

<b>Title:</b> Validation IA: The Agriculture (Model Clauses for Fixed Equipment) (England) Regulations 2015, <b>IA No:</b> DEFRA1697  <b>Lead department or agency:</b> Defra  <b>Other departments or agencies:</b> N/A	<b>Impact Assessment (IA)</b>		
	<b>Date:</b> 06/03/2015		
	<b>Stage:</b> Final		
	<b>Source of intervention:</b> Domestic		
	<b>Type of measure:</b> Secondary legislation		
<b>Contact for enquiries:</b> Tom Murray (02072385292) or Jenny Barker (01173723638)			
<b>Summary: Intervention and Options</b>			<b>RPC Opinion:</b> RPC Opinion Status

Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out? Measure qualifies as
£0m	£0m	£0m	Yes   Zero Net Cost

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

The Agriculture (Maintenance Repair and Insurance of Fixed Equipment) Regulations 1973 (“1973 Regulations”) need modernising to include items now in common use, to update monetary caps set at 1988 values and to provide a more pragmatic split of some existing liabilities. The new statutory instrument (the “instrument”) will consolidate the Agriculture (Miscellaneous Time-Limits) Regulations 1959 and revoke the now redundant Agriculture (Time-Limit) Regulations 1988. Government intervention is necessary as the 1973 Regulations are deemed to be incorporated into every agricultural holding made under the Agricultural Holdings Act 1986. They need updating and modernising to be fit for current use by industry.

**What are the policy objectives and the intended effects?**

The policy objective is to ensure an efficient and effective agricultural tenanted sector. The new instrument will set out clearly the split of liabilities between a landlord and tenant for fixed equipment on a holding. It replaces the 1973 Regulations and reduces the number of legislative instruments. The effect of these changes will be to simplify and modernise the legislative framework governing agricultural holdings in England.

**What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)**

**Do nothing:** Leaving the 1973 Regulations unchanged was considered. However, this will cause them to become even further out of date and may lead to more disputes. For this reason doing nothing was ruled out.

**Update and consolidate this instrument:** This is our preferred option. It has the support of all key industry bodies who asked for this change and it has the support of the majority of the responses to the public consultation. It will resolve the current problems of outdated monetary caps and unclear liabilities for fixed equipment now in common use on holdings.

<b>Will the policy be reviewed?</b> It will not be reviewed. <b>If applicable, set review date:</b> Month/Year					
Does implementation go beyond minimum EU requirements?				No	
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		<b>Micro</b> Yes	<b>&lt; 20</b> Yes	<b>Small</b> Yes	<b>Medium</b> No
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)				<b>Traded:</b>	
				<b>Non-traded:</b>	

***I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.***

Signed by the responsible Minister: George Eustice Date: 21st March 2015

# Summary: Analysis & Evidence

# Policy Option 1

**Description:** Update and modernise the 1973 Regulations.

## FULL ECONOMIC ASSESSMENT

Price Base Year 2015	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	High: Optional	Best Estimate: £0m

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional	Optional	Optional
High	Optional	Optional	Optional
Best Estimate	£0m	£0.4m	£3.0m

### Description and scale of key monetised costs by 'main affected groups'

The new instrument is expected to generate a monetised cost on a main affected group. Tenants will now be responsible for paying up to £500 a year (an increase from £100 in 1988) to repair and replace broken, cracked, or slipped roof tiles or slates as damage occurs. It is estimated that this will cost tenants an additional £3.0m in present value terms over the appraisal period. No familiarisation costs are expected. This is because tenants and landlords will already need to refer to the schedule to identify current liabilities.

### Other key non-monetised costs by 'main affected groups'

The removal of an annual fixed cash limit for tenants to recover costs from landlords will prevent some landlords from benefitting by keeping capital in assets more productive than the holding's fixed equipment. This benefit comes at the expense of these landlord's tenants. This will generate a cost to a small number of landlords who use this regulation (see non-monetised benefits section for the reciprocal benefit to tenants).

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional	Optional	Optional
High	Optional	Optional	Optional
Best Estimate	£0m	£0.4m	£3.0m

### Description and scale of key monetised benefits by 'main affected groups'

Landlords will benefit from reduced annual expenditure on maintenance of tiles due to the updated cash limit. They will no longer be responsible for repair to broken and slipped tiles which cost between £100 and £500. These become the responsibility of the tenant. This is estimated to be equivalent to the tenants' expenditure with a present value benefit best estimate to landlords of £3.0m in present value terms over the appraisal period.

### Other key non-monetised benefits by 'main affected groups'

This instrument will remove unclear liability and reduce the likelihood of disputes occurring. Secondly, benefits may arise from improvements to health and safety standards and more timely repair of fixed equipment. The latter may lead to some farm productivity benefits or minimise costs. Thirdly, removal of a fixed cash limit for tenants to recover costs from landlords ends the opportunity cost of tenants having capital tied up in unproductive assets. These benefits cannot be quantified in any meaningful way.

