Island Communities Impact Assessment: Proposed Removal of the Outer Isles Discount

1. INTRODUCTION

The 2018 Islands (Scotland) Act introduced a requirement for Scottish public authorities to undertake an Island Communities Impact Assessment ('ICIA' or 'the Assessment') to determine the impacts that policies, strategies or services might have on island communities in Scotland.

Crown Estate Scotland is currently undertaking a review of its rental levels and other terms associated with seabed leases for finfish and shellfish farming. Commissioned in 2019 and led by an appointed panel of independent experts, the review covered all aquaculture business sectors. Finalised recommendations proposed for adoption were agreed by the Crown Estate Scotland Board in June 2021. Engagement on the proposals was undertaken with Scottish Government in the summer and subsequently with industry.

At present, there is a 10% discount applied to rents for lease agreements in the outer isles. The discount is referred to as the Outer Isles Discount (OID).[1] The focus of this assessment is the proposed removal of the OID to create a standard fee structure across Scotland with parity of charges, and the impact this could have on island communities in Scotland. The structure of the assessment broadly follows the template included in Scottish Government's Island Communities Impact Assessments: Guidance and Toolkit[2].

2. OBJECTIVES

The OID has been in place for over 20 years, a significant proportion of the time that the Scottish aquaculture industry has been operating. It was introduced to offset additional costs associated with production and route to market at that time. The basis for the proposed removal is that both farmed finfish and farmed shellfish industries have changed significantly since the OID was introduced, particularly the finfish industry. Relative costs of production and sales are now far more nuanced against a range of factors of which geography is only one. In addition, the geography-related challenges that do remain are not unique to the outer isles and a simple geographic discount for outer isles tenants only is no longer considered equitable.

The review recommends the removal of the OID to bring rent for seabed leases for aquaculture in the outer isles into line with those for seabed leases on the mainland and other islands where the discount does not apply such as those of the Inner Hebrides and Clyde.

[1] The outer isles are defined as Shetland Islands, Orkney Islands and Na h-Eileanan Siar.
[2] https://www.gov.scot/publications/island-communities-impact-assessments-guidance-toolkit/documents/

3. STAKEHOLDERS

We have identified finfish and shellfish farming tenants as the key stakeholders in the context of the proposed OID removal. More detail about tenants and data to inform the assessment is set out below:

- Data relating to finfish farming tenants operating seabed leases in the outer isles and their production from these leases
- Wider operating and production data relating to finfish farming tenants who operate on the outer isles as well as the mainland and other islands not subject to the OID
- Price forecasting information from the price reference index that will be used to calculate rents when reviewed terms are implemented (Fish Pool Index)
- Data relating to shellfish farming tenants in the outer isles and the equipment-based rents associated with their seabed leases

There are no differences between the data available from different islands to inform our decision making. The data described above relating to tenants and production is collected by Crown Estate Scotland and a standard approach is taken in terms of gathering data across all regions of Scotland. All seabed leases within finfish and shellfish sectors have standard terms that apply to those sectors, irrespective of location with the exception of the OID that applies in the Outer Isles.

4. CONSULTATION

Early engagement with Scottish Government, starting in December 2020, regarding the scope of the Assessment indicated it should be limited to the removal of the OID, given that its removal was the only aspect of the review of lease terms that could impact island communities (albeit only the outer isles) differently from those elsewhere on the mainland and other islands.

As the direct impacts of the removal of the OID would be limited to finfish and shellfish tenants, the consultation was focussed on finfish and shellfish tenants with seabed leases in the outer isles.

The consultation was undertaken through specific questions posed in a document entitled 'Aquaculture Review - Island Communities Impact Assessment' that set out the case for removal of the OID. This was circulated by e-mail to all relevant tenants along with copies of the review recommendations and the review report itself.

Tenants were asked to complete a survey (online and / or by email). Online responses could be submitted confidentially.

Tenants were asked to respond within four weeks.

The questions posed were as follows:

1. Does your business currently benefit from the OID?
   If yes, will the removal of the OID have a significant and negative effect on your business? If yes, please explain.

