

Private Housing (Tenancies) (Scotland) Bill

Written submission to the Infrastructure and Capital investment Committee

Homes for Scotland

Introduction

1. In October 2014, I was appointed by Homes for Scotland, with funding from the Scottish Government (SG), as Scotland's Private Rented Sector (PRS) "Champion". My remit was to take forward the recommendations of a major research project, launched by then Deputy First Minister in November 2013, aimed at encouraging the emergence in Scotland of new build PRS at scale, funded by significant long-term investor funds. My role as PRS Champion is supported by the PRS Working Party, a team of experts from industry, trade associations, managing agents, financiers, local authorities and government.
2. Large scale PRS developments funded by institutional investment from pension schemes and life insurance funds are already commonplace in other countries, including amongst others the USA, Canada, Germany, Netherlands and Switzerland. Purpose built PRS developments are now also increasingly prevalent in England – the British Property Federation's recent Build to Rent (BTR) manifesto, launched last month, noted significant activity in London and the South East and developments either complete or in the pipeline in Liverpool, Manchester, Sheffield and Birmingham.
3. My appointment recognises the opportunities that that this approach could bring for Scotland in terms of rapidly increasing supply and boosting flexibility, choice and affordability in the market, particularly in urban areas. At the moment, there is very little new build PRS development in Scotland and this new rental sector is very different from the existing buy-to-let PRS dominated by small amateur landlords. However, the PRS Working Party estimates that there is scope to deliver between 7,000 and 10,000 additional new purpose built PRS homes over the remainder of the decade if the right conditions can be created for investment. Shared amenities are a feature of these developments which are pre-sold with high demand for lettings from tenants.
4. That is a significant opportunity, but securing it will require a planning and policy framework that works to support and encourage investment. The final content of the Private Housing (Tenancies) (Scotland) Bill will be a critical element in determining whether that is in place, so I welcome the opportunity to provide evidence to the Committee.
5. The Bill is not the only focus of attention of the new build PRS agenda. The PRS Working Party has 3 sub-groups that have identified a range of actions which will help to rapidly secure growth, including: proposals for a Rental Income Guarantee Scheme; planning related measures and guidance; revised design/ mix standards; surplus public sector land proposals; a new residential valuation methodology being developed with RICS Scotland; and actions to improve the availability and quality of PRS data. These are under discussion

with the SG and other key organisations, with positive progress being made and a potential target to issue a BTR PRS prospectus for Scotland is scheduled for 2016.

Preparation of Response

6. In addition to discussion with members of the PRS Working Party, this response draws on survey input from 25 investors, fund managers and others in the development community with a detailed understanding of the new build PRS and/or purpose built student accommodation markets. This survey has provided a detailed and up to date understanding of investor views on the Bill.
7. These responses have been anonymised, but I can confirm that the companies that responded to the survey are involved in the investment of funds across the UK in the order of billions of pounds. Given that these organisations and others like them will determine whether the new build PRS opportunity is grasped in Scotland, it is clearly important that the Committee understands their perspective.
8. In broad terms the responses confirm significant interest in investing in new build rented housing in Scotland – 16 respondents indicated an interest in this market with the potential value of activity ranging from 10% to 50% of their total UK investment. However, the proposals in the Bill were repeatedly highlighted as being either potentially or definitely problematic in terms of that investment.

Summary of Views

9. As PRS Champion, I support the Scottish Government's desire to increase quality in the private rented sector and the recognition of the need to ensure that any new regime takes a balanced approach to the needs of investors and tenants. A stable, predictable, simple and fair tenancy regulatory environment is fundamental to attracting long term institutional funds, and there is much in the Bill that will help to deliver the modernised system which Scotland needs.
10. I also welcome the positive engagement that I and the PRS Working Party have had with the Scottish Government on a range of PRS initiatives, which indicates a genuine desire by Ministers to increase the supply of new build PRS homes. One such significant outcome was the setting of Multiple Dwelling Relief within the new Land and Buildings Transaction Tax so as to avoid an unintended negative outcome.
11. I am however concerned that some aspects of the Bill will run counter to that desire and serve to close off the new build PRS opportunity before it has a genuine chance to emerge. By increasing risk – or the perception of risk – and potentially reducing investment returns for investors and landlords, the Bill could cut across other positive measures and prevent developments coming forward.

