

Negotiating and Conducting Rent Reviews

Recommended Guidance for Landlords and Tenants

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National Farmers Union of Scotland
Scottish Land and Estates
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in association with
The Scottish Government's Independent Adviser on Tenant Farming

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Introduction

Fundamental to a healthy rented sector within Scottish agriculture is a reasonable degree of predictability about future rent levels for tenanted farms. Uncertainty makes it more difficult for landlords and tenants to plan and invest with confidence, and therefore impacts negatively on the industry and wider economy. Predictability is more likely to be achieved if the procedure whereby rents are reviewed is systematic, and based on a shared assessment of objective criteria that are fully transparent to both parties.

In July 2014 the NFUS, SLE and STFA jointly responded to concerns about rising uncertainty around future rent levels for 1991 Act tenancies by issuing industry led guidance designed to encourage short to medium term stability. This used CPI data from the Office of National Statistics to create a simple inflation linked sense test, and feedback on the application of this has been positive. The 2014 guidance was, however, an interim response to an immediate problem, and the industry bodies have now decided to revise and further develop their guidance to take account of emerging thinking contained within the Land Reform Bill 2015.

This new guidance replaces that issued in July 2014, and extends the concept of a systematic procedure based on full transparency of data sources. It retains but simplifies the inflation linked sense test, and it provides for concise procedural recording so as to create a basis for future risk based audit. The new guidance is itself an interim measure until provisions arising from the Land Reform Bill 2015 come into force, and the industry bodies will review their position before that stage (in particular in the light of whatever is decided with regard to proposals for a code of practice on rent reviews under a new Tenant Farming Commissioner).

Under existing TFF Guidelines initiating parties in respect of autumn 2015 rent reviews will have submitted written proposals on or before 28 July. This new guidance postdates that, and so initial written proposals will not necessarily take full account of the need for transparency that is now being emphasised. The industry bodies recommend that this be addressed where necessary through stage 4 and 5 discussions.

Core Principles

The guidance is underpinned by three core principles, and these should be at the forefront of the thinking of both parties throughout the review process –

1. Rent should be charged only on land and fixed equipment provided by the landlord, and should ignore any potential income contribution attributable to improvements or fixtures belonging to the tenant.
2. Proposals and counter proposals should be presented in a form that is fully transparent, and they should contain sufficient detail to enable each party to understand and verify the other's calculations.
3. Each party should be afforded sufficient time to give full and careful consideration to proposals (and counter proposals) tabled by the other.

Basis of the Guidance

The guidance has no statutory basis and is built on an assumption of reason and reasonableness among all involved. It is intended to relate only to tenancies where rents are regulated under statute, and its fundamental purpose is to eliminate the kind of delays and prolonged disputes over rent that have sometimes been seen in recent years. The guidance describes a recommended procedure whereby the landlord and tenant, often assisted by professional intermediaries, are encouraged to enter into a structured

dialogue based on transparent criteria leading to a rent settlement that they both agree is demonstrably reasonable.

The guidance builds on the TFF Introduction and Guide to Good Practice for Farm Rent Reviews, and SAAVA's more detailed Practitioners' Guide to Scottish Agricultural Rent Reviews. Statutory procedures for rent reviews, including requirements for serving notice and deadlines for submission of applications to the Land Court, continue to apply. The guidance provides a step by step procedure which ensures timeliness and transparency, and incorporates a "sense check" against CPI data in order to prevent extreme and potentially damaging situations from arising.

The industry bodies recognise that a great many landlords and tenants have for generations agreed rent settlements between themselves on the basis of entirely informal and sometimes relatively casual dialogue. This guidance is not intended to intervene in the working of such relationships where they exist, but if this guidance is not to be followed in its entirety then the two parties are advised to fully satisfy themselves, in writing if at all possible, that this is what they both wish to happen.