### Key assumptions/sensitivities/risks

Assumptions are required for the future rate of decline of relevant holdings and the proportion of them that contain houses and buildings (i.e fixed equipment). Further assumptions are made about the average cost to tenants of tile repair and replacement. These assumptions are sensitivity tested in the Risks and Assumptions section.

Discount rate (%) 3.5

## BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: £0.3m	Benefits: £0.3m	Net: £0.0m	Yes	Zero net cost

# Evidence Base (for summary sheets)

## Problem under consideration

The Agriculture (Maintenance, Repair and Insurance of Fixed Equipment) Regulations 1973 as amended (the “1973 Regulations”) allocate the responsibility between the landlord and tenant of an agricultural holding for maintaining, repairing and insuring fixed equipment. The 1973 Regulations apply to agricultural tenancies governed by the Agricultural Holdings Act 1986 (the “1986 Act”). There are approximately 21,500 such holdings in England accounting for about 17% of its agricultural area.<sup>1</sup>

The 1973 Regulations were amended in 1988 and are out of date because:

- a) They do not prescribe the terms for the maintenance, replacement and repair of fixed equipment for technologies developed since the regulations were drafted and for items now in common use.
- b) They include fixed monetary caps that have not been updated since 1988.
- c) A different split of liabilities for certain items would be more pragmatic for the parties concerned.

The proposed change is part of the Government’s Red Tape Challenge to simplify, update and reduce the burden of regulations on business and delivers a Farming Regulation Task Force recommendation to update the 1973 Regulations. It has been subject to an 8-week consultation. The Tenancy Reform Industry Group (TRIG) and the majority of respondents to the public consultation support the proposed change.<sup>2</sup> The legislative change proposed covers England and so this validation impact assessment (IA) focusses on England only.

## Rationale for intervention

The rationale for government intervention is that the 1973 Regulations are incorporated in to tenancy agreements governed by the 1986 Act. No new tenancy agreements can be set up under the 1986 Act except under succession rules. However, for the 21,500 agreements already in place in England, it is imperative that the 1973 Regulations are updated so that responsibilities are defined for items now in common use on holdings, monetary caps reflect current market costs and responsibilities for new technologies developed since the regulations were drafted are included. This will help to avoid disputes on where responsibility sits for the liabilities that might arise under a tenancy agreement, i.e. the landlord or tenant.

The rationale for government intervention can be divided into two broad categories. These are **unclear liability** and **outdated prices** as a result of the 1973 Regulations becoming out of date.

Unclear liability: the responsibility of liability for certain modern items is not specified in the 1973 Regulations. Unclear liability through outdated legislation may unnecessarily inhibit the efficient running of the farm, create uncertainty between landlord and tenant and lead to the following problems:

- Inequitable distribution of maintenance, repair and replacement costs between landlord and tenant. This will have financial and welfare impacts to individual parties. Welfare impacts will vary according to individual holdings depending on how uncertain liability is currently handled.
- It can generate disputes which incur cost to resolve. A dispute may also lead to repairs being delayed which can lead to further deterioration of fixed equipment.
- Health and safety may be compromised, e.g. neglect of testing gas and electrical systems.
- Insufficient provision for immediate emergency repair to underground water pipes may lead to greater water damage costs than are necessary.

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<sup>1</sup> Based on Defra analysis of the 2013 June Survey of Agriculture and Horticulture.

<sup>2</sup> The range of organisations represented on the TRIG include: National Farmers Union, Tenant Farmers Association, Country Land and Business Association, Royal Institute of Chartered Surveyors, Agricultural Law Association, National Federation of Young Farmers Clubs, Farmers’ Union of Wales, Central Agricultural Association of Valuers and the Association of Chief Estates Surveyors.

To modernise the 1973 Regulations this instrument adds new liabilities and makes changes to some existing liabilities. Annex 1 lists these additions and amendments (as they are not individually analysed in the main body of this IA) and the resulting impact on the split in liabilities.<sup>3</sup>

**Outdated prices:** Fixed cash limits have not been updated since 1988 and do not reflect current prices. Outdated prices are currently found in two areas of the 1973 Regulations:

- Tenants have a duty of care to roofs and are liable to repair and replace broken, cracked or slipped roof tiles and slates, as the damage occurs, up to £100 a year. If the cost exceeds £100 the landlord is responsible.
- Where the landlord is liable to execute replacements but fails to act within 3 months of receiving written notice from the tenant, the tenant may execute the replacement and recover the reasonable cost of that work up to £2,000 or their annual rent (whichever is less) per year.

Insufficient fixed annual cash limits will reduce the incentive for tenants to carry out appropriate maintenance work. For the maintenance of roof tiles and slates, the £100 limit is a crude method to distinguish between repairs that might be considered minor or major. Over time the fixed limit will push maintenance originally considered the responsibility of the tenant onto the landlord.

