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BREXIT BRIEFING

MARCH 2019

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REPLACING THE BPS

Brexit or no Brexit, the trend and pressure in direct support is downwards. Within the EU the CAP budget is due to decrease in the next budget period 2021-2027 by around 15% and in the UK the best guess is for a phasing out to zero over the same period. What this means for level playing fields and trade in world markets is still anyone's guess, but a reduction of the BPS, probably to zero, is a likelihood that farm businesses need to plan for.

The government makes much of the potential for productivity gains, but is perhaps arrogant in assuming that producers do not already do their best to optimise yields and livestock production to maximise margin (note optimise does not equal maximise). Arable yields have certainly risen, and a further 0.5t/ha over a 7-year period is perhaps not unrealistic, but production comes at a cost and it is margin that counts, not yield. At the end of the day, support is already decoupled from production, and future profitability of growing crops and rearing livestock will depend entirely on changes to the trading environment, for both inputs and outputs. Therefore the action needed is for businesses to replace BPS from other means, i.e. alternative ways of making income from the assets they hold. The word 'diversification' often conjures up images of holiday lets and liveries but there is so much more to it:

Diversification of Skills - Often it is the people within the farm business who hold a skill or a passion, and the key is unlocking it. Whether it be ironwork in the workshop, promoting and selling added-value products or managing land for others, turning one's hand to new things will mean dilution of time available for existing enterprises. Ultimately, people do things they enjoy well.

Diversification of Property Assets - The opportunities to use land, yards and buildings for different income sources are wide ranging, from letting buildings or containers through to alternative agricultural opportunities that have managed margins and therefore some insulation from trade deals – bed and breakfasting pigs and, in the right locality, broiler poultry are two good examples. Care needs to be taken to understand the full cost of debt repayment where bank funded investment is required, in order to ensure the proposal delivers positive and meaningful net cash returns. At some point and in some form there will be opportunities to earn money from providing public goods. 'ELMs' are on the radar but not down in black and white as yet. The potential to compete/conflict with field-based production does give cause for concern.

Diversification of Capital - The hard truth is that capital tied up in land delivers, typically, a 1% return (income yield). There are other easily available asset classes that can beat this hands down, albeit with different risks, different taxation issues which may affect family wealth, and different skill sets required for management. However, the fact that 75 acres of outlying land, sold and reinvested, could replace the BPS income on over 500 acres of the core farm cannot be ignored. Better still, if cash is not the issue then leveraging the farm balance sheet to invest in off farm assets such as commercial property can deliver a range of wins – improved returns, more liquid assets, diversified income sources, etc.

Ultimately, expanding the business to generate a substantial additional income is a tough challenge and not for the fainted hearted, but opportunities abound particularly close to chimney pots. However, if for whatever reason expansion is not an option, then a realistic future view of the business must be taken. Is it a diverse and successful rural business – the primary source of the proprietor's income, or is it a residential and countryside amenity proposition – in which case how is it funded?

To talk through business strategy, please contact William Tongue on 07866 693899 email william.tongue@berrys.uk.com.

STRUCTURING LOANS & FINANCE

As the only certainty remains the uncertainty of Brexit, farming businesses are considering what can be done now to manage the risk. Whilst there is reference to the transition period and a reduction of direct aid and with the increasing emphasis on environmental and conservational land management, how the final post-Brexit financial landscape will look is unknown. The key will be business adaptability and flexibility to react to the obligations and requirements of the new agreements as they develop.

However, farming businesses can review the structure of their balance sheets and more importantly, debt. The provision of debt is driven by the valuation of available security and the ability of the business to service the debt. In the short to medium term, business profitability and asset values are vulnerable to the Brexit process and outcome, and farming businesses should look to secure long-term debt now whilst accounts can evidence serviceability, asset values can secure debt and long-term interest rates remain very competitive.

Three Steps:

1. Ensure that the business overdraft is not financing long-term asset purchase, which could affect cash available at times of poor profitability.

2. Ensure current long-term debt is actually long-term debt. Shorter contractual terms could expose the business to a loan review in the middle of the Brexit process when serviceability and asset values might not be so supportive.

3. Currently lenders are keen to lend – why expose the business to a change in future lending policy?

To discuss working and loan capital management, please contact Jon Stables on 01536 532378 email jon.stables@berrys.uk.com or William Tongue on 07866 693899 email william.tongue@berrys.uk.com.

DO WHAT YOU DO BUT DO IT BETTER!

The deadline of 2027 announced by the Agriculture Bill has provided a focus for understanding how to replace the income lost from subsidy.

