Briefing

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Reforming the agricultural tenancy sector in Scotland: the proposals

This note seeks to provide a flavour of some of the more eye-catching proposals to reform the agricultural tenancy sector in Scotland.

At the Royal Highland Show in 2013, Richard Lochhead MSP and Cabinet Secretary for Rural Affairs and the Environment announced that there would be a review of the Agricultural Holdings legislation. Initially part of the Scottish Government's general review on land reform, it was decided that the Agricultural Holdings legislation merited separate attention. The review group appointed pursuant to that announcement recently released its final report, making a total of 49 recommendations to reform the agricultural tenancy sector in Scotland.

Rather than provide a detailed analysis of all 49 recommendations, this note seeks to provide a flavour of some of the more eye-catching proposals and what they might mean in practice. The proposals are very much at an early stage – not all will be implemented, and certainly not in current form. However, they do provide an indication of the way the wind is blowing.

The stated aims of the report are to:

- encourage further agricultural letting given the significant recent decline in the letting of agricultural land, encouraging new entrants and facilitating retirement with dignity;
- establish suitable letting vehicles for the 21st century; and
- promote and ensure productive relations between tenants and landlords, including providing effective means for speedy and cost effective dispute resolution.

Against these aims, one of the first recommendations of the report is the creation of a new office of Tenant Farming Commissioner to promote and secure effective landlord/tenant relationships and behaviour across the sector. Concerns have been voiced about the cost of this, and whether the Commissioner would have "teeth", and it is suggested that agreed codes of practice would be implemented and adhered to.

Rent

With regard to the setting of rents (and specifically noting the recent well publicised cases in which agricultural rents were steeply increased under the current statutory review procedure), the group propose that the review of rents for secure 1991 Act tenancies should be amended so that rents are determined on the basis of the productive capacity of the holding rather than on an open market basis. The productive capacity test assumes that the land is farmed by a hypothetical tenant (who is an efficient and experienced farmer with adequate resources who will make best use of the farm), using the fixed equipment provided by the landlord and taking account of the budget for the holding and any contribution from non-agricultural diversified activity.

This test seeks to strike a balance between setting a fair rent for the holding, having regard to its productivity, and ensuring that the landowner recovers a sustainable investment from renting the land in the first place. However, given the drastic departure that this represents from the current process it may, if implemented, take a few years for the market to stabilise and indeed further high increases (or decreases depending upon the nature of the holding) may result in the short term.

The rent review period will remain at 3years and it is suggested that any housing provided (in excess of that required for the reasonable labour requirements on the holding), should be considered when regulating review/ determining rent. The industry will also be encouraged to publicise rental calculations to assist in negotiated settlement of rents.

Investment and Improvements

Capital investment has always been a tricky subject for secure 1991 Act tenancies. Often, improvements are effected by the tenant but not properly documented and therefore not compensated at waygo. Alternatively, the tenant may be unable to raise sufficient funds to implement any improvements they desire because they are unable to grant a mortgage or security over their tenancy, in the same way that they could if they owned the land. As a result, the group recommends that secure 1991 Act tenancies should be registerable in the Land Register (in the same manner as ownership) in an attempt to facilitate the tenant's ability to grant a standard security over the lease to raise funds. However, given that resumption of all or part of the tenancy may be possible (in line with the terms of the tenancy and statute) and the tenancy is terminable by the landlord through service of an incontestable notice to quit, including where there is a breach of the tenancy, the tenancy would still remain unsuitable for security purposes from a lender's perspective. Further protection would be required and this might include step-in rights enabling the lender to remedy any breach caused by the tenant before the landlord can terminate the tenancy but, as this detracts from the landlord's ability to terminate the lease, such provisions may well have implications under the European Convention on Human Rights ("ECHR").

In the same vein, an amnesty on improvements for 3 years is also recommended with a view to providing a period during which tenants can have previous improvements properly documented (with the ability for landlords to object and referral to the Land Court in the event of a dispute) to ensure that such improvements are compensated where they are eligible.

Succession

Succession to secure 1991 Act tenancies was a key issue for the group. Current provisions for succession and assignation are complex and differ depending upon whether a transfer takes place on the death of the current tenant or during their lifetime. Although it was not suggested that the class of persons entitled to succeed to/be assigned a tenancy should be significantly widened (again due to the negative impact on landlords' rights and ECHR implications), the group sensibly proposed that the provisions for succession and lifetime assignation should be aligned and that the class of beneficiaries should be same.

