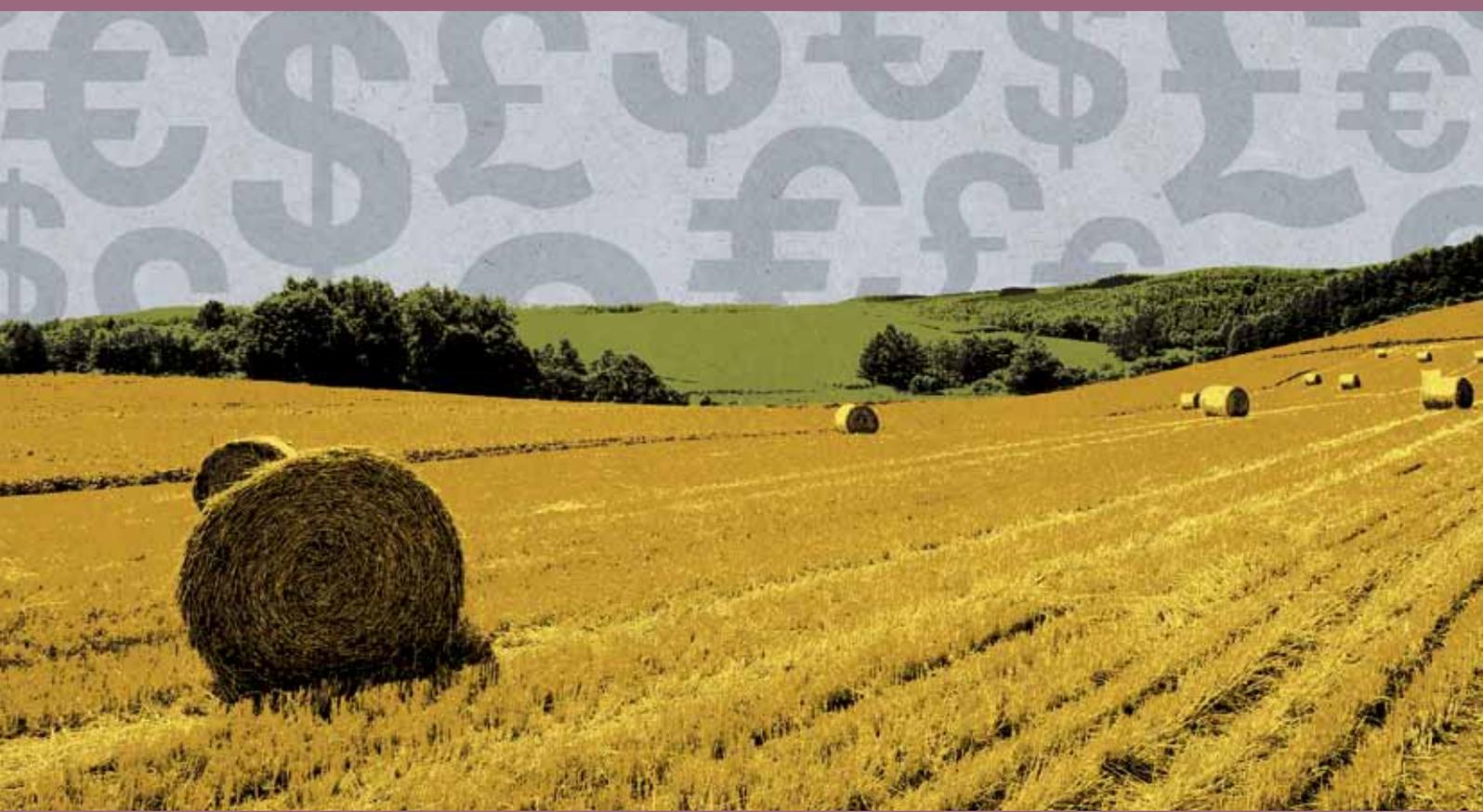


CHESTERTON HUMBERTS RESEARCH BRIEF – SPRING 2012



RETURN TO THE COUNTRY?

