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CAAV NATIONAL TUTORIAL 2023

Agricultural Holdings Act 1986 – Rent Review

1 INTRODUCTION TO RENT REVIEW UNDER THE 1986 ACT

A consequence of the long-term security of tenure provided by the Agricultural Holdings Act 1986 ("the 1986 Act"), removing or varying the normal common law contractual rights of termination, is that either party should be free at appropriate intervals during the tenancy to have the rent payable reviewed in the context of existing economic circumstances and depending on what was being provided by the landlord. Rent assessment on review is essentially an exercise in valuation rather than strict application of legally defined principles.

Section 12 of and Sch 2 to the 1986 Act established a procedural code which deals with rent review. In outline, the rent review procedure commences when either the landlord or the tenant may demand arbitration as to the rent properly payable. The arbitrator is obliged to follow the statutory rental formula (see below).

The new rent then takes effect from the earliest date on which the tenancy could next have been terminated by notice to quit, i.e. the first annual term date of the tenancy not earlier than 12 months following the date of the demand. Subject to specified exceptions, such reviews can take place **not more than once every three years.**

The rent review process begins through a trigger notice known as a section 12 notice which can be served either by the **landlord or the tenant** on the other party at least 12 months and no more than 24 months before the date of the rent review.

The section 12 notice is a formal notice which requires the rent to be settled by arbitration. However, the rent does not necessarily have to be referred to an arbitrator if the parties agree the level of rent prior to the rent review date.

2 TERMS AND DRAFTING OF A SECTION 12 NOTICE

The key points to remember are as follows:

(a) the 'review date' must be the next *available* termination date falling at least 12 months after service of the section 12 notice;

(b) by virtue of section 12(4) of the 1986 Act, the next termination date is defined by reference to the earliest date at which the tenancy could have been terminated by notice to quit.

(c) the notice must be of at least 12 months but no more than 24 months duration;

(d) the serving party therefore must ensure that they have identified the correct term date of the tenancy;

(e) the general rule of construction is that a tenancy expressed from a certain date means that it runs from the first moment of the following day. An exception to the general rule of construction is where the rent is payable in advance. Then the term commences on and from the date named as that is from when it runs.

(f) always include the running words rather than specifying the precise date to avoid invalidity – notice could be valid and effective for 2018 review date if you miss deadline for 2017 review date for example;

(g) *Yeandle v Reigate & Banstead Borough Council* [1996] found that in relation to a tenancy commencing on 29 September, the tenancy would be construed as ending on either the last moment of the 28th or on the first moment of the 29th. There is therefore an argument that the "*next available*" termination date will be 28th rather than 29th; i.e. term date is 25 March, so for the section 12 notice to be effective for a review on 25 March 2018 it will have to have been served and received, at the latest, by or on 24 March 2017 (and after 25 March 2016). However, always try to make sure that it is served by 23 March at the very latest, to ensure that there is no potential for argument as to service; and

(h) Once served a section 12 notice cannot be withdrawn unilaterally. It has been held in one county court case that a demand for arbitration is a trigger notice which once given cannot be 'ungiven'. Either side can use it to make a case for an increase or reduction in the rent.

3 COMPLIANCE WITH SECTION 12 OF THE 1986 ACT

As with the exercise of all rights granted by the agricultural holdings legislation, strict compliance with the statutory procedures for the exercise of such rights is essential if the rights are not to be lost or statute barred.

In order to comply with the requirements of section 12, the Notice must be:

(a) in writing;

(b) requiring "*rent payable to be referred to arbitration from the next termination date*";

(c) correctly identify the parties and the holding.

Note that if the freehold reversion has been severed, case law suggests that all of the landlords must act together in serving rent review notices.

If there are joint tenants, the notice must be addressed to all of them and ideally should be served on all of them.

Drafting note: always use a reliable precedent.

4 SERVICE:

The rules governing service of notices in the 1986 Act can be found at section 93. These **must** be adhered to strictly and one or more of the stated methods of service complied with**.** These are as follows:

(a) delivered to recipient personally;

(b) left at his proper address (last known address); and

(c) sent by recorded delivery post.

