation of land from scrub to arable or where with regular maintenance the improvement could be considered to last in perpetuity such as drainage or dyke building does not depreciate and therefore if not black patched could be accounted for by crediting the tenant with an annual return on the capital expended. In practice it should be possible to black patch these improvements.

6.4.5 One of the improvements without which it would be virtually impossible to operate a viable farming system is the provision to the farm of an electricity supply. Most supplies were provided in the 1950s and in many cases the cost of this provision was met by the tenant. Once connected, the maintenance and replacement costs of this infrastructure are met by the electricity companies themselves. It can therefore be considered as a one-off improvement which lasts in perpetuity and the tenant could be credited with a return of 10% on the initial cost of the improvement NOT the current cost of the provision to account for this. This would equate to approximately £50 being deducted in most cases in perpetuity. It should be noted that in most cases a new lease will have been granted either compensating the previous tenant at waygoing or having written off the improvement under the old lease. Improvements done under previous leases (unless carried forward into a new lease) should be considered as the landlord’s fixed equipment going forward.

6.4.6 With depreciating assets, which have not been black patched, it could be argued that the tenant would carry them out only if they envisaged a return on the capital expended and that capital to be repaid over the lifetime of the asset. Improvements would only be considered in this way if they are likely to form part of the landlord's fixed equipment obligation or are intrinsic to the definition of the farming system. The challenge with this assessment is that in some instances the land without the improvement would have very little rental value. For example, steep grassland without fencing would have little value but once fenced it can be grazed and thus has an enhanced rental value. In this analysis the potential value of the land is not considered if the improvement is black patched. Thus, in such circumstances, it would be more appropriate for the rent to be based on the value with the improvement in place and a relevant deduction made in order to disregard the improvement. A number of depreciation options have been considered as follows:

1) Depreciation and interest at historic cost.
2) Depreciation and interest at current replacement cost.
3) Depreciation and interest at current value to an incoming tenant.

6.4.7 The example tables show the effect of each option on a hypothetical 1000 metres of fencing depreciated over a 20-year period.

Table 7: Historic Cost / Depreciated

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14	Year 15	Year 16	Year 17	Year 18	Year 19	Year 20	
Fence Cost /metre	4.50	4.60	4.70	4.80	4.90	5.00	5.10	5.20	5.30	5.40	5.50	5.60	5.70	5.80	5.90	6.00	6.10	6.20	6.30	6.40	
Rent Review	**Year 1**			**Year 4**			**Year 7**			**Year 10**			**Year 13**			**Year 16**			**Year 19**		**Total**
Value	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	£4,500	
Depreciation	£225	£225	£225	£225	£225	£225	£225	£225	£225	£225	£225	£225	£225	£225	£225	£225	£225	£225	£225	£225	**£4,500**
Interest at 3%	£135	£135	£135	£135	£135	£135	£135	£135	£135	£135	£135	£135	£135	£135	£135	£135	£135	£135	£135	£135	**£2,700**
Deductable (Dep + Int)	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£360**	**£7,200**
Deductable /Metre	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	£0.36	

6.4.8 As the capital is being repaid over time, then the outstanding amount will start at 100% and gradually reduce to 0% over the estimated lifespan of the fixed equipment. In line with the non-depreciating assets, long term interest rates appropriate to the deemed life of the investment should be used to determine the fair opportunity cost of not having the ability to invest capital elsewhere. In the case of the above fencing example we have used 3%. This means the cost of the improvement is fully paid off over its lifespan so accurate record keeping at rent reviews would be vital to ensure this approach was feasible.

6.4.9 The obvious advantage of this approach is that it attempts to put the tenant in the position he would have been in had the landlord made the initial investment through making an equal deduction to the rent over the estimated lifespan of the fixed equipment plus a sum for interest.

6.4.10 The disadvantage of this approach is that it is inconsistent with the 2003 Act which made write off agreements void. If at the end of the 20 years there is still value in the fence and this continues to be accounted for using this method then the tenant begins to make a profit from the investment. When assessing the rent, a tenant's improvements should be disregarded which means their presence should neither benefit or disadvantage either party. As such without the ability to write off an improvement at the end of its financial lifespan we believe this model has fundamental flaws.

Table 8: Current Cost

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14	Year 15	Year 16	Year 17	Year 18	Year 19	Year 20	
Fence Cost /metre	4.50	4.60	4.70	4.80	4.90	5.00	5.10	5.20	5.30	5.40	5.50	5.60	5.70	5.80	5.90	6.00	6.10	6.20	6.30	6.40	
Rent Review	**Year 1**			**Year 4**			**Year 7**			**Year 10**			**Year 13**			**Year 16**			**Year 19**		**Total**
Value	£4,500	£4,500	£4,500	£4,800	£4,800	£4,800	£5,100	£5,100	£5,100	£5,400	£5,400	£5,400	£5,700	£5,700	£5,700	£6,000	£6,000	£6,000	£6,300	£6,300	
Depreciation	£225	£225	£225	£240	£240	£240	£255	£255	£255	£270	£270	£270	£285	£285	£285	£300	£300	£300	£315	£315	**£5,355**
Interest at 3%	£135	£135	£135	£144	£144	£144	£153	£153	£153	£162	£162	£162	£171	£171	£171	£180	£180	£180	£189	£189	**£3,213**
Deductable (Dep + Int)	**£360**	**£360**	**£360**	**£384**	**£384**	**£384**	**£408**	**£408**	**£408**	**£432**	**£432**	**£432**	**£456**	**£456**	**£456**	**£480**	**£480**	**£480**	**£504**	**£504**	**£8,568**
Deductable /Metre	£0.36	£0.36	£0.36	£0.38	£0.38	£0.38	£0.41	£0.41	£0.41	£0.43	£0.43	£0.43	£0.46	£0.46	£0.46	£0.48	£0.48	£0.48	£0.50	£0.50	

6.4.11 The current cost approach considers the improvement based on current costs at each rent review and like the previous model compensates the tenant via a reduction of rent over the estimated lifespan of the improvement. Again depreciation and interest are based on a percentage of the cost but in this case because the cost is increasing so are these rates over the lifespan of the fixed equipment.

6.4.12 This method is practical in its application as current costs are always available and do not rely on a record of when the improvement was put in place as the previous model does.

6.4.13 The current cost approach, does however, provide an inflated return on the tenant's investment and is considered to disadvantage the landlord and benefit the tenant with the result likely to be a profit at the end of the estimated lifespan and then an additional profit if the improvement is still functional beyond the estimated lifespan.

Table 9: Value to Incoming Tenant

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11	Year 12	Year 13	Year 14	Year 15	Year 16	Year 17	Year 18	Year 19	Year 20	
Fence Cost /metre	4.50	4.60	4.70	4.80	4.90	5.00	5.10	5.20	5.30	5.40	5.50	5.60	5.70	5.80	5.90	6.00	6.10	6.20	6.30	6.40	
Rent Review	**Year 1**			**Year 4**			**Year 7**			**Year 10**			**Year 13**			**Year 16**			**Year 19**		**Total**
Value	£4,500	£4,500	£4,500	£4,080	£4,080	£4,080	£3,570	£3,570	£3,570	£2,970	£2,970	£2,970	£2,280	£2,280	£2,280	£1,500	£1,500	£1,500	£1,500	£1,500	
Depreciation	£225	£225	£225	£204	£204	£204	£179	£179	£179	£149	£149	£149	£114	£114	£114	£75	£75	£75	£75	£75	**£2,985**
Interest at 3%	£135	£135	£135	£115	£115	£115	£96	£96	£96	£80	£80	£80	£67	£67	£67	£57	£57	£57	£57	£57	**£1,750**
Deductable (Dep + Int)	**£360**	**£360**	**£360**	**£319**	**£319**	**£319**	**£275**	**£275**	**£275**	**£229**	**£229**	**£229**	**£181**	**£181**	**£181**	**£132**	**£132**	**£132**	**£132**	**£132**	**£4,735**
Deductable /Metre	£0.36	£0.36	£0.36	£0.31	£0.31	£0.31	£0.27	£0.27	£0.27	£0.22	£0.22	£0.22	£0.18	£0.18	£0.18	£0.13	£0.13	£0.13	£0.13	£0.13	

6.4.14 The value to an incoming tenant approach considers the improvement based on the current cost depreciated to reflect its current value to an incoming tenant. This would involve a revaluation of the fixed equipment at each rent review and compensates the tenant for the improvement via a reduction in rent for so long as the improvement is functional and considered to provide value. Depreciation and interest are based on a percentage of the value. The principal of this approach is therefore to compensate the tenant for the value to the holding the improvement provides rather than attempt to fully repay the cost of it.

6.4.15 This approach has the obvious benefits of being practical as it is already used as a means of valuation at waygoing, so we know it can be applied by practitioners robustly. It is therefore more easily deductable than a pure cost analysis which has write off implications.

6.4.16 The difficulty with this approach is that it does not result in the tenant fully recovering the investment made in the improvement over the estimated lifespan. Although it values out the improvement unless the cost is completely recovered over the lifespan of the fixed equipment it is difficult to conclude that it has been fully disregarded as it would be if completely black patched. Although this appears to be the fairest approach as it can be consistently applied throughout the period that the fixed equipment provides value to the holding, we do appreciate that it may still have weaknesses in terms of reaching a fair rent.

6.4.17 The value to an incoming tenant approach does not allow the tenant to recover their costs (£4.12/metre) over the 20 year term modelled. However costs will be recovered at waygoing and the deduction will continue to be made beyond the anticipated lifespan of the improvement if the fence remains stockproof and serviceable. Obviously the deduction is based on the value to an incoming tenant at the time of assessment, so the poorer the quality, the less deduction relevant. For these reasons the value to an incoming tenant approach is probably the most fair means of accounting for non black patched improvements.

6.4.18 The difficulties in adopting a cost and deduction method for disregarding tenant's improvements (as outlined in depreciation tables 1 & 2) relate to the ability to under or over account for them. The following factors put the fairness of these approaches into question:

1. Proportion of improvement which has been grant funded. Although the 2016 Act points to grant funded improvements being undertaken by the tenant being disregarded, it would seem unfair to use a cost basis to deduct these from the rent if neither the landlord nor tenant has financially contributed to them.
2. Likelihood of a hypothetical tenant relying on borrowings in order to undertake the improvement and the relevance of this to the likely interest rate to be included in the deduction or whether it is relevant to include an interest rate at all. The inclusion of an interest rate could be seen to benefit the tenant for undertaking the improvement especially where it is not written off when the cost has been re-couped. On the other hand there is undoubtedly an opportunity cost which is relevant when disregarding the improvement.

3. Double counting: many of the improvements would be compensated at waygo at which point the tenant's investment will be recouped. Making an annual rental deduction reflects the tenant's investment and provides a return on it but also must reflect the fact that should the tenancy end, the remainder of the value of the improvement is available to the tenant through their waygo valuation. This valuation is on the basis of the value to an incoming tenant therefore a reduction in the rent using this methodology allows the procedures to remain consistent and avoid the opportunity for double counting.
4. There is often ambiguity over the fixed equipment provided at the commencement of the tenancy. Records of condition, detailing the landlord's fixed equipment, are seldom available. Therefore what is and what is not a tenant's improvement may be difficult to establish in many cases.

6.4.19 It can be concluded that tenants' improvements must be black patched wherever possible to avoid the complexities and inevitable subjectivity of discounting them from the rent. Where, in order to facilitate the hypothetical farming system, the improvement needs to be taken into account it must be deducted from the landlord's surplus.

6.4.20 We consider deducting non black patched improvements to be a complicated process with the creation of an exact methodology proving to be difficult in practice. Due to the diversity of tenant's improvements it is not sensible to provide a prescriptive methodology for the valuation of the improvement. It must reflect the value to an incoming tenant but also account for the land's potential or latent value. We consider this to be an aspect of the legislation which needs to rely on both parties being transparent, reasonable and fair to enable agreement on the rental value of the non-black patched improvement. This may be facilitated by guidance notes from the Tenant Farming Commissioner.

6.4.21 In terms of adjustments made for post-lease agreements or unusual lease conditions which place a higher level of obligation on the tenant, the following differences exist from how we have considered improvements:

1. Post lease agreements or unusual lease terms are case specific and all place differing obligations on the tenant so should be considered on a case by case basis. In some cases the obligations placed on the tenant will be the same as are contained in a standard 1991 Act tenancy and no adjustments will be relevant. It is common for post lease agreements to place landlord renewing obligations on the tenant and these do need to be considered on the basis of an increased cost obligation.
2. Where a renewal of landlord's fixed equipment is placed on the tenant, this fixed equipment should be considered when assessing the farm type and therefore adjustments cannot be made through black patching as would most commonly be the case when dealing with tenants improvements.
3. The value to an incoming tenant cost and deduction method would also not be appropriate because it is not the value to an incoming tenant which needs to be assessed, it is the cost of 'the increased obligation' to 'a tenant' which needs to be accounted for.

6.4.22 Therefore where a landlord's obligation to renew has been placed on the tenant via a post lease agreement or unusual lease terms, we believe this is best dealt with by deducting the annualised current cost of the renewal where it is evident that it has been undertaken. It would only be where the tenant has gone beyond the renewal obligations of a post lease agreement/lease terms by providing an element of betterment that it might be necessary to black patch the betterment element. An example might be erecting a modern steel portal framed building to replace a traditional U-shaped steading.

6.5 Consideration of other factors

6.5.1 The 2016 Act states that the Land Court should determine the fair rent 'taking account of all the circumstances' and having regard 'in particular' to productive capacity, surplus residential accommodation and land/buildings used for a purpose that is not an agricultural purpose. This leaves the Land Court with the capacity to consider other areas which they feel may be relevant to the 'fair rent'. From the work undertaken we consider that the following fall outwith the main three areas being considered and perhaps could be included separately in order to set the 'fair rent'.

1. Sitting tenant rents – there would generally be an acceptance that when considering 'fairness' it would be reasonable to conclude that similar holdings should have similar rents. A sense check using existing farm rents would seem to be a reasonable consideration.
2. Residential accommodation – the productive capacity model as it sits does not account for residential accommodation 'on farm'. It is based around business systems and output generated rather than the advantages available if accommodation is located on the farm. This would result in a farm with accommodation for the farmer and his staff being rented at the same level as a farm which does not provide such accommodation. An obviously unfair outcome.

6.5.2 In terms of the use of sitting tenant rents agreed or set in the previous three years, we believe this would be a useful sense check and should be defined as such in further regulations as a relevant factor within 'all circumstances'.

6.5.3 With residential accommodation which is not considered to be surplus to the requirements of the holding, the ability to account for this is unclear and possibly needs further research depending on the method used for calculating productive capacity.

6.5.4 In England this is accounted for through dealing with all the costs involved in the non surplus residential accommodation within the budget (council tax, property repairs, etc) then separately an amount is added per annum to reflect the benefit the residential accommodation provides. Figures used are a fraction of residential letting rents and have been derived from successful agreement rather than having any standard methodology to them. Evidence provided by the CAAV showed broadly that farmhouses achieve rents of £3-4,000 with variations reflecting condition and cottages typically achieve £1,250-1,500.

6.5.5 It is unclear whether the issue of non surplus residential accommodation can be dealt with within the productive capacity calculation or not. One means of dealing with it could be to consider the increased cost involved in being based 'off farm' to being based 'on farm' for example higher fuel costs and potentially higher wages if a house is not supplied as part of the employment contract. This could be dealt with through varying the expected gross profit percentage within the gross output model i.e. a fully equipped unit would perhaps be expected to make 30% of Gross Profit while a unit with higher costs would make less. Again more research into a realistic range of percentages would be required to ensure fairness to both parties. Fairness should ensure that residential accommodation which is not surplus to the requirements of the holding is accounted for.

6.6 Worked Examples

6.6.1 The below table summarises the results of the ten sample farms using the gross output model and the farm budget model. **Appendix 4** gives a further breakdown of the ten sample farms and shows the results of models 1 and 2. These models were considered to be unworkable in practice due to a reliance on out of date datasets, the potential for huge variance in results and a general lack of flexibility to allow for changing market conditions.

Table 10: Worked Examples of Model 3 & Model 6

FARM	SYSTEM	COMPAR-ABLES (£/ac)	MODEL 3: GROSS OUTPUT 2013 to 2015 30% £Range (Avg. Rent)	MODEL 3: GROSS OUTPUT 2015-2017 Type £Range (Avg. Rent)	MODEL 6: FARM BUDGET (£/ac)	DEDUCTIONS FOR IMPROVEMENTS (not been made to figures in model 3 & 6)
A	General Cropping with Potatoes	32 - 67	£176k - £194k (Avg £99/ac)	£174k - £194k (Avg £92/ac)	33	10 acres of reduced production reflecting 50/50 share of drainage improvement over 20 acres
B	Upland Cattle + Sheep	43 - 59	£161k - £191k (Avg £59/ac)	£145k - £191k (Avg £54/ac)	53	Water pipe and troughs - £659 Fencing (6km) - £1,440
C	Cereal Non-LFA	80 - 120	£365-£400k (Avg £74/ac)	£365K - £415k (Avg £76/ac)	18	
D	Lowland Cattle and Sheep	42 - 71	£35k - £42k (Avg £65/ac)	£33k - £42k (Avg £60/ac)	49	
E	Lowland Cattle	35 - 59	£58k - £64k (Avg £66/ac)	£49k - £57k (Avg £56/ac)	39	60 acres of drainage assessed as: 30 acres improved grass and 30 acres of rough grazings. Fencing (3km) - £600 Water - £443 Electricity - £50
F	Mixed, non-LFA, Beef Finishing	77 - 121	£535k - £630k (Avg £81/ac)	£491k - £579k (Avg £75/ac)	50	Fencing (10 km) - £2,400
G	Lowland Cattle & Sheep LFA	38 - 77	£40k - £47k (Avg £48/ac)	£33k - £42k (Avg £39/ac)	47	Fencing (2.5km) - £600

Table 10: Worked Examples of Model 3 & Model 6

FARM	SYSTEM	COMPAR-ABLES (£/ac)	MODEL 3: GROSS OUTPUT 2013 to 2015 30% £Range (Avg. Rent)	MODEL 3: GROSS OUTPUT 2015-2017 Type £Range (Avg. Rent)	MODEL 6: FARM BUDGET (£/ac)	DEDUCTIONS FOR IMPROVEMENTS (not been made to figures in model 3 & 6)
H	Lowland Sheep, Non-LFA	39 - 52	£14k - £19k (Avg £42/ac)	£14k - £19k (Avg £40/ac)	31	See comment V below
I	Dairy	39 - 73	£185k - £244k (Avg £114/ac)	£185k - £245k (Avg £110/ac)	71	Water troughs - £63
J	Hill Sheep	4 - 25	£98k - £120k (Avg £5.2/ac or £13/ewe)	£88k - £117k (Avg £5/ac or £11/ewe)	3	Adjusted stocking density to reflect bracken spraying, liming and hill reseeding

Notes:

I. Gross output uses 3 historic years.

II. Gross output 2015 FAS, 2016 SAC handbook and 2017 represents current yields and prices.

III. Farm budget is made up from current prices, SAC variable cost figures (2016/2017) and fixed costs derived from the Scottish Government Farm Account Survey 2016 (**Appendix 5**).

IV. Fencing, water and electricity deduction, based on the value to incoming tenant model.

V. The rent in Farm H was influenced significantly by high machinery fixed costs, relative to the holding, its size and its hypothetical machinery register. As a result this was amended from Scottish Government FAS survey figures.

6.7 Common Issues arising from the samples

6.7.1 Issues with Gross Output Model

6.7.1.1 The Gross Output system has the advantage of simplifying the calculation of productive capacity by focusing on the output of the farm. Within the Statement of Facts (as discussed in the previous chapter) a rationale for the farming system, yields, prices and livestock productivity will be explicit with the combination of all of these factors determining the gross output. In order to normalise agricultural markets a 3 year average for each enterprise would be used. We believe that the average should comprise the previous year, the current year and an estimate of what the next year may bring. The main issue with this model is that it simplifies the assessment of costs and may potentially disadvantage one farm type over another. For this reason further research into a fair range for expected profit percentages should be undertaken to validate the use of this model. Research should involve approaching a range of banks to produce ranges from the farm accounts they keep so that these can be analysed to identify averages, ensuring at all times that the research is based on a competent farmer.

6.7.1.2 The challenge of assessing fixed and variable costs would be avoided by the use of well established banking principles which consider a competent farm business would generate a profit before rent, interest and drawings of 30%. Therefore 30% of the gross output could be split 50:50 before deductions are made for land based tenant's improvements which have not been black patched.

6.7.2 Issues with the Budget Model

6.7.2.1 The budget model's main issue relates to the amount of variables it contains which could be argued over. For example, even published data produces information with huge variation. The below table outlines the differences between the labour hours per enterprise per HA per annum published in the SAC Handbook and the John Nix handbook:

Table 11: Standard Labour Hour Data Comparison

Enterprise	SAC (hrs)	John Nix (hrs)
Cereals	18	9.2
Grassland	3.1	3.2
Rough Grazing	1.5	1.6
Beef cows (lowground)	26	10.8
Beef Cows (upland)	26	13.44
Other cattle	12	12
Sheep lowground (Ewes)	5.2	4
Sheep upland (Ewes)	3.7	3.6
Dairy Cows	35	32

6.7.2.2 The table below shows how the above data variations effect the rents for the 10 sample farms:

Table 12: Standard Labour Hour Data Comparison Per Farm

	SAC SLR	JN SLR			Labour (inc.T)	
Farm	**inc. T**	**inc. T**	**SAC Rent**	**JN Rent**	**Modelled**	**Rent**
A	1.11	0.57	33	36	1.11	33
B	2.89	2.26	22	36	1.5	53
C	2.91	1.49	9	24	2	18
D	0.63	0.5	49	49	0.63	49
E	1.16	0.76	39	48	1.16	39
F	4.76	3.69	37	45	3	50
G	0.68	0.53	47	47	0.68	47
H	0.34	0.29	65	65	0.34	65
I	2.11	1.96	71	75	2	74
J	4.06	3.37	1	3	1	6

6.7.2.3 It is difficult to promote a model which can vary so much based on published data variances - never mind variances which will also take account of varying price and cost data from varying years with varying assumptions based on varying preferences.

