Compensation costs associated with the transfer test

An analysis to support the Land Reform Bill 2024

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Summary

The Land Reform (Scotland) Bill 2024 was introduced into the Scottish Parliament on the 13th March 2024. Amongst other measures, the Bill introduces a transfer test, which broadly provides a new power for Scottish Ministers to instruct landowners selling large landholdings over 1,000 hectares in size to sell this land in a particular manner (through a process known as 'lotting'), where certain conditions are met. As part of this process, landowners will be entitled to apply to Scottish Ministers for compensation for any loss or expense that is incurred in complying with the procedural requirements of the transfer test.

There is an expectation that the financial costs to Scottish Government arising from provisions within Bills (including compensation costs, in this case) are quantified. The objective of this report, therefore, was to identify clearly the types of compensation that could arise and the key variables which would drive significant compensation claims in future. This is evidenced in this report through the creation of illustrative case studies and high-level financial projections of plausible compensation costs over a 25 year period – providing reasonable and evidence-based high and low scenarios of likely costs over time and in real terms.

The report was commissioned by the Land Reform Bill Policy Team and was written by RESAS, with guidance sought from the Government Actuary Department and Scottish Land Commission staff.

The following points summarize the main findings of the report

- The transfer test is expected to impact a relatively small number of transactions each year and a small proportion of land. There were known to be fewer than 30 transactions of landholdings over 1,000 hectares in the last 4 years of available data[1] which could be in scope for the transfer test.

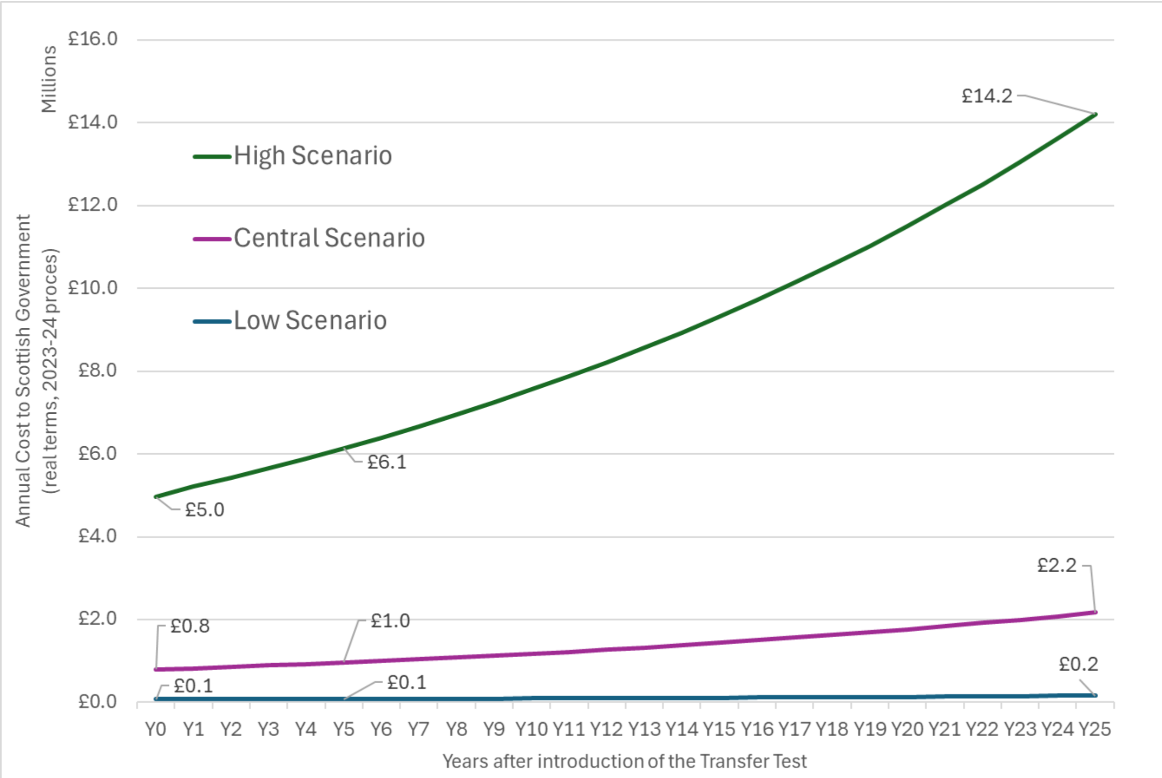
- The modelling contained in this report captured six different possible grounds for compensation costs linked to the transfer test process. These included claims based on a 'loss of interest' due to the prohibition of a land sale during either the investigation stage of the process or the lotting decision process, potential changes in the market value of the landholding if demonstrated to be linked to the lotting decision, additional legal expenses related to a lotting decision and direct costs associated with Scottish Ministers buying land.

[1] Note there are some reasons to believe this number may be understated to a degree, see section 3.7.1.

- There were a significant number of analytical judgements required to produce quantitative estimates of the potential financial costs associated with the transfer test. These include assumptions about the future of Scotland's land market (growth in land values, land area associated with transactions) and assumptions about the transfer test process (the time taken for processes to complete, or changes in land values due to lotting). This led to a large range of costs produced in the costing model between the low scenario and high scenario compensation cost projections.

- In the central case scenario, at the year of introduction (assuming 2023-24 prices), annual compensation costs were projected to be £0.8m per year, rising to £1.0m per year after 5 years. However, as shown below, the range of values around this central projection is significant (£0.1m to £5 million in the first year). A key finding to highlight is that most costs only arise for land sales where a positive lotting decision is made by Scottish Ministers.

Figure 1 - Annual Compensation Costs associated with the transfer test (all scenarios) in real terms (2023-24 prices)



- There are a range of factors that limit our confidence in these projections which should be stated up-front. These include: limited and incomplete historic data on land transactions that would be subject to a transfer test, lack of clarity on how the appeals process might compound compensation costs that are not directly captured in the projections and challenges in making an ex-ante assessment of the impact of lotting on market values of landholdings in general.

- In practice, due to the limited number of large land transactions and the high degree of variance in the nature of Scotland's rural land, costs are likely to be unpredictable from year-to-year depending on the particular characteristics of land sold.

- Bearing these limitations in mind, the analysis shows Scottish Ministers need to be prepared to take on a potentially significant degree of financial risk in exercising the powers within the proposed transfer test, notwithstanding that some uncertainty may be reduced once the transfer test is operating in practice and assumptions around the operationalization of the transfer test can be made with a higher degree of confidence. The analysis shows compensation as a result of reductions in land value due to a lotting decision is likely to be the largest component of overall compensation costs. The analysis also shows that the annual costs of compensation tend to rise over time (even after accounting for the effects of inflation). This is driven by the assumption that the value of land will rise at a faster rate than general prices.

- There are a range of factors that are expected to reduce possible compensation costs that arise from the transfer test process. Crucially, any policy actions that could either reduce the proportion of landholding sales subject to LCC investigations or a lotting process would – all else equal – reduce compensation costs, however this must be balanced with achieving the policy aims. A faster process would reduce costs linked to delays in a sale, but this has to be weighed against the risk of errors in bringing together evidence and advice in expedited circumstances, which could lead to landowners making more successful appeals against decisions.

- If landowners were encouraged to consider factors that could lead to a lotting decision prior to a sale (for example through engagement with communities to inform land management plans) and provided with an option to demonstrate that proposed sales of landholdings had considered community sustainability this may reduce expected compensation costs to Scottish Ministers and reduce the complexity around incurred costs and avoiding time costs and uncertainties involved in making compensation claims for landowners. It is suggested that this is considered as part of further development of these proposals through regulations and guidance.

1 Background

1.1 Context

The Land Reform (Scotland) Bill 2024 was introduced into the Scottish Parliament on the 13th March 2024. Reflecting research conducted by the Scottish Land Commission and recommendations around the impact of the scale and concentration of land ownership in Scotland, sections 4 to 6 of the Bill propose to introduce a new ‘transfer test’ which will apply to transfers of certain large landholdings in Scotland.

The aim of the transfer test is to provide an opportunity for Scottish Ministers to consider whether requiring a large landholding (an area of land which is over 1,000 hectares in geographical extent) to be sold in smaller lots to different purchasers could *‘be anticipated to increase the supply of more varied plots of land in a way that might be expected to have a positive impact on the ongoing sustainability of communities in the area’*[2].

As part of the transfer test, landowners will have the right to claim compensation from Scottish Ministers to meet any additional costs or losses that arise from the implementation of this process. The total costs of potential compensation claims to the Scottish Government were unclear at the point the Bill was introduced into the Scottish Parliament. The Financial Memorandum that accompanied the Bill stated that any costs will be ‘*highly dependent on the individual landholding*’ and did not set out to estimate the total financial costs to the Scottish Government arising from this part of the Bill.

Following the introduction of the Bill, the Land Reform Bill Team commissioned advice and analysis from RESAS (Rural and Environmental Science Analytical Services Division), supported by the UK Government Actuary’s Department, with regards to conducting an assessment of the expected financial costs (or contingent liability[3]) that may arise due to the existence of the compensation provisions in this part of the Bill, as well as identifying potential policy actions which could mitigate risks of significant future costs arising.

This report also supports the requirement set out in the Scottish Public Finance Manual (SPFM)[4] which provides guidance on the proper handling and reporting of

[2] Policy Memorandum accessible (parliament.scot)
[3] The accounting standard definition of a contingent liability is a present obligation that arises from past events but is not recognised because it is not probable that a transfer of economic benefits will be required to settle the obligation; or the amount of the obligation cannot be measured with sufficient reliability.
[4] Contingent liabilities - Scottish Public Finance Manual - gov.scot (www.gov.scot)

public funds. The guidance makes clear that “a most careful appraisal of the risks… should be carried out before accepting any contingent liabilities” and that “in all cases steps should be taken to restrict the total contingent liability to a low scenario”. Whilst a more holistic assessment of the risks (including a legal risk assessment) is still required, the findings of this analytical project are intended to support the Land Reform Bill team by providing an evidence base that assesses the financial risk to Scottish Government identified in the Financial Memorandum ahead of further parliamentary scrutiny of the Land Reform Bill by the Scottish Parliament.

1.2 The objectives of this report

This report was commissioned by Land Reform Bill Team and sought to address the following objectives:

- **Objective 1:** Create a comprehensive process map of the transfer test process, capturing all possible outcomes that may arise in a typical case (including the appeals process), identifying clearly the types of compensation that could arise and the key variables which would drive significant compensation claims.

- **Objective 2:** Develop 3-5 stylised ‘Case Studies’ which, as far as practicable, are informed by reasonable assumptions on key variables in the process that will determine the size of compensation claims in a particular case to illustrate the potential range of impacts on the Scottish Government (low impact to high impact).

- **Objective 3:** Assess potential policy actions and make recommendations as to what could be effective in reducing the risk of significant compensation payments arising in the transfer test process over time.

- **Objective 4:** Assess the feasibility of generating broader quantitative scenarios or projections to illustrate the overall total potential SG financial risk associated with the compensation provisions over time in line with requirements of a Financial Memorandum.

Quality assurance of this report, and in particular, the financial projections with respect to objective 4 were provided by the UK Government Actuary’s Department. Feedback was also sought from data analysts in the Scottish Land Commission (SLC), and further quality assurance checks were carried out by RESAS. Policy input and review was provided by the Land Reform Bill Team.

1.3 A summary of Scotland's rural land market

The Business and Regulatory Impact Assessment (BRIA)[5] published alongside the Bill sets out that rural Scotland accounts for 98% (7.62 million hectares) of the total land mass of Scotland (7.79 million hectares) and 17% of Scotland's population are resident there[6]. The majority of rural land in Scotland is privately owned and managed.

To inform the BRIA, research conducted by the James Hutton Institute combined information sourced from the Who Owns Scotland dataset, Forestry and Land Scotland data and IACS data - which combined cover around 5.5m hectares of Scotland's land. Based on this research, there were an estimated 1,066 large landholdings in Scotland with a geographical extent of over 1,000 hectares[7] and therefore may be in scope of a future transfer test when the provisions of the Bill are in force. These landholdings have an estimated total combined land area of 4.32 million hectares (or approximately 55% of Scotland's total land).

The transfer test will only apply to land that is actively transacted in the land market. The rural land market in Scotland is relatively small, with proportionally very little land area transacted every year[8]. Evidence gathered by the SLC's latest rural land market report[9] suggests that in recent years (2020 – 2022) the average number of rural land sales (above 25 hectares) was around 250 transactions per year, with 59% of land being classified as farmland, 31% being classified as forestry and woodlands and 10% being classified as 'estates'. Based on this data, the vast majority of rural land transactions would not be impacted by the transfer test.

Across a 4-year period (2020 – 2023), there were 26 transactions (4-11 transactions per year) were for landholdings above 1,000 ha. These sales are likely to be in scope when we consider the possible impact of the transfer test and any associated compensation costs. The average size of a landholding was around 3,000 hectares and most landholdings sold were classed as 'estates' (around three-quarters). The total land area sold between 2020 and 2023 was 79,200 hectares. This would be approximately 19,800 hectares per year and equivalent to less than 0.5% of the total area of land that we estimate is held in landholdings over 1,000 hectares.