The Investment Case for UK Agricultural Land

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The Investment Case for UK Agricultural Land

- Average farmland values in England & Wales reached record levels in 2011 and Chesterton Humberts forecasts that they will increase by an average of 6% per annum over the next five years
- Growth in farmland values has outpaced equities since the early noughties and residential property since 2007
- Over a 5 and 10 year period, rural property total returns outperformed equities by 690 bps and 960 bps respectively
- UK agricultural income growth over the past decade was over three times higher than the EU27 average

INTRODUCTION

The combination of a growing population, rising soft commodity prices and the drive to find sustainable alternative fuel sources is placing growing pressure on the supply of agricultural land which in turn is attracting increasing investor interest. This report examines the performance of the agricultural sector over time and assesses its longer term prospects.

AGRICULTURAL LAND AS AN INVESTMENT ASSET CLASS

Agricultural land is a tangible asset which offers portfolio diversification opportunities, and there is low correlation between yields for farmland and those for other mainstream assets.

The case for investing in the agricultural sector is becoming increasingly compelling. Agricultural land is a tangible asset which offers portfolio diversification opportunities, and there is low correlation between yields for farmland and those for other mainstream assets. This has been of particular relevance during the post-global recession years when agricultural land has performed well in contrast to the uncertainty surrounding the more established asset classes. Moreover, farmland investments have historically provided an effective hedge against inflation and represent a renewable resource unlike, for example, oil and precious metals.

The UK additionally offers tax planning incentives associated specifically with agricultural land which further enhance the attractiveness of the sector. These relate principally to income tax, capital gains tax and inheritance tax. Furthermore, the UK property system is transparent and offers clear title to

owners, within a stable political and economic environment.

Investor interest in agricultural land has increased since the global recession with wealthy individuals (for investment and lifestyle purposes), private equity funds, institutions and specialist agri-funds all represented although the majority of farmland transactions are accounted for by farmers looking to expand operations and, in the current environment, take advantage of high soft commodity prices. Foreign purchasers have benefitted from the relative weakness of Sterling over the past few years.

Accessing the market can be difficult, however, as there is currently a shortage of available land and around 25% of deals which take place are transacted off-market. Transaction volume in 2011 was similar to that recorded in 2010 and was a little under 5% higher than the 10 year annual average.