6.7.2.4 It can be assumed that through the use of a ‘statement of facts’ agreements can be made on the productive capacity of the holding i.e. what yields would be expected, what carrying capacity would be expected and what the fixed equipment provided by the landlord could be used for. Such aspects can then easily be converted into gross output using pricing evidence. However costs are not as easy to agree on and can be easily inflated or missed depending on a party’s motives. Aspects of fixed costs such as labour, machinery and interest can also be personal to the business and although it can be argued that we are considering the ‘hypothetical tenant’ it is fair to say that implying a hypothetical tenant could do something more cost effectively would be controversial. As far as costs are concerned it is therefore very difficult to avoid these becoming personal.

6.7.2.5 The potential for significant variations within the huge variety of cost and price information used means that the rental figure can also vary significantly. With such potential variance we would suggest that this model could only work if a relevant sense check or checks were put in place. For example it could be that the creation of a budget was the primary means of calculating the rent with two sense checks in the shape of the output model and the comparable sitting tenant model to ensure the rent set is fair.

6.7.2.6 The down side to recommending that a full budget, a gross output assessment and a comparable evidence assessment is done would be the likely time and cost of this. It is unlikely that landlords and tenants would choose to undertake such work themselves which would mean that professional advice would be sought and such an onerous assessment would end up expensive.

6.7.2.7 Another alternative we considered was that agreed figures be produced annually for rent review budgeting purposes to provide variable and fixed cost guidelines for the main enterprises and farm types. However given the difficulties the above models have shown when dealing with standard data we believe such a data source would become out of date too quickly and therefore become inaccurate and inappropriate in practice. For this reason we do not recommend a standard dataset produced for rent reviews is taken forward.

6.7.3 Issues with accounting for non black patched improvements

6.7.3.1 From working through the sample farms, the main tenant improvements which were difficult to black patch when considering the productive capacity were land improvements such as fencing, water supplies and access. The main difficulty found with such improvements involves the lack of a record of condition and the uncertainty of splitting the improvements between the landlord and tenant. For example in terms of fencing there are often occasions where there has been shared investment in the fencing or the tenant claims to own all the fencing but is unsure what level of fencing was supplied at the outset of the lease.

6.7.3.2 In terms of drainage, further difficulties were experienced where a tenant had re-drained an entire area but since the work had been done the landlord had supplied the materials for the renewal of sections as and when required. It is also common practice generally for the tenant to pay for the labour and the landlord to provide materials for drainage repairs and renewal works.

6.7.3.3 For water supplies, most tenancies would not have supplied water troughs at the outset, instead water would have been deemed to be available via waterings. Changes in SEPA regulations have meant many tenants have fenced off waterings and provided water troughs, often via grant funding. It is difficult to account for such improvements where the landlord has supplied the holding in the order it should be supplied and is under no obligation to update this standard due to changing regulations.

6.7.3.4 As previously discussed the question of potential or latent value needs to be addressed and valued. From the sample farms, fencing and drainage were the most obvious examples. On one of the livestock stock farms the tenant identified most of the fencing to be his own. If this were valued on the basis of value to an incoming tenant and an annual sum deducted from the rent to reflect the tenant's capital tied up in the fencing then this could be annualised as follows: assuming 6 km of fencing was split equally between 4 valuation categories of £1.5, £2.5, £3.5 and £4.5/metre. At the rent review, the value of the fencing would be £18,000, taking account of interest on tenant's capital at 3% (£540) and depreciating the fence over 20 years (£900) the total deduction to the landlord's share of the divisible surplus would be £1,440.

6.7.3.5 A further example relates to a farm on which the tenant had drained approximately one third of it. The landlord had contributed by providing the materials and the tenant provided / paid for the labour. Thus the tenant's capital had resulted in the farm being broadly classified as ploughable grass which before the improvements would have had significant areas of less productive permanent pasture and rushes. The farm was approximately 150 acres of which 60 acres had been improved. Following our recommendation on the treatment of drainage, we would classify 30 acres of grass as ploughable and the other 30 as permanent pasture with rushes. This classification therefore accounts for the joint improvement of the land.

6.7.3.6 The concept of dealing with such improvements via the amount a tenant would pay more in terms of rent for their inclusion has been agreed by the Team. How this is accounted for in terms of value will need to be decided on by both parties in order to use the method which best represents the situation. In order to avoid future dispute and uncertainty it is considered relevant for parties to use the tenant's amnesty to document all tenants' improvements so that they can be identified easily at rent review with their relevance to the holding agreed by both parties. Such a process would simplify all future rent negotiations and minimise the opportunity for conflict.

6.8 Recommendations

- Clarity is required to ensure that the productive capacity can be calculated using the Gross Output model proposed. Further research into what percentage of Gross Output would reflect the expected Gross Profit of a competent farmer, how this may vary and what factors would allow it to be varied is required;
- a black patch approach to tenant's improvements should be adhered to except where the improvement is required to be considered in order to derive a sensible farming system for the holding;
- non black patched improvements should be accounted for and deducted in terms of the additional rent a tenant would pay for them. This may be done using a relevant cost and deduction method agreed to be reasonable by both parties;

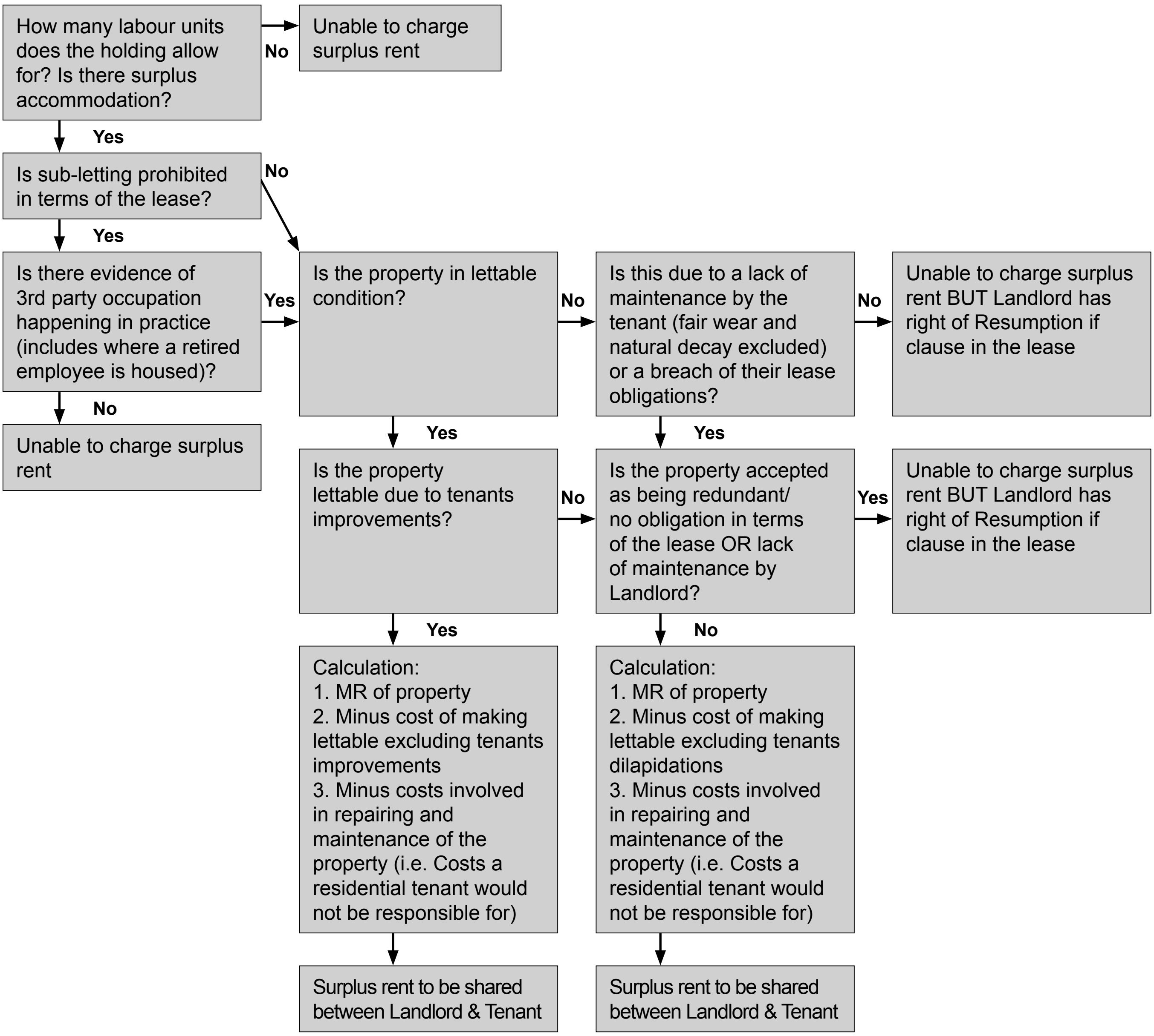
- where an improvement is undertaken using grant aid, the amount that represents the landlord’s contribution should be taken into account in the rental assessment. The amount which represents the tenant’s contribution should be disregarded from the rental assessment. This approach would be considered as fair to both parties but different to what has been done in the past and what is outlined in the Rent Review Tender document;
- as standard it is recommended that the divisible surplus is split 50/50 before deductions for improvements and additions for surplus residential accommodation and non-agricultural use. Adjustments to the 50/50 split will only be justified where the result of this is considered to be ‘unfair’;
- the inclusion of adequate residential accommodation for the holding can either be accounted for by varying the gross profit percentage used in the gross output model or by considering this in terms of ‘all of the circumstances’ outwith the three statutory considerations of the Act. Further research is required to ensure a fair means of accounting for non surplus residential accommodation;
- use of comparable sitting tenant rents agreed or set in the previous three years should be allowed as a reasonable sense check for productive capacity;
- guidance should encourage parties to complete a ‘Statement of Facts’ and record all tenant’s improvements and tenant’s fixtures within the timeframe of the Tenant’s amnesty.

7. Residential Surplus

Chapter 7: Residential Surplus

7.1 Description of Model

7.1.1 The following model of assessing the rent for surplus residential accommodation is considered to be in-keeping with the 2016 Act taking account of Standard Labour Requirements (SLR) and excluding accommodation occupied by the tenant:



7.2 Issues arising from the model

7.2.1 The main elements to be considered prior to determining a property as surplus and subject to a separate rental assessment are:

7.2.2 Is the property surplus in terms of the labour units required for the farm?

7.2.2.1 **Proposed Answer:** First it must be determined, using the proposed hypothetical farming system and with reference to SAC handbook labour units, whether there is surplus residential accommodation. If there is, then we believe it is possible to rentalise residential accommodation by the amount it is surplus. For example if the labour requirement is 1.2 and a farmhouse and cottage are supplied with the tenancy then 80% of the Cottage rental value can be considered. In terms of the legislation the Farmhouse which is occupied by the tenant cannot be considered as surplus residential accommodation whether part of it is considered to be surplus in terms of the holding or not. However, generally there may be scope to consider this as part of the overall fair rent calculation. Where a Farmhouse is surplus, or an element of it is surplus, and no part of it is occupied by the tenant, it can be considered as surplus residential accommodation.

7.2.2.2 Where a property is actively being sub-let by the tenant and this has been consented to by the landlord, then the effect of that consent on the rent will remain unchanged by the 2016 Act. The Team consider that where sub-letting is prohibited, the parties should be free to come to separate agreements in terms of the split of the rent for cottages whether considered as surplus or not. Where sub-letting is taking place with consent but there is no agreement on how the rental income from the sub-let is to be dealt with, we consider that our recommended approach, as set out on the following page, should apply.

7.2.2.3 **Alternative Approach:** An alternative approach to this is to make a judgement on whether a property is surplus based on the labour units required. For example if a holding required 1.2 labour units it would be reasonable to consider the provision of two houses with the holding as being surplus to requirement and for 0.2 of a labour unit the tenant would not employ additional labour on a housed basis and may instead contract in some additional labour from time to time. In this case it is likely that up to 0.5 labour units would not require to be housed and therefore any housing over this amount could be considered as surplus. On the other hand, for anything over 0.5 of a labour unit there could perhaps be an argument made for having an employee and providing them with a house so housing within this allocation may be considered to be required for the holding and not available for a surplus charge. This approach is considered to be subjective in its application and more open to dispute than the previous option.

7.2.2.4 We consider that a more scientific approach is less likely to disadvantage the parties involved as the actual labour requirement reflects the proportion of rent which can be charged. Also, through worked examples by the time the improvements, compliance requirements and annual maintenance costs are accounted for there is very little left to apportion to rent where the full property is not considered to be surplus. Within the ten sample farms there was not an example where the tenant housed more labour than was required for the holding; in the majority of cases the actual labour housed was less than the SLR. This of course may indicate that the SLR rates need to be revised.

7.2.2.5 **Recommended Approach:** Further research and a review of the SLR data produced by SAC is required along with further regulations to formalise the use of the scientific approach in determining the surplus residential accommodation capable of being rentalised within an agricultural holding.

7.2.3 Is the property able to be sub-let in terms of the lease?

7.2.3.1 **Proposed Answer:** If the property is considered as surplus but the lease prohibits sub-letting, the surplus accommodation cannot be rentalised unless sub-letting has been consented to through written consent or past evidence of sub-letting being undertaken and accepted by the landlord. For the avoidance of doubt, where residential accommodation is considered to be surplus, acceptance of sub-letting by the landlord can be proven by acknowledgment at previous rent reviews or a knowledge of the sub-let and no evidence of an objection to it being issued. Where a property is considered surplus in terms of the labour units and is occupied by family members, retired employees or family friends this would be assumed to be sub-let as there is evidence of third party occupancy and the property is surplus to the needs of the agricultural holding.

7.2.3.2 **Recommended Approach:** No specific allowance for seasonal workers, retired employees or family members is necessary as this is only relevant to the actual tenant's business. Surplus residential accommodation should be based on the SLRs required for the holding and the tenant should only be charged a surplus rent on the proportion of accommodation provided over and above what is required for the holding.

7.2.4 Has the property been declared as redundant in terms of the lease or through agreement with the landlord?

7.2.4.1 **Proposed Answer:** If the property has been considered as redundant or has been written off as neither party having ongoing obligation through an agreement between the parties, it should not be taken into account when considering the surplus residential accommodation on the holding. If the tenant has thereafter brought the property up to a rentable standard and is actively sub-letting it should not be considered in the rental assessment.

7.2.4.2 **Recommended Approach:** Properties declared by both parties as ‘redundant’ or ‘no obligation’ should be excluded from any surplus residential accommodation calculations.

7.2.5 How should the assessment consider the different legislation for residential letting?

7.2.5.1 **Proposed Answer:** The fact that residential tenancies are governed by different legislation and impose different obligations on Landlords and Tenants should be taken into account in the rent assessment process. Surplus residential properties may be let by tenants under Regulated, Assured or Short Assured tenancies currently (in the future they will be let under Private Residential Tenancies). In terms of the Housing (Scotland) Acts, these types of tenancy all have different security implications and means of calculating the rent. When considering whether or not to consent to a sub-let the landlord should consider the implication of the sub-let on the agricultural tenancy as a whole.

7.2.5.2 In terms of the rent determination the specific tenancy is not a valid consideration when assessing the rent from surplus residential property. It should be noted that this may disadvantage some tenants where they are only able to receive a fair rent for the property as the sub-tenant has been in occupation prior to the implementation of the Housing (Scotland) Act 1988. This is likely to apply to a very small amount of tenancies, if any. All types of residential tenancy are however governed by the Repairing Standard and as such the current cost of meeting the compliance elements of the Housing (Scotland) Acts should be annualised and discounted from the Market Rent whether they have been undertaken by the actual tenant of not.

7.2.5.3 **Alternative Approach:** An alternative approach is to consider the property as supplied by the landlord, black patching all tenant's improvements. In terms of compliance in many cases, the tenant may be sub-letting or allowing the property to be occupied by a third party without undertaking the necessary compliance works. We believe the occupation of the property suggests it is in use and can therefore be considered as lettable, subject to the necessary costs of bringing the property up to a modern lettable standard are met. In terms of the fairness approach, it would be unreasonable to propose a surplus rent could not be charged on a property which was being actively used or had the ability to be actively used subject to all necessary costs being deducted.

7.2.5.4 **Recommended Approach:** Deductions to account for the requirements of the repairing standard should be based on what is required - not what has been carried out by the actual tenant. Further regulations should ensure that compliance costs can be accounted for and discounted rather than a black patch approach being undertaken.

7.2.6 How should the assessment account for tenants improvements?

7.2.6.1 **Proposed Answer:** The requirements for a surplus property to be let under the Housing (Scotland) Act will be considered as has been discussed above. For property improvements it is necessary to value them out of the property's rental value. New kitchens, bathrooms, central heating should be treated this way. The cost of these can be discounted either through analysing their impact on the rent through an analysis of comparable evidence or annualising their current cost and deducting them from the rent. This allows rents to start from reference to comparable evidence with tenant's improvements then discounted from this. This method is considered to be the most scientific and fair way to rentalise surplus residential accommodation.

7.2.6.2 **Alternative Approach:** An alternative approach would be to completely black patch the property and consider the open market rent without any tenants improvements. This does not work for a number of reasons as follows:

- It assumes that the landlord would supply all the compliance measures to make the property fit for sub-letting. The landlord has different obligations for residential property if let as part of an agricultural tenancy in comparison with a direct residential tenancy. The cost of such measures must be considered for the surplus rent as a landlord would have to assume that the tenant was sub-letting the property in a compliant condition. By black patching these elements consideration of a market rent is not possible, which in turn should mean that sub-letting the property is not possible. It is likely landlords would withdraw consent for sub-letting if they were unable to achieve any rental benefit by permitting it;
- black patching tenant's improvements such as new kitchens, bathrooms and central heating makes the analysis of comparables very difficult as it is impossible to consider what was initially supplied by the landlord (i.e. what was taken out in order to put the improvement in). This leaves the determination of open market rent of an improved property open to debate due to a shortage of comparables. A more objective approach is to analyse market rent based on the property as it is, cost the tenant's improvements through contractor costings and adjust the rent. Annualising these improvements through using a likely lifespan provides an objective means of making deductions to the rent. Through the use of current costs the inflation element these improvements attribute to the rent is also taken into account and deducted.

7.2.6.3 **Recommended Approach:** Tenant's improvements which are required to meet the Repairing Standard, meet a basic standard for letting or have been taken into consideration when analysing comparables should be valued out of the rent on the basis of the additional rent a tenant would pay for their inclusion. Tenant's improvements not falling into these categories should be black patched. Wherever possible tenant's improvements should be black patched and relevant comparable evidence used to calculate the open market rent applicable.

7.2.7 How should the surplus rent following deductions be split between the landlord and tenant?

7.2.7.1 **Proposed Answer:** It is common practice for surplus cottages to be rentalised on the basis of a third of the rent to go to the landlord or half the rent following deductions being made for higher maintenance obligations and an allowance for voids. The Mortgage Advice Bureau suggests average voids for rental properties are 3 weeks per annum; as such 5% of the annual rent should be deducted to account for this with an additional 5% for management and 10% for the higher maintenance obligation not accounted for in the compliance and improvements deductions already made. This 10% is in line with the figure HMRC use as an allowance for buy-to-let income calculations and was discussed with a number of banks as being realistic. Discussions with banks also provided clarity on what they would expect their buy to let clients to budget on. It was suggested, due to the recent increases in compliance required for residential property, it is now expected that 30% of the rental income is set against voids, management and maintenance, so debt servicing is based on 70% of the total income. Interestingly the model adopted is considered to be consistent with the 30% figure once the compliance measures are taken into account. The standard percentages within the models are therefore considered to be robust but capable of being adjusted to reflect market demand and proximity to services. The remaining surplus rent should be split 50/50 between landlord and tenant.

7.2.7.2 **Alternative Approach:** The industry standard has been to apply 1/3 or 33% of the rent to management, maintenance and voids and split the remaining rent 50/50 between the landlord and tenant. This option is considered to be less scientific and less open to adjustments. It also doesn’t specifically take compliance measures into account. A second alternative is to split the surplus rent in line with the percentage of capital invested by the landlord and tenant but as previously discussed this can lead to rents being heavily weighted in the landlord’s favour which can be seen as unfair.

7.2.7.3 **Recommended Approach:** Rather than the standard 1/3, 1/3, 1/3 model, a more rational approach taking account of actual business budgeting techniques is recommended with an adjustment where evidence is available of the actual costs experienced in relation to voids, maintenance and management. A valid sense check of this would be the industry practice approach ensuring deductions made for compliance, management, maintenance and voids come to approximately 33% (banks use 30%). The surplus rent should then be split equally between the Landlord and Tenant.

7.3 Worked Examples

7.3.1 In order to show how the recommendations work in practice, we have used one of the sample farm examples to illustrate the possible results.

7.3.2 Example: Holding with a small acreage and two farmhouses one of which is occupied by the tenant.

<u>Step 1</u> – Exclude the farmhouse occupied by the tenant.

<u>Step 2</u> – Calculate the labour units required for the farm = 0.28 labour units.

<u>Step 3</u> – Consider whether there is a prohibition in the lease to sub-let or whether there has been consent to the sub-let in writing or through knowledge and acceptance in practice.

<u>Step 4</u> – Consider what the surplus residential accommodation is = 100% of the farmhouse which is not occupied by the tenant (additional property). It is irrelevant who is occupying this farmhouse.

<u>Step 5</u> – Consider the condition of the property defined as surplus. If classified as redundant it should not be rentalised.

<u>Step 6</u> – Calculate the market rent of the property black patching tenant’s improvements wherever possible.

<u>Step 7</u> – Deduct the cost of all compliance measures required to meet the repairing standard.

Step 8 – Deduct the cost of any tenant's improvements considered when calculating the market rent i.e. new kitchen, central heating (if possible these should be black patched if comparable evidence is available).

