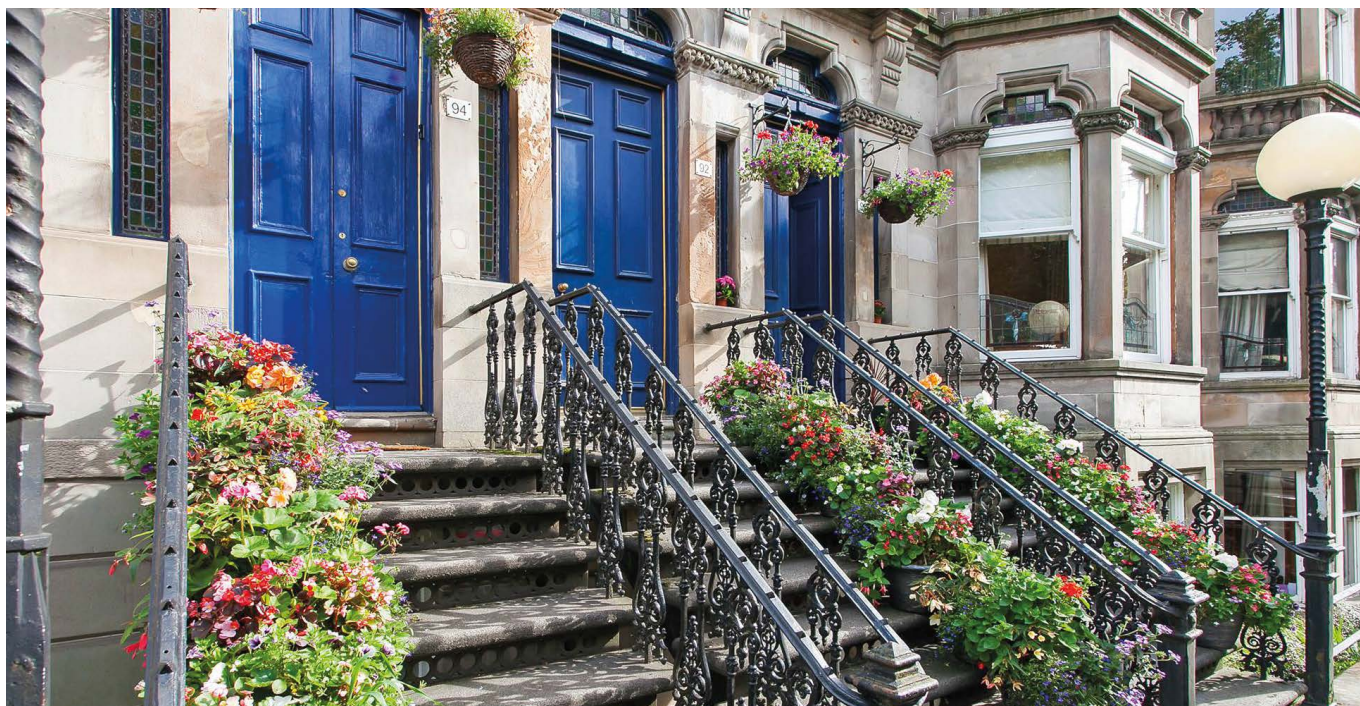


NOVEMBER 2022

Scottish residential rentals – a frozen market





INTRODUCTION

The perception of an overheated rental market, which is partly contributing to a cost-of-living crisis, has moved the Scottish Government to attempt to freeze the market for 6 months.

The rent freeze for all private sector and social sector residential rents, announced on 6 September 2022, will last until the end of March 2023, with the possibility of an extension beyond this date. A ban on evictions is also running alongside the rent freeze.

We have summarised the key aspects in this Market Briefing.



The Rent Freeze is a reality that all those working in the rented sector in Scotland will have to deal with over the next six months at least. Although it may help tenants in managing their income and costs, it will likely place pressure on landlords, who are not immune to the cost of living crisis.