2. Do you agree with the rationale for the removal of the OID?
   If no, please explain.

3. Do you consider the removal of the OID will impact significantly on the prospects for aquaculture development and investment in Shetland, Orkney and/or the Outer Hebrides? If yes, please explain.

4. Do you consider the removal of the OID will impact significantly on the economy of Shetland, Orkney and/or the Outer Hebrides? If yes, please explain.

5. Do you have any further comments?

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Out of six finfish tenants and 40 shellfish tenants with leases in the Outer Isles, 10 individual sources responded (with two responding via email and online survey). Six written submissions (three from finfish tenants, one from a shellfish tenant, one from the salmon sector trade body and one from the Shetland seafood trade body that includes aquaculture) and six online responses were received.

All written responses and at least 5 out of the 6 online responses were from tenants in Shetland and Orkney. With the exception of one online response that did not foresee any issue with its removal, the responses were all against removal of the OID, citing that doing so would impact significantly both on prospects for aquaculture development and the economy in the Outer Isles.

6. ASSESSMENT

The purpose of the assessment is to determine whether the policy, strategy or service (i.e. fees related to finfish and shellfish seabed leases being standardised across Scotland) is likely to have an effect on an island community which is significantly different from its effect on other communities (including other island communities).

Below, we have set out the context for the assessment, the consultation findings and our assessment of the likely effect of the removal of the OID.

The focus of the assessment is determining whether the removal of the OID will result in effects that could significantly impact finfish and shellfish tenants in the outer isles which could then result in effects on the communities in which they operate.

We have considered it reasonable to assume therefore that if the tenant’s businesses themselves are unlikely to experience significant effects, there will be no consequent impacts on the island communities.

6.1 Consultation Responses

Responses to the consultation questions generally referred to higher costs associated with operating a business in the outer isles, and noted continued reliance on ferries for certain aspects of the business. However, there was little clear evidence provided by respondents on how the rental increase represented by removal of the OID would specifically impact business operations to any significant degree, over and above the generally higher costs experienced in the outer isles anyway.

One shellfish response and one trade body argued for parity of charges between mainland/inner isles and the outer isles (the aim of the proposed removal of the OID), albeit seeking a rent reduction for the former rather than an increase for the latter through the removal of the OID). This reflects an understandable opposition to an increase in rent but argues against differentiating rent between the outer isles and the mainland/other islands.

The essence of the argument for the removal of the OID is that it is no longer equitable as a simple limited geographic discount, either in relation to logistical challenges and associated costs faced by tenants in the outer isles compared to those in remoter parts of the mainland and/or inner Hebrides, or in relation to the comparative advantages or disadvantages conferred on individual tenants to mitigate the generally higher cost burden of island-based production by their particular business circumstances and resources.

A more detailed argument to support the absence of any significant impacts of this removal in the context of the finfish and shellfish sectors is presented below.

6.2 Finfish Context – prognosis at review implementation in 2023

The following summary of anticipated finfish operations on the outer isles in 2023 is based on production levels as reported for 2020 in conjunction with the Fish Pool Index (‘FPI’) market price forecast for 2023 (as at the end of November 2021, with the SSF purchase of Grieg Seafood assumed approved and completed):

- With one exception, the tenant companies farming on the outer isles are multinationals based in Norway, Canada or the Faroe Islands.
- The breakdown of finfish tenants farming across the mainland/inner isles and the outer isles is predicted to be the same as now in January 2023 (anticipating the SSF purchase of Grieg Seafood completed):
    - Total finfish tenants – 9
    - Tenants farming on both mainland (and inner isles) and outer isles – 4
    - Tenants farming on mainland (and inner isles) only – 4
    - Tenants farming on outer isles only – 1
    - Total finfish leases – 268
    - Outer Isles finfish leases – 153 (57% of total)
- Using reported 2020 production levels, the spread between mainland/inner isles and the outer isles is as follows:
    - Outer Isles production was 55% of total Scottish finfish production (the 5-year average is 50%)
    - For tenants producing solely in the outer isles (one), their production was
        - 16% of total Scottish production and
        - 29% of total Outer Isles production
    - For tenants producing on the mainland (and inner isles) and outer isles:
        - their total production was 81% of Scottish volumes, and
        - their outer isles production was
            - 39% of Scottish production
            - 49% of their own total production (mainland + outer isles) and

        - 71% of total outer isles production
    - For tenants producing only on the mainland and inner isles, their production was 3% of Scottish volumes

The data shows a balanced spread across the mainland and inner isles, and the outer isles for both leases and production volumes.