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[5] Purpose and Intended Effect - Land Reform (Scotland) Bill: business and regulatory impact assessment - gov.scot (www.gov.scot)

[6] Rural Scotland Key Facts 2021 - gov.scot (www.gov.scot)

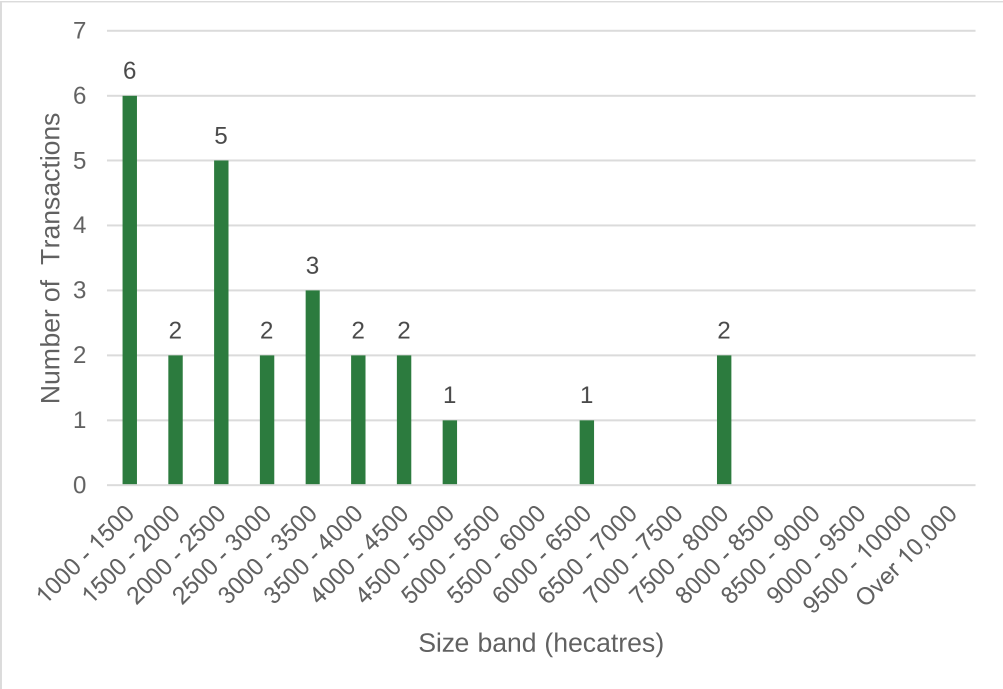
[7] As set out in the BRIA, these estimates are not definitive due to the challenge of identifying multiple titles in close geographical proximity with single ownership, and other challenges with the underlying datasets.

[8] SLC Rural Land Market Insights 2023 (landcommission.gov.scot)

[9] Rural Land Market Report 2024

As figure 1 shows, the average size of a landholding that was transacted in the period 2020-2023 that would be in scope for the transfer test (over 1,000 ha) was 2,853 hectares. However, it is more likely that a sale is below this average than above it (17 sales below the average and 12 sales above the average in this period where data is available), with a few large landholdings which are more than double the average.

Figure 1. Large Landholding Sales in Scotland (2020 – 2023) by size band (hectares)



Source: Scottish Land Commission

It should be noted that there are limitations to the data on landholding sales published by the Scottish Land Commission. These are discussed in detail in section 3.7

1.4 The transfer test

As set out in the Policy Memorandum[10] accompanying the Bill, the aim of the transfer test is to provide an opportunity for Scottish Ministers to consider whether requiring a large landholding (an area of land which is over 1,000 hectares in size) to be sold in smaller lots to different purchasers could '*be anticipated to increase the supply of more varied plots of land in a way that might be expected to have a positive impact on the ongoing sustainability of communities in the area*'.

[10] Policy Memorandum accessible (parliament.scot)

The proposed process will introduce a prohibition of the transfer of land until a lotting decision is made (subject to some exemptions[11]) and will involve Scottish Ministers, except in limited circumstances, requesting that an investigation and report is produced by the Land and Communities Commissioner (LCC) at the Scottish Land Commission (SLC) for each sale subject to a transfer test. This investigation and report will inform a decision by Scottish Ministers as to whether a lotting decision is appropriate in each sale.

Where the LCC considers that Ministerial tests for requiring lotting cannot be met, they may provide a short report to Scottish Ministers confirming this and allowing for a Ministerial decision to release the land from the transfer test process at this point.

Otherwise, it is anticipated that the LCC will conduct further investigations, which can include seeking advice from those with appropriate experience of lotting land on whether lotting would be appropriate in order to improve the availability of land in the area, and on how the land should be lotted (if viable).

Once an investigation by the LCC is complete, a report will be submitted to Scottish Ministers. Scottish Ministers must then take that report into account when making any lotting decision. If Scottish Ministers decide to order lotting, they must specify the lots, and the lots must then be transferred to different purchasers. The landowner can only then proceed to sell land in line with the lotting decision made by Scottish Ministers (although there will be a right of appeal).

Scottish Ministers must review a lotting decision if an application to that effect is made more than one year after the decision is made, or more than 1 year after an earlier review. The Scottish Ministers must either confirm the decision, withdraw the decision and make a new one, or offer to buy one or more of the lots.

Ultimately, Scottish Ministers can offer to buy land only if they are satisfied that it is likely that the land has not been transferred as it is less commercially attractive than it would have been had the lotting decision not been made. The land can only be bought at an appropriate price to be determined by an independent valuer. An owner may specifically request that Scottish Ministers consider offering to buy land as part of the review process.

The steps of transfer test process are set out in more detail in Annex A in this report.

[11] Exempt transfers include transfers between spouses, a transfer between companies in the same group and a transfer other than for value. See section 40(4) of the 2003 Act for the full list.

1.5 Compensation for Landowners

As set out in the Policy Memorandum for the Bill, landowners will be entitled to apply to Scottish Ministers for compensation for any loss or expense that is incurred in complying with procedural requirements of the transfer test, attributable to a potential transfer being prevented, or attributable to a lotting decision (including the requirement that lots be transferred to different purchasers). The amount of compensation will be determined by Scottish Ministers, or by the Lands Tribunal on an appeal against the Ministerial determination.

The scale of compensation in an individual case relating to loss in value would depend on the difference in sale value between the lotted estate and the whole estate. The total liability for the Scottish Government will also depend on how many landholdings Ministers direct to be lotted. Where compensation relates to a delay arising from the prohibitions on transfer of land, the compensation will depend on any costs incurred as a result of the delay or any loss in value during the delay. Engagement with land agents ahead of the introduction of the Bill suggested that costs involved in the sale of land in lots versus as a whole will be highly dependent on the individual landholding. In the current land market, lotting of land for sale is most often carried out with the priority of achieving best value rather than for other motivations.

For the purposes of the analysis set out in this report, six areas of possible compensation have been identified as potentially significant and that will contribute to a contingent liability for Scottish Ministers (see section 3.3 and 3.4 for details of how these costs have been estimated):

A. A loss in market value of the landholding due the prohibition on the sale of a landholding during the period of an LCC investigation and prior to a lotting decision by Scottish Ministers.

B. A loss in market value of the landholding due to a positive lotting decision made by Scottish Ministers, which is determined by the difference in market value between the lotted landholding and the whole landholding.

C. A loss in market value due to a delay in sale of a landholding due to the lotting decision e.g. if it can be demonstrated that a private buyer was in a position to purchase the whole landholding prior to a lotting decision.

D. The direct cost to Scottish Ministers in purchasing land that has been subject to lotting but where a private buyer cannot be found.

E. The cost of additional legal fees incurred by landowners related to a positive lotting decision made by Scottish Ministers e.g. in relation to splitting the deeds into multiple lots, land registry costs etc.

F. The cost of additional expenses (net of any revenues) associated with ownership of the landholding (or part of it) for a period longer than otherwise expected due to lotting e.g. debt interest payments, land servicing costs, insurance costs etc.

In section 4, further sources of compensation are discussed which have not been directly considered in this report or in the financial projections that accompany this report as set out in section 3.

2 Illustrative Case Studies

2.1 Overview of Case Studies

The purpose of the case studies set out in this report is to demonstrate the increasing complexity and associated compensation costs that could be introduced by the transfer test process for the sale of a typical large landholding. It must be recognised that these ‘case studies’ are necessarily highly stylised and designed to demonstrate a wide range of possible outcomes.

Annex A sets out a simplified ‘process map’ of the transfer test process, capturing in some detail the possible outcomes that can follow a decision by a landowner to sell a landholding over 1,000 hectares once the provisions of the Bill are in force.

The Case Studies relate to different outcomes that are set out in the process map. Table 1 summarises each case study and the types of compensation we have identified that will apply in each case study (note that the letters in bold refer to the list on page 6). A key finding to highlight is that most costs only arise for land sales where a positive lotting decision is made by Scottish Ministers (case studies 3-5), which – as is set out in section 3.3 – we assume will be the minority of land sales brought through the transfer test process.

Summary of the Case Studies

Table 1. Summary of Case Studies of transfer test Compensation Costs

Case Study Description	Description of compensation costs that arise in each case
Counterfactual: assumes a ‘typical’ large landholding is sold within 6 months and no transfer test applies to the sale.	Not applicable as transfer test not in place.
Case Study 1: Sale of large landholding, where a landowner demonstrates that they are under financial distress and are exempt from an in-depth LCC investigation.	Negligible grounds for compensation, due to short time a sale will be prohibited. There is potential for the risk of compensation to be mitigated (see section 4).
Case Study 2: Sale of landholding where an in-depth report by LCC is carried out, but a decision against lotting is made by Scottish Ministers.	Compensation can arise due to loss in market value of the landholding during LCC investigation **(A)**.

Case Study 3: Sale of a landholding where an in-depth report by LCC is carried out decision to lot is made by Scottish Ministers - straightforward case, no appeals.	Compensation can arise due to loss in market value of the landholding during LCC investigation **(A)**, a loss in market value due to the lotting decision reducing the total value of the land **(B)**, a delay in sale of all/part of the landholding due to lotting **(C)**, additional legal expenses linked to lotting **(D)**, net expenses due to a delay in sale **(E)**.
Case Study 4: Sale of a landholding where an in-depth report by LCC is carried out decision to lot is made by Scottish Ministers - complex case with appeals, all lots are ultimately sold.	As per case study 3, with some costs **(C, D, E)** increased due to additional delays.
Case Study 5: A landowner subject to lotting decision, with a sale that ends in Scottish Ministers purchasing land.	As per case study 4, with additional direct costs to Scottish Ministers **(F)**.

2.2 Case Studies in Detail

2.2.1 Counterfactual

To assess the impact of the transfer test, it is first useful to establish a stylised counterfactual which captures the types of costs involved in a typical transfer of a large landholding prior to the introduction of the Bill and transfer test. Any compensation could therefore only be claimed on costs that would not have been incurred in this counterfactual scenario and where this can be demonstrated by the landowner.

As set out in section 1.3, the number of sales of landholdings in this part of the market are limited (there have been fewer than 30 sales in the last 4 years). The time it takes to sell land can vary depending on market conditions and other factors and is not readily monitored. There is also a significant number of ‘off-market’ sales in this part of the rural land market which means monitoring the transaction time period is challenging.

For the purpose of the counterfactual, it is assumed that a landowner intends to sell land amounting to over 1,000 ha on the open market (i.e. this is not an exempt transfer for purposes of the Land Reform legislation). The landholding is of a size of 1,500 ha. The landowner incurs some fees prior to the sale of the land (legal fees, valuation fees, marketing fees). The sale is assumed to complete after a short period of 6 months from the point at which it first enters the market. The sale completes for a value of £3.5 million (£2,333 per ha). In the meantime, the landowner is assumed to still be incurring some costs related to owning the land, which could include public liability insurance and other charges related to land ownership, as well as potentially gaining some income (such as farm subsidies or rental income from tenants). Once the sale completes, the landowner incurs a fee charged by a land agent, which is typically based on % of the achieved market price.

2.2.2 Case Study 1: A landowner in ‘financial stress’

In the first case, it is assumed that the same landowner intends to sell the same area of land as is set out in the counterfactual scenario.

The sale is, however, prohibited under the transfer test provision, as the land is over 1,000 ha. However, the landowner in this case makes representations to Scottish Ministers that the sale has been brought about due to significant financial hardship, which is accepted by Scottish Ministers after a short period of time.

Some minimal additional costs might be incurred by the landowner to provide sufficient evidence to show that the sale is to alleviate financial distress. However, it is assumed that the sale is completed after a period of 6 months from the point at which it first reaches the market after the prohibition of sale is lifted. The achieved price of the land is similar (£3.5 million). In the meantime, the landowner is still paying costs related to insurance and other charges on the land. Once the sale completes, the landowner incurs a real estate fee, based on % of the achieved land price.

Case Study 1 shows that in some cases where there in financial stress there may be a minimal case for compensation.

The time period in which a prohibition on a sale is likely to be in force is expected to be short.

For the purposes of modelling possible compensation costs arising from the transfer test, we assume that cases which are ruled out before the LCC is asked to investigate a landholding sale will have negligible amounts of compensation.

2.2.3 Case Study 2: A landowner subject to a LCC investigation only

In the second case, it is assumed that the same landowner intends to sell the same area of land as is set out in the counterfactual scenario and case study 1.

Similarly, the sale is prohibited under the transfer test provision, as the land area is over 1,000 ha, however, in this instance the landowner is not in significant financial hardship.

Therefore, Scottish ministers instruct the Land and Communities Commissioner (LCC) to investigate the land sale. After an initial investigation, the LCC recommend that a further report is compiled, setting out considerations relating to sustainability of local communities and land agent advice on options for lotting part of the landholding. The report is compiled and a decision made by Scottish Ministers on lotting after a period of 12 weeks from the original notification (in practice the length is time is expected to vary, see section 3.3).

On receiving the report from the LCC, Scottish Ministers decide to not pursue a lotting decision in this case, as the evidence presented is deemed to be not satisfactory to recommend lotting.

After this initial period of 12 weeks, the prohibition on sale is lifted and the landholding is put on sale on the open market and the sale completes within 6 months. The land is sold for £3.5 million. Once the sale completes, the landowner incurs a real estate fee, which is based on % of the achieved land price.

