

CARTER
JONAS

The Model Estate

Summer 2011





Introduction

The Model Estate is a fictitious rural estate comprising a combination of in-hand and let farms managed for illustrative purposes by Carter Jonas. It also includes both commercial and residential elements and is located within the geographical triangle bounded by the M4, M40 and M5 motorways.

This report provides a more detailed overview of each of the various elements of the estate since the first Model Estate report in 2009. In addition, the Model Estate is also set against the performance of a basket of recognised asset classes including wine, gold, antiques, classic cars, equities and commercial and residential property. The principal purpose of this analysis is to place the Model Estate and agricultural land in general in a wider context, enabling an assessment of its performance against a variety of asset classes which an estate owner may well have an interest or presence in. Significantly, this report also includes an insight into the substantial taxation savings available via the ownership of agricultural land versus alternative asset classes.

The Model Estate's Performance

The 2009 valuation of the Model Estate totalled £26.3 million and produced a total return of 0.5% (capital and revenue combined). The 2010 valuation has risen to £28.2 million and produced a total return figure of 7% for the entire estate and 9% for the trading estate, excluding the principal Manor House.

This improvement in performance mirrors the healthy and improving sentiment across the UK farmland market as values have continued to rise and revenue returns have continued to deliver stable growth, despite the wider uncertain economic climate.

The table below details the components of the Model Estate which comprises 3,208 acres;

Property Type	Description	Previous Total Return (30/09/2009)	Revised Total Return (30/09/2010)	Percentage Change %
Let Farms	1,549 acres of arable and 371 acres of grassland. Three of the six let farms are let on FBTs ¹ and the remaining three on AHAs ² . 3 farmhouses (1 FBT and 2 AHA) and 4 cottages (1 Ag Protected ³ , 1 AST ⁴ and 2 vacant)	£7.4 million	£8.9 million	19.3%
In-hand Farms	1,073 acres of arable and 71 acres of grassland. Grade II* Manor House and farmhouse	£13.2 million	£14.1 million	6.4%
Let Residential	6 houses (3 AST, 1 Ag Protected, 1 Rent Act and 1 Non-Housing Act),	£1.8 million	£1.9 million	2.3%
Let Commercial	14 properties (8 L&T Act ⁵ , 3 in hand, 1 licence and 2 vacant)	£3.7 million	£3.2 million	-13.5%
Other Properties	Telecoms mast, a syndicate shoot and fishing rights	£129,000	£129,000	0%
	Total value	£26.3 million	£28.2 million	7%

¹ Farm Business Tenancy

⁴ Assured Shorthold Tenancy

² Agriculture Holdings Act 1986

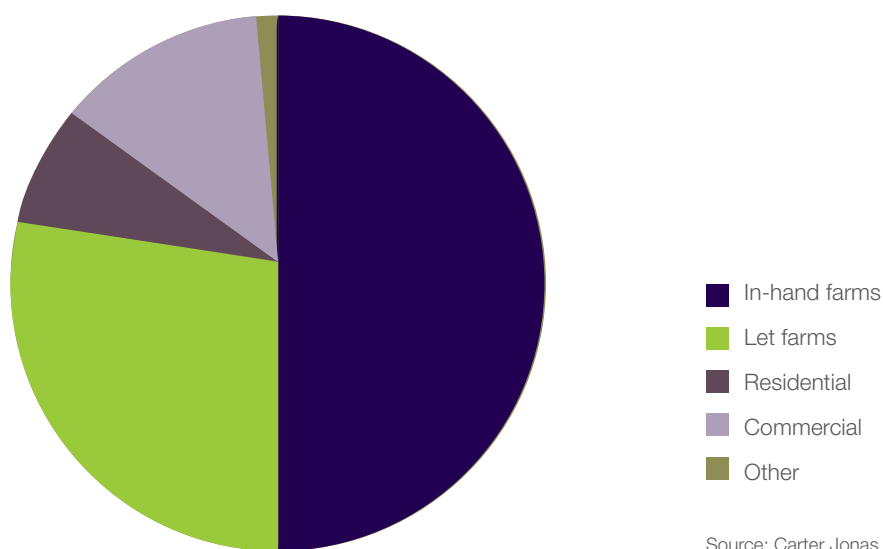
⁵ Landlord and Tenant Act (1954)

³ Rent (Agriculture) Act 1976

Detailed Model Estate Performance

The various elements of the estate, as a percentage of the total capital value, have remained largely unchanged during 2010. The let farms increased their proportion of the capital value from 28.4% to 31.7% whilst the commercial element decreased from 14.1% to 11.4%. The varying proportions are a reflection of the changing fortunes of both sectors.