Most production is by tenants with operations across different areas of Scotland, with over 80% of reported Scottish volumes in 2020 coming from tenants who operate in both mainland/inner isles and outer isles locations.

We estimate that the direct financial implications of the removal of the OID will be as follows:

1. 80% of tenants will experience an increase in their costs of less than 0.1% as a percentage of the production-based turnover for the whole business, with the average projected increase in costs for tenants farming in both locations (i.e. mainland/inner isles and outer isles) amounting to 0.05% of whole business production turnover.
2. The projected average increase in costs across all outer isles tenants is 0.06% of whole business production turnover, which in monetary terms projected on 2023 price forecasts constitutes an increase of £0.45m out of a total turnover for the finfish industry in the outer isles alone of £781 million.
3. The sole tenant operating in the outer isles only, will experience an increase in costs of 0.1% of whole business production turnover which constitutes £0.13m in a total business production turnover of £127.8 million

The significance of these implications should be viewed in the current industry context:

- The finfish industry is highly consolidated and well-resourced. Only one tenant operating in the outer isles has a projected 2023 turnover under £100 million (it is in fact circa £30 million). The other four tenants with seabed leases in the outer isles are multi-national companies with projected 2023 production turnover ranging from £127 million to over £260 million.

- The industry is trading in a mature global market that exhibits a consistent 4% to 6% growth year on year. Output has grown by 18% in the past five years and is anticipated to increase again to a record level in 2021. Demand and prices have largely recovered from the effects of the pandemic - finfish were less affected than other aquaculture sectors as it has a strong retail element to its market. Demand for additional capacity is evident and has not been slowed to any significant extent by either Covid or Brexit with 14 new applications for option agreements submitted to Crown Estate Scotland in the past 12 months.

- Postponing OID removal until January 2023 is designed to help give operators time to manage the change.

- The relatively homogenous geographic spread of seabed leases and production volumes for the majority of tenants responsible for over 80% of Scottish volumes indicates that the nature of the finfish industry in Scotland, most notably the farmed salmon sector that constitutes 98% of finfish volume, is such that despite some costs for operators in the outer isles generally being acknowledged as higher than those experienced by mainland operators, cost factors associated with geographic location are nevertheless far less significant than others relating to development prospects and investment opportunity.

- Key locational drivers include the availability of suitable environmental and operational/logistical conditions for developments at or above the minimum optimal scale weighed alongside other considerations, e.g. local authority aquaculture policies; presence/absence of environmental and other marine user/stakeholder conflicts; and local attitudes to aquaculture developments.

- Opportunities to reduce production costs through shared resource with adjacent established farms are likely to be more profitable in the more contained geography of the outer isles than mainland and inner isles.

In the context of the wider review, finfish rents were last reviewed in 20XX, since which time the finfish sector has grown and developed significantly. The independent review concluded that a rent increase was appropriate for all finfish tenants. Therefore, a rental of 1% of production turnover benchmark rate (‘benchmark’) will be introduced in 2023. This will mean a circa 78% increase in rents based on the forecast 2023 market FPI price, when compared to the current fixed production tariff that by comparison represents a 0.56% of production turnover benchmark. The wider review has concluded this is a reasonable increase which fairly reflects the current business and financial circumstances of our finfish tenants.

The removal of the OID is therefore considered highly unlikely to be significant when placed against industry circumstances and its economic drivers for development and investment.