In terms of compensation, it is possible that the landowner could make a claim for costs incurred due to the delay in the sale of the landholding brought about by the LCC investigation. Relative to the counterfactual, the sale has been delayed by 12 weeks – the length of time the prohibition on a sale was in force. The claim for compensation is assumed to be on the ‘loss of interest’ basis, wherein a claim is made against the loss of interest on a capital gain of £3.5 million from the sale of the land. The formula used to calculate compensation is not set out in legislation but for modelling purposes it is assumed that a standard approach is taken, this is set out in section 3.4.

2.2.4 Case Study 3 – A landowner subject to lotting decision, with a sale that proceeds quickly

In the third case, again it is assumed that the same landholding is sold as in the other case studies.

Similar to case study 2, the landowner is not in financial hardship and Scottish ministers instruct the LCC to investigate the land sale, and report back after a period of 12 weeks.

In this case however, on receiving the report from the LCC, Scottish Ministers do decide to pursue a lotting decision in this case, as the evidence presented is satisfactory to recommend lotting. Around 10% of the landholding is required to be sold separately to a different buyer (150 ha in this case).

The landowner accepts the lotting decision made by Scottish Ministers (no appeal is made against this decision) and the prohibition on sale is lifted. The larger part of the landholding is sold to a private buyer (for £3.2 million) within 6 months. The smaller part of the landholding is sold after a period of 12 months for £0.25 million.

In terms of compensation, it is possible that the landowner could – as in case study 2 – make a claim for costs incurred due to the delay in the sale of the land due to the LCC investigation and lotting decision. Relative to the counterfactual, the sale of the larger portion of the land was delayed by 12 weeks – the length of time the prohibition on a sale was in force.

However, in addition to this, it is possible that the landowner could also claim that the smaller area of land was also subject to a further delay due to the lotting decision. The landowner would have to demonstrate that the private buyer of the larger area would have otherwise purchased the entire landholding for this to be accepted however. The claim for compensation, if successful, is assumed to be on the ‘loss of interest’ basis, wherein a claim is made against the loss of interest on a capital gain of £0.25 million from the sale of the smaller portion of land.

It should be noted that it this case the landholding sold for £3.45m, £50,000 less than in the counterfactual scenario. If this could be linked to the transfer test, then the landowner could also make a claim for the loss in market value of the landholding. In practice, it is unclear how this could be established (in reality the counterfactual will not be known in a given case), however it is possible that advice on valuation of the landholding as a whole could be sought from land agent(s) to inform the LCC report. Should the landholding sell in lots for less than this valuation, this could be argued to be a result of a lotting decision, triggering a right to compensation. Alternatively, there may be evidence that a private buyer made an offer to buy the land at a higher price prior to the lotting decision being made which could be used to evidence a claim.

Finally, it is likely that due to the lotting decision, the landowner may incur additional legal fees in relation to splitting the deeds into multiple lots and land registry costs etc. These are likely to vary but are expected to be reasonably small for each transaction, relative to other compensation costs. The landowner may also be able to demonstrate that there were on-going costs related to holding the smaller land area for longer than would have been the case had a private buyer bought the whole landholding.

2.2.5 Case Study 4 – A landowner subject to lotting decision, with a sale that is appealed

In the fourth case, again it is assumed that the same land is sold as in the other case studies.

Similar to case 2, 3 and 4, the landowner is not in financial hardship and Scottish Ministers instruct the Land and Communities Commissioner to investigate the land sale, and report back after a period of 12 weeks.

On receiving the report from the LCC, Scottish Ministers do decide to pursue a lotting decision in this case and, as in case study 4, around 10% of the landholding is required to be sold separately to a different buyer (150 ha in this case).

Unlike case study 3, the landowner does not accept the lotting decision made by Scottish Ministers and appeals the decision. Whilst the decision is under appeal, a prohibition on the sale of the landholding is extended. The appeal is made within 28 days of the lotting decision, and is heard at the court of session (the time period for an appeal to be heard at the court of session could be significant – over 12 months). However, in this case, the appeal is ultimately not successful and finds in favour of Scottish Ministers. The landowner does not make subsequent appeals against this decision (note in practice an appeal could be made to several courts, and ultimately the Supreme Court – see section 3.7.3)

As set out in case study 3, the larger part of the landholding is sold to a private buyer (for £3.2 million) within 6 months after the appeal is heard. The smaller part of the landholding is sold after a period of 12 months after the appeal is heard for £0.25 million.

In terms of compensation, it is possible that the landowner could – as in case study 2 and 3 - makes a claim for costs incurred due to the delay in the sale of the land due to the LCC investigation and lotting decision. Relative to the counterfactual, the sale of the larger portion of the land was delayed by 12 weeks – the length of time the prohibition on a sale was in force. As the decision was appealed however, in practice the delay was more significant in this case. In these circumstances, we are assuming the appellant does not have a right to compensation for the period of time caused by the wait for an appeal hearing. However, this may not be the case, and if the appeal was to have been successful and find in favour of the appellant, then further compensation may arise (see section 3.7.3 for a discussion on appeals). It should be noted that, the Courts have rules of procedure in place which are designed to exclude, restrict and discourage appeals with no realistic prospects of success.

Similar to case study 4, compensation could also be claimed against a fall in value of the landholding as a whole due to the lotting decision and for the delay in sale of the smaller land parcel following a lotting decision. There may also be additional legal costs incurred by the landowner and on-going costs linked to holding a smaller land parcel for longer than otherwise would have been the case had a private buyer been able to buy the whole landholding.

2.2.6 Case Study 5 - A landowner subject to lotting decision, with a sale that ends in Scottish Ministers purchasing land

In the fifth case, again we assume that the same land is sold as in the other case studies.

In this fifth case study, the process is very similar to case study 4 with all compensation costs being similar. However, in this case after a period of 12 months the landowner has not found a buyer for the smaller plot of land. Scottish Ministers are asked by the landowner to purchase this plot of land directly. Scottish Ministers agree to purchase this land as they are satisfied that it is likely that the land has not been transferred as it is less commercially attractive than it would have been had the lotting decision not been made. The assumption is that the commercial viability of proposed lots will be a consideration in a Ministerial lotting decision, and that this decision will be supported by relevant expert advice. Accordingly, it is not anticipated that the Land Reform Bill will lead to significant areas of land being purchased by Scottish Ministers.

Scottish Ministers buy the smaller plot (150 ha) of land for a price of £0.3 million directly from the landowner. This cost to Scottish Ministers would be in addition to other compensation claims that may arise as in case 4.

3 Projections of Compensation Costs

3.1 Purpose of Projections

The annual cost of compensation claims to the Scottish Government arising from the compensation provisions set out in the transfer test were unclear at the point the Bill was introduced into the Scottish Parliament (March 2024). The Financial Memorandum stated that any costs will be ‘highly dependent on the individual landholding’ and does not set out to quantify the possible financial costs to the Scottish Government arising from this part of the Bill.

The Finance and Public Administration Committee of the Scottish Parliament have recently expressed concerns in relation to the quality of information in Financial Memorandums[12]. There is therefore a renewed expectation that financial costs to Scottish Government, such as those arising from compensation claims made by Landowners related to the application of the transfer test, should be quantified to the extent that is possible. Costs may be presented with a high scenario and low scenario estimation to demonstrate the level of uncertainty in projecting costs and that costs must be adjusted by the GDP deflator measure of inflation.

The Projections set out in this section of the report attempt to meet these requirements for this part of the Bill.

3.2 Data sources

The Scottish Land Commission have developed improved reporting and information on the rural land market and developed a methodology for regular reporting using Registers of Scotland (RoS) data on transfers of legal titles over land. Table 2 sets out the latest data to be contained in the Rural Land Market report 2024. The number of land transactions has varied from as low as 5 in 2023 to 12 in 2020.

Scottish Land Commission analysis is based on information held in RoS, augmented by a complex data matching process to other relevant data sources where available. Transfers of land can include transfers for monetary and non-monetary values (e.g. the implement of a will). In some cases where no consideration was found, Scottish Land Commission, used sales particulars (for example ‘offers over £3.5M’) as a proxy for the value of land. This could mean that average land values used in this analysis, derived from this data may understate the true value of land to an unknown degree – potentially biasing our cost projections. Limitations to this data is discussed in more detail in 3.7.1.

[12] Quality and Consistency of Financial Memorandums Letter of 26 July 2024 | Scottish Parliament Website

Table 2. Number and Geographical Extent of Large Landholding Transactions (over 1,000 ha) per year (2020 – 2023)

	Number of transactions	Area of Land Transacted (ha)	Average Land per transaction (ha)
2020	11	34,700	3,200
2021	4	12,600	3,200
2022	6	13,400	2,200
2023	5	18,500	3,700
Average per year	6.5	19,800	3,000
Total	**26**	**79,200**	

Source: Scottish Land Commission, figures rounded to nearest 100 ha.

3.3 Analytical Judgements

In the process of establishing reasonable estimates for the costs associated with the compensation provisions, a number of key judgements or assumptions were required to be made to construct reasonable low scenario, central and high scenario cost estimates. These were divided into assumptions regarding the future values of the Scottish land market (in landholdings over 1,000 ha), and assumptions regarding the key policy processes associated with the operation of the transfer test.

3.3.1 Land Market Assumptions

Table 3 sets out the key assumptions used in the analysis with respect to the part of the land market in Scotland subject to the transfer test. These assumptions underpin the projections of compensation costs outlined in section 3.5. In the central projection it is assumed that on average 8 large landholding transactions are made each year that are subject to the transfer test, with an average size of 3,000 ha per transaction. It is assumed that land values will increase in line with observed historical patterns of long-run farmland prices over the past 30 years (an annual growth rate of around 6.5%), outpacing growth in general prices across the economy (the GDP deflator, which settles at 2% p.a. post 2028). The average value of a large landholding is calculated as £2,280 per hectare (2023-24 prices) based on the latest data from Scottish Land Commission analysis.

Table 3. Land Market Assumptions used Compensation Projections

	Land Market Assumptions	Rationale for assumption	Low scenario	Central	High scenario	Source
1	Number of large landholding transactions per year	Scottish Land Commission data (compiled for the Rural Land Market Report 2024) suggests that there were 11 land transactions over 1,000 hectares in 2020, but between 4-6 per year in 2021 to 2023. The high scenario value for transactions was assumed to be 12 per year based on this data. We use an average of 8 transactions per year (slightly above the observed average).	4	8	12	Rural Land Market Report 2024, Scottish Land Commission
2	Average size (hectares) of a large landholding transaction per year	Scottish Land Commission data (compiled for the Rural Land Market Report 2024) suggests the average size of a land transaction in Scotland above 1,000 ha between 2020 and 2023 was 3,000 ha. The low scenario and high scenario values are taken from the low scenario and high scenario average recorded in the years covered in the report (2020-2023), rounded to the nearest 100 ha.	2,200 ha	3,000 ha	3,700 ha	Rural Land Market Report 2024, Scottish Land Commission
3	Annual growth rate of land values[13]	The Savills Farmland Values Survey records average market values by land type across the England, Scotland and Wales. The growth in farmland value per ha from 1992-2023 was used generate an annual land value growth assumption. We use a +/-1.5% around the mean to capture variance in this rate over time. It is recognized that farmland value maybe a poor proxy for land in upland areas of Scotland.	5.0%	6.5%	8.0%	Savills Farmland Values Survey, Savills Research

[13] It should be noted that whilst the growth rate of land values changes between the minimum, central and maximum projections, the same GDP deflator is used to provide the real values for each of the projections. It could be argued that annual land value growth rates are higher due to higher levels of inflation which would make a higher GDP deflator justifiable in the maximum scenario. However, this would be difficult to justify and therefore for simplicity and ease of comparison, the GDP deflator has not been adjusted.

Land Market Assumptions		Rationale for assumption	Low scenario	Central	High scenario	Source
4	Average value of a hectare in large landholdings	The average value for a hectare of land is based on the average price of large landholding sales (>1,000 ha) between 2020-2023 (as per the Rural Land Market Report 2024). Sales prices for large landholdings vary significantly according to location, land use and other factors. An interval of +/- £750 per hectare is used around the average. This judgment is based on an analysis of recent land sales.	£1,530	£2,280	£3,030	Rural Land Market Report 2024, Scottish Land Commission and analyst judgement.
5	Future bank of England Interest Rate	For the central estimate we have used the OBR's forecast for the Bank of England rate in 2030 (3.6%) as at October 2024. For purposes of testing sensitivity to this forecast the low scenario and high scenario rates are +/- 1% around this central estimate (2.6% - 4.6%).	2.6%	3.6%	4.6%	October 2024 OBR Economic and Fiscal Outlook Report

Figures 1 and 2 show the assumed characteristics of this part of Scotland’s land market that underpin the 25-year compensation projections in section 3.5. Cumulatively, over a 25-year period, we assume between 442 and 770 thousand hectares of land will be subject to the transfer test, with a total cumulative market value of between £1.0bn and £3.5bn (in 2023-24 prices).