Figure 1: UK farmland purchasers by type: 2008-11

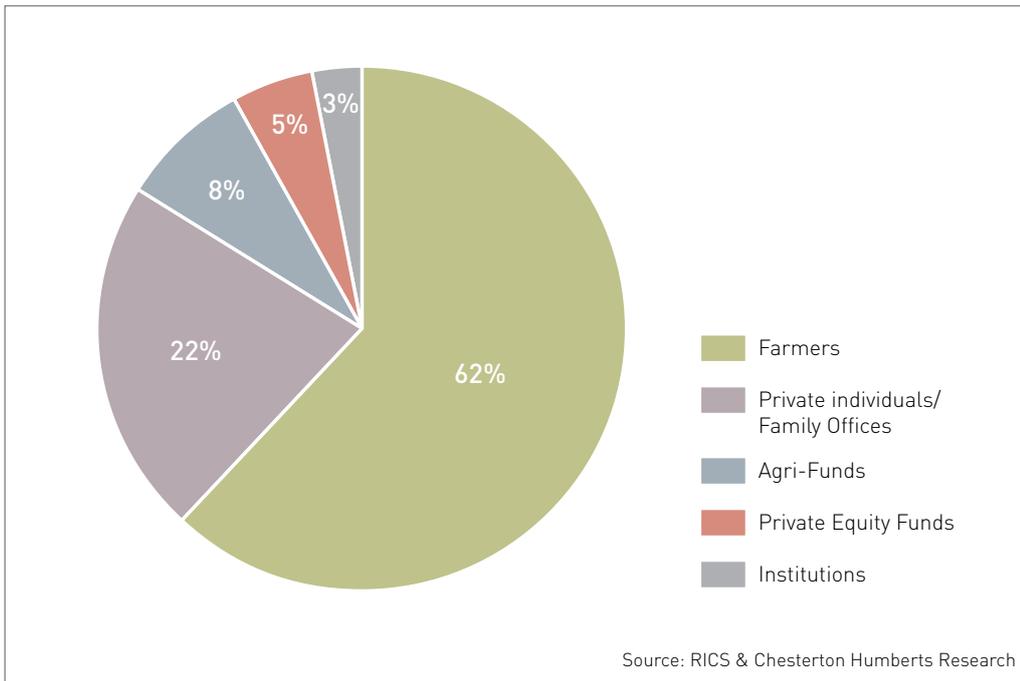
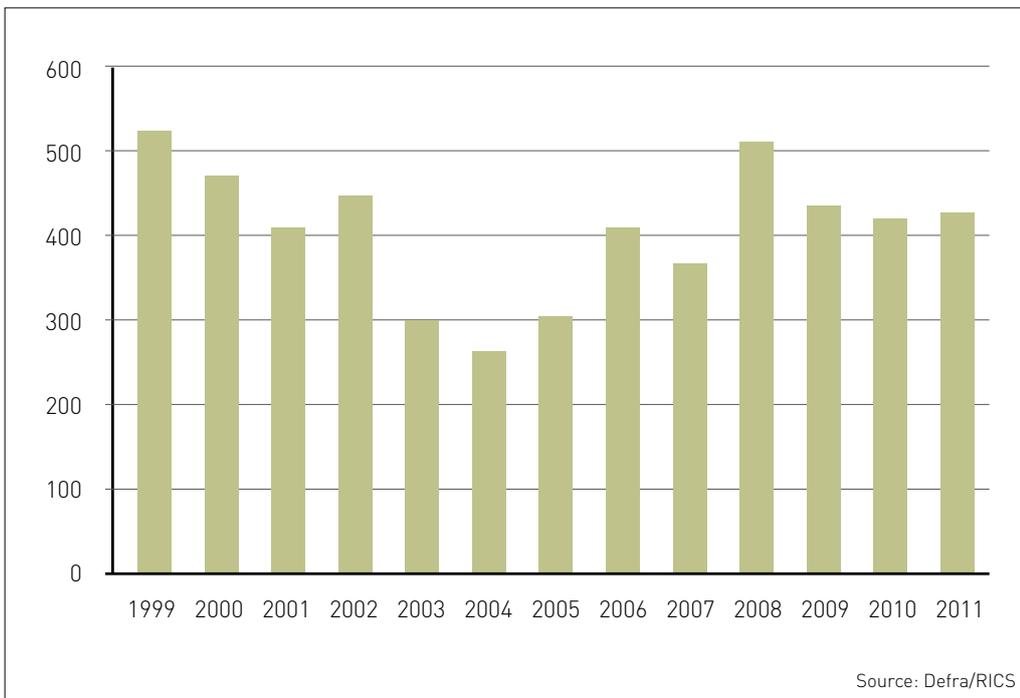


