Regulatory Policy Committee	**Validation of the One-in, Two-out Status and the Net Direct Impact on Business**
Validation Impact Assessment (IA)	The Agriculture (calculation of value of compensation) (Revocation) regulations 2015
Lead Department/Agency	Department for Environment, Food and Rural Affairs
IA Number	DEFRA1698
Origin	Domestic
Expected date of implementation	October 2015 (SNR 10)
Date of Regulatory Triage Confirmation	n/a
Date submitted to RPC	23 February 2015
Date of RPC Validation	2 April 2015
RPC reference	RPC15-FT-DEFRA-2361
Departmental Assessment	
One-in, Two-out status	Zero Net Cost
Estimate of the Equivalent Annual Net Cost to Business (EANCB)	N/A
RPC assessment	**VALIDATED**

Summary RPC comments

The validation IA is fit for purpose.

The IA says that this is a deregulatory proposal. The Department presents the direct incremental cost to business of the measure as equal to the direct incremental benefit to business. As such and in accordance with the guidance, the proposal will be treated as zero net cost for One-in, Two-out purposes.

Background (extracts from IA)

What is the problem under consideration? Why is government intervention necessary?

"The Agriculture (Calculation of Value for Compensation) Regulations 1978 (and amending regulations) sets out a method to calculate compensation payable to outgoing tenants with holdings that come under the Agricultural Holdings Act [AHA] 1986. The Compensation Regulations were last updated in 1983 and specify prices fixed to the same year. They accordingly no longer compensate tenants adequately for the value of certain improvements they have made to the land. This means tenants have less incentive to farm the

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land sustainably in the last years of their tenancy. In addition, the prescribed methodology is inflexible to the varied circumstances of agricultural holdings today."

What are the policy objectives and the intended effects?

"The policy objective is to encourage tenants to farm sustainably in the last years of their tenancy. By revoking the Agriculture (Calculation of Value for Compensation) Regulations 1978 (and amending regulations) landlords and tenants will have the ability to settle compensation claims (governed by the Agricultural Holdings Act 1986) using current market values and calculation methods that best suit their individual circumstances."

RPC comments

The Department proposes to revoke the Agriculture (calculation of value for compensation) Regulations 1978 (the compensation regulations). The Department has confirmed this is a Red Tape Challenge measure and therefore automatically qualifies for the fast track.

The proposal removes the current prescriptive approach and gives landlords and tenants flexibility to settle compensation claims using a calculation method that best suits their needs. It will also bring the process in line with current tenancies set up under the Agricultural Holdings Act 1995. Landlords, incoming and outgoing tenants are all considered businesses.

The Department has provided monetised estimates of the impact of the proposal but explains that there is a large degree of uncertainty about (a) the rate at which tenancies governed by the Agricultural Holdings Act 1986 (AHA tenancies) will fall over time and (b) the market price of fertilisers. The price of fertilisers is relevant in calculating the compensation due to outgoing tenants as it is a key input that improves the productivity of the land.

Based on previous years, the Department estimates that out of a total of 21,509 AHA tenancies, between 200 and 700 (best estimate is 465) are terminated each year. The Department estimates that fertiliser prices will increase by 2.5% each year, in real terms. The Department has used an appraisal period of 45 years.

<u>Benefits</u>

As the benefits of the inputs used by outgoing tenants will be partially captured by the incoming tenant, without compensation the current tenant may allow the land to degrade. Compensation gives the outgoing tenant incentives to sustain the productivity of the land during and beyond his/her last year of tenancy. Allowing compensation to be agreed freely, without imposing a predefined methodology using out of date prices, will improve these incentives by giving confidence to outgoing tenants that they will be

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fairly compensated.

Maintaining the quality of the land produces a direct benefit to the incoming tenant who will not have to take remedial action to return the land to its previous level of productivity. The Department models this benefit by assuming that, in the absence of fair compensation, the incoming tenant would experience a productivity loss of 0.5% in the first year, 0.25% in the second year and 0.125% in the third.

The estimated annual benefit to incoming tenants of avoiding these losses to productivity is £4.0 million.

<u>Costs</u>

The Department expects the proposal to result in the following costs:

1. Landlords will compensate outgoing tenants for certain materials at their current value, estimated to be £105.4 million.

2. Both landlords and outgoing tenants will incur a negotiation cost to agree new prices, estimated to be £3.3 million.

The increase in compensation that will occur as a result of this proposal effectively represents a financial transfer between the landlord and the incoming tenant and therefore does not impose a net cost on business.

Allowing tenants and landlords to negotiate freely the level of compensation will increase the cost of reaching an agreement. This cost is estimated to be £3.3 million each year, which is less than the estimated benefit of greater land productivity (£4.0 million). However, given the uncertainty surrounding both these figures, the Department has chosen to assume they are at least equal. The Department does not expect the proposal to result in additional familiarisation costs as interested parties will only need to become familiar with the regulations at the end of a tenancy. This was confirmed by industry representatives.

The IA says that this is a deregulatory proposal. The Department presents the direct incremental cost to business of the measure as equal to the direct incremental benefit to business. In accordance with the guidance, the proposal will be treated as zero net cost for One-in, Two-out purposes.

Signed		**Michael Gibbons,** Chairman

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