Summary of characteristics of the future land market

Figure 2: Cumulative extent of landholdings transferred in sales subject to the transfer test over a 25-year period

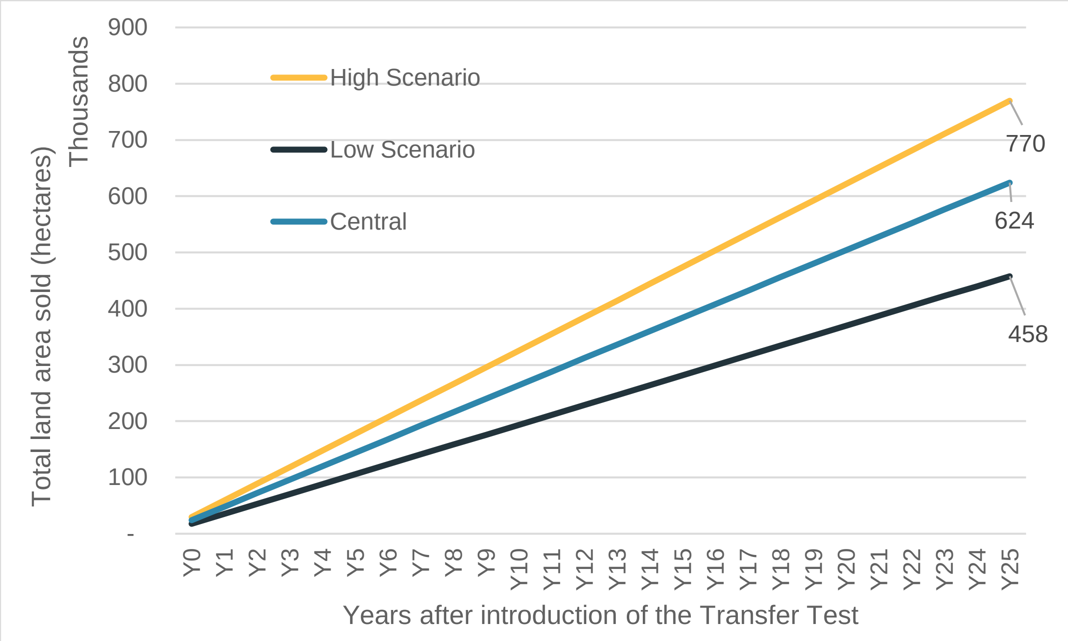
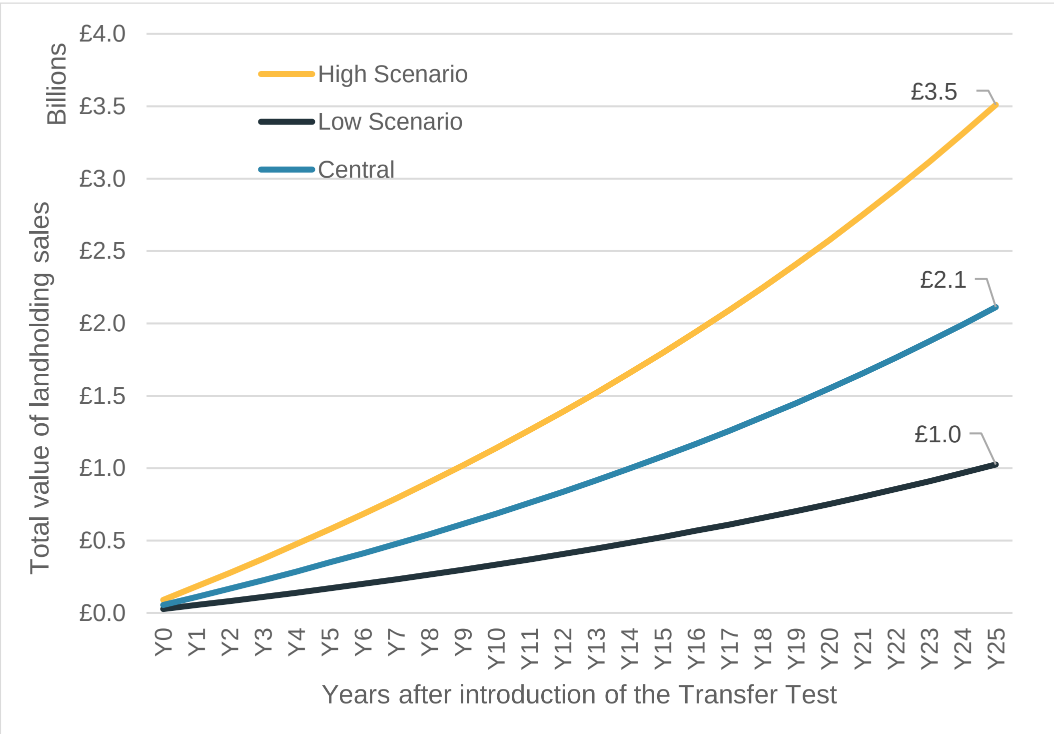


Figure 3: Cumulative market value (real terms, 2023-24 prices) of landholdings transferred in sales subject the transfer test over a 25-year period



3.3.2 Transfer test Process Assumptions

Table 4 sets out key the key assumptions used in the analysis with respect to the practical operation of the transfer test, as set out in the Bill.

Table 4. Transfer Test Assumptions used for Compensation Projections

	Transfer test Assumptions	Rationale for assumption	Low scenario	Central	High scenario	Source
1	The proportion of large landholding transactions that are subject to further investigation by the LCC	The Land and Communities Commissioner (LCC) will assess whether an in-depth investigation into a proposed landholding sale is required. An internal exercise was carried out by SLC officials on previous sales of large landholdings in 2023, where a judgement was made as to whether or not there would have been reasonable grounds to conduct a further investigation or not on a particular sale. This judgement provides the central estimate for the purpose of scenario modelling.	20%	40%	60%	Judgement based on internal exercise by SLC
2	The average time taken for the LCC to conduct an investigation and report to Scottish Ministers (weeks)	Discussions between Land Reform policy team and SLC officials indicate the investigation times are likely to vary from a few weeks to months (depending on complexity). The range reflects reasonable lower and upper bounds for the average time this process is expected to take (including a ministerial decision) in weeks.	6	12	18	Judgement based on discussions between SG and SLC officials
3	Proportion of large-scale land holdings that are subject to an LLC investigation where a lotting decision is made by Scottish Ministers	It is expected that Scottish Ministers will base a lotting decision on an in-depth LCC investigation. In the high scenario case, it is assumed most landholding transactions which are subject to an LCC investigation will be subject to a positive lotting decision by Scottish Ministers.	25%	50%	75%	Judgement of SG policy officials
4	Average proportion of a large landholding that is lotted separately for community sustainability purposes	While a lotting decision will apply to the entire landholding for sale, it is expected that in most cases where Scottish Ministers make a positive lotting decision, a significant part of the landholding may be approved for sale to a single owner, with smaller lots specified in a way that would allow for key community needs such as housing plots or sites for business development.	5%	10%	15%	Judgement of SG policy officials

Transfer test Assumptions		Rationale for assumption	Low scenario	Central	High scenario	Source
5	Change in total value of landholding due to lotting decision	In the absence of the transfer test, it is assumed that landholdings are marketed in lots which maximise private returns for the landowner. A lotting decision - which divides the landholding to maximise public benefits - may therefore reduce the value of land that could otherwise have been achieved. It is challenging to judge ex-ante the degree to which land values may decline due to lotting decisions – this will depend on the nature of the lotting decision. However, given lotting decisions are expected to impact a relatively small proportion of the overall landholding in most cases, it is likely that the impact of the lotting decision itself will be relatively small. Therefore, a range has been used between a 1% reduction (low scenario case) to a 4% reduction in land value (high scenario case).	1%	2.5%	4%	Policy informed judgement
6	Additional expenses of lotting incurred by the landowner (total legal fees)	As a result of a lotting decision, the landowner is likely to incur additional legal fees associated with selling their land in accordance with the lotting decision. These costs could be claimed by the landowner as compensation. The costs are assumed to range from £5,000 to £25,000 per landholding.	£10,000	£25,000	£50,000	Policy informed judgement
7	Average delay in sale of land that is lotted (<u>months</u>)	As a result of a lotting decision, the landowner will need to sell land in lots to different buyers. This may take some time to complete - and could arguably take longer than if a lotting decision had not been made. It may be that a buyer for a smaller lot takes a longer period of time to raise funds and complete a sale compared to a buyer who - without the lotting decision - could have been in a position to buy the entire landholding. This buyer is assumed to purchase a smaller lot on average (5% - 15%) of the original landholding. There is a 12-month period set out in the Bill, after which the landowner can ask for the lotting decision to be reviewed. This would risk the lotting decision	8	12	16	Policy informed judgement

Transfer test Assumptions		Rationale for assumption	Low scenario	Central	High scenario	Source
		being overturned. We, therefore, assume in most cases this will place a natural point at which sales will complete and is used in the central scenario (-/+ 4 months).				
8	Ongoing financial costs and fees related to existing commercial arrangements made in connection with land ownership, net of payments received by holding the land (cost per year, per hectare)	It may be the case that the landowner continues to bear fees and costs related to existing commercial arrangements made in connection with land ownership (public land liability insurance, forestry management charges) that would otherwise have been terminated earlier if the sale of land was not subject to the transfer test. However, there will also continue to be benefits to land ownership in some cases (continued farm subsidy payments, or rental income from tenants). It is judged that in some cases there will be costs per hectare of £5 per year.	£0	£5	£10	Policy informed judgement
9	Proportion of land that is unsold that is purchased by Scottish Government	Should, as a result of the lotting decision, it be clear that there are no private buyers for part(s) of a lotted landholding, then Scottish Ministers may chose to buy this land directly from the landowner. It is not the intention of the Transfer Process that any land will be purchased by Scottish Ministers, however a prudent assumption has been made to capture possible costs arising.	1%	2%	5%	Policy informed judgement

Table 4 sets out 9 key assumptions which underpin the compensation cost projections in section 3.5. There are varying degrees of uncertainty associated with each step in this process, and therefore varying degrees of judgement that have been required to arrive at each assumption – with a high degree of uncertainty around a reasonable central assumption in some cases. We have attempted to put broad and reasonable upper and lower bounds to each key assumption in the analysis to illustrate this uncertainty. Additionally, we have generally erred on the side of prudence for these assumptions i.e. where we have had a high level of uncertainty, we have chosen assumptions that would increase the cost of claims on Scottish Government.

In our central compensation cost projection, we assume that 40% of large landholding sales each year (around 3-4 sales per year) will be subject to an in-depth investigation by the LCC and that half of these sales will result in a positive lotting decision by Scottish Ministers. We have also judged that in most cases a small area of the landholding (between 5% and 15% of the total landholding area, and 10% in the central case) will be required to be sold separately in the lotting process, typically to a different kind of buyer (e.g. housing trust, small business) than who might be anticipated to buy an entire landholding .

As only a small area is likely to be lotted separately in the Transfer test process, the possible impact on the total value of the landholding is judged to be minimal (a reduction in total value of between 1% to 4% is used).

In our central projection, we also assume that land parcels which have been lotted separately (10% of the original landholding) may take longer to sell, if – as is likely – the land parcel is sold to a buyer with less resources such as a housing trust or small business. In the central scenario, we assume a delay of 12 months to sell this parcel of land which is informed by the provision in the Bill that a landowner may request a review of a lotting decision, if land has not transacted within 12 months. This will likely give a practical focus for prospective new landowners to process a sale before or at this legislative deadline.

In our central assumption, it is likely that a small proportion of landholdings that are subject to being lotted cannot ultimately be sold to a private buyer. In this case, Scottish Ministers may step in to buy the land. It is not the policy intention that Scottish Ministers will purchase significant areas of land through the transfer test process, with this being viewed as a worse-case scenario for intervention in the land market. As such, we have judged that only a small proportion (2%) of land area subject to a lotting decision is ultimately bought by Scottish Ministers.

Finally, compensation can take the form of meeting additional expenses incurred by the landowner due to the lotting decision. The first of these is anticipated to be additional legal costs that the landowner may incur to market land in accordance with the lotting decision. In the central case, we assume this will cost £25,000 per landholding that is subject to lotting. The other expenses that could be claimed are on-going costs related to holding on to the land for longer than anticipated (insurance costs, forest management charges etc.). This will vary on a case-by-case basis and any revenues the landowner continues to receive on the landholding (rental income form properties or farm payments) would also have to be factored in to any compensation. This is discussed in section 3.7. For the purposes of the central case we assume the landowner incurs £5 per hectare of net costs per year on land. Land that is lotted and takes longer to sell (for example to a less well-resourced buyer) is relevant (on-going costs on the non-lotted part of the landholding is out-of-scope as these would have been incurred in the counterfactual).

3.4 Methodology

A simplified methodology was applied to estimate potential compensation costs associated with the transfer test. These are summarised in the bullet points below:

1. An annual estimate for the total area of land subject to a) the transfer test and initial LCC investigation, b) the Transfer test, initial LCC investigation and a positive lotting decision by Scottish Ministers and c) the purchase by Scottish Ministers as a result of the lotting process ending in a situation where a there is no buyer for some portion of the landholding.

2. Compensation is calculated for the delay in sale due to the initial LCC investigation (Cost A, page 9) on the basis of a pro rata ‘loss of interest’ calculation given by the equation below. Where Comp1 is the total amount of compensation payable by Scottish Ministers for this reason, ‘T’ is the average time period (in weeks) needed to complete an LCC investigate and for Scottish Ministers to make a lotting decision, ‘P’ is the average market price of land per hectare, ‘H’ is the number of hectares subject to the LCC investigation and ‘r’ is the Bank of England base rate.

$$Comp1 = \frac{T}{52} * P * H * r$$

3. An estimate of the change in total value of landholding due to lotting decision is calculated. This is calculated with reference to the total value of land that is subject to a positive lotting decision each year in a given projection, multiplied by one minus the relevant factor, as set out in assumption 5 in table 4.

4. Compensation is calculated for the loss in value due to a delay in sale of a landholding that is linked to the lotting decision on the basis of a second pro-rata ‘loss of interest’ calculation given by the equation below. Where ‘Comp2’ is the total amount of compensation payable by Scottish Ministers for this reason, ‘C’ is the proportion of the landholding which has been lotted and subject to purchase by a buyer to enhance community sustainability, ‘T’ is the period of time between the sale of the smaller landholding to complete after a lotting decision is made in weeks, ‘P’ is the average market price of land per hectare, ‘H’ is the number of hectares subject to lotting and ‘r’ is the Bank of England base rate.

$$Comp2 = C * \frac{T}{52} * P * H * r$$

5. The cost of additional legal expenses are calculated by using the relevant assumption for legal costs per transaction (assumption 6 in table 4), multiplied by the number of transactions subject to a lotting decision.

