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# A GUIDE TO – the Use of Tenanted Agricultural Holdings for Non-Agricultural Purposes (Diversification)

Diversification, or using the land and fixed equipment from an agricultural holding for non-agricultural purposes, can provide an income stream that complements farming activities. Activities not classed as agriculture may be considered 'diversification' and the importance of this is likely to grow as agricultural subsidies decline.

This guide includes information on timelines, notification, and compensation at the end of the lease when setting up a diversified interest, and outlines the procedures to follow.

Users of this guide are advised to obtain independent legal advice relevant to their particular circumstances before acting upon any of the information contained in this guide.

## INTRODUCTION

The ability to use the land and fixed equipment comprising an agricultural holding for non-agricultural purposes can greatly enhance the financial viability of the holding and provide an income stream to complement the contribution of the mainstream agricultural activities. The Scottish Government Farm Business Income Estimates report (2017-18) reveals that more than half of the surveyed farms have diversified activities and that those with some form of diversification generate significantly more income per annum than those that don't. The ability to engage in diversification is likely to become ever more important as agricultural subsidies decline and if commodity markets come under pressure. Prior to the 2003 Agricultural Holdings (Scotland) Act, the ability of tenants of agricultural holdings to engage in diversification was limited. However, the 2003 Act established the right of tenants of 1991 Act secure tenancies, Limited Duration Tenancies, Modern Limited Duration Tenancies and Repairing Tenancies (once in force) to establish diversified business streams as long as the correct procedures are followed with regard to obtaining the landlord's consent. This guide does not cover diversification through tree planting, which is the subject of separate guidance which can be found at [landcommission.gov.scot](http://landcommission.gov.scot).

## The Tenant's Rights

If the tenant has obtained consent by following the procedures set out in the 2003 Act, any prohibition in the lease on the use of the holding for non-agricultural purposes is null and void. It would seem that there is no restriction on the amount of the holding that can be used for diversification. If the landlord's consent is obtained, it would be possible to use the whole of the holding while retaining the full protection of the 1991 Agricultural Holdings (Scotland) Act. It is also the case that any prohibition in the lease on sub-letting can be ignored if the prohibition impedes the use of the land for a non-agricultural purpose and if the sub-letting is ancillary to the tenant's own use. So, a tenant cannot sub-let land to someone who is simply using that land for that person's own non-agricultural business activity but can sub-let if it is for a use that is part of the tenant's non-agricultural activity.

The 2003 Act also makes clear that the use of the land for a permitted non-agricultural purpose is treated as being in accordance with the rules of good husbandry. It is important to note that a tenant cannot benefit from the above if the diversification was carried out without the consent of the landlord prior to the 2003 Act becoming law.





## What Constitutes a Diversification?

Essentially, any activity which is not classed as agriculture may be called a diversification. What constitutes 'agriculture' is generally determined by reference to such definitions as exist within the Agricultural Holdings Acts which define agriculture as follows:

"Agriculture includes horticulture, fruit growing, seed growing, dairy farming and livestock breeding and keeping, the use of land as grazing land, meadow land, osier land, market gardens and nursery grounds, and the use of land for woodlands where that use is ancillary to the farming of the land for other agricultural purposes"

and the livestock referred to in this definition include:

"any creature kept for the production of food, wool, skins or fur, and for the purposes of its use in the farming of the land".

There is clearly scope for different positions to be adopted with regard to what constitutes a diversification and case law may be required in the future to provide clarity, but in the meantime there is general agreement that the following activities are clearly non-agricultural activities:

- Operating a bed and breakfast business
- Farm shops, cafes and restaurants
- Children's play areas
- Holiday cottages
- Golf courses and driving ranges
- Camping/caravanning sites
- Off-roading tracks for quads or 4x4 vehicles.

With regard to livestock, it seems clear that unusual animals kept for meat and/or milk production (e.g. buffalos or deer) or for wool production (e.g. alpacas) would come within the meaning of agriculture but the situation is less clear with regard to horse grazing. Horses kept for the purpose of pulling farm implements would seem to be within the definition of agriculture, but there is case law to support the view that if a tenant operates a business that provides grazing and other facilities for owners of horses kept for sport or recreation then this is a non-agricultural activity.

