

Aquaculture Review – Final Recommendations for Adoption

Introduction

This paper sets out the final recommendations of Crown Estate Scotland's Review of Aquaculture Leasing approved by the Board for adoption as revised lease and leasing terms.

An overview of the process and the final recommendations approved by the Board is provided below

Overview - Process

Following the approval of Crown Estate Scotland's Aquaculture Strategy in 2019, the decision was taken to conduct a 'root and branch' review of leasing to address Crown Estate Scotland's strategic priorities and offer reasonable and proportionate terms and adoption processes for its tenants' businesses.

The review covered all aquaculture sectors and aimed to explore and recommend rent and lease terms in line with the strategy themes of **sharing financial success, sustainable performance, and optimisation** (effective use of the marine resource).

Revised terms must support implementation of the Scottish Crown Estate Act 2019 specifically regarding managing assets in a way that maintains and enhances value, regenerates return and promotes sustainable development.

Following a competitive tendering process, an expert panel was appointed in October 2019 to undertake the review, comprising a consortium led by Stephen Pollock a director of Avison Young and including Rafe Staples, a director of Powis Hughes, and John Webster, a director of Webster Rae.

The process followed that of standard rent reviews which are typically conducted every five years. Recommendations proposed in the Review Report were presented to the Board for approval in February 2021 and finalised in May 2021. These recommendations will now be consulted upon with the Scottish Government and, once this is concluded, with the aquaculture industry. Industry consultation will also serve to inform the conclusions of a finalised Islands Impact Assessment.

In line with the aquaculture strategy themes, the scope of the review covered:

- (i) **Revenues** – *to recognise value*
- (ii) **Wider management/lease terms**– *for sustainable performance and development*
- (iii) **Mechanisms through which leases and licences, including option agreements, are offered to the market** - *to optimise value.*

These were considered by individual aquaculture sector (finfish, shellfish, seaweed) and it was agreed that this would recognise differences between the nature of the activity undertaken, the markets and the businesses that characterise the individual sectors.

In broad terms, outputs covered the following:

For **revenues** key questions of the degree to which the annual rents reflect market price (in light of consistently strengthening market prices for salmon over the last review period); the appropriate turnover percentage to be used; payment terms for royalty-based rents charged in arrears; and retention or not of the Outer Isles Discount (OID).¹

The expert panel dealt with this element of the review which involved consideration of industry performance, current practice in Scotland and in other producer countries, and engagement with industry.

For **lease terms** addressing sustainable performance management in accordance with our legislative mandate and role, and not overstep the distinction that must be maintained between those of the statutory authorities who regulate the industry.

This was best achieved through measures that reflect our priorities for responsible tenancy of the shared marine environment - obligations that extend a duty of care and stewardship beyond development-specific consenting conditions.

Several options that might accord with such obligations were assessed against an appraisal matrix of criteria for sustainability, socio-economics and optimisation, and the resultant recommendations appear below under the Sustainability section of this paper.

For **leasing mechanisms**, criteria used for the assessment of applications and granting of development rights include consideration of both revenue and business performance related options.

In the case of the former, the requirements of the Scottish Public Finance Manual for asset management were included, and for the latter the Crown Estate Scotland Aquaculture Strategy was a consideration. We already have published criteria for grants of lease and lease options. The review examines possible additions to these that might accord with financial and/or sustainability obligations.

Recommended measures were included in either revenue or wider management lease terms as appropriate. It should be noted that auctioning was considered as part of this review and is referenced in the Review Report.

Recommendations of the Review were presented to the Crown Estate Scotland Board in February 2021. An overview of the finalised recommendations for adoption is provided below.

¹ The OID has historically been applied to operations on Na h-Eileanan Siar, Orkney and Shetland nominally due to costs of production being different to those on mainland. This review - and previous rent reviews - have noted the lack of evidence to justify the discount and the lack of evidence to indicate that it supports production in those areas.

Final Recommendations

Rent and leasing mechanisms

Changes to rent and leasing structure reflect the growth and consolidation of the salmon industry and the status of both shellfish and seaweed sectors as nascent but with potential to deliver wider benefits.

Finfish: Salmon

1. Rent should remain dependent on the level of production on the leased subjects but move to a percentage of notional turnover rather than a set rate per kilo of harvested fish.
2. The overall charge as a proportion of turnover will be 1.5%, linked to a revision in the lease to include a tenant's option to renew for a further period of 25 years giving additional security over the leased asset.

This benchmark arises from two elements – 1% of turnover as a reflection of the historical benchmark levied for salmon plus a further 0.5% of turnover through inclusion of the option to renew.

The breakdown of the reviewed benchmark is relevant to its implementation as follows;

From 1 January 2023 until 31 December 2025, all existing and new lease agreements will have rent charged at a 1% benchmark rate.

From 1 January 2026 rent will be charged at the 1.5% benchmark rate.

3. The rent will be based on the total of the weight of harvested fish in a reporting period, referenced to the Fish Pool market price index for average Norwegian product in that period and converted from Euros to Sterling applying HMRC referenced exchange rates. This referencing will provide for accurate assessment of turnover and enable the benchmark proportion to be more consistently realised.
4. Reporting will allow invoicing half-yearly in arrears based on the average price for the period, so the reported statistics for January to June will form the basis of a rent invoice issued in August in the same year, and those reported for July to December will be invoiced in February of the following year.
5. The OID for finfish will no longer apply after 1 January 2023. ²
6. The Minimum Rent will apply when there is no harvested production over a reporting period or where the benchmark rate for production would realise a rent lower than that for no production at all. Minimum Rent replaces Vacant Rent.

