

Review of Agricultural Holdings Legislation 2014

A first stage contribution from Scottish Land & Estates

20 March 2014



Executive Summary

Scottish Land & Estates welcomes this review because collectively all those with an interest in agricultural holdings legislation need to find a way of drawing a line in the sand to rejuvenate the let sector and this review could provide a means of doing just that.

A vision for Scottish agriculture

The current situation is less than ideal. We lack a shared vision for the tenanted sector's place within Scottish agriculture. Our post war legislation created a tenancy vehicle which has been significantly altered retrospectively and is in many cases no longer fit for purpose, often creating stagnation and obstructing progress in the agricultural sector. All those involved in tenant farming need to come together around a shared vision for agriculture and the role of tenancies in delivering that vision. Scottish Land & Estates believes we have to re-focus on a flexible and economically viable industry.

Aspirations for the tenant farming sector

The Review Group has successfully identified eight characteristics of a dynamic and successful tenant farming sector. The one which underpins the rest is the underlying culture within the sector. We would suggest a ninth characteristic relating to stability. We support the Review Group's emphasis on flexibility and seeking to ensure that the tenancy regime is fit for purpose for the 21st century.

Absolute Right to Buy decisively rejected

Along with the vast majority of the sector, Scottish Land & Estates rejects in the strongest possible terms the introduction of an Absolute Right to Buy (ARtB) for tenants of 1991 Act tenancies. ARtB would be a blunt, disproportionate and inequitable tool which would be catastrophic for the let sector. The possibility should be decisively ruled out.

Tackling problem areas in 1991 Act tenancies

- The process of how **rent reviews** are conducted should be improved with increased **transparency** through training and awareness-raising;
- Tenants should be confident the legislation ensures **fair compensation at waygo** so a line should be drawn in the sand to deal with historic worries by establishing an '**amnesty**' on existing tenants' improvements, before returning to an updated regime for dealing with future improvements.
- The concerns about **bad practice** in the sector should be dealt with by establishing an independent ombudsman type body underpinned by a robust voluntary code of practice. This function should be performed by the proposed **Office of Scottish Tenant Farming**, which should be given powers to investigate, refer and make recommendations with reports published.

Looking Forward

- **Confidence is everything.** At present confidence in the let sector has been severely undermined which results in landowners perceiving letting as a high risk activity. The unfortunate consequence is that the sector enters a cycle of decline as the lack of landowner confidence restricts letting, which in turn prompts calls for reform which further undermine confidence and so on. Efforts have to be made to rebuild landowner confidence if the let sector is to work successfully.
- 2003 Act tenancies do provide fairly **flexible letting vehicles**, but there is a need for awareness-raising of the flexibility available and scope to introduce further flexibility.
- The sector as a whole should work together to enhance support for **new entrants**, establishing a new entrants' hub, a mentoring scheme and developing share farming opportunities.
- Landowners make business decisions and changes to the **fiscal environment** that make letting more attractive should be considered.

Change

The tenanted sector needs to change in order for it to be fit for purpose for the 21st Century. All parties need to embrace change and Scottish Land & Estates members are willing to play their part in bringing about a better future that is in the interests of all.

Agricultural Holdings legislation should:

Enable FLEXIBILITY

Be FAIR

Be UNAMBIGUOUS

Provide SAFETY NET LEGISLATION

Be STABLE

Introduction

Scottish Land & Estates welcomes the opportunity to contribute views and evidence to the Review of Agricultural Holdings Legislation. Our members run diverse businesses and are involved in letting agricultural holdings to others and renting land in to farm themselves. Agricultural holdings legislation is therefore central to many of our members' businesses and so this review is a high priority for this organisation.

We envisage this being the first of a number of different types of submission this organisation will make over the course of the review and we would ask that this submission is treated as an initial contribution. We would wish to reserve the ability to make further submissions and provide supplementary information as and when it is appropriate. In this submission we have attempted to answer the three questions set out by the group in the invitation letter dated 11 February 2014 and we have sought to move on to look at possible options for the Scottish Government.

Scottish Land & Estates welcomes the review

Scottish Land & Estates welcomes this review because the current debate around farm tenancies is failing Scottish agriculture. Collectively, all those with an interest in tenant farming need to find a way of drawing a line in the sand and rejuvenating the tenanted sector in Scottish agriculture and we hope that the review process will provide the platform for moving forward.

Scottish Land & Estates is also heartened by the approach taken to the review so far. The Review Group's approach—of seeking to set out a vision for the sector before looking at the degree to which current legislation and relations within the sector can deliver that vision—is eminently rational. It is an approach we support because it ensures that decisions are made on the grounds of careful consideration rather than preconceived ideas. If anything, Scottish Land & Estates would go a little further to take the opportunity to have a constructive and positive dialogue about the future of Scottish agriculture as a whole. We need a vision of where we want to go before we can think clearly about the tenanted sector's role in delivering that vision. With that in mind, we have sought to articulate a vision which can then inform thinking about agricultural holdings legislation.

Scottish Land & Estates' vision

A strategic vision for agriculture as a whole is a prerequisite for a considered debate about the tenanted sector and while Scottish Land & Estates acknowledges that a vision for agriculture must be developed within the industry as a whole, we have sought to articulate our perspective in order to structure our thinking.

Scottish Land & Estates wants to see a prosperous and flexible farming industry that contributes to Scotland's economic growth and helps tackle the major challenges of food and environmental security. Agriculture should be economically viable and market-oriented whilst also delivering a wide range of public goods such as environmental protection and management.

A prosperous farming industry: re-focusing on economically viable farming

The diversity of Scottish agriculture and the difficulties experienced by many as a result of poor land quality, has underpinned the recent emphasis on defending the amount of agricultural support payments. These payments are often critically important for many businesses because without them many farming businesses are uneconomic. The understandable focus on support payments has tended, however, to push harsh economic realities to the background.

We believe that the emphasis has to be on getting better returns from the market, not from subsidy. In the long-term, subsidy support levels are likely to decline. Our agricultural policy must be focused on competitive businesses delivering quality products for the market. As such, the agricultural industry must be:

- **Market-oriented:** farming businesses should be making decisions on the basis of the market and not simply in response to policy signals. The amount of public support is also likely to decline over time; ensuring that businesses are less dependent on public support will be vital.
- **Flexible:** in recent times we have begun to experience greater market volatility and variability in the weather and at the same time consumer preferences continue to evolve rapidly. Farming businesses will have to be ready to adapt and change to new circumstances.
- **Innovative:** the agricultural industry must adopt new technologies, processes and relationships if it is to change and adapt. New ideas, fresh thinking: these are the hallmarks of a dynamic and forward-looking industry.
- **Well informed by latest intelligence:** a dynamic, responsive, market-oriented industry needs to have the latest information on demand and consumer choices readily available.
- **Supported by world-class research and knowledge exchange:** the ability of the industry to increase productivity whilst also enhancing the environment will depend on new ideas and technologies being brought to the market place and communicated to farmers.

Scottish farmers must be:

- **Entrepreneurial:** farmers must be focused on running efficient businesses and seeking out new opportunities.
- **Skilled to produce quality produce:** Scottish farmers already produce high quality produce, but we need to make sure that this continues in the future and that the next generation of farmers gets the education and training that will provide them with the skills to succeed in a dynamic and flexible agricultural industry.
- **Skilled to manage and enhance the environment:** many environmental public goods are delivered through current farming practice, but if we want to specifically deliver enhanced levels of public goods in terms of wildlife, water quality, air quality and landscape, specialist knowledge and expertise will be required.
- **Connected to achieve power in the supply chain:** vulnerability to the market power exerted by large businesses can squeeze farmers' own operations and therefore limit their ability to be innovative and take risks. Connectivity needs to be with the wider world (i.e. IT) and with each other (i.e. co-operation and joint working).

A farming industry with environmental stewardship at its heart

Scotland's environment is one of the nation's core assets. Scotland's global image is one that depends upon the natural heritage and since farmers are responsible for the management and conservation and much of our landscape and biodiversity, they perform a vital role that is valuable to society as a whole. Scotland's environment is not generally in a poor state, but the whole picture is complex because there are diverse issues across Scotland. In some highly productive areas diffuse pollution and soil health are problems, but in other more remote areas there are concerns about destocking and the consequences for biodiversity and there are concerns about habitat fragmentation. The appropriate response to these changes will vary depending on the issue. In some areas the most important thing will be to ensure a continuation of active farming activity. In others, changes in farming practice will be required to reduce negative impacts from certain activities. One thing is certain, farmers and land managers are key to enhancing Scotland's environment.

