Contents

Chapter 1 – Industry description and background

1.1 Setting the scene

The previous edition of this book was written in the summer of 2008 at which time the farming industry was starting to emerge from a long and painful period of stagnation going back to the mid-1990s. Just as we went to press, the credit crunch struck and we have since seen the rescue of two major banks, a series of international bailouts and a prolonged period during which base interest rates have been well below inflation.

In the wider world, populations have continued to rise. Despite some slowing of worldwide growth the major engines of economic change in India and China have continued to drive rising standards of living in those countries, and as a result, have sucked in grain stocks and have helped keep food prices well away from the troughs of the 1990s. At the same time the needs of the biofuels industry have created a new demand, whilst the traditional problems of drought, flood and frost have had some impact on world production.

The effect of all of these factors on UK agriculture has been broadly positive. For example, in the four years to the summer of 2012 the price of feed wheat rose by some 26 per cent, oilseed rape by 21 per cent and potatoes by 13 per cent. Pork, beef and lamb rose by 21, 31 and 35 per cent respectively, with only milk lagging behind with a rise of barely seven per cent over the period. Unsurprisingly perhaps, input costs have responded to both the pressures of the market place and the increase in oil prices, with diesel and fertiliser costs increasing by over 70 per cent in the same period. All these changes have come about at a time when RPI inflation has risen at a modest 11.5 per cent over the four-year period.

After several years in the financial wilderness, then, farming is currently being perceived more positively. Banks that are being urged to lend more money whilst simultaneously reducing the risk on their balance sheets now see agriculture as an attractive proposition, with rising land prices underpinning better profitability. The same rise in land values gives a confidence to the industry, and backed by better commodity prices and some optimism for the medium term, many farmers are looking to invest for the future, secure their succession and expand their holding.

Of course, life is never that simple. The catchphrase 'farming industry' covers a huge variety of enterprises from the part time smallholder on a rented holding, to the diversified and integrated agribusinesses farming many thousands of hectares and their perceptions will not necessarily be the same. Whilst the 'big picture' may look quite encouraging, the difficulties of drought, flood, pests and disease are the same today as they always were, and in the short term these issues are far more pressing than US grain reports or Russian export policies. Bank managers may be happier to lend to farmers than to most other businesses, but they still want to see forecasts being met and no surprises in the cashflows.

There is also still some uncertainty overhanging the UK industry as the Single Payment regime moves towards the end of the current review process. In recent years the Single Payment and its predecessor schemes have been of fundamental importance for UK farmers and for many years the whole industry would have been running at a substantial and unsustainable loss in the absence of that support. A fundamental review is largely complete with a view to implementing a new scheme from January 2015, and there is a general view among commentators that the scheme has moved towards more environmental requirements, and less financial rewards.

Land

Land values in the last three or four years have increased significantly moving the reported average values from approximately £5,500 to at least £7,500 per acre with many actual deals closing at well above that level. Enduring taxation advantages and limited supply are relevant factors in the market place and the sharp increases in values have encouraged owners to sell where they would not usually have done so. Continued access to affordable debt with bank base rate remaining at an all-time low and fixed rates looking attractive has enabled the profitable farmer to add to land holdings. The returns even at much improved commodity prices still look insufficient to justify the investment but farmers are happy to spread the costs over existing unencumbered holdings and to remind advisors that 'there has never been a good time to buy and the long term will prove the decision a wise one', or words to that effect.

Reported land value results do of course ignore those poorer holdings that do not find a buyer and are inevitably averages.

Land value increases lead inevitably to upward pressure in rents with a hardening of rents under Agricultural Holdings Act tenancies from the £60 per acre to the £90 per acre in arable units and Farm Business Tenancies being renewed in the region of £130 to £150 per acre with those going to tender achieving £200 plus.

Common Agricultural Policy

The current system of support under the Common Agricultural Policy of the European Union was introduced on 1 January 2005 and was due to end on 31 December 2012.

Proposals were issued by the Commission in October 2011 for a revised system planned to take effect from 1 January 2014 effectively rolling forward the existing scheme for a further 12 months.

The new scheme will go live on 1 January 2015.

The key proposal is that the existing system of entitlements will come to an end with the issuing of new entitlements in the first year of the revised scheme based on land occupation at that time assuming the applicant is an 'active farmer'.

The new scheme will make payments in two parts being a basic payment likely to be somewhere around 70 per cent of the payment with the balance arising from 'greening payments' based on 'ecological focus assessments'.

It is likely that UK applicants will see their levels of support fall given a freeze on the CAP budget and the demands of supporting the more recent members in the same fund.