Figure 2: reported farmland transactions

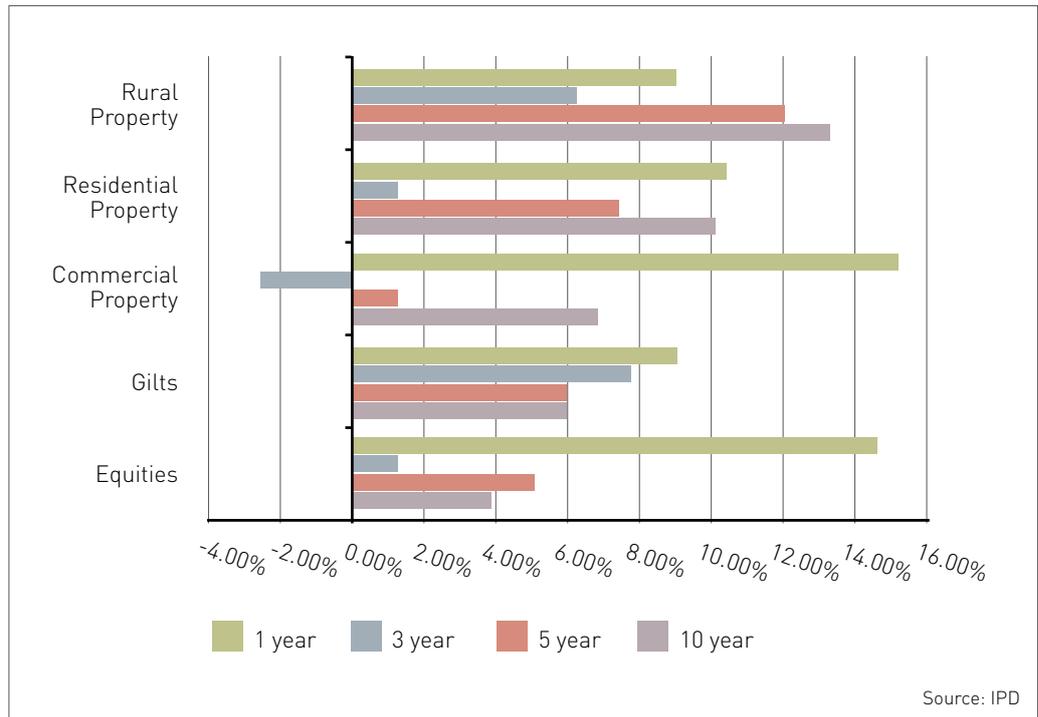


KEY PERFORMANCE INDICATORS

According to the IPD Rural Property Investment Index, the sector in the UK has delivered superior total returns compared to commercial property, residential property and

equities over a three, five and 10 year period and has outperformed gilts over a five and 10 year period.

Figure 3: UK nominal total returns, ungeared, as at end-December 2010



Year on year growth of average farmland values has outpaced that of equities since the early noughties.

Average farmland values in England & Wales have almost quadrupled since 1995 and the RICS Rural Land Market Survey reported that they reached a record high in 2011 of £20,722 per hectare. Year on year growth of

average farmland values has outpaced that of equities since the early noughties, residential property since 2007 and has only been overtaken by gold in the last two years.