Dr. John Boyle, Director of Research & Strategy

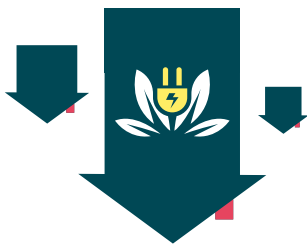
KEY FINDINGS



1. About the bill

The Cost of Living (Tenant Protection) Bill came into effect on 28th October 2022 and will run until **end March 2023** (although this could be extended by a year).

It sets a temporary power to **cap rents** with tenancies. The initial cap is set at 0%.



2. Potential consequences

Probably limited impact if legislation lasts just 6 months, but **more significant** if extended.

Will **affect new housing development** – affordable and Build to Rent (BTR).

Will affect **NetZero commitments** and **energy efficiency drive** across all rental sectors.



3. Challenging conceptions

Danger of policy being made on the basis of **sectoral misconceptions**, with a **lack of data** to examine what is happening in the Private Rental Sector (PRS) in particular.

Rents within existing tenancies seem to have been **largely stable** prior to the rent freeze. By contrast, **new tenancies** (which are not subject to a rent freeze) are experiencing above average rent increases in major cities.

Scottish Government survey evidence suggests rents are **generally affordable** in private and social rented sectors, although a significant proportion of households is struggling financially.

Private Rented Sector (PRS) landlord income returns are **generally modest**, especially in comparison to those in the commercial sector.

KEY FINDINGS EXPLORED

1. About the bill



BACKGROUND

The Scottish Government was already committed to introducing a national system of rent controls by 2025 and has been consulting widely on this, with the aim of achieving a broad political consensus through the Cross Party Group on Housing at Holyrood (which Rettie & Co. is represented on). Details of this Group's latest report can be found [here](#).

Proposals to introduce a 2-year rent freeze were advocated by the Scottish Labour Party but voted down by the Government and its Green MSP partners. However, the Government has now introduced a rent freeze of its own as a 'humanitarian measure.' This emergency legislation was passed a few weeks after the initial (surprise) announcement.

Full details of the relevant legislation can be found [here](#).

KEY ASPECTS OF THE LEGISLATION



What does the Bill apply to?

It applies to residential tenancies in Scotland, private and public, including Build to Rent (BTR) and Purpose Built Student Accommodation (PBSA).

What are the terms of the rent freeze?

Rents aren't currently permitted to rise during the period of the freeze up to the end of March 2023. However, the Government has the ability to change the permitted rate of increase (rent cap). PBSA provisions are slightly different in that the cap only applies from when the legislation comes into force and only impacts on aspects of the charges applied.

Are all rents affected?

The Bill only applies to increases in rent (within tenancies) from 6 September 2022. It does not affect rents at the start of tenancies or rent increase notices if they were served before 6th September 2022.

What if landlords are running into financial difficulty as a result of the freeze and increased running costs?

Landlords can apply to a rent officer for a rent increase to cover up to half of the increase in prescribed property costs, including mortgage interest; insurance premiums (other than general building and contents insurance); and a service charge paid for by the landlord and for which the tenant is liable in terms of the lease. The maximum increase that can be claimed is up to 50%, capped at 3% of the passing rent.

How long is the rent freeze to last?

It's intended to last until the end of March 2023, but Scottish Ministers have the power to extend this to 30 September 2023 and 31 March 2024. However, the Government must review the provisions to assess whether they remain necessary and proportionate, having regard to the cost of living, and report every 3 months on that review. Ministers also have the ability to end the rent freeze earlier.

Are there any exemptions to the ban on evictions?

The Bill prevents the enforcement of eviction orders for a maximum period of 6 months. Landlords can still serve a notice of proceedings or a notice to leave and raise eviction proceedings in the Sheriff Court or First Tier Tribunal. For private residential tenancies, exemptions to the moratorium include where the property is to be sold by a lender (e.g. after being repossessed); where the tenant has engaged in criminal or anti-social behaviour; where a private landlord needs to sell or live in the property due to financial hardship; and where substantial rent arrears have been built-up (i.e. around 6 months' rent in the private rented sector and £2,250 in the social rented sector). Student tenancies are treated differently, with the only exception on the grounds of the student engaging in criminal or anti-social behaviour.