Components of the Model Estate 2010



Let farms

Once again, the let farms component of the estate showed the strongest performance of all elements of the estate, producing an impressive total return of 19.3% in 2010 with a cumulative value of £8.9 million. This element comprises six farms with a collective size of 1,549 acres. Essentially, the rise in total return can be attributed to rapid land value appreciation and strengthening revenue returns on the back of firm agricultural commodity values.

Over the course of the year there have only been modest changes to the tenancies on the estate so that the majority of the total return growth has been from core land value appreciation rather than capitalising on the reversionary interest in long term tenancies. However, the agent is focused on identifying and progressing opportunities for the release of assets from tenancies to maximise the Model Estate's performance.

As there are a number of agricultural rents due for negotiation in the forthcoming year, it is worth noting that consideration will be given to the number of 'surplus' cottages within agricultural tenancies and that negotiating the release of some back to the estate has been adopted as part of the estate's policy. This should help improve the total return to the estate in the short to medium term.

In-hand farms

The in-hand farms within the estate are two predominantly arable holdings which, collectively, total 1,073 acres of arable and 71 acres of grassland; namely Manor Farm and Home Farm. The principal estate house and surrounding grounds, which are open to the public on certain dates of the year, are also included within the in-hand element. This sector of the estate produced a total return of 6.4% in 2010, an increase from its 2009 level of 3.0%.

This improvement was largely attributable to capital growth as a result of an ongoing lack of supply of land across the country which has bolstered a general rise in land values of circa 5% across the board during 2010. The sustained dramatic increase in cereal prices from late 2010 has helped to generate further interest in arable land as an asset class helping to boost land values while pasture land has witnessed a more stable period.

The total return of the in-hand element of the estate significantly increases to 11.8% if the Manor House is excluded from the analysis, as it clearly comprises a significant capital value although currently produces minimal income. The cumulative estate total return rises to 9% from 7% on a one year basis as a result of this exclusion and enables the Model Estate to be directly comparable to agricultural land and the various asset classes which do not include a non-income producing “trophy” asset. For the purposes of the analysis against other asset classes in this report, the higher and more comparable figure of 9% has been used.

Let Residential

The let residential element of the Model Estate comprises six houses with a cumulative capital value of £1.86 million as at September 2010. The total return produced by this element stood at 2.3%, well above its 2009 level of 0.5%. The improvement in performance derived from the larger residential properties i.e. those with values over £250,000, which have witnessed an increase in values compared to the lower value ones which have plateaued.

The houses are held on a variety of occupancies and are managed accordingly: three are held on Assured Shorthold Tenancies (ASTs), one under the Rent (Agriculture) Act 1976, one under the Rent Act and the other is a Non-Housing Act tenancy.

In light of its modest revenue performance over recent years, the agent’s advice is to consider the disposal of some of the low yielding properties whose sale will not have a detrimental impact on the core estate, although, to date, no firm commitment or decision has been made on this matter. However, the analysis and management of the performance of all assets is deemed an increasingly significant part of the agent’s remit and is considered on an ongoing basis to ensure the maximum return on investment is provided to the client.

Let Commercial

The let commercial element of the portfolio includes 14 properties totalling 58,100 sq ft split into three holdings: Manor Farm and Home Farm buildings and East Oxbury Airfield.

The commercial element of the estate produced a total return of -13.5% as a result of the decline in capital values, in addition to a considerable fall in income. This is in sharp contrast to the wider UK commercial property market which witnessed a notable increase in capital values over the same time period and reflects the differing fortunes of primary, secondary and tertiary commercial properties. Clearly, the performance of this sector will be under close review in forthcoming years, although it is considered that the low point of the commercial sector, as a whole, has now passed and increased optimism and improved sentiment will be evidenced, resulting in an improved performance in 2011.