Tenant cost recovery claims for replacements are likely to cost more today than in 1988 to get the same work done. Whilst tenants can make claims of any size, the landlord is only required to pay back a maximum of £2,000 per year. A claim of more than £2,000 can be paid back over multiple years, tying up tenants' capital which might have otherwise been spent in more productive avenues.

The current cash limits may also pose the following problems:

- Low annual cash limits may incentivise tenants to undertake only partial repairs which may deteriorate and lead to large future repairs or replacement costs that could have been avoided.
- Productivity may fall if delayed repairs reduce functionality of fixed equipment.

### **Policy objective**

The policy objective is to ensure an efficient and effective tenanted agricultural sector in England. Setting out a clear split in responsibilities for the landlord and tenant to maintain, repair, replace and insure fixed equipment will keep the holding in good productive working order and minimise disputes. This legislative change delivers on the Government's Red Tape Challenge and the Farming Regulation Task Force commitment to update and modernise the 1973 Regulations.

This instrument also consolidates the Agriculture (Miscellaneous Time-Limits) Regulations 1959. This will not result in any change to policy but it will make the legislative framework more streamlined. For this reason it is not given further consideration here. The instrument also revokes the now redundant Agriculture (Time-Limit) Regulations 1988. These changes will deliver the Red Tape Challenge commitment to simplify the legislative framework for agricultural tenancies.

This instrument also includes third party determination as an alternative to arbitration for disputes. The impact of this has already been assessed as part of the Deregulation Act 2015, therefore this is not considered further here.

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<sup>3</sup>Please note that updating fixed cash limits to overcome outdated prices also represents an update of existing liabilities. However, to keep the analysis simple, we prefer to keep these changes separate from the liabilities highlighted in Annex 1. Updating the cash limits is explained fully in the main body of this validation Impact Assessment.

## **1986 Act agricultural tenancy agreements**

The relevance of this instrument depends on the number of 1986 Act agreements that remain in the future. Table 1 shows total area and number of agricultural holdings in England has been falling over time, a natural result of being superseded by newer agreements made under the Agricultural Tenancies Act 1995. Most recent data estimates that 21,509 holdings remained in 2013.

Care needs to be taken when projecting the rate at which these holdings may decline in the future. Agricultural holdings may conceivably continue to exist for many years due to succession rights. A holding signed in early 1984 could credibly remain in place for another 99 years from its commencement date if succession rights be invoked and each generation farm the land for 40 years. This is equivalent to an average fall of 213 agreements per year from 2013.

However, between 2000 and 2013 the estimated number of agreements has fallen by over 10,000 at an average of 717 per year, although this appears to have slowed considerably in recent years.<sup>4</sup> If this rate of decline was to continue then no holdings would be left in 28 years' time.

**Table 1: Agriculture Holding Act 1986 Agreements (England only)**

<b>Year</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
Area ('000 hectares)	2,157	2,191	1,999	1,940	1,894	1,859	1833
Number of holdings	30,826	30,316	27,629	28,369	27,790	26,597	25,838
<b>Year</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
Area ('000 hectares)	1,767	1,727	1,637	1,590	1,592	1,592	1,565
Number of holdings	24,923	24,755	23,068	21,675	21,670	21,618	21,509

*Source: June Survey of Agriculture and Horticulture*

Notwithstanding the uncertainty surrounding the future rate of decline, a best estimate is considered to be the midpoint of the two methods above (465 holdings). The Risks and Assumptions section analyses the impact of increasing or decreasing this rate on the quantitative analysis.

## **Summary of preferred option**

The preferred option is to make the following changes to the 1973 Regulations:

- 1) Update the schedule of equipment and responsibility of liability between landlord and tenant. This includes the provision of new liabilities and amends some existing liabilities to extend their scope and/or change where liability lies for those items. This is set out in more detail in Annex 1.
- 2) Update the tenant's duty of care for broken, cracked and slipped tiles from £100 to £500 per year.
- 3) Remove the existing monetary cap so the tenant can recover in full the 'reasonable cost' of any replacements they make.<sup>5</sup>

Changes to the 1973 Regulations were compared against a baseline of doing nothing. Doing nothing will result in the 1973 Regulations becoming further outdated and exacerbate current issues further strengthening the rationale for intervention made above. The frequency of disputes is expected to rise, health and safety risks will increase and maintenance of fixed equipment will decline.

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<sup>4</sup> Note that between 2002 and 2003 the number of holdings increased. This is due to sample variation caused as the June Survey consists of a sample and is not a census.

<sup>5</sup> This will bring the regulation on cost recovery for replacement in line with the regulation on cost recovery for repairing.