Step 9 – Deduct 20% of the annual rent to account for voids, management and a higher maintenance obligation. Adjustments should be made to this to account for aspects particular to the holding i.e. proximity to market, proximity to services and contractors etc.

Step 10 – Cross check deduction made for compliance, voids, management and maintenance against 33% industry standard.

Step 11 – Split the surplus rent 50/50 between the landlord and the tenant.

Table 13: Example

Property	Market Rent	Proportion lettable	Compliance costs per annum	Tenant's Improvements costs per annum	10% Maint	10% Voids & Mgt	Rent	50/50 split	% MR
Farmhouse	£6000	0%	£0	£0	0	0	£0	£0	0
Additional Property	£6000	100%	£482.67	£966	600	600	£3351.33	£1675.66	27.9

7.3.3 The above table applies the following standard costs which have been compiled through reference to contractor's quotes and would be used as the starting point for negotiations. These would need to be updated at each rent review so long as the improvement was being taken into account when calculating the open market rent.

Table 14: Compliance Current Costs

Maintenance Provision	£ inc VAT	Renewal (yrs)	£/annum
EPC	**£78**	**10**	**£7.80**
EICR	**£300**	**5**	**£60.00**
Smoke Detectors	**£144**	**10**	**£14.40**
Heat Detectors	**£144**	**10**	**£14.40**
CO alarms	**£48**	**10**	**£4.80**
Replace Battery on CO Alarm	**£20**	**5**	**£4.00**
Landlord Registration	**£11**	**3**	**£3.67**
Boiler service (annual)	**£90**	**1**	**£90.00**
Water Filtration System annual service	**£220**	**1**	**£220.00**
Legionella Risk Assessment	**£36**	**1**	**£36.00**
Empty Septic Tank	**£276**	**10**	**£28.00**
TOTAL			**£483.07**

Table 15: Tenant's Improvements Current Costs

Maintenance Provision	£ inc VAT	Renewal (yrs)	£/annum
Kitchen	£7000	20	£350.00
Double glazing	£5400	25	£216.00
Central Heating	£6000	15	£400.00
TOTAL	£18,400	60	**£966.00**

7.4 Common issues arising from the sample

7.4.1 Issues with standard cost data:

- There are various methods of pricing works. These can be done on comparables using hourly rates plus material costs, quotes from contractors or by using building price books;
- hourly rates vary depending on the size of the company and how they price works. Labour rates can vary from £20/hr to £35/hr;
- if the works are to be ‘wrapped’ up into one contract and dealt with by one main contractor, 15% should be allowed over and above the total construction cost to cover the ‘on site’ element, such as CDM, insurance, office, toilets, site fencing and travel i.e. the cost of prelims. If the site is really isolated or difficult to access with machines etc. this percentage may rise. This may need considered if tenant’s improvements are to such an extent that a complete renovation was undertaken;
- it is standard to base budget costings on previous examples and Prelims with caveats. It would seem reasonable to use this as a starting point for negotiations;
- lifespan is based on materials/products specified. Lifespans can be adjusted following negotiations. Information on standard lifespans can be easily obtained from discussions with local contractors;
- as a sense check to standard costs, it should always be considered how much extra rent a tenant would pay for an improvement being present compared to where it was not. Often for elements such as central heating and double glazing it is difficult to determine differences through analysing comparables but general rules of thumb can be drawn. For example, from a broad analysis of comparables in the Aberdeenshire area it would seem that central heating would perhaps justify an additional £10-£25 per month of rent. However these figures do seem low so it should be noted that care should always be taken when determining such rules of thumb as often there are other specific factors involved which cause rents to differ (it would be rare to find an example of two identical properties, one with central heating and one without).

7.4.2 <u>Issues with where a farm does not have enough acres to justify a house.</u>

The Act specifically lists accommodation occupied by the tenant of the holding as being disregarded in terms of surplus residential accommodation. This does present an issue where holdings are small and would not justify a whole labour unit. The below table shows what the rent would be if the farmhouse that the tenant occupied could be considered as surplus using the proposed model:

Table 16: Example

Property	Market Rent	Proportion lettable	Compliance costs per annum	Tenant's Improvements costs per annum	10% Maint	10% Voids & Mgt	Rent	50/50 split	% MR
Farmhouse	6000	72%	482.67	1000	600	600	1637.33	818.66	13.6
Additional Property	6000	100%	482.67	966	600	600	3351.33	1675.66	27.9
Total	**12,000**							**2,494.32**	**20.75**

- It is difficult to assess the rental value of the farmhouse of a very small holding in the productive capacity of the farmland or through the fixed equipment generally;
- it could be argued that the reference to ‘in particular’ within the Act could allow the presence of the farmhouse to be considered when calculating the fair rent as another consideration outwith the productive capacity, the residential surplus and the non-agricultural use. Additional considerations such as these are outwith the remit of this report and would be for the Land Court to determine whether justified or not;
- we do however note that this is a contentious issue and acknowledge there is an argument for a farmhouse being automatically included as part of an agricultural tenancy where it is utilised by the tenant in order to work the holding;

- there does appear to be an anomaly within the legislation in terms of the existence of joint tenants and the potential for the legislation to prevent two properties from being considered within the surplus residential accommodation calculation. However we believe this is addressed within the Explanatory Notes (March 2016) through reference to 'the sole farmhouse occupied by the tenant';
- Hamish Lean advises that the legislation relating to surplus residential accommodation is explicit in terms of the farmhouse which is occupied by the tenant and cannot be changed without an amendment. As such we cannot comment on it in terms of further regulation.

7.4.3 Taking account of voids and maintenance

We believe the percentages used are valid in terms of being recognised by banks, mortgage companies and HMRC as averages. However we accept adjustments may need to be made to account for the following:

- Remote areas are likely to be vulnerable to longer void periods and higher maintenance costs so the percentages should be increased to account for this;
- high rent demand areas which are less susceptible to periods of voids;
- it could be argued that a number of maintenance costs have already been accounted for in the deductions made e.g. annual boiler services. 10% should therefore be considered as a full maintenance consideration and should only be adjusted upwards if there are significantly higher than normal maintenance costs. This would need to be evidenced by the tenant. In more rural locations it may be more appropriate to agree an actual annual figure rather than a percentage of the rent as rents are often lower and repair/maintenance costs higher;
- adjustments made to decrease these percentages would also need to be fully justified but may be relevant in situations where the lease or a post-lease agreement dictates that the landlord is responsible for an element of the renewals.

A cross check with the industry practice model is shown below as another means of considering management, voids and maintenance costs.

Table 17: Example

Property	Market Rent	Proportion lettable	Compliance costs per annum	Tenant's Improvements costs per annum	33% Voids & Mgt	Rent	50/50 split	% MR
Farmhouse	6000	0%	0	0	0	0	0	0
Additional Property	6000	100%	0	966	1980	3054	1527	25.45

- The difficulty with this method is that it does not adjust for compliance only for tenant's improvements actually carried out. This prevents full consideration of required costs for letting to be taken into account. It is also less flexible to changing compliance costs, for example it did not change to reflect the higher electrical inspection obligation now applicable and will not be able to cope with changes in energy efficiency standards going forwards. This system would benefit tenants who are letting out non-compliant properties and therefore disadvantage tenants who had undertaken all the works involved in making properties compliant;
- although simplistic and easy to follow in its application, it is considered overly rigid when considering the variety of different scenarios present on tenanted farms;
- this method discourages investment in surplus properties and is not recommended as the best means of calculating the rent going forwards. However it could be used as a sense check to the previous model where there is uncertainty on the costs used. It determines that the landlord should be able to achieve roughly one third of the open market rent of the property following the exclusion of improvements.

7.4.4 Splitting the surplus rent according to capital invested.

- A 50/50 split of the surplus rent has been considered to be fair in practice and has been used as an industry standard generally (i.e. a deduction for maintenance then a 50/50 split or split a 1/3 for maintenance, a 1/3 for the tenant and a 1/3 for the landlord);
- the following table looks at what would happen to the rent if the split was based on the percentage of capital investment present (i.e. the cost of renewal annualised through reference to the expected lifetime of the element being assessed) within the property i.e. the landlord's share is based on the property itself and the tenants share is based on the improvements they have made to the property.

Table 18: Example

Property	Market Rent	Propor-tion lettable	Comp-liance costs per annum	Tenant's Improve-ments costs per annum	10% Maint	10% Voids & Mgt	Rent	% capital investment split	% MR
Farmhouse	6000	0%	0	0	0	0	0	0	0
Additional Property	6000	100%	482.67	966	600	600	3351.33	2245.39	37.4

- Although this method is logical in practice it does tend to favour the landlord's interest due to the fact they own the actual property which is generally where the essence of the cost of renewal lies. Even if this was calculated on a value basis rather than a cost basis it still comes out heavily weighted towards the landlord - unless the tenant's improvements are to such an extent that renewal of elements of the property itself have been undertaken;

- also due to the number of elements involved in valuing the cost of everything owned by the landlord and everything owned by the tenant there leaves an element of room for error in cost analysis and the possibility for double counting or missing out certain elements. Therefore this model for calculating the surplus rent is seen to be higher risk, more subjective and therefore more open to debate;
- with such a high risk of this method causing conflict between the parties involved, a 50/50 split approach is regarded by the team to be the most fair. Accurate deductions can be made for tenant's improvements, management, maintenance and voids.

7.4.5 Where a proportion of a property is lettable

- We have previously discussed the justification for considering a proportion of a property as able to be considered in terms of the surplus rent in line with the SLR of the holding;
- in terms of the calculation, the timing of when to consider the proportion let makes a difference to the surplus rental figure. For example if you consider the proportion let before considering the tenant's improvements, maintenance, voids and management, the surplus rent is less than if you consider the proportion let after accounting for these. See example of the two different results below:

Table 19: Proportion considered before deductions for improvements

Property	Market Rent	Propor-tion lettable	Comp-liance costs per annum	Tenant's Improve-ments costs per annum	10% Maint	10% Voids & Mgt	Rent	50/50 split	% MR
Surplus Property 1	6000	72%	482.67	1000	600	600	1637.33	818.66	13.6
Surplus Property 2	6000	100%	482.67	966	600	600	3351.33	1675.66	27.9

Table 20: Proportion considered after deductions for improvements

Property	Market Rent	Compliance costs per annum	Tenant's Improvements costs per annum	10% Maint	10% Voids & Mgt	Proportion lettable	Rent	50/50 split	% MR
Surplus Property 1	6000	482.67	1000	600	600	72%	2,388.47	1194.23	19.9
Surplus Property 2	6000	482.67	966	600	600	100%	3351.33	1675.66	27.9

- The question which should therefore be posed is: 'if only a proportion of the rent is applicable for consideration should only a proportion of the costs be applicable for consideration?'
- one argument is that if you are considering an element of a property as being surplus then you must account for all the costs in making the whole property lettable as it is impossible to only let part of a property;
- it should be noted that where a property is actually being sub-let by the tenant with the consent of the landlord, the rental element of that property will be defined through the agreement with the landlord rather than via chapter 5, section 10 of the 2016 Act;
- the proportion calculation is most likely to come into play where a property is being occupied by either staff (seasonable or full time), the tenant's family or retired employees and where the labour units required for the holding equate to a proportion of one additional labour unit required;
- with reference to the above it would seem fair that if the landlord and tenant are sharing in the potential rental income from the property they should also share in the potential costs. The potential costs will more than likely be over-inflated as they will take into account what should be done in order to sub-let rather than what has been done.

7.5 Recommendations

- An update of the SLR data contained within the SAC handbook should be undertaken;
- surplus residential accommodation should be defined using the SAC handbook's SLR figures for a holding;
- the open market rent should be calculated on the proportion of residential accommodation over and above what is required for the holding. Regulations and/or Best Practice Guidance must allow this to be calculated using the method outlined in paragraph 7.2.2.1 of this report;
- clarity needs to be added to ensure that compliance with the Housing (Scotland) Act is accounted for when calculating the cost to be deducted from the open market rent;
- tenant's improvements should be black patched wherever possible unless they are considered when analysing comparable evidence to come to the open market rent;
- non black patched improvements should be deducted through assessing the amount of additional rent the improvement warrants through an analysis of comparables then deducting it from the market rent or spreading the current cost over the likely lifetime of the improvement and deducting its annualised rate from the market rent. The overall basis for the deduction of non black patched improvements should be to reasonably consider how much the improvement adds to the rent at each rent review and deduct it on that basis.

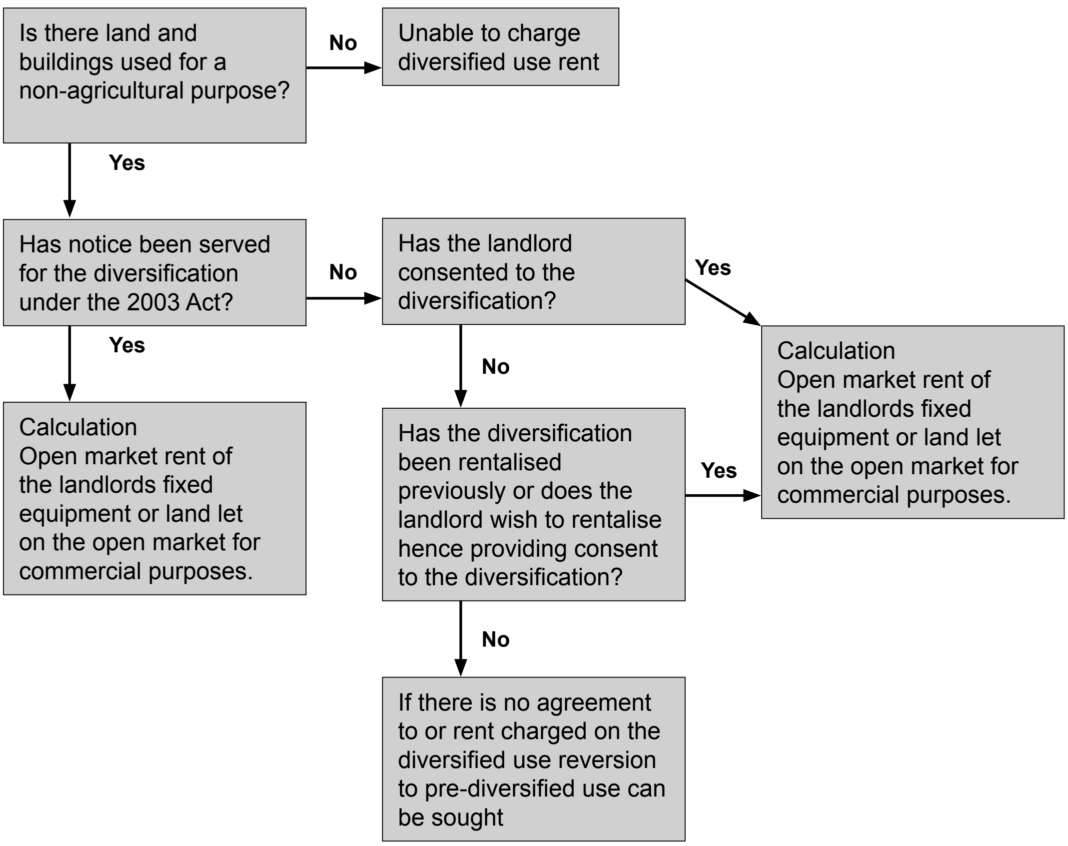
8. Non–Agricultural Use

Chapter 8: Non-Agricultural Use

8.1 Description of Model

8.1.1 In terms of the 2016 Act, non-agricultural use is assessed on the basis of what a tenant would pay for the site for commercial purposes. The site is the property, land and/or buildings used by 'the tenant' for the non-agricultural use. Therefore it relates to what 'a tenant' would pay for the use of the site rather than what 'the tenant' is using the site for. If non-agricultural use is taken account of in the rent review process then that would be taken as the landlord granting consent to a diversification from agriculture even if it had not been notified in line with the procedures set out in the 2003 Act. Following the rent review the landlord would be personally barred from objecting to the diversification if it had been taken into account as a non-agricultural use within the assessment of the rent.

8.1.2 The below model outlines the process for considering non-agricultural/diversified activities.



8.2 Issues arising from the model and proposed solutions

The main elements to be considered prior to determining if a non-agricultural/diversified use is in place are:

8.2.1 Is there land and/or buildings used for a non-agricultural use?

8.2.1.1 **Proposed Answer:** The first aspect of this is to confirm that an activity being undertaken on farm is considered to be a diversified activity. For something to be considered as a diversified activity it needs to be considered as non-agricultural. To distinguish where this is applicable it is often useful to look at whether a building or site has changed from agricultural use to business use in terms of its planning status or rateable value. However this will not always be an accurate assessment as it is common on farms for non-agricultural/diversified activities to take place without being identified up by the Assessor or Planning Authority. It should also be noted that there are areas where the definition falls within agriculture for the purposes of planning but outwith for the purposes of an agricultural tenancy. In such instances the use can be based on the most likely commercial use or if this is not obvious then it would fall back to being let as part of the farm for agricultural purposes.

8.2.1.2 **Recommended Approach:** The determination of a diversified use should rely on scale, use, extent and therefore contribution to the tenant's business.

8.2.2 Has the landlord consented to the diversified use?

8.2.2.1 **Proposed Answer:** As noted previously, consent can be granted by not objecting to a notice under the 2003 Act or it can be implied through the parties attributing a rent to the non-agricultural use at past rent reviews. It is clear that if a landlord does not wish to consent to the non-agricultural use taking place then it should not be considered separately to the farm in the rent assessment. Once a rent has been attributed to a non-agricultural use the landlord would be personally barred from objecting to that use and requiring the tenant revert to the pre-diversified use.

8.2.2.2 **Recommended Approach:** If rent is attributed to a non-agricultural use, consent to the diversification will be implied and the opportunity to object to the use in the future will not be available.

8.2.3 Rent of the landlords fixed equipment let on the open market for commercial purposes

8.2.3.1 **Proposed Answer:** Generally speaking, whilst there are a range of factors which influence commercial rental values, the Use Class of the buildings defined in the planning consent is often the starting point. Most diversified commercial use seen on farm (considering only landlord's fixed equipment) would be categorised as small scale general industrial use or storage and distribution in terms of the Use Class. Farm buildings will generally be considered as agricultural unless the tenant has been granted planning permission to change the Use Class. For the use to be valued it must be assumed that the relevant planning permission is in place for the diversified activity for the purposes of the commercial rental valuation.

8.2.3.2 In order to consider the rental value of the diversified use it will be necessary to assume a planning Use Class, even if that planning Use Class is agricultural, in the absence of a specific planning consent. The following table outlines the main general use classes, although it should be noted that all Use Classes subject to planning permission are not necessarily specified within the table i.e. equestrian use and other specialised uses.

Table 21: Use Class Table

Town and Country Planning (Use Classes) Scotland Order 1997 (as amended)		Description	Town and Country Planning (General Permitted Development) Scotland Order 1992 (as amended)
Class 1	Shops	Shops, hairdressers, travel and tickets agencies, post offices, cold food shops such as sandwich bars, undertakers, funeral directors, launderettes/dry cleaners and repair shops	No permitted change
Sui generis		Car showrooms	Permitted change of up to 235 sq m to class 1
Class 2	Financial and professional services	Financial services such as banks and building societies and professional services including estate and employment agencies and betting offices	Permitted change to class 1
Sui generis		Taxi and vehicle hire businesses	No permitted change
Class 3	Restaurants and cafés	Premises for the sale of food or drink for consumption on the premises	Permitted change to class 1 and 2
Sui generis		Public houses	No permitted change
		Hot food takeaways	Permitted change to class 1 and 2
Class 4	Business	(a) Offices not within class 2	Permitted change of up to 235 sq m to class 6
		(b) Research and development	Permitted change of up to 235 sq m to class 6
		(c) Light industry	Permitted change of up to 235 sq m to class 6
Class 5	General industry	Use for the carrying on of an industrial process other than one falling within class 4	Permitted change to class 4 or up to 235 sq m to class 6
Class 6	Storage or distribution	Storage or distribution	Permitted change to class 4
Class 7	Hotels and hostels	Hotels, boarding houses, guest houses and hostels	No permitted change
Class 8	Residential institutions	Hospitals and nursing homes; residential schools, colleges and training centres	No permitted change
Class 9	Houses	(a) Houses occupied by a single person, or a number living together as a family	No permitted change
		(b) Those living together as a single household of five persons or less	No permitted change
		(c) Limited use as a bed and breakfast or guesthouse where at any one time not more than two bedrooms (one bedroom in premises of less than four bedrooms) are used by guests	No permitted change
Sui generis		Flats	No permitted change
Class 10	Non-residential institutions	Crèches, day nurseries, day centres, schools and colleges, art galleries, museums, exhibition halls, public libraries and places for social activities of a religious body	No permitted change
Class 11	Assembly and leisure	Cinemas, concert halls, bingo halls, casinos, dance halls, discotheques, skating rinks, swimming baths and gymnasiums	No permitted change
Sui generis		Theatres, amusement centres, places for motor vehicle recreation or firearm sport	No permitted change

(Source: Town and Country Planning Scotland Order 1997)

8.2.3.3 The Scottish Government has developed a useful guide to Farm Diversification and Planning Permission in Scotland. In order to consider what a building would be marketed as on the open market we need to consider what Use Class is permitted (for this we have to assume planning permission is in place for the current use).

8.2.3.4 The need for planning permission usually depends on the scale of the operation. Examples of where planning permission would be required for a diversified activity are as follows:

- tearooms;
- restaurants;
- riding schools;
- pony-trekking centres;
- off-road driving centres;
- war game centres;
- food processing operations that require raw produce to be brought onto the farm for processing, packaging and onward distribution to retailers;
- golf course or golf driving ranges.

