SPF SCOTTISH PROPERTY FEDERATION

7 December 2020

SPF RESPONSE TO THE FINANCE AND CONSTITUTION COMMITTEE'S CALL FOR EVIDENCE ON THE FAIR RENTS (SCOTLAND) BILL FINANCIAL MEMORANDUM

Introduction

1. The Scottish Property Federation (SPF) is the voice for the property industry in Scotland. We include among our members: property investors, including major institutional pension and life funds; developers; landlords of commercial and residential property; and professional property consultants and advisers.

Key Interest

- **The SPF is firmly of the view that any form of rent control is unnecessary, not justified by data on rent increases in Scotland, and will have negative consequences for both landlords and tenants. The only stable long-term solution to control rent levels is to introduce measures to incentivise and facilitate increases in the supply of properties in the marketplace. Trying to control rents by regulation is likely to lead to a deterioration in property quality, a fall in investment in the sector, a culture of more frequent annual rent increases throughout a tenancy, and a loss of tenant mobility. These consequences would go against the Government's strategic aims of enabling growth and investment in the PRS and meeting the needs of the people living in the sector, consumers seeking accommodation, and landlords committed to continuous improvement.**

2. The SPF's responses to the issues raised in the questionnaire that supported the Committee's call for evidence on the Financial Memorandum that accompanied the Fair Rents Scotland Bill are as follows:

<u>Question 1</u> Did you take part in any consultation exercise preceding the Bill and, if so, did you comment on the financial assumptions made?

SPF Comments: Yes.

<u>Question 2</u> If applicable, do you believe your comments on the financial assumptions have been accurately reflected in the FM?

SPF Comments: No.

As stated in our response to the proposed Bill there are significant financial consequences for our investor, landlords and manager members with a knock-on effect to tenants. Our members are firmly of the view that the Financial Memorandum that accompanies this Bill does not reflect the true costs arising from the provisions in the Bill, and we question the robustness of the information included.

There is frequent reference in the Financial Memorandum to no costs, de minimis costs or costs that are not significant, the extent of which have not been set out in the summary table or elsewhere in the Memorandum.

We would expect the Financial Memorandum to set out the best estimates of the administrative, compliance and other costs to which the provisions of the Bill would give rise as a minimum. It should also include best estimates of the time scales over which such costs would be expected to arise, and an indication of the margins of risk and uncertainty in such estimates.

Financial Memoranda are required so that the Parliament can have the best possible information on the costs (and benefits) arising from proposed legislation and should be comprehensive and include sufficient detail on the basis of figures to enable the Parliament to come to a view on their robustness. We do not think that this Financial Memorandum meets these requirements.

<u>Question 3</u> **Did you have sufficient time to contribute to the consultation exercise?**

SPF Comments: Yes.

<u>Question 4</u> **If the Bill has any financial implications for your organisation, do you believe that they have been accurately reflected in the FM? If not, please provide details.**

SPF Comments: No.

There would be a considerable impact on investment in the sector. A key tenet for financial institutions to invest in the sector is both capital and rental growth. Changing legislation or the threat of changes as proposed will stop such investment, and as a direct consequence even fewer new rental homes will be built. Without investment in housing, economic growth will fall.

If additional rent controls were to be put in place this would incur immediate valuation issues for landlords. This is because professional valuers may deem that there has been a transfer of risk and thus a diminution of value. This will have an impact on small and larger scale investors, or potential investors in new build PRS. It is important that consideration is given to the wider consequences of any tenancy law reform on the value of property assets held by current investors. There are considerable financial implications for our investor, agent and manager members, which ultimately means there will be a knock-on effect of additional costs for tenants.

Institutionally funded PRS at scale has the opportunity of making a significant difference to the current housing crisis due to higher occupier absorption rates, by enabling larger development phases and creating new places and communities more quickly. Institutional and other large-scale reputable investors, such as major institutional pension and life funds, are actively interested in professionally managed PRS. However, the SPF is very concerned that any changes, or even suggestion of changes, to the regulation of Tenancy Regime or introduction of further rent controls could deter this vital source of funding. The associated additional investor risk premium could leave Scotland disadvantaged and potentially uninvestable in this sector. The loss of liquidity and the impairment of value would be unacceptable to many investors.

Our members suggest that consideration should be given as to how Scotland can be positively differentiated, in order to attract this much needed source of large-scale private funding. Without this increase in supply and choice there will inevitably continue to be price inflation pressure in local hotspots like Edinburgh and rents will move accordingly.

We believe that the introduction of a blanket rent control, may also cause significant distress to smaller landlords because it would also give no protection from any increased borrowing costs (an increase in the Bank of England base rate for example). The consequence of increased borrowing costs, not being met by commensurate rental increases at review, could lead smaller landlords to exit the PRS, which will diminish housing supply rather than increase it, thus exacerbating pressures on supply.

<u>Question 5</u> **