Updating the schedule of equipment and responsibility of liability and modernising cash limits presents the most effective way to overcome unclear liability and outdated prices. However, there are two limitations of this preferred approach. Firstly, it cannot reliably future proof the instrument as new technologies and fixed equipment develop. Secondly, updating the fixed cash limit for the care of roofs will not account for changes to the cost of maintenance in the future. However, a cash limit must be retained to delineate minor repairs. For this reason we plan to review the fixed cash limit within 10 years as set out below.<sup>6</sup>

### **Impact of preferred option**

To anticipate the findings, the preferred option changes result in no net cost or benefit. There may also be some non-monetised benefits. There is an estimated redistribution from tenants to landlords of around £3m over the assessment period.

### **Costs and benefits of preferred option**

#### **1) Update the schedule of equipment and responsibility of liability for model clauses**

Defra's consultation document, published on the 18 August 2014 recommends many specific changes to the 1973 Regulations. It is not proportionate for this validation IA to analyse each change individually. This is not least because it is unclear to what extent individual holdings will utilise each clause in practice. Instead, we provide a qualitative economic assessment of the expected direction of impacts and whether society will be affected as a result.

Currently, there are a number of omissions in the 1973 Regulations which lead to unclear liability. In these situations the landlord and tenant do not have the information necessary to determine responsibility for the liability. Both parties will have limited incentive to maintain, replace or repair fixed equipment unless they are explicitly prescribed to do so.

In the improbable circumstance that both parties suffer no welfare impacts from disrepair of fixed equipment then it is not efficient for either landlord or tenant to undertake any maintenance, replacement or repair work. Most likely is that at least one of the parties will be negatively affected by reduced functionality of fixed equipment and will suffer a welfare loss. For example if unclear liability risks the integrity of fixed equipment it may encourage the landlord to act or accept loss of future rents. The tenant, on the other hand, may act if unclear liability inhibits the day to day activities and therefore output of the farm. Alternatively, landlords and tenants may informally agree on responsibility.

If no maintenance, replacement or repair takes place privately and leads to a dispute then arbitration or third party determination is an alternative solution. Arbitration judges where responsibility lies on a case by case basis and can be costly. It will impose unnecessary costs on either or both parties which could be avoided if the 1973 Regulations are updated.

Current outcomes may not balance responsibilities in the spirit of the existing regulations. The introduction of new liabilities and the amendment of existing liabilities provide tenants and landlords with a more up to date set of responsibilities. It will remove some cases of uncertain liability and ensure an appropriate division of responsibilities.

Any direct welfare gain to one party is expected to come at the expense of the other party and lead to zero net cost. Non-monetised benefits will be realised through a cost saving if updating the 1973

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<sup>6</sup> It should also be noted that a monetary cap will be introduced to allow for the additional provision that tenants can carry out work on underground water pipes without giving landlords written notice, with the ability to recover reasonable costs up to £2,000 per incident. This is in addition to an existing provision that tenants may execute repairs to an underground water pipe where the landlord has failed to act within a week of receiving written notice from the tenant of the necessary repairs. See Annex 1, Table 2 for further information.

Regulations reduces the propensity for disputes to happen. The likelihood of a dispute occurring should be determined by the amount of fixed equipment for which unclear liability exists. This will be heterogeneous for each holding and so a meaningful value cannot be quantified. A second non-monetised benefit could arise through improved health and safety standards.<sup>7</sup> A third non-monetised benefit could be a reduced risk of water damage from leaking underground water pipes.<sup>8</sup>

Updating the schedule of fixed equipment is not expected to generate any familiarisation costs. Industry experts from the TRIG advise that this is because tenants and landlords will still need to refer to the schedule to identify current liabilities for the maintenance, replacement and repair of fixed equipment. The proposed update to the schedule will therefore not alter the amount of time it takes to identify the party responsible for the fixed equipment.

## 2) Update cash limit for tile repair from £100 to £500

Tenants currently are responsible for paying up to £100 per year to renew broken or cracked tiles or slates and to replace slipped tiles and slate as damage occurs. Whilst landlords have full liability to repair and replace the roofs on the holding, the spirit of the 1973 Regulations is that tenants should carry out minor repairs. This is because it is more practical for the tenant on the holding to deal with such small repairs independently.

We propose to increase the cash limit to £500 to reflect changes in prices since 1988. This increase is greater than traditional measures of inflation. The Retail Price Index estimates prices have increased by 134% between 1988 and 2013, a rise from £100 to £234.<sup>9</sup> However, broad inflation measures are not representative of the specific costs tenants face today. This includes the cost of replacement tiles, scaffolding and labour components of repair work. This follows expert advice from TRIG that for health and safety reasons scaffolding is now commonplace for such tasks which were not in 1988.

The model places all holdings into the following four groups in any given calendar year:

- Group 1.** No repairs are required or the terms prescribed in this instrument do not apply.<sup>10</sup>
- Group 2.** Repairs cost more than £500 and are immediately the responsibility of the landlord.
- Group 3.** Repairs cost less than £100 and are the responsibility of the tenant
- Group 4.** Repairs cost £100 to £500 and become the responsibility of the tenant in the preferred option.