The Procedure in Practice

The procedure can be initiated by either the landlord or the tenant through the serving of a written notice. It creates a structured dialogue based on open and transparent reasoning, and it includes the option of involving a third party to facilitate negotiations. The main steps of the recommended procedure are summarised in appendix A and are as follows –

Step 1 – Initiating a Rent Review

Rents for farms let under 1991 Act tenancies can be reviewed no more frequently than once every three years, and reviews should be timed to coincide with the anniversary of the start of the lease. Either the landlord or the tenant may initiate a review. They should do so by writing formally to the other party, but normally only after a preliminary conversation. The letter initiating the review constitutes a formal written notice under the relevant legislation, and must be served no more than two years and no less than one year before the date when the revised rent is due to come into effect (the "due date").

A copy of this joint industry guidance should be included with the initiating letter to ensure that both parties follow the same review procedure, and a careful record should be kept by both parties showing how each step has been fulfilled (see pro forma in appendix E). These records may, by agreement, be subject to inspection by the Scottish Government's Independent Adviser on Tenant Farming at a later date (see below).

Step 2 – Farm Inspection and Discussion

Not less than six months before the due date the landlord and tenant should meet on the farm to assess the nature of the holding, and any changes to fixed equipment, diversification, or other circumstances since the last review. It is important that both parties agree in detail what it is that is being rented, and how this varies (if at all) from that which was agreed as being rented at the time of the last review. Where necessary the discussion should be paused or deferred pending agreement on a record of tenant's improvements, and/or a record of condition (see other Joint Guidance to be issued autumn 2015).

The discussion should explore in detail the expectations of both parties with regard to the rent calculation, so that when a written proposal is issued it contains no surprises. In the interests of maintaining a good working relationship it will frequently be helpful if both the landlord and tenant attend the initial on farm discussion in person, while the complexities of later stages may often be delegated to professional intermediaries.

Step 3 – Written Proposal

Not less than four months before the due date the party initiating the review should write to the other party setting out in full and thorough detail the proposed rent (which may be lower or higher than the current rent), how it has been calculated, the source of any variables and/or comparable data used, and an explanation of any adjustments made to reflect the particular nature of the farm. The Practitioners' Guide to Scottish Agricultural Rent Reviews published by SAAVA provides detailed information on rent assessments, and should be referred to where relevant. Crucially the party receiving the written proposal should be able to see exactly how the proposed rent has been calculated, and should be able to verify the source of any data used in the calculations. The written proposal should also refer to the inflation linked sense test (see below) if appropriate.

Where reference is made in the proposal to rents on comparable farms, it is recognised that the requirement for complete transparency may potentially raise difficult issues with respect to data protection legislation. The core principle of transparency is, however, extremely important in underpinning a rent review process that is both fair and seen to be fair. Landlords and tenants wishing to refer to comparable farms in their proposals should therefore follow the supplementary advice given in appendix B.

Step 4 – Written Response

Not less than two months before the due date the other party should respond in writing either accepting the proposed rent, seeking further (reasonable) clarification, or setting out a counter proposal. If a counter proposal is made, this should be set out in full and thorough detail in exactly the same manner as outlined for the initial proposal in step 3 above, and include reference to the inflation linked sense test if appropriate.

Step 5 – Further Discussions

In most cases the time allowed for steps 2, 3 and 4 above will be sufficient for amicable agreement to be reached. In a small number of situations the complexity of issues involved, and/or the nature of interpersonal relations, may require a more prolonged discussion. This should last no longer than the time required for a second iteration of steps 2, 3 and 4, and to assist with this it may be helpful to involve in the discussion a third party who is respected by both landlord and tenant.

This may mean that discussions continue past the due date, and the rent review timetable may either have to be deferred by a year or the initiating party may have to lodge an application with the Land Court to (potentially) have the rent determined in order to protect their position. The industry bodies are concerned about the damage that can be done to landlord/tenant relationships by the threat implicit in an application to the Land Court at this stage, but they also recognise the risk of unjustified prevarication without this option being available. In such circumstances the initiating party should assess the two alternatives with some care, and should only opt to apply to the Land Court instead of deferring for a year where this is genuinely necessary.

Step 6 – Professional Mediation

In the rare cases where further discussions fail to produce agreement it is likely that professional mediation will be required, at shared cost. Step 6 should involve further discussion as in step 5, but facilitated by a professional mediator with a knowledge of the issues involved. The choice of mediator is crucial to success, and care should be taken to appoint someone in whom both parties have complete confidence. Further information is given in the Practitioners' Guide to Scottish Agricultural Rent Reviews published by SAAVA. Members of the RICS and a number of professional intermediary firms offer services of this nature.