5 **FREQUENCY OF RENT REVIEWS:**

The general rule (subject to exceptions) is that the rent of an agricultural holding can only be reviewed once every three years where there is a rent change by agreement or arbitration or third party determination. Schedule 2 para 4(1) provides for a minimum three year period between rent reviews. However, reviews can take place less frequently than every three years.

A section 12 notice can of course be served before the expiration of three years from the last rent review because at least 12 months' notice must be given. It is the date from which the notice takes effect which is the relevant date in determining whether the notice is premature by reference to the three-year rule and not the date of service. Therefore, a section 12 notice that expires before the three year cycle has run its course will be rendered **ineffective**.

A three year cycle runs from:

(a) the commencement of tenancy;

(b) the date from which previous review took effect (increase or reduction, but not a standstill review); or

(c) the date of arbitrator's decision that rent should remain the same.

There are exceptions to the three-year rule, which will **not** re-start the cycle:

(a) a rent change that reflects a change in the terms of the tenancy itself, rather than a wider review, will not trigger the three year cycle *(Sch 2, para 4(2)(a))*- this may be following an arbitrator's award specifying the terms of the written tenancy or where an arbitrator has made an award bringing the terms of the tenancy in line with the model clauses;

(b) rent changes due to agreed (minor) adjustments of boundaries *(Sch 2, para 6): Mann v Gardner* [1991] - surrender of cottage was a major change in extent of holding and therefore it did trigger three year cycle;

(c) apportionment of rent between landlords upon severance of reversion *(Sch 2 para 5)*;

(d) express surrender and re-grant under s4(1)(g) of 1995 Act (grant of new AHA tenancy after 1 September 1995) provided rent stays the same *(Sch 2, para 7)*;

(e) rent adjustments by reason only of improvements carried out by the landlord or following changes to fixed equipment (section 13) **provided** change falls into one of 3 specific statutory exceptions *(Sch 2 para 4(2)(b))*:

- an increase in rent under section 13(1) following improvements by landlord within section 13(2) and the service of written notice by landlord within 6 months of completion of improvement seeking an increase in rent by an amount equal to the increase in the rental value of the holding attributable to the improvement; or

- an increase agreed between landlord and tenant within 6 months of completion of improvement by landlord (section 13(3)); or

- any reduction in rent agreed between landlord and tenant following change in landlord's fixed equipment on the holding.

(f) rent reduction consequent upon an effective notice to quit part of the holding (under section 33 of the 1986 Act or under a provision to that effect in the tenancy agreement) *(Sch 2 para 4(2)(c))*.

(g) Rent changes arising from the exercise of an option to tax under Schedule 10 to the Value Added Tax Act 1994, or revocation of such an option. *(Sch 2 para 4(2)(d))*.

6 **DATE OF VALUATION:**

The valuation date for the purposes of the review is the next termination date (as mentioned in the Notice). It should be noted that parties may be negotiating **before** this date or an arbitrator may be considering the matter many months **after** it.

7 **TIMESCALES:**

Before the review/term date the parties must have either:

(a) agreed the rent between them; or

(b) appointed an arbitrator by agreement *and* the arbitrator has accepted appointment in writing by this date; or

(c) lodged an application with the RICS/CAAV/ALA for the appointment of an arbitrator (one party can do this unilaterally). It should be noted that no application may be made to the President of the RICS/President of the CAAV/Chair of the ALA earlier than four months before the date from which the new rent is to take effect.

(Section 12(3) of the 1986 Act)

The timeframe is strict. The opportunity for review is lost if the deadline is missed i.e. the section 12 notice becomes ineffective.

The period between service of the Notice and the review date can be usefully used to discuss both rent review and other key issues affecting the tenancy, such as: diversification; investment; succession etc. Once the matter proceeds to an arbitrator, he can only consider the rent in accordance with the provisions of Schedule 2 of the AHA. What is actually reviewed is: *"the rent properly payable in respect of the holding*". That excludes anything other than 'rent' – i.e. interest payments for improvements; insurance premiums; charges for BPS entitlements if leased to tenant. This is discussed in more detail below.