² At a 1.5% benchmark rate the discount is 0.15% of whatever reporting period market price index reference is, e.g. if £5/kg it will be 0.75p/kg

The baseline Minimum Rent will rise by £500 to £1500 pa. Rather than a flat fee that does not recognise permitted biomass capacity, the rate will now apply per 500 tonne tranche of CAR Licence permitted maximum biomass (or part thereof) to reflect the productive value of individual site agreements.

So, where there has been no harvested production over a reporting period for sites with consented biomass limits of:

- < 500 tonnes – the Minimum Rent will be £1500 pa
- 500 tonnes < 1000 tonnes - the Minimum Rent will be £3000 pa
- 1000 tonnes < 1500 tonnes - the Minimum Rent will be £4500 pa
- 1500 tonnes < 2000 tonnes - the Minimum Rent will be £6000 pa, and so on.

Minimum Rent for the 6 monthly reporting periods will be at 50% of the above pa charges

To incentivise production and prevent 'land-banking', the per annum Minimum Rent will double after 4 years of no harvested production and every second year thereafter while that situation persists, as it does in current lease terms (although this will not apply to dedicated 'nursery' sites producing fish for on-growing elsewhere on an annual basis by the same tenant, which are subject to their own specific rent – see below)

7. Leased sites that are used to produce fish that are transferred and on-grown to harvest at another location, i.e. so-called 'nursery sites' that yield no harvested production but are nevertheless in productive use, will now be liable for an annual rent equivalent to three times the applicable Minimum Rent to recognise the productive value. For example, a leased site licenced by CAR for a maximum biomass of 900 tonnes and used to produce juvenile fish for on-growing at another location will be liable for rent of $3 \times £3000 = £9000$ pa
(Note: it is assumed that fish from such nursery sites will be on-grown at another site within the same producer company/business, ie. an internal transfer, and the charging regime above reflects this situation. Where fish from a nursery site are sold on to a third party they will be counted and charged as harvested production)

Finfish: Sea-grown Trout

8. Rent will be 50% of the salmon price formula. Minimum Rent and 'nursery' site rent calculations will also be 50% of that for salmon.

Finfish: All

9. Changing from rents charged annually in arrears to reviewed payment terms charged half yearly in arrears will end the more favourable cash-flow arrangements which the finfish tenants have benefited from for many years. This change will become effective between March 2023 and March 2024 when rent for reported production during 2022 will be due in March, June, September and December of 2023, and rent for reported production during 2023 will be due in September 2023 and March 2024.

Shellfish

10. The fixed equipment-based rent structure for shellfish remains in place and shellfish tariffs remain as currently set. The phasing of rents at the start of a new lease will be retained for start-up businesses but not for established operators.

We will also be open to granting small scale trial leases within Lease Option extents to enable confirmation of development prospects, as an enabling measure for more productive spending on planning fees.

11. The minimum species rents however will be increased in line with inflation (from £135 to £200 for mussels and from £115 to £175 for oysters).
12. The OID for shellfish production will be removed three years after implementation of reviewed terms and will therefore no longer apply after 1st January 2026. The impact of this recommendation will be explored through an Islands Communities Impact Assessment.

Seaweed

13. Rents for seaweed farms will mirror the equipment-based structure for shellfish. We will similarly be open to granting small scale trial leases within Lease Option extents to enable confirmation of development prospects.
14. Crown Estate Scotland recognises the nascent stage of the sector's development and want to encourage and incentivise operators. This, combined with a different type of downstream supply chain to that of shellfish and finfish production, means that there is as yet no clear and confirmed market that might yield up a price from which business value could be reliably determined. As such the rent will be that of the lowest for different shellfish species – 5.5p per metre of long-line but subject to a minimum of £135.

Lease Option Agreements (LOA)

15. A sector-specific charge will be introduced for LOA. LOAs are one-off charges.
16. For shellfish this will equal 1 x species specific minimum rent, so for Mussels - £200 and for Oysters - £175.
17. For seaweed this will equal 1 x minimum rent - £135.
18. For finfish this will be 1 x average Minimum Rent. Based on extant CAR Licence biomass limits for existing tenants, the average salmon farm biomass limit is 1320 tonnes and that for trout is 970 tonnes.

This will make the LOA charge for salmon £4500 and for trout £1500.

Sustainability

We propose introducing contractual terms to encourage sustainability. These are additional to measures and regulations enforced by other public bodies such as SEPA.

19. A reporting requirement will be included in the lease. Reporting topics may either be sector-specific or apply to all aquaculture tenants and will be reviewed periodically to ensure they remain relevant.
20. Reports will be required annually 'per tenant' and reference individual leased subjects where necessary. They will be published on the Crown Estate Scotland website to enable stakeholder transparency on tenants' performance in these matters.
21. The initial topics for reporting, which will be accompanied by appropriate guidance will be;
 - For Finfish Tenants

Participation in (collaborative) Management Agreements to mitigate cumulative impacts
 - For all Tenants

Management of plastic used on the leased area.
22. Reported performance will be used to inform assessments for applications for additional seabed interest where appropriate. For example, participation in Management Agreements by finfish tenants will be used to assess risk in granting access to areas that already have incumbents.
23. Reporting on the management of plastics will require a report on plastic usage and a separate signed annual declaration of the equipment deployed (rather than simply consented) on each leased site and attestation that it remains properly installed and maintained ('the Declaration'). This will be subject to periodic audit and where the Declaration either fails to be submitted or is found to misrepresent equipment in poor order, a restoration bond/security will be due.
24. Revised lease terms will now require such a restoration bond/security to cover decommissioning costs in the event of business default, but this requirement will be placed in abeyance annually on receipt of the signed Declaration.