If a tenancy falls into groups 1, 2 or 3 then the preferred option has no impact. In group 1 the instrument serves no active purpose. In group 2 repairs continue to be defined as substantial and are landlords' responsibility. In group 3 the 1973 Regulations already specify that tenants must pay.

In group 4 tenants are responsible to repair broken, cracked and slipped tiles which would have fallen to landlords in the 1973 Regulations. TRIG advises that such repairs should be tenants' liability and so this change realigns the cash limits with the original regulation. Landlords' will benefit from no longer being

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<sup>7</sup> For example, the new instrument will change an existing liability to repair the electrical supply system (including consumer boards) from tenants to landlords. Currently there is a risk that tenants choose not to undertake repairs which may create a safety hazard. Placing contractual responsibility on landlords reduces the risk of neglect, improves tenants' working environment and fits with landlords' fire safety requirements. From a welfare perspective, no change in cost is expected because tenants currently trade-off the amount of repair to undertake and the level of risk to face. Benefits could arise if the new instrument prevents tenants making risk based decisions based on imperfect information.

<sup>8</sup> The additional provision that tenants can carry out up to £2,000 work on underground water pipes without serving written notice upon the landlord allows them to take immediate action to address a leak and prevent water damage. The tenant is able to recover reasonable costs up to £2,000 per incident for this work. Landlords can then intervene to repair and replace as needed. This approach should minimise cost to both the landlord and tenant of a leaking underground water pipe which may otherwise cause significantly damage. TRIG expert advice deems a fixed monetary cap of £2,000 necessary because it allows landlords to keep some control over the financial exposure they will face.

<sup>9</sup> The Retail Price Index can be found online at <http://www.ons.gov.uk/ons/datasets-and-tables/data-selector.html?cdid=CHAW&dataset=mm23&table-id=2.1>

<sup>10</sup> The regulations have no role in cases where no fixed equipment is on the holding or where landlords and tenants have entered into a separate agreement that overrides the terms prescribed in this instrument.

liable for these costs. An estimate of the number of that fall into group 4 is needed to estimate the impact of updating the cash limits. Unfortunately, no data source exists to observe this. Instead we rely on TRIG's expert advice.

TRIG experts estimate that one third of all 1986 Act agreements will be affected by the changing provisions for tiles (hence 7,170 of 21,509 in 2013). The remaining two-thirds are land only agreements and therefore the cash limit will not apply. Table 2 summarises TRIG's estimate on how many agreements fall into each of the four groups defined above. This is then narrowed to a best estimate for the analysis.

**Table 2: TRIG estimates on repair and renewal of tiles and slates and 2013 June Survey estimates**

<b>Group</b>	<b>TRIG estimate (%)</b>	<b>TRIG estimate (number)<sup>11</sup></b>	<b>Best estimate for analysis (number)</b>
Group1	50%	3,535	3,535
Group 2	2% to 4%	143 to 287	215
Group 3	32% to 38%	2,294 to 2,724	2,527
<b>Group 4</b>	<b>8% to 16%</b>	<b>574 to 1,147</b>	<b>842</b>

Three further assumptions are made to calculate the overall cost of updating the 1973 Regulations. These assumptions are all tested in the Risks and Assumptions section. These are:

- 1) Agricultural holdings decline at a rate of 465 per year from the 21,509 estimated in Table 1.
- 2) Tenant repair is assumed to cost £500, i.e. the maximum £100 to £500 range. This will generate the maximum cost to tenants and reflects uncertainty about the size of claims.
- 3) Over time, 80% of holdings which expire are assumed to contain no fixed equipment. This is the estimated proportion of land only holdings from recent CAAV surveys.<sup>12</sup>

Government is not including a review of the whole of this instrument but we are specifying that the fixed monetary caps should be reviewed within 10 years. At this point the £500 cash limit should be updated again. For this reason, the relevant appraisal period for the analysis is 10 years (although the review could take place earlier). The timescale of within 10 years is to achieve a balance between the uncertainty and burden that reviews bring to both industry and Government with the need to keep the monetary caps reflective of actual costs. This does not preclude a review of either the monetary caps or the whole of these Regulations being delivered at any time if stakeholders and Government consider that appropriate.

Table 3 provides the present value annual cost to tenants and benefits to landlords from updating the cash limit to £500. June Survey of Agriculture and Horticulture (2013) data has been converted to a 2015 baseline assuming 465 holdings terminate each year. The planned policy commencement date is 1 October 2015 and so the new cash limit is assumed to affect only one quarter of the 820 cases in the first year. A 3.5% discount rate is applied in line with the HM Treasury Green Book.

<sup>11</sup> This has been calculated by applying TRIG's percentage estimates to the June Survey estimate on the number of AHA holdings (21,509).

