

## **Explanatory Memorandum to the Agriculture (Calculation of Value for Compensation) (Revocations) (Wales) Regulations 2019**

This explanatory Memorandum has been completed by the Economy Science and Natural Resources Group and is laid before the National Assembly for Wales in conjunction with the above subordinate legislation and in accordance with Standing Order 27.1.

### **Ministers Declaration**

In my view, this Explanatory Memorandum gives a fair and reasonable view of the expected impact of the Agriculture (Calculation of Value for Compensation) (Revocations) (Wales) Regulations 2019. I am satisfied the benefits justify the likely costs.

Lesley Griffiths AM

**Minister for Environment, Energy and Rural Affairs**

26 September 2019

## **Part One – Explanatory Memorandum**

### **1. Description**

The Agriculture (Calculation of Value for Compensation) Regulations 1978 (and amending regulations) set out a method to calculate compensation payable to outgoing tenants with holdings that come under the Agricultural Holdings Act 1986. The Compensation Regulations were last updated in 1983 and specify prices fixed to the same year. They accordingly no longer compensate tenants adequately for the value of certain improvements they have made to the land. This means tenants have less incentive to farm the land sustainably towards the end of their tenancy.

The prescribed methodology is inflexible set against the varied nature of agricultural holdings today.

### **2. Matters of Special Interest to the Constitutional and Legislative Affairs Committee**

This Statutory Instrument revokes and replaces the Agriculture (Maintenance, Repair and Insurance of Fix Equipment) Regulations 1973, in exercise of the powers conferred to the Welsh Ministers by Section 7(1) and (2) of the Agricultural Holdings Act 1986.

### **3. Legislative Background**

This Statutory Instrument revokes the Agriculture (Calculation of Value for Compensation) Regulations 1978 in Wales and three instruments which amended these regulations.

The Welsh Ministers may revoke the following regulations in exercise of the powers conferred by Section 66(2) of the Agricultural Holdings Act 1986.

The Agricultural Holdings Act 1986 (the “1986 Act”) applies to agricultural tenancy agreements entered into before 1 September 1995, and to such tenancies passed to a successor after that date, which are specifically excluded from the Agricultural Tenancies Act 1995 (“AHA tenancies”). It is accepted approximately 30% of agricultural land in Wales is farmed through tenancy agreements and are an important element in Welsh agriculture.

### **4. Purpose and Intent of the Legislation**

The relationship between a landlord and their agricultural tenant is governed partly by the terms of their individual tenancy agreement and partly by agricultural tenancy legislation.

The agricultural tenancy sector is crucial to Wales’ rural economy and the proposed reforms will help maintain cohesive farming communities across Wales to include areas where the Welsh language is prevalent. The goals of the Wellbeing of Future Generations (Wales) Act include making Wales prosperous. These proposals have the capacity to contribute towards the development a rural economy which generates wealth, provides employment opportunities and one which is ecologically,

economically and socially resilient whilst promoting and protecting heritage and culture.

This Statutory Instrument is part of the Welsh Government's endeavour to simplify and update the regulation of farming businesses. The changes introduced by this instrument are supported by the Tenancy Reform Industry Group ("TRIG") which includes representatives of tenant farmers, landlords and agricultural valuers.

By revoking the Agriculture (Calculation of Value for Compensation) Regulations 1978 (and amending regulations) landlords and tenants will have the ability to settle compensation claims (governed by the Agricultural Holdings Act 1986) using current market values and calculation methods that best suit their individual circumstances.

These changes will streamline and modernise the legislative framework governing agricultural holdings in Wales and will help farm businesses to become more professional, resilient and prosperous.

## **5. Consultation**

### **Consultation Period and Distribution**

The consultation period ran from 1 December 2016 to 23 February 2017. It sought views on proposed changes to secondary legislation governing the repair and maintenance of fixed equipment and end of tenancy compensation, for agricultural tenancies in Wales governed by the Agricultural Holdings Act 1986.

