



Rural land market outlook

Total returns to rural land set to moderate in 2015

- Weakness in commodity prices to keep rental growth subdued
- Political uncertainty set to weigh on growth in land prices
- Commercial property set to outperform rural land

The RICS-RAU Rural Land Market Survey has shown farmland prices grew strongly over the course of 2014. Demand has been increasing from a variety of channels while supply conditions continue to remain tight. The average price of an acre of farmland grew by almost 8.5% during the year to surpass the £10,000 mark for the first time in the survey's history. This marks the fifth consecutive year of growth and prices have risen by an average of almost 10% per annum over the period (see chart 1). Meanwhile, surveyors estimates of the price of bare land rose by 6% in 2014 with arable land seeing the strongest gains.

While the performance of rural land has been impressive in recent years, we think that capital value growth will slow somewhat over the coming quarters with political uncertainty and the prospect of continued weak growth in farmland rents weighing on returns. Meanwhile, we expect firm GDP growth (2.5%) this year and a further improvement in the employment picture to drive a strong rise in commercial capital and rental values (as indicated by the Q4 RICS Commercial Property Market Monitor) and to support a more moderate but steady improvement in the residential sector. We envisage the commercial sector outperforming both the residential and rural land sectors this year with total returns of 13% relative to around 7% and 6% in the others respectively.

Growth in supply of key agricultural commodities in some of the UK's main trading partners has been putting downward pressure on the prices of some of the country's main grain produce and has led to a significant tightening in farmers profit margins. As chart 2 shows, this has resulted in a substantial moderation in rental growth over the course of the last year or so. With the end-2014 stocks of some of the EU's key cereal grains at multi-year highs, and with pressure on commodity prices likely to continue well into 2015, the outlook for rental growth is relatively weak and we are currently pencilling in a rise of between 1-2% over the year.

Chart one: RICS land price and total return indices

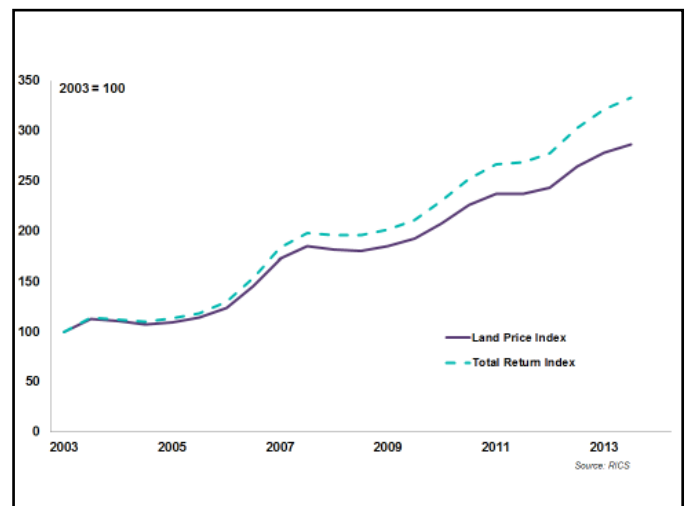
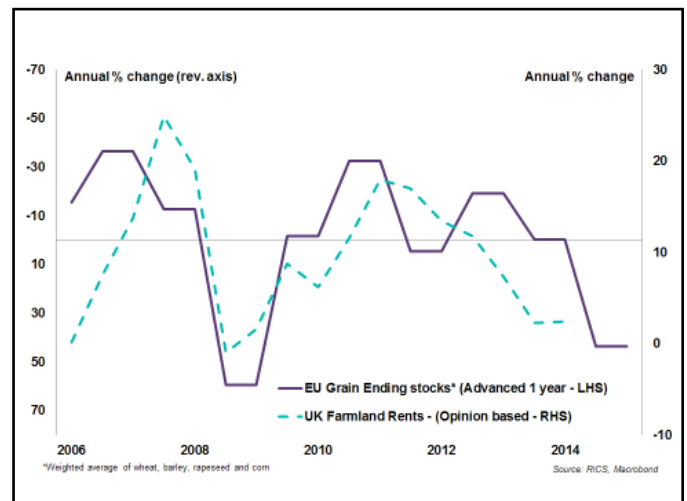


Chart two: UK farmland rents and EU grain stocks



With the more diverse buyer pool of recent years, rental yields are perhaps less of a motivating factor than before and farmland demand continued to outpace supply in 2014 (see chart 3). A net balance of 25% of surveyors reported growth in demand during the year while around 10% noted that availability of both commercial and mixed farmland had declined. Indeed, the Farmers Weekly Land Tracker showed that publicly marketed farmland fell by more than 19% over the course of 2014 to just 122,000 acres; the lowest amount since they began recording the data in 2005.