Step 7 – Resolution

A tiny minority of rent review disputes cannot be resolved through negotiation. In such cases the only options that remain available are expert determination, binding arbitration or (*in extremis*) recourse to the Land Court. The cost of the third of these can be extremely high, and the impact on the landlord/tenant relationship can be severe. In most cases it will be far cheaper, quicker and less damaging for the two parties to agree either to accept the determination of a mutually agreed expert or to submit their dispute to binding arbitration.

The industry bodies, while recognising the right of both parties to have their dispute heard in the Land Court if they insist on doing so, nonetheless strongly encourage use of one of the alternatives wherever possible.

The Inflation Linked Sense Test

Large and disproportionate changes to rent can be destabilising for any business (landlord or tenant), and in July 2014 the three industry bodies issued guidance designed to minimise the risk of this happening unless fully justified and affordable as a result of changes in circumstances. The sense test within the 2014 guidance - that in the absence of exceptional factors rent adjustments on a like for like basis should avoid significant divergence from inflation as measured by the Consumer Price Index (CPI) – has undoubtedly been helpful in achieving greater stability (“like for like” meaning circumstances where there is no significant change to what is being rented).

The industry bodies recognise, however, that use of the CPI has been something of a blunt instrument. It ignores the fact that input and output price inflation or deflation in the agricultural sector, including changes to support payments, can sometimes be very different from those experienced across the country as a whole. So while the new guidance retains the sense test as a useful safety check against destabilising changes in rent, it does so in a more flexible and pragmatic manner.

In order to apply the sense test under the new guidance the rent proposal should first be calculated as outlined in step 3. The outcome of this calculation will normally be the rent that is proposed, but it should be compared against the equivalent figure indicated by changes in the CPI (see appendices C and D). Where there is a significant discrepancy the proposal should include an explanation as to why this is so, including why the proposal is unlikely to be destabilising to either the landlord’s or tenant’s business notwithstanding the divergence from CPI.

Maintaining a Record of Procedure

The industry bodies are aware that under the terms of the Land Reform Bill 2015 there may in due course be established a position of Tenant Farming Commissioner with a remit to prepare codes of practice, including a code relating to negotiating and conducting rent reviews. The industry bodies see their new guidance as potentially providing a basis for such a code, and they are anxious that it operates in an equivalent manner.

All landlords, tenants and professional intermediaries are therefore asked, while working to this guidance, to maintain a concise written record of key dates and associated notes for stages 1 – 7, and to be willing on request and in confidence to make this record available to the Scottish Government’s Independent Adviser on Tenant Farming so that he is in a position to undertake a risk based compliance audit should the industry bodies collectively ask him to do so. A pro-forma Record of Procedure is given in appendix E.

