

**TOWNSEND CHARTERED SURVEYORS**

# Operators taking 40 to 95% of BNG sale profits

As the Biodiversity Net Gain (BNG) market gathers pace, land agent and surveyor expert **Hugh Townsend** weighs up the options of using an operator to sell units or doing it yourself



**A**S farmers continue to look around for ideas as to how to replace BPS (Basic Payment Scheme) payments, one of the most exciting options for farm diversification is selling 'Natural Capital' in the form of Biodiversity Net Gain (BNG) units.

Whilst this market is still emerging, since the end of September it gathered pace when we found out that the secondary legislation will be published in November and take effect from January. This new 'mandatory' market, along with selling Carbon and Nutrient Neutrality (NN) credits, has the potential to create significant funds to replace lost income from BPS if handled correctly. As such, it is vital that farmers and landowners take the best advice possible and utilise the most appropriate means of selling these assets. There are a multiple and confusing array of options currently being offered to landowners and our comments below centre around two model types i.e. renting out your land or doing it yourself.

There are many types of operators using different models, some as partnerships, joint ventures or tenants and our comments do not represent any single or all models or hybrids being offered to farmers. Our comments are not an analysis of what net profits any operator makes after arbitrating the risks they take and the costs they bear but concentrates on comparing the alternative opportunity a landowner has to deal with their own sale and the gross sale proceeds themselves showing the percentages they will lose using an operator.

## 1. Lease land or sell units yourself?

One option is to lease out your land for 30 plus years for an annual rental and allow a third party ("an operator") to sell the units. This option allows the operator (your tenant) to sell the resulting units and keep all the sale proceeds, which will essentially never be under your control despite being created on your land. [1]

The second involves commission-

ing your own BNG report, assessing the land and deciding on suitable habitat improvements, selling the net gain units directly to a developer for an upfront payment and then completing the works yourself. The second option will potentially result in significantly more money in your pocket. [2]

### 1.1 Using an operator

An operator is gambling against the risk of not being able to sell any units or for a lot less than predicted, in the hope of making a lot of money. They are risking the set-up costs of the arrangements with the landowner and the annual rental and management payments. However, they can often stop the annual payments when they like during the first five years. Whilst the costs are not insignificant the rewards for the operator could be extremely high.

Example: Gross sale proceeds from 95 acres producing 2.0 units per acre at £25,000 per unit [3] giving gross sale proceeds of £4.7m with all sold within a 12-month period. This is without taking account of the operators' costs and the costs of sale. [4] In the example above there would be gross sale proceeds of £50,000 per acre. However, if one uses a higher sale price (with current sales we are seeing between £35-45,000 per unit [5]) and although land cannot always produce two units per acre, in ideal circumstances areas of Lowland Meadow could produce 3.5 units per acre and if there is high demand, you could be looking at up to £157,500 gross sale proceeds per acre on some land.

In real terms therefore just £230 per acre per annum i.e. only 4.3% of the gross sales proceeds going to the landowner with the rest, 95.7%, going to the operator. [6]

### 1.2 Selling your own

If the landowner sold the units themselves through their own agent, they should be keeping at least 90-95% of the gross sale proceeds after sale costs (and after legislation in November an increasingly higher percentage of sale proceeds) which



► Developers will now be required to improve biodiversity from January next year under new Biodiversity Net Gain (BNG) regulations

The Donkey Sanctuary

would then in comparison range up to £149,000 per acre (subject to lot sizes sold, and the land's ability to produce BNG units), plus the other benefits listed below and keeping full control of their land yourself.

Do it yourself and have a chance of up to £149,000 per acre upfront before habitat and management costs. This compares with the first option of accepting £6,905 per acre in total with a chance of being paid it over the next 30 years.

## 2. Positives and negatives

So it seems on the share of the project gross sale proceeds, you would want to sell your own units. However let's check there are no other benefits from leasing the land to an operator or negatives of doing it yourself. [7]

Whilst there are some benefits to leasing out land which first appear to outweigh the negatives, these can be heavily compromised when one looks at the small print. Receiving the full net sale proceeds yourself upfront, being many times the value of the annual payments once all units are sold, will for most people far outweigh what then become the insignificant benefits of using an operator.

Using your own independent chartered surveyor/land agent with a duty to act in your best interests and for you alone, should get you nearer to 90-95% of the gross sale proceeds paid upfront selling on the open marketplace, compared to as little as 14% or less, at today's value of the gross sale proceeds, spread over 30 years.