Supporting economically marginal but environmentally rich farming systems

We have put great emphasis on economically viable farming and profitability, but it is important to acknowledge that there are types of farming (usually extensive hill farming) that are economically marginal and find it difficult to survive in a free market. These systems are reliant on ongoing financial support and if these farming businesses collapsed there would be unacceptable social, landscape and biodiversity change. Supporting these businesses is potentially difficult, however, because public goods payments based on agricultural income foregone will not guarantee the survival of these businesses where agricultural market income is marginal. Thus at the same time as encouraging most farmers to focus on the market and profitability the CAP must give much more focus to targeting support at these economically marginal but environmentally rich farming systems. Rural development support should also be targeted at supporting environmentally rich farming systems. Public investment should support farmers in adding value to their traditional production through labelling, promotion, marketing and local processing, and in finding new sources of revenue linked to their land stewardship mainly through tourism and recreation etc. Government and the industry may also need to address whether agriculture remains the most beneficial land use in socio-economic-environmental terms in all areas.

Delivering the vision: farm tenancies working for Scottish agriculture

Flexibility and adaptability are central to Scottish agriculture's ability to meet the challenges of the future and there are many areas where this flexibility needs to be built in. As markets change farm businesses will have to adapt; they may need access to more land or they may need the flexibility to enter into new business ventures. There is also potentially a growing emphasis on non-food products and on activity outwith agriculture. To enable land managers to adapt to emerging markets and to capitalise on new opportunities it will be important that they are free to enter into business relationships that are appropriate to their needs.

In this context, at a high level, the let farming sector provides the industry as a whole with an element of flexibility. The ability to access land without owning it, and therefore having to find the capital to buy it, is a valuable characteristic of Scottish agriculture. Those countries that are even more dominated by owner-occupation than Scotland, such as Ireland, face real difficulties with regard to the structure of their farming industry: small farms often struggle financially because of their scale but are unable to expand because of the lack of available land and the

cost of it. Farm tenancies are, then, extremely important. They provide tenure flexibility for existing businesses and new entrants to the sector.

Yet at the same time as they provide the industry as a whole with a degree of flexibility, at the level of the individual they are potentially not flexible enough. The legislative regime is complex and establishes a prescriptive framework that governs landlord-tenant relationships and it is arguably the case that the more prescriptive the framework (as the current regime has become over time), the less responsive, relevant and adaptable it is.

Today's farm tenancy regime does not, therefore, help us deliver the vision of a flexible and vibrant farming sector. Partly because of the legislative regime (which has extended tenant rights in 1991 Act secure tenancies in particular and so established an inflexible system) and partly because of the surrounding political and cultural context (which has created instability and undermined confidence), the let sector is today far from the ideal that those with an interest in the sector would like to see.

It is important therefore to re-articulate the principles that must underpin the statutory regime surrounding farm tenancies:

Any statutory regime for agricultural holdings must:

- Enable FLEXIBILITY: it must provide a framework that allows the parties to adapt their businesses to changing circumstances
- Be FAIR: it must balance the rights and responsibilities of landowners and tenants
- Be UNAMBIGUOUS: it must be as simple as possible so that all parties can understand the framework
- PROVIDE SAFETY NET LEGISLATION rather than detailed prescription of landowner/tenant relationships
- Be STABLE: stability underpins confidence; instability and regular changes in the law undermine confidence

A focus on flexibility requires openness to change and outcome

If it is accepted that Scottish agriculture needs systems that have the capacity to change and to allow the creation of farm structures that allow farmers to thrive in the 21st Century, then this means that when designing a farm tenancy regime that will deliver for the future it is important not to set out to preserve the current structure in aspic and not to pre-determine the outcome.

It is tempting, when thinking about agricultural policy, to view the current industry structure as something that needs to be defended as if that current structure is the best it could possibly be. It is true that the current structure has evolved over time for good reasons, but any strategic vision that emphasises flexibility and puts a primary focus on allowing the market to operate must also be one that accepts change. At present, the predominant letting vehicle (the secure 1991 Act tenancy) is itself a blockage in the system that limits change.

There is also a possible tendency to set out to defend the number of tenancies or the area of let land. But there is arguably little merit in protecting the existing number of tenancies if some of those units are too small to be viable in today's agricultural industry. The emphasis on economically viable farming suggests that agricultural policy should not be freighted with preconceptions that one farming structure is best; rather, we should allow the market to work and determine the most appropriate structures for the 21st Century. We should provide farmers and the industry with the tools to adapt and let them do so in ways that work for them, recognising, of course, the need to balance this process with social and environmental objectives.

This means that when thinking about farm tenancies:

- The focus must be on freeing the sector up to find its own level rather than pre-determining the acceptable number of tenancies or area let.
- We must accept change and avoid defending against change to the status quo.
- We must be careful about what we think counts as success; success must be a system that works for both parties and is used to help deliver a successful Scottish agriculture, not a set amount of let land or a certain number of tenancies.
- We must provide the tools, not determine the outcome.

Review Group Questions

In its invitation, the Review Group seeks feedback on three specific questions, and we will attempt to address these in turn below.

Question 1 – Do the eight criteria [set out by the Review Group] accurately summarise the main characteristics of a tenant farming sector that would be fit for purpose in 21st century Scotland?

Scottish Land & Estates agrees with the eight characteristics set out for a dynamic and successful tenant farming sector. We feel that they chime with our own vision and do reflect the aspirations of all those with a serious interest in a healthy tenanted sector.

We would, however, like to suggest an alteration and an addition. Firstly, by way of alteration, we would suggest that the final characteristic (the underlying culture will be forward looking and based on shared endeavour, mutual respect and partnership between owners and tenants) is one which underpins all the others and that purely from a presentational perspective this should be the first characteristic listed.

At present, while we contend that the majority of landlords and tenants maintain professional and business-like relationships, if we had to characterise the sector from the landlords' perspective two words would feature heavily: fear and suspicion. Agricultural landlords fear the introduction of legislation which further erodes their rights and interests and they remain suspicious of the political motivations of many involved in the debate. There also appears to be little respect for the legitimacy of a landowner's interest and all this ultimately undermines landowners' (and landowner advisors') confidence with the result that landlords retreat from letting completely or increasingly turn to short-term letting (which enables them to reduce their exposure to the risk of future legislation), thus undermining the sector as a whole.

Tenants on the other hand are heavily protected and security is entrenched with concession not featuring in any dialogue or negotiation about tenancy issues from the tenants' perspective. Landlords perceive the pendulum has swung too far to the prejudice of the whole sector. It must be acknowledged that some tenants (albeit a vocal minority) have no incentive to maintain or develop positive relations or to pursue partnerships and shared endeavour. To act in such a way as to bring about a total breakdown of the landlord tenant relationship will serve their ends better, for example to try to justify an absolute right to buy.

The underlying culture is therefore absolutely key to the future of the let sector. It is vitally important that we collectively find a way of establishing and embedding a new culture that is forward looking and based on mutual understanding, shared endeavour, fairness, mutual respect and partnership and therefore consigns any sense of a feudal relationship to the dustbin: landlords and tenants are running businesses and are engaged in a business relationship and should engage on that basis.

We would also like to suggest an additional characteristic of a tenant farming sector that would be fit for purpose in 21st century Scotland: stability.

- *There will be stability in the political, fiscal and legal environments surrounding farm tenancies and everyone involved has confidence to plan and make long-term decisions.*

Stability is important because it underpins confidence and without confidence the let sector will not work properly. At present, the let sector suffers from instability. Ongoing calls for reform prompt political intervention or the threat of political intervention, which in turn raises fear about future legislation that will conflict with the interests of landowners, thus undermining confidence to invest or let. Anyone facing the prospect of losing their asset (because of retrospective legislative change) will naturally seek to limit their liability. This is particularly unfortunate because it becomes a self-fulfilling prophecy. The more that confidence is undermined the more the landlord retrenches, the more the reform lobby cries out for reform and so on in a downward spiral. Stability is therefore extremely important if the let sector is to work because landlords (and tenants) need to have confidence that arrangements they enter into will be honoured and that their investment is safe.

Consequently, with our amendments, the nine characteristics would read as follows:

- The underlying culture will be forward looking and based on shared endeavour, mutual respect and partnership between owners and tenants.
- A range of flexible tenancy options will be available to suit diverse business needs and evolving economic circumstances.
- People, and especially new entrants to the industry, will be able to move into, through and out of the tenanted sector as their business develops.
- Business investment in the tenanted sector will be subject to equivalent flexibilities and constraints to those that characterise the owner occupied sector.
- Barriers to entry (including those arising from the CAP) will be low so that people, including new entrants, able to farm successfully and can establish and develop a business regardless of their background circumstances.
- Rent levels will reflect commercial returns from a well-managed farming business using the tenanted land and associated assets in a manner that accords with the Land Use Strategy.
- The supply of tenanted land will be broadly compatible with demand at these rent levels.
- Risk will be shared between tenant and owner in a manner that encourages innovation and provides inbuilt resilience to unpredictable changes (in markets, fiscal support, etc.).
- There will be stability in the political, fiscal and legal environments surrounding farm tenancies and everyone involved has confidence to plan and make long-term decisions.

Question 2: In so far as the current situation falls short of these aspirations, what are the most important gaps and weaknesses that need to be addressed?

We have sought to answer this question with reference to each of the aspirational characteristics.

1. A range of flexible tenancy options will be available to suit diverse business needs and evolving economic circumstances.