8.2.3.5 Diversified uses less likely to require planning permission and therefore more difficult to define a use class for are:

- Small scale educational facilities i.e. demonstrating farm jobs or providing facilities for bird and wildlife watching;
- sub-letting of machinery storage space and workshop space;
- small processing operations, ancillary to the farm use;
- caravan & camping sites. Certain permitted development rights are given particularly if you have a site certified by an organisation such as the Caravan Club. In most other cases planning permission will be needed for caravans;
- farm shops: If a farm shop is ancillary to the farm and is in an existing building, planning permission is not normally required. However, if a significant percentage of the goods sold are brought in for sale from off farm, then planning permission will be required. The planning authority's main consideration is likely to be the nature and scale of the shopping activity together with the amount of traffic it will generate.

8.2.3.6 For diversified uses where planning permission would not be required, it may be more difficult to define the commercial use to attribute a rental figure to with reference to the open market. Often due to the scale and extent of the use, it may not be appropriate to attribute a diversified rental against the non-agricultural use as it may be entirely based on tenant endeavour. The rental calculation must consider what a hypothetical commercial tenant would do with the landlord's fixed equipment which may result in no diversified business use being applicable.

8.2.3.7 **Recommended Approach:** Planning permission must be assumed in line with the tenant's actual non-agricultural use and can be used as a starting point for deciphering what the site would be marketed as commercially. It should be noted that some aspects of non-agricultural use will fall within agriculture from a planning perspective but could still be deemed commercial use in terms of the agricultural holdings legislation, allowing for an open market rent to still be applied i.e. forestry and some types of small scale storage.

8.2.4 <u>What general assumptions need to be made when considering the diversified use?</u>

8.2.4.1 **Proposed Answer:** Most diversified uses are very specific to the tenant's improvements and therefore the commercial use, if let on the open market only using landlord's fixed equipment, could be different from the actual tenant's use so long as it falls within the same use class. When considering letting on the open market for a commercial purpose the following need to be taken into account:

a) Location of the building - it may sit within the centre of a working farm with the remainder of the farm retaining its agricultural character. The likely restrictions will be related to access to markets and ability to trade from such a location rather than the presence of agricultural activity in close proximity to the use.
b) Access provisions - the tenant can have a non-agricultural use on farm due to the fact they have the right to occupy the whole farm. It is therefore reasonable to presume there are no access difficulties which would prevent the commercial use from taking place and no conflicts with other users.

c) Comparable evidence – needs to be adjusted accordingly. Where possible ‘comparable’ should reflect only the landlord’s fixed equipment, black patching tenant’s improvements so far as possible.

d) Terms of the lease – commercial leases are generally use-specific and freedom of contract means they are difficult to standardise. As it is an agricultural tenant, comparable evidence should be based on leases which would have similar terms to that of the agricultural tenancy being reviewed i.e. full repairing and insuring, a long lease term and similar rent review provisions (i.e. three yearly by open market).

8.2.4.2 The likely open market commercial rent figure for the landlord’s site should have necessary deductions for tenant’s improvements, voids, management, and maintenance before coming to the likely rent to be charged. When considering a fair rent it would seem appropriate that this is crosschecked against the likely income a hypothetical tenant would achieve from the Use Class as the basis of the residential model. The calculation would be the likely income the tenant would receive minus voids, management and maintenance, minus tenants improvements not black patched with the surplus split 50/50. A cross check with the hypothetical tenant’s net enterprise income would promote the assessment of a fair rent. However such an assessment could only be used as a sense check where there is a lack of relevant comparable evidence and not the primary method for assessing the rent.

8.2.4.3 **Alternative Approach:** An alternative approach would be to consider the tenant's actual diversification and rentalise it on a net enterprise income basis. This is not in keeping with the Act and is discussed with reference to examples later in this chapter. Where comparable evidence is limited and the tenant's diversification is specialised, but does rely on the provision of land and fixed equipment from the landlord, the enterprise income basis could be justified. Considering the earning capacity of the actual diversification, deducting the tenant's improvements from this, making a deduction for voids, maintenance and management and then splitting the surplus 50/50 could be considered as an alternative calculation method. However this would not be recommended due to the difficulties in ensuring that all tenant's improvements are accounted for and deducted. Where possible it is best to black patch tenant's improvements - which this method does not promote.

8.2.4.4 **Recommended Approach:** Make general assumptions on the structure of a hypothetical commercial lease based on the actual tenant's obligations in terms of the agricultural lease and value the rent on a comparable basis in the first instance. The net enterprise income method using what a hypothetical commercial tenant would likely achieve from the landlord's fixed equipment could be used as a sense check where there is a lack of relevant comparable evidence. We do not recommend calculating the rent on the basis of the actual tenant's diversification.

8.2.5 Should tenant's improvements be excluded?

8.2.5.1 **Proposed Answer:** The Act states that the open market rent can only be applied to fixed equipment provided by the landlord or land which is being used for a non-agricultural use. Tenant's improvements must therefore be excluded from the assessment. In order to do this the standard approach is to black patch tenant's improvements where possible and only include improvements which are necessary in order to make valid comparisons with other open market letting evidence. Such improvements would then need to be deducted on the basis of what element of the rent they represent. Ideally this should be done by an analysis of comparables to see how rents vary depending on certain elements or using an annualised cost approach.

8.2.5.2 **Alternative Approach:** An alternative approach would be to completely black patch the improvements and consider the open market rent without any tenant's improvements. However, in some cases it is impossible to analyse comparables using a black patch approach to tenant's improvements as there are no comparables available. Using this approach would lead to a number of diversified activities being unable to be accounted for in rent reviews. This does not seem to be the intention of the Act and does not meet with the concept of 'fair'.

8.2.5.3 **Recommended Approach:** Generally improvements should be black patched unless comparable evidence takes account of tenant's improvements such as hard coring for storage. Such improvements should be deducted from the rent either through an analysis of their impact on the rent via comparables or through annualising their current cost and deducting it from the rent. The legislation must allow for improvements to be accounted for on an annualised cost basis.

8.3 Working Examples

8.3.1 Although the model above seems self explanatory, in practice there are a number of issues arising from the calculation of diversified rental income. In order to analyse the calculation for compliance with the legislation we have outlined the results from some of the farm samples we looked at:

8.3.2 <u>Example 1: Dutch barn used for DIY livery</u>

8.3.2.1 In Example 1 the Landlord provided a Dutch barn (500 sq m) (5380 sq ft) constructed of a concrete floor, steel frame, steel sheet walls and roof. The tenant had installed 7 x steel frame stables, the water supply to each stable and renewed the cladding on the roof. Previously the building was used for bale storage with the current use now consisting of ¾ DIY livery and ¼ straw storage for DIY livery. The building was therefore considered to be 100% diversified in terms of its use.

Calculating the Diversified Rent: Comparable Method

8.3.2.2 The comparable method is in-keeping with the legislation as it is the main way of determining the open market rental value of an asset. The difficulty with this method is in finding comparable evidence and then making adjustments in order to make that evidence relevant to the subject being assessed.

8.3.2.3 For a DIY livery, the comparable evidence considered would ideally encompass the following similarities:

1. Location.
2. Lease terms (rent, term, repairs and maintenance obligations, insurance, termination).
3. Scale.
4. Condition of fixed equipment supplied by the landlord i.e. type and quality of stables, condition of main building, water, electric, heating.
5. Facilities/opportunities included i.e. hacking, riding schools (outdoor or indoor), DIY/Half or full livery, hay/haylage supply, cleaning facilities, secure tack room, toilets, other high tech facilities such as horse walkers, solariums etc.
6. Presence of other activities i.e. farming, heavy machinery, other animals (risk of disease).
7. Health & Safety i.e. proximity to roads, presence of children, asbestos, security, hygiene.
8. Grazing (ability to have separate grazing, fencing suitability, provision of water supply, age of grass, variety of field sizes to accommodate different horse types).
9. Availability of labour.

8.3.2.4 The comparable evidence method can be difficult in practice as relevant comparable evidence is not always available which means significant adjustments may need to be made. The more adjustments made, the more the rent is open to debate.

8.3.2.5 The following worked example shows how this works in practice.

Comparable Evidence

8.3.2.6 A DIY livery yard with stables within a traditional steading with grazing and a house let under a separate lease is let at £300 per stable per annum. The tenant in this case is responsible for the full repairing and insuring of the unit and has put in the stable kit herself. Essentially the landlord has provided the traditional steading, water supply and electricity supply. Although it is situated in a more affluent location than the subject to be valued, it is similar in most regards. The following differences have been identified and need to be accounted for through adjustments in the rent:

1) Location in terms of proximity to market demand.
2) Consideration of whether a traditional building should be considered differently to a Dutch barn for its ability to facilitate the provision of stabling. May be more open to the elements than a traditional building but probably easier to access.
3) Provision of a secure tack holding facility is included in the comparable evidence but not in the subject farm.
4) Deduction for tenant's improvements in terms of the water supply and roof cladding. Should be done on an annualised cost basis.

8.3.2.7 A worked example of this method would be:

7 x stables let at £300 per stable per annum = £2100

Table 22: Location Analysis

Location	DIY Livery (£/week)	Facilities
Comparable Evidence Location	48	Use of arena, stable, secure tack room and hay, straw and turnout
Subject Location	31	Use of arena, secure tack room & a 12 x 12ft stable

8.3.2.8 The previous table shows that DIY livery does not appear to be hugely location sensitive as the above variations reflect the addition of hay and straw in the comparable evidence example. Bearing in mind the location and tack facilities, it may be necessary to discount the rent slightly per stable per annum.

8.3.2.9 The applicable rent for this would therefore be around £2000 per annum. This would then need to be adjusted to reflect the tenant's investment. Through annualising the likely cost of improvements, a £350 deduction was made to the overall rent. This would leave an open market commercial rent of £1650 per annum.

8.3.2.10 Other comparables looked at included more facilities provided by the landlord and ranged from £520 to £775 per stable per annum. Again once adequate deductions were made to remove the grazing, housing and additional facilities provided by the landlord, most comparables seemed to be in the region of £300 to £350 per stable per annum.

8.3.2.11 In this case what the tenant is doing and what a hypothetical tenant would do are the same. A net enterprise income method in this instance would be based on the income likely to be received from the equestrian use based on the fixed equipment provided by the landlord with cost based deductions for improvements which a tenant would likely make. For example, it would be reasonable to consider a tenant would put in stables and a water supply to operate a DIY livery. It would be unreasonable to consider a tenant to operate a full livery service as this relies on a tenant's specialism and management.

8.3.2.12 The standard method of calculating the net enterprise income has been to start with the income generated from the use, deduct tenant's improvements, allow 33% to be taken off to account for the tenant's management, voids and maintenance then split the surplus 50% to the landlord and 50% to the tenant. There is some evidence of the landlord's share of the surplus rent being between 20 and 40% depending on the level of tenant's endeavour. However the industry practice is to allow for costs, typically 33% and then split the balance 50:50.

8.3.2.13 A worked example of this would be:

7 x stables let at £30 per stable per week = £10,920

Deduction for tenants improvements = £350

Deduct 33% for voids, repairs & management (£3603.6) = £6966.40

Landlord entitled to 50% of the surplus rent = £3483.20

8.3.2.14 The difficulty with this method is determining whether it is supported by the current legislation. It is calculated via the likely earnings of the defined commercial use rather than reference to open market comparables; although in order to derive the income open market comparables are utilised i.e., stable rates for DIY livery. Where there is a lack of relevant comparable evidence it would be appropriate to use this method as a sense check. In the use of this method it is important to take into consideration any relevant operating costs.

8.3.3 <u>Example 2: Workshop/Storage</u>

8.3.3.1 Another example of diversified income which we came across when looking at the sample farms was sub-letting for storage which would be classed as light industrial use although in terms of scale it may not have required planning permission. With such a use there is a subtle difference as to whether it would be classified as a non-agricultural use or just sub-letting. Sub-letting would be prohibited in most leases and therefore a rent could be agreed via separate agreement but not within the capacity of the rent review. Where sub-letting is ancillary to the tenant's non-agricultural use it can be considered as non-agricultural use for the purposes of the rental calculation. For example in the case of storage, if the tenant is providing a service in terms of security, maintenance etc rather than just sub-letting a shed then the activity can be considered as non-agricultural use. In this example the tenant is operating a storage business and not just sub-letting.

8.3.3.2 This is likely to be a common farm diversification and in terms of the legislation it is reasonably straight forward to find comparables for this type of use on the open market. In terms of the Aberdeenshire area, light industrial use for storage or the letting of a workshop space seems to range from £60 to £750 per month depending on the facilities which are provided. In the case of the comparable the sheds used for diversification were very basic (barely wind and water tight in some cases).

8.3.3.3 In terms of comparable evidence the following information is relevant.

Table 23: Storage Comparables Analysis

Location	Type	Size	Rent (£)
Fraserburgh, Aberdeenshire	Commercial shed complete with racking	742 sq m	1600/month
Oldmeldrum, Aberdeenshire	Garage	1 car	60/month
Buchan Braes Industrial Estate, Peterhead	industrial unit	135 sq m	750/month
Westhill, Aberdeenshire	New Storage container, CCTV security	73 sq m	150/month
Peterhead, Aberdeenshire	Storage containers, secure site	73 sq m	90/month

8.3.3.4 The workshops/storage facilities looked at on the sample farm ranged from 105 to 140 sq m and were located within close proximity to Aberdeen. The most comparable example is probably the container as it provides basic storage although would be smaller than the buildings on the farm. A comparable rent could therefore be £200 per month (£2,400 per annum).

8.3.3.5 In this case, the actual tenant's diversification and what a hypothetical tenant's use of the subjects would be are the same i.e. sub-letting areas within the sheds for the storage of machinery and providing a surveillance service. Due to the amount of comparable evidence available in this case the net enterprise income sense check would not be necessary. However, if it was to be utilised it would calculate the income based on the likely rent a hypothetical commercial tenant would receive for the use of the buildings and the likely service which would be provided with deductions made for management, maintenance and voids. Therefore the surplus rent would be an enhanced rent to the open market comparable rent as it would look at the potential business rather than the commercial rent possible from the landlord's fixed equipment.

8.3.4 Example 3: Specialised Agricultural Processing Operations

8.3.4.1 For specialist agricultural processing, including packing on farm rather than offsite, it is often difficult to decipher whether a diversification exists. This is further complicated by our planning assessment indicating that no consent would be required.

8.3.4.2 When considering whether an additional rent is attributable, it is important to consider what the building/yard space is used for and how much of this is due to the landlord's fixed equipment. For example the following could be considered:

1) Is the barn/store/shed/yard on the farm being used for production and processing rather than purely agriculture?
2) Does the lease specify what type of holding the farm is let as and is the use consistent with this?
3) What elements of the barn/store/shed/yard has the tenant implemented in order for them to undertake the diversified activity?
4) Would the barn/store/shed/yard still be capable of being defined as an agricultural building without the tenant's improvements? For example production/processing activities would fall under agriculture, light industrial use or storage and distribution. Most barns/stores/sheds/yards could be considered under this use class regardless of tenant's improvements.

5) Is the business at a scale of operation whereby a surplus rent is attributable? Would the diversified use be considered as a separate business activity or project which is entirely based around a tenant's interests and endeavours?

8.3.4.3 In the example we looked at it was considered that the scale of the production and food processing was at a level where it would be considered as a non-agricultural/diversified activity. However, due to the level of tenant investment the comparable evidence utilised was in line with that analysed in the previous example (small scale industrial storage). This meant square foot industrial rental figures were not relevant as they were for industrial buildings which were fully internally fitted with internal walls, flooring, good lighting, spacious accommodation and a clean space to work. Further the building used was split with the diversified use.

8.3.4.4 In terms of small scale storage units, small lockups and container storage were looked at with rents of £135 to £185 per month being applicable. This would give a rental of £1620 to £2220 per year. A deduction would also be made to adjust these comparables as the storage offered would be neither secure nor private.

8.3.4.5 In terms of the net enterprise income method it is unreasonable to base this on what 'the tenant' is doing since it is based so highly on tenant improvement and specialism. In this case it is difficult to come up with a non-agricultural use which a hypothetical commercial tenant would undertake with half a building which makes the net enterprise income method difficult. However, it is fair to assume that a commercial tenant would pay a rent for the building in order to operate a business especially if that business relied on other activities nearby (as the actual tenant's diversification does).

8.3.4.6 A diversified rent of approximately £1,500 to £2,000 per annum could be argued for in this example.

8.3.5 Example 4: Seasonal Farm Shop

8.3.5.1 This example constituted a small redundant building which had been converted by the tenant into a toilet/packaging area/cafe for the sale of fruit grown on the farm and home bakes for a 6 week period every summer. The tenant had put in the water, electric and internal fittings as well as making the building wind and water tight. Due to the use of the buildings for selling farm produce and the nature and scale of the business it would be unlikely that this diversification required planning consent.

8.3.5.2 When considering this it was concluded that the use would still be agriculture in terms of the fixed equipment provided by the landlord, the scale of the activity taking place and the seasonal nature of the business - so no diversified rent was appropriate.

8.3.6 Example 5: Ground lets

8.3.6.1 Finally we found an example where an area of 1440 sq m had been turned into a Dutch barn and hard standing area used for the storage and drying of timber as part of a biomass business. The infrastructure had all been supplied and erected by the tenant which meant that the only element being utilised was the ground.

8.3.6.2 In terms of Use Class the storage of timber for biomass is likely to come under forestry which still comes under the definition of agricultural use. However, since the building and storage space exceeds 465 sq m, planning permission would have been sought for it and the current use could be considered as storage or distribution in terms of the Use Class. An element of diversified use obviously exists over the area despite a proportion still being used for agricultural storage. The shed that now replaces the previous sheds is 720 sq m (half of which is used for drying timber with the other half used for storage of machinery). The 720 sq m of yard space is used for storing timber.

8.3.6.3 It is therefore relevant to consider 1080 sq m as capable of letting on the open market for storage and distribution. As the building fully belongs to the tenant then the whole 1080 sq m should be considered in terms of an unimproved ground let.

8.3.6.4 We have found a number of unimproved ground let comparables in rural locations. These are generally set at £1 to £1.50 per square metre with the most comparable being an area let as a timber stacking area for £1.15 per square metre. These comparables are based on an area which is hard cored so deductions need made to account for the cost of this. From working out the cost of hard coring this area then annualising it by adopting a lifetime for it a discount of £0.2 per square metre was concluded. A diversified rent of approximately £1,080 would be applicable in this instance.

8.3.6.5 This figure feels fair as it does not take the tenant's own use into account and only reflects the increased rental value available to the landlord through the existence of a non-specialised diversified use.

8.4 Recommendations

- Clarity is required to ensure it is possible to cross check the comparable approach with the hypothetical tenant net enterprise income approach in order to promote a reasonable sense check where there is a lack of comparable evidence to allow for the calculation of a 'fair rent'.

- The ability to both black patch and deduct tenant's improvements through a cost and deduction method should be clarified in the regulations. The overall basis for the deduction of non black patched improvements should be to reasonably consider how much the improvement adds to the rent and deduct it on that basis.

9. Dispute Avoidance

Chapter 9: Dispute Avoidance

9.1 Other Relevant Factors: Dispute Resolution

9.1.1 The Invitation to Tender outlines the project's requirement to assess methods of deriving a fair rent on the basis of productive capacity, surplus residential accommodation and non-agricultural use. The Team was also asked to consider other relevant factors.

9.1.2 The drive to reform the agricultural rent review process arose from the perceived number of farm rent reviews which were requiring resolution in the Land Court. One of the reasons for this was the adjustment of comparable rents; essentially the discounts applied to the comparable rent to allow for scarcity and marriage value. Parties did not properly understand each other's position and this lack of understanding often led to dispute.

9.1.3 Whilst considering a procedure for assessing the productive capacity of the farm, the Team also felt it appropriate to detail a system for farm rent reviews which would minimise the number of areas to be negotiated, make as many of the calculations in a transparent and scientific fashion so that it is explicit on how the rent proposed had been arrived at. The challenge with making the procedure too simple is that it then becomes too inflexible and parties become disadvantaged as a result.

9.1.4 We have identified the following three different pathways for settling a rent review:

1. Litigation and/or Arbitration.
2. Alternative methods of dispute resolution.
3. Dispute Avoidance.

The objective of the Act was to implement a fair rent procedure through productive capacity assessment. The challenge at the same time is to produce a system which reduces the opportunity for dispute. However, for the various reasons noted throughout the report there are often a variety of factors which can be debated when arriving at the productive capacity which presents a huge potential for conflict within this system. Of the above three pathways the preference should always be ‘dispute avoidance’ which we believe is possible if best practice guidance facilitates an intellectually honest and transparent process.

9.2 Achieving the Objective

9.2.1 In order to achieve this aim we would promote complete transparent communication through a prohibition of ‘without prejudice’ correspondence, the disclosure of all relevant information (i.e. litigation insurance), the agreement of a Statement of Facts and the acceptance that all surplus income should be split 50/50 unless justified otherwise. These are the main concepts believed to underpin dispute avoidance.

9.2.2 The purpose of ‘without prejudice’ correspondence is to prevent the use of written material being introduced to the dispute resolution process later on in the rent review, should the matter proceed to court. It can enable parties to take a hard and perhaps extreme position and can serve to drag out a rent review. The adoption of an extreme position cannot be conducive to achieving a settlement. The Team believes that it would be in the interests of all parties that ‘without prejudice’ correspondence be prevented with best practice guidance being put in its place.

9.2.3 At the outset of the farm rent review we believe that disclosure of all relevant information and the agreement of a Statement of Facts is essential. This factual capture will also record tenant’s improvements and fixtures. Its purpose would be to accurately identify the physical characteristics of the farm. In addition, lease terms that would influence the rent are identified. This document sets out the factual information relevant to determine productive capacity but also surplus residential accommodation and non-agricultural income. The purpose of establishing the factual matrix at the outset will help narrow the issues between the parties. If mediation, arbitration or indeed Land Court action is required then such additional third party involvement is focused to those points which are therefore not agreed. This will also serve to mitigate costs. A proposed template for a Statement of Facts is attached at **Appendix 3**.