## 2.1 USING AN OPERATOR

### POSITIVES

- Annual payments regardless of whether units have sold
- Habitat management may be carried out by the operator if you do not want to do this yourself, in return for a reduction of nearly 4/5 th of the total annual payment
- Costs of surveys, and other fees paid for other than for any independent advice you seek (sometimes a contribution can be made by the operator)
- Potential for relatively small 'Golden hello'/signing up bonus
- Payment monies held in escrow, in trust or secured via a financial bond.
- In-house guidance on ecological aims and objectives and how to achieve them is offered.
- If for whatever reason a BNG habitat bank cannot be achieved within five years, in some cases the landowner will not have lost invested money in this project, rather they will have received annual payments for several years but will not receive further payments thereafter.
- Landowner does not need to provide proof of financial security for

the 30-year term.

- Potential sometimes to receive annual rental as an upfront advance sum at year five after land has been entered into a Habitat Bank.
- Costs of enhancement/creation works paid for by the operator.

### NEGATIVES

- Only receiving the equivalent of a small percentage of the gross sale proceeds of the units spread over 30 years which at today's value maybe a share of 14% or less of gross sale proceeds.
- Rely on a third party to continue to make annual payments and remain in business.
- Still may have to do habitat works to obtain full annual payment which can be split between a rental for a FBT and management payment. Commonly management payments are nearly four times the rental.
- More likely to be conflict of interest and threaten the legitimacy of project if operator offering to do everything including acting as the 'responsible body'.
- It is unknown how reliable these securities will be in practice. "The

## 3. Security / guarantees

Another important consideration is just how secure are an operator's guarantees of annual payments. Whilst there might be suggested means of securing it by holding monies in escrow, under a financial bond etc, just how secure this will be

would depend on the structure of the arrangement and what is classed as "fulfilling the conditions" by the landowner for release of funds. In the case of a 30-year lease with an accompanying covenant on the land, it is difficult to say without seeing the details of such a guarantee what





devil is in the detail" and the landowner could be "left carry the baby" for the rest of the 30 years with Section 106 or conservation covenant still attached to the land and no annual payments.

- Could be less freedom to approach works how you want.
- Break clauses in favour of the operator may result in the FBT only lasting for five years or less. Some arrangements allow the operators a five-year break option (for which no reason is needed) to fall away if the land is not successfully entered into a Habitat Bank. Therefore any suggestion that there is 30 years' of secure annual payments would often be incorrect (although if this does not occur the land would then be free for alternative use again thereafter). The process of entering the Habitat Bank will be carried out by the operator which could mean they control whether they wish to press on for the Habitat Bank in the first place if the LPA is not making it easy or market conditions change. It may not suit their model to do this if it is too costly.
- There is a reliance on the operator to prove financial security instead and for them or the operating

would pass as "fulfilment" and whether creditors would also have claims on the fund.

A few operators have originated from the City of London which needs to be taken into account as to the context in which one views what is on offer with these financial instru-

subsidiary to not go out of business.

- This may however be only the equivalent to half the total value of receiving the rental for every year for the term ignoring interest etc.
- The sale proceeds from the BNG units will sometimes have a further payment only after the operator has received up to 10 times of the payments to be made to the landowner at today's value. For example: over £5m to the tenant against the landowner receiving £500,000. And then the further split thereafter remaining still at the same percentage over the £5m for the landowner.
- Sporting rights may be reserved by the operator. A landowner can be responsible to maintain and repair all fixed equipment including what the operator constructs including water supply and usage. The operator may have access over other land owned by landowner. Section 106/conservation covenant/FBT etc possibly registered/noted on title deeds of landowner's title.
- All other types of Natural Capital can be sold by the operator, and they keep 100% of the sale proceeds. This could include carbon and Nutrient Neutrality.

It will be important to obtain City-based legal advice not just local/agricultural advice.

Farmers and landowners in previous emerging markets of this type have been stung in the past, for example with milk quota in the early 1980s, and again in 2005 with the

## 2.2 SELLING YOUR OWN

### POSITIVES

- Receive all proceeds from your sold units upfront.
- Retain full control over your land.
- Decide when to sell units and commit to 30-year obligations.