6. The cost of additional expenses (net of any revenues) associated with ownership of the landholding (or part of it) for a period longer than otherwise expected due to lotting is calculated on the basis of multiplying the relevant rate per hectare per year by the number of hectares that are subject to the lotting decision on a pro-rata basis.

7. The cost to Scottish Ministers of purchasing land is determined by applying the assumed proportion of land bought by Ministers (assumption 9 in table 4) by the value of land where a decision to lot was made.

3.5 Projection Results

3.5.1 Central Projection

Cost projections have been produced over a 25-year period, using the low scenario, high scenario and central assumptions as set out in tables 3 and 4 for the characteristics of the future land market in Scotland (for landholdings over 1,000 ha) and the transfer test process. The costs are presented in nominal (cash) terms and in real terms (adjusted by the GDP deflator, with a 2% growth assumption applied beyond 2030). Costs are presented in 2023-24 prices.

A key finding is that the profile of projected costs in each scenario vary by an order of magnitude, i.e. from £100,000s of compensation costs per year in the 'Low scenario Projection', to several million pounds of costs per year in the 'High scenario Projection'.

Figures 4, 5 and 6 present the main results of the Central Projection for annual compensation costs related to the transfer test.

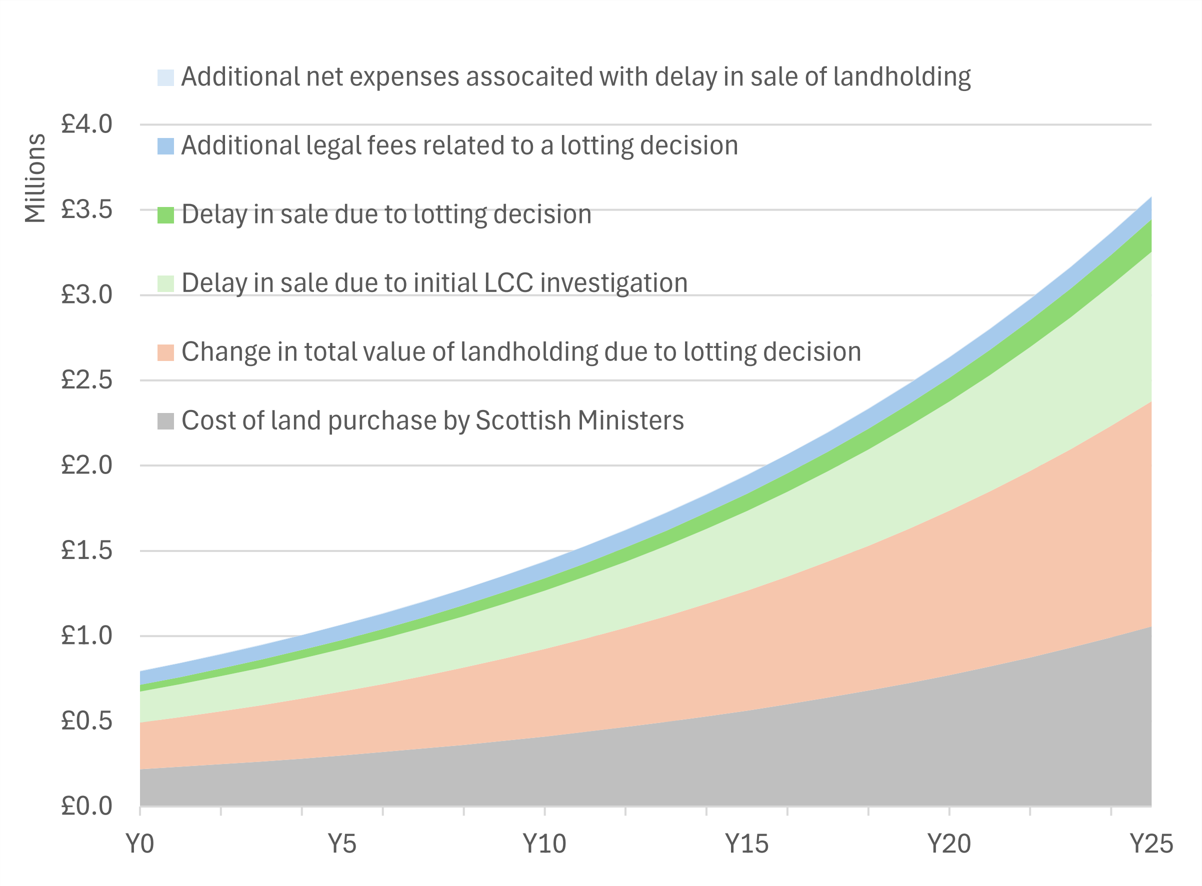
At the year of introduction (assuming 2023-24 introduction and prices), annual compensation costs are projected to be less than £0.8m per year, rising to £1m per year after 5 years. Costs continue to increase over the projection period to £2.2m per year after 25 years.

The constituent compensation costs in this projection are shown in figure 6. The largest component of compensation costs is related to losses in value of land following a lotting decision. As shown in the assumptions judgement section of this report, there is limited evidence to support a reasonable assumption for reductions in land value due to lotting.

The second largest component of costs, representing just under a third of the total (29%) is the direct cost of land purchases by Scottish Ministers. This is of interest, given that it is assumed only a modest level of land is ultimately purchased by Ministers (2% of land area subject to a lotting decision and 0.4% of land subject to the Transfer test). A loss of value due to delays associated with the prohibition of sale during the LCC investigation stage makes up a further quarter (24%) of overall costs.

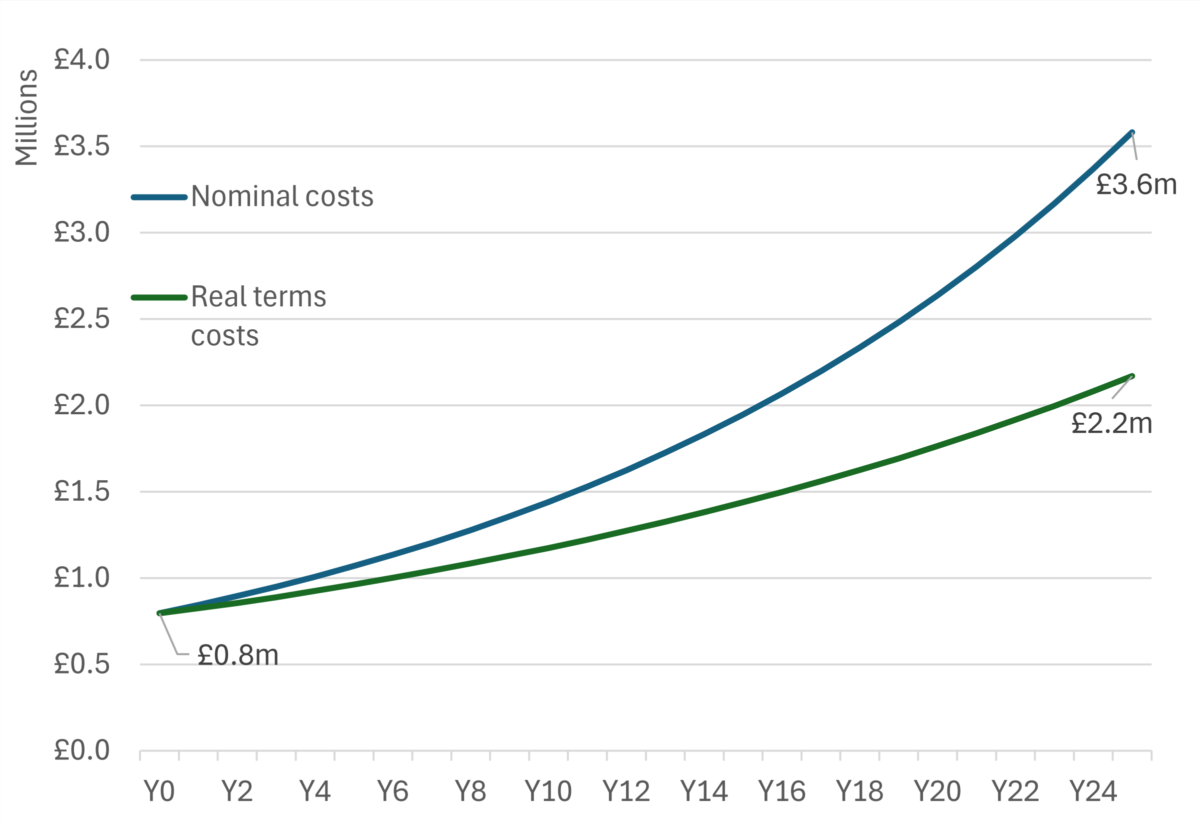
The delay due to a lotting decision (5%) makes a relatively small contribution to overall costs in this projection, given the small number of transactions that we assume are actually lotted in the transfer test process. A small contribution to compensation costs comes from the need to meet additional legal fees or meet any other net expenses associated with holding on to the landholding (or part of it) for longer than expected due to the lotting process.

Figure 4 – Annual Compensation Costs associated with the transfer test (Central Projection) in nominal terms, split by compensation type



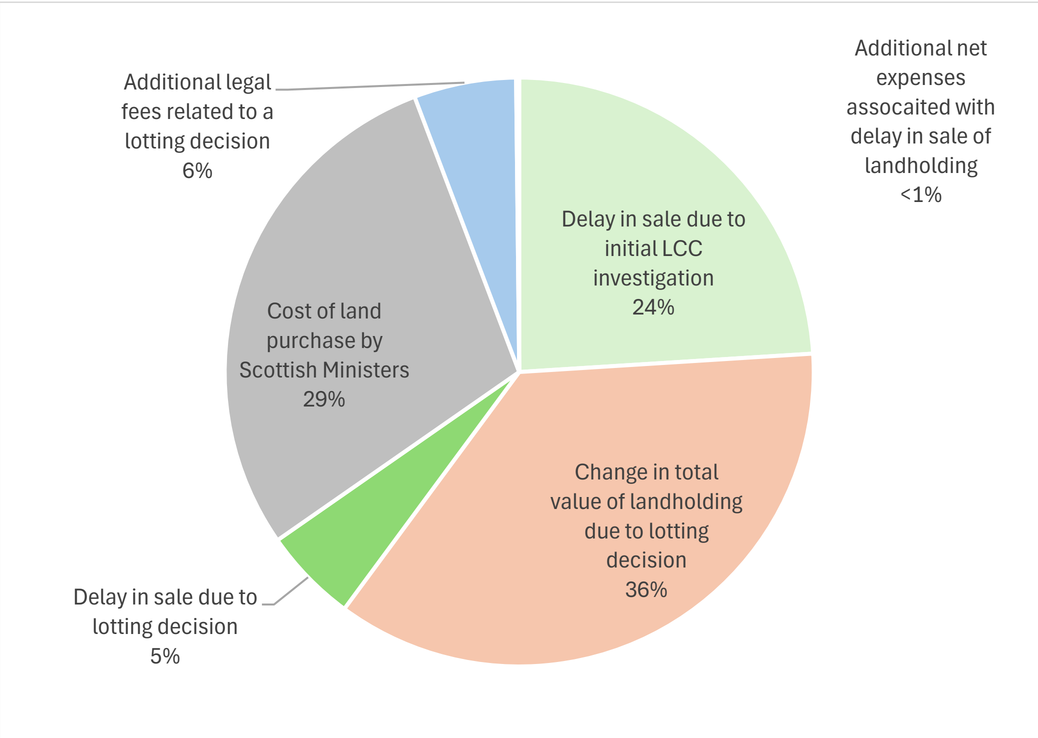
Source: Scottish Government analysis

Figure 5 - Annual Compensation Costs associated with the transfer test (Central Projection) in nominal and real terms (2023-24 prices)



Source: Scottish Government analysis

Figure 6 – Total compensation costs over a 25-year period associated with the transfer test (Central Projection), distribution of costs by origin

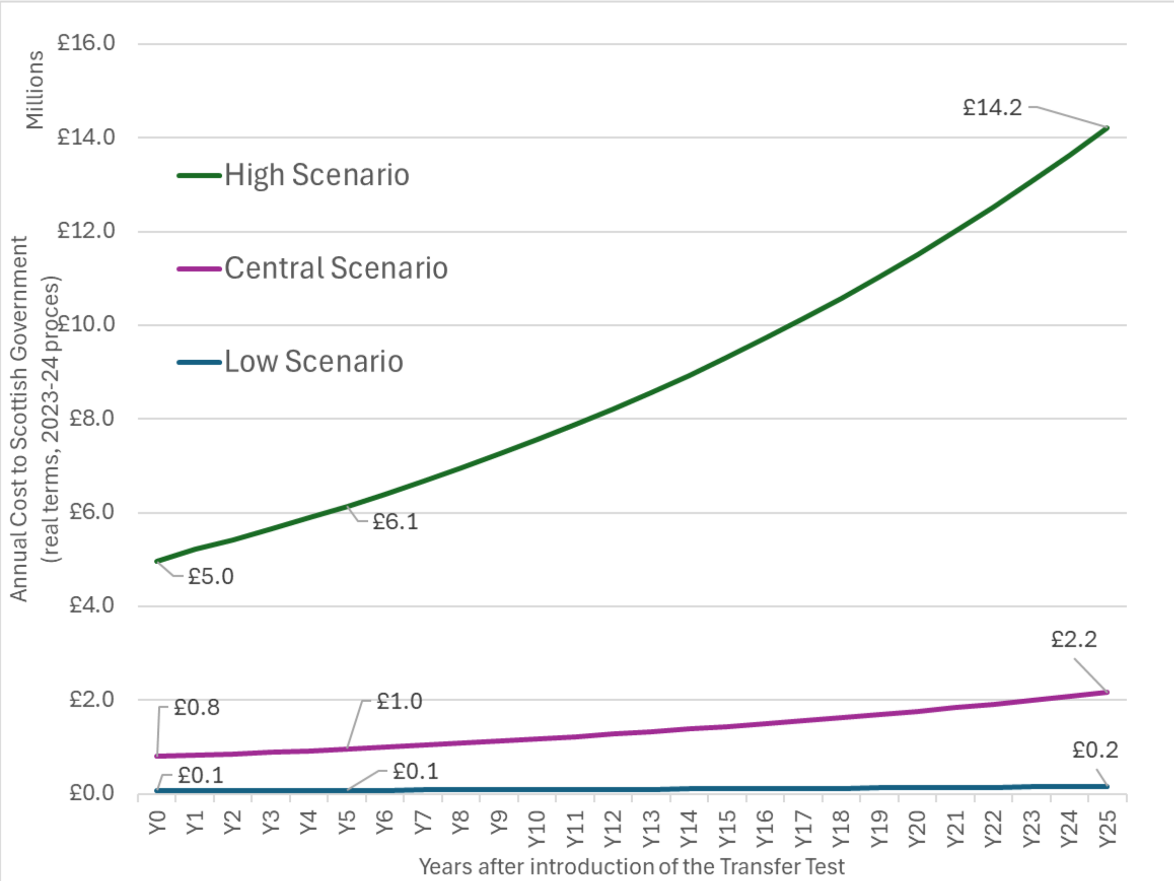


Source: Scottish Government Analysis

3.5.2 High Scenario and Low Scenario Projections

Figure 7 shows the range of costs under the high scenario, low scenario and central projections. Further detail behind these projections is provided in Annex B. The analysis suggests that costs in the year of introduction (2023-24 prices) of the transfer test could range from as low as £0.1m to as high as £5m, rising to between £0.1m and £6.1m per year after 5 years. The wide confidence interval around the central projection underlies the significant uncertainty associated with key assumptions and judgements outlined in section 3.3.