8 **THE RENT REVIEW FORMULA**

As stated above, the arbitrator must determine the rent properly payable in accordance with the statutory rental formula. He must determine whether the rent should be

increased, reduced or remain the same and must award the appropriate rent in consequence:

The formula is contained at Schedule 2 paragraph 1(1), which states:

> *"the rent at which the holding might reasonably be expected to be let by a prudent and willing landlord to a prudent and willing tenant, taking into account all relevant factors, including the terms of the tenancy (including those relating to rent), the character and situation of the holding (including the locality), the productive capacity of the holding and its related earning capacity, and the current level of rents for comparable lettings"*

The key concept is ***the sum for which the holding might reasonably be expected to be let by a prudent and willing landlord to a prudent and willing tenant.***

The key points are as follows:

(a) The exercise involves hypothetical parties **not** the actual landlord and tenant:

- 'hypothetical tenant' is considering the holding with its opportunities and handicaps and the opportunities and obligations offered by the tenancy agreement at the review date; and
- 'hypothetical landlord' is offering the farm as it stands at the review date.

(b) "*All relevant factors*" are any factor whose relevance to the rent can be shown.

(c) Factors to be disregarded under Schedule 2, paragraphs 2 & 3 are as follows*:*

- tenant's improvements (including improvements by tenant under previous tenancy if carried over and not compensated at expiry);
- tenant's fixed equipment;
- grant funded element of any landlord's improvements.
- effect on rent of the tenant's actual occupation;
- dilapidations caused or permitted by the tenant;
- high farming; and
- anything adding value which is *personal* to the sitting tenant – e.g. supermarket contracts; planning permissions limited to the tenant.
- Following a change brought in by the Agriculture Act 2020, where a landlord and tenant have a written agreement specifying the tenant must make payments in return for an improvement financed by the landlord, the arbitrator must disregard the fact that the tenant is required to make a payment **and** any benefit to the tenant from the improvements before the date that the last payment is made.

(d) There are 4 key factors that the rent review formula requires the arbitrator to consider in every rent review:

- terms of tenancy;
- character and situation of the holding;
- productive capacity and related earning capacity of the holding; and
- current rents for comparable lettings.

Note that although the Arbitrator is required to have regard to these matters by the wording the Act that does not mean that any other factors considered to be relevant should be diminished in importance in any way.

For each of those 4 factors, the following will be relevant:

(a) terms of tenancy	(1) Identify the terms of the tenancy: • terms of written agreement – including terms as to rent • any memoranda, letters of consent or other documents varying terms • any acts of waiver/variation of terms • any overriding statutory provisions • if oral agreement – behaviour of parties; statutory provisions on terms – model clauses etc. (2) Then consider the impact of those terms, including: • repairing obligations • specific user clauses or requirements as to stock levels; • BPS provisions; • diversification consents; • farmhouse residency clauses; • agricultural worker/prohibition on subletting clauses on cottages; and • ELS/HLS schemes in force which incomer would take on.

(b)	character and situation of holding	(1) the physical nature of the holding: • size; • soil type; • topography; • climate; • layout; • drainage; • buildings + fixed equipment (quality + quantity); • dwellings; • any public access across holding; and • SSSI's, NVZ zone and other statutory designations. (2) locality of the holding: • attractiveness of area; • access to additional land; • access to markets; • landscape; • BPS region; and • restrictions or schemes available as consequence of its location. List is not exhaustive and anything relevant to the particular holding should be considered. Some factors may be more significant than others in certain cases. The key features of the holding in question should be considered.
(c)	productive capacity and related earning capacity	This requires an appraisal of the physical and financial farming potential of the holding *Schedule 2, paragraph 1(2)* contains the definitions. The two concepts are separate and should be appraised in sequence. (1) Productive capacity: a physical assessment of holding's potential for production in hands of competent tenant using a farming system suitable to