<sup>12</sup> The 2013 Central Association of Agricultural Valuers Survey estimates that 84.1% of lets were land only agreements. The 2012 Survey estimates 82.5%.



**Table 3: Maximum total cost to tenant farmers of raising cash limits for tile repair**

Year	No. Holdings	Group 4 holdings (842 in 2013)	Cost to tenants (PV £2015)	Benefit to landlords (PV £2015)
2015	20,579	820	£0.10m	£0.10m
2016	20,114	810	£0.39m	£0.39m
2017	19,649	799	£0.37m	£0.37m
2018	19,184	788	£0.36m	£0.36m
2019	18,719	777	£0.34m	£0.34m
2020	18,254	766	£0.32m	£0.32m
2021	17,789	755	£0.31m	£0.31m
2022	17,324	744	£0.29m	£0.29m
2023	16,859	733	£0.28m	£0.28m
2024	16,394	722	£0.26m	£0.26m
		<b>Total</b>	<b>£3.0m</b>	<b>£3.0m</b>

Overall, the present value cost to tenants is estimated to be £3.0m and the present value benefit to landlords £3.0m over the appraisal period. This is redistribution from tenant to landlord and is zero net cost from a societal perspective.

Updating the cash limit from £100 to £500 will help ensure there is an effective incentive for tenants regularly to replace tiles and slates as needed to help avoid larger future repairs which are the responsibility of the landlord. This is a non-monetised benefit. For the same reasons as above, there are not anticipated to be any familiarisation cost because both parties will need to refer to this instrument to determine liability in any event.

### 3) Allow tenants to claim 'reasonable cost' to replace fixed cash limit of £2,000

Currently, tenants can serve written notice to landlords to carry out their responsibilities for replacing fixed equipment. The landlord has three months to act then the tenant can carry out the replacement and recover their reasonable costs up to £2,000, or equivalent of annual rent (whichever is less) per year until the full amount has been recouped. The preferred option is to remove the fixed cash limit to allow a tenant to recover in full and at the outset the 'reasonable cost' of the work undertaken.

Unless the holding is very small, the annual rent cash limit will be obsolete. Table 4 presents 2012/13 Farm Business Survey data of rent per hectare by total farm area. Rent per hectare is higher for holdings smaller than 50 hectares, with a point estimate of £199. This indicates only holdings below about 10 hectares will be restricted by annual rents rather than the £2,000 cash limit.<sup>13</sup>

**Table 4: AHA agreements by total farm area size band (2012/13)**

Total farm area size band	Rent £/ha 2012	2012 95% confidence interval
Less than 50ha	£199	± 22
50ha to 100ha	£156	± 15
100ha to 200ha	£163	± 10
200ha to 300ha	£157	± 20
Greater than 300ha	£165	± 29
<b>All farms</b>	<b>£163</b>	<b>± 12</b>

Superficially it would appear that annual rent limits perform better than a fixed cash limit because they will be determined by prevailing market conditions. However, there is no convincing argument why a pre-

<sup>13</sup> The 95% confidence interval indicates this could fall between 9 and 11 hectares

determined monetary cap is needed when tenants wish to recover costs which have been incurred as a result of the landlord failing to carry out their replacement responsibilities.

In the majority of cases landlords are expected to act within three months of written notice. Here the 1973 Regulations provide a reasonable period to ensure landlords undertake the replacement responsibilities.

No evidence exists to identify the number of holdings where tenant cost recovery for replacement will be used. However, TRIG estimates that cost recovery may apply to between 40% and 50% of all 1986 Act holdings. TRIG does not anticipate that cost recovery is a regular occurrence and estimate that it is between a 1-in-20 year and 1-in-50 year event, or 2% to 5% of relevant agreements. This corresponds to between 172 and 538 of the 21,509 agreements in 2013.<sup>14</sup> These numbers will fall over time as the total number of agreements decline.

Cost recovery is limited to £2,000 in any single year, but the full cost can be recovered across multiple years. For example, if a tenant spends £5,000 today they can claim £2,000 in the current year, £2,000 next year and the final £1,000 in the second year as long as no other claims are outstanding. The removal of a fixed cash limit will instead allow the tenant to claim £5,000 in the current year.

The cash limit imposes a cost on tenants because tenants claiming cost recovery of more than £2,000 unnecessarily have capital tied up in the landlords' fixed equipment. This capital could have otherwise been used more productively. For example this could have been invested in a bank or building society and earned the going rate of interest. These productive benefits are in effect transferred to landlords who can hold onto capital for longer. This may create a disincentive to landlords to carry out their maintenance responsibilities in the expectation that tenants will apply cost recovery and can claim only £2,000 per year.

The removal of cash limits mean tenants can recover costs more immediately and remove the opportunity cost of tying up capital. Conversely, landlords will no longer benefit from paying for replacement of fixed equipment over multiple years and lose out on the potential benefits of holding this capital. This leads to redistribution from landlord to tenant. Given the heterogeneous nature of cost recovery, the low number of expected cases and uncertainty in projecting future real interest rates, this impact assessment does not attempt to monetise the value of this redistribution. The EANCB is estimated to be £0, and is zero net cost from a societal perspective.