A more detailed appraisal of the new scheme is dealt with later in the text to the extent it is agreed at the time of writing.

The Arable sector

As we update the text, the 2013 harvest is behind us. The year 2011 was a time of sustained drought particularly in the east and this continued into spring 2012 when the inevitable correction arrived with a sustained cold and exceptionally wet spring and summer (possibly the worst for a century). This had a significant effect on crops and grass alike turning what looked like excellent potential into disappointing quality and yield and a burden of increased input costs in an attempt to combat disease. Both 2012 and 2011 offered extreme contrast with the very low yields of 2011 with little straw and early harvest turning to much higher yields with heavy straw production but with the issues of slow ripening and disease taking the shine off the results. Both years, however, enjoyed the enhanced prices available despite the strengthening of sterling. Expectations of poor US and continental European harvests have ensured world grain prices were at an all-time high with improvements locally in potato and vegetable returns. 2013 was different again with a wet 2012 autumn and cold spring in 2013 dampening expectations. 2013 harvest was better than expected in a lot of cases but prices of all commodities fell back by up to 25 per cent over 2012 on the back of better worldwide production.

The industry continues to experience ever increasing input costs with significant rises in fuel and fertiliser/spray costs and usage.

The Sugar Beet grower is experiencing a second harvest much improved over 2010–11 and continuing negotiations with British Sugar have secured an increase in price. Uncertainty still exists within the Sugar Regime with the impending abolition of the European quota system in 2017.

The Livestock sector

Starting with the milk industry, recent developments have seen a shift reversal in the cuts in the price paid by the dairy companies following an agreement on a code of conduct in the industry. Whether this has the desired effect of giving the producer a return above cost of production long term, will no doubt be seen in due course. Feed prices have stabilised after the drought in 2011 and extreme wet weather of 2012 impacting on forage crops with a better forage crop harvest. The milk industry had seen a better period of profitability in the immediate past and the value of cattle has increased as a result, but a low level of milk production in the UK has not seen an appreciable increase in the value of milk quota. There continues to be issues with Bovine Tuberculosis in the West and a high profile debate on badgers and their role in spreading this disease. The flight from milk in the Eastern counties continues with those few producers left cashing in on high cow prices often on the back of their TB free status.

The beef sector has continued to enjoy strong prices but has had to contend with increased input costs from improved arable prices and a high World price for protein. Calf prices have firmed (giving some relief to the dairy sector) further increasing costs to the beef finishers.

Sheep farmers have seen some recent respite from the cycle of low returns with lamb price increasing and even a better price for wool (although still very low). Disease has once again reared its head with the introduction from Europe of the Schmallenberg Virus (SBV). It is thought to be spread by midges and causes birth defects in sheep, goats and cattle although there is no evidence that is has any effects on humans. The greater effect has so far been felt in the UK sheep sector. Little is known of the disease although work is in hand on a vaccine.

Pig farmers continue on the well-trodden path of highly variable returns. After a period of relative prosperity the 'all pig price' index has remained strong but feed costs in particular rose in 2012–13 dramatically eating into the margins although the fall in commodity prices from the 2013 harvest have helped a good deal. As with the dairy industry the sector continues to campaign vocally for a fair price but continues to compete with a cheaper continental product as our competitors slowly move to meeting EC welfare requirements with the attendant cost implications.

Similar concerns apply to the poultry sector coupled with the abolition of caged bird production of eggs in January 2012 leading to a boom in free range production whilst some overseas caged bird eggs continue to be imported. The relative speed at which production can be increased in this sector can lead to spikes of over supply and falls in prices as a result. As with pigs, this sector is now in the hands of ever fewer producers who are more able to weather the ongoing problems.

1.2 Introduction to the industry analysis

Agriculture is a highly visible primary industry which suffers from problems of public perception not helped by the increasing urbanisation of the UK population. The population often has somewhat outdated pastoral perceptions of the countryside and what should go on in it. Therefore, countryside maintenance, welfare issues, visible pollution and other similar issues are important. Also, there are demands for tourism and leisure that are not always compatible with food production. This has placed the industry under increasing pressure from most interested parties.

The current CAP took on board the requirements of World Trade Organisation (WTO) agreements and moved European agricultural support away from food production security towards environmental support, reducing trade distorting support through the subsidies system which will no doubt continue as a theme under the current renegotiation process.

The source of most of the following data is from *Agriculture in the United Kingdom* 2012 produced annually by Defra as a requirement of the *Agriculture Act* 1993.