9.2.4 The Statement of Facts of the tenancy will be a more significant component of the first rent review under the new system than in subsequent reviews. It will only need to be updated with details of new improvements or new landlord’s fixed equipment carried out since the last review. The Statement of Facts would be informed by a tenant’s application to the Tenants’ Amnesty on Improvements. We recommend that the Statement of Facts is completed within the Tenants’ Amnesty timeframe in order to minimise disputes within the rent review system going forwards.

9.2.5 Finally, it should be agreed between parties that a 50/50 split of the surplus rent is fair and equitable with any other means of determining a split being highly likely to cause dispute between the parties involved. The concept of a 50/50 split is derived from what a tenant is likely to consider when bidding for a farm. Pushing a higher split of the surplus towards the landlord is likely to risk the business being unviable and going below 50/50 would not be competitive and would not give the landlord a fair return on their capital.

9.2.6 The Act makes provision that where no agreement on rent is reached following a rent review notice being served that the landlord or the tenant of the holding may (whether the sender of the notice or not) refer the question of what the rent payable in respect of the holding to the Land Court. Such a referral must be made prior to the rent agreement date. It has often been commented on that the Land Court is an expensive and time consuming means of resolving a dispute. The CAAV previously canvassed for support for an amendment to allow parties the option of agreeing to have disputes referred to arbitration under the Arbitration (Scotland) Act 2010 (or expert determination) for a final and binding decision as an alternative to the Land Court. However this was thought to increase the risk of uncertainty as to which approach should apply and the likelihood for an increased number of appeals and cost.

9.2.7 The debate concluded that further guidance was required to ensure tenants were aware of the alternative approaches to dispute resolution which are open to them.

9.2.8 The role of Tenant Farming Commissioner is to promote and encourage good relations between Landlords and Tenants and publish codes of practice. As part of this role we believe work is required to guide Landlords and Tenants to alternative methods of dispute resolution such as mediation and expert determination to encourage a communication based means of resolving disputes in order to improve relationships and prevent future disputes by resolving underlying issues.

9.2.9 Such an approach would involve the following actions from the Tenant Farming Commissioner:

- The creation of a Code outlining the recommended conduct of landlords, tenants and their agents throughout the rent review process. This should include guidance on the use of ‘without prejudice’ correspondence, the disclosure of all relevant information, the agreement of a Statement of Facts (with reasonable ranges worked into this) and the agreement on the split of surplus being 50/50;

- the creation of a Code outlining the best practice procedure for dispute avoidance and resolution;
- the creation of a timeframe as to when each method should be trialled within a rent review process and at what point moving onto the Land Court is acceptable. This should be seen as the last resort;
- the provision of rent review focused training for mediators, arbiters and experts;
- the production of an approved list of mediators, arbiters and experts;
- the creation of a helpline/guidance means of communication directly linked to the Scottish Government so that complaints can be lodged about landlords/tenants/agents/mediators/arbiters/experts and investigated accordingly.

10. Discussion & Recommendations

Chapter 10: Discussion & Recommendations

10.1 Farm Data

10.1.1 Prior to commencement of the survey stage of the project, the Team was clear about the information which needed to be collected to inform a productive capacity assessment. It was also clear from the outset that collection of adequate data required a farm inspection during which the tenant was able to identify the challenges associated with farming there as well as identifying the productive areas.

10.1.2 It was clear from our sample farms that tenant investment had significantly influenced the farming systems employed by the tenant. It enabled farmers to start dairy enterprises, to significantly intensify their existing enterprises and to operate modern alternative enterprises. It was therefore necessary during the inspection, to consider what farming systems were typical to the area and also which farming system the landlord's own fixed equipment would lend itself to. Thus part of the farm inspection was to consider / discuss what would be possible in the absence of the tenant's improvements.

10.1.3 With the physical data collected, thought was given to where farm accounts data would come from. Clearly any data used in a model must be readily available to all, be available with sufficient detail and be produced regularly in the same format to enable years to be compared or averaged.

10.1.4 The Scottish Government's Farm Business Survey (FBS) Datasets (http://www.gov.scot/Topics/Statistics/Browse/Agriculture-Fisheries/Publications/FASdata) provide detailed farm accounts at farm down to enterprise account level. The Cost Centre Analysis Tables provided detailed output and input costs for 8 typical farm types, analysed on a £/farm basis. "Detailed Tables" information provides average farm data, available at average, top and bottom quartile level for the same 8 farm types. Average farm size is available with this data set and therefore it was possible to arrive at £/hectare rates. The final FBS data set is the enterprise margin. There is a huge amount of information available here with 9 arable, 12 beef, 3 dairy and 6 sheep enterprises. The information here is produced on a £/hectare basis.

10.1.5 In addition to the Scottish Government's direct information, the SAC Farm Management Handbook is a significant data source which produces annual farm account and enterprise information.

10.1.6 There are other data sources which we considered including Quality Meat Scotland (QMS) figures, John Nix Pocketbook and current/future price data all of which would be appropriate to use within a model. It was obvious from the research though that restricting a model to the use of one dataset provided for inflexible and often disproportionate results.

10.1.7 The challenge with all of these datasets is making sure that you know how the figure is analysed and therefore how useful it is for a particular analysis and also whether it can be compared with another dataset. For example while using the Cost Centre Analysis Tables we were informed that they followed EU accounting practice and therefore machinery was written down over 5 years and buildings over 10 years. The effect of this is to overstate the depreciation for most farm businesses.

10.1.8 It is clear from the practical application of these data sets to the models that the present format provides challenges. The ability to drill down to a rate per hectare is not possible with some of the datasets and then importing data from other sources could result in double counting or omission.

10.1.9 We would recommend that the productive capacity uses the Output model and/or a budget approach based on 3 years of data (one past, one current and one future). Examples of these models are contained in **Appendix 6**. Further research is required to justify what range of gross profit (subsequently divided 50/50) should be accepted as being possible from a competent farming system.

10.2 Hypothetical Farming System

10.2.1 The hypothetical farming system was determined by an understanding of the local farming practices adjusted to account for the specifics of the farm and the landlord's fixed equipment. The farming system must be capable of producing a sustainable yield when farmed by a competent, efficient and experienced tenant, with adequate resources. This is the first step for any of the models or for a budget.

10.2.2 Local farming practices are the first step in considering what a tenant's farm business would be. As identified above, some of the farms surveyed employed a farming system which relied heavily on the tenant's own capital and endeavour: a dairy enterprise where the tenant provided the parlour and stalls and a pig farm on which the farrowing and fattening houses were owned by the tenant. Looking at these two examples, the hypothetical tenant on the first would likely have used the farm for a lowland cattle enterprise and on the piggery example the neighbouring farms were all arable. Local farming practices would also determine whether vegetable crops would be included in the rotation and whether there was a market in the area for land available for third party agreements, for potatoes, carrots, turnips etc.

10.2.3 The next step is to consider the fixed equipment provided by the landlord and assess what farming system it would support. The sample farms identified a number of cereal farms where modern grain storage facilities were not present. The Team felt that arable farming today did not necessarily require on-farm grain storage. The presence of grain groups and co-operative storage facilities enables a modern arable farmer to buy space in these stores or indeed to sell his crop off the back of the combine. If no grain storage is present then the prices used in the productive capacity assessment need to reflect this fact either through a lower price or through a deduction for off farm storage costs.

10.2.4 The provision of fences, water troughs and access undoubtedly influence what a hypothetical farming system would be on the farm. The challenge here is to recognise the potential value of the farm and acknowledge that a competent, efficient and experienced tenant would be prepared to invest in the farm to enable a realistic farming system, appropriate to the area to take place. Within our sample there were a number of farms where the tenant had provided much of the fencing and water troughs. In theory without fencing and water troughs, grazing based farming systems could not be employed. Thus, rather than disregarding the presence of the tenant’s fencing and water troughs, the Team considers their presence, but as discussed below this needs to be valued out of the farm rent. Such an approach is considered to be a competent, efficient and experienced farmer’s approach.

10.2.5 The final step in the assessment of the farming system looks at the farm itself: the size and shape of the fields and all other physical factors which influence the agricultural capability of the land. A good example of how these physical factors influence the farming system was the pig farm mentioned above. Thus, after excluding the tenant’s improvements, the local farming practice, soils, drainage and aspect all indicated that the farm would suit an arable farming system. However, after considering field size, shape, shading from field side trees and location of significant drainage ditches and roads it was decided that the farm did not suit modern arable farming practices. Further the location of roads, tracks and ditches meant that it would be extremely difficult to amalgamate fields for arable production. The productive capacity was therefore considered on a lowland cattle and sheep basis.

10.2.6 The hypothetical system on which the productive capacity is assessed therefore need not be the system currently employed by the tenant. The Team believes that an allowance needs to be made for the opportunities which a tenant can reasonably be expected to have access to on signing a lease for the farm and therefore consideration needs to be given to what a competent, efficient and experienced tenant with adequate resources would do.

10.2.7 We would recommend a Statement of Facts defining the specifics of the tenancy and the capability of the holding is produced within the tenant’s amnesty timeframe in order to assist rent review negotiations under the new system. Such a process would need to be encouraged via guidance rather than implemented by statute.

10.3 Productive Capacity

10.3.1 The production of a detailed farm budget was considered but the initial focus was on the models and whether there was a way of arriving at a fair rent through a model, using published data.

10.3.2 Whilst using the FBS and SAC Farm Management Handbook data it was clear that very different results could be achieved for the same farming system using different survey data. For example farm productivity could be assessed directly from the FBS Detailed Tables or using the rotation to build up an enterprise based budget.

10.3.3 The differences between the datasets meant that it was challenging to draw conclusions on productivity models. In addition, having to allocate the hypothetical farms into one of eight farm types described, in the FBS and SAC data, was limiting. The Team determined that use of the SAC and FBS data was going to create ambiguity in the rents generated from this method. The clarity of the results was further tarnished by challenges associated with obtaining relevant fixed cost information on an area basis from the survey data.

10.3.4 In terms of the Gross Output approach, the advantage of simplifying the calculation of productive capacity focuses on the output of the farm. The main issue with this system is that it perhaps over simplifies the assessment and may disadvantage one party over another from time to time, perhaps in low margin farm types. The challenge of assessing fixed and variable costs would be avoided in this approach by the use of well established banking principles which consider the profit a competent farm business would generate on a percentage of gross output basis. This could then be split 50:50 before deductions are made for land based tenant's improvements which have not been black patched and deductions for Post Lease Agreements and other unusual lease terms. We recommend further research is undertaken on this model to assess whether it can be implemented in a fair way taking account of different farm types and the margins they are likely to generate.

10.3.5 The concept of an equal share of any divisible surplus is one which inherently feels fair and indeed is one which is supported from arbitrations in England. It is based on the premise that in order for a rent to be generated both the landlord’s capital, land and buildings, and the tenant’s working capital need to combine to generate a business surplus. We looked to explore this position and feel the following analogy helped us settle on an equal share: in an absolute ransom neither party benefits without the co-operation of each other. Therefore we recommend a 50/50 split of the divisible surplus is used unless there is significant justification otherwise.

10.3.6 Dealing with tenant's improvements by analysing their influence on the rental value has been discussed and agreed within the Team. One way to monetarise this is to consider the cost of the improvement, its value to an incoming tenant, its lifespan and provide an interest charge to represent the opportunity cost of having the tenant’s capital tied up in the improvement. Care needs to be taken when dealing with grant improvements and considering how to disregard them in a fair manner. Land based improvements cannot be black patched easily in order to still account for the holdings potential value. A number of approaches have been discussed in this regard and it was considered that a cost and deduction based approach was the fairest means of dealing with non black patched improvements provided a reasonableness sense check is applied to this to prevent the deduction becoming disproportionate. Although a number of scenarios have been tested using various models for deductions, we believe a prescriptive means of deducting improvements would be too restrictive in practice. Any method of deduction needs to be agreed by both parties as being fair.

10.3.7 We recommend the use of the tenant’s amnesty to document all tenant’s improvements and fixtures so that they can be identified easily at rent review with their relevance to the holding agreed by both parties. Such a process would simplify all future rent negotiations and minimise the opportunity for dispute.

10.3.8 In the previous chapter we considered measures which the Team felt were important for Dispute Avoidance - in particular the Statement of Facts. This would play an important role in the assessment of the productive capacity. A cornerstone to the success of this option would be an honest, transparent and reasonable approach taken by the parties. Partisan positions could not be tolerated and facts based on market research a prerequisite to two parties reaching agreement.

10.3.9 A Statement of Facts would be agreed to set out the physical factors of the farm. This would be carried out in open correspondence and therefore available for scrutiny by the Tenant Farming Commissioner or Land Court should agreement fail to be reached. Any scope for dispute would be narrowed.

10.3.10 With a farm budget approach it would be possible to be more precise with a budget rather than using the survey data. With this precision comes greater scope for disagreement and dispute.

10.3.11 Whilst a share of gross output appears to be a fair and workable basis of a productive capacity based rent review, the Team believes that a sense check should also be allowed for. A sense check could be with sitting tenant rents on comparable holdings agreed and set in the last three years as it would seem fair that similar holdings pay similar rents.

10.4 Surplus Residential

10.4.1 The assessment of surplus residential accommodation is determined by the hypothetical farming system and the SAC Handbook's SLR. The Team is advocating rentalising any accommodation, excepting any residential property the tenant is living in themselves, which would form part of the surplus residential property. The preference for this model was that it was scientific and avoided a threshold based approach.

10.4.2 The threshold based approach would need to rely on a set of rules to determine what the threshold would be. In other words a second house would be required for a farming system when the SLR was greater than 1.5, for example.

10.4.3 From our experience, the Team believes that the SLRs overestimate modern labour requirements and would recommend that they are reviewed to ensure that a fair appraisal of the labour required for a farming system can be carried out and thus fairly assess what residential property would be deemed surplus.

10.4.4 The use of comparable evidence and the challenges with analysing it were one of the main reasons for agricultural rental reform. The legislation provides for a market evidence based assessment of surplus residential accommodation. The challenge is that many of the farm cottages we saw had a lot of tenant's capital invested in them. With the Repairing Standard defining the minimum standard that a property must be before it can be let, there will be next to no unimproved, very basic properties available to let. Therefore comparable evidence will be thin. The Team's view is that comparable evidence is sought for properties matching the properties unimproved condition so far as possible with rents adjusted to reflect the tenant's improvements as and when they need to be taken into account in order to assess the market rent. Tenant's improvements which are required to meet the Repairing Standard should not be black patched and should be accounted for in terms of cost whether they are in place or not. Improvements such as central heating, new kitchens and double glazing should be black patched unless taken into account in order to assess comparable evidence.

10.4.5 The question of whether a rent should be attributed to surplus properties occupied by retired employees and family members if there is a prohibition on sub-letting needs to be determined. We would suggest where there is third party occupation, the landlord has been aware of such occupation and the property is surplus in terms of the SLR then it should be considered as surplus.

10.4.6 The legislation as it stands excludes any house occupied by the tenant being assessed as surplus and the property's rental value is effectively included with the land. Whilst there is an argument to support the inclusion of a house with the land in remote parts of the country, there is equally a fairness question which arises if a farmhouse is included with a very small acreage in a location where alternative accommodation is available. The Team suggests that this could be accounted for in the 'all of the considerations' part of the Act.

10.4.7 During debate on valuing out non black patched improvements within the Team, it became apparent that different approaches were required to adjust the rent of surplus residential accommodation and non-agricultural property compared with those improvements required to determine the productive capacity of the holding. The former two components of a farm rent are to be assessed on the basis of open market rent whilst the farm land is assessed on the basis of its productive capacity.

10.4.8 Surplus residential and non-agricultural property's non black patched improvements need to be considered on an annualised current cost basis. This removes the challenge of assessing the value of a non-agricultural improvement to an incoming agricultural tenant and avoids the potential of undervaluing the improvement due to the differing legislative obligations.

10.4.9 The current cost basis proposed for deducting non-agricultural improvements ensures an inflationary element is present in the analysis of the cost of the improvement which compliments the market rent analysis. As generally accounting for these improvements will relate to costs expected in order to meet the repairing standard or be able to analyse comparables reference to interest rates would not be relevant.

10.5 Non-agricultural / Diversified Income

10.5.1 The property diversified from agricultural use is identified as the property used by the tenant for that diversified use. The rental value of this property is then defined as what a tenant would pay for it. The hypothetical tenant need not be an agricultural tenant. The use of the property need not be the same use to which the tenant is using it for but it would need to fall within the same planning use class.

10.5.2 From the Team's experience and from the farms visited, it is clear that diversifications can be very specific to both tenant and location. What is clear is that the skills and expertise of a tenant should not underpin the value of a diversification. There are diversifications which rely almost solely on a tenant's skills and expertise and that is why we need to be careful in promoting a budgetary approach or sense check for diversified income. On the other hand there are opportunities which are created naturally by the landlord's fixed equipment and its location and a budgetary approach, with suitable adjustments, would make a sensible check in the absence of relevant comparable evidence as a method of assessing rent.

Appendices

Appendix 1 – Project Plan

06/12/17

	Action	Responsibility
1	**SG Main Timings**	
1.1	Tender Submission Deadline	JD, HG
1.2	Contract Awarded	SG
1.3	Inception Meeting	SG, JD, HG
1.4	Field Work completed	JD, HG
1.5	Interim Report completed	JD,HG
1.6	Final Report completed	JD, HG
1.7	Presentations to SG and Tenant Farming Sector Main Stakeholder Groups	JD, HG
2	**Interpretation and preparation**	
2.1	Contact with SG to arrange protocol for contacting all farm tenant, arranging information hand-over (all contacts details for tenants & IACS plan)	SG, JD, HG
2.2	Analysis of schedule of farm rents to do and creation of a location efficient plan of implementation	SG, JD, HG
3	**Review of Productive Capacity and Legal Context**	
3.1	Analysis of the 2016 Act	JD, HG, WB, HL
3.2	Inception Meeting	JD, HG, SG
4	**Field Work**	
4.1	Inspection 1	JD, HG
	Write up report & budget	JD, HG, GM
4.2	Inspection 2	JD, HG
	Write up report & budget	JD, HG, GM
4.3	Inspection 3	JD, HG
	SG update email	JD, HG, SG
	Write up report & budget	JD, HG, GM
4.4	Inspection 4	JD, HG
	Write up report & budget	JD, HG, GM
4.5	Inspection 5	JD, HG
	Write up report & budget	JD, HG, GM
	SG update email	JD, HG, SG
4.6	Inspection 6	JD, HG
	Write up report & budget	JD, HG, GM
4.7	Inspection 7	JD, HG
	Write up report & budget	JD, HG, GM
	SG update email	JD, HG, SG
4.8	Inspection 8	JD, HG
	Write up report & budget	JD, HG, GM
4.9	Inspection 9	JD, HG
	Write up report & budget	JD, HG, GM
4.10	Inspection 10	JD, HG
	Write up report & budget	JD, HG, GM
	SG update email	JD, HG, SG
4.11	Field Work completed	JD, HG
	Cross check with Watson Bell	JD, HG, WB
5	**Interim Report**	
5.1	Finalise Rent Review Proposals	JD, HG, GM
5.2	Analyse initial findings, outcomes and emerging conclusions. Include problems experienced and draft solutions.	JD, HG
5.3	SG update email	JD, HG, SG
5.4	Discuss with Watson Bell	JD, HG, WB
5.5	Discuss with Hamish Lean	JD, HG, HL
5.6	Write up Report	JD, HG
5.7	Submit Interim Report	JD, HG, SG
6	**Final Report**	
6.1	Bring together Rent Review Evidence	JD, HG
6.2	Consider alternative approaches and justify	JD, HG
6.3	SG update email	JD, HG, SG
6.4	Discuss with Watson Bell and Hamish Lean to consider whether the new system is fit for purpose	JD, HG, WB, HL
6.5	Write up report	JD, HG
6.6	SG update email	JD, HG, SG
6.7	Report reviewed by Watson Bell	JD, HG, WB
6.8	Amendments made and report finalised	JD, HG
6.9	Submit Final Report	JD, HG
6.10	Await Presentation Dates from SG	JD, HG, SG
6.11	Presentation to SG	JD, HG
6.12	Presentation to tenant farming stakeholders	JD, HG
7	**Follow up Actions**	**JD, HG**

Appendix 2 – Legal Analysis

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
1 Rent review: service of notice	“(1) The landlord of an agricultural holding to which this paragraph applies may initiate a review of the rent that is to be payable in respect of the holding by serving a notice in writing on the tenant of the holding. (2) The tenant of such an agricultural holding may initiate such a review by serving a notice in writing on the landlord of the holding. (3) A notice served under sub-paragraph (1) or (2) is a “rent review notice”. (4) This paragraph applies to an agricultural holding in respect of which— (a) the lease was entered into before 27 November 2003; or (b) the lease— (i) was entered into in writing on or after that date but prior to the commencement of the tenancy, and (ii) expressly states that this Act is to apply in relation to the tenancy.”	N/A	N/A

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
2 Form and content of rent review notice	"(1) A rent review notice must be dated and state the following — (a) the names and designations of the landlord and the tenant of the agricultural holding; (b) the name (if any) and the address of the holding or such other description of the holding as will identify it; (c) the rent currently payable in respect of the holding; (d) the rent that the person serving the notice proposes should be payable; (e) the date by which the landlord and the tenant must reach agreement as to what the rent payable should be (the "rent agreement date"). (2) The rent review notice must be accompanied by information in writing explaining the basis on which the rent proposed by the person serving the notice has been calculated. (3) For the purposes of sub-paragraph (1)(e), the rent agreement date stated in the rent	- Consideration of the practicality of including information on what the rent should be over a year in advance of the effective date. - Consideration of the sensitivity of the productive capacity model for reviewing the rent and how the date of analysis will impact on the result. - Consideration of whether proposed rental timeframes should be set by legislation or guidance.	- Removal of (d) the proposed rent cannot be calculated prior to a rent inspection which should not take place until after the notice is served. Requires amendment to primary legislation. - Best practice guidance should be updated to dictate a timeframe for a rent review procedure similar to that which is currently outlined. - It is felt dictating a timeframe within statute is too inflexible to cope with circumstantial delays caused by farming operations or unforeseen events.