Benefit may arise if removal of the £2,000 cash limit reduces the incentives for tenants only to carry out partial replacement, or none at all, to avoid tying up their capital which in turn may generate large repairs in the future that could have been avoided. Furthermore, farm productivity may unnecessarily be reduced if buildings or fixed equipment end up in non-working order due to delayed repairs. There is no observable evidence to establish the prevalence of these benefits and so they are left non-monetised.

Cash limits offer some protection to landlords from large cost recovery claims of tenants in any single year. But it is difficult to justify that the cash flow needs of the landlord deserve more protection than the tenant. The presence of arbitration and third party determination to resolve disputes should provide sufficient disincentive for tenants to risk raising cost recovery claims that are beyond reasonable cost. For this reason no additional disputes are estimated to occur. Once again there are not anticipated to be any familiarisation cost because both parties will need to refer to the instrument anyway to determine liability.

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<sup>14</sup> The lower bound assumes 40% of holdings have fixed equipment and that cost recovery is a one in 50 year event. The upper bound assumes 50% of holdings have fixed equipment and that cost recovery is a one in 20 year event.

## **Conclusions**

This validation IA analyses the inclusion of new liabilities to cover modern items, a different split of liabilities for some existing items and updating of current monetary caps. The preferred option will change the responsibility of maintaining, repairing and replacing fixed equipment between landlords and tenants. This will lead to a redistribution of welfare between the two parties but with no overall welfare impact from a societal perspective. This leads to a present value net benefit of £0 for the preferred option and a corresponding EANCB of £0. The preferred option is zero net cost under the OITO methodology.

Whilst a review of the instrument as a whole is not provided, there is a requirement that the monetary caps will be reviewed within 10 years' time to ensure they will be updated to reflect changes in costs.<sup>15</sup> This timescale is aimed at achieving a balance between the uncertainty and burden that reviews can bring to both industry and Government with the need to keep the monetary cap as in line with real costs as possible. However, this does not preclude a review of these Regulations before or after this if stakeholders and Government require it.

## **Risks and assumptions**

This section summarises the sensitivity of the assumptions on the care of roofs. These sensitivities will not affect the conclusion that the preferred option is zero net cost. Instead it will determine the size of redistribution between tenant and landlord. In conclusion, the size of redistribution is generally insensitive to the underpinning assumptions. The exception is uncertainty regarding the average cost to tenants affected by increasing cash limit to £500. For this reason the best estimate assumes the maximum possible average cost.

### *1) The rate of decline of holdings over time*

The best estimate for the annual fall in the number of holdings is 465 per year. If the rate of decline differs from 465 it would have an impact on level of redistribution from tenant to landlord. The analysis above identified between 213 and 717 holdings per year as reasonable range. An average annual fall of 213 increases the estimated redistribution from £3.0m to £3.2m over appraisal period. An average fall of 717 per year reduces the estimation redistribution slightly to £2.9m.

### *2) Proportion of holdings with houses and buildings*

TRIG advise that one third of 1986 Act holdings contain a house or buildings. Estimates of the total redistribution are fairly sensitive to the total proportion of holdings with a house or buildings. For example, if the true proportion was 50% (20%), based on our best estimate of the rate of AHA decline of 465, the level of redistribution would rise (fall) from £3.0m to £4.5m (£1.8m).

### *3) Average cost to tenants updating cash limit*

To estimate the transfer from tenants to landlords, an estimate of the average cost of tile replacement to tenants in Group 4 was made; where repairs cost between £100 and £500. These repairs will be the responsibility of the tenant under the proposed changes. For our previous analysis we estimated that the average cost of replacement for a tenant in this group was £500. The impact of varying the average claim on the total level of the redistribution was examined. For an average claim of £300, the level of redistribution would be £1.82m. This is a 40% fall in the size of the redistribution. However, due to the uncertainty in the average cost for these holdings, we prefer for it to remain at its maximum level.

### *4) AHAs with houses and farm buildings as a percentage of the total fall*

The best estimate assumes the fall in holdings with buildings as a percentage of the total fall was 20%, with the remaining 80% being land only lettings. This is based on evidence presented in the CAAV

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<sup>15</sup> These are the fixed monetary caps in the new instrument for tile repair (£500) and immediate tenant work on underground water pipes (£2,000)

Annual land Occupation Survey 2013. We find the size of redistribution between tenant and landlord is insensitive to this assumption. For example, if the true percentage was to double to 40% with houses or buildings, the estimate for present value redistribution would fall by only 9% to £2.74m.