The vast majority of Scottish Land & Estates members would favour much greater freedom of contract whereby two parties could enter into a contractual arrangement that suited their respective needs in the context of prevailing market conditions. However, lack of trust within the sector has resulted in any proposals for greater freedom of contract in tenancies being rejected. While believing that this rejection is unfortunate, Scottish Land & Estates understands the concerns that underpin it (i.e. that freedom of contract would undermine tenant rights because landlords would be in the more powerful position by virtue of the finite amount of land and the high demand from prospective tenants) and therefore accepts that the pragmatic way forward will involve a range of flexible tenancy options with some in-built safeguards.

The question therefore is whether or not the tenancy options available today are fit for purpose for the 21st century. Currently we have a range of tenancy options but the respective flexibility of these options is varied. There are (excluding crofts and small holdings) 1991 Act tenancies, 1991 Act Ltd Partnership tenancies, Limited Duration Tenancies (LDTs), Short Limited Duration Tenancies (SLDTs) and seasonal grazing lets.

From the landowners perspective it is clear that 1991 Act tenancies are not fit for purpose for the 21st century and that the number of these tenancies is going to decline over time because they are not an attractive option for landowners. 1991 Act tenancies are unattractive because the landlord has no control over the term of the lease and because the balance between the interests of the tenant and landlord is tipped too far in the tenant's favour. In the judgement on the Moonzie case in 2012 Lord Gill highlighted how the position of the tenant in an existing 1991 Act tenancy has been strengthened over time leading him to conclude that 'it is unlikely that, in the absence of compelling reasons such as tax considerations, any landlord properly advised would now enter into a 1991 Act tenancy'.

This means that the tenancy options currently available for new lettings are LDTs, SLDTs and grazings lets and the question is the degree to which these vehicles are sufficiently flexible to meet the government's aspirations, and, if not, whether they need to be altered or a new vehicle needs to be developed.

Scottish Land & Estates has explored the issue of flexible letting options at length and our considered response is that LDTs and SLDTs could provide sufficient flexibility but that awareness of the flexibility available is limited.

To be clear, Scottish Land & Estates reached this position after a great deal of deliberation. The organisation has previously mooted the possibility of a new flexible business tenancy (a Scottish Rural Business Tenancy) which would differ from the existing letting vehicles in the flexibility it would offer to both landlord and tenant, allowing them to agree terms and conditions suited to

their individual interests and objectives. Ideally it would allow a single letting arrangement to be put in place for a business which involves both agricultural and non-agricultural elements, for example both arable cropping and an equestrian centre or riding school with tack shop. Such a letting vehicle would facilitate the development of diverse rural businesses, thereby helping to underpin the sustainability of Scotland's rural communities. However, when previously raised (in 2009) with the Cabinet Secretary this idea was seen as not providing a solution or way forward.

In the context of our proposal for a rural business tenancy being rejected, Scottish Land & Estates has also sought to reflect upon the degree to which the existing vehicles can provide sufficient flexibility.

While adding a new more commercial tenancy to the range of options available would undoubtedly be a boost to the sector, Scottish Land & Estates has concluded that the 2003 Act tenancies do provide a good basis for going forward (and landlords were utilising them before the recent focus on ARtB effectively put a halt to letting). However, anecdotal evidence suggests that landlords and tenants are not utilising the full flexibility now allowed under these vehicles.

Scottish Land & Estates believes that the key weakness at present therefore relates to the degree to which the interested parties understand the level of flexibility that is available under LDTs. This problem is exacerbated where parties are reluctant to seek professional advice or are not engaged with a representative body which can provide information. LDTs potentially allow quite significant flexibility in terms of setting the term beyond 10 years, the provision of fixed equipment and the basis for calculation of rent review. There is therefore a strong case for some form of awareness-raising or knowledge sharing in the industry of the range of operations covered under LDTs and the types of situations that can be successfully catered for within an LDT.

There is also a possible alteration to legislation that might increase flexibility under LDTs relating to allowing contractual resumption.

2. People, and especially new entrants to the industry, will be able to move into, through and out of the tenanted sector as their business develops.

It is widely accepted that the tenancy sector is currently fairly static with limited exit from the sector through retirement from 1991 Act tenancies and limited opportunity for new entrants through new tenancies being offered. As land is a finite resource, the two are inextricably linked. 1991 Act tenancies are highly prized by tenants due to the security of tenure, reasonable rents and the level of statutory protection offered aligned with the perceived potential for a right to buy. This, combined with a CAP system which allows Single Farm Payment to be claimed by those not actively farming, has resulted in many tenants holding on to 1991 Act tenancies well after retirement age even where there is no obvious successor. While this may be entirely rational decision-making on the part of the tenant, unfortunately the landlord often has to watch as the holding gets less productive, whilst other more active tenants cry out for more land and new entrants seek opportunities.

In addition, on the rare occasions when 1991 Act tenancies do come to an end through the lack of a successor, current uncertainties over changes to legislation and lack of confidence means

that land is not always re-let with estates either opting to farm in-hand or use other contractual arrangements to avoid the risk of a tenancy. While the land is still being actively farmed and supporting the rural economy, it is no longer within the tenanted sector, and so not contributing to either our own or the Government's vision for a thriving let sector.

We acknowledge that one of the reasons put forward for the reluctance to give up a 1991 Act tenancy is the tenant's uncertainty about obtaining adequate compensation for tenant's improvements at the end of the tenancy. Scottish Land & Estates takes the view that the legislation sets out procedures for both parties relating to tenant's improvements and that many of the problems have come about because these provisions have not been adhered to or because of poor record keeping by one or both parties. If everyone understood and adhered to the existing rules there would not be such a concern around compensation. Nevertheless, Scottish Land & Estates acknowledges that there is an issue which this review could seek to address, so we suggest a potential solution later in this response.

So, is there a gap between the ideal and the present day? Yes.

- There is insufficient attention to pension/retirement planning.
- There is no confidence to let land.
- The CAP enables tenants (and owner occupiers) to remain in situ whilst becoming less and less productive.
- There is insufficient awareness and adherence to the legislative provisions relating to compensation for tenants' improvements
- As a result of all this, too few tenancies are coming to an end and of those that do, too few are being re-let.

3. Business investment in the tenanted sector will be subject to equivalent flexibilities and constraints to those that characterise the owner occupied sector.

In terms of the ability to secure finance for business investment, Scottish Land & Estates understands that tenants are currently subject to broadly equivalent flexibilities and constraints to those that characterise the owner occupied sector. Lenders tell us that what matters most is a clear and robust business plan regardless of whether the business operates on owned or rented property taking into account the wider assets of the business.

Having said this, the terms of a tenancy will obviously have implications for the ability to borrow and invest – a shorter tenancy will limit the options – so the tenanted and owner-occupied sectors will never be exactly the same, but what matters most is the business. Businesses in other sectors (retail, manufacturing, financial services etc.) are able to secure investment while operating from rented property, so there is no sound justification why tenure should be a limiting factor for farming businesses. The business plan and ability to service the debt are paramount.

The focus should therefore be on creating and nurturing profitable businesses. Part of the problem surrounding agricultural tenancies relates to the fact that security of tenure has effectively fixed many holdings at a size that limits their ability to maintain profitability as the industry changes. Consequently, rent and finances become much more contentious issues and

hit the headlines. Flexibility is needed in the system because this would allow business units to change, which in turn allows businesses to be structured in ways to maximise profitability thus justifying investment.

4. Barriers to entry (including those arising from the CAP) will be low so that people, including new entrants, able to farm successfully can establish and develop a business regardless of their background circumstances.

The TFF commissioned research in 2008/2009 into barriers to entry. This work resulted in two useful publications, (a) Barriers to New Entrants to Scottish Farming¹ and (b) Getting new talent into the industry: A guide to methods for a phased entry into farming². We would recommend these reports to the Review Group.

In 2008 the most widely identified barriers were the lack of tenancies, the value of land and competition from existing farmers. Second level barriers are the lack of working capital, the unattractive nature of the industry, the Single Farm Payment system and the lack of confidence or security. Unfortunately progress has been such that this continues to broadly represent the position.

Taking the most widely identified barriers, it is clear that the lack of tenancies is not being helped by the current and ongoing discussion of ARtB (although we would highlight that landowners were utilising the newer vehicles prior to June 2013³). But there are also wider issues, such as the fiscal attractiveness and flexibility of other options, which are making landlords turn away from letting. Land has increased in value and looks set to continue on that trajectory and there is still just as much competition for land from other farmers (if not more so now given the move to area payments) driven by recent profitability in the sector and expansionism to benefit from marginal economic benefits. Farming being a high fixed cost business therefore often benefits from big economic gains from expansion and the spreading of fixed costs. Clearly the barriers to entry remain high and we are a long way from the ideal.

It is important, however, to remain realistic. It will remain the case that farming is a capital intensive business with high barriers to entry. It may be that as an industry we have to be more open to alternative ways in, such as share farming.