	the holding. Take holding as it stands with all its fixed equipment and facilities (whether provided by the landlord or tenant): • Expressed in terms of physical output (tonnes of wheat; litres of milk etc.) • "competent tenant" introduces a hypothetical tenant • "farming system suitable to holding" – may not be actual system current tenant has adopted (2) Related earning capacity: the expected profits arising from that level of productive capacity: • This comprises the second stage, once you have determined productive capacity. • It is essentially a measure of the financial return that would be obtained from the suitable system of farming adopted by the hypothetical competent tenant. ***Points to note:*** • Income from non-agricultural sources must be ignored – BPS payments; diversified enterprises; receipts from sub-letting of cottages; agri-environment schemes (or any grants not directly connected to agricultural production). • The result of this test must be taken into account by the arbitrator along with all other relevant factors according to the circumstances of each case. It is not a determinative factor.
(d) comparables	*"the current level of rents for comparable lettings"* Rents payable in respect of tenancies of comparable agricultural holdings let on terms similar to those of this tenancy. *Schedule 2, paragraph 1(3):* • "*agricultural holdings*" are defined within section 1 of the 1986 Act as meaning "*the aggregate of land (whether agricultural or not) comprised in a contract of tenancy*".

	The admissible comparables are **not** confined to open market lettings, but include rents fixed by agreement or arbitration, and rents likely to become payable. Must disregard any elements of the rents which are due to: • premiums within comparable rents; • scarcity value; and • marriage value. Comparables offer essential market evidence but care must be taken to ensure that they are relevant and provide a true comparable. You may need to strip out differences between the physical nature of the holdings and/or the terms of the tenancies and make adjustments accordingly to the rental value of the comparable. Check no specific circumstances which caused the rent of the comparable to be set as it was – i.e. provision of new fixed equipment/improvements; an agreed succession. There is a lot of debate about whether the definition extends to FBT's under the 1995 Act. It is arguable that the section 1 definition does include FBT's but many tenants argue that FBT rents are open market, whilst AHA rents are not. This uncertainty about whether FBT rents can be included as 'comparables' is often sidestepped by arbitrators including them under the "any other relevant factor" heading.

(e) The rent review formula requires the arbitrator to consider "*any other relevant factors*" in addition to the 4 mandatory factors. This is a very important final limb. It ensures that arbitrator is able to consider the full range of circumstances which have a bearing on the rent of the particular holding at the valuation date. The parties can adduce evidence on all matters that they consider to be relevant.

(f) What sort of thing may fall under this final head?

- non-agricultural income;
- BPS income and obligations;
- FBT rental comparables which do not fall within the specific 'comparables' criteria;
- Agri-environment scheme income and obligations; and

- marriage value of subject holding (while marriage value is taken out of comparables, in order to make them comparable, the marriage value of the subject holding in the market place is to be considered). Therefore, when assessing the rent of an agricultural holding (though not the comparable), any value the holding may have for farmers in the district with established and often equipped holdings to take on the subject holding to be farmed with the prospective tenant's existing established land holdings as part of an enlarged single agricultural unit, must be taken into account.

(g) Although Sch 2 para 1(3)(a) requires scarcity value to be valued out of the rent of comparable holdings (as highlighted above), the 1986 Act is silent as to whether it is to be disregarded in relation to the subject holding itself. However, if scarcity value were allowed in respect of the subject holding it would undermine the central aim of the Sch 2 rental formula, to link rent to productive capacity and related earning capacity, breaking the link with inflated tenders on the first lettings. However, the point remains to be resolved before the courts.

9 **DO ANY OF THESE FIVE FACTORS CARRY MORE WEIGHT THAN ANY OF THE OTHERS?**

(a) No. None of them formally take precedence over any other and in each individual case the arbitrator will have to determine how much weight to place on each point in the particular circumstances.

(b) It is common to see reviews dominated by budgets and the productive capacity/related earning capacity limb. However, in actual fact, this limb has equal weight to the others.