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
	review notice must not fall— (a) earlier than 12 months from the date on which the notice is served; (b) later than 2 years from that date. (4) The Scottish Ministers may by regulations make further provision about: (a) the form and content of rent review notices, (b) the information that must or may accompany them. (5) Regulations under sub-paragraph (4) are subject to the negative procedure.”		
3 *Timing of rent review notice*	(1) A rent review notice may not be served under paragraph 1 if the rent agreement date stated in the notice would fall before the end of the period of 3 years beginning with the latest of— (a) the commencement of the tenancy, 7(2)(a) or otherwise) took effect, (c) the date as from which a previous determination under paragraph 7(2)(b) that the rent should	N/A	N/A

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
	continue unchanged took effect. (2) For the purposes of sub-paragraph (1)(b), the following are to be disregarded— (a) a variation of rent under section 14, (b) an increase of rent under section 15(1), (c) a reduction of rent under section 31, (d) a variation of rent arising under—; (i) the exercise or revocation of an option to tax under schedule 10 of the Value Added Tax Act 1994, or (ii) a change in the rate of value added tax applicable to grants of interests in, or rights over land in respect of which such an option has effect.		
4 *Withdrawal of rent review notice*	(1) This paragraph applies where— (a) a rent review notice is served under paragraph 1, (b) no agreement has been reached between the landlord and the tenant as to the rent that is to be payable in respect of the holding, and (c) no determination has been made by the Land Court under paragraph 7(2) as to the rent that is to be payable in respect of the holding. (2) The person who served the rent review	N/A	N/A

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
	notice may withdraw it but only with the consent of the recipient of the notice.		
5 *Termination of rent review notice*	A rent review notice ceases to have effect on the earliest of the following— (a) the date it is withdrawn, (b) the date the landlord and the tenant reach agreement as to the rent that is to be payable in respect of the holding, (c) where no referral is made to the Land Court under paragraph 6(2), the day after the rent agreement date, (d) where a referral is made to the Land Court under paragraph 6(2), the date on which the Land Court determines under paragraph 7(2) the question of what the rent payable in respect of the holding is to be.	N/A	N/A
6 *Referral of rent to the Land Court*	(1) This paragraph applies where— (a) a rent review notice is served under paragraph 1, (b) no agreement has been reached between the landlord and the tenant as to the rent that is to be payable in respect of the holding. (2) The landlord or the tenant of the holding may (whether the sender of the notice or not) refer the question	- Alternative methods of dispute resolution.	- Recommend that through the development of guidance the Land Court is advised to be the method of last resort with alternative methods of dispute resolution promoted. - Dispute avoidance through the agreement of a statement of facts within the period of the amnesty should

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
	of what the rent payable in respect of the holding should be to the Land Court. (3) The landlord or the tenant may not make such a referral after the rent agreement date.		be promoted through best practice guidance. - 'Without prejudice' correspondence should be banned in order to enhance transparency and remove the opportunity for debate.
7 *Powers of Land Court on referral under paragraph 6*	(1) This paragraph applies where a landlord or a tenant makes a referral to the Land Court under paragraph 6(2). (2) The Land Court must determine what the rent payable in respect of the holding is to be as from the rent agreement date and may— (a) vary the rent currently payable in respect of the holding, (b) determine that the rent should continue unchanged. (3) The rent that is to be payable in respect of the holding is the rent that the Land Court, taking account of all the circumstances, considers is the fair rent for the holding. (4) In determining the fair rent for the holding, the Land Court must have regard, in particular, to— (a) the productive capacity of the holding,	- Fair rent is not defined and is open to interpretation in terms of its definition under RICS and its definition in line with residential regulated tenancies. Defined in the ITT as 'a rent which will be fair to both the landlord and their tenant farmer'. - 'all the circumstances' and 'in particular' allows for the	- Fair rent should be defined further in order to avoid ambiguity. - The meaning of fair rent is believed to be derived from crofting legislation. Further research through an analysis of case law in this respect could be helpful in defining it. - Recommend that the ability to account for non-surplus residential accommodation and be able to sense check using reference to relevant sitting

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
	(b) the open market rent of any surplus residential accommodation on the holding provided by the landlord, (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.	Land Court to consider other relevant factors outwith those outlined in (a), (b) & (c).	tenant rents should be included when considering 'all the circumstances' in order to determine a fair rent.
8 *New rent to take effect from rent agreement date*	The rent agreed between the landlord and the tenant or, as the case may be, determined in accordance with paragraph 7 is to take effect from the rent agreement date.	N/A	N/A
9 Productive capacity	"(1) 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	Definition as set out in the ITT: *"The 'productive capacity of the agricultural holding' means the sustainable yield of agricultural products that would reasonably be expected from the agricultural holding under a system of farming suitable to it when farmed by:* • *a competent, efficient and experienced tenant farmer;* • *with adequate*	- Recommend that productive capacity can be calculated in terms of the likely output generated from the holding which includes the assumption that a hypothetical holding would have access to subsidy payments common at the time of the rent review. • The definition assumes that a 'hypothetical tenant farmer' would be expected to make the

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
	regard to the productive capacity of the holding. (2) regulations under sub-paragraph (1) are subject to the affirmative procedure."	*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: *The productive capacity of the agricultural holding is to be determined:* • *taking account of the physical character of the agricultural holding relevant to its use for agriculture as a trade or business, including but not limited to those factors detailed in the non-exhaustive list (on next page);* • *having disregarded the presence of fixed equipment and any tenant farmer's improvement so far as;* *(i) it has been provided wholly or partly at the expense of*	best use out of the farm productive capacity. A farmer would ensure the 'latent value' of the farm is utilised. • Latent Value can be defined as what a competent tenant would be expected to do to ensure productivity throughout his tenancy. • The reference to 'Trade or business' in section 1(2) of the 1991 Act allows potential to use standard % of output for costs used by banks as can assume 'a farmer' would not continue a business if it was not profitable in the long term. Recommend further research is done into what range of % banks would expect from a competent farm over a 3 year cycle. • Recommend a black patch approach to most tenants improvements; • Land improvements such as fencing, water

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
		the tenant farmer (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; and *(ii) it has not been provided under an obligation imposed on the tenant farmer 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 on the agricultural holding at that date;* • *taking account of the fixed equipment provided by the landlord;* • *allowing for any land and fixed equipment provided by the landlord that is accepted as*	troughs, access can be considered as reasonable in terms of the farmer extracting the 'latent value' from the farm and a deduction can therefore be made to account for these in terms of the impact their inclusion would have to the rent; • Grant Aid where the tenant has done something with grant aid this must be disregarded from the rent assessment. Recommend further research is done to determine whether this is 'fair'; • Grant Aid where the landlord and tenant make a contribution – the tenant's contribution and the whole grant should be disregarded. i.e., if a building was put up with 40% grant, 30% tenant contribution, and 30% landlord contribution, 30% of that building could be considered in the analysis of rent. Recommend the element of grant funding which represents the landlord's contribution is accounted for in the rent assessment with the amount that reflects the tenant's contribution disregarded; • Further research is needed where the improvement is 100%

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
		being used for a purpose that is not an agricultural purpose relevant to paragraph 7(4) of Schedule 1A; • *having disregarded any dilapidation to, or deterioration of or damage to fixed equipment or land caused or permitted by the tenant farmer;* • *taking account of the extent to which the agricultural holding may reasonably be farmed with other land or to the extent an agricultural holding may be farmed with contractors providing machinery services in place of the overhead costs of owning machinery;* • *taking account of the terms of the lease by which the agricultural holding is let to the tenant farmer;* • *taking account of the terms of any other legally enforceable agreement or restriction affecting the use of the agricultural holding; and* • *using the yields that would reasonably*	grant aid funded to consider whether completely disregarding it is fair. • Recommend clarity that if a farm is let for a specific purpose this must be adhered to when defining the farming system. • Recommend presence of a post-lease agreement or pre-1948 Act must be considered in terms of placing a higher cost burden on the tenant which will impact productivity. • Recommend as a standard model the divisible surplus should be split 50/50 with adjustments potentially made to this where it is still thought to be unfair following the main discounts being made.

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
		be expected from the agricultural holding for that system of farming conducted by such a tenant farmer.	
10 Surplus residential accommodation	"(1) Residential accommodation on an agricultural holding is surplus to the extent that it exceeds what is necessary to provide accommodation for the standard labour requirement of the holding. (2) In determining, for the purposes of paragraph 7(4)(b), whether residential accommodation is surplus the Land Court— (a) may take into account whether the standard labour requirement of the holding varies (seasonally or otherwise); (b) must disregard — (i) any accommodation all or part of which is occupied by the tenant of the holding, (ii) any accommodation if the tenant is prohibited (by the lease or otherwise) from sub-letting it. (3) But any such prohibition as is mentioned in sub-	• How the standard labour requirement (SLR) is applied to the holding to calculate surplus property. Consider how relevant the SAC handbook SLR calculation is and whether it requires adjustment. • Consideration of seasonal need for accommodation. • Farmhouse occupied by the tenant cannot be considered. • Prohibition in the lease and no evidence of ever renting out cannot be rentalised. • Where sub-let under the 2003 Act the properties would be considered in the diversification section of the rent	• SAC SLR data to be used. Recommend this is updated to reflect current agricultural practices. • Recommend further regulation to allow the calculation of rent to take account of the element of property which exceeds the labour required, i.e. if a holding requires 1.2 labour units and contains a Farmhouse and a Cottage, 80% of the market rent for the Cottage could be considered in the rent assessment. • Recommend clarification that the Farmhouse occupied by the tenant can only be considered in the productive capacity or 'all the considerations' element of the rent assessment. • Recommend it is made explicit that formal permission to sub-let or

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
	paragraph (2)(b)(ii) is to be ignored if the tenant has sub-let the accommodation by virtue of section 39(3) of the Agricultural Holdings (Scotland) Act 2003. (4) In having regard for the purposes of paragraph 7(4)(b) to the open market rent for any surplus residential accommodation, the Land Court — (a) must take into account all the circumstances, including — (i) the condition of the accommodation and its location; and (ii) where accommodation is occupied by a retired agricultural worker, under an arrangement or agreement between the landlord and the tenant of the holding, at no rent or at a rent that is below what the open market rent for that accommodation would otherwise be, that fact. (b) where the accommodation is not currently let, must disregard that fact. (5) Where regard is had to the open market rent for surplus residential	assessment. • Starting point is open market rent for the type of property and the area. • Where no rent is received and the property is occupied by a retired agricultural worker and there is a prohibition on sub-letting the property should not be rentalised. Where rent is being received and the landlord has consented to this formally or otherwise the open market rental can be considered.	evidence that landlord has accepted sub-letting in the past will allow for consideration in the rent assessment. • Recommend the minimum standard for surplus accommodation should be based on the repairing standard for residential accommodation and the costs relevant to this should be accounted for regardless of if they have been undertaken by the tenant. • Tenants improvements should be black patched where possible and only included in order to assess comparables. • Non black patched improvements should be discounted through assessing what their presence adds to the rent via: 1) an analysis of rents with and without the improvement 2) Annualising then deducting the cost of the improvement. • Standard costs of improvements should be applied through availability of actual evidence (invoice) or an

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
	accommodation for the purposes of paragraph 7(4)(b), that accommodation is to be disregarded for the purposes of paragraph 7(4)(c). (6) The Scottish Ministers may by regulations make provision about the standard labour requirement of agricultural holdings, including— (a) how the standard labour requirement 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 determine the standard labour requirement of the holding. (7) Regulations under sub-paragraph (6) are subject to the affirmative procedure.”		assessment of local costs (quotes from local contractors). • The tenant’s higher maintenance obligations and potential void periods should be taken into account before the surplus market rent is split 50/50 between the landlord and tenant. Such deductions are to be based on buy to let budgets produced by mortgage companies or industry practice (33%).
11 *Open market rent*	For the purposes of paragraphs 7(4) and 10(4)(a)(ii), the “open market rent” means the rent at which— *(a)* any surplus residential accommodation; (b) any fixed	• Confirmation on whether a diversified use is to be rented at the open market for that specific use or at the open market for a commercial use.	• Rental value is based on what a tenant would pay for the site for commercial purposes. This is based on what the landlord has provided and excludes all tenant improvements. • Where there is no

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
	equipment or land used for a purpose that is not an agricultural purpose, might reasonably be expected to be let on the open market by a willing landlord to a willing tenant.		comparable evidence available we recommend this is calculated through reference to the hypothetical use's net enterprise income.
12 *Power of Land Court to phase in new rent*	(1) This paragraph applies where the Land Court determines under paragraph 7(2) that the rent payable in respect of an agricultural holding (the "new rent") is to be— (a) 30% or more higher; or (b) 30% or more lower, than the rent currently payable in respect of the holding (the "original rent"). (2) The tenant or the landlord may apply to the Land Court to have the new rent phased in. (3) The Land Court may, if it considers that it would cause the tenant or, as the case may be, the landlord undue hardship were the new rent to be payable from the rent agreement date, order that the new rent be phased in over a 3 year period in accordance with sub-paragraphs (4) to (6). (4) The rent payable in	N/A	N/A

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
	the first year after the rent agreement date is; (a) where sub-paragraph (1)(a) applies, the sum of the original rent and one third of the difference between the new rent and the original rent; or (b) where sub-paragraph (1)(b) applies, the original rent less one third of the difference between the original rent and the new rent. (5) The rent payable in the second year after the rent agreement date is; (a) where sub-paragraph (1)(a) applies, the sum of the original rent and two thirds of the difference between the new rent and the original rent; (b) where sub-paragraph (1)(b) applies, the original rent less two thirds of the difference between the original rent and the new rent. (6) The rent payable from the third year after the rent agreement date is the new rent.		
13 *Interpretation*	In this schedule— “open market rent” has the meaning given by paragraph 11, “rent agreement date” has the meaning given by paragraph 2(1)(e),	N/A	N/A

Section	Commentary on the Act	Areas to be considered for further regulation	Further regulations required (approved by Hamish Lean)
	“rent review notice” has the meaning given by paragraph 1(3), “surplus residential accommodation” has the meaning given by paragraph 10.		

Appendix 3 – Statement of Facts & Expert Statement Template

Appendix 3: Statement of Facts

Date: ____

Landlord: ____

Tenant: ____

Type of Tenancy: __________________________________

Date of Lease: ____________________________________

Current Rent: _____________________________________

Restrictions to Use (Designations/Listed Buildings/Planning): ___________________________

Relevant Details of Lease e.g. Significant terms, Post lease agreement, Minutes of Agreement, Diversification Notices, Consents to sub-let, improvements notices, improvements agreed through the amnesty, Record of Condition etc

____

____

____

Subjects of Let:
(Note: To be based on the subjects provided by the Landlord excluding all Tenant's Improvements)
Total acres: ______

Land Type	**Ha**	**Acres**	**Comment on quality**
Ploughable			
Permanent pasture			
Rough Grazing			
Hill			
TOTAL			

Land: LFA / NVZ / BP region details / LFASS / Land Classification / Current Use

____

____

	LIVESTOCK PRICES			
	Suckler Cows	**Dairy**	**Beef**	**Ewes**
Year 1				
Year 2				
Year 3				
AVERAGE				

	ARABLE YIELDS				
	Ha	**SB**	**WW**	**WB**	**WOSR**
Best					
Secondary					

	ARABLE PRICES				
	WO	**SB**	**WW**	**WB**	**WOSR**
Year 1					
Year 2					
Year 3					
AVERAGE					

Rotation: details of the rotation and justification

Agreed Farming System

ARABLE **Ha**	Crop 1 Ha	Crop 2 Ha	Crop 3 Ha	Crop 4 Ha	Crop 5 Ha
GRASS **Ha** Supporting	Suckler Cows No.	Ewes No.	Beef Cattle No.	Other No.	Other No.

Comments (include potential for potato lets, actual tenant experience which could be relevant in consideration)

____

____

____

Surplus Residential Accommodation

	Standard Labour Requirements (SLR)		
	Ha or Number	Hrs/Yr (SAC handbook)	Labour units required
Arable			
Beef Cows			
Dairy Cows	Per cow		
Ewes (lowland)	Per ewe		
TOTAL			

Surplus Residential Property on Farm: property name, property details, no beds, Landlord improvements, current use, separate agreement?

____

____

Tenant’s Improvements to Residential Property: works, cost of works, approx. date of the works

Diversified Income

Location of Diversified Activity: identify on a plan the extent of the diversified use.

Planning Consent Details:

Relevant Areas: Area of building (m2) and yard (m2) (area used for agricultural purposes if applicable)

Tenant’s Improvements: details of improvements which facilitate the diversification

Assumed hypothetical tenant commercial use:

Appendix 4 – Models 1 & 2 Analysis

Appendix 4: Models 1 & 2 Analysis

Summary of Sample Farms

Farm	Main Land Class	Characteristics	Fixed Equipment	Improvements
A	3.1	Surrounded by arable and dairy farms, quite flat land, light sandy soils, 10 acres susceptible to subsidence, no fencing but all cropable, drainage is good.	GP shed, Traditional building, lean-to, Dutch barn, Potato shed. General – adequate for an arable farm	Grain drying equipment and 20 acres of field drainage.
B	5.2	Surrounded by livestock farms, steep slopes, stoney land, LFA, access track through middle of farm, good boundary fences, water via ditches.	U-shaped traditional steading, 3 x small lean-to buildings, Byre, 50% of dung midden, 2 x feed stores. General – adequate for a low maintenance livestock farm.	Internal fencing is 70% tenant's, 12 x water troughs, 12 gates, sliding door, concrete ramp, roof beams, one gutter, internal feed bins.
C	3.1	Surrounded by mixed arable/livestock units, very productive land, NVZ area, no fences or water troughs.	Traditional U-shaped steading, storage buildings, Dutch barn, Cattle Court. General – adequate for an arable farm with grain storage offsite.	Grain Stores and grain handling facilities.
D	3.2	Surrounded by mixed arable/livestock units, fields quite flat, small and awkward shaped, soil is quite heavy, LFA, fields accessible from the road, drainage issues in some fields with rashes evident.	Cattle Court, Silage pit, byre, store. General – adequate for an extensive cattle/sheep farm. General – adequate for a small livestock farm.	Drier bins, concrete floor, removal of loft.

Farm	Main Land Class	Characteristics	Fixed Equipment	Improvements
E	3.1	Surrounded by livestock farms, wet area so arable would not suit, generally very flat and difficult to drain, LFA & NVZ, good access through farm, fencing mainly owned by the tenant.	Traditional L-shaped steading, storage building, workshop, GP shed and small outbuildings. General – adequate for a low maintenance livestock farm.	60 acres drainage. Electric and water supplies renewed, fencing and drainage. Significant dairy buildings and fittings.
F	2/3.1	Surrounded by mixed arable/livestock units, fields fairly flat, loamy soil, fields all accessible from farm track, NVZ.	Mixture of traditional buildings and Dutch barns. General – adequate for a mixed arable, livestock farm with grain storage offsite.	10km fencing, large grain store, internal gates and handling facilities within LL buildings.
G	3.2	Surrounded by livestock farms, generally quite flat with steeper areas where land is poorer (5.2), LFA, NVZ, buildings are at the centre of farm with fields accessible, SRDP funded most of fencing.	U-shaped traditional buildings with infill cattle court, Dutch barn & lean-to. General – adequate for an upland livestock farm.	Fencing, new trees (grant funded), GP shed.
H	3.2	Surrounded by arable units, near built up area, fields are generally flat, stoney land with gas pipeline running through, small farm, easily accessible.	2 x traditional steadings, Dutch barn, kennels, workshop. General – adequate for a forage farm.	Doors and gates on buildings.
I	3.1	Surrounded by livestock farms, generally quite flat with steeper areas where land is poorer (5.2), LFA, rabbit problem, buildings are at the centre of farm with fields accessible.	Mixture of traditional buildings, calf stores, cattle courts, and storage buildings. General – adequate for a livestock unit or dairy.	Water troughs, some drainage, dyke repairs, water troughs, fencing, new parlour, hen shed, slurry storage.

Farm	Main Land Class	Characteristics	Fixed Equipment	Improvements
J	6.2	Surrounded by livestock farms, steep, peaty hill farm, LFA, road right through farm maintained by Landlord.	Traditional buildings, handling facilities (50/50), GP shed (50/50), Dutch barn. General – Adequate for a hill sheep farm.	Sprayed bracken (90% grant funded), grant funded grass seed mix, GP shed.

<u>Models 1 & 2</u>

FARM	SYSTEM	COMPARABLES (£/ac)	MODEL 1 SAC (£/ac)	MODEL 1 FBS (£/ac)	MODEL 2 (£/ac)
A	General Cropping with Pots	32 – 67	77 – 126 (101)	95 – 117 (104)	114 – 123 (118)
B	Upland Cattle + Sheep	43 - 59	57 – 62 (60)	66 – 80 (73)	49 – 61 (55)
C	Cereal Non LFA, no Pots	80 - 120	43 – 86 (60)	33 – 56 (44)	
D	Lowland Cattle & Sheep	42 - 71	56 – 60 (58)	64 – 79 (71)	21 – 50 (38)
E	Upland Cattle	35 - 59	0 – 2.4	72 - 85	58 – 64 (66)
F	Mixed, Non-LFA, Beef Finishing	77 – 121	27 – 92	37 – 60	
G	Lowland Cattle & Sheep LFA	38 – 77	35 – 64	54 – 56	
H	Lowland Sheep Non-LFA	39 – 52	0	0	
I	Dairy	39 – 73	0 - 58	26 – 86	
J	Hill Sheep	4 – 25	0 – 6	3.6 – 4.2	

One of the aims of the project was to find a means of applying an objective method for calculating productive capacity so that transparency and consistency left little room for debate. Models 1 and 2 attempted to do this through using available datasets to calculate the productive capacity of a holding through gross margin analysis or standard farm types.