5. Rent levels will reflect commercial returns from a well-managed farming business using the tenanted land and associated assets in a manner that accords with the Land Use Strategy.

The current system for setting rents should work in a way that ensures that rent levels reflect commercial returns and the overall attractiveness of the unit to the tenant. If a new unit is offered for let, prospective tenants bid on the basis of their expectations of the commercial returns of the unit and if, for example, a house is included and they desire to live in it as a home. In this way the prospective tenants use their knowledge of the markets, the land and their

¹http://www.tenantfarmingforum.org.uk/eblock/services/resources.ashx/000/244/597/58_final_report_from_cont_ractors.pdf

²http://www.tenantfarmingforum.org.uk/eblock/services/resources.ashx/000/261/856/49_GETTING_STARTED_IN_FARMING_final_final_guide_March_2009.pdf

³ See <http://www.scotland.gov.uk/Topics/Statistics/Browse/Agriculture-Fisheries/agtenancy>

business to make a judgement about what they believe is a reasonable rent. This avoids the necessity of introducing a much more direct connection between rent levels and commercial returns, which is sometimes proposed by advocates of change, which would involve highly protracted discussions about farm policy, productivity and potential commercial returns. Indeed, it is difficult to envisage how introducing into farm rent reviews a judgement about how efficiently a farm is being managed could possibly foster better relations between landlords and tenants.

With regard to rent review, the Court of Session in the Moonzie appeal has set out clearly the process to give effect to the requirements of s13 of the 1991 Act. This has now provided certainty and has, for the most part, allowed parties to proceed with rent reviews using a clear framework which has judicial authority. In the decision, Lord Gill explained why a budget approach might be only one of a number of factors to be considered by a party preparing a tender for a lease on the open market. It is clear that market forces will then influence the bid; in a strong economic market, tenants may consider future prospects good and thus bid or agree rents higher than justified purely by budget, economic prospects being one factor taken into account. Conversely, in a weak market the bid or agreed figure may be less than is justified purely by the budgeted figures.

The open market approach, where comparable rents are the principle evidence, smooths volatility in rents which is vital for both landlord and tenant in business planning. While it is acknowledged that there are some problems inherent in the analysis of comparable evidence, this is simpler and less prone to dispute than the budget approach, where both parties may be using different criteria and dates for setting the budget.

Where the current approach falls down is when a limited availability of land to rent distorts the market approach because the limited availability creates very high demand and potentially distorted rents (although the review process should allow for market evidence to be adjusted to reflect distortion). Scottish Land & Estates takes the view that the answer to this problem is not to seek a new way of setting rents; rather, it is to put in place measures that will boost confidence and so increase the availability of land to let thus enabling the open market approach to work properly.

Scottish Land & Estates would commend the work of the Rent Review Working Group. This group of independent professionals (approved by all TFF members) looked at the issue of rent reviews and made recommendations to enhance the current situation. It is disappointing that the issue of rent reviews rumbles on; this relates more to the fact that not everyone liked the outcome (without seeing any of the Group's recommendations implemented) than there being real problems that have not been addressed.

6. The supply of tenanted land will be broadly compatible with demand at these rent levels.

We are clearly a very long way from the ideal of a balance between supply and demand. Supply of land to let is restricted because landowners 1) do not have the confidence to let; 2) are potentially able to make better returns by farming in hand; 3) potentially see greater advantages in retaining control for CAP reasons; or 4) have fiscal reasons.

The primary gap or weakness relates to confidence. As long as landowners perceive letting as a risky undertaking supply will be restricted. Confidence is one of the main factors stopping tenure change even if it makes sense for other reasons such as economics or risk management. It is also important to acknowledge that there is a finite amount of land available; but whilst this is the case the tenure of land can still change – for instance farmed directly going into the let sector. Demand could outstrip supply on an ongoing basis if agriculture continues to perform well and remains supported.

7. Risk will be shared between tenant and owner in a manner that encourages innovation and provides inbuilt resilience to unpredictable changes (in markets, fiscal support etc).

There are different issues relating to risk. The first relates to the landowners' perception of the riskiness of letting and the second relates to how, assuming that letting is viewed more positively, we can get landowners and tenants to work better together to share risk.

On the first issue we would highlight that landowners let land on long-term tenancies rather than farming in hand because it is a low risk, low yield strategy i.e. because it is a fairly safe investment it does not yield a high financial return (compared to riskier ventures that may yield a higher return). Unfortunately, the debate surrounding farm tenancies has caused landowners to perceive a political risk to letting land. The media attention together with an apparent political willingness to intervene has created a great deal of uncertainty. This uncertainty turns a low risk, low yield business relationship into a high risk, low yield venture that no business would reasonably contemplate.

This said, at present, the degree to which landlords and tenants under existing tenancies are willing to share risk varies widely and will be dependent on the individuals concerned. The majority of landlords and tenants will be getting on regardless of the political context with both parties investing in the business for the future. However, the political context, and the spectre of the absolute right to buy (ARtB), severely undermines the prospects of wider risk sharing because any landlords investing in holdings under secure tenancies today could be investing in a property that may be bought from them at a discount to the vacant possession value in the near future.

To move towards a situation where there is enhanced risk sharing there is something of a culture change and there would need to be a period of stability to underpin confidence for investment by both parties. This period of stability would have to be for a considerable length of time because things change slowly in the agricultural holdings arena simply by virtue of the fact that secure tenancies come to an end infrequently and planning for investment takes time.

8. The underlying culture will be forward looking and based on shared endeavour, mutual respect and partnership between owners and tenants.

Scottish Land & Estates believes, and has repeatedly stated, that in the vast majority of cases tenants and landlords get on professionally and amicably. As in any walk of life there will be a spectrum of relationships from those where landlords and tenants are extremely happy with their arrangements to those where the relationship has broken down completely. Our members indicate to us that the vast majority of landlords and tenants are somewhere in the middle and

so we view it as extremely unfortunate that the cases where relations are less than perfect are picked out and held up as indicative of the whole sector.

This is not to say, however, that the culture of the let sector cannot be improved. It is difficult to generalise in this area but it is likely to be the case that the best relationships occur where the tenant and landowner know each other. Scottish Land & Estates would therefore encourage as far as possible better personal contact between landowners and tenants.

It is not always the case, however, that the landowner is in a position to meet tenants on a regular basis and so they commonly employ agents to act on their behalf. There are perfectly legitimate reasons why landowners manage their affairs in this way and there are many examples where it works to the satisfaction of all parties. But one aspect of the underlying culture that is repeatedly raised is the role of agents in the relationship between tenants and landlords. This role is frequently portrayed as negative with the landlord's agent framed as heavy handed, arrogant and bullish. Scottish Land & Estates would emphasise that whilst such behaviour has been reported anecdotally there is little hard evidence of it and it should also be borne in mind that most advisors are members of the RICS which is a body with high professional standards.

Scottish Land & Estates also suspects that this issue arises partly because many tenants choose not to employ agents to act on their behalf, while it is common place for landowners to employ professionals to manage tenancy issues for them. With a tenancy arguably one of the farmer's most important assets, and tenancy legislation being as complex as it is, it is still surprising how few farmers take professional advice on tenancy issues. Most will engage all sorts of other professional advisers such as accountants, financial advisers, animal nutritionists, vets and management consultants but will not engage an agent to negotiate a rent review. We believe if more parties could be encouraged to take advice, the scope for a perception of power imbalance would be reduced.

It is also important to acknowledge that the culture of the sector is about more than simply the relations between tenant and landlord/agent; it is also about the relations between the tenant and landlord representative bodies. It is often the case that the debate about farm tenancies is played out in the press and through what becomes portrayed as a pitched battle between ourselves and the STFA. Scottish Land & Estates is well aware that such a situation does not help and we try to limit our engagement in this sort of 'tit for tat'. What is needed is much better dialogue between the different representative organisations and Scottish Land & Estates is willing to do its part in this respect. Our suggestion for an "ombudsman" type body may help reduce the damaging instances of issues being played out in the media and would offer an alternative forum for resolution of disputes.

Unfortunately, however, Scottish Land & Estates believes that it is the potential prospect of ARtB that sets the context for this set of relationships. As long as there is even a faint hope that ARtB could be brought forward in any form, it is in the interests of some tenants/tenants' organisations to portray the whole sector as broken. The more that such an idea takes hold the more they are able to push for ARtB and ultimately their own financial gain. If a new culture is to be established it will have to be on the basis of working in the same direction and as long as ARtB remains even a faint hope, tenants and landlords will be prone to pulling in different directions.

9. There will be stability in the political, fiscal and legal environments surrounding farm tenancies and everyone involved has confidence to plan and make long term decisions.

While we have to accept that there are some financial mechanisms that will continue to change on a regular cycle (such as CAP) and it is extremely difficult to secure long-term commitments that last beyond a political term, the current political landscape provides a negative backdrop to agricultural letting. From the landowner's perspective there is a pervasive uncertainty. Landowners perceive that they are still viewed negatively and are likely to be subject to legislation that is contrary to their interests. This means that they do not see a stable political and legal landscape that provides the basis for long-term thinking and confidence to let.