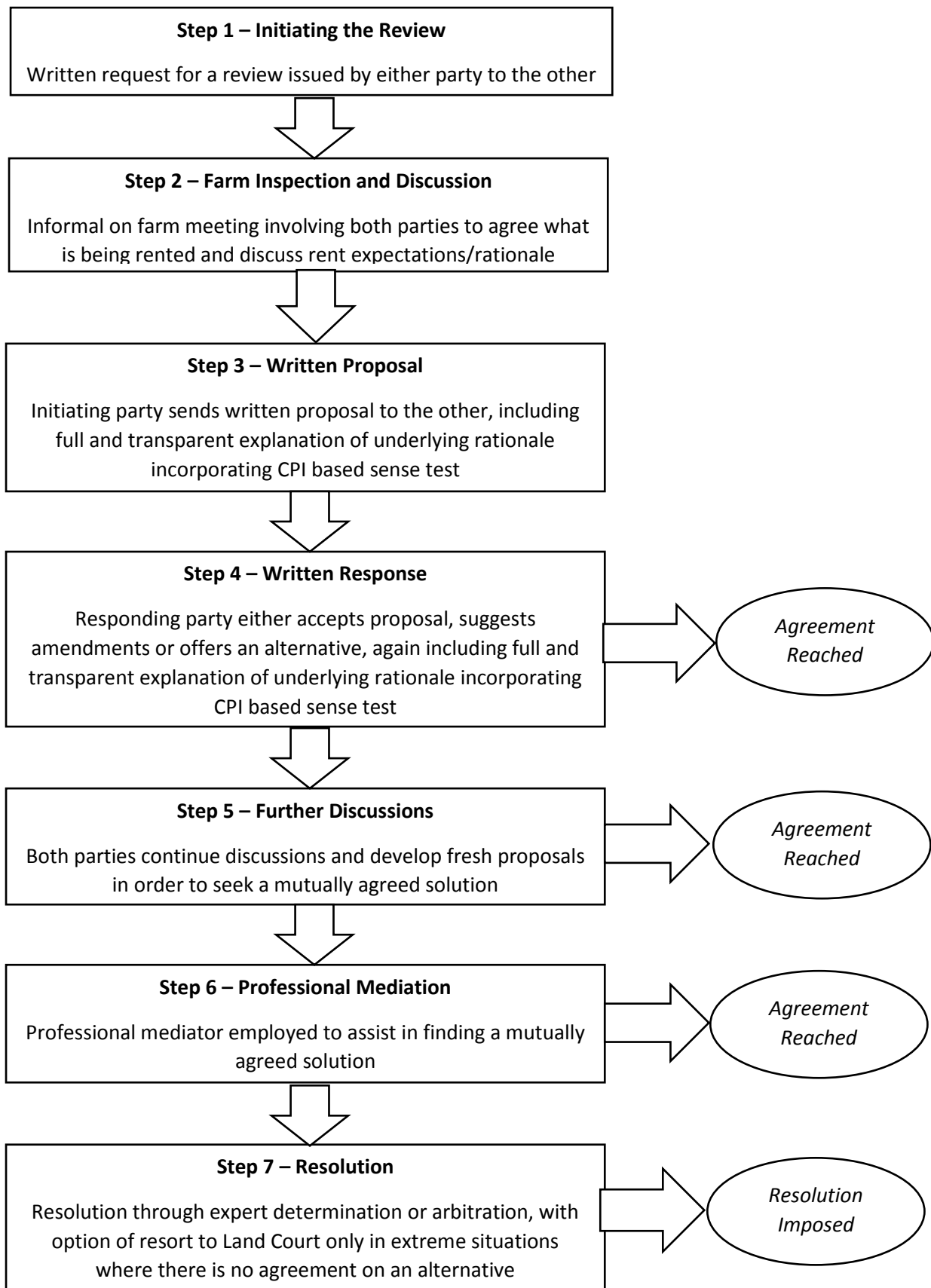
In Summary

The NFUS, SLE and STFA have been concerned about uncertainty around rents payable for 1991 Act tenancies in Scotland, and they issued industry led guidance designed to help tackle this in July 2014. Recognising that the Land Reform Bill 2015 now contains proposals that may have an impact on the way in which rents are reviewed and calculated, the three organisations have decided to jointly issue revised guidance as an interim measure pending the Bill being enacted and coming into force.

The revised guidance asks all landlords and tenants to follow a simple step by step procedure in order to agree changes to rent through a shared, systematic, and transparent process which incorporates an additional sense test based on published data for UK inflation. Support for and adherence to the guidance will be sought from all interested parties, and will be subject to ongoing review by the three signatory organisations.

Statutory procedures for rent reviews continue to apply. Landlords' and tenants' statutory rights are unaffected. The guidance seeks simply to provide robust encouragement and an effective framework in order to minimise any risk to the industry that may arise from conflict around rent increases for tenanted farms.

Appendix A – Flow Chart Illustrating the Guidance in Practice



Appendix B – Supplementary Advice on the Use of Comparable Farms for Rent Comparison Purposes

Under current legislation rent proposals will often include reference to what is being paid and/or offered on other comparable farms. Unless the identity of these farms is fully transparent to both parties, it may be difficult for the receiving party to properly assess and (if appropriate) challenge the basis on which a proposal is being made. This has the potential to result in an unfair rent review process, and rents could in theory be agreed for which there is not, in reality, adequate justification in terms of the legislation.