**Direct costs and benefits to business calculations (following OITO methodology)**

This policy is within the scope of One-In, Two-Out and has been classified as zero net cost. The policy to update and modernise the 1973 Regulations to make them fit for current use has been requested by representative of the tenants and landlords effected and has the support of the majority of responses to the public consultation.

Annex 1: Further detail on the majority of changes to the schedule of items included in the Agriculture (Maintenance, Repair and Insurance of Fixed Equipment) Regulations 1973 as amended in 1988.<sup>16</sup>

**Table 1: Items to be included in the Instrument that are not currently covered in the 1973 Regulations**

Items	Split of liabilities in this Instrument
1. Reed beds for water and sewage treatment.	The landlord to repair and replace. The tenant to maintain.
2. Slurry, silage and other effluent systems excluding anaerobic digesters.	The landlord to repair and replace. The tenant to maintain and to repair or replace removable covers relating to these items.
3. Fixed equipment generating electricity, heat or power (including solar panels, heat pumps, wind turbines and anaerobic digesters) which is wholly for the use or benefit of the tenant.	The tenant to repair. The landlord to replace.
4. Gas pipes, fixed liquid petroleum and gas tanks.	The landlord to repair and replace.
5. Vehicle fuel and oil tanks.	The tenant to repair. The landlord to replace.
6. Fire, carbon monoxide, smoke and similar safety detection systems.	The landlord to repair and replace (provision is also made for the tenant to repair and replace these items if needed and to recover the cost of this from the landlord).
7. Radon pumps.	The tenant to repair. The landlord to replace.
8. Roof and wall insulation.	The landlord to repair and replace.
9. Insulation of water pipes.	The tenant to repair. The landlord to replace.
10. Livestock handling systems and sheep dips.	The tenant to repair. The landlord to replace.
11. Signs and notices.	The tenant to repair and replace.

<sup>16</sup> These tables provide additional information on the detailed changes proposed to the items provided for in the Instrument that are not otherwise referenced in the main body of this Impact Assessment .

<b>Table 2: Amendments made by the Instrument to the 1973 Regulations</b>		
<b>Existing items</b>	<b>Amendment being made</b>	<b>Split of liabilities in this instrument</b>
<b>1.</b> Boilers, ranges and grates. Tenant to repair and landlord to replace.	Expand to specify 'space and water heating systems (including the repair of any boiler but not its replacement), ranges and grates'	The tenant to repair. The Landlord to replace.
<b>2.</b> Main and exterior walls. Landlord to repair and replace.	Expand to include structural frames and cladding.	The landlord to repair and replace.
<b>3.</b> Chimney stacks and pots. Landlord to repair and replace.	Expand to include chimney linings, fireplaces, firebacks and firebricks.	The landlord to repair and replace.
<b>4.</b> Roofs with the landlord to repair and replace.	Expand to include bargeboards, fascias and soffits.	The landlord to repair and replace. Addition of provisions for the landlord to recover a proportion of reasonable costs of repair and replacement work and maintenance on bargeboards, fascias and soffits.
<b>5.</b> Landlord liable to repair and replace doors, windows, skylights including frames of those items but excepting glass, glass substitute, sash cords, locks and fastenings.	Include a liability for the tenant to repair and replace door and window furniture including glass and glass substitute, sash cords, locks and fastenings (accept if the glass needs replacing due to the landlord repairing or replacing the door, window or skylight frame).	The tenant to repair and replace door and window furniture accept where the glass or glass substitute needs replacing as the result of repairs or replacement to the door, window frame, sill or skylight which are currently the landlord's responsibility. The landlord can recover half the reasonable cost of the repair and replacement of doors, windows and skylight frames and sills from the tenant.
<b>6.</b> The electrical system is currently split with the tenant to repair and landlord to replace when it is incapable of repair.	Amend to specify that the landlord will be liable to repair and replace the 'electrical supply system including the consumer board but excluding sockets, switches, light fittings and similar electrical furniture'. Including a new duty on the landlord to regularly inspect, maintain and service the electrical supply system.  Amend to make tenant liable to repair and replace 'electrical sockets, switches, light fittings on or outside the surface of walls, ceilings and floors excluding switches that are part of the consumer board'.	The landlord to repair and replace the electrical supply system including the consumer board and to regularly inspect service and maintain it. The tenant to repair and replace electrical sockets, switches and light fittings.
<b>7.</b> Gates. Tenant to repair and the landlord to replace.	Expand to include garden and yard doors with the tenant to repair and the landlord to replace.	The tenant to repair and landlord to replace.
<b>8.</b> Underground water pipes Landlord to repair and replace with provision for tenant to serve written notice on the landlord to do the work. If not completed within a week of that notice the tenant can do the work and recover the full cost.	Expand to make the additional provision that the tenant can now also carry out work on water pipes without giving the landlord written notice with the ability to recover reasonable costs up to £2,000 per incident.	The landlord to repair and replace with the additional provision for the tenant to carry out emergency work and recover costs up to £2,000 without written notice.