## Obtaining Consent

It is important that the correct procedures are followed when consent for a diversification is being sought. The ability to override any clause in the lease that prevents the use of the holding for non-agricultural purposes is dependent on consent having been properly obtained. Failure to do so may lead to the activity being considered as a breach of the lease or may prevent the tenant claiming compensation for the activity at termination of the lease.

### Making an Informal Approach

As readers will see from the description of the procedure which follows, there are several time limits which can be missed. If that happens, one party or the other may be dissatisfied. Rather than initially serve a formal notice of diversification, tenants are recommended to approach the landlord directly in order to discuss the proposal. This will hopefully enable the parties to reach an agreement on how the project should proceed, and is a better approach for future good relationships. Once a way forward is agreed, the tenant is to then serve a Notice in agreed terms, with the landlord making an agreed response.

## Notification Procedures

Prior to commencing the activity, the tenant must send a “notice of diversification” to the landlord. The notice must be given in writing not less than 70 days before commencing the activity and must specify:

- What the non-agricultural purpose is
- The land that would be used for the purpose
- Any changes that the tenant plans to make to that land
- The date on which the tenant proposes to begin using the land for the activity.

The tenant is required to consider, and to comment on in the notice of diversification, what grounds the landlord might have to object to the diversification (these are covered later in this guide). The tenant should therefore try to anticipate what objections might come from the landlord and should provide explanation that will help to allay any concerns that the landlord may have. It will be in the tenant’s interest to provide as much detail as possible about the diversification and its impact on the holding. This should include a business plan and an indication of how the activity will be financed and managed.

## Landlord’s Right to Request Further Information

On receipt of the notice of diversification the landlord may, on one occasion only, and within 30 days of receiving the notice, request further information from the tenant relating to the intended use of the land for non-agricultural purposes and to the financing or management of the business. A request for further information is relevant if it is necessary to enable the landlord to decide whether there are grounds for objecting to the proposal.

The tenant is to provide any information that is reasonably requested within 30 days of receiving the request from the landlord.

## Landlord's Right to Object to the Proposal

The landlord may only object to the proposal on the following grounds:

- a) The landlord reasonably considers that the intended use of the land would:
  - Lessen significantly the amenity of the land or the surrounding area
  - Substantially prejudice the use of the land for agricultural purposes in the future
  - Be detrimental to the sound management of the estate of which the land consists or forms part of
  - Cause the landlord to suffer undue hardship.
- b) Where the tenant is proposing to create a business, the landlord reasonably considers that the changes or the business will not be viable.
- c) The tenant has failed to provide any additional information asked for within 30 days of the request being made.

## Landlord's Right to Impose Conditions

In granting consent, the landlord may impose on the tenant any reasonable conditions relating to the use of the land for the non-agricultural purpose. The Act is silent on the question of what constitutes a reasonable condition, but it must relate to the use of the land for the non-agricultural purpose.

If the landlord wishes to object to the proposal, or to consent but with conditions, they must inform the tenant in writing within 60 days of receipt of the notice of diversification or, if the landlord has requested further information, within 60 days of making that request. If the landlord does not respond to the tenant within those time periods the tenant is entitled to go ahead with the diversification as though consent had been given, and with no conditions having been imposed.



## Tenant's Right to Challenge the Landlord's Objections

If the landlord objects and the tenant does not respond to that objection, the onus is on the landlord to go to court within 60 days, otherwise the objection falls away and the tenant can proceed. If the tenant responds and says that they don't agree with the objection, the landlord has to go to the Land Court. In the case of a tenant's challenge to the landlord's objection, it is for the landlord to make an application to the Land Court to have the objection determined as being reasonable. The application must be made within 60 days of the tenant being informed of the objection. The Land Court may reject the objection, uphold the objection or decide that the proposal may go ahead but with conditions imposed by the Land Court. If the landlord does not apply to the Land Court within the 60-day period, the objection ceases to have any effect and the tenant can proceed.