1.3 Industry structure

1.3.1 Number and size of holdings

Agriculture is one of the country's largest industries. After a decade of decline, recent years have seen a large movement in commodity values coupled with significant inflation in input costs. It currently contributes £4.7bn to national GDP (approximately 0.5 per cent of GDP). This was a fall of 14 per cent over 2011.

Each farming business has a 'Holding Number', enabling a record to be maintained of all agricultural holdings. The size of holdings is currently measured in the UK for statistical purposes on the basis of 'commercial' units which thereby exclude small units and the hobbyist. An analysis of the position in 2011 is shown in Table 1.1:

Table 1.1 Number of holdings

	Number of holdings '000
Under 20 hectares	104
20 to 50	42
50 to 100	34
100 and over	42
Total	222

Of this area of 17,149,000 hectares, 6,258,000 is regarded as croppable.

1.3.2 Land use

Total available land for agriculture amounts to around 18.3m hectares (45.22m acres) of land in the UK. This is in the region of 76 per cent of the total land area of more than 24.1m hectares (59.5m acres).

The 18.3m hectares in agriculture are used as shown in Table 1.2.

Table 1.2 Use of land

	'000 Ha	%
Crops	4,748	24
Uncropped land	153	3
Grass under five years old	1,357	7
Permanent grass	5,799	31
Owned rough grazing	3,926	24
Common rough grazing	1,200	6
Other land: roads; buildings; woodlands	1,166	5
Total		100

The areas of the main individual crops grown on the 4,748 hectares used for cropping are shown in Table 1.3.

Table 1.3 Areas of individual crops

	'000 Ha	%
Cereals		66
Wheat	1,992	
Barley	1,002	
Oats	122	
Rye and mixed corn & Triticale	26	
Other crops		21
Oilseed rape	785	
Sugar beet	120	
Peas and beans	120	3
Linseed	28	
Potatoes	149	3
Maize	158	3
Horticulture		4
Vegetables	123	
Orchard fruit	24	
Soft fruit & wine grapes	9	
Nursery stock, bulbs and flowers	12	
Glasshouse crops	3	

1.3.3 Livestock numbers

The number of cattle and sheep had in the past been generally dictated by quota: milk quota in the dairy herds, and headage quota in beef and sheep. Reform of the CAP in 2005 removed the quota system for cattle and sheep although milk quota will continue in the short term and possibly longer. Livestock numbers are now being dictated by sector profitability as has been the case for unsupported livestock (pigs and poultry) for years. Profitability depends more and more on intensive competition from Brazil and the Far East, as well as consumer demand, welfare legislation and 'food scares'. At the time of writing, the increase in commodity prices is putting significant pressure on the livestock sector as feed costs escalate. Particular problems exist in dairying with low milk prices and within the pig sector, even though here numbers tend to be cyclical as a result of producers responding to their profitability.

Table 1.4 Livestock numbers

	Numbers '000
Dairy cows held in herds	1,812
Beef cows held in herds	1,657
Other cattle	6,431
Ewes and shearlings	15,229
Lambs under one year old	16,229
Breeding sows	357
Gilts in pig	69
Other pigs	4,055
Table poultry including broilers	102,558
Laying poultry	46,653
Other poultry	10,870

1.3.4 Self-sufficiency

The UK is approximately 60 per cent self-sufficient in total food and feed of all types, and 76 per cent self-sufficient in indigenous food and feed. The self-sufficiency of individual products is shown in Table 1.5.

Table 1.5 Self-sufficiency of individual products

Commodity	***% Self-sufficient***
Wheat	98
Barley	108
Oats	92
Oilseed rape	168
Linseed	226
Potatoes	77
Sugar	59
Fresh vegetables	56
Fresh fruit	10
Beef and veal	84
Mutton and lamb	101
Pork	59
Poultry meat	89
Dairy products	103
Eggs	85

1.3.5 Workforce

There has been a steady decline in the agricultural workforce over the years to around 481,000, representing approximately 1.5 per cent of the total employed workforce. The total number employed as an average for the years 1994–96 was 621,000, demonstrating the reduction. More telling is the breakdown between farm workers and farmers. Farm worker numbers have declined from 249,000 in 1996 to 172,000 in 2012 with the number of farmers falling from 372,000 to 298,000 in the same period. This shows the continued fall in those employed on farms and the increasing reliance on the farmer's own labour.

1.3.6 Farming income and productivity

The agricultural industry in the UK has an excellent record of increasing outputs as a result of optimising yields. As technology enables yields to improve, so it leads to reductions in manpower requirements, increasing overall efficiency.