KEY FINDINGS EXPLORED

2. Potential consequences



There is a pipeline of new rented private accommodation estimated to be £3.5bn earmarked for Scotland... We fear this legislation will now undermine the likelihood of many of these complex and capital-intensive projects actually being delivered any time soon.

David Melhuish, Director, Scottish Property Federation

While there will be clear consequences of this policy, some tenant and consumer groups have welcomed the announcement. Living Rent called the legislation, "a massive relief." Shelter Scotland also broadly welcomed it.

In the **social rented sector**, rents will effectively be frozen until April anyway, so a freeze to March should not make any difference. The possibility of extending a rent freeze into next year, however, has been flagged by the [Scottish Federation of Housing Associations \(SFHA\)](#) as a [threat to affordable housing provision](#) across Scotland as well as the sector's net zero commitments.

In the **private rental sector (PRS)**, housing providers (from small-scale landlords to large institutional investors) have also expressed strong concerns. [The Scottish Property Federation \(SPF\)](#) believes that the freeze could [compromise the ability to deliver Build to Rent housing](#) (delivered by institutional investors) and stall existing schemes.

There has already been some fallout in the aftermath of the rent freeze announcement, with [Springfield](#) stating that it has [paused its expansion into BTR](#) and the entrepreneur, Lord Willie Haughey, halting his [plans to build 11,000 affordable homes for rent across Scotland](#).



Over half of social tenants are entitled to have their rents covered by welfare benefits, so a rent freeze will not affect their actual income but will mean housing associations have to cut back on service provision.

Aaron Hill, Director of Policy and Membership, Scottish Federation of Housing Associations

KEY FINDINGS EXPLORED

3. Challenging conceptions



Scottish Government policy on the rental sector seems now to be driven by tenant groups, such as Living Rent, and Green Party politicians who have previously been vocal about supporting the aims of Living Rent.

Many conceptions of the rental sector are often used to justify policies like rent freezes and controls, and we explore some of these below. It's important in policymaking to have a proper and objective look at the evidence and attempt to fill the evidential gaps before embarking on extensive legislative change, otherwise there are dangers of significant interventions not just failing to address the problems they are targeting but making matters worse.

A. RENTS ARE RISING RAPIDLY AND EXCESSIVELY



The statistics also show that landlords will stop at nothing to milk profit out of people desperate for a roof over their head.

Living Rent spokesperson

- One of the major problems in analysing the PRS in Scotland, or the wider UK, is the paucity of data on the sector. This includes on actual rents paid within tenancies. It's clear from data from the main portals, such as [Citylets](#), that rents have been rising ahead of inflation in the main cities over the last 5-10 years. This is also picked-up in the [Scottish Government's analysis of Broad Rental Market Areas in Scotland](#). However, these sources consider **advertised** rents and such rents make-up a small proportion of the total stock in any given year (probably only **around 10-15%** on an individual portal).
- [The Office for National Statistics](#) (ONS) does attempt to measure actual rents in Scotland and their latest data shows rent inflation was **only 3.9%** last year and that annual rises in the last decade have been **below** inflation. However, their results do not drill down into city areas where advertised rents are rising fastest.
- The recent study for the [Nationwide Foundation \(Rent Better\)](#) highlighted that the majority of tenants (59%) said that their rent had not changed since they moved into the property.
- Tenants can also challenge what are deemed to be unfair rent increases.

This can be done by referring a landlord's notice of a rent increase to Rent Service Scotland (RSS), a Scottish Government body. [Recent statistics published by RSS](#) show that, if an increase is deemed to be unfair, the system has limited the increase or denied it altogether.

59%
of tenants have not had a rent increase since they moved in

Source: [Nationwide Foundation \(Rent Better\)](#)

KEY FINDINGS EXPLORED

3. Challenging conceptions *continued*



B. RENTS ARE UNAFFORDABLE



It is unacceptable that tenants struggling with the cost of living should be facing a rent rise next year when they can barely afford to pay this year's increase.