All of the barns which comprise Manor Farm buildings are currently occupied on five year leases with reviews due in January 2011. The reviews will prove critical in terms of the future performance and viability of the commercial element of the estate. During 2010, the tenant of Old Barn, let under the Landlord & Tenant 1954 Act, pleaded hardship issues and it was decided that instead of losing the tenant and incurring the liability for business rates on the vacant premises, a reduced rent of £23,500 per annum was agreed for a period of 12 months which will then be reviewed. It is important to confirm that only in certain instances would this request have been considered. It was due mainly to the over-supply of similar types of accommodation within the local market that the agent advised this approach to retaining tenants.

Home Farm buildings comprise three vacant barns and their collective value has decreased by 13.8% during 2010. East Oxbury Airfield has six buildings, two of which have just become vacant and are indicative of the smaller storage-style commercial accommodation often available on surrounding rural estates.

Other properties

This element of the estate comprises a telecoms mast, a syndicate shoot and fishing rights to both the River Garner and Ambrose Lakes. The income and valuation of all three components have remained stable over the last year. Consequently, the total return of this small segment of the estate in 2010 was 0.2%.

Planning implications

The latest proposed route of HS2, the new high speed rail line between London and the West Midlands, has been outlined to run within the estate boundaries. Whilst still at the consultation stage, the rail link is expected to have a significant impact on the ongoing minerals investigation and impede the potential for gravel extraction. No formal action can be taken before the end of the consultation period, in which the agents plan to take an active role at the detailed local consultation due to occur later this year on behalf of the clients. However, the situation requires close attention and will be reported on in the next edition of the Model Estate report.

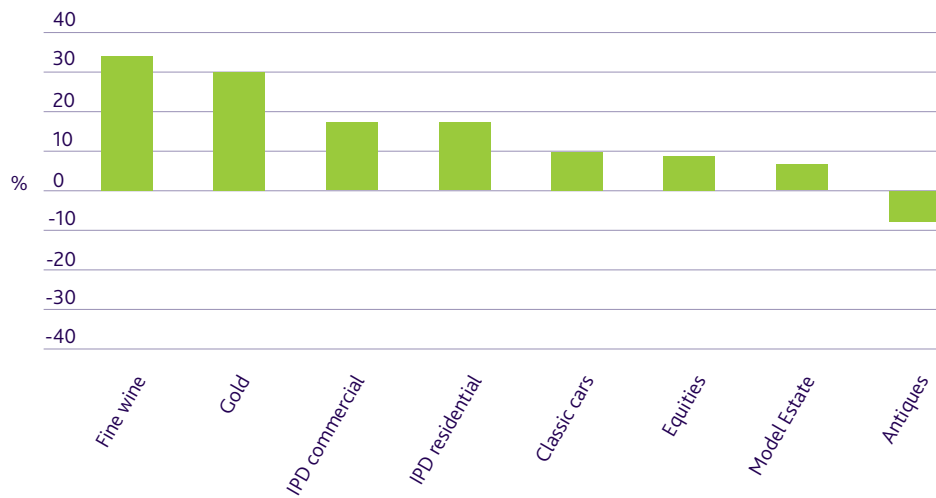
Summary

Whilst the changes in the Model Estate's performance can be attributed to several key factors, none the less the performance achieved illustrates the robust nature of rural property as an asset class.

The Model Estate vs Asset Classes

Despite the continuing global economic turmoil throughout 2010, the vast majority of the various asset classes included within this report have produced remarkably buoyant returns. This is likely to be a reflection of increasing numbers of investors keen to take a 'flight to safety' towards such assets at such a time. None of the asset classes measured here include a "lifestyle" element and so the performance of the Model Estate excludes the Manor House in order to ensure consistency in performance measurement.