Figure 4: Average transacted farmland prices in England & Wales

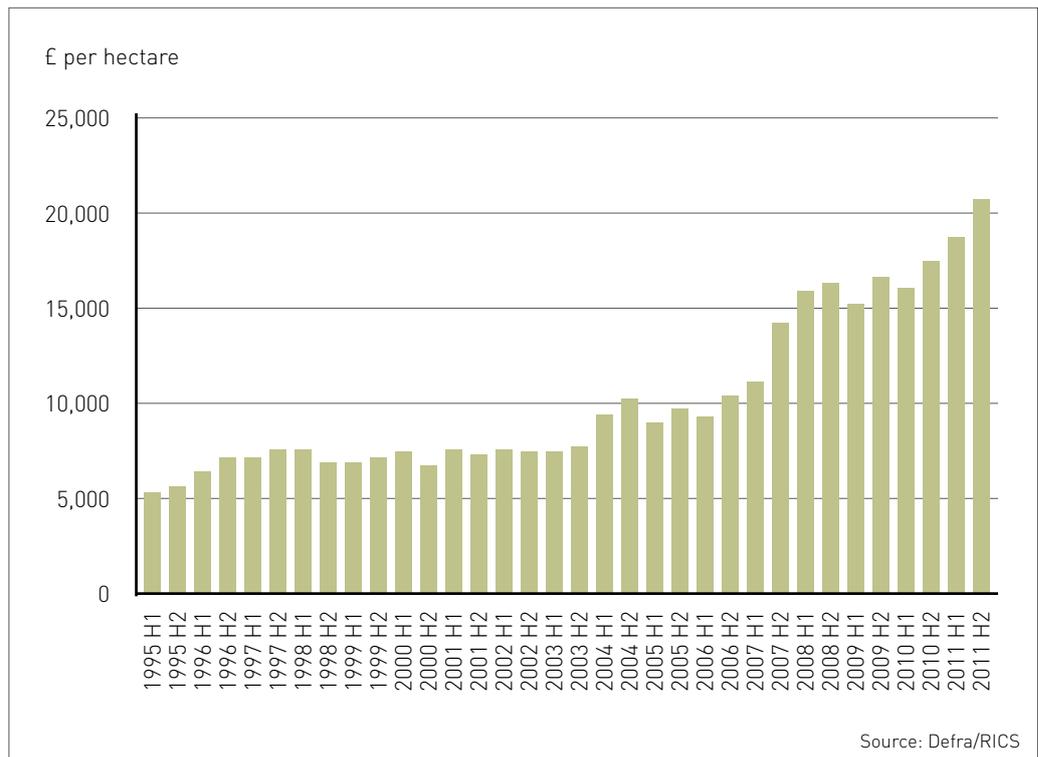
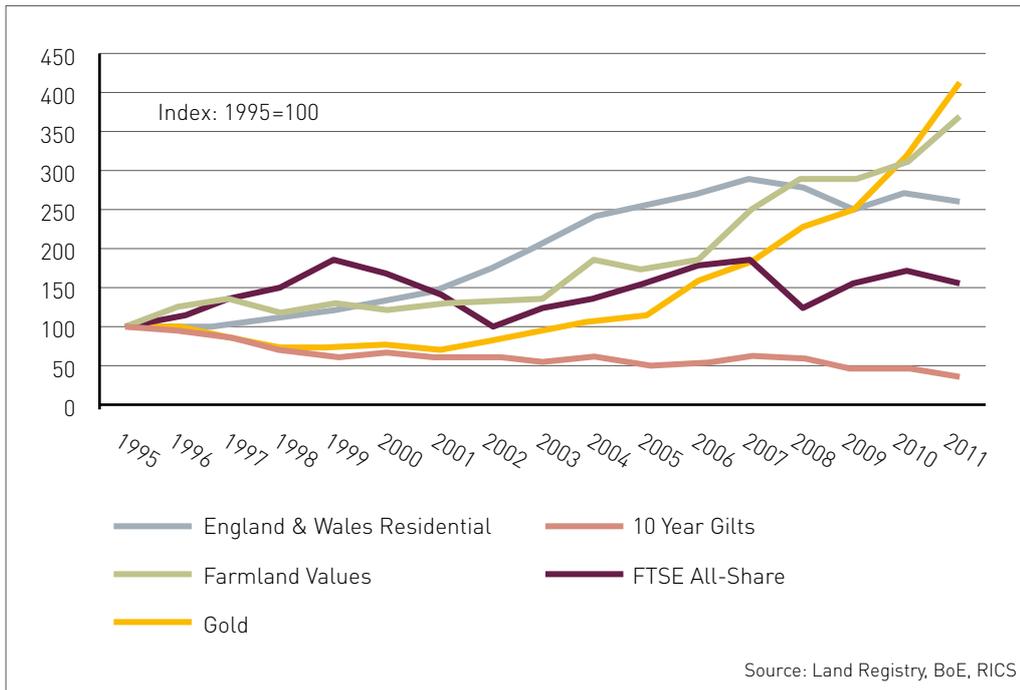