As the buyer profile has become more multifaceted, competition for specific types of units has become more heated. Respondents to the H2 RICS-RAU survey reported strong growth in demand from institutional investors for larger parcels of prime arable land and the suggestion is that institutional demand will continue to be a factor driving price growth in the year to come. Indeed, this specific demand for larger units pushed the average transaction size to a multi-year high of over 49 hectares during the second half of 2014. Lifestyle buyers (those whose primary interest is not farming) have also been playing a greater role in the market in recent years and demand for mixed residential units has been increasing since late 2013.

UK farmland has long been seen as a safe haven asset due to its steady growth profile over so much of the last decade as well as its favourable tax treatment. The upcoming general election may instil a certain doubt in the minds of investors motivated by land's benign tax status and is likely to contribute to a moderation in price growth over the year. However, both the pressure on farm incomes due to the recent falls in commodity prices and base effects following the strong growth of recent years are likely to be the biggest factors restraining growth in 2015 (see chart 4). In all we expect to see the price of rural land rise by around 5% over the course of the year.

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Chart three: Farmland demand and availability

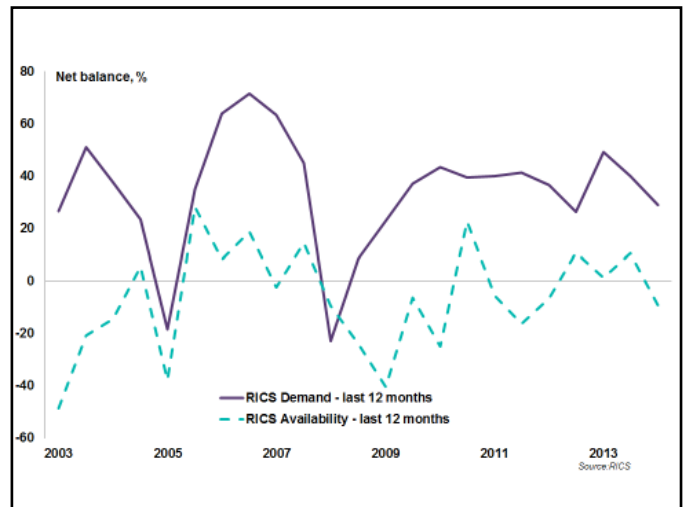
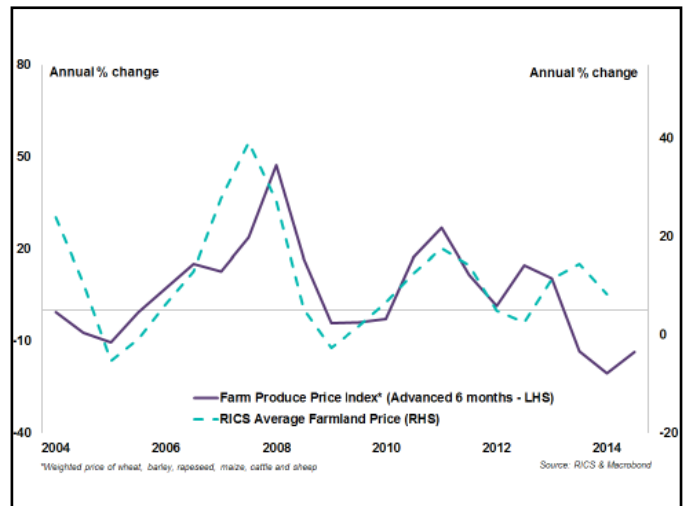


Chart 4: Farm produce prices and RICS Farmland Price Index





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