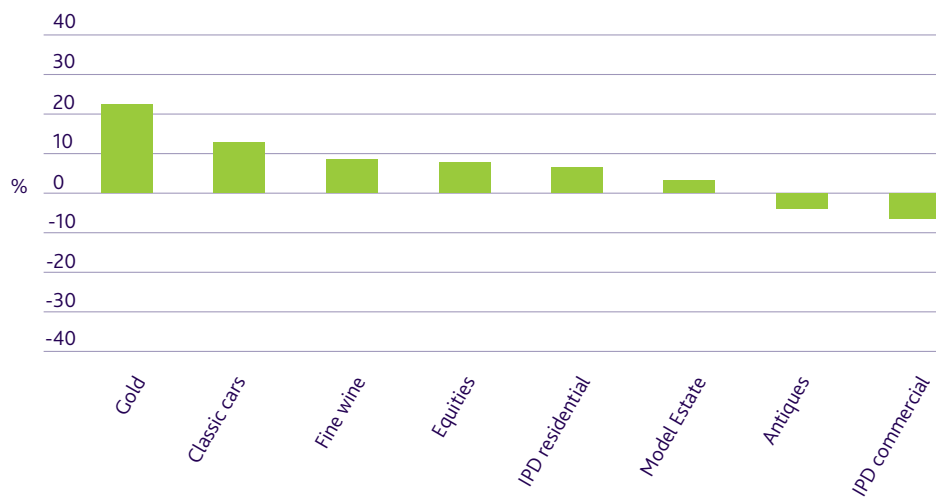
Total return asset performance 2009-2010



Fine wine witnessed the strongest performance in 2010, producing an impressive 34.7% with unabated demand from China proving an increasingly significant factor in the return. The asset class's particularly strong 2010 return has bolstered its longer-term performance of 9.5% and 7.9% per annum annualised over the last two and three years, respectively.

Gold was the second highest performing asset class in 2010, producing a 30.4% return. This impressive figure is in line with levels recorded in previous years resulting in annualised returns of 22.6% and 20.7% per annum over the last two and three years, respectively. This consistently high level of return reinforces the attractiveness of the asset to a wide range of investors which is unlikely to dissipate over the medium-term as the volatile economic conditions currently being witnessed across the globe are forecast to continue.

Total return asset performance 2008-2010



Both commercial and residential property sectors across the UK experienced a marked improvement in performance during 2010, after a torrid two years; commercial property recorded a 16.8% total return in 2010 and residential slightly lower at 16.6%.

Whilst commercial property produced an impressive return in 2010, this disguised a significant variation in the performance of individual sectors within the asset class. Central London offices drove the performance of the sector as a whole, while provincial offices were the weakest performing segment. Similarly, returns on shopping centres improved notably from their 2009 level although provincial shops witnessed a dismal performance. This stark variation of returns within the same segment of the asset class clearly illustrates the complexities of the sector and highlights the requirement of detailed knowledge of market trends and movements. It is clear that such market expertise has far greater implications on the performance level of the sector than agricultural land which demonstrates a much lesser degree of variance.

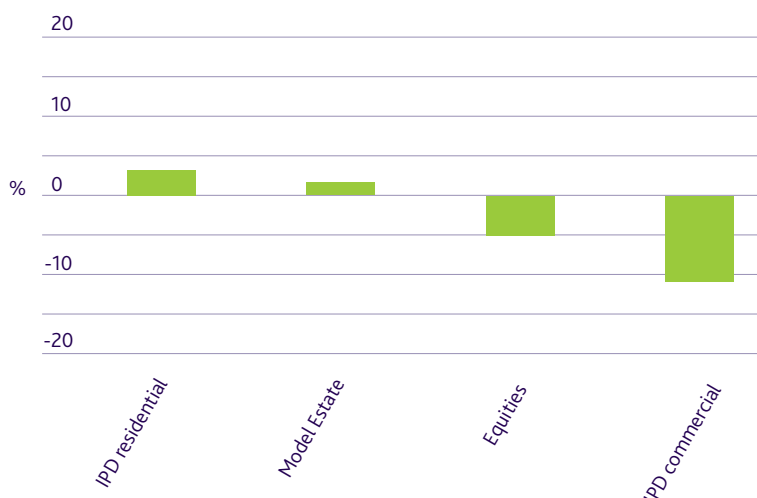
Classic cars are a new entrant to the Model Estate report. The index used is the HAGI6 Top Index, which is designed to measure the rare collector's automobile market, ranging from pre-war to the new millennium vehicles. The asset class produced a 2010 return of 9.9% which, in fact, has strengthened over the longer-term to provide a 12.8% and 16.6% return per annum annualised.