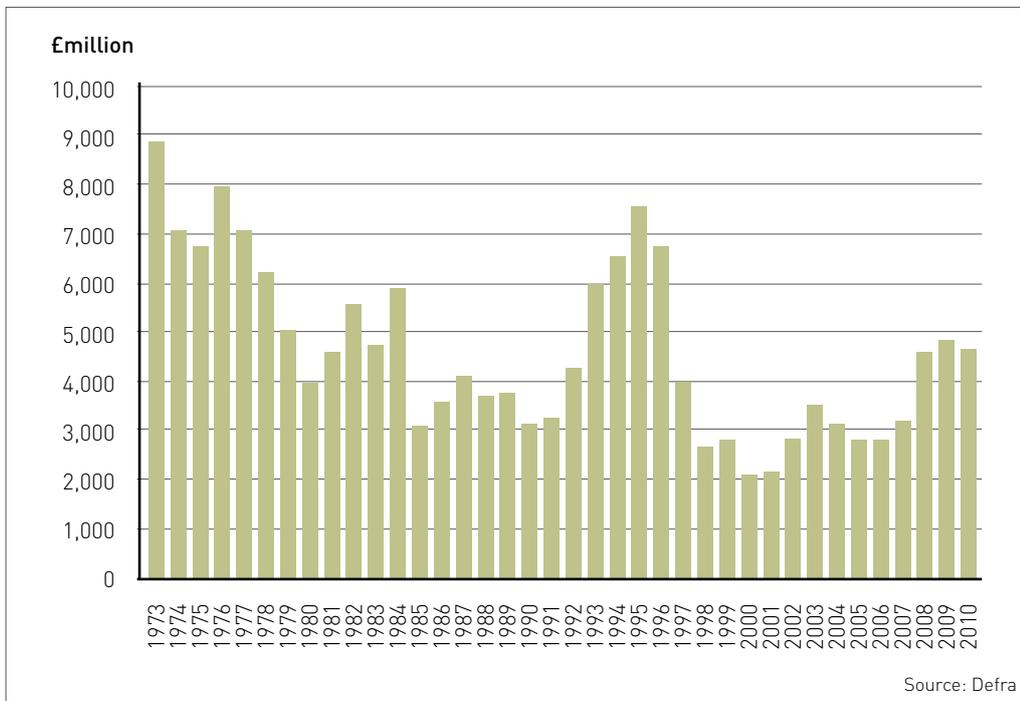
Figure 5: Growth in England & Wales farmland values vs growth of selected assets



Total real income from farming (TIFF) has been volatile over the past four decades but trended upwards during the noughties during which period it more than doubled in real

terms. Over the past decade livestock output has contributed on average around 54% of total gross farm output compared to crop output which has averaged around 34.5%.

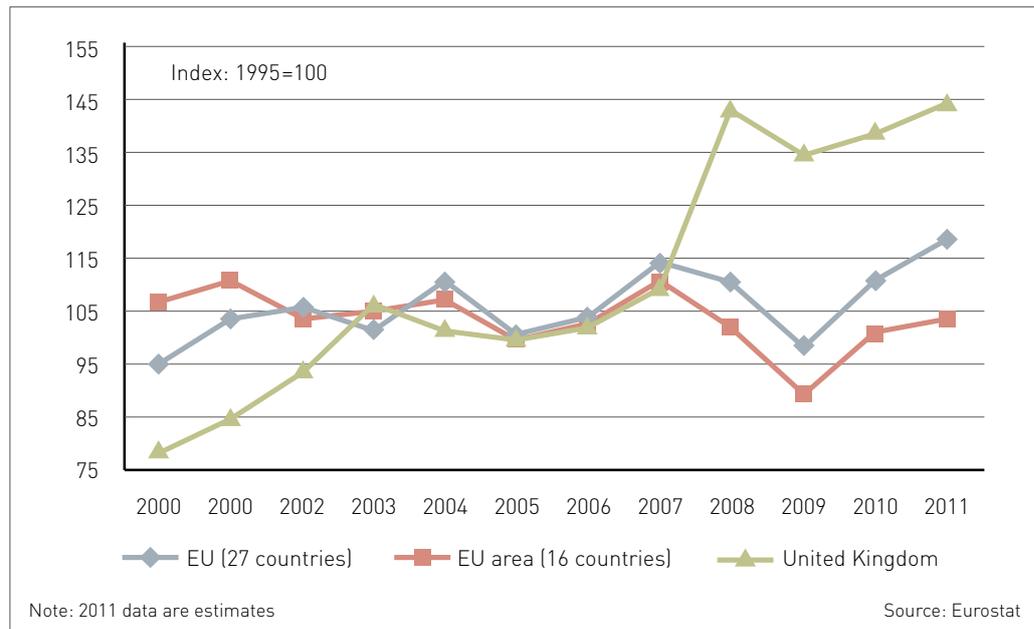
Figure 6: Total real income from UK farming (TIFF)