In general there is no formal duty of confidentiality implied in a landlord/tenant relationship unless this is expressly provided for (for example in the terms of a lease, or by correspondence being marked “confidential”). However both parties have a duty to protect personal information, and rents data could be regarded as such especially where the landlord and/or tenant is an individual rather than a commercial entity. This raises a significant challenge with respect to the fundamental emphasis that this guidance places on transparency and equal access to information by both parties, because data protection legislation may prevent the farms used for comparison purposes from being identified in rent proposals unless consent has been given.

While the vast majority of landlords and tenants use data from comparable farms in an entirely fair and appropriate manner, the industry bodies recognise the risk that such data could be misused where the farms are not identified. A landlord might, for example, choose to only use data from farms with unusually high rents, or a tenant might choose to only use data from farms with unusually low rents. Either party might choose to use data from farms that are not fully comparable. For these and other reasons it is highly desirable that both parties are able to see exactly which farms are being used for comparison purposes, and able to challenge their use if appropriate.

The industry bodies have considered this issue in some depth. The principle of fair and equal access to information is an important one, but it may be unhelpful if some farms become excluded for comparison purposes because consent to identify them has been refused. The guidance therefore recommends the following approach where a landlord or tenant wishes to use another farm for comparison purposes –

- In the first instance the consent of the landlord and/or tenant of the comparable farm(s) should always be sought. Where it is given the farm(s) may be identified in the proposal together with the rent(s) payable, and all landlords and tenants are urged to cooperate in providing consent when they are asked to do so.
- If consent genuinely cannot be obtained, and there are no other suitable comparable farms that can be used to support the rent proposal, then one of the two following options should be followed –
 - a. Where the rent payable on at least three comparable farms is known to the proposing party, these farms should be identified in the proposal but an average rent across all of them should be given so as to avoid jeopardising the security of personal data for any one of those farms.
 - b. *In extremis* and where at least three comparable farms are demonstrably not available (and consent cannot be obtained), then one or two comparable farms may be used without being identified. In such circumstances the fullest possible description of the comparable farms should be given, subject to the need to avoid those farms being identifiable so as to protect personal data.

The NFUS, SLE and STFA will facilitate the operation of this guidance by actively encouraging all of their members to give consent when it is requested as above. Where consent is refused this may be reported to

one of the industry bodies who may ask the Scottish Government's Independent Advisor on Tenant Farming to investigate further.

Appendix C – CPI monthly data 1994 to 2015

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Jan	82.5	84.5	86.8	88.6	89.9	91.4	92.1	92.9	94.4	95.7	97
Feb	82.9	84.9	87.2	88.8	90.3	91.5	92.4	93.1	94.5	96	97.2
March	83.1	85.3	87.5	89	90.5	92	92.6	93.4	94.9	96.3	97.4
April	83.9	85.8	88	89.4	91	92.4	92.9	94	95.3	96.7	97.8
May	84.1	86.2	88.3	89.6	91.5	92.7	93.2	94.7	95.5	96.7	98.1
June	84.1	86.3	88.4	89.8	91.3	92.6	93.3	94.9	95.5	96.5	98.1
July	83.6	85.8	87.8	89.5	90.8	92	92.8	94.2	95.2	96.5	97.8
Aug	84.1	86.3	88.3	90	91.2	92.3	92.8	94.5	95.5	96.8	98.1
Sept	84.2	86.7	88.7	90.3	91.6	92.7	93.6	94.8	95.7	97.1	98.2
Oct	84	86.5	88.7	90.3	91.6	92.6	93.5	94.7	95.9	97.2	98.4
Nov	84.1	86.5	88.7	90.4	91.7	92.7	93.7	94.5	95.9	97.2	98.6
Dec	84.5	87	89	90.5	91.9	93	93.7	94.7	96.3	97.5	99.1