The proposals are designed to support an efficient and effective agricultural tenanted sector in Wales. Amendments to existing legislation aim to clarify regulatory requirements, such as calculating compensation payable to outgoing tenants as the current legislation no longer compensate tenants adequately for the value of certain improvements made to the land. This may encourage tenants to invest in and farm the land more sustainably in the last years of their tenancies.

The proposed changes are based on the recommendations of the Tenancy Reform Industry Group (TRIG), a non-statutory advisory body which represents the interests of agricultural landlords and tenants. The UK Government has enacted similar changes following public consultation in England in 2014. The proposed changes will ensure tenants and landlords in Wales are subject to the same regulatory requirements as farmers in England and are not disadvantaged.

<https://beta.gov.wales/agricultural-tenancies-repair-and-maintenance-fixed-equipment-and-end-tenancy-compensation>

Responses were received from:

- Agricultural Land Tribunal (Wales)
- Pontypool Park Estate Office
- Messrs Sprackling – Tenant Farmers
- The Tenant Farmers Association
- NFU Cymru
- CAAV (Central Association of Agricultural Valuers)

- Anonymous
- CLA – Country Landowners Association
- S Robertson

### **5.1. Summary of Changes**

We wish to revoke the Agriculture (Calculation of Value for Compensation) Regulations 1978 as amended (the “compensation regulations”).

The Compensation Regulations apply to agricultural tenancies governed by the Agricultural Holdings Act 1986 (the “1986 Act”) i.e. agreements entered into before 1 September 1995 (and any succession tenancies granted after that date).

The Compensation Regulations make provision in England and Wales for calculating the compensation payable to the outgoing tenant of an agricultural holding in respect of “improvements” and “tenant-right matters” as set out in the 1986 Act. The regulations set out both the calculation method and fixed prices for determining the compensation due. As they were last amended in 1983 the fixed prices are now undervalued which means outgoing tenants are inadequately compensated.

### **5.2. Objectives of the Regulations**

The policy objective is to ensure an efficient and effective agricultural tenanted sector in Wales. By ensuring an outgoing tenant is compensated sufficiently for the investment they make to the agricultural land from which they will not directly benefit. This may encourage tenants to farm sustainably towards the end of their tenancy and incentivise good agricultural practices in the long term.

### **5.3. Rationale for intervention**

Government intervention is necessary because the provisions of the 1986 Act are incorporated into every agricultural tenancy agreement made under it (unless alternative arrangements are made in a written agreement).

The 1986 Act stipulates the amount of compensation “*shall be the value of the improvement or matter to an incoming tenant*”. By revoking the compensation regulations, agricultural tenants and landlords will be free to agree the method for calculating compensation that best suits their particular circumstances and to settle compensation claims at current market values. This will incentivise good land management by the tenant and modernise the compensation arrangements for 1986 Act tenancies. It will bring them in line with current tenancies under the Agricultural Holdings Act 1995.

Compensating an outgoing tenant for the value of fertilised land or crops left behind encourages the tenant to farm sustainably towards the end of a tenancy. It will; assist an incoming tenant or other farming occupier whose tenancy may start too late in the year to cultivate the land effectively or to remedy any deficiencies in soil status.

## 6. Regulatory Impact Assessment

### 6.1. Policy Options

#### Option 1

##### *Do Nothing:*

Leaving the regulations unchanged was considered. This will result in the calculation of compensation becoming further out of date compared to current farming practices and will reduce further the incentives for outgoing tenants to invest appropriately in the land. This will have implications for the future productivity of the land.

#### Option 2

##### *Update and consolidate this instrument:*

Revoke the Agriculture (Calculation of Compensation) Regulations 1978 (and amending regulations).

**The preferred option is Option 2.** This option is deregulatory and gives landlords and tenants flexibility to settle compensation claims at current market values using a calculation method that best suits their individual needs. It also received the support of 73% of respondents to the public consultation.