12. This concern is informed by the fact that 20 of the 22 individuals who expressed a view on the Bill proposals in survey responses indicated that it had had or would have an impact on their investment decisions. This is not to say that some investment would definitely not happen if the Bill is passed in its current form. However, as noted above, respondents repeatedly highlighted proposals as being either potentially or definitely problematic in terms of the potential risks created, particularly when compared with the position in other parts of the UK.
13. Of the two that noted that the Bill would not have an impact, one indicated that while the proposals would create further uncertainty in terms of return profile, other issues would ultimately determine whether or not they would invest.
14. In terms of specifics, the most pressing concerns were raised with regard to proposals on rent controls. However the impact of the proposals on the providers of purpose built student accommodation (PBSA) and the removal of the “no fault” ground were also raised. This PBSA aspect has relevance given the potential “contagion risk” for the new build PRS.
15. As one respondent with plans to invest over £250m in the PRS over the next two years noted: *“The proposals set out in the Bill have made us very wary of the possibility of investing in Scotland. We would previously have considered this but feel that the new proposals on rent controls in particular and, to a lesser extent, the less-landlord-friendly security of tenure proposals, as well as the potential for the government to introduce further anti-landlord legislation in the future, outweigh the potential benefits of investing in Scottish housing.”*
16. Another organisation with plans to invest £1bn over two years in the UK highlighted difficulties with the introduction of new regulation at an early stage in the emergence of a new approach: *“What investors want is as much certainty of regulatory stability as possible, and this is less the case in Scotland as the rest of the UK. This is a young sector, where understanding of the metrics is still being developed, and any uncertainty in any part of the equation that makes Build to Rent work is damaging.”*
17. Further commentary on the implications of the Bill for the emergence of a purpose built new build PRS sector are set out below.

Impact on Purpose Built Student Accommodation (PBSA)

18. PBSA is now well established within Scotland’s housing market, supported by a range of institutional investors.
19. Whilst this aspect of the market has not been my primary focus, the impact of the proposals in the Bill are undoubtedly relevant in that they may shape the overall appetite for investment in the nascent new build PRS. Discussions suggest that it is likely that there will be an overlap between those that invest in PBSA and those we seek to attract to invest in building for rent at scale. Based on my engagement with investors, there are genuine grounds for concern that a detrimental impact on one market will impact on another.

20. It is in that context that I am concerned about the implications of the Bill for PBSA. There is a clear risk that introducing a single tenancy for all tenants – except those exempted under existing legislation – and shaking up a model that is seen to work will have a significant negative effect on both students and investors in the sector. The concerns regarding the implications of the Bill for certainty in the market have been set out clearly by others in their written and oral evidence to the Committee, so I will not go into detail.

21. In commenting on the Bill one respondent to the survey noted that the proposals: “... *have had a huge impact on our appetite as they would make it very difficult for us to operate a student model if we do not know how many rooms we will have free for the following academic year at key points in the letting cycle...*” Other comments included:

- *“We will look to diversify our investments out of Scotland if the Bill impacts directly our business to manage the transitional rental market that is the “Student Accommodation Sector”.”*
- *“Very concerned that the lack of differentiation for student accommodation will impact on investor appetite.”*
- *“Uncertainty around the number of suitable bed spaces available will create a housing issue for students. This could make Scottish Universities less competitive than their counterparts in the rest of the UK. The proposals will deter many investors from investing in Scottish PRS and PBSA”*
- *“We are concerned that the detrimental impact of the bill on the student residential market will undermine the embryonic PRS investment market, causing institutional investors to turn away from Scotland as an investible location, a process that will be very difficult to reverse.”*

22. With that as context and given the consequent risks to PRS investment, I believe that students in PBSA should be exempt from the new regime, in the same way as proposed for tenancies in accommodation let by the universities/academic institutions. As an alternative, I would echo the call of others for students to be able to opt in to a specialist tenancy agreement with a defined duration covering a fixed term of 9 to 12 months, allowing for upfront clarity about the position and an approach that works for both students and investors alike.

Rent Control in Pressured Areas

23. Provisions in the Bill to introduce a mechanism whereby rental caps can be introduced in “pressured areas” are clearly designed as a response to concerns expressed about rising rents. However, as other respondents to the Committee have noted, the evidence available – unlike house price data this generally comes from rents offered through on-line portals rather than rents actually recorded in tenancy agreements – does not suggest that rental prices in Scotland are rising excessively. And if affordability is a key concern, the best

way to secure this would be to stimulate additional supply in the market, increasing choice and flexibility for tenants. This ambition to increase supply is at the heart of the purpose built PRS agenda and reflects the Scottish Government's stated objective to increase the supply of all tenures.

