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RURAL BRIEF

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Welcome to this latest issue of the Knight Frank Rural Brief

For farmers and landowners the rest of 2009 looks set to offer some interesting challenges.

While the government pledges on one hand to put food security and production at the top of its agenda, farmers are faced with the threat from the other of having to put more land into environmental schemes and a lack of assertive action to combat the ever-increasing menace of bovine TB.

Meanwhile, pressure continues to build on the valuable tax reliefs available via the ownership of agricultural land, making it vital for landowners to ensure they minimise any potential tax liabilities on their estates.

This Rural Brief discusses these and other key issues affecting farmers and landowners as well as providing an update on commodity and input costs. I hope you find it useful and informative.

Headlines

- Land values weaken, according to Knight Frank research
- Commodity markets remain uncertain
- Agricultural property relief
- VAT cut hope for building repairs
- Price drop slows for prime property
- Voluntary set-aside on cards
- Nitrogen limits lifted
- TB menace grows
- DEFRA overestimates farmland area

FARMLAND MARKET –
Values weaken slightly in stagnant market

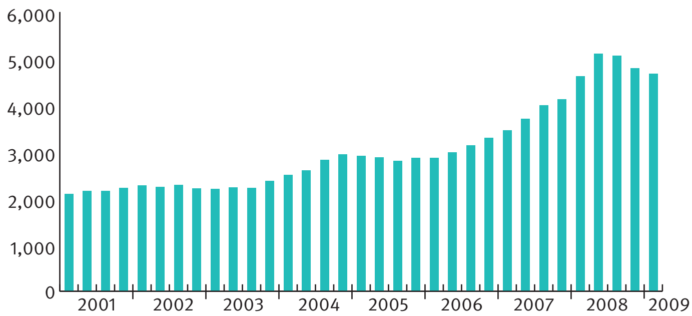
Farmland values weakened by a further 2.6% in the first quarter of 2009, according to the Knight Frank Farmland Index, but the rate of decline has slowed significantly since the final three months of 2008 when values dropped by 5.2%. The average price of English farmland is now £4673/acre.

Values have now fallen in three consecutive quarters, the first time this has happened since 2000, but the slide needs to be put into context. Prices are still up slightly on an annual basis (1.1%) following exceptionally strong growth in the first half of 2008 and the agricultural land market certainly remains more resilient than other property sectors. Average farmhouse values, for example, have fallen by almost 20% during the same period.

The fact that farmland has not fallen so much, despite commodity prices halving and lifestyle and investor buyers stepping back from the market, says much about its strength. A lot of this derives from the limited availability of farmland for sale – the volume of farmland advertised in *Farmers Weekly* dropped by one third in the first quarter of the year. Although there will be some forced sales this year, these will mainly be farming businesses that have over-extended themselves by diversifying outside core agriculture; the majority of farmers are well used to weathering periods of poor prices and there is unlikely to be a glut of land for sale this year.

Prices may weaken marginally next quarter, but investors, farmers and a small number of residential buyers will return to the market by the end of the year and this extra demand should ensure values level off again. If commodity markets improve, prices could start to rise again as early as the final quarter of this year.

Farmland prices (£/acre)



Source: Knight Frank Research

PRESSURE STILL ON FARMERS, DESPITE FIRMING COMMODITY PRICES

The first three months of 2009 have been reasonably positive for farmers as the figures in the table below show, although the announcement that this year's 160th Royal Show will be the last is a reminder of the changing status of agriculture in the UK.

Spot feed wheat values have rallied 13% to over £100/t and the futures market for November 2009 is offering almost £120/t, with £125/t available in March 2010. Fertiliser, the main input cost for farmers, has dropped in price by about 30% since the beginning of the year and fuel prices are also down significantly from their peak.

However, it is worth bearing in mind that many arable farmers will only be making money on wheat at over £120/t so the numbers are still finely balanced. Much of the fertiliser for the 2009 crop was also bought when prices were at their peak – much to the annoyance of farmers.

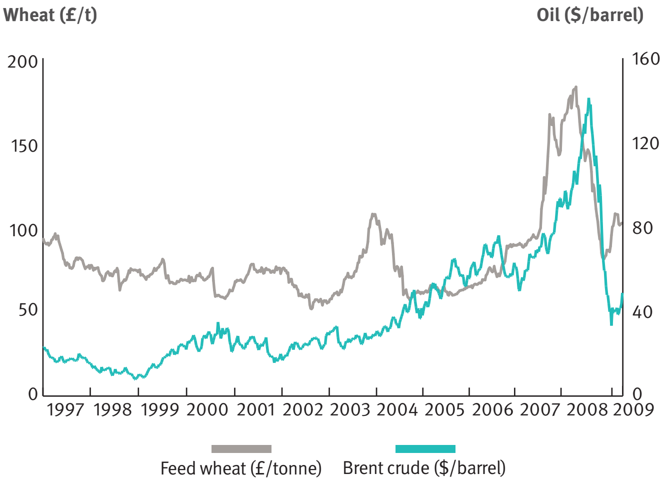
Without the contribution of the single farm payment (SFP), the main EU agricultural subsidy, the UK's total income from farming is predicted to be negative this year, highlighting why support payments remain such a political issue during world trade talks.