The challenge of assessing productivity capacity is highlighted by a comparison of the outcomes from an upland cattle farm using SAC Farm Management Handbook figures and also using the FBS data for the same (both adaptations of model 1). The SAC data revealed a rent, based on a 50% share of the net farm income of between £0 and £2.40/acre whilst the FBS data revealed rents of £72 to £85 per acre for the same period. Both of these processes are essentially adaptations of a full budget using published data sets in an attempt to remove subjectivity and therefore the regions for debate. However with the ability for published data to yield such varying results and the fact that by the time it is published it is often already out of date makes such a model unworkable in practice. In the Models 1 & 2 table on the previous page, the SAC gross margin data was half that in the FBS data. Such variances and inflexibility could not be recommended as a means to avoid dispute.

Looking at the variability of the enterprise data there were significant differences. The SAC data showed average Spring Barley gross margin at £210 compared with £168 per acre in the FBS data set. Comparisons of livestock enterprise FBS and SAC survey data was not possible due to the differences with enterprise descriptions. We considered a variation on Model 1 which utilised contractor rates to inform the budget on fixed costs. The thought being that contractor costs would represent machinery and labour costs required. This was not unanimously supported within the Team and was dropped as a model mainly because it was felt that the contractor’s rates would value into the budget significant marriage value savings and would not represent what a tenant would do.

Using the whole farm data in model 2 for the same period the rent average was between £58 and £64 per acre. The whole farm data also came from the same FBS data source but reported differently in the Cost Centre Analysis Tables. Although not a hugely unrealistic result it was felt that pushing farms into a specific farm type was unrealistic in practice and would undoubtedly lead to debate. Output figures varied significantly between the survey data used and it was not easy to reconcile these differences. Access to the base data which made up the output figures was not available for the whole farm data. As a result this model was only tested for 4 of the 10 sample farms before being deemed unworkable.

Appendix 5 – Fixed Cost Data

Appendix 5: Copy of Scottish Government Fixed Cost Data

Table 1a

Fixed Costs Data: FAS 2016

Breakdown of fixed costs per hectare (agricultural area) by type of farming

Standard Output Farm Type: All types

Tenure Type: All types

UNWEIGHTED

Sample FAS 2016: Sample year is 2016

Fixed Cost Variables (£/ha)		Cereals	General Cropping	Dairy	LFA Specialist Sheep	LFA Cattle	LFA Sheep & Cattle	Lowland Cattle & Sheep	Mixed	All Types
		2015/16	2015/16	2015/16	2015/16	2015/16	2015/16	2015/16	2015/16	2015/16
Count of Farms		68	51	43	48	124	63	28	75	500
Agricultural Area (ha)		183.5	195.2	160.4	1223.7	200.2	546.9	145.3	217.4	335.4
Machinery and Car Costs	Machinery fuel and oil	53	65	77	10	38	21	57	58	46
	Electricity	15	21	60	5	14	8	18	16	18
	Other Contract Work	3	1	3	0	1	1	2	1	1
	Machinery Repairs	69	83	102	11	44	20	63	63	54
	Car fuel- Farm Share	11	10	16	5	9	5	14	9	9
	Car repairs- Farm Share	6	6	8	2	5	3	8	5	5
	Car licence- Farm Share	1	2	2	1	2	1	2	1	1
	Car insurance- Farm Share	3	3	7	1	3	2	4	2	3
	Total Machinery Costs (ex depn)	230	281	409	40	156	79	224	202	190
Property Costs	Total Repairs to Property Costs	48	36	63	12	33	18	48	34	35
Other Fixed Costs	Crop drying fuel	15	14	0	0	0	0	0	8	5
	Heating fuel	12	13	19	5	12	6	13	11	11
	Water	5	6	22	1	6	1	11	5	6
	Insurance	30	32	38	10	29	14	34	32	27
	Telephone (Farm Business) Land Line, Mobile, Broadband	4	3	3	1	2	2	3	2	2
	Miscellaneous	59	57	64	16	44	25	57	51	46
	Total other fixed costs	127	127	148	34	94	49	120	110	98
	Total Fixed Costs (per Ha)	405	444	620	86	283	146	392	346	323

Footnote: Where applicable - data is gross of depreciation

source:RESAS

Table 2a

Depreciation Costs Data: FAS 2016

Breakdown of depreciation costs per hectare (agricultural area) by type of farming

Standard Output Farm Type: All types

Tenure Type: All types

UNWEIGHTED

Sample FAS 2016: Sample year is 2016

Fixed Cost Variables (£/ha)		Cereals	General Cropping	Dairy	LFA Specialist Sheep	LFA Cattle	LFA Sheep & Cattle	Lowland Cattle & Sheep	Mixed	All Types
		2015/16	2015/16	2015/16	2015/16	2015/16	2015/16	2015/16	2015/16	2015/16
Count of Farms		68	51	43	48	124	63	28	75	500
Agricultural Area (ha)		184	195	160	1,224	200	547	145	217	335
Depreciation Costs	Machinery Depreciation	175	224	193	31	120	58	138	175	137
	Car Depreciation- Farm Share	5	12	12	2	6	3	6	5	6
	Depreciation of Buildings & Works	51	50	233	8	47	18	52	60	59

Footnote: Machinery at 20% and Land & Buildings at 10%

source:RESAS

Notes

Data supplied is not weighted or indexed.

RESAS data published online is weighed and the previous year's RPI indexed.

Monetary data in Table 1 is gross of depreciation.

Table 2 displays the relevant separate depreciation costs - machinery at 20% and land and buildings at 10%.

Tables 1a and 2a are on a per hectare basis.

The data supplied as per hectare number is based on the Total Agricultural Area of the farm.

Total crops and grass plus rough grazing equals Total Agricultural Area.

Additional Points

Allocating fixed costs on a flat per hectare data can lead to vague or imprecise results. It does not take into account the interactions between factors such as machinery, capital, land, effort and efficiency on individual farms.

Scale will also affect the per hectare data.

The MIN MAX MEAN statistics of the agricultural area are included as an indication of the variation of farm area in Table 3.

The FBS results are obtained from a sample of around 500 farms. These are stratified by farm type, and size. The survey does not currently include farms predominantly engaged in horticulture, poultry, egg production or pig production.

The coverage of the survey is restricted to those farms which have considerable economic activity (at least 25,000 Euros of output) and are not considered as spare-time farms (have a Standard Labour Requirement SLR) of more than 0.5).

Around 12,000 holdings are represented at present.

Appendix 6 – Gross Output & Farm Budget Analysis

Please note that some of these figures may not total exactly as the formulas used work on pre-rounded figures.

FARM A - GROSS OUTPUT														
Arable Unit use Pots in rotation														
Use WOSR figures - none for SOSR		**2017-2018**				**2016-2017**				**2015-16**				
		Projected figures				**Current Gross Output - SAC Handbook**				**Gross Output - FBS**				
	No	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**			
Gross Output - WW	21	1,388	28,857		21	1,206	25,073		21	1,100	22,869			
Gross Output - SB	54	845	45,757		54	734	39,746		54	759	41,100			
Gross Output - WOSR	27	1,300	35,308		27	1,260	34,222		27	1,156	31,397			
Gross Output - POTS	10	5,100	51,000		10	5,090	50,900		10	5,799	57,990			
				£ 160,922				**£ 149,941**				**£ 153,356**		
Subsidy														
BPS														
Payment Region 1	118	244	24,468		118	244	24,468		118	244	24,468			
Payment Region 2	-	31	-		-	31	-		-	31	-	**TOTAL**		
(based on 2019 values & £0.85228 conversion rate)				**£ 24,468**				**£ 24,468**				**£ 24,468**		
														Average
Total Output				**£ 185,389**				**£ 174,409**				**£ 177,824**		**£ 178,478**
												30% of Av GO		**£ 53,543**
												50/50 Split		**£ 26,772**
												Per Acre		**£ 92**

Please note that some of these figures may not total exactly as the formulas used work on pre-rounded figures.

FARM B GROSS OUTPUT													
									ha	**acres**			
Spring Calving Cows & Commercial sheep									182	450	**LFA**		
Assume same systems		**2017-2018**				**2016-2017**				**2015-2016**			
		Projected figures				**SAC Handbook**				**FBS Data**			
	No	**Value (£)**	**Total (£)**			**No**	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**	
Gross Output - Cows	100	660	66,000		100	631	63,100		100	863	86,300		
Gross Output - Sheep	500	90	45,000		500	92	46,140		500	138	69,000		
				£ 111,000				**£ 109,240**				**£ 155,300**	
Subsidy													
BPS - 2019													
Payment Region 1	141	244	29,359		141	244	29,359		141	244	29,359		
Payment Region 2	41	31	1,070		41	31	1,070		41	31	1,070		
(based on 2019 values & £0.85228 conversion rate)												**TOTAL**	
LFASS - 2017	194	34	5,653	**£ 36,083**	194	34	5,653	**£ 36,083**	194	34	5,653	**£ 36,083**	
													Average
Gross Output				**£ 147,083**				**£ 145,323**				**£ 191,383**	**£ 161,263**
												30% of Av GO	**£ 48,379**
												50/50 Split	**£ 24,189**
												Per Acre	**£ 54**

Please note that some of these figures may not total exactly as the formulas used work on pre-rounded figures.

FARM C GROSS OUTPUT													
		2017-2018				**2016-2017**				**2015-16**			
		Projected figures				**SAC Handbook**				**FBS data**			
	No	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		
Gross Output - WW	103	1,388	142,762		103	1,206	124,042		103	1,100	113,140		
Gross Output - WOSR	51	1,300	66,855		51	1,260	64,798		51	1,156	59,450		
Gross Output - SO	103	805	82,798		103	785	80,741		103	720	74,055		
Gross Output - WB	51	1,050	53,999		51	1,011	51,993		51	967	49,730		
Gross Output - Sheep	200	17	3,400		200	18	3,600		200	17	3,400		
				£ 349,814				**£ 325,174**				**£ 299,775**	
Subsidy													
BPS													
Payment Region 1	312	244	64,816		312	244	64,816		312	244	64,816		
Payment Region 2	0	31	0		0	31	0		0	31	0	**TOTAL**	**AVERAGE**
(based on 2019 values & £0.85228 conversion rate)				**£ 64,816**				**£ 64,816**				**£ 64,816**	**£ 64,816**
Total Output				**£ 414,629**				**£ 389,990**				**£ 364,591**	**£ 389,737**
												30% of Av GO	**£ 116,921**
												50/50 Split	**£ 58,461**
												Per Acre	**£ 76**

Please note that some of these figures may not total exactly as the formulas used work on pre-rounded figures.

FARM D GROSS OUTPUT													
Spring Calving Cows & Commercial sheep													
		2017-2018				**2016-2017**				**2015-2016**			
		Projected figures				**SAC Handbook**				**FBS Data**			
	No	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		
Gross Output - Cows	20	660	13,200		20	631	12,620		20	863	17,260		
Gross Output - Sheep	110	90	9,900		110	92	10,151		110	138	15,180		
				£ 23,100				**£ 22,771**				**£ 32,440**	
Subsidy													
BPS													
Payment Region 1	37	244	7,590		37	244	7,590		37	244	7,590		
Payment Region 2	-	31	-		-	31	-		-	31	-		
(based on 2019 values & £0.85228 conversion rate)													
LFASS	50	52	2,207		50	52	2,207		50	52	2,207	**TOTAL**	**AVERAGE**
				£ 9,797				**£ 9,797**				**£ 9,797**	**£ 9,797**
Total Output				**£ 32,897**				**£ 32,568**				**£ 42,237**	**£ 35,901**
												30% of Av GO	**£ 10,770**
												50-50 Split	**£ 5,385**
												Per Acre	**£ 60**

Please note that some of these figures may not total exactly as the formulas used work on pre-rounded figures.

FARM E GROSS OUTPUT													
Beef lowland suckler herds													
		2017-2018				**2016-2017**				**2015-2016**			
		Projected Figures				**SAC Handbook**				**FBS Data**			
	No	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		
Gross Output - Cows	60	640	38,400		60	628	37,680		60	753	45,180		
				£ 38,400				**£ 37,680**				**£ 45,180**	
Subsidy													
BPS - 2019													
Payment Region 1	57	244	11,768		57	244	11,768		57	244	11,768		
Payment Region 2		31	-			31	-			31	-		
(based on 2019 values & £0.85228 conversion rate)												**TOTAL**	**AVERAGE**
				£ 11,768				**£ 11,768**				**£ 11,768**	**£ 11,678**
Gross Output				**£ 50,168**				**£ 49,448**				**£ 56,948**	**£ 52,188**
												30% of Av GO	**£ 15,656**
												50-50 Split	**£ 7,828**
												Per Acre	**£ 56**

Please note that some of these figures may not total exactly as the formulas used work on pre-rounded figures.

FARM F GROSS OUTPUT													
		2017-2018				**2016-2017**				**2015-2016**			
		Projected figures				**SAC Handbook**				**FBS Data**			
	No	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		
Gross Output - WW	111	1,388	153,833		111	1,206	133,662		111	1,100	121,914		
Gross Output - WOSR	55	1,300	72,040		55	1,260	69,823		55	1,156	64,060		
Gross Output - SO	111	805	89,219		111	785	87,002		111	720	79,798		
Gross Output - WB	55	1,050	58,186		55	1,011	56,025		55	967	53,587		
Gross Output - Beef	300	385	115,500		300	179	53,700		300	419	125,700		
				£ 488,777				**£ 400,212**				**£ 445,058**	
Subsidy													
BPS													
Payment Region 1	436	244	90,638		436	244	90,638		436	244	90,638		
Payment Region 2	-	31	-		-	31	-		-	31	-	**TOTAL**	**AVERAGE**
(based on 2019 values & £0.85228 conversion rate)				**£ 90,638**				**£ 90,638**				**£ 90,638**	**£ 90,638**
Total Output				**£ 579,415**				**£ 490,849**				**£ 535,696**	**£ 535,320**
												30% of Av GO	**£ 160,596**
												50-50 Split	**£ 80,298**
												Per acre	**£ 75**

Please note that some of these figures may not total exactly as the formulas used work on pre-rounded figures.

FARM G GROSS OUTPUT													
Spring Calving Cows & Commercial sheep		**2017-2018**				**2016-2017**				**2015-2016**			
		Projected figures				**SAC Handbook**				**FBS data**			
	No	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		
Gross Output - Cows	20	660	13,200		20	631	12,620		20	863	17,260		
Gross Output - Sheep	110	90	9,900		110	92	10,151		110	138	15,180		
				£ 23,100				**£ 22,771**				**£ 32,440**	
Subsidy													
BPS													
Payment Region 1	37	244	7,590		37	244	7,590		37	244	7,590		
Payment Region 2	-	31	-		-	31	-		-	31	-		
(based on 2019 values & £0.85228 conversion rate)													
LFASS	50	52	2,207		50	52	2,207		50	52	2,207	**TOTAL**	**AVERAGE**
				£ 9,797				**£ 9,797**				**£ 9,797**	**£ 9,797**
Total Output				**£ 32,897**				**£ 32,568**				**£ 42,237**	**£ 35,901**
												30% of Av GO	**£ 10,770**
												50-50 Split	**£ 5,385**
												Per Acre	**£ 39**

Please note that some of these figures may not total exactly as the formulas used work on pre-rounded figures.

FARM H GROSS OUTPUT													
Lowland sheep - crossbred ewes													
		2017-2018				**2016-2017**				**2015-2016**			
		Projected Values				**SAC Handbook**				**FBS Data**			
	No	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		
Gross Output - Sheep	100	90	9,000		100	92	9,228		100	138	13,800		
				£ 9,000				**£ 9,228**				**£ 13,800**	
Subsidy													
BPS													
Payment Region 1	24	244	4,949		24	244	4,949		24	244	4,949		
Payment Region 2	0	31	0		0	31	0		0	31	0		
(based on 2019 values & £0.85228 conversion rate)												**TOTAL**	**AVERAGE**
				£ 4,949				**£ 4,949**				**£ 4,949**	**£ 4,949**
Total Output				**£ 13,949**				**£ 14,177**				**£ 18,749**	**£ 15,625**
												30% of Av GO	**£ 4,688**
												50-50 Split	**£ 2,344**
												Per Acre	**£ 40**

Please note that some of these figures may not total exactly as the formulas used work on pre-rounded figures.

FARM I GROSS OUTPUT													
		2017-2018				**2016-2017**				**2015-2016**			
		Projected figures				**SAC Handbook**				**FBS Data**			
	No	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		
Gross Output - Milk	100	2,200	220,000		100	1,903	190,300		100	1,613	161,300		
Gross Output	-	117	-		-	117	-		-	138	-		
				£ 220,000				**£ 190,300**				**£ 161,300**	
Subsidy													
BPS													
Payment Region 1	119	244	24,655		119	244	24,655		119	244	24,655		
Payment Region 2	-	31	-		-	31	-		-	31	-	**TOTAL**	**AVERAGE**
(based on 2019 values & £0.85228 conversion rate)				**£ 24,655**				**£ 24,655**				**£ 24,655**	**£ 24,655**
Total Output				**£ 244,655**				**£ 214,955**				**£ 185,955**	**£ 215,189**
												30% of Av GO	**£ 64,557**
												50-50 Split	**£ 32,278**
												Per Acre	**£ 110**

Please note that some of these figures may not total exactly as the formulas used work on pre-rounded figures.

FARM J GROSS OUTPUT													
		2017-2018				**2016-2017**				**2015-2016**			
		Projected Figures				**SAC Handbook**				**FBS Data**			
	No	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		**No**	**Value (£)**	**Total (£)**		
Gross Output - Sheep	1,300	30	39,000		1,300	28	36,491		1,300	50	65,000		
Gross Output	-	117	-		-	117	-		-	138	-		
				£ 39,000				**£ 36,491**				**£ 65,000**	
Subsidy													
BPS													
Payment Region 1	17	244	3,442		17	244	3,442		17	244	3,442		
Payment Region 3	1,275	12	13,041		1,275	12	13,041		1,275	12	13,041		
(based on 2019 values & £0.85228 conversion rate)													
SUSSS	325	78	21,605		325	78	21,605		325	78	21,605		
LFASS	217	62	13,476		217	62	13,476		217	62	13,476	**TOTAL**	**AVERAGE**
				£ 51,564				**£ 51,564**				**£ 51,564**	**£ 51,564**
Total Output				**£ 90,564**				**£ 88,055**				**£ 116,564**	**£ 98,394**
												30% of Av GO	**£ 29,518**
												50-50 Split	**£ 14,759**
												Per Acre	**£ 5**

Farm A

Farming System	General Cropping					
Crop	Yield	Price	Ha	Total		
WW	9	132	21	24,592		
WW Straw	4	45	21	3,780		
SB	5.45	130	54	38,365		
SB Straw	4	60	54	12,996		
WOSR	3.4	308	27	28,442		
Pots		617	10	6,170		
					£	114,345
	Performance	Price	No.s	Total		
Livestock					£	-
	Region	Rate	Ha	Total		
Subsidy	1	208	118	24,458		
					£	24,458
				TOTAL OUTPUT	£	138,803
Variable Costs						
Crop		Cost	Ha	Total		
WW		442	21	9,149		
SB		273	54	14,783		
WOSR		408	27	11,081		
Contractors		130	102	13,261		
Pots			10	0		
					£	48,275
		Price	No.s	Total		
Livestock1						
Fixed Costs	Farm SLR	Adjusted	£/man			
Labour	1.11	0.11	15868.8	1,746		
Housing						
		£/ha	Ha	Total		
Total Machinery		281	118	33,049		
Depreciation				17,100		
Total Property		36	118	4,234		
Total Other		127	118	14,937		
					£	71,065
				TOTAL COSTS	£	119,340
				DIVISIBLE SURPLUS	£	19,463
				50:50 Split	£	9,732
				£/ac	£	33

Minimum Machinery Reqirements			Depn Rate	Depn
Tractors	x1	£75,000	10%	£7,500
Plough		£18,000	10%	£1,800
One pass / Seeder		£20,000	10%	£2,000
Roller		£8,000	10%	£800
Trailers	x2	£12,000	10%	£1,200
Bailer		£8,000	10%	£800
Telehandler		£30,000	10%	£3,000
		£171,000		**£17,100**

Standard Labour Requirement			
	hrs/yr	No.	Total
Cereals	18	118	2,116.989
		Total	£ 2,116.99
Standard annual labour unit	1,900		1.11
Adjustment for excessive labour requirement			0.11

Notes

Farming system based on Scottish Government Farm Business Survey classification - Sample year 2016
Yield is based on our assessment of the farm, allowing for it location and fixed equipment
Price - based on current market price (considering future prices)
Straw output based on £/ha sold in the bout
Potato output is based on rental of £ 740/ha less £ 123/ha management and plough charge
Total area equals crop areas plus 5%
Subsidy is based on regional average for 2019 and exchanged at £0.85228
Variable costs are from John Nix Farm Management Pocketbook 2017
Standard Labour Requirements from SAC Handbook
Cost per labour unit based on £7.20 per hour for 1,900 hrs plus NI Contribution, Employers liability insurance and pension contribution

Farm B

Farming System	**LFA Cattle & Sheep**				
Crop	**Yield**	**Price (£)**	**Ha**	**Total (£)**	
					0
Livestock	**Performance**	**Price (£)**	**No.s**	**Total (£)**	
Spring calving cows	0.92	406	100	40,600	
Commercial Sheep	1.5	79	500	39,500	
					£ 80,100
	Region	**Rate (£)**	**Ha**	**Total (£)**	
Subsidy	1	208	141	29,322	
	2	26	41	1,074	
Beef Calf Scheme		71	18	1,278	
LFASS		34	194.4	6,633	
					£ 38,307
				TOTAL OUTPUT	**£ 118,407**
Variable Costs					
Crop		**Cost (£)**	**Ha**	**Total (£)**	
Livestock		**Cost (£)**	**No.s**	**Total (£)**	
Spring calving cows		213	100	21,300	
Commercial Sheep		46	500	23,000	
					£ 44,300
Fixed Costs	**Farm SLR**	**Adjusted**	**£/man**		
Labour	2.89	0.5	15868.8	7,934	
Housing					
		£/ha	**Ha**	**Total (£)**	
Total Machinery		79	141	11,139	
Depreciation				8,400	
Total Property		18	141	2,538	
Total Other		49	141	6,909	
					£ 36,920
				TOTAL COSTS	**£ 81,220**
				DIVISIBLE SURPLUS	**£ 37,187**
				50:50 Split	**£ 18,593**
				£/ac	**£ 53**