Options for the Scottish Government

Question 3: What are the main causes that underlie these weaknesses, and which are the most susceptible to action by the Scottish Government?

We have identified above what we believe to be the major gaps between the aspirational and the existing systems and where there are weaknesses in the current legislation and why. In this section we want to outline some potential options for dealing with the problems discussed above, but before doing so it is important that we address the most high profile option for Scottish Government: the Absolute Right to Buy (ARtB). There are fundamental objections to the Absolute Right to Buy on the grounds that it represents the deprivation of property rights—ARtB should be recognised for what it is, the forced sale of someone's asset—but here we focus on the potential impact of ARtB on the sector and the way that it actually runs counter to all the aspirations for the tenanted sector as a whole.

An Absolute Right to Buy would be an absolute disaster for Scottish farming

The introduction of an Absolute Right to Buy for tenant farmers in 1991 Act tenancies is proposed by some as an answer to the difficulties in the tenant farming sector. Scottish Land & Estates opposes this suggestion in the strongest possible terms. Anyone with a genuine interest in maintaining a healthy tenanted sector in Scotland, and therefore a successful Scottish agricultural industry, cannot possibly advocate an absolute right to buy. ARtB would be a blunt, disproportionate and inequitable tool which could create a windfall for one generation of tenants but destroy what is left of the sector and have serious adverse consequences for farming generally. It would be much more beneficial to the sector to recognise that most modern landlords and tenants behave reasonably and professionally, but where poor practice exists we should work to develop effective mechanisms to deal with it.

Here we seek to demonstrate how an ARtB would not support or contribute to the attainment of any of the aspirational characteristics for the sector as set out by the group and that it actually runs contrary to many of them and in turn contrary to the government's vision:

- *The underlying culture will be forward looking and based on shared endeavour, mutual respect and partnership between owners and tenants.*

It is impossible to envisage such a culture if ARtB was to be introduced. Indeed, such a measure would destroy trust, mutual respect and partnership where it currently exists. ARtB is not forward looking. It is promoted by some as an ideological fix to correct perceived historical wrongs. For others there should be no doubt that it is simply motivated by self-interest rather than any altruistic desire for a sustainable, dynamic let sector which provides opportunity for all. Even where it is driven by frustration at a poor relationship with their landlord, policy reactions should focus on those particular cases not on solutions such as ARtB which would affect all relationships regardless of their success.

- *A range of flexible tenancy options will be available to suit diverse business needs and evolving business circumstances.*

The introduction of an ARtB would undermine the aspiration of having a range of flexible tenancy options because the subsequent loss in confidence in letting in any form would negate the value of having a range of options: they would simply not be used as landowners retreated from letting given the precedent that ARtB would set.

It is sometimes suggested that ARtB is needed to clear the air and that once that initial hurdle was overcome there would be a new era of letting; a re-invigorated let sector. However, this is at best naive and misleading. There is no evidence to suggest that the new owner occupiers created through ARtB or onward purchasers would start creating tenancies in any significant numbers. Indeed, there is a strong case to argue that such owners may be even more risk averse precisely because they would have acquired their land as a result of retrospective changes to tenancy legislation, the very sort of changes that could possibly be applied to them at a future date. There can be no guarantee that new tenancies would not in the future again be affected by retrospective change and the risk of such change would make any landowner thinking about the use of their primary asset extremely cautious when considering letting in future, especially over extended periods of time. In any case it is very likely that leases created would provide short term opportunities for existing farmers rather than the kind of longer-term fully equipped farm opportunities which have resulted in so many successful farm businesses in Scotland.

It is also claimed that since it has been stated that ARtB would only apply to 1991 Act tenancies were it to be introduced, letting on other vehicles such as LDTs should remain unaffected. Again this is at best naïve. If ARtB were actually introduced whereby the government specifically intervenes retrospectively in an agreement between two parties to give one of those parties the right to buy, the precedent would be set and landowners would take the message that the government will act against them as it chooses. Landowners will therefore act rationally and seek to reduce their exposure to potential future risk associated with other letting vehicles: what is to stop the same process being applied to LDTs in a few years' time?

- *People, and especially new entrants to the industry, will be able to move into, through, and out of the tenanted sector as their business develops.*

ARtB will do nothing to assist new entrants or movement between tenancies. The new group of landowner/owner-occupier created through ARtB is unlikely to re-let land whether to a new

entrant or otherwise so ARtB will reduce the size of the tenanted sector by removing land from it and thus reducing opportunities to let.

The negative impact on new entrants to farming which would result from the introduction of an ARtB cannot be overstated. A tenancy is generally the only realistic prospect of a younger person without significant capital assets being able to enter the agricultural sector. As stated above, anyone with a genuine interest in maintaining a healthy tenanted sector in Scotland cannot advocate an absolute right to buy.

- *Business investment in the tenanted sector will be subject to equivalent flexibilities and constraints to those that characterise the owner occupied sector.*

If ARtB were introduced it would have wide ranging consequences for the rest of the let sector. Contrary to the claims of those that ARtB should not have any impact on the use of the 2003 Act letting vehicles, the introduction of ARtB would fundamentally undermine confidence in letting. It would prompt short-termism as landowners seek to limit their exposure to any future risk. Such short-termism makes business investment difficult and would compound the differences between the owner-occupier and tenanted sectors.

ARtB is also sometimes claimed as the salvation for tenants that want to invest in their holding, but we would suggest that ARtB would actually create a cadre of new owner-occupiers that would struggle to invest. A tenant seeking to exercise a right to buy would presumably have to obtain substantial funding to purchase the unit in the first place (thereby subsequently replacing their landlord with a bank, quite possibly having to make much higher annual capital and interest payments than they previously paid in rent), which would then put them in a weaker position to be able to invest in the holding than when they rented it. Current agricultural rents have been demonstrated to be good value in the context of bank borrowing.

Scottish Land & Estates strongly believes that evidence should be taken from lenders themselves, but the major agricultural lenders have told Scottish Land & Estates that sound business planning for business investment is required for banks to lend, whether the business operates on owned or rented property.

- *Barriers to entry (including those arising from the CAP) will be low so that people, including new entrants, are able to farm successfully and can establish and develop a business regardless of their background circumstances.*

The tenanted sector would shrink as a result of ARtB. Rather than reduce barriers, ARtB would create a further barrier to entry. New entrants will be particularly disadvantaged if significant numbers of farms were bought to be re-sold to crystallise the marriage value. These farms would be bought by existing well-funded farmers and landowners.

- *Rent levels will reflect commercial returns from a well-managed farming business using the tenanted land and associated assets in a manner that accords with the Land Use Strategy.*

With land being removed from the tenanted sector via ARtB, and therefore a perceived high risk to letting, it is likely to place an upward pressure on rents for the land that is left. This would not reflect the objective of rents reflecting commercial returns.

- *The supply of tenanted land will be broadly compatible with demand at these rent levels.*

ARtB will reduce the supply of land in the tenanted sector but demand will remain unaffected.

- *Risk will be shared between tenant and owner in a manner that encourages innovation and provides inbuilt resilience to unpredictable changes (in markets, fiscal support etc)*

The risk of ARtB has created an imbalance between owner and tenant already. Agricultural tenancies of any sort are treated as high risk for professionally advised landowners at present and manifestation of that risk by the introduction of ARtB will clearly not aid sharing of risk.

- *There will be stability in the political, fiscal and legal environments surrounding farm tenancies and everyone involved has confidence to plan and make long term decisions.*

Discussion of ARtB since the 2003 Act has severely eroded confidence to let land. Landowners need tenant farmers, and vice versa, and the parties have demonstrated that they will use other mutually agreeable contractual arrangements rather than tenancies to achieve their objectives whilst the political environment surrounding tenancies remains unstable. Successive governments have demonstrated the desire to tinker with legislation succeeding sometimes to pitch tenants and landlords against each other to create a “them” and “us” mentality which does not exist outside the farm tenancy. The current review has re-ignited the debate and has dented confidence further. It is hoped that the outcome of the review will be definitive in its denouncement of ARtB. Even then, it will take time to restore confidence to previous levels. That journey must begin immediately upon conclusion of this review.

A swift rejection of ARtB is the best way forward

We would respectfully suggest that the Review Group should make a clear, unequivocal denouncement of ARtB in a way that convinces all parties that it will not be pursued in any form. Any rejection of ARtB needs to be done in such a way that the threat of its future use is removed as far as possible. A partial ARtB for a specific set of cases, for example, could do just as much damage as a blanket right. Once the door is open it would create pressure for further change so the issue would not go away, and indeed would only serve to create further deterioration in relations because examples of broken relationships are used to justify ARtB in the first place. Any lingering threat of a return to debate about ARtB will have the same consequences for letting as we have seen in recent years and so how the debate about ARtB is concluded has very real consequences for the degree to which the aspirations of the Review Group will be met in future. There needs to be a clear break from the current debate and a new beginning that consigns ARtB to history and seeks to establish a new culture of mutual trust. ARtB should be ruled out before moving on because it would be difficult to develop a new culture based on trust if landowners felt that it was being held over their heads in order to achieve concessions.