A lot of commentators are advising farmers to make the best use of their assets, which for some will mean stepping beyond the 'comfortable' realms of traditional commodity farming and venturing into something new. However, diversification is not a sticking plaster to slap on an inefficient or failing farm business – it is not guaranteed to boost income. A strong core business is needed for a new enterprise to work alongside.

Benchmarking data can help to show underperforming areas in the existing business, which may highlight areas of weakness in technical ability (above the gross margin) and management ability (below the gross margin). A business is likely to have a number of advisors already to assist with technical performance: agronomists, nutritionists, vets, soil scientists, contract farmers, foot trimmers, etc. In the case that technical performance is weak, hold existing advisors to account to understand where improvements need to be made.

Below the gross margin, the biggest differences are often additional income, maybe in the form of contracting or a diversified enterprise. Stakeholder communication breakdown in the business can cause stagnation and an inability to move forward because decisions are not being made; day-to-day jobs are completed but planning for the future is kicked into the long grass for another day. Where this is the case, an independent third party can be the catalyst to help facilitate discussions between business stakeholders to ensure that key decisions are made to move the business forward and ultimately improve profitability.

Marginal gains within existing activities will help to plug the gap that subsidy leaves behind. If decisions are not being made at a strategic level, question why and what can be changed.

A review of your business can help to highlight areas that need improvement and an independent third party can help to facilitate strategic business discussions. Please contact Guy Banham on 01536 532379 email guy.banham@berrys.uk.com.

COUNTRYSIDE STEWARDSHIP 2019 BOOK A FREE 'FARM APPRAISAL'

There are a variety of funding streams available under CS, from one-off capital grants to longer-term schemes, which can benefit both the natural environment and farm profitability. Information request deadlines are looming and we are offering free 'Farm Appraisals' to advise and assess which schemes will be the most suitable.

Please contact Tom Harris in the first instance on 01327 227246 or Vicky Price on 01432 809834.

STAFF FOCUS: KATIE LEAK

WHAT ARE YOUR FARMING EXPERIENCES, QUALIFICATIONS AND WORK HISTORY?

I have no farming experience, just a love of the countryside and animals. I was very lucky to get my first pony at the age of 7 and have owned horses for 40 years so naturally I am very keen on the management of the countryside and farming in general. On leaving school I worked in retail while studying part-time for secretarial qualifications, then moved into office work for a few years. I decided on the change of direction at 28 and went to Brooksby College where I gained a distinction in the Certificate for Administrators in Rural Business course.

WHY DID YOU CHOOSE YOUR CAREER?

This brought my office skills and love of the countryside together.

WHICH PART OF YOUR JOB DO YOU FIND MOST REWARDING?

I enjoy the relationships I have with the clients. I am out of the office quite a bit, working on-site at various clients' premises doing their bookkeeping, and I see how their businesses run and help them to keep track of their cashflow.

WHAT IS THE WORST PART OF YOUR JOB?

Quite a bit of time gets wasted trying to speak to an actual person at utility companies or HMRC.

WHAT DO YOU DO TO RELAX?

I love riding my horse Ben and, now that I have fulfilled a long-held ambition to own a 3.5t horsebox, I try to get out to as many competitions and training sessions that time and money will allow. Some of you may have met my dog Molly, in the office, and we enjoy long walks together. After the animals have been exercised, I also enjoy working in my garden and I am looking forward to the lighter nights so I can get on with growing my own fruit and veg.

EXCHANGE RATES

Since the decision to leave the EU was taken in the Referendum in June 2016, there has been a significant weakening in the value of sterling against the US dollar and the euro. At the close of 2018 the value of the pound was 17% weaker than in November 2015.

There has been some recovery from the lowest points since 2016 but we are still in a world where sterling is worth much less than before the Brexit decision was taken. There is no doubt that the weaker pound has been a boost for commodity prices in the agricultural sector, with the cereal and red meat markets in particular seeing the benefit.

Not surprisingly, most commentators caveat any forecasting around whether we leave the EU with a 'deal' or 'no deal'. If we see an 'orderly exit' then we should see sterling recover to around 1.45 against the dollar from current levels of 1.30 and to around 1.25 from its current position of 1.13. The gloomy outlook from most commentators is that a 'no deal' situation is likely to see sterling collapse further, possibly to as low as 1.10 against the dollar and towards par with the euro. It is very much a case of sit tight and wait and see but most commentators err on the side of forecasting a slight further devaluation in sterling before any recovery is seen.

To discuss, please contact Mark Lord on 01743 290634 email mark.lord@berrys.uk.com.

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