This will bring Welsh legislation in line with other UK administration established in 2015. No negative impacts have been identified at this point for the tenanted sector or the wider agricultural industry in Wales. This will make policy far easier to understand and lessen the complications by having consistent regulations with other UK administrations.

### 6.2. Summary of Preferred Option

The preferred option is to revoke the Agriculture (Calculation of Value for Compensation) Regulations 1978 and its amending regulations:

- (1) The Agriculture (Calculation of Value for Compensation)(Amendment) Regulations 1980;
- (2) The Agriculture (Calculation of Value for Compensation)(Amendment) Regulations 1981;
- (3) The Agriculture (Calculation of Value for Compensation)(Amendment) Regulations 1983;

Revoking the Compensation Regulations will remove the current prescriptive approach and allow the tenant and landlord to meet a privately agreed outcome at the end of the tenancy agreement. Reaching a fair outcome should be in the interests of both the landlord and the outgoing tenant as it provides appropriate incentives to manage the land properly.

### 6.3. Costs and Benefits

The proposed changes will directly affect the outgoing tenant and landlord as the two parties to an expiring tenancy and also the incoming tenant or other farm occupier. The three parties are considered separate businesses participating in the same market.

No data is available on the expected number of agricultural tenancy agreements coming to an end each year so it is not possible to calculate the aggregate cost of the proposed changes.

Revoking the Compensation Regulations is expected to generate two monetised costs.

Compensation materials will incur additional costs to landlords and tenants as it changes values to reflect current average costs rather than being fixed in 1983 prices.

Outdated prices are mainly expected to affect the compensation payments to outgoing tenant farmers in the following three items:

- a) Unexhausted manorial values;
- b) Residual value of feeding stuffs consumed; and
- c) Residual sod values.

Changes in the price of key factor inputs to the land over time, such as fertilisers, mean that the prices fixed in the statutory instruments of 1978 to 1983 are not a true reflection of present day value. These values were originally set on the basis of the cost of nitrogen, phosphate and potash fertilisers.

Currently outgoing AHA tenants are compensated at values fixed to 1983. The table below illustrates the variation in nominal prices of these fertilisers over time. Prices have been volatile, peaking for all three fertilisers in 2008/9. In real terms prices have risen on average by 4.98% per year over this period. This value is largely driven by a price spike in 2008/2009. Between 1978 and 2008 prices remained almost constant in real terms. The parties are currently bound by nominal prices set over three decades ago when the increased value of agricultural produce has seen fertiliser prices that are both higher and more volatile.

Fertiliser	Nominal price (£/tonne) in any given year						
	1983	1986	1993	2001	2007	2009	2015
Ammonium Nitrate (34.5% N)	£138	£149	£110	£115	£156	£368	£265
Triple Superphosphate (45% P)	£141	£179	£110	£127	£148	£690	£275
Muriate of Potash (60% K)	£91	£107	£105	£112	£145	£580	£275

Source: 1983 to 2015 editions of the *John Nix Farm Management Pocketbook*

The presence of fixed prices in the existing Compensation Regulations generates a cost to incoming tenants as they are faced with remedial action to return the land to full productivity. This is because outgoing tenants are not incentivised to invest in improving the quality of the land they farm because they know they are unlikely to receive commensurate compensation.

Revoking the Compensation Regulations will increase the cost to the landlord who must now pay compensation at current market values and remove the need for remedial action by the incoming tenant. It should also result in reducing the unnecessary productivity loss for the incoming tenant.

It is important to note the size of the financial cost to landlords and the corresponding saving to incoming tenants is likely to be dependent on the ability of landlords to recover their costs through increasing land rents. If compensation costs can wholly be recovered through future land rents then landlords and incoming tenants are not expected to experience any changes in welfare standards. It is the expert opinion of TRIG that rental prices will not be sensitive to the level of compensation paid.