The antiques index used within the report measures the value of various pieces of furniture and tracks back to 1968. It monitors oak, walnut, early mahogany, late mahogany, Regency, early Victorian and country furniture and therefore provides a very comprehensive index of the antiques asset class. It has produced a -7.3% return in 2010 and a -4.1% and -2.7% per annum annualised return over the last two and three years. The lacklustre performance reflects purchasers continuing to remain very selective and demanding pieces in excellent order. Much antique furniture, particularly oak, appears to have become too bulky for the modern interior. A number of commentators on the market now state that the bottom of the antiques market has now been reached and project a more positive period for the asset class in 2012.

Summary

The outstanding capital growth experienced by gold, fine wine and classic cars is of interest for comparative purposes but it should also be remembered that they do not offer a revenue return and can incur significant expense as an asset. To achieve a true comparative analysis, the Model Estate should be benchmarked against residential and commercial property and equities. On this basis the Model Estate achieves a total return of 1.8% (2007 – 2010 annualised) compared with 2.2% by residential property at the top of the leader board. The graph below illustrates this change in ranking.

Total return asset performance 2007-2010



Source: Carter Jonas

The longer-term performance of the Model Estate illustrates a continuing resilient picture in terms of returns reinforcing its ability to produce robust and indeed strengthening returns particularly at a time of global uncertainty and fragility.

⁶ Historic Automobile Group International (HAGI™) is an independent research house and think tank with specialised expertise in the rare classic motorcar sector.

Taxation

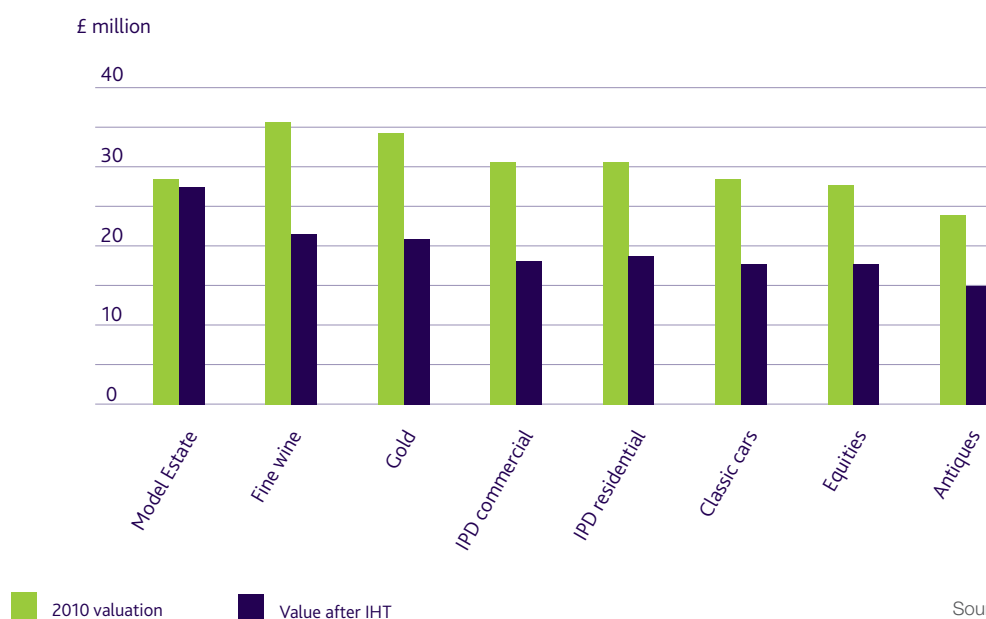
A critical factor underpinning the performance of the Model Estate and agricultural property as an asset class is the benign Inheritance Tax (IHT) regime. The advantages offered by this asset class, in terms of the financial stability it delivers and fiscal advantage it offers, fuels capital growth as supply remains tight across the market. Despite the importance of IHT in understanding why the Model Estate performs strongly, it is rarely analysed. This aspect warrants consideration in order to illustrate the overall performance of the Model Estate against the alternative asset classes included within the report.