Farming income peaked in 1995 and has subsequently dropped dramatically from its peak of £5,297m to £2,500m in 2007 from there to rise again to 2011 at £5,785m, falling back to £4,700m in 2012 which is based on total income from farming, being gross output including subsidies, less gross inputs, depreciation, interest, rent and hired labour.

1.3.7 Capital

The capital employed in individual farming businesses is discussed in Chapter 4. The balance sheet for agriculture in the UK from a lender's point of view continues to be strong. This is because of the value of the land and property. The value of tenanted land is also included in the following table. The statistical information available is somewhat out of date with respect to land and the value will have increased in the last two or three years significantly.

Table 1.6 The aggregate balance sheet for agriculture in the UK – December 2010

	£ million
Assets	
Fixed	
Land and buildings (2009)	176,379
Plant, machinery and vehicles	9,449
Breeding livestock	7,756
Total fixed capital	193,584

	£ million
Current	
Trading livestock	2,860
Crops and stores	3,486
Debtors and cash	1,219
Total current assets	7,565
Total assets	201,149
Liabilities	
Long and medium-term	
Bank loans & asset finance	2,523
Family and other debt	118
Total long and medium-term	2,641
Short-term	
Bank overdraft	575
Other including trade credit and leasing	607
Total short-term	1,282
Total liabilities	3,923
Net worth	197,226

Farmers' equity as a proportion of net worth remains high despite considerable pressures over the past decades, mainly as a result of the increasingly high value of land.

The following table demonstrates that investment in agriculture remains significant and largely consistent even with highly variable returns in recent years. Generous upfront tax allowances on plant and machinery have without doubt enhanced the level of investment made.

Table 1.7 Investment in assets

	2009	**2010**	**2011**
	£ million	*£ million*	*£ million*
Buildings and works	983	836	821
Plant and machinery	1,425	1,333	1,364
Vehicles	35	31	33
Total	2,443	2,200	2,218

1.4 The Common Agricultural Policy (CAP)

1.4.1 A recent history

The EC Common Agricultural Policy was introduced to provide a support mechanism for a number of farm products. It also aims to improve farm structure and the means of agricultural production, to ensure that food continues to be supplied to the consumer at a fair price and that farmers have a fair standard of living through the operation of stable markets.

Major reform of the CAP was agreed in 2003 as a result of WTO agreements and the accession of a number of eastern European countries to the EU. Under WTO classifications, agricultural support is split into three main areas:

1. Direct aid (blue box).
2. Market support (amber box).
3. Rural development (green box).

The McSharry reforms of the mid-1990s saw the introduction of 'arable aid' and 'set aside' schemes with support moved from direct aid to market support, and the latest reforms move still further down this road with the concept of decoupling aid from production.

The current regime came into effect on 1 January 2005. It is a complicated scheme and we do not intend to provide anything other than an overview here.

With a move to decoupling, the question arose as to how the support payments would be allocated and calculated under the new scheme. Various methods were available and all possibilities were adopted in the UK, depending on the farm's region. The general basis of calculation was arrived at by reference to the position in 2000, 2001 and 2002. These reference years provided the source basis of the historical entitlements based on the various sources of EU subsidy received in those calendar years. These included arable aid, set aside and all livestock subsidies for cattle and sheep. Additionally, support to the dairy industry and compensation for the reform of the sugar sector have been added to the Single Payment Scheme. The livestock subsidies were based largely on allocated quotas that were in effect abolished on the introduction of the new system. It should be noted that partial coupling endured for certain pulse crops.

The alternative was to consider a flat-rate system based on the regional acreage.

1.4.2 Outline of the Single Payment Scheme

Within the UK, Scotland and Wales went for an individual historical system, while Northern Ireland adopted a hybrid of the two. England adopted a sophisticated hybrid that starts with an historical system and moves to a flat-rate system over eight years. These also vary according to the three topographical regions in England; namely lowland, non-moorland severely disadvantaged areas and moorland severely disadvantaged areas.

In order to receive the entitlements the holder had to be in occupation of eligible land for the required occupation period and comply with Cross Compliance Rules which entailed:

- Statutory Management Requirements – directives on such areas as livestock welfare, the environment and public health; and
- Good Agricultural and Environmental Condition – keeping the land in good order. These rules apply to the whole unit and cover policies on cultivating, hedge cutting, soil management and the maintenance of permanent pasture.