UK agricultural income growth over the past decade compares favourably with the rest of Europe. According to EC statistics, estimated 2011 income from UK agricultural activity was just under 83% higher than in

2000, whereas the corresponding figure for the EU27 countries was 24.5% and for the Eurozone countries income in 2011 was 4.2% lower than in 2000.

Figure 7: Income from agricultural activity: UK vs EU27 vs Eurozone



Technology advances should result in improved crop yields thereby making farming more efficient and profitable as well as enabling the further development of useful non-food crops.

The type of tenancy agreement can significantly affect rental income. Average rents for farmland let under the Agricultural Tenancies Act 1995 are currently over 1.75 times higher than those regulated by the Agricultural Holdings Act 1986 and have risen by 36% for arable land and by 35% for pasture land between H1 2009 and H2 2011, while the corresponding increases for land let under the Agricultural Holdings Act 1986 are much lower at 12% and 9% respectively. Furthermore, the gap between rents for farmland let under the Agricultural Tenancies Act 1995 compared to the Agricultural Holdings Act 1986 has widened by more than 20% since H1 2009.

Efficiency in the UK agricultural sector has improved considerably over the past four decades thanks to advances in technology, the growth of large-scale capital intensive farms run by corporate owners and the impact of farming policy changes, notably the Common Agricultural Policy (CAP). According to data from Defra, total factor productivity for the sector increased by 51% between 1973 and 2010.

OUTLOOK

A number of factors point to a positive long term outlook for the agricultural sector. Increasing affluence and changing patterns of consumption are already leading to rising per capita demand for food and the world's population could reach 9.3 billion (a 35% increase) by 2050 according to UN medium

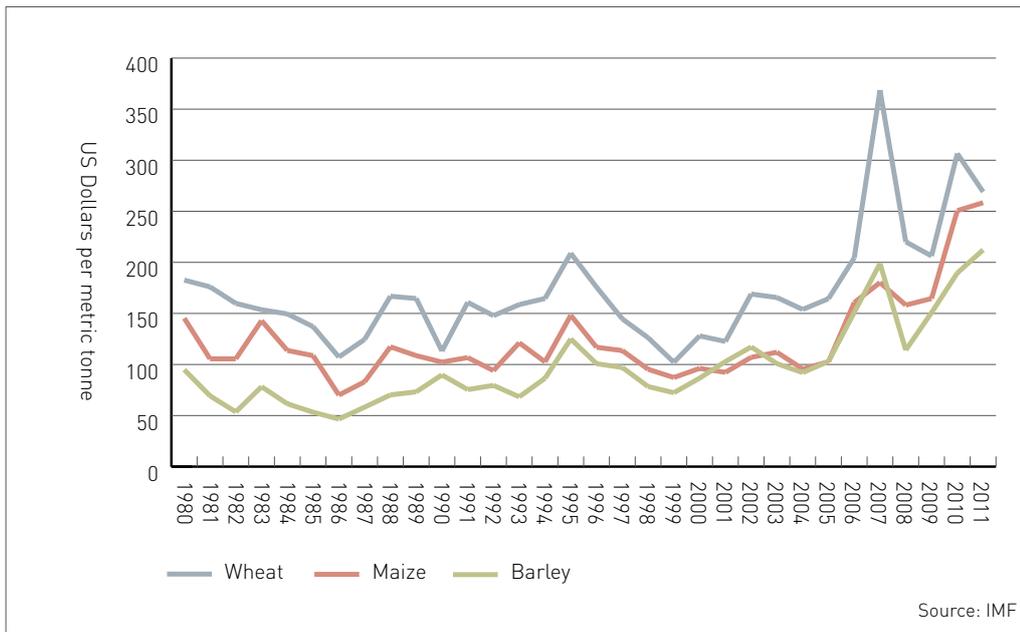
scenario forecasts. This will place increasing importance on agricultural resources and annual global consumption of wheat and cereals has already outstripped production in six out of the past 11 years with the shortfall having to be made up from existing stocks.