This is borne out by the circumstances of the single outer isles only finfish tenant. These have arisen as a result of an acquisition, by a foreign owned multinational, of outer isles leases divested for competition reasons in a much larger industry merger some years ago. The decision to invest and purchase (in a competitive bid) for these sites despite their outer isles locations and evident associated cost considerations, supports the premise that other more beneficial factors were overriding. This quite possibly includes the attraction of Scottish production opportunity itself, irrespective of local geography.

Lastly it is evident that any impact on tenants’ businesses will not be the same for all finfish tenants who operate in the outer isles. Amelioration for some will be down to whether they have mainland operations or not, whether ferries are subject to Road Equivalent Tariff (Outer Hebrides) or not (Northern Isles) and the scale and associated infrastructure with respect to vessels, location of processing and other facilities such as feed plants, and other resources.

As a consequence, it is reasonable to anticipate that factors that now contribute to development opportunity and investment in finfish farming in the outer isles outweigh simple geographically associated cost implications. Therefore, it is anticipated that removal of the OID is unlikely to change either current operational or development spending by finfish tenants here, nor diminish investment appetite. This is all the more the case given the scale and resources of the businesses involved and in the context of the wider rent revisions for industry as a whole as a result of the review.

6.3 Shellfish Context

The distribution and nature of bivalve shellfish production in Scotland is far more distinct for mainland and other islands in comparison with the outer isles, with tenants being located in either (one of) the outer isles, or the mainland and inner isles but not both.

Very latterly we have seen one larger Shetland-based tenant acquire interests in another of the outer isles and explore opportunities on the mainland, but this is not typical.

The number of shellfish leases and tenants change year-to-year and some finfish producers hold one or two shellfish leases too. As of December 2021, the breakdown of shellfish tenants is:

- Outer Isles – 40 (Shetland 27, Outer Hebrides 11, and Orkney 2)
- Mainland/Inner Isles - 44

Shellfish leases held by finfish producers are generally used by contracted shellfish operators who are tenants of their own leases too.

The shellfish industry remains fairly static in terms of both output and lease numbers, but this industry-wide overview shields more localised dynamics that has seen Shetland come to dominate mussel farming in Scotland to the extent that it now has over 75% of national production. We are now seeing the emergence of some larger companies there as a result of organic growth, acquisitions, and some contract operation of third party leases.

The wider industry stasis is acknowledged in the wider review by the recommendation that shellfish rents should remain unchanged, which reflects the approach in previous reviews. As a result, the farmed shellfish industry in Scotland has not had an increase in rents since 2005, and indeed was subject to a reduction in 2010.

Our data on shellfish rent roll indicates a gradual consolidation of shellfish production in the outer isles in terms of both the proportion of agreements and, as a consequence, rent. This is dominated by Shetland that while having only just under 30% of tenants, still has over 50% of lease agreements. The fact that this produces nearly 80% of Scottish farmed mussels also demonstrates the degree to which leased sites are either more fully utilised here and / or of a more viable scale.

By comparison, the Outer Hebrides have 13% of both tenants and lease agreements and Orkney 2% and 1% respectively

The predominance of Shetland for mussel farming is a result of a number of factors including the release of sites when the salmon industry underwent challenging times some years ago and many finfish leases were changed to shellfish; good growing conditions compared to many inshore mainland locations; and recognition by authorities and communities of a local economy that is dependent on fishing and aquaculture and therefore are arguably more encouraging of farm development proposals than is the case on the mainland and inner isles .

This recognition and approach are not wholly dissimilar in Orkney and the Outer Hebrides, albeit development appetite here is less and more reflective possibly of mainland and inner isle's locations.

It is reasonable to conclude that despite generally higher costs associated with outer isles (or any island), these have not limited development of the shellfish sector in the outer isles where other criteria clearly create circumstances that favour the industry. This is most evident for Shetland where arguably it offers far more beneficial development opportunities than are available in either Orkney or the Outer Hebrides.

The relative prosperity/resilience of the shellfish sector in Shetland has also persisted when the OID was reduced from 20% to 10% of rents charged since 2010.

It may be said therefore that the OID is no longer a significant factor in investment decisions compared to the role of more influential factors governing the location of farm developments, and it is the presence of these other factors alongside development appetite that contributes to the relative distribution of the sectors' current operators and production. This is valid for comparisons between the mainland and other islands vs outer isles and between the islands of the outer isles themselves.

Lastly and perhaps most significantly for the purposes of this assessment, the importance of the impacts of removing the OID must also be viewed in terms of direct financial implications. The total rent roll for all outer isles tenants is just over £49,000 which means the discounted sum to be reinstated when the OID is removed in four years' time amounts to just under £5,500 across all of the Outer Isles lease agreements. This equates to an average per tenant of £136.45 per annum or per lease agreement of £30.32 per annum.

The conclusion is that shellfish business opportunity and prosperity is not significantly influenced by a simple island/mainland distinction that justifies the OID. In addition, its removal will result in an insignificant increase in costs to the businesses involved.

It should also be noted that no tenant likes to see the rent going up, even if the increase is to create an equitable approach to use of a shared resource (the seabed) with other shellfish tenants on the mainland and other islands.

The wider review is recommending that shellfish rents are unchanged (the third review in a row to make such a recommendation) and they will therefore remain at or below levels in 2006. In addition, the removal of the OID for shellfish tenants is proposed for 2026 which provides tenants with four years to prepare for this. As a result, it is concluded that for shellfish tenants, the removal of the OID is unlikely to be significant for the outer isles tenants and consequently unlikely to have any significant 'downstream' impacts for outer isles communities.

In considering the sums involved for the shellfish sector, these may also be viewed in the context of the historical and on-going enabling work commissioned by Crown Estate Scotland to further the development and performance of shellfish farming in Scotland.

In 2021 this includes a recently concluded 'Investigation into Alternative Markets for Farmed Scottish Shellfish' (https://www.crownestatescotland.com/resources/documents/alternative-markets-for-farmed-scottish-shellfish-and-associated-requirements) and a recently commissioned 'Blue Economy Plan for Shellfish' that will draw on the above study and previous CES projects to provide insights and recommendations for the sector's contribution to Scotland's blue economy.

7. CONCLUSION

The above assessment has indicated that the removal of the OID for aquaculture tenancies in the Outer Isles will not have a likely effect on an island community which is significantly different from its effects on other communities as follows:

- The nature, scale and financial status of the finfish sector can accommodate the very minor percentage of turnover the OID represents; and
- The actual sums involved for shellfish farmers are low relative to the turnover of the business and other operational costs (and are similar to the increases when the OID was reduced by the same amount 10 years ago that not appear to affect the growth and prosperity of the sector in the outer isles at that time, most clearly in Shetland).
- The removal of the OID is not a measure that will result in tenants in the outer isles paying more than those operating on the mainland or other islands, but one that means simply that they will pay the same i.e. it will enable parity across Scotland. Non-outer isles island

tenants as well as some mainland tenants may also encounter similar logistical challenges and costs to those of outer isle tenants and are already subject to rent that is not discounted. This measure simply brings the terms of business for leases in the outer isles into alignment with those already prevailing here.

- As with all CES coastal net revenues, any increase in net revenues from this measure will be passed back to local authorities to support local coastal community development projects. This measure is not therefore assessed to have any wider negative impacts on island communities.

It is not proposed to vary the approach across different communities. The principle behind implementation of the measure is the standardisation of terms of business across all tenants and all locations. Simple geographic distinctions relating to only some islands are no longer equitable in addressing the many, varied, and evolving influences on tenants' businesses and wider industry development prospects across both the mainland and the islands.

Outcomes will be identified and monitored through normal business monitoring and management of seabed leasing for finfish and shellfish, and applications related to further development opportunities.

Given the conclusion that the removal of the OID is not likely to have an effect on an island community which is significantly different from its effect on other communities, in line with Scottish Government guidance, no full ICIA (i.e. Step 5 in the guidance) is proposed.

The ICIA will be published on our website and made available in an easy read format on request.

ICIA completed by: Alex Adrian
Position: Aquaculture Operations Manager
Signature:

Date completed: 17 December 2021

ICIA approved by: Simon Hodge
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Date approved:..20/01/2022