A recommendation was also made for any secure 1991 Act tenant to be able to convert their tenancy into a new long duration and "modern" Limited Duration Tenancy ("LDT") with a minimum term of 35 years. The tenant would then be entitled to transfer that LDT to anyone on the open market and for value. The aim here is to allow a secure agricultural tenant with no identified successors to effectively sell the tenancy to a third party. However, the tenancy must have a definite duration as otherwise there may be too great a negative impact on the landlord's property rights under the ECHR. That being said, should these provisions be enacted there is still a negative impact for any landowners expecting to obtain vacant possession of their holding in the next few years.

Right to Buy

The proposal to give secure 1991 Act tenants the absolute right to buy their holding was well publicised. This would be an extension of the current statutory provision whereby a tenant can register a pre-emptive right to buy the holding if the landlord enters into discussions to sell it. The group properly identified that allowing an absolute right to buy would negatively impact the sector by deterring landlords from letting land. Instead, they have suggested that all 1991 Act tenants should automatically have a pre-emptive right to buy – i.e. without the need to register a notice of interest – and for that right to buy only to be triggered in the event that the land is marketed for sale or a negotiation is successfully concluded on a private contract to sell the land.

The latter part of this proposal is to be welcomed as the current provision (whereby the right can be triggered as soon as the landlord enters into discussions to sell the land) is vague. It can deter landlords from taking steps to ascertain if they might wish to sell the land for fear of inadvertently triggering the right.

As to the former, allowing agricultural tenants an automatic right to buy may mean that the process of offering the land to the tenant would have to be undergone even where the tenant has no interest in acquiring the land (and would not have registered a notice).

As a means of anti-avoidance, it has also been suggested

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that where the landlord is a company then the right to buy should be triggered upon a sale of shares in the company for value. This raises the question of where such anti-avoidance provisions should stop – transfers via the back door may also take place where the landlord is a limited liability partnership or other legal structure.

Lastly, it is recommended that where the landlord persistently fails to fulfil their obligations under the tenancy the tenant should ultimately be entitled to apply to the Land Court for an order requiring a sale of the holding. Whilst it is intended that this is something of a last resort, it is notable that the effect of such an order would be to trigger the tenant's right to buy.

New Tenancies

Looking ahead, the group recommended new forms of LDT as the means of letting agricultural land. They suggested a new "modern" LDT with a minimum ten-year term and greater freedom for parties to agree the terms of the lease (many of which are currently prescribed by statute). An optional break at 5 years is suggested only where the tenant is a new entrant. Although not expressly stated, a consequence of this recommendation is that the current Short Limited Duration Tenancy ("SLDT") of up to 5 years would be abolished (otherwise it provides a means of circumventing the new LDT). Whilst current SLDTs may not be affected, they would ultimately be phased out if new SLDTs were prohibited.

The group also recommended a 35 year full repairing LDT to allow the tenant to take on full responsibility for the repair, renewal and replacement of all fixed equipment. The aim here is to incentivise landlords to let units to capable tenants, knowing that the landlord will have little responsibility for the holding and that it would be in good hands – albeit for a much prolonged period and with rent reviews being based on the productive capacity test.

Modern LDTs would be assignable within their duration (including for market value) but the landlord would have the ability to object on the basis of current grounds such as lack of finance, ability or character of the assignee.

Existing grazing lets would be retained – but extended to expressly include cropping – and would be the sole means of letting agricultural land for a period of less than 10 years. It may be that anti-avoidance provisions are imposed to prevent landlords granting successive grazing lets in an attempt to avoid creation of an LDT.

Limited Partnerships

Limited partnership leases have been the subject of much high profile case law and complex legislation. The review makes no recommendation other than to set state that landlords and general partners should try and negotiate to convert the tenancies into new modern LDT's on appropriate terms.

The general principle of phasing out limited partnership leases cannot be faulted – in our experience the legislation often gives rise to circumstances which could not have been envisaged by either party at the outset. They can be something of a minefield, both to the landowner (in potentially being exposed to the liabilities of the limited partnership and/or being unable to recover vacant possession of the holding as envisaged), and also to the general partner/tenant (who may lose possession of the holding sooner than anticipated, and without the usual notice).

Conclusion

As indicated at the outset, this note is intended as a canter through the recommendations and to give a flavour of the reform that is presently on the agenda for the agricultural tenancy sector. Although Richard Lochead is keen that the recommendations are dealt with in the Land Reform Bill and passed before May 2016, we are still at an early stage in the process and there will no doubt be further twists and turns before any legislation is enacted. However, both landowners and tenant farmers alike would be well advised to consider their individual circumstances and what the implications of reform may be for them- and accordingly what actions (if any) should be taken in order to best protect their position.

Some of the recommendations are more radical than others, but it is nonetheless clear that significant change is on the agenda which will impact on both sides.

For further information or advice on any of the issues discussed in this briefing note, please get in touch with any of the lawyers listed overleaf or with your usual Shepherd and Wedderburn contact.

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