Minimum Machinery Reqirements		**Depn Rate**	**Depn**
Tractors	£45,000	10%	£4,500
Trailer	£4,000	10%	£400
Telehandler	£20,000	10%	£2,000
Quad & Trailer	£6,000	10%	£600
Float	£4,000	10%	£400
Handling Crates	£5,000	10%	£500
	£84,000		**£8,400**

Standard Labour Requirement			
	hrs/yr	**No.**	**Total (£)**
Grassland	3.1	141	437.1
Rough grazing	1.5	41	61.5
Beef Cows	26	100	2,600
Other cattle	12	20	240
Sheep upland	3.7	500	1,850
Other sheep (upland)	3.1	100	310
		Total	**£ 5,498.60**
Standard Annual Labour Unit	1,900		2.89
Adjusted Labour Requirements			**0.5**

Notes

Farming system based on Scottish Government Farm Business Survey classification - Sample year 2016
Yield is based on our assessment of the farm, allowing for it location and fixed equipment
Price - based on current market price (considering future prices)
Total area equals crop areas plus 5%
Subsidy (BPS) is based on regional average for 2019 and exchanged at £0.85228
Variable costs are from John Nix Farm Management Pocketbook 2017
Standard Labour Requirements from SAC Handbook. Adjusted figure reflects what was happening on the farm
Cost per labour unit based on £7.20 per hour for 1,900 hrs plus NI Contribution, Employers liability insurance and pension contribution
Fixed costs based on Region 1 land area

Farm C

Farming System	General Cropping					
Crop	Yield	Price	Ha	Total		
WW	9	132	102	121,176		
WW Straw	4	45	102	18,360		
SO	3	115	102	35,190		
SO Straw	4	60	102	6,240		
WB	7.5	120	51	6,120		
WB Straw	4	50	51	10,200		
WOSR	3.4	308	52	54,454		
					£	251,740
	Performance	Price	No.s	Total		
Livestock					£	-
	Region	Rate	Ha	Total		
Subsidy	1	208	312	64,816	£	64,816
					£	316,556
				TOTAL OUTPUT		
Variable Costs						
Crop		Cost	Ha	Total		
WW		442	102	45,084		
SO		217	102	22,134		
WOSR		408	52	21,216		
WB		351	51	17,901		
	0		0	0		
					£	106,335
		Price	No.s	Total		
Livestock1				0	£	-
Fixed Costs	Farm SLR	Adjusted	£/man			
Labour	2.91	1.00	15868.8	15,869		
Housing						
		£/ha	Ha	Total		
Total Machinery		281	312	87,582		
Depreciation				27,700		
Total Property		36	312	11,220		
Total Other		127	312	39,583		
					£	181,955
				TOTAL COSTS	£	288,290
				DIVISIBLE SURPLUS	£	28,267
				50:50 Split	£	14,133
				£/ac	£	18

Minimum Machinery Reqirements			Depn Rate	Depn
Tractors	x2	£100,000	10%	£10,000
Plough		£18,000	10%	£1,800
One pass / Seeder		£20,000	10%	£2,000
Roller		£8,000	10%	£800
Trailers	x2	£18,000	10%	£1,800
Baler		£8,000	10%	£800
Telehandler		£30,000	10%	£3,000
Combine		£75,000	10%	£7,500
		£277,000		**£27,700**

Standard Labour Requirement				
	hrs/yr	No.		Total
Cereals	18	307		5,526
		Total	£	5,526
Standard annual labour unit	1,900			2.91
Adjust labour requirement				1.00

Notes

Farming system based on Scottish Government Farm Business Survey classification - Sample year 2016
Yield is based on our assessment of the farm, allowing for it location and fixed equipment
Price - based on current market price (considering future prices)
Straw output based on £/ha sold in the bout
Potato output is based on rental of £740/ha less £123/ha management and plough charge
Total area equals crop areas plus 5%
Subsidy is based on regional average for 2019 and exchanged at £0.85228
Variable costs are from John Nix Farm Management Pocketbook 2017
Standard Labour Requirements from SAC Handbook. Adjusted figure reflects what was happening on the farm.
Cost per labour unit based on £7.20 per hour for 1,900 hrs plus NI Contribution, Employers liability insurance and pension contribution

Farm D

Farming System	LFA Cattle & Sheep					
Crop	**Yield**	**Price**	**Ha**	**Total**		
					£	-
Livestock	**Performance**	**Price**	**No.s**	**Total**		
Spring calving cows	0.92	406	20	8,120		
Commercial Sheep	1.5	76	110	8,360		
					£	**16,480**
	Region	**Rate**	**Ha**	**Total**		
Subsidy	1	208	37	7,590		
	2	26	0	0		
Beef Calf Scheme		71	18	1,278		
LFASS		52	49.64	2,589		
					£	**11,458**
				TOTAL OUTPUT	£	**27,938**
Variable Costs						
Crop		**Cost**	**Ha**	**Total**		
Livestock		**Cost**	**No.s**	**Total**		
Spring calving cows		213	20	4,260		
Commercial Sheep		46	110	5,060		
					£	**9,320**
Fixed Costs	**Farm SLR**	**Adjusted**	**£/man**			
Labour	0.63	0	15868.8	0		
Housing						
		£/ha	**Ha**	**Total**		
Total Machinery		79	37	2,884		
Depreciation				4,500		
Total Property		18	37	657		
Total Other		49	37	1,789		
					£	**9,829**
				TOTAL COSTS	£	**19,149**
				DIVISIBLE SURPLUS	£	**8,789**
				50:50 Split	£	**4,394**
				£/ac	£	**49**

Minimum Machinery Requirements		**Depn Rate**	**Depn**
Tractor& loader	£30,000	10%	£3,000
Trailer	£4,000	10%	£400
Quad & Trailer	£5,000	10%	£500
Float	£3,000	10%	£300
Handling Crates	£3,000	10%	£300
	£45,000		**£4,500**

Standard Labour Requirement			
	hrs/yr	**No.**	**Total**
Grassland	3.1	36.5	113.15
Beef Cows	26	20	520
Other cattle	12	5	60
Sheep upland	3.7	110	407
Other sheep (upland)	3.1	30	93
		Total	**£1,193.15**
Standard annual labour unit	1,900		0.63
Adjustment			0

Notes
Farming system based on Scottish Government Farm Business Survey classification - Sample year 2016
Yield is based on our assessment of the farm, allowing for it location and fixed equipment
Price - based on current market price (considering future prices)
Subsidy is based on regional average for 2019 and exchanged at £0.85228
Variable costs are from John Nix Farm Management Pocketbook 2017
Standard Labour Requirements from SAC Handbook
Cost per labour unit based on £7.20 per hour for 1,900 hrs plus NI Contribution, Employers liability insurance and pension contribution

Farm E

Farming System	Beef Lowland Suckler Herd				
Crop	**Yield**	**Price**	**Ha**	**Total**	
					£ -
Livestock	**Performance**	**Price**	**No.s**	**Total**	
Spring calving Cows	0.92	438	60	26,280	
					£26,280
	Region	**Rate**	**Ha**	**Total**	
Subsidy	1	208	57	11,768	
	2	26	0	0	
	3	11	0	0	
Beef Calf Scheme		71	54	3,834	
					£15,602
Variable Costs				**TOTAL OUTPUT**	**£41,882**
Crop		**Cost**	**Ha**	**Total**	
Livestock		**Cost**	**No.s**	**Total**	
			0	0	
Spring calving Cows		216	60	12,960	
					£12,960
Fixed Costs	**Farm SLR**	**Adjusted**	**£/man**		
Labour	1.16	0.16	15868.8	2,539	
Housing					
		£/ha	**Ha**	**Total**	
Total Machinery		79	57	4,471	
Depreciation				7,100	
Total Property		18	57	1,019	
Total Other		49	57	2,773	
					£17,901
				TOTAL COSTS	**£30,861**
				DIVISIBLE SURPLUS	**£11,021**
				50:50 Split	**£ 5,511**
				£/ac	**£ 39**

Minimum Machinery Reqirements		**Depn Rate**	**Depn**
Tractors	£30,000	10%	£3,000
Float	£2,000	10%	£200
Handling Crates/Race	£5,000	10%	£500
Mixer wagon	£8,000	10%	£800
Trailers	£6,000	10%	£600
Telehandler	£20,000	10%	£2,000
	£71,000		**£7,100**

Standard Labour Requirement			
	hrs/yr	**No.**	**Total**
Grassland	3.1	56.59	175.429
Silage (1st plus 50% sec)	17	20	340
Beef Cows	26	60	1,560
Other cattle	12	10	120
		Total	**£2,195.43**
Standard annual labour unit	1,900		1.16
Adjustment for excessive labour requirement			0

Notes

Farming system based on Scottish Government Farm Business Survey classification - Sample year 2016
Yield is based on our assessment of the farm, allowing for its location and fixed equipment
Price - based on current market price (considering future prices) - minus replacement costs
Subsidy is based on regional average for 2019 and exchanged at £0.85228
Variable costs are from John Nix Farm Management Pocketbook 2017
Standard Labour Requirements from SAC Handbook
Cost per labour unit based on £7.20 per hour for 1,900 hrs plus NI Contribution, Employers liability insurance and pension contribution

Farm F

Farming System	General Cropping & Specialist Beef				
Crop	Yield	Price	Ha	Total	
WW	8.5	132	56	62,394	
WW Straw	4	45	56	10,080	
SB	5.45	130	112	79,274	
SB Straw	4	60	112	26,854	
WB	7	120	47	39,866	
WB Straw	4	50	47	9,400	
Pots		617	15	9,255	
					£ 237,123.5
	Performance	Price	No.s	Total	
Livestock		419	350	146,650	£ 146,650.0
	Region	Rate	Ha	Total	
Subsidy	1	208	435	90,426	£ 90,425.6
	2	26	1.02	27	£ 26.5
				TOTAL OUTPUT	£ 474,225.7
Variable Costs					
Crop		Cost	Ha	Total	
WW		442	56	24,580	
SB		273	112	30,546	
WB		351	47	16,658	
Pots			15	0	
					£ 71,784.1
		Price	No.s	Total	
Livestock1		110	350	38,500	£ 38,500.0
Fixed Costs	Farm SLR	Adjusted	£/man		
Labour	4.76	2	15868.8	31,738	
Housing					
		£/ha	Ha	Total	
Total Machinery		281	435	122,187	
Depreciation				32,400	
Total Property		36	435	15,654	
Total Other		127	435	55,223	
					£ 257,202.1
				TOTAL COSTS	£ 367,486.2
				DIVISIBLE SURPLUS	£ 106,739.5
				50:50 Split	£ 53,369.7
				£/ac	£ 49.7

Minimum Machinery Reqirements			Depn Rate	Depn
Tractors	x3	£135,000	10%	£13,500
Plough		£18,000	10%	£1,800
One pass / Seeder		£20,000	10%	£2,000
Roller		£8,000	10%	£800
Trailers	x3	£18,000	10%	£1,800
Baler		£10,000	10%	£1,000
Telehandler		£30,000	10%	£3,000
Combine		£75,000	10%	£7,500
Muck Slurry equipment		£10,000	10%	£1,000
		£324,000		**£32,400**

Standard Labour Requirement			
	hrs/yr	No.	Total
Cereals	18	235	4,230
Grassland	3.1	200	620
Other cattle	12	350	4,200
		Total	£ 9,050.0
Standard annual labour unit	1,900		4.76
Adjusted labour units to reflect current farm practice (excludes tenant labour)			2

Notes

Farming system based on Scottish Government Farm Business Survey classification - Sample year 2016
Yield is based on our assessment of the farm, allowing for it location and fixed equipment
Price - based on current market price (considering future prices)
Straw output based on £/ha sold in the bout
Potato output is based on rental of £ 740/ha less £ 123/ha management and plough charge
Total area equals crop areas plus 5%
Subsidy is based on regional average for 2019 and exchanged at £0.85228
Variable costs are from John Nix Farm Management Pocketbook 2017
Standard Labour Requirements from SAC Handbook. Adjusted figure reflects what was happening on the farm
Cost per labour unit based on £7.20 per hour for 1,900 hrs plus NI Contribution, Employers liability insurance and pension contribution

Farm G

Farming System	**LFA Cattle & Sheep**				
Crop	**Yield**	**Price**	**Ha**	**Total**	
					£ -
Livestock	**Performance**	**Price**	**No.s**	**Total**	
Spring calving cows	0.92	406	25	10,150	
Commercial Sheep	1.5	79	100	7,900	
					£18,050
	Region	**Rate**	**Ha**	**Total**	
Subsidy	1	208	40	8,281	
	2	26	15	405	
Beef Calf Scheme		71	23	1,633	
LFASS		52	59.7	3,114	
					£13,433
				TOTAL OUTPUT	**£31,483**
Variable Costs					
Crop		**Cost**	**Ha**	**Total**	
Livestock		**Cost**	**No.s**	**Total**	
Spring calving cows		213	25	5,325	
Commercial Sheep		46	100	4,600	
					£ 9,925
Fixed Costs	**Farm SLR**	**Adjusted**	**£/man**		
Labour	0.68	0	15868.8	0	
Housing					
		£/ha	**Ha**	**Total**	
Total Machinery		79	40	3,146	
Depreciation				6,400	
Total Property		18	40	717	
Total Other		49	40	1,951	
					£12,214
				TOTAL COSTS	**£22,139**
				DIVISIBLE SURPLUS	**£ 9,344**
				50:50 Split	**£ 4,672**
				£/ac	**£ 47**

Minimum Machinery Requirements		**Depn Rate**	**Depn**
Tractor & Loader	£45,000	10%	£4,500
Trailer	£4,000	10%	£400
Quad & Trailer	£6,000	10%	£600
Float	£4,000	10%	£400
Handling Crates/Race	£5,000	10%	£500
	£64,000		**£6,400**

Standard Labour Requirement	**hrs/yr**	**No.**	**Total**
Grassland	3.1	40	124
Rough grazing	1.5	15	22.5
Beef Cows	26	25	650
Other cattle	12	5	60
Sheep upland	3.7	100	370
Other sheep (upland)	3.1	20	62
		Total	**£1,289**
Standard annual labour unit	1,900		0.68

Notes

Farming system based on Scottish Government Farm Business Survey classification - Sample year 2016
Yield is based on our assessment of the farm, allowing for it location and fixed equipment
Price - based on current market price (considering future prices)
Total area equals crop areas plus 5%
Subsidy is based on regional average for 2019 and exchanged at £0.85228
Variable costs are from John Nix Farm Management Pocketbook 2017
Standard Labour Requirements from SAC Handbook
Cost per labour unit based on £7.20 per hour for 1,900 hrs plus NI Contribution, Employers liability insurance and pension contribution
Fixed costs per Region 1 land

Farm H

Farming System	Lowground Sheep				
Crop	Yield	Price	Ha	Total	
					£ -
Livestock	Performance	Price	No.s	Total	
Commercial Sheep	1.7	93	100	9,300	
					£ 9,300
	Region	Rate	Ha	Total	
Subsidy	1	208	24	4,949	
	2	26	0	0	
Beef Calf Scheme		71	0	0	
LFASS		52	0	0	
					£ 4,949
				TOTAL OUTPUT	£14,249
Variable Costs					
Crop		Cost	Ha	Total	
Livestock		Cost	No.s	Total	
0		213	0	0	
Commercial Sheep		46	100	4,600	
					£ 4,600
Fixed Costs	Farm SLR	Adjusted	£/man		
Labour	0.34	0	15868.8	0	
Housing					
		£/ha	Ha	Total	
Total Machinery				1,000	
Depreciation				1,050	
Total Property		48	24	1,142	
Total Other		120	24	2,856	
					£ 6,048
				TOTAL COSTS	£10,648
				DIVISIBLE SURPLUS	£ 3,601
				50:50 Split	£ 1,800
				£/ac	£ 31

Minimum Machinery Requirements		Depn Rate	Depn
Quad & Trailer	£6,000	10%	£600
Float	£2,000	10%	£200
Handling Crates/Race	£2,500	10%	£250
	£10,500		**£1,050**

Standard Labour Requirement			
	hrs/yr	No.	Total
Grassland	3.1	24	74.4
Sheep lowland	5.2	100	520
Other sheep (low)	2.9	20	58
		Total	£ 652.40
Standard annual labour unit	1,900		0.34

Notes

Farming system based on Scottish Government Farm Business Survey classification - Sample year 2016
Yield is based on our assessment of the farm, allowing for it location and fixed equipment
Price - based on current market price (considering future prices)
Total area equals crop areas plus 5%
Subsidy is based on regional average for 2019 and exchanged at £0.85228
Variable costs are from John Nix Farm Management Pocketbook 2017
Standard Labour Requirements from SAC Handbook
Cost per labour unit based on £7.20 per hour for 1,900 hrs plus NI Contribution, Employers liability insurance and pension contribution
Fixed cost assessed as per unit

Farm I

Farming System	Dairy					
Crop	Yield	Price	Ha	Total		
					£	-
Livestock	Performance	Price	No.s	Total		
Dairy	8500l	2,100	100	210,000		
	26ppl				£	210,000
	Region	Rate	Ha	Total		
Subsidy	1	208	125	25,907		
	2	26	0	0		
	3	11	0	0		
Beef Calf Scheme		71	0	0		
LFASS		62	0	0		
SUSSS		66	0	0		
					£	25,907
				TOTAL OUTPUT	£	235,907
Variable Costs						
Crop		Cost	Ha	Total		
Livestock		Cost	No.s	Total		
			0	0		
Dairy		928	100	92,800		
					£	92,800
Fixed Costs	Farm SLR	Adjusted	£/man			
Labour	2.11	1.11	15868.8	17,614		
Housing						
		£/ha	Ha	Total		
Total Machinery		371	125	46,219		
Depreciation				19,300		
Total Property		0	125	0		
Total Other		130	125	16,195		
					£	99,329
				TOTAL COSTS	£	192,129
				DIVISIBLE SURPLUS	£	43,778
				50:50 Split	£	21,889
				£/ac	£	71

Minimum Machinery Requirements		Depn Rate	Depn
Tractors	£120,000	10%	£12,000
Slurry Equipment	£15,000	10%	£1,500
Float	£2,000	10%	£200
Handling Crates/Race	£5,000	10%	£500
Mixer wagon	£15,000	10%	£1,500
Trailers	£6,000	10%	£600
Telehandler	£30,000	10%	£3,000
	£193,000		**£19,300**

Standard Labour Requirement				
	hrs/yr	No.		Total
Grassland	3.1	124.58		386.198
Dairy Cows (100cows)	35	100		3,500
Other cattle	12	10		120
		Total	£	4,006
Standard annual labour unit	1,900			2.11

Notes

Farming system based on Scottish Government Farm Business Survey classification - Sample year 2016
Yield is based on our assessment of the farm, allowing for it location and fixed equipment
Price - based on current market price (considering future prices)
Total area equals crop areas plus 5%
Subsidy is based on regional average for 2019 and exchanged at £0.85228
Variable costs are from John Nix Farm Management Pocketbook 2017
Standard Labour Requirements from SAC Handbook. Adjusted figure reflects what was happening on the farm
Cost per labour unit based on £7.20 per hour for 1,900 hrs plus NI Contribution, Employers liability insurance and pension contribution
Silage done by Contractors

Farm J

Farming System	Specialist Sheep LFA Extensive Hill					
Crop	Yield	Price	Ha	Total		
					£	-
Livestock	Performance	Price	No.s	Total		
Extensive Hill	0.9	25	1,300	32,500		
					£	32,500
	Region	Rate	Ha	Total		
Subsidy	1	208	17	3,442		
	2	26	0	0		
	3	11	1,275	14,026		
Beef Calf Scheme		71	0	0		
LFASS		62	217	13,476		
SUSSS		66	325	21,450		
					£	52,393
				TOTAL OUTPUT	£	84,893
Variable Costs						
Crop		Cost	Ha	Total		
Livestock		Cost	No.s	Total		
		213	0	0		
Extensive Hill		19	1,300	24,700		
					£	24,700
Fixed Costs	Farm SLR	Adjusted	£/man			
Labour	4.06	1.00	15,868.8	15,869		
Housing						
				Total		
Total Machinery				4,000		
Depreciation				4,050		
Total Property				3,000		
Total Other				11,000		
					£	37,919
				TOTAL COSTS	£	62,619
				DIVISIBLE SURPLUS	£	22,275
				50:50 Split	£	11,137
				£/ac	£	3

Minimum Machinery Requirements		Depn Rate	Depn
Tractor & loader	£30,000	10%	£3,000
Quad & Trailer	£6,000	10%	£600
Float	£2,000	10%	£200
Handling Crates/Race	£2,500	10%	£250
	£40,500		**£4,050**

Standard Labour Requirement			
	hrs/yr	No.	Total
Grassland	3.1	17	52.7
Rough grazing	1.5	1275	1912.5
Sheep upland	3.7	1300	4,810
Other sheep (upland)	3.1	300	930
		Total £	7,705
Standard annual labour unit	1,900		4.06
Adjusted Labour (ex tenant's labour)			1.00

Notes
Farming system based on Scottish Government Farm Business Survey classification - Sample year 2016
Yield is based on our assessment of the farm, allowing for it location and fixed equipment
Price - based on current market price (considering future prices)
Total area equals crop areas plus 5%
Subsidy is based on regional average for 2019 and exchanged at £0.85228
Variable costs are from John Nix Farm Management Pocketbook 2017
Standard Labour Requirements from SAC Handbook. Adjusted figure reflects what was happening on the farm
Cost per labour unit based on £7.20 per hour for 1,900 hrs plus NI Contribution, Employers liability insurance and pension contribution
Fixed costs per in bye ground - adjusted for unit found

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