What really needs to be done?

Once ARtB is decisively ruled out the first over-arching issue is then how to change the culture and relations within the sector. It is essential that we find a way of getting past what appears to be the societal prejudice against estates and landowners. If ARtB were decisively ruled out it might not have much impact on letting if landowners perceive that they continue to be seen as the 'bad guy'; they will simply expect another assault on their interests in the not-too-distant future and remain risk averse. So we, collectively, need to find ways of breaking down the stereotypes. Clearly landowners and Scottish Land & Estates have to make moves in this direction. It will have to involve a long process of engagement. But the detail of how this cultural change can be achieved will need expert input.

Having said this, here we focus on improving the current arrangements surrounding existing 1991 Act tenancies and then on some wider options to re-invigorate the sector and encourage new letting. With regard to 1991 Act tenancies we focus on:

- Rent reviews
- Compensation for improvements
- Succession
- Dealing with bad practice

None of this can be achieved by government on its own. The whole sector will need to work with government to bring about change. These options are not presented as fully developed proposals, but rather are presented to demonstrate that our members have given serious thought to the issues and wish to be instrumental in developing meaningful, long-term solutions. We recognise that in some cases this may take us into uncomfortable and challenging territory (which some of our own members may not like) but Scottish Land & Estates is keen to take a wide view in the sincere belief that the tenant farming sector is a vital component of Scottish agriculture and must be protected and promoted. We have tried to keep at the forefront of all our proposals the government's vision for a dynamic tenant farming sector which forms part of a sustainable future for Scottish farming and is getting the best out of the land and people with opportunities for new entrants.

We also go on to discuss some possible options for re-invigorating the let sector, focusing on:

- Rebuilding confidence
- Flexibility
- New entrants
- Combating short-termism
- Fiscal incentives

Dealing with issues surrounding 1991 Act tenancies

Rent reviews

Scottish Land & Estates supports the conclusions of the independent Rent Review Working Group and does not believe that the legislation, as amended, requires further overhauling. We

now have clarity following recent case law which is helpful. While we acknowledge that other parties have called for the whole basis of rent review to be altered (i.e. rents to be more closely linked to the productive capacity of the holding), we have not been convinced that further changes to the legislative basis for rent review would be any significant improvement. Nor have we seen any evidence that adjusting the assessment methodology will result in a different rent, so all the downsides of change (uncertainty, lack of legal clarity) will result without changing things on the ground. This reinforces the view that contrary to some perceptions the current system produces an appropriate assessment of rent. A further major change in the legislation will simply create a period of further instability as it will inevitably lead to court cases which again test the limits of the legislation. For reference we have included our responses to the Rent Review Working Group in Appendix I.

However, while the legislation is not in need of further reform in this area, Scottish Land & Estates does believe that how rent reviews are conducted should be improved. The focus should be on training, good practice and improving relationships rather than legislative change. This work, which has already been started by TFF, would form part of some of our other ideas set out below.

Compensation for Improvements

During the course of a tenancy the tenant may carry out improvements that are reasonable and desirable for the holding and generally the tenant is entitled to compensation from the landlord for them. It is clear, however, that some tenants feel that they are not being or are unlikely to be fairly recompensed for improvements at waygo. As well as causing resentment, this may be causing some to delay retirement or reduce investment in the holding.

The reasons for this situation are numerous but include poor administration (not following the statutory notice procedure) in the past, Write Down Agreements and, sometimes, spurious objections from landlords with the costs of going to the Land Court for an adjudication deemed to be disproportionate to the matter at hand.

Scottish Land & Estates position is that if a tenant's improvement is not excessive and would be necessary for an incoming tenant (whether or not it was considered necessary at the outset of the lease) then it is fair the landlord should compensate the tenant at waygo. Where this is not currently provided for in legislation then we feel some reform may be justified.

Our recommendations on compensation for improvements have been split into two categories: in the first place, improvements already carried out, and, in the second place, future improvements which take place after new legislation comes into force.

In terms of compensation for improvements which have already been carried out, Scottish Land & Estates favours a simplistic approach which recognises the right of tenants to be adequately compensated for appropriate improvements. We are extremely wary of retrospective changes, particularly in cases where write down agreements (WDAs) were entered into and we are conscious that our approach will have financial implications for members which we are unable to quantify at present.

With the above in mind, Scottish Land & Estates recommends consideration be given to possible modifications to the current arrangements for dealing with tenants' improvements at waygo to

the effect that, for a limited period only, a tenant may serve notice on the landlord for new improvements (those carried out after November 1948) undertaken before the enactment of the legislation. This would amount to a time-limited amnesty on tenants' improvements where the relevant statutory requirements have not been met (subject to landlords retaining the right to object), after which the current arrangements, as amended for future improvements, would prevail. These recommendations are:

- For a period of one year from the date of enactment of new legislation the tenant will have the opportunity to serve notice on the landlord in relation to post November 1948 improvements carried out prior to the enactment of new legislation on the holding, either
 1. where no notice was served (or has been lost), or
 2. cases where notices were served but objected to (e.g. proposed improvement was unreasonable at the time), or
 3. cases where a WDA for an improvement was entered into.

Improvements notified during this period will be eligible to be treated as qualifying improvements if, as at the date of the new notification, the improvement is something that should be provided to maintain efficient production, subject to the conditions below.

- The landlord, if in receipt of such a notice, will have a period of one month to object to the tenant's notice;
- The tenant will have the right to refer any objection by the landlord to the Land Court;
- The amount of compensation due to be paid by the landlord to the tenant at waygo will be the sum fairly representing the value of the improvement to an incoming tenant and any benefit which the landlord agreed in writing (or which can be shown by any other evidence) to the tenant in consideration of the tenant carrying out the improvement is to be taken into account;

There is a value in the notification process currently enshrined in legislation, if for nothing else than requiring landlords and tenants to talk to each other about improvements and keeps channels for dialogue open, so we recommend that from the expiry of the amnesty period the existing statutory provisions for compensation will prevail in relation to improvements, subject to the following recommendation for improvements carried out after the date of enactment:

- Part II of Schedule 5 to the 1991 Act should be updated to ensure that its terms are reflective of modern agricultural practices
- Compensation should relate to those improvements which, as at the date of notification, are something that should be provided to maintain efficient production on the holding.
- The amount of compensation due to be paid by the landlord to the tenant at waygo will be the sum fairly representing the value of the improvement to an incoming tenant and any benefit which the landlord agreed in writing (or which can be shown

- by any other evidence) to the tenant in consideration of the tenant carrying out the improvement is to be taken into account.
- No compensation payment should be made in respect of any grant paid towards the cost of a qualifying improvement.

This will mean that, if a tenant does not take advantage of the time-limited amnesty in relation to improvements carried out before the date of enactment, he/she will lose the opportunity to correct any defect in the notice/consent requirements or address situations where a WDA was entered into. The amnesty would not apply to tenants' improvements to the extent that they were undesirable, unreasonable or exceeded that which was necessary to maintain sufficient production at the date of notification.

Any amnesty and legislative change would need to be accompanied by an awareness raising campaign so that all parties are fully aware of the requirements of the legislation and an acknowledgement that future failure to adhere to proper procedures may result in loss of compensation at waygo.

Scottish Land & Estates expects that the above suggestion would not be universally welcomed by all landlords but believes that it represents a possible way to draw a line in the sand and would be in the overall interests of the sector. It offers an opportunity to deal with past issues which have potential to cause difficulties and provide a clean slate.

Succession

The Public Services Reform (Agricultural Holdings) (Scotland) Order 2011 extended the class of near relative successor to include grandchildren. This change was the result of consensus within the Tenant Farming Forum to avoid the rare cases where successors to a tenancy died "out of turn" thus resulting in potential hardship. There has been some pressure to widen succession further but Scottish Land & Estates does not believe this is in the best interests of the tenanted sector and would simply imbed 1991 Act tenancies further to the detriment of a dynamic sector.

No further change to legislation is required. There is a need to encourage lifetime succession planning through awareness-raising of existing provisions and there is also a need to encourage retirement planning where family successors do not exist to allow new blood into the industry.

Dealing with bad practice

One of the areas of contention that is repeatedly raised relates to reputed bad practice by landlords or by agents acting on landlords' behalf. Scottish Land & Estates challenges the portrayal of widespread bad practice and recognises that it is in the interests of those that want reform to emphasise isolated cases and create the impression that the entire system is broken. However, where there is genuine poor practice, there should be a mechanism whereby these cases can be identified and comprehensively dealt with so that they cannot continue to be used for political gain.

But before setting out an idea that could be pursued by the Scottish Government it is important to note that for many of the contentious areas within the landlord/tenant relationship, there are already remedies available which are generally under-utilised. It is important to understand

the existing remedies for bad practice before creating new ones (see box on repairs and renewals).