IHT is levied on each of the alternative asset classes included in this report, assuming they are held and are subject to UK taxation, at the rate of 40% of the capital value after any spouse transfers and the nil rate band has been deducted. Agricultural land and qualifying houses and buildings fall into the privileged position of being exempt from IHT, subject to strict criteria being adhered to, providing the Model Estate with a significant IHT advantage. Rural property benefits from a further concession in that the IHT can be paid to HMRC every 10 years based on a valuation. This can enable some portfolios to make provision for the IHT out of revenue, whilst the alternative asset classes pay any IHT within six months of falling due.

All asset classes can take some steps to mitigate the impact of IHT in the event of an expected death through the use of Trusts and Potentially Exempt Transfers. The key benefit provided by an asset class such as the Model Estate is the IHT advantage in the event of an untimely death.

Based on an equivalent capital value as the Model Estate of £28.2 million, the alternative asset classes will incur an IHT charge of approximately £11.2 million in the event of an untimely death if these assets were held personally by the deceased after the nil rate band has been deducted. By comparison, and in the same circumstances, the liability for IHT is reduced to £1.9 million on the Model Estate, representing an IHT saving of £9.3 million (an 83% reduction). The graph below illustrates how this year's valuation of all the asset classes might reduce, and by what extent, after an untimely death and applicable IHT demanded. This demonstrates the change in overall wealth and the advantage that the Model Estate can deliver.

2010 Capital and Inheritance Tax Valuations



How has the Model Estate achieved these tax savings?

- East Oxbury Manor is open to the public after conditional exemption to IHT was granted on the owner's father's death resulting in nil IHT being payable on its full value of £6.25 million.
- The in-hand farmland of 1,168 acres, including Home Farmhouse, qualifies for 100% Agricultural Property Relief (APR) with the woodland benefiting from Business Property Relief (BPR). Consequently, neither attract a liability for IHT on the combined value of £7.8 million.
- The let farms are occupied under both AHA tenancies and also FBTs and attract APR at either 50% or 100%, respectively (AHA tenancies subject to succession or surrender and re-grant post 1995 attract 100%). The value for IHT has been reduced from £8.9 million down to £1.5 million.
- The estate's current configuration means that the residential portfolio is subject to IHT at 40% on the full value. However, following the decision under the Balfour case, the Estate Trustees are reorganising the estate and are taking more land in-hand to increase the trading activity. This enables BPR relief to be secured on the residential portfolio by demonstrating that the trading activity is key and the investment income is an ancillary source of income.
- The commercial premises continue to attract BPR at 100% as they are let as part of the trading business benefiting from the Balfour case.

Summary

The taxation benefits are a key component in a myriad of complex reasons behind rural land and estate ownership. The modest revenue return delivered by rural property is more than compensated for by the capital growth and substantial capital taxation savings that can be secured

Conclusion

The Model Estate report aims to bring to life some of the feasible events to be expected during the strategic and annual management of rural assets. As with any working estate, there are a variety of ongoing issues which require both immediate action and long-term monitoring.

The Model Estate produced a total return of 9% in 2010 and, admittedly, does not compete with the double digit returns of fine wine and gold. That said, neither of these asset classes provide a revenue return and thus are different from the Model Estate which offers a significant lifestyle benefit above and beyond all other asset classes included within the analysis. In addition, the significant taxation benefits outlined further reinforce agricultural land's attractiveness compared to investing and holding the alternative classes included within the report.

Over its period of management, the Model Estate has provided robust levels of capital and revenue returns which prove it worthy of consideration as an asset class.

About Carter Jonas

Carter Jonas manages over a million acres of land for both private and institutional clients and is well placed to advise on all matters relating to rural property. In addition, we have a strong presence in both commercial and residential property, planning, architectural and building surveying and mineral extraction and therefore are able to offer an all inclusive solution to almost any property issue.



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