### NEGATIVES

- Payment is dependent on completing sales.
- Funding your costs of habitat improvements/enhancements (although you may need to do this anyway to obtain the full payment from the operator if leasing).
- Funding your own surveys upfront and paying a sale commission from sale proceeds and conveyance/professional fees.

allocation of Single Farm Payment entitlements. We will not really know how such guarantees will withstand ultimate scrutiny in the courts until an operator has sold enough of their units and/or they go into liquidation. It will be interesting to see if any City-based lawyer would put their name to advice in the small print saying the guarantees will 100% withstand such court scrutiny and if any insurance company would offer any form of cover until it is fully tested in this way.

#### 4. Responsible Bodies

Care should be taken when dealing with operators applying to be responsible bodies whilst also being involved with a landowner or themselves completing/managing the habitat enhancements and/or selling the units. Whilst they are yet to be approved for this monitoring role, at the time of writing, as the application system has only just opened, should they be allowed to do this then there could be serious concerns around a conflict of interest and the legitimacy of any BNG units validated by them. This could have dire consequences for the landowner who may be left with the commitment for the 30-year term without any payments and possible problems for the developer using the units.

During 40 years of brokerage and having experience of over eight similar emerging markets to BNG, a new market of this type always has teething problems until it becomes transparent. This will happen firstly when sale prices are reported nationally, as was the case in the 1990 after we started publishing national milk quota sale prices, in Farmers Weekly. And secondly when it becomes clear how different packages offered by different operators try to acquire and sell these intangible assets. This will not only benefit landowners but also developers by creating an efficient market.

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**FOOTNOTES 1:** When leasing land, the landowner may only receive the equivalent of a very small percentage of the gross sale proceeds as low as 14% over the 30-year period. This is however comparing the total sum of annual payments over 30 years without account for interest or capital growth the operator will benefit from if all the BNG units are sold.

**2:** This is a result of having direct control of any units, who they go to and at what price and keeping most of the sale proceeds. Whilst the landowner will be responsible for all costs of the project, many farmers would find that the actions required would be well within their capabilities and they are most likely to do this anyway if letting the land in order to obtain the higher payment from the operator in any event. The proceeds of sale(s), whilst subject to market fluctuation, are estimated to be significant. It may appear somewhat of a gamble compared to settling for a guaranteed annual income, but early case studies show that what you receive through leasing the land will only make up a small fraction of what you could have achieved doing it yourself.

**3:** One of the estimates in a range published by DEFRA in 2021.

**4:** In this example the landowner receives £97/ac rental p.a. and £283/ac habitat management payment p.a. and rising by 2.4% each year for 30 years. This adds up to approx. £1.5m over 30 years i.e. 31% of gross sale proceeds (ignoring the landowner's cost of creating and managing the habitat for the operator/tenant). The operator could have their 69% share very early on if the units are sold. The landowner however has to wait for all their annual payments over the next 30 years. To assess the true value to the landowner of the £1.5m, compared to what the operator might receive, one needs to take this delay into account. At an interest rate of 3% ignoring any capital investment growth, the £1.5m reduces at today's value to £997k. If one takes also into account a 3% capital growth, if invested, this reduces the value to £656k. A possible 14% or less of the share of the gross sale proceeds, especially if the sale price is more than the DEFRA's suggested £25k per unit. These observations do not take account of the operator's costs including sale costs of the units nor current average sale costs of up to 10% if using your own agent and could reduce post legislation in November to 5% depending on lot sizes sold.

**5:** These are prices in the current 'voluntary' marketplace. No one yet knows what supply and demand will be following January, for example: how this may vary geographically, whether LPAs will be able to continue offering units, if eNGOs will supply more units and how many larger developers will use their own land or alternatively whether there will be a rush to satisfy a backlog of demand, the volume of development generally will create a high on going demand and the published Statutory units indicate DEFRA's updated assessment that there will be high demand.

**6:** In comparison with this outcome, a landowner leasing the land to an operator, will be still looking at an annual rental, before the costs of doing the habitat works/management, of £10,000 per acre at today's value (interest/income lost only) and taking account also of the lost investment return, only £6,905 per acre for the whole 30-year term. The delay of receiving monies annually for 30 years and its real value today is shown using a conservative application of the Duxbury Tables.

**7:** At the time of writing we do not yet know how HMRC will tax the sale proceeds of BNG whether as income or capital and no account has been taken of this. All offers from operators should be subject to your own independent professional advice.