Repairs and renewals – current remedies

Many landlord and tenant relationships are long standing and characterised by informality. Each party can be wary of implementing the formalities for fear of upsetting the applecart. Minor routine issues can over time become major problems such as tenant's repairs and landlord's renewals. A clear understanding by both parties as to the others' obligations and where the line is drawn between repair and renewal is essential to avoid dispute. It is clear that the current framework already offers tenants a heavily protected position.

Landlords' failures:

In the case of landlords' renewals, there are existing remedies available to the tenant. Without the benefit of legislation, it is well established that the rent can be withheld by the tenant at common law due to a material breach by the landlord to put fixed equipment in a proper state of repair and it is argued this would probably apply to other fixed equipment-related obligations of the landlord. If that latter is ambiguous then legislation could be required.

In addition, s15A of the 1991 Act permits, from 2003, a tenant to apply to the Land Court for an order authorising him to withhold rent in a 91 Act lease where the landlord has materially failed to comply with a Land Court Order to fulfil an obligation relating to fixed equipment. S12 of 2003 Act deals with LDTs and SLDTs and there is similar provision for Land Court orders, with the rent being consigned into court and drawn down by the tenant to pay for repairs which the Land Court authorises as being the landlord's responsibility.

Tenants' failures:

In LDTs/SLDTs there is no statutory right of irritancy of the lease and each lease will have to specify the grounds for irritancy. There is protection for the tenant in that, like conventional irritancies in 91 Act tenancies, they are limited in certain circumstances. For example, no irritancy is permitted on grounds of bad husbandry if there is a permitted diversification.

A landlord can give the tenant a demand to remedy a breach of repair of fixed equipment. The tenant is protected from poor practice by the landlord here because he/she can apply to the Land Court to have the demand modified in relation to the time given for remedy and the work to be done. Defective procedure can be challenged and the tenant can claim that there has been acquiescence or waiver by the landlord. If there has been improper behaviour by the landlord, the tenant can claim oppression. For 1991 Act leases, irritancy is much the same although there is the statutory irritancy for unpaid rent.

Landlords do have the option of applying for a certificate of bad husbandry which can then lead to an incontestable notice to quit. Again there are protections for the tenant in that one of the defences will be where a material contributory factor has been the landlord's own breach of good estate management rules.

The reasons for the under-utilisation of existing remedies may be varied but could include:

- Lack of awareness - parties may have genuine problems but may be unaware of their remedies. Problems may have arisen through a lack of awareness about the other party's rights and obligations. Greater awareness would increase mutual understanding and thus reduce the scope for dispute.
- Legal Ambiguity – if the law is ambiguous or the legal remedy too difficult to implement Government can legislate to clarify the law or simplify the processes.
- Fear of deteriorating landlord/tenant relationship – There are claims that tenants are subject to poor practice by landlords or agents and that they have little recourse. Some aggrieved tenants say they feel unable to complain or report what they see as bad practice precisely because they fear further reprisals from the landlord. Equally landlords say they are afraid to use legal remedies where tenant management is lacking for fear of negative publicity and fuelling land reform agendas.
- Fear of cost of going to the land court.

Whatever the reasons, our first point on bad practice is that there are remedies available in many situations and they should be utilised. Consequently, we suggest that, in the first instance, rather than reinventing the wheel to develop new legislative remedies there should be a high profile campaign of awareness raising using case studies of real life examples to demonstrate the available remedies where they already exist and how to use them.

We do recognise, however, that not all grievances arise because a statutory provision has been breached. In some cases the letter of the law may have been applied, but it is the manner in which the relationship is conducted which creates a problem. More widespread use of standardised templates and developing industry norms for routine matters such as inspections, repair notices and rent reviews could be hugely beneficial in reducing the opportunity for dispute.

To be clear, however, Scottish Land & Estates is not taking the view that remedies exist for all circumstances and therefore that nothing further needs to be done. Scottish Land & Estates has occasionally been approached by MSPs, NFUS or STFA with cases where a landlord is accused of bad practice, and where we have been approached we have sought to help in whatever way we could. We would stress, though, that where we have looked into the cases brought to our attention it is *always* the case that the situation is more complex and multi-faceted than originally reported. Sadly this complexity never makes it into the press and so Scottish Land & Estates would welcome an independent ombudsman type body with powers to investigate in order to ascertain the facts.

Scottish Land & Estates supports the proposals from TFF for a new body to be created, an Office of Scottish Tenant Farming (OSTF) to monitor the state of the sector and help tenants and landlords by providing signposting and information.

However, we believe this body could go further to tackle poor behaviour and change culture in the long term. There is a balance to be struck so that there is confidence poor behaviour will be

challenged without fear of reprisal but that those already operating according to good practice will not be unduly burdened. A statutory, mandatory regime would be a disproportionate burden to impose on the whole sector, so we think independent self-regulation could facilitate the cultural change required at this stage.

Office of Scottish Tenant Farming

In addition to advisory and information giving functions, the OSTF should have authority to carry out investigations either in response to a complaint or on its own initiative, carry out ongoing monitoring (spot checks, audits), publicise findings and make recommendations to government. It is critical that both landlords and tenants are able to pursue redress through this route.

The foundation for the OSTF would be a robust and recognised industry code of practice to which all members of the new body would sign up.

The OSTF would need to take cognisance of existing codes of practice such as those published by the TFF and the Scottish Land & Estates members' charter, but may wish to amalgamate this into a single Code. The Code would underpin all the functions of the OSTF and would include some general requirements, for example, that landlords should have an open and transparent management policy, appoint a specific person to be the point of contact for each tenant, have a transparent complaints procedure, agree to comply with industry standards and best practice guidance and should act fairly and reasonably in respect of tenancy matters (dependent on the size of the landlord's letting operation: some of the requirements may not be relevant to landlords with few tenancies). The Code could provide much more detail and guidance in relation to potentially contentious topics such as conducting rent reviews.

The constitution, funding and powers of the new body should be a matter for further discussion but we envisage the OSTF would be an ombudsman type body rather than a tribunal. We believe that the non-statutory ombudsman model underpinned by voluntary codes of practice would raise standards of management and practice across the sector and marginalise those who do not co-operate. Parties to the voluntary scheme would enter a legally binding contract at the point of entry into the scheme allowing the body to investigate and thereby agreeing to abide by any decisions made. Incentives for entry into the scheme could be developed to encourage wide participation.

The main features of the new body:

- its purpose would be to resolve complaints not to regulate, although decisions may be seen as precedents and may have wider effect;
- it would be used to resolve complaints where there is a perceived or real imbalance of power between parties;
- access would be free for parties and they are not at risk of an order for costs;
- it would handle enquiries as well as complaints, because dealing with an enquiry may head off a complaint (for example, by resolving a misunderstanding);
- when dealing with complaints, OSTF would seek to achieve a fair resolution at the earliest

possible stage – rather than working towards an assumed future hearing;

- it would use flexible and informal procedures – resolving cases by mediation, recommendation or decision as appropriate;
- it would not just rely on the evidence the parties volunteer. OSTF would actively investigate cases (using their specialist expertise), calling for the information they need;
- so the outcome is not affected by how well either of the parties presents his/her/its case, and representation by lawyers (or others) would not be necessary;
- recommendations/decisions would be based on what is fair in the circumstances, taking account of good practice as well as law;
- it would publicly feedback the general lessons from cases handled, so stakeholders (including government/regulators) could take steps to improve things for the future and any bad practice would become a matter of public record;

The powers and remit of the OSTF could include the following:-

- Investigation and reporting powers;
- Publication of findings;
- Referral to mediation;
- Advice/Recommendations for improvement;
- Voluntary Management plans/agreements;
- Voluntary Mentoring scheme.

Re-invigorating the let sector

In order to inform the discussion about how to re-invigorate the let sector Scottish Land & Estates believes that it is important to shine a light on landowner decision making with regard to letting. Contrary to claims by some sectors of the industry, landowners are not philosophically opposed to letting land. In fact, letting land often constitutes a major part of a landowners' business and, as such, landowners have a very strong interest in continuing to let land. A landowner is, however, just like any other farmer, running a business and they make their decisions on that basis. As with all businesses, landowners respond to external pressures by seeking to minimise risk and maximise income and at present, there are several interconnected factors that influence decisions about whether to let the land or keep it in hand. These are:

1. Financial return

- a. Returns are potentially much higher if land is farmed in hand rather than let out (although the degree to which this is the case will vary from business to business and across sectors).
- b. Increasing the scale of farm businesses is the most common reaction to external economic pressures. Where opportunities exist to expand in hand farming operations landowners will take these as do farmers whatever their main tenure.
- c. The nature of agricultural support provided through the CAP favours in hand farming because it increases the financial performance of the occupier of the land.
- d. The taxation regime treats in hand farming much more favourably than land as a let asset. Farming in hand provides significant Income, Inheritance and Capital Gains Tax advantages.