Sterling has continued to weaken against the dollar and remains historically low against the euro, although it has clawed back some ground this year. Because the SFP is set in euros and converted into sterling on 30 September, UK claimants will lose out if it the pound strengthens further before then. Some commentators are suggesting that it may be worth locking into the current exchange rate now using one of the hedging services on offer from banks or currency specialists.

Looking forward, there are mixed messages for grain markets. Globally, demand is falling as the recession bites, but the subsequent drop in prices has prompted a decline in world wheat plantings, with the UK acreage falling by as much as 10%. There have also been significant reductions in the US, Russia and Ukraine. Much still depends on weather conditions in key growing areas, but if this translates into a drop in production it could help support prices. In the UK, the announcement that the Ensus bioethanol plant on Teeside will take 1.1 million tonnes of wheat from the 2009/10 crop is also positive.

Meanwhile, the European Commission has acted to help bolster falling dairy commodity prices by increasing the amount of butter it puts into intervention stocks and issuing new export refunds for butter and skimmed milk powder.

Wheat prices v oil



Sources: Farmer Weekly, DairyCo, DEFRA, Knight Frank Research, HGCA, EIA

Agricultural price changes 2007-2008

Commodity prices	Mar 2008	Dec 2008	Mar 2009	Quarterly change (%)	Annual change (%)
Feed wheat (£/t ex-farm)	181	90	102	13.3	-43.6
Oilseed Rape (£/t ex-farm)	360	231	244	5.6	-32.2
Cattle (R4L steers p/kg dw)	250	278	285	2.5	14.0
Sheep (R3L lambs p/kg dw)	326	292	380	30.1	16.6
Pigs (DAPP p/kg dw GB av)	114	131	143	9.2	25.4
Input prices					
Red Diesel (p/litre)	53	41	40	-2.4	-24.5
Oil ($/barrel Brent Crude)	104	43	48	11.6	-53.8
Fertiliser (£/t AN 34.5%)	285	381	264	-30.7	-7.4
Soyameal feed (Argentine £/t)	260	237*	255	7.6	-1.9
Economic indicators					
Interest rates B of E base %)	5.25	2	0.5	-75.0	-90.5
Inflation (CPI)	2.5	3.1	3.2**	3.2	28.0
£:€ rate	1.25	1.02	1.08	5.9	-13.6
£:$ rate	1.99	1.46	1.43	-2.1	-28.1

*November Figures/**February 2009

AGRICULTURAL PROPERTY RELIEF

The European Commission is warning that the UK could face legal action unless it makes changes to Agricultural Property Relief (APR) legislation, which can exempt farmland and certain other classes of agricultural property from inheritance tax.

Currently, only assets held within the UK qualify for this relief, meaning any holdings owned in Europe would be taxed at the full rate of 40% on the death of a landowning UK taxpayer. The EU claims this restriction is not compatible with the free movement of capital within the union as enshrined in Article 56 of the EC treaty because it dissuades UK taxpayers from buying land in other member states.

Accountants are concerned that the EU criticism could encourage the UK government, which has been progressively clamping down on APR claims anyway – particularly in relation to farmhouses – to look again at APR.

EU OPENS DOOR FOR VAT CUT ON HISTORIC BUILDING REPAIRS

A more welcome EU intervention into UK taxation policy is the commission's decision to allow the VAT rate on building repairs and maintenance bills to be cut from 15% to 5%. The move, if implemented by the UK government, will be particularly welcomed by the owners of historic or listed buildings. These can be extremely expensive to maintain or repair especially as onerous conditions can sometimes be applied to any work carried out on listed buildings.

It would also partially correct the anomaly that has long allowed alterations or additions to listed buildings to be zero-rated for VAT purposes. Conservation bodies, which are now lobbying the government to act on the EU's decision, claim this has encouraged the changing rather than the maintenance of the UK's historic built environment.

FALL IN PRIME COUNTRY HOUSE VALUES STARTS TO SLOW

The price of prime country property continued to fall in the early part of this year, but the rate of decline has halved. According to the latest Knight Frank Prime Country House Index, the average value of prime country properties fell by 4.7% in the first three months of the year, compared with a 9% fall in the final quarter of 2008. Prices have now dropped by 20% in the past 12 months.