Although displaying a fair degree of volatility over the past three decades, world food prices have nonetheless trended upwards over this period and in 2011 reached record levels. The value of UK food exports has also risen strongly during the noughties (+83%), helped by the relative decline of Sterling against the major international currencies since 2007. It is highly likely that food prices will continue to trend upwards over the longer term given the mounting pressure on consumption from the expanding global population.

Technology advances should result in improved crop yields thereby making farming more efficient and profitable as well as enabling the further development of useful non-food crops, ranging from plastics to pharmaceuticals and bio-fuels.

The increasing importance of the bio-fuels sector can be seen in its growing share of UK crop output which tripled during the noughties from around 3% in 2000 to 9.1% in 2010. There are several Government schemes designed to promote greater use of renewable energy sources and the 2009 Renewable Energy Directive has set a target of delivering 15% (compared to 3% in 2009) of the UK's energy consumption from renewable sources by 2020.

Figure 8: World Cereal Prices 1980-2011



On the supply side, the amount of potentially usable agricultural land is finite and albeit reclamation is possible it is an expensive and not always successful option. In the face of the likely growing supply/demand imbalance, farm output prices are likely to rise as are land values. We forecast that UK farmland values will increase by an average of 6% per annum over the next five years.

There are issues which will need addressing. Land degradation as a result of chemical, physical or biological changes presents a risk to the future capacity to produce. However, prudent land management combined with the efficient use of technology should largely counter these effects. For example, according to the European Commission, the long-term application of compost will establish higher nitrogen levels in soils which should enable compost to replace synthetic fertilisers.

The potential risks of climate change are well-documented, notably with regard to water availability, pests and diseases.

However, climate change can also bring opportunities including longer growing seasons, reduced frost damage in the winter as well as creating potential new locations for crops. A recent Defra report concluded that warmer temperatures and higher concentrations of CO₂ in the atmosphere should lead to higher yields of many crops currently grown in the UK.

Government policy, both at UK and international level, will also be crucial in determining the future well-being of the sector. The EU's Common Agricultural Policy (CAP) is the most important framework under which UK farmers currently operate and over one third of its budget is spent on direct payments to farmers. Last October the European Commission published its proposals for a reform of CAP effective from 2014-2020 but the package has already been criticised by UK government. We await the outcome of the consultation process with interest.

CONTACT

Chesterton Humberts is a multi-disciplinary property business covering Residential Sales & Lettings, Estate/Property Management, International, Rural and Commercial with 70 offices worldwide.

Chesterton Humberts' Rural Division prides itself with the expertise that its knowledgeable professional Rural Teams have gained over many years experience in the rural property sector. The combined specialisms of the Teams range from involvement with farmers, landowners and estate owners to ensuing advice and work in estate management, sales and acquisitions, professional services (including valuation), planning and equestrian.

Should you have any questions regarding this report or wish for any other information concerning the UK rural property market please do not hesitate to contact any of the names listed below.

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