- e. A landowner will seek to compare rental income with potential liability. A landlord's liabilities under Agricultural Holdings legislation are often not reflected in rental return, which undermines the attractiveness of letting. This may be particularly the case where units are small and generally uneconomic which adds to resistance to realistic rents.
- f. If land is farmed in hand it often releases other assets such as houses to let. A farm house, for example, could often be let for at least as much as the entire farm. Alternatively, property released may be used to provide new businesses premises in rural areas (providing wider benefits to the community).

2. Management

- a. Bringing land in hand, when it is possible to do so, brings it back under the landowner's control.
- b. Farming in hand or under a contract farming arrangement allows a much greater degree of flexibility to react to changes in the market or wider circumstances. Becoming locked into a long-term letting arrangement potentially limits the landowner's ability to best utilise their assets.
- c. Landowners have a responsibility to support existing businesses and current tenants and will look to see if it would make sense to amalgamate the land with adjacent (tenanted or in hand) holdings in order to help create units that are going to be robust in the long-term and able to compete on a global basis. It is in the landowner's interest to see if they can help ensure the profitability of their existing tenants.
- d. Many landowners will let farms in the context of other operations, such as sporting interests, housing and forestry. They will make decisions based on how all these operations fit together and sometimes re-letting a farm may not fit with the landowner's wider business plan.
- e. Where future development potential exists landowners will prefer to keep land in hand to minimise the risk of it not being available when the necessary permissions etc. are in place.

3. The changing political context

- a. Landowners effectively let land as a form of risk management. Previously land was let on long-term tenancies rather than farming in hand because it was a low risk, low yield strategy, which was seen as an essential part of a wider business portfolio that might also include higher risk ventures. Today's political background means that many landowners view letting as a high risk, low yield venture.

At present, then, given the balance between risk and income associated with letting, the sensible business decision, in many cases, is to either keep the land in hand until the political and policy environment is more certain before moving back into letting, or simply farm in hand and seek to maximise the value of the available assets in other ways. This is straightforward business management, not some ideological opposition to letting land.

We highlight these issues not to demonstrate the unattractiveness of letting land, but to focus attention on the way that landowners are simply adapting to a changing context and an evolving set of external pressures. It is very important to note that the decision making influences are very different for different landowners. Some, despite the fiscal or financial attractiveness of in

hand farming will not want the risk or complexity of doing so. They may only be doing so at present to avoid letting. As the context changes—such as with greater political and policy certainty—so the decision making processes will also change, potentially allowing for a more positive outlook on letting land. One of the keys to re-invigorating the tenanted sector will be a set of measures that a) re-builds confidence; and b) makes it more financially attractive to let.

Rebuilding confidence

Tenants need security and confidence to invest but landlords need confidence to let in the first place. This confidence will only come about when there is a sustained period of stability in terms of the legislative, fiscal and political environments. Scottish Land & Estates suggests that progress can only be made within a political context which is less fixed on finding ways to redistribute land/assets and more focused on land management which achieves best use of our limited resources. The political context should acknowledge that landowners have a legitimate interest and should seek to achieve a balance between the respective rights and responsibilities of both tenants and landlords.

Culture – tackling short-termism

Landlords' approach to letting has developed in the context of a pervasive fear that political intervention will not be in their interests. The consequence tends to be a shift to short-termism because that allows the landlord to retain greater control and therefore less exposure to medium term risk of legislation that may not be in their interest. Promoting a culture of long-termism requires the development of trust between the landlord and tenant representative bodies and a wider acknowledgement across the political spectrum that for the let sector to work it has to work for both the tenant and the landlord.

Flexibility

The inflexibility of the 1991 Act tenancy is well documented and understood by most parties. However there is a lack of understanding amongst tenants, landlords and agents of the flexibility already allowable under LDTs in terms of freedom to agree duration, provision of fixed equipment and possible innovative bases for rent review (e.g. linked to wheat price). Scottish Land & Estates suggests a campaign to raise awareness of the flexibility currently allowed in LDTs and SLDTs. But Scottish Land & Estates also suggests that further improvements could be made to LDTs which would increase their use such as allowing contractual resumption.

While a range of flexible letting vehicles is clearly important to a successful tenanted sector, landowners and farmers also need to be made aware of alternatives to letting as a means of entrance into agriculture. This would ensure the greatest possible flexibility and opportunity. Some of these routes may lead to a tenancy. One such option which should be explored and developed is share farming whereby the owner offers a contract to a share farmer to enable them to farm all or part of that farmland. The owner provides the farm, the fixed equipment, the fixed machinery and he also pays for a share of certain input costs (depending on the actual agreement reached). The share farmer provides the working machinery and the labour and also pays for a share of the input costs. Each is rewarded by a share of the gross output. In the case of livestock, landowner and share farmer normally share the ownership of the livestock. Although well-liked and widely used in America, Australia and New Zealand, there has not been

significant development of share farming in the UK. This has in part been due to fears that the arrangement could unintentionally create an agricultural tenancy. It is critical when establishing a share farming agreement that this does not happen. There is no statute or other law governing share farming as such. Freedom of contract allows for flexibility for the share farmer and landowner to suit their requirements. Therefore no legislative change is required to increase uptake of this model. Rather what is required is advice, guidance and awareness raising ideally by government supported by industry bodies.

We also suggest the establishment of a monitor farm type exemplar, detailed guidance pack including model agreements, and delivery of series of information sessions throughout Scotland.

Wider new entrants package / portal

Given the recognised challenges faced by new entrants, Scottish Land & Estates has explored at length the issue of what landlords can do to help. There has been an expectation that landowners should be able to bring more land to the market to provide new opportunities to new entrants and some members have done precisely that. Another response has been a pilot scheme by the Forestry Commission, all of which has been widely welcomed and helpful in shaping what support is most significant to those trying to enter the farming industry.

From the new entrant's perspective, the barriers to getting into the industry can be high, so the government's efforts to help new entrants through equality of access to direct farm support plus additional support through the SRDP are welcome. But clearly access to land is a critical issue and so a functioning tenancy system is central to the future. Consequently some of the other issues we have addressed in this submission—such as attempting to fix issues surrounding compensation at waygo, thus providing greater certainty for exiting tenants, and seeking to boost confidence to let—will have an impact on opportunities for new entrants.

From the landlords' perspective, while some landowners have done so, letting to new entrants can, unfortunately, be unattractive. This is because a new entrant can be seen as riskier than an established farmer. But there are also investment issues. While bare land can be let under an LDT, quite often significant investment is required in the holding prior to letting it and the return on that investment can be extremely low. This can be unattractive financially compared with leasing the land to a neighbouring holding which needs to spread its fixed costs.

Nevertheless Scottish Land & Estates joins with the rest of the industry in recognising the importance of new blood and is committed to work with government and partners to develop sustainable business models for those wanting to set off on the first rung of the farming ladder. From our recent research and discussions with young farmers we suggest:

- That a central hub that provides support to new entrants be established (with funding and structure to be defined through industry-wide agreement):
 - The hub could provide business advice, information on tenancies, information on opportunities arising i.e. land/units to let
 - The hub could provide networking opportunities
 - The hub could filter applicants for new entrant units to avoid wasted time and money applying for numerous holdings.

- That a government support package is created that provides capital funding, professional advice, bank interest / loan guarantees and a mentoring option for qualifying candidates.
- Adjustment of SRDP regulations to permit funding of mobile equipment to reflect the short term nature of new entrant lease arrangements.
- Incentives to encourage estates to create 'stepping stones' letting structures once land starts to come back in hand from moribund secure tenancies.
- Development of share farming models to make them more attractive and mainstream as an alternative first step on the ladder.

Fiscal incentives

There are a number of taxation issues which affect agricultural tenancies to a lesser or greater degree. Some of these are reserved to Westminster and some are devolved to Scotland. These include:

1. Stamp Duty Land Tax / Land and Buildings Transaction Tax
2. Income Tax
 - rental income v trading income
 - potential reliefs for New Entrants
3. Inheritance Tax Relief (agricultural property relief/business property relief)
4. VAT
5. Capital Gains Tax

At present there are some taxation provisions which are useful to letting, such as 100% APR for IHT purposes. There have been ongoing suggestions that this relief could be removed, but Scottish Land & Estates would argue strongly for its retention. Scottish Land & Estates recommends that the Review Group takes impartial evidence from accountants and/or taxation lawyers who have particular experience in rural taxation issues. Either or both of the Institute of Chartered Accountants of Scotland and the Law Society of Scotland will be in a position to propose suitable experts.

Next steps

Scottish Land & Estates has drawn up this submission to set out our initial position on the main issues in the context of the call for evidence from the group, but we envisage other organisations will bring ideas forward and that these may usefully require a response from us. We are very open to a dialogue about proposals and hope that the group will feel able to come back to us as necessary to discuss ideas as they emerge.

Scottish Land & Estates would also very much welcome the opportunity to host the group on site visits to explore the issues and understand the landowner's perspective and we are also working on a series of case studies to shine a light on aspects of the let sector from the landlord's point of view. We will forward these to the group as soon as possible.