10 **WHAT DOCUMENTS/INFORMATION WILL YOU WANT FROM YOUR CLIENT IF YOU ARE INSTRUCTED TO ACT FOR HIM IN THE REVIEW PROCESS?**

(a) tenancy agreement and any related memoranda, correspondence and documents;

(b) up-to-date plans of the holding;

(c) basic payment scheme details – re. both payments and entitlements;

(d) information on any other grants or agri-environment schemes relevant to the holding;

(e) schedule of landlords and tenant's improvements/fixtures respectively;

(f) in respect of any cottages on the holding, details of any tenancy in place, rent passing etc.;

(g) copies of the farm accounts and any available budgets; and

(h) accounts and information relating to any diversified enterprises on the holding.

11 **WHAT ARE THE KEY STEPS IN THE RENT REVIEW ARBITRATION PROCESS?**

WHAT RULES GOVERN THE PROCESS?

The procedures for assessing the rent after the arbitrator has been appointed are the same as for all other arbitrations. A hearing will be convened; evidence adduced etc., before the arbitrator ultimately makes his award. The prescribed time limits must be strictly complied with. An arbitrator is **not** a valuer appointed to fix the rent, but the equivalent of a judge appointed to adjudicate between two conflicting points of view and sets of evidence. An arbitration is a private process. It is confidential and disclosure is permitted only in very limited circumstances, including with the consent of the parties or by order of the court.

The key points are as follows:

(a) All arbitrations under the 1986 Act are governed by the Arbitration Act 1996.

(b) Previously, Schedule 11 of the 1986 Act provided a specific and detailed arbitration regime which included many specific time-limits and deadlines. These are no longer relevant.

(c) Before the review/term date, the parties must have either formally appointed an arbitrator by agreement, or have submitted an application to the RICS/CAAV/ALA for an appointment to be made.

(d) The appointed arbitrator will confirm his terms of reference with the parties and may convene a preliminary meeting (by telephone or at a hearing) to determine the matters in issue and to issue directions to bring the matter to a hearing.

(e) Alternatively, if the parties are able to reach agreement, the arbitrator may issue directions suggested by the parties.

(f) The procedure and timetable to be applied is to be agreed between the parties with the guidance of the arbitrator. If agreement cannot be reached, the arbitrator will issue directions to ensure that the matter is dealt with without unnecessary delay and expense.

(g) The directions are likely to include a timetable dealing with the following matters:

- identification of the issues in dispute;
- preparation of a List of Issues and Statement of Agreed Facts; this should include agreement on comparables and the format for budgets if possible;
- exchange of statements of case;
- disclosure of relevant documents by both parties;
- exchange of expert witness reports (and potentially a meeting between expert witnesses);
- exchange of written submissions or skeleton arguments; and

- confirmation of whether the matter will be dealt with on the basis of written submissions or at a hearing.

(h) Section 33 of the Arbitration Act 1996 requires arbitrators to act fairly and impartially between the parties and adopt procedures suitable to the circumstances of the particular case, avoiding unnecessary delay and expense, so as to provide a fair means for the resolution of matters falling to be determined with each party able to put his case and respond to the other.

(i) The arbitrator must conduct the rent review arbitration pursuant to the provisions of section 12 and Schedule 2 of the AHA.

(j) The arbitrator is entitled to appoint a legal advisor to assist him on any issues of law that have been identified. The parties will be responsible for the additional cost.

12 RENT VARIATION FOR IMPROVEMENTS UNDER SECTION 13 OF THE 1986 ACT

Section 13 entitles a landlord who has carried out improvements to an agricultural holding to obtain an increase in rent by reason of the improvement in certain circumstances. He must first give notice within six months of completion of the improvement. The amount of the rent increase will be an amount equal to the increase in the rental value of the holding attributable to the carrying out of the improvement. The increase takes effect from completion of the improvement. However, it only applies to specific improvements listed in section 13(2).

To obtain an increase in rent the landlord must give notice in writing to the tenant within six months of the completion of the improvement. If he fails to do so, having first agreed with the tenant that interest shall be payable on the improvement, he does not forgo that interest but merely cannot claim it as rent.

If the landlord agrees an increase in rent with the tenant without going through the statutory notice procedures under section 13, he will start the three-year rent review cycle and may thereby delay an overall rent review.

Any dispute arising between the landlord and the tenant of the holding under section 13 shall be determined by arbitration or third party determination *(section 13(7) and section 13(7A)).*

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