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Jan	98.6	100.5	103.2	105.5	108.7	112.4	116.9	121.1	124.4	126.7	127.1
Feb	98.8	100.9	103.7	106.3	109.6	112.9	117.8	121.8	125.2	127.4	127.4
March	99.3	101.1	104.2	106.7	109.8	113.5	118.1	122.2	125.6	127.7	127.6
April	99.7	101.7	104.5	107.6	110.1	114.2	119.3	122.9	125.9	128.1	128.0
May	100.0	102.2	104.8	108.3	110.7	114.4	119.5	122.8	126.1	128.0	128.2
June	100.0	102.5	105.0	109.0	111.0	114.6	119.4	122.3	125.9	128.3	
July	100.1	102.5	104.4	109.0	110.9	114.3	119.4	122.5	125.8	127.8	
Aug	100.4	102.9	104.7	109.7	111.4	114.9	120.1	123.1	126.4	128.3	
Sept	100.6	103.0	104.8	110.3	111.5	114.9	120.9	123.5	126.8	128.4	
Oct	100.7	103.2	105.3	110.0	111.7	115.2	121.0	124.2	126.9	128.5	
Nov	100.7	103.4	105.6	109.9	112.0	115.6	121.2	124.4	127.0	128.2	
Dec	101.0	104.0	106.2	109.5	112.6	116.8	121.7	125.0	127.5	128.2	

Note that future CPI data and data back to 1988 can be found on the Office for National Statistics website:

<http://www.ons.gov.uk/ons/index.html>

**Appendix D – Worked Examples Showing Application of Sense Test
(Note that rent figures used are based on entirely fictional farms and are illustrative only)**

Farm A

Date of rent review (valuation date under S13) – 28 May 2015

Date of last recorded rent review – 28 May 2012

Previous rent - £50 per acre

Proposed new rent based on calculations using SAAVA guidance - £53 per acre

CPI index at May 2012 – 122.8

CPI index at May 2015 – 128.2

Sense test level for new rent on like for like basis = $50 \times 128.2/122.8 = £52.20$ per acre

Conclusion – proposed new rent meets sense test

Farm B

Date of rent review – 28 May 2015

Date of last recorded rent review – 28 May 2005

Previous rent - £40 per acre

Proposed new rent based on calculations using SAAVA guidance - £62 per acre

CPI index at May 2005 – 100.0

CPI index at May 2015 – 128.2

Sense test level for new rent on like for like basis = $40 \times 128.2/100.0 = £52.28$ per acre

Conclusion – proposed new rent fails sense test

Further explanation required in the proposal to justify the divergence – for example by reference to falling energy and fertiliser costs leading to increased profit margins and overall net income well ahead of CPI inflation

Farm C

Date of rent review – 28 May 2015

Date of last recorded rent review – 28 May 2010

Previous rent - £45 per acre

Proposed new rent based on calculations using SAAVA guidance - £45 per acre (i.e. unchanged)

CPI index at May 2005 – 114.4

CPI index at May 2015 – 128.2

Sense test level for new rent on like for like basis = $45 \times 128.2/114.4 = £50.43$ per acre

Conclusion – proposed new rent fails sense test

Further explanation required in the proposal to justify the divergence – for example by reference to falling levels of support payments leading to static overall net income

Appendix E – Pro-Forma Record of Procedure

Step 1 – Initiating the Review

- Date initiated and by whom?
- Copy of initiating letter attached or on file?
- Copy of this guidance enclosed with initiating letter?

Step 2 – Farm Inspection and Discussion

- Date of meeting on farm?
- Who attended?
- Key points discussed, including any points of significant disagreement?

Step 3 – Written Proposal

- Date sent/received?
- Copy of written proposal attached or on file?
- Sense test conducted ... outcome?

Step 4 – Written Response

- Date sent/received?
- Copy of written response attached or on file?
- Sense test conducted ... outcome?
- Agreement reached and procedure completed?
- If not what action taken to ensure further constructive discussions?

Step 5 – Further Discussions

- Date of further meeting on farm?
- Copy of further written proposal attached or on file?
- Copy of further written response attached or on file?
- Agreement reached and procedure completed?
- If not what action taken to secure professional mediation?

Step 6 – Professional Mediation

- Date of mediated meeting on farm?
- Copy of mediated written proposal attached or on file?
- Copy of mediated written response attached or on file?
- Agreement reached and procedure completed?
- If not what action taken to agree referral to expert determination, binding arbitration or Land Court?
- Reasons for option agreed?

Step 7 - Resolution

- Date of expert determination or binding arbitration?
- Outcome?
- If recourse to Land Court, reasons for this being unavoidable?