24. Accordingly, whilst I welcome the recognition that rents should be market led and acknowledge that the Scottish Government's proposals are intended only to apply in clearly defined circumstances, I am concerned that their inclusion in the Bill will have a negative impact on investor interest and, accordingly, the prospects for the new build PRS.
25. Proposals on rent controls were cited by almost all survey respondents as a source of particular concern – not so much their specific nature but rather the very fact of their existence and the resultant uncertainty and risk for investors about the future.
26. It should be noted that the investors which we are looking to encourage will work on the basis of predictable rents that reflect the market in order to avoid the problem of voids and ensure a stable income stream. As one respondent to the survey noted: *"...in their core, PRS owners want stability and predictability of income"*. Investors will be determined to avoid voids and short term occupancy in their developments.
27. The potential introduction of controls on rents however introduces uncertainty about the future context for these developments. Comments from respondents on this point included:
- *"Rent controls, even if relatively 'soft', i.e. with a focus only on rent pressured areas where direct Government permission is needed to intervene, is likely to cause divestment as will be seen as the 'thin end of the wedge' by small and large investors."*
 - *"The rent control issue is a very significant negative for institutional investors in the sector. This is a very retrograde step for PRS in Scotland."*
 - *"...we have seen the damage that rent controls do to a rental market place. They cause investment in the sector to disappear which in turn ultimately causes further housing pressure as new supply is not delivered. We have seen decades of supply constraints created by governments imposing restrictions such as rent control. Likely due to this, governments around the world have pared back rent controls in recent years and have started once again enjoying significant investment in the sector."*
 - *"Rent controls have also been repeatedly proved to reduce landlords' reinvestment into buildings, thus lowering the future quality of existing stock. The Scottish government should be encouraging high quality, purpose-built rental property, not driving it away. This lost investment will be to the benefit of regional English cities."*

- *“Over the long term, evidence suggests that rental growth caps have reduced residential development in almost every jurisdiction it has been introduced”*

28. With the above in mind, my preference would be to see the removal of rent control proposals from the Bill – I would encourage the Committee to reach the same conclusion as decision makers in, for example, Ireland and Wales. As stated earlier, the best way to address any concerns about the level of rents in the market is to stimulate an increase in the supply of new homes.

29. If controls are introduced, I would however:

- Ask for a review clause to be inserted, for instance allowing for a review of the effectiveness and relevance of controls, say no later than five years after the coming into the force of the Act. This review should allow for controls to be removed if it can be demonstrated that they are not required.
- Ask that any developments incorporating the proposed Rental Income Guarantee Scheme, should it emerge, be exempted from rent control measures.
- Echo the call from others for the public and private sectors to work together to put in place mechanisms that allow Government and local authorities to gather, track and publish accurate information on market trends in the PRS before the changes in the Bill come into force. If the market is to have confidence in any arrangements, it will be essential that pressured areas are not drawn more widely than the data can justify. As one respondent noted: *“If local authorities make decisions on rent controls based on average area wide prices, it risks deterring the types of high quality build to rent development that improves urban place making.”*

No Fault Ground

30. Finally, the removal of the “no fault” ground for repossession at the end of a lease, when coupled with the unintended consequences around PBSA investment and the prospect of rent controls could make Scotland less attractive compared to other nations, especially the rest of the UK. The following comments from survey respondents were noted:

- *“The new rules make it significantly harder for honest, large, reputable managers to control the atmosphere and management of the building”*
- *“Timing of this could not have come at a more inopportune time. The institutional sector is for the first time in many years reviewing the sector and for the Scottish Government to now introduce discussion on rent controls and end of tenancy protection...[means]...every single investor we have spoken to is now wanting senior governmental level guidance on the policy intention.”*
- *“Rent control and security of tenure are issues that have an obvious impact upon investment decisions. If these proposals impact negatively upon*

investment returns as compared to other areas of the UK then investment in Scotland may prove more difficult.”

Conclusion

31. I am grateful to the Committee for the opportunity to outline my views on the Bill, I would be very happy to discuss these issues in more detail, noting the need to consider the impact of proposals on the future PRS alongside that which is already in place.

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