Figure 7 – Projected Annual Compensation Costs associated with the transfer test in real terms – high, central and low scenarios (2023-24 prices)

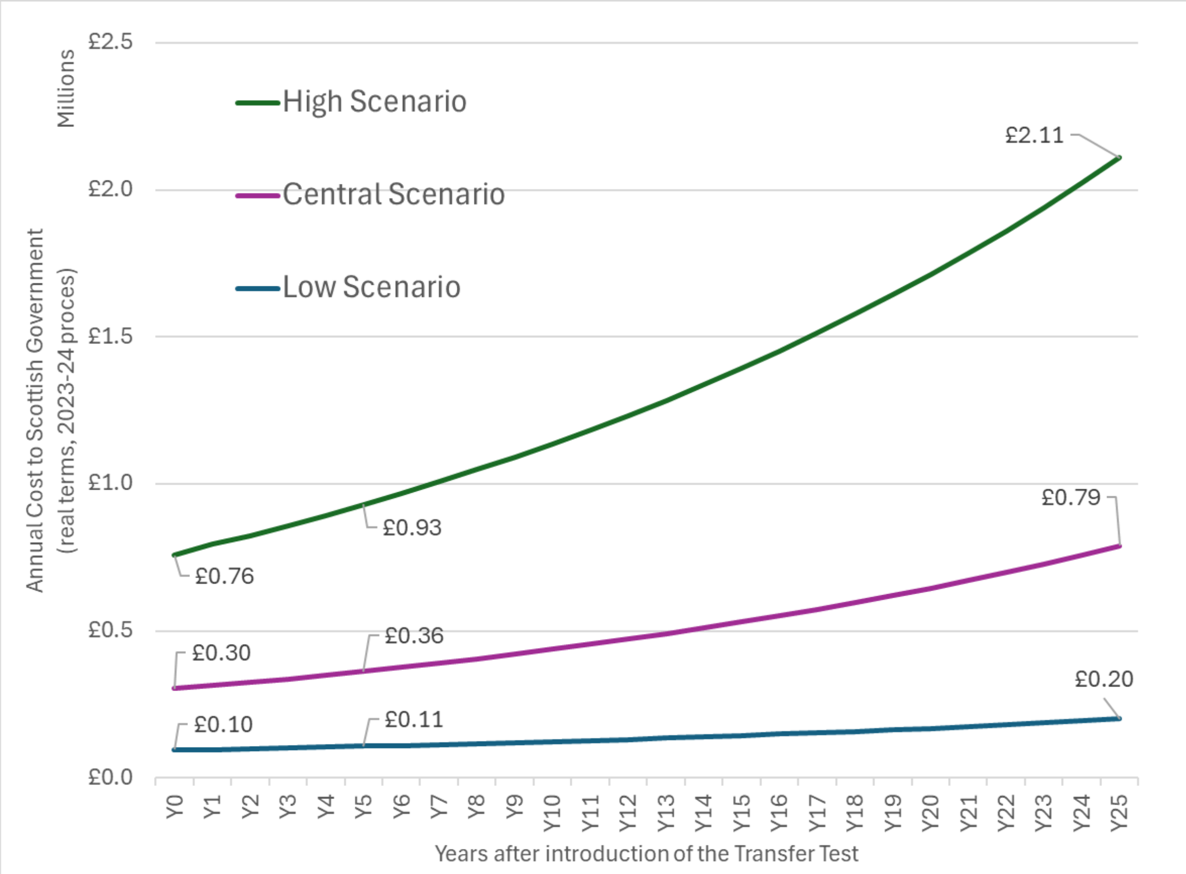


Source: Scottish Government Analysis

Further to the final projections outlined in figure 4, it was recognised that the cost profiles used in each projection were 'smooth', as they are based on a similar number of transactions per year (8) of a similar geographical extent on average with no annual variation built into the projections. However, in practice we recognise that this is not a realistic model of the land market, as the number of transactions and land area being sold each year will be subject to a high degree of volatility from year to year. As set out in figure 1, the land market in landholdings over 1,000 hectares is characterised by a left-skewness in the distribution of sales – with more sales falling below the long-run average. Annex C sets out a stylised projection with a more ‘realistic’ profile of compensation costs – reflecting the uncertainty in the number of transactions and size of landholdings each year. It is not an attempt to show a precise prediction (what years will see higher/lower costs), but to demonstrate that – even if all the parameters in the assumptions used in the central projection were broadly correct - in practice costs are still likely to vary considerably from year to year (i.e. reaching above £1.5m before year 5). This further demonstrates the degree of financial uncertainty inherent in these provisions of the Bill.

Finally, an alternative way to present these cost projections is to show costs on a ‘per land transaction’ basis, thus stripping out the assumptions around the number of land transactions subject to LCC investigation and lotting in each scenario (a source of uncertainty in the projections). Figure 8 presents the low, central and high scenarios for compensation costs on a ‘per transaction’ basis for each land transaction subject to lotting (excludes the cost of ministers purchasing lots).

Figure 8 – Projected annual compensation costs associated with the transfer test per land transaction directed to lotting in real terms (2023-24 prices)



Source: Scottish Government Analysis

A typical amount of compensation for a land transaction directed to lotting is estimated to be £0.3m in the year of introduction, rising to £0.36m by year 5 in the central scenario. In the low and high scenarios, the cost in the year of introduction ranges form £0.1m to £0.76m per case These costs exclude any costs associated with Ministers buying land directly, as it is assumed that this will not occur in a typical case[14].

3.6 Key Findings from Cost Projections

The cost projections highlight the following policy conclusions.

Firstly, there are order of magnitude differences in cost projections using the low scenario and high scenario assumptions, which demonstrates the uncertainty inherent in modelling compensation costs in this case. By year 5 after implementation of the transfer test, our projections suggest costs could range from as low as £0.1m per year to as high as £6.1m per year in real terms. Therefore, it is clear that Scottish Ministers need to be prepared to take on a significant degree of potential financial risk in the proposed transfer test ahead of introduction of the Bill, notwithstanding that some uncertainty may be reduced once the transfer test is operating in practice and assumptions around the operationalisation of the transfer test can be made with a higher degree of confidence.

Secondly, the amount of land we expect to be transacted over a 25-year period subject to this test is relatively small. There is estimated to be around 4.52m hectares of land held in landholdings over 1,000 hectares currently, but only 0.6m hectares (13%) of land is projected to transact over this period in the central projection, and an even smaller sub-set of this land is expected to be lotted to other buyers for the purposes of enhancing community sustainability in practice. As such, it is an implicit assumption in this model that the number of plots of land (or the frequency of transfers) over 1,000 ha will not change over time as a consequence of the actions of the transfer test alone.

Thirdly, regardless of the scenario tested, the annual costs of compensation tend to rise over time (even after accounting for the effects of inflation). This is driven by the assumption that the value of land will rise at a faster rate than general prices (the GDP deflator in this case). Annual growth in GDP deflator since 1993 has been 2.3% per year; annual growth in land value index since 1993 was 6.5% per year. See 3.7.2. for more detail on future land value.

Fourthly, the costs associated with compensation of additional new or ongoing expenses that a landowner may bear as a result of a lotting decision are generally minimal relative to other costs identified in this report. Costs associated with on-going expenses are negligible across all scenarios, whilst the cost of additional legal

[14] Consistent with the projections used in the analysis, if including the cost of assumed land purchases by Ministers this would add £0.17m per transaction in the central scenario, £0.56 in the high scenario and £0.04 in the low scenario.

expenses as a result of a lotting decision range from just 3% to 13% of total costs (see Annex B), and are only 6% in the central projection.

Compensation as a result of reductions in land value due to a lotting decision is the largest component cost in the central projections (representing 36% of the total costs). However this costing has the least robust grounding in evidence and is most sensitive to the judgements applied. In practice, there is uncertainty in how landowners could demonstrate a reduction in land value linked to the lotting decision alone, which may mitigate these costs arising in practice. On the other hand, it could be difficult for Scottish Ministers to prove the opposite, that the lotting decision did **not** cause a reduction in land value. Estimates of the land value of the total landholding and the landholding in lotted form from a suitably qualified individual (i.e. a land agent) will be important in estimating the financial impact of the lotting decision.

Finally, the projections are based on averages (for number of transactions and extent of landholdings) and suggest a smooth incremental increase in compensation costs over time. Due to the nature of the land market, there will be in practice significant variability in the profile of costs as reflected in the projections of compensation costs shown in figure 5 (and Annex C).

3.7 Limitations

3.7.1 Data on landholding transactions

The main data underpinning the projections presented in this report are sourced from secondary analysis of RoS data carried out by the Scottish Land Commission and published in the Rural Land Market Report 2024. RoS data is not produced for research purposes and the data is known to understate the true extent of landholding transactions over 1,000 ha and the market value of land transacted. The data also only captures market sales in the past 4 years, which has been characterised by some notable shifts in the land market – including a large number of forestry sales in 2021-22.

Firstly, there are a number of technical challenges related to data processing including difficulty in assigning area (hectarage) to all land sales due to uncaptured data and delays in cadastral parcel mapping and the difficulty in assigning full price paid to all land sales due to the prevalence of non-monetary considerations registered with RoS. These challenges pose particular issues for assessing the estates market - which represent around two-thirds of landholding sales over 1,000 ha - due to the higher number of estates missing key relevant information.

Secondly, the analysis of RoS data is based on final land as sold on in the land market. This may mean that there will be cases of landholdings above 1,000 hectares were brought to market by a single landowner but ultimately sold in lots of less than 1,000 hectares. It is therefore likely we are missing some transactions under 1,000 ha which might in practice have been captured by the transfer test process.

Given these limitations, it is more than likely that the SLC data might understate the number of relevant transactions and the market value of these transactions – however as we don't know to what degree this introduces error into our projections, we have not explicitly been able to correct for this bias in the analysis.

3.7.2 Future trends in land market values

We have based our assumption on the growth of land values in the projection in this report based on historic land value growth, as reflected in the Savills Farmland Values Survey (for land in Scotland). We recognise that this is a proxy for land value growth generally in areas that could be subject to the transfer test (which will also include estate land and forestry land). It also assumes that land values will continue to increase at a rate greater than the level of general prices (as denoted by the GDP deflator). Should land prices grow at a rate lower than the rate of inflation, then it is possible that costs of compensation (in real terms) will fall over time.

3.7.3 Appeals processes related to the transfer test

Our analysis has not explicitly made any adjustments for the likely impact of appeals processes that are built into the transfer test Process. Appeals could extend the timescales for a delay in transactions (particularly with respect to some of the case studies presented in section 2) as they will be dealt with by the Court of Session in the first instance. The lotting decision can be ultimately be appealed up to three times – in the Inner court, the Outer court and the Supreme Court.

It is arguable that, even if a case was brough to Court of Session (and this took a number of months to be disposed), a right to compensation would not be created in the case that the appeal finds in favor of Scottish Ministers. However, should the appeal find in favor of the appellant (landowner), then this could create a compensation risk that is not explicitly set out in the modelling presented in this report. A further analysis would need to be carried out to capture risks from such appeals. In discussions with the Land Reform Policy Team, it was suggested that there is a likelihood that the first few lotting decisions made by Scottish Ministers will be tested in the courts through an appeal, to test the legislation.

As such, <u>this should be considered as an unquantified risk in the projections set out in this report</u>.

3.7.4 Change in market value due to a lotting decision

The projections attempt to capture, to a limited degree, the possibility that land values in areas that are lotted may fall relative to what could have been achieved had a landholding been sold as a single entity. In practice, it would be challenging for a landowner to provide evidence of a change in land value to Scottish Ministers. Where some assessment of land value is made by land agents to inform the decision of Scottish Ministers, it is plausible this could be used as a basis to make a claim of a fall in market value, should the sale of the landholding in the lots pre-determined by the lotting decision fall short of land agents valuations. It is unclear what other mechanisms could be deployed in practice to evidence such falls in value.