The entitlements due to a farmer will be calculated taking into account the subsidies claimed in the reference years. These cover arable aid, set aside, livestock payments and dairy premium (based on milk quota on hand in March 2005). They are paid either in euros or sterling, at the recipient's choice, and the conversion factor is set annually with reference to exchange rates in September.

The entitlements are separate from the land occupied and can be traded. They can only be activated by the completion of an annual claim form (SP5a), to be filed annually with the RPA by 15 May. For years 2005 to 2007, the claimant must have occupied or 'have had at their disposal' eligible land for at least a ten-month period in each claim year that can vary from year to year but cannot overlap with a previous occupation period. From 2008, the occupation criterion changed to a one-day test coinciding with the application date of 15 May. There is still an overriding requirement that the land must continue in agricultural usage (although not necessarily in the hands of the claimant) up to 31 December in the scheme year.

Initially, to further complicate matters, there were additional rules affecting the 'negative list crops'. These are previously unsupported crops made up of soft fruit, vegetables and potatoes (SVP). Land in such production could be used only to validate regional payments and only to the extent that the grower has a sufficient reference area available (SVP entitlements). These rules were designed to keep control over the acreage put down to negative list crops. From 2008, these rules were abolished.

The set-aside system continues under the new regime with a limit set since 2008 of zero per cent. Since 2005, the requirement has varied from eight to ten per cent. The concept has not been abolished but merely set at zero per cent whilst there is a perceived under supply of commodities in the world market. Each producer is allocated set-aside entitlements and needs one hectare of eligible land in set aside to validate a claim for each set-aside entitlement.

Over and above annual set-aside requirements there are deductions made into the National Reserve to fund special claimants and new entrants and further deductions under 'modulation' to fund rural development funding. Member States can further deduct 'voluntary' modulation which has been activated by the UK, and the rates vary over the regions.

Extra money raised in the UK will be used to fund agri-environmental schemes such as the Entry Level Scheme and the Higher Level Scheme, as well as organic conversions and Environmental Stewardship.

The existing system of payments under the CAP was due to end on 31 December 2012. New proposals were published by the Commission in October 2011 with a planned start to a revised scheme of 1 January 2014 thus extending the current system for one further year. The complexity of the proposals coupled with the need to gain acceptance from 17 member nations resulted in the introduction being further delayed until 1 January 2015.

1.4.3 CAP Reform Consultation

The CAP Reform consultation document was published on 31 October 2013. As the final form of the revised CAP regime is still to be determined it is not possible at the time of writing to provide guidance on accounting and taxation implications.

Following the negotiations in Brussels over the last few years and the announcement of a broad consensus between the EU Member Nations in summer 2013, much of the detail of the next round of CAP Reform was referred back to individual Member States to thrash out the details.

Outline

Many elements of the new CAP will be similar to current arrangements and take effect from 1 January 2015. The scheme will retain its two pillar structure, pillar one delivering direct payments to farmers and pillar two promoting rural development. A new Basic Payment Scheme (BPS) will replace the Single Payment Scheme as the main element of pillar one which will be amended to exclude some claimants from the Scheme but to provide enhanced support for younger farmers. Pillar two will be delivered by way of support for more important designated sites such as SSSIs and targeted improvements in the wider countryside which may well need to include the land on more than one holding.

Direct Payments

- No new regions will be created and there will be no change to regional boundaries.
- There will be a Single Payment rate for both upland and lowland claims which effectively will reduce the lowland rate by about £6 per hectare.
- The Government has previously suggested that payment on claims over €150,000 will be reduced by five per cent but that the concept of salary mitigation will not be pursued.

  In addition to the capping concept, the Government has considered enhancing payments to smaller holdings but has decided against doing so.
- There will be no introduction of a coupled support scheme for, e.g. protein crops.
- There will be a minimum claim size of five hectares.
- The existing SP entitlements will be rolled forward into the new scheme. There will be a national reserve for young farmers and new entrants.
- The 'active farmer test' which will remove, e.g. airports, railways, water works, etc. from the claimant list will be implemented subject to a threshold of €5,000.
- There will not be a small farmers scheme.
- There will be a young farmers scheme which will give an enhancement of 25 per cent to the basic payment. The size of a young farmers claim will be somewhere between 25 and 90 hectares but no decision has been made on this point of detail.

Greening

- The broad approach to greening will be to monitor it via the direct payments regulation rather than implementing a national certification scheme – although this point is subject to consultation.
- Crop diversification rules will apply to all holdings with greater than ten hectares of arable land. Between ten and 30 hectares there must be two crops and over 30 hectares there must be three crops none of which must cover more than 75 per cent of the arable land (and the two main crops