This significant readjustment suggests that vendors of even the best houses now realise they have to adapt to market conditions and be realistic if they want to achieve a successful sale. There are signs that this change of attitude has led to some confidence returning to the market as potential purchasers take advantage of the reduced prices and falling interest rates. Sensible pricing has also led to the return of competitive bidding, with guide prices being exceeded in some instances.

Prime Country Property – price change by sector

Property Type	Quarter 1 price change %	Annual price change %	Average value £
Cottage	-4.4	-21.1	0.44m
Farmhouse	-4.0	-19.2	1.1m
Manor House	-5.9	-19.8	2.6m
Unweighted average	-4.7	-20.0	1.3m

Source: Knight Frank Residential Research

VOLUNTARY APPROACH URGED FOR "SON OF SET-ASIDE"

As reported in the last issue of the Knight Frank Rural Brief, the UK government is unwilling to abandon the concept of set-aside completely, even though it has been officially scrapped as part of the Common Agricultural Policy. However, it has now bowed to pressure from farming and landowning organisations by agreeing to consider a voluntary scheme.

It is feared that compulsory measures, which could see 5% of arable land taken out of production and turned over to conservation, would actually have an adverse effect on wildlife because many farmers would abandon existing schemes. The plan also appears to contradict a recent government pledge to maximise food production in the future.

Bodies like the National Farmers Union and the Country Land and Business Association now have under two months to come up with an alternative. The difficulty they face is that the government has set no clear targets for the benefits it hopes the new environmental set-aside scheme will deliver or how they will be measured. Details of the consultation process, which closes on 27 May, can be found on the DEFRA website.

WELSH & ENGLISH TAKE DIFFERENT APPROACH TO BOVINE TB

Over 40% more cattle were slaughtered in Great Britain during 2008 because of bovine tuberculosis than in 2007, according to latest government figures. Nearly 40,000 animals were killed with a 19% rise in new incidences of the disease. The number of herds affected rose by a fifth with almost 8,000 under TB restrictions, about 9% of the national herd.

In Wales, the national assembly has taken radical action by deciding to cull 80% of the badger population (which is widely blamed by farmers and vets for the spread of TB) in a designated area, in conjunction with tough new bio-security measures. Such a move is bound to be controversial because it is disputed that culls are actually effective in controlling TB or that badgers are even responsible for its spread.

Whitehall, perhaps acknowledging the strength of the pro-badger lobby and the potential public outcry, has refused to allow the culling of badgers. Instead, DEFRA secretary Hilary Benn has announced that trials of an injectable TB vaccine for badgers will start next summer. Farmers will be expected to help catch the badgers in the trial areas.

Mr Benn has acknowledged that an injectable vaccine will not be practical on a widespread scale, but said it was the first step towards the development of a more easily administered oral vaccine.

LIVESTOCK FARMERS WIN ANNUAL NVZ REPRIEVE

Livestock farmers within the newly expanded Nitrogen Vulnerable Zones, which now cover 70% of England and Wales, and parts of Scotland, have been granted permission to apply for a derogation that allows them to exceed the EU's 170kg/ha limit on the application of nitrogen from animal manures.

This option will be of particular benefit to dairy units, with an estimated 40-50% likely to be above the limit. Complying with the original limit would either have meant reducing stock numbers or a huge financially unviable investment in new slurry-handling facilities.

The derogation process, however, won't be as straightforward as many would like. Farmers will have to apply on an annual basis and will still need to keep within an overall nitrogen application limit. There will also be a heavy paperwork burden with detailed nutrient plans for each field required.

GOVERNMENT ADDS £56BN TO FARMING'S BALANCE SHEET

The Department of the Environment, Food and Rural Affairs (DEFRA) was forced into an embarrassing U-turn last month when farm minister Huw Irranca-Davies over-estimated the area of English farmland by a staggering 5m hectares.

In a statement to parliament, the minister claimed England possessed 14m hectares of farmland. At current average values this would have boosted the total value of agricultural land in England by £56bn.

Sadly for landowners DEFRA was later forced to admit that England in its entirety including towns and cities is still only 13m hectares with farmland accounting for 9.3m hectares.

Farming organisations and the Conservative party said that while the mistake was so big it was almost laughable, it was worrying that DEFRA didn't even know how much land it was responsible for.

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READY TO HELP –

Knight Frank offers a wealth of in-depth specialised experience covering the rural property sector. Please get in touch with any of our experts if we can be of any help to you or your business.

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