3.7.5 Uncertainty inherent in projecting a small number of transactions

There is inherent uncertainty in the projections due to the nature of such a small number of transactions expected to be subject to the transfer test each year. This means that there may be material fluctuations in compensation costs from year to year which are highly unpredictable. These fluctuations could result from only a small change in the number of transactions or the size of the land that is lotted in each year. This is demonstrated in the projections in Annex C.

3.7.6 Taking into account change in land market value for reasons other than lotting

Our projections do not include any change to land value outside of the lotting decisions made by Scottish Ministers. However, it is not unfathomable to imagine a situation where a delay in sale due to LLC reporting delays or a positive lotting decision being made could lead to a sale during less favourable market conditions. However, given this would be impossible to predict, and land values have generally been increasing over time, we have not allowed for this scenario in the projections.

4 A discussion on recommendations for reducing compensation costs

This section addresses the third objective of this report, assessing potential policy actions that could be effective in reducing the risk of significant compensation payments arising in the transfer test process over time.

4.1 Factors identified in cost projections

The modelling that underpins the cost projections that are set out in section 3 can be used to draw some broad conclusions on the variables that will likely increase the size of future compensation costs related to the transfer test.

- **The proportion of large landholding transactions each year where a positive lotting decision is made by Scottish Ministers**

Firstly, there is an obvious logic to the fact that the scale of any compensation costs in our projection model will increase with the proportion of landholdings that are subject to either an in-depth LCC investigation or a lotting decision. It is likely that the compensation claims that might arise following a light-touch LCC report or in cases where the landowner demonstrates they are in financial hardship (i.e. case study 1) will generate negligible levels of compensation claims, as a lotting decisions are expected to be made by Scottish Ministers relatively quickly (i.e. a few days to a week).

However, in cases where there is an in-depth LCC investigation is required, the length of time in which there is a prohibition of the sale of the landholding will be extended – potentially by a considerable degree (a number of months). This delay is likely to generate more legitimate claims of loss of market value on a loss of interest basis linked to the transfer test.

These loses will be compounded in cases where Scottish Ministers do decide to lot the landholding, as this opens up additional possibilities for compensation costs, as set out in the case studies. Our central assumption is that 40% of land transactions that would be in scope for the Transfer test will require an in-depth LCC investigation. If this were to be increases to all cases, then costs would rise by around 50% – even if the same number of cases were subject to a positive lotting decision ultimately.

Therefore, should in practice the transfer test provision mean investigations were pursued more actively on a high proportion of sales, the compensation costs could rise significantly above what the projections contained within this report imply.

- **The time period in which a prohibition on a sale is applied**

Secondly, and related to the above factor on the proportion of landholdings subject to lotting, the average time period for a LCC investigation to report and Scottish Ministers to make a lotting decision can ratchet up potential compensation costs. In our 'high scenario' case projection the *average* (note this means that some cases may take longer than 18 weeks in practice) time for a LCC report would be 18 weeks. Relative to the central scenario, a change in the average time of 1 week would increase costs by around 2%. Therefore, limiting the time taken for LCC investigation and Scottish Ministers decision on lotting will limit the compensation payable.

- **Reductions in land value due to lotting**

As discussed, there is a very limited evidence base underpinning the assumption on changes in total land value due to lotting decisions. The potential reduction in land value will vary on a case-by-case basis and will also be a matter of professional judgement of land agents. It is envisaged, from a policy perspective, that Ministerial decisions will be supported by some kind of analysis of any changes in land value in a particular case due to a particular lotting decision proposed to Scottish Ministers that can be relied upon by Scottish Ministers when claims are made around loss in value due to lotting.

- **Definition of eligible expenses**

In the case studies and projections, we have assumed that landowners could claim for additional costs linked to holding land for longer than otherwise intended. The precise mechanism for how this will be calculated in practice is unclear. We have assumed that costs could only be claimed on a smaller lot, which we envisage in most cases is purchased for a use which would be aligned with the objective of the transfer test of improving sustainability of local communities, in which case on-going costs for that land could be claimed. If costs could be claimed against the entire landholding, this could increase the level of compensation payable.
{REDACTED – under section 29(1)(a)}

4.2 Other considerations

In the course of writing this report, two other considerations which might have an impact on compensation costs were raised.

Firstly, there may be exogenous shocks to the land market and land values during the time in which there is a prohibition on the sale of the land (noted in limitation 3.7.6). It is not possible to accounting for such shocks within the projections presented in this report and it is likely to be a matter of legal opinion whether such a shock occurring during this period would lead to compensation of any lost value. However, a delayed sale due to a positive lotting decision (not just the delay in sale due to the LLC report being commissioned) that means that land is sold when prices have fallen due to an exogenous shock is more likely to be claimable than if the sale took a shorter length of time, similar to the counterfactual of the land not being lotted.

Secondly, whilst it is the case – mechanistically – that reducing the time period for processes in the transfer test, has the effect of reducing time delays on sales and therefore the likely compensation claims that could be linked to such delays, it should be borne in mind that there is a risk that a faster process could lead to inaccuracies in advice brough forward thought the LCC investigation process. Errors (such as valuations), may mean decisions are more likely to be successfully challenged at appeal and this could inadvertently increase compensation risk.

5 Conclusions

This report set out to provide an evidence-based assessment of the potential financial costs associated with the transfer test within the Land Reform Bill and to map out areas where such compensation costs could be reduced or mitigated.

The final conclusions are as follows:

- The transfer test is expected to impact a relatively small number of land transactions each year and a small proportion of Scotland's land.

- We found there to be at least six different possible grounds for compensation costs linked to the transfer test process. These ranged from claims based on a 'loss of interest' due to the prohibition of a land sale during either the investigation stage of the process by the Large Landholding Commissioner or the lotting decision process by Scottish Ministers, potential changes in the market value of the landholding if demonstrated to be linked to the lotting decision, additional legal expenses related to a lotting decision and direct costs associated with Scottish Ministers buying plots of land.

- There were a significant number of analytical judgements required to produce quantitative estimates of the potential financial costs associated with the Transfer test. This lead to a large range to costs produced in the costing model between the low scenario and high scenario compensation cost projections.

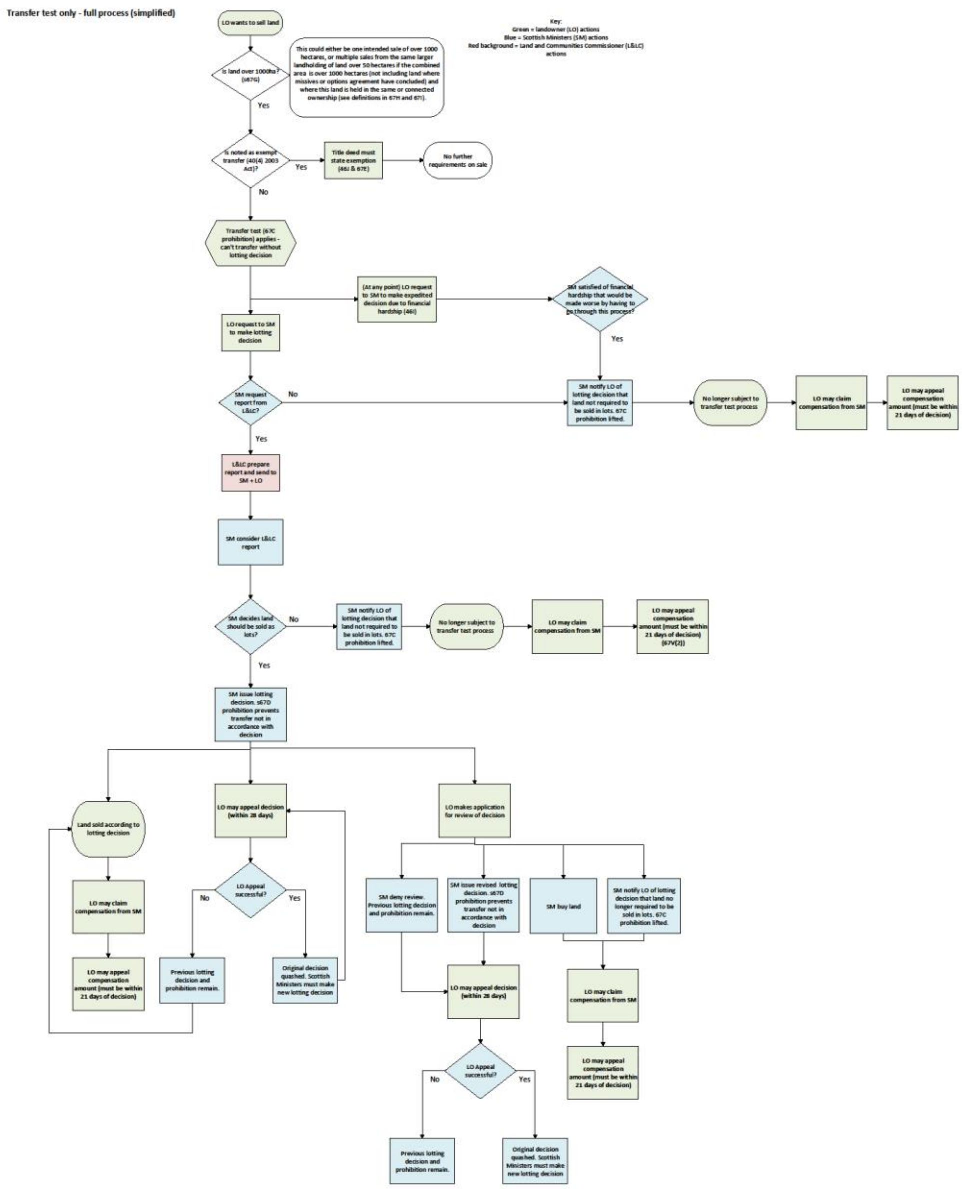
- In the central case scenario, at the year of introduction (assuming 2023-24 prices), annual compensation costs were projected to be less than £0.6m per year, rising to £0.7m per year after 5 years. However, as the range of values around this central projection is significant (£0.1m to £3.2 million in the first year).

- There are a range of factors that are expected to reduce possible compensation costs that arise from the transfer test process. Crucially, any policy actions that could either reduce the proportion of landholding sales subject to LCC investigations or a lotting process would – all else equal – reduce compensation costs. However, although a faster process would reduce costs linked to delays in a sale, this has to be weighed against the risk of errors in bringing together evidence and advice in expedited circumstances, which could lead to landowners making more successful appeals against decisions.

- {REDACTED- under section 29(1)(a)}

6 Annex A – Process Map of the Transfer Test

*Click on image to enlarge and see full map



7 Annex B – Details of Sensitivity Analysis

<u>High scenario projection</u>

Figure 1B: Annual Compensation Costs associated with the transfer test (High scenario projection) in nominal terms

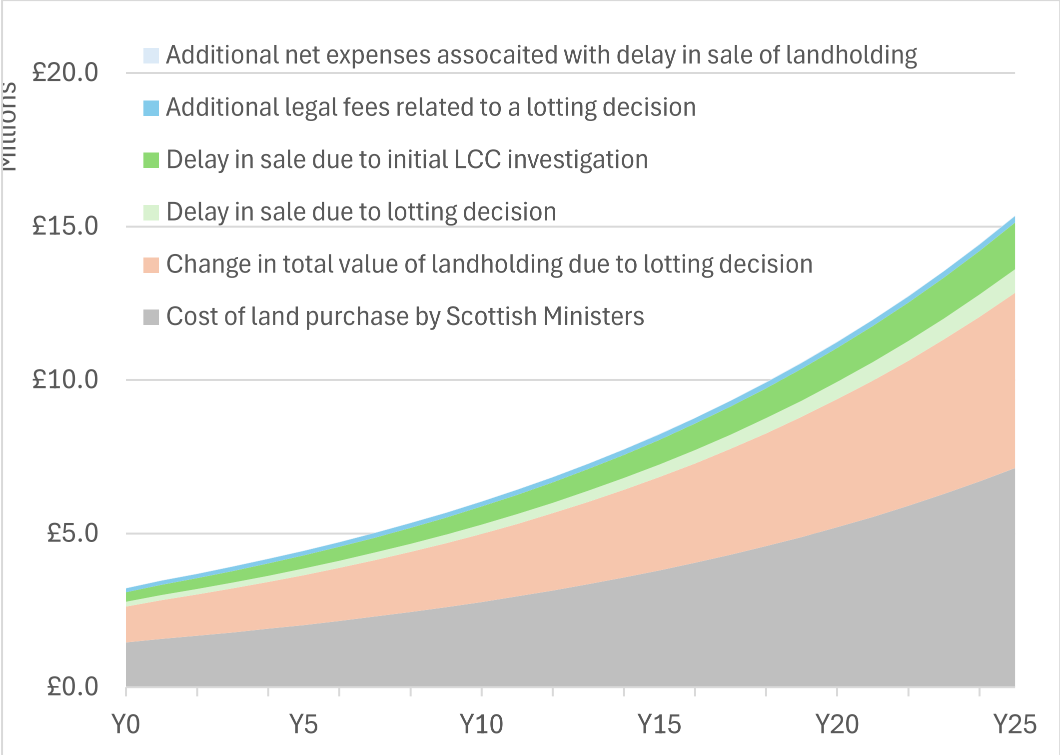


Figure 2B: Annual Compensation Costs associated with the transfer test (High Scenario Projection) in nominal and real terms (2023-24 prices)