There will be a negotiation cost to agree new prices. This may require a small amount of additional agricultural valuers time beyond what is already required at the end of an agricultural tenancy.

The expert advice from TRIG with regards to the preferred option is:

- In the first year after revoking the Compensation Regulations, each terminated AHA requires two hours of professional agricultural valuer's time to prepare the claim;
- A further two hours is required for further review and discussion;
- Tenancy work is overwhelmingly charged on a time basis and a reasonable charge out rate is £120 per hour. This is based on a weighted average of an hourly rate of a partner/associate (33.33%) with support from an associate/assistant (66.67%<sup>1</sup>);
- This hourly rate is expected to remain constant over time in real terms;
- In most cases the outgoing tenant will be responsible to pay the additional valuation time, but in some instances the landlord could pay or contribute. On average it is estimated the tenant will cover two thirds of the cost and landlords one third; and
- Over time, agricultural valuers will learn how to apply these additional requirements reducing the total number of hours to calculate compensation. Time requirements are expected to remain at 4 hours for years 0 and 1, 3.5 hours for year 2, 3 hours for year 3 and 2.5 hours for all subsequent years<sup>2</sup>.

Revoking the Compensation Regulations may also have other impacts. Benefits may be realised through improving the sustainability of farming at the end of an AHA tenancy. There may be a cost if the policy change leads to an increase in arbitration cases or new provisions for expert determination. There is insufficient evidence to assess how often these occur.

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<sup>1</sup> Figures obtained from the Tenancy Reform Industry Group

<sup>2</sup> Figures obtained from the Tenancy Reform Industry Group

## **6.4. Conclusions**

In conclusion, Option 2 will offer the greater benefit to the tenanted farming sector.

## **7. Sector Impacts**

### **7.1. Impacts on Local Government**

The changes in legislation will result in local authorities facing increased costs from having to compensate outgoing tenants on local authority farms at the going market value for a larger number of improvements eligible for end-of-tenancy compensation. This is consistent with private landlords.

### **7.2. Impact on Voluntary Sector**

There are no foreseen impacts on the Voluntary Sector

### **7.3. Impact of Small Business**

The impact on tenanted farms and landlords has been assessed in this document.

There are no foreseen impacts on other small businesses

## **8. Duties / Impact Assessments**

An Integrated Impact Assessment has been carried out. With limited available data no negative impacts have been foreseen in equality, Welsh language or biodiversity; the Welsh Government's three mandatory areas for assessment.

## **9. Competition Assessment**

Please see **Annex A**

## **10. Post Implementation Review**

The Welsh Government will monitor the impact of the regulations and will gather data regarding farm tenancies in Wales. The Welsh Government will continue to have a dialogue with key stakeholders in order to collate feedback on the impact of the new legislation and consider future changes to the regulatory regime. Amendment to the policy and legislation may be considered following the UK's exit from the European Union. Guidance will be issued once the new regulations come into force.



## Annex A

The competition filter test	
Question	Answer yes or no
<b>Q1:</b> In the market(s) affected by the new regulation, does any firm have more than 10% market share?	No
<b>Q2:</b> In the market(s) affected by the new regulation, does any firm have more than 20% market share?	No
<b>Q3:</b> In the market(s) affected by the new regulation, do the largest three firms together have at least 50% market share?	No
<b>Q4:</b> Would the costs of the regulation affect some firms substantially more than others?	No
<b>Q5:</b> Is the regulation likely to affect the market structure, changing the number or size of businesses/organisation?	No
<b>Q6:</b> Would the regulation lead to higher set-up costs for new or potential suppliers that existing suppliers do not have to meet?	No
<b>Q7:</b> Would the regulation lead to higher ongoing costs for new or potential suppliers that existing suppliers do not have to meet?	No
<b>Q8:</b> Is the sector characterised by rapid technological change?	No
<b>Q9:</b> Would the regulation restrict the ability of suppliers to choose the price, quality, range or location of their products?	No