## Tenant's Right to Challenge any Conditions Imposed by the Landlord

In the case of a tenant's challenge to any condition imposed by the landlord, it is for the tenant to make an application to the Land Court to have the condition determined as being unreasonable. The Land Court may remove the condition and may impose in its place such other reasonable conditions as it considers appropriate. There does not appear to be any time limit on the tenant's ability to apply to the Land Court to have a condition removed.

## Impact on the Rent for the Holding

The tenant can expect that the landlord's consent to the development of a non-agricultural enterprise will be conditional on the landlord sharing in the uplift in income that the enterprise is expected to realise. When the proposed new 'Fair Rent' system becomes law the Land Court, in determining the rent for a holding, will take account of the open market rental value of any land or fixed equipment provided by the landlord and which is used by the tenant for a non-agricultural purpose. The open market rental value is the commercial rent that the land or fixed equipment might reasonably expect to attract if let on the open market by a willing landlord to a willing tenant, after allowing for any tenant's investments into the diversification.

## Compensation Entitlement at the End of the Lease

### For the tenant

The ability of a tenant to claim compensation at waygo for tenants' improvements listed in Schedule 5 of the 1991 Act depends on those improvements being of relevance to the agricultural value of the holding. It follows therefore that the tenant's investments in non-agricultural activities will not be eligible for compensation in this way. However, the 2003 Act has enabled a tenant to claim compensation by another route. On quitting the holding, a tenant who has created a diversification which was properly consented by the landlord, and which took place after November 2003, can claim compensation if the impact of that diversification work has been an increase in the value of the holding. The compensation is based on an assessment of the value to an incoming tenant of the diversification activity after taking account of any benefit (recorded in writing) that the landlord may have given to the tenant when agreeing to the activity. The valuer may also take account of any grants received by the tenant.

If a tenant is converting their tenancy from a 1991 Act tenancy to a Modern Limited Duration tenancy, the above compensation is payable at the date of conversion but otherwise may be claimed when the tenant leaves the holding.

The tenant should be aware that the right to compensation may not apply if the diversification is such that the land cannot be used for agriculture by an incoming tenant, or if the use of fixed equipment has been such as to make it impossible for the landlord to meet their obligations to an incoming tenant in respect of the provision of fixed equipment.

## For the landlord

Just as the tenant may be entitled to compensation if the diversification has increased the value of the holding, the landlord may be entitled to compensation if the diversification has reduced the value of the holding, and the landlord may seek such compensation regardless of whether the activity was properly consented or not. The basis of the claim, which can only be enforced when the tenant quits the holding, is the difference in the value of the land with and without the diversification. The landlord's claim for compensation for a reduction in value is enforceable regardless of whether or not the diversification was permitted.

The landlord must give notice to the tenant in writing of their intention to make a claim and must do so no later than three months before the termination of the tenancy.

## Diversification Outside of the Agricultural Holdings Legislation

Diversification within the confines of a 1991 Act tenancy, a Limited Duration tenancy or a Modern Limited Duration tenancy is a route that will be suitable for many tenants and many diversification projects but there are also limitations. The tenant is limited to carrying out diversification by their own hand so has limited opportunity to take a funding partner into the business and, as the diversification is taking place within the scope of an agricultural lease, the tenant will be unable to borrow money against the lease.

Where the diversification is, or is likely to become, a significant enterprise, it may be sensible for both landlord and tenant to consider taking the land and buildings used in the diversification out of the agricultural lease and entering into a commercial lease instead. This would allow more freedom to agree terms, it could enable the tenant to take other partners into the business and, as the lease is now a commercial lease, it may represent an asset that can be borrowed against. For example, a tenant who is four years into a fixed duration lease of 15 years may wish to convert some of the farm buildings into a farm shop and restaurant but may not have enough funding available and is concerned about the relatively short time that is left on the lease. By taking those buildings out of the agricultural lease and entering into a commercial lease, the tenant has the opportunity to negotiate a longer lease, to take a funding partner into the business and/or to borrow from the banks against the asset of the commercial lease. In order that security can be granted over such a lease, it has to be registered in the Land Register of Scotland and have a duration of 20 years or more.

If a decision is made to enter into a commercial lease, both parties will need to take professional advice to ensure that both parties are clear about their respective rights and obligations.



Highland Cattle Safari, courtesy STFA



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