Scottish Tenants Organisation spokesperson in Property Industry Eye, 24th October 2022.

- The most recent results from the Scottish Household Survey (SHS, 2019) shows that PRS households tend to manage slightly less well financially compared with households generally, with 45% stating that they are managing well compared with 56% of all households, although there has been an improvement among private renters managing well financially compared to a decade ago (37% in 2009-2010). Only **14%** of PRS tenants said that they are not managing well financially, which is slightly higher than the total population of households (9%).
- Affordability issues are more acute in the social rented sector, where only 28% of the sample

said that they are managing well financially and 21% said they are not managing well. However, even here, among people on the lowest incomes, only **around one in five** seem to be struggling financially, albeit this survey was conducted pre-pandemic and well before the current cost of living crisis.

- The consultation paper on the [New Deal for Tenants](#) suggested that, nationally over the period 2017-20, PRS households in the lowest income quintile were paying an average of almost half of their household income on housing costs, with the equivalent figure for social rented households in the lowest income quintile at 38%. It does appear that people on lower

incomes are more likely to be paying a higher proportion of their income on rent and having financial difficulties as a result. Freezes in Local Housing Allowance (LA) in recent years, reducing housing benefits, will likely have contributed to this hardship.

14%
of PRS tenants report they are not managing well financially

Source: [Scottish Household Survey](#)

KEY FINDINGS EXPLORED

3. Challenging conceptions *continued*

C. LANDLORDS MAKE PLENTY OF MONEY AND CAN AFFORD A RENT FREEZE



It is part of our journey set out in the Bute House agreement to make rents less about maximising profit out of homes and more about affordability, quality and tenants' voices.

Ariane Burgess MSP in Stage 1 debate on Cost of Living (Tenant Protection Scotland) Bill

- Private landlords typically invest in the sector for an income. The rental yield measures the return on investment from the rental income of a property and is calculated as a percentage relative to the property's value. The average gross rental yield across the UK is under 4%. This represents a modest but usually steady return. Institutional investors are also typically buying in Scotland, with a yield expectation of around 4%. This is **lower than expected**

returns in commercial investment, which are normally around 5-6%.

- Landlords can also benefit from increasing capital values. As data from the long running Nationwide house price series shows, house prices do tend to rise in real terms over time and landlords who bought at the end of the 1990s certainly have made a significant return. However, landlords who bought at the market peak in 2007 will still, on average, be

down in real terms today in terms of capital values. Buying property as an investment is a risk and values may go up as well as down. What investors should be focused on is ensuring that they are generating a reasonable positive net yield.

<4%

average gross rental yield across the UK

D. RENT CONTROLS WORK AROUND THE WORLD AND SCOTLAND WILL BE NO DIFFERENT



Rent controls operate successfully in Sweden, France, Germany and Ireland and we will work with the Scottish Government to get the policy right so that we can keep rents at fair and affordable rates for residents.

Adam McVey, SNP Leader on City of Edinburgh Council Quoted in Edinburgh Live, 15 April 2022