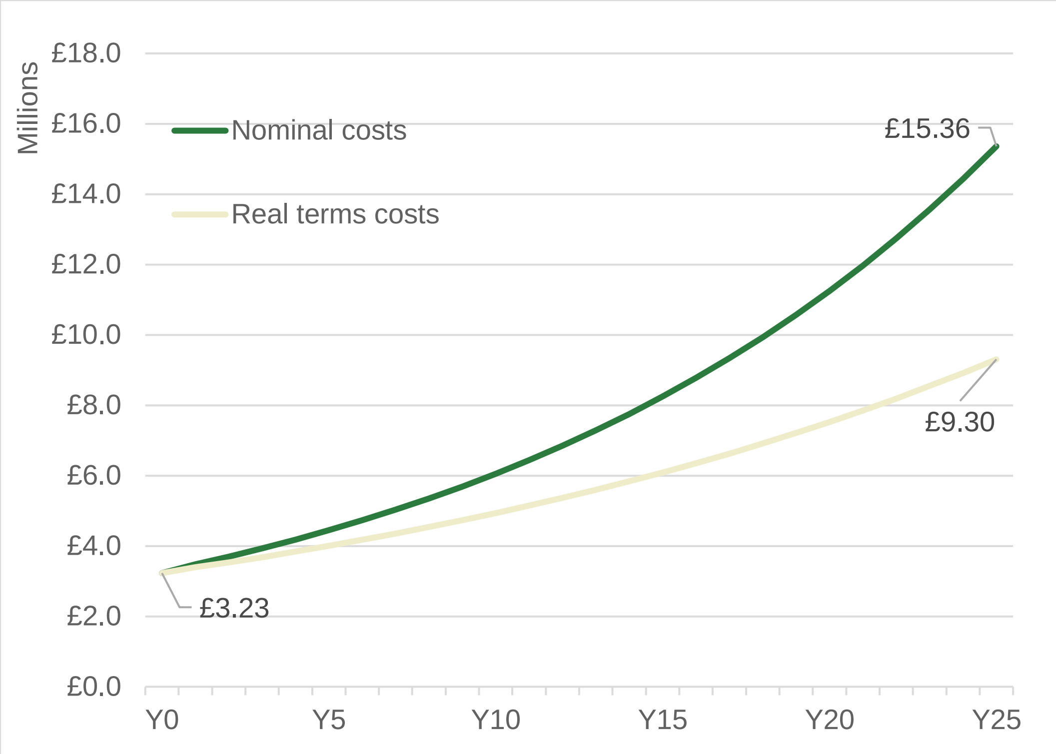
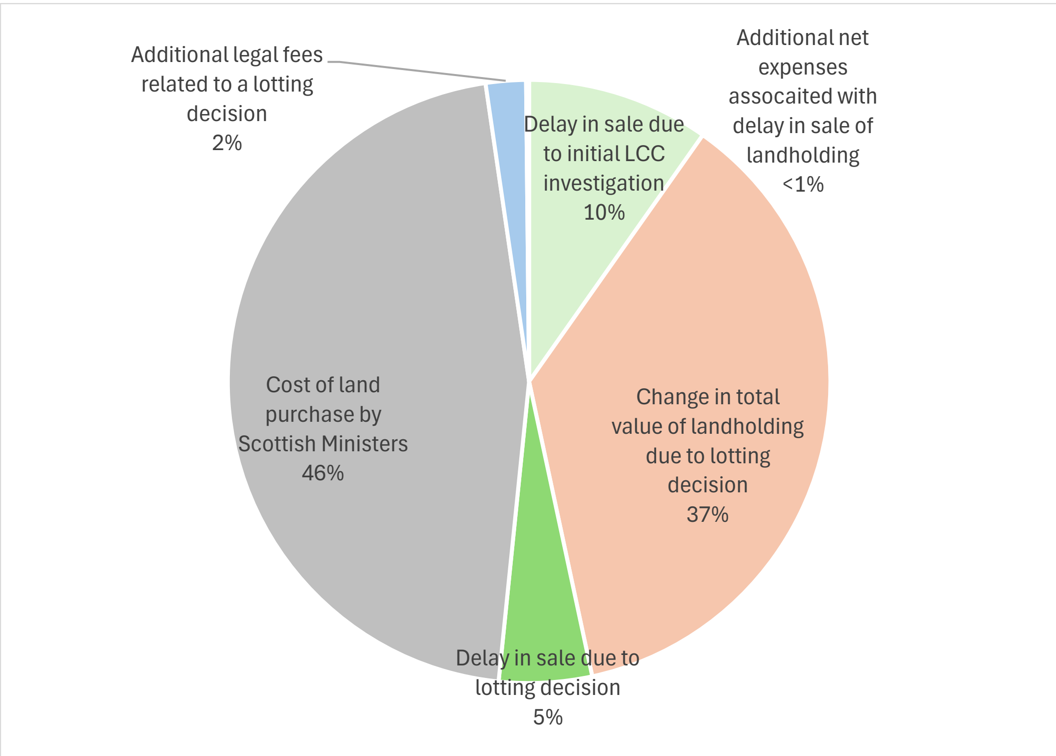


Figure 3B: Total compensation costs associated with the transfer test (High Scenario Projection), distribution of costs by origin



Low Scenario Projection

Figure 4B: Annual Compensation Costs associated with the transfer test (Low Scenario Projection) in nominal terms

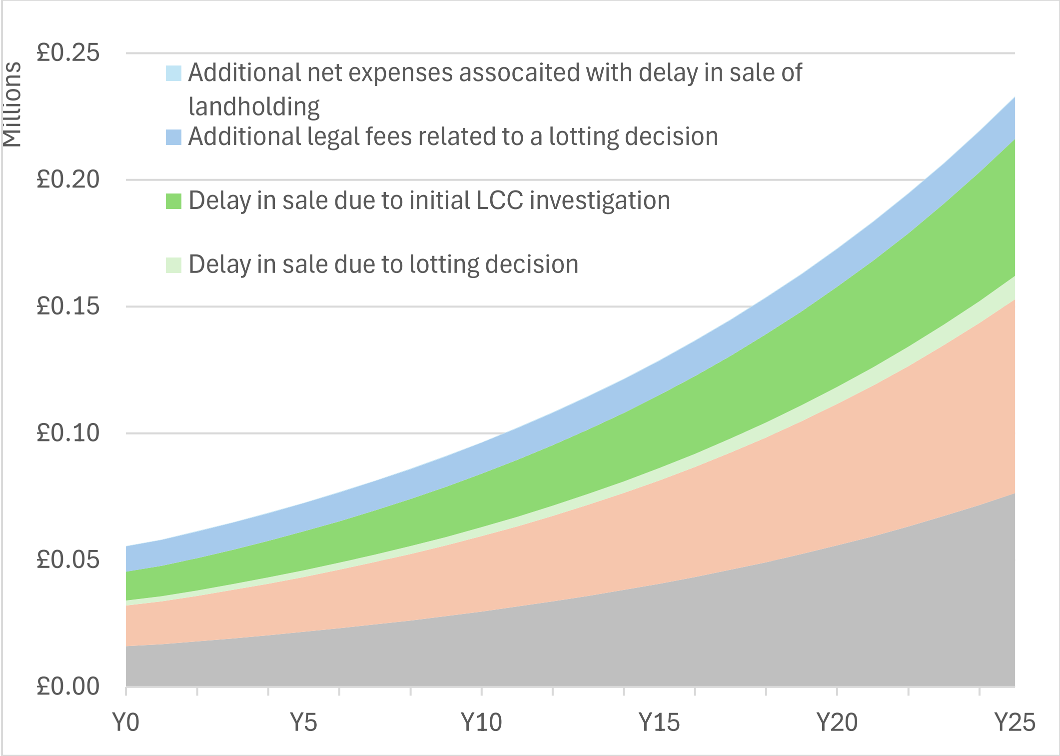
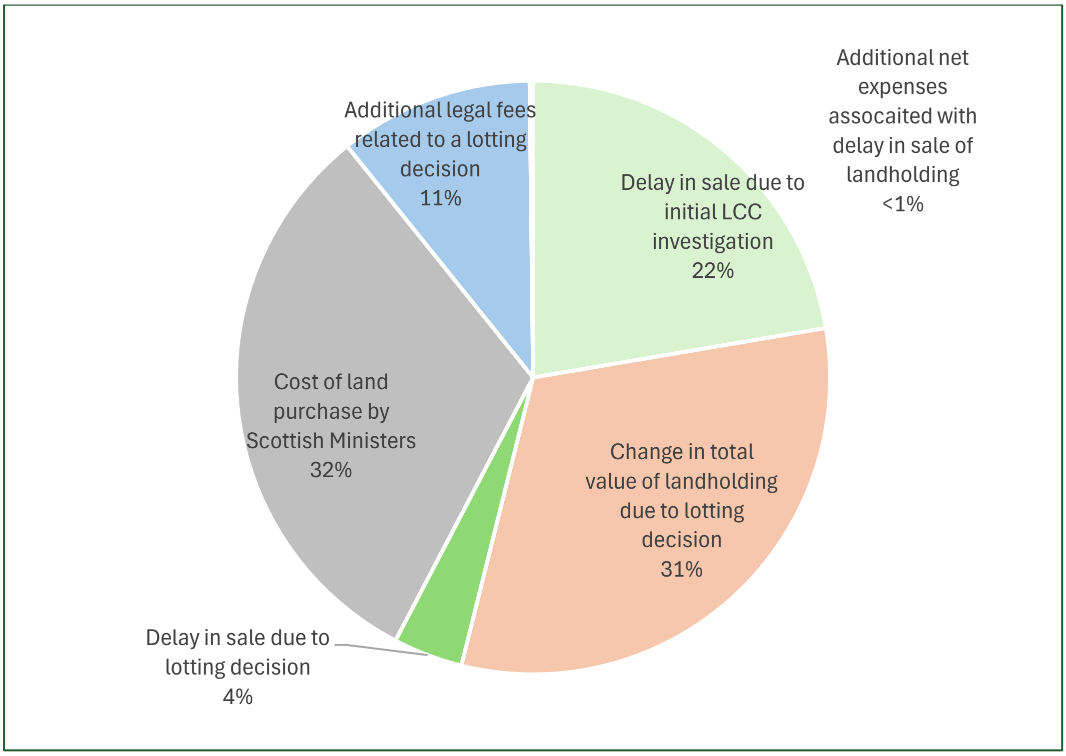


Figure 5B: Annual Compensation Costs associated with the transfer test (Low Scenario Projection) in nominal and real terms (2023-24 prices)

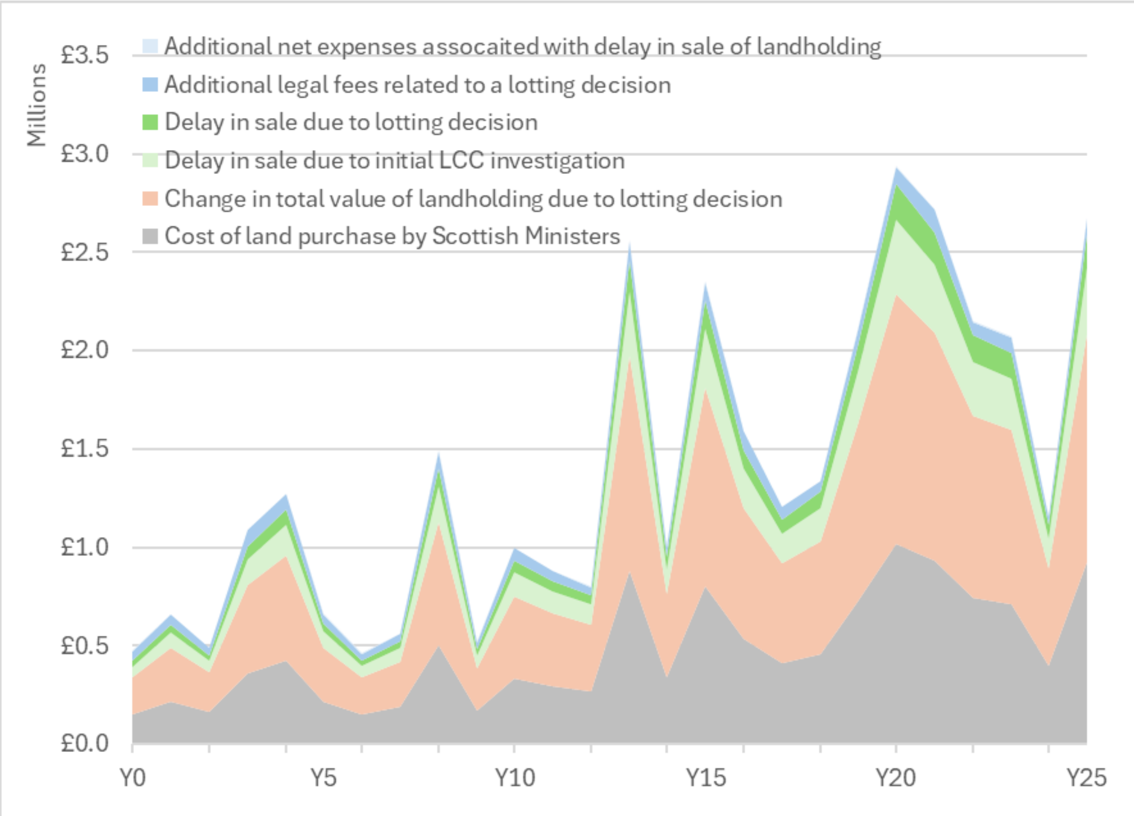
Figure 2B: Total compensation costs associated with the transfer test (Low Scenario Projection), distribution of costs by origin



8 Annex C – Applying a Pareto Distribution to Cost Projections

This annex sets out an alternative central cost projection. Using a pareto distribution of future land sale sizes and randomising the number of land transactions per year (within the bounds set out in table 3 of this report), we can present a stylised projection which captures the reality of the volatility in possible compensation costs – with larger variations from year to year.

Figure 1C - Annual Compensation Costs associated with the transfer test (Central Projection) in nominal terms



Source: Scottish Government analysis