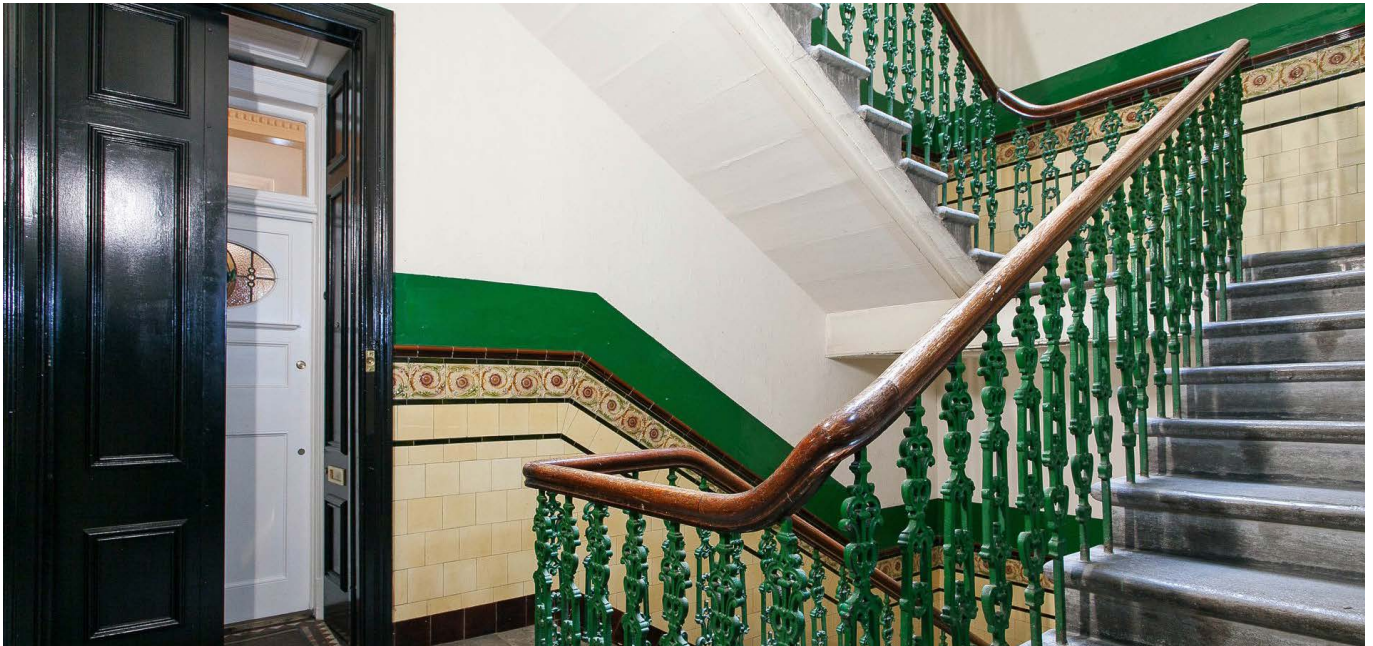
- There is an extensive history of rent control in the UK as well as other parts of the world. This recent paper by the UK Collaborative Centre for Housing Evidence, in which Rettie & Co. was a participant, is well worth a read to understand the nuances and impacts of rent control regimes across the world. As the research

makes clear, you cannot just select systems, or parts of systems, that you favour, implement in Scotland and assume they will work the same. Every country has its own legislative, cultural and institutional approach to housing that means what happens in one country will not necessarily happen in another. A number of

countries with rent control regimes have also experienced some significant issues.

What happens in one country will not necessarily happen in another

SOME TENTATIVE CONCLUSIONS



- The Rent Freeze is a reality that all those working in the rented sector in Scotland will have to deal with over the next six months at least. Although it may help tenants in managing their income and costs, it will likely place pressure on landlords, who are not immune to the cost of living crisis.
- It is not a complete rent freeze and evictions ban. There are a number of ways in which landlords can legitimately look to increase rent and evict tenants in special circumstances.
- If temporary, the impact may be minor in terms of the support it offers tenants and the difficulties it creates for landlords and investors. If extended, there are concerns about impact on the availability of rental stock going forward. In a country with a housing crisis, legislating against new supply is something the Government needs to be cautious about.
- There also needs to be a much calmer analysis of what is actually happening in rental markets based on reputable data and evidence, and less on assertion, anecdote and the twisting of often limited data to attempt to prove a point. The rental sector in Scotland is complex and the data on the market is very thin. Without the data to baseline, let alone monitor and evaluate, we risk pulling policy levers in the dark.
- The lessons of rent control in other countries also need to be heeded.

Main authors:



Dr. John Boyle
Director of Research & Strategy
0131 624 4073
john.boyle@rettie.co.uk



Karen Turner
Director of Lettings
0131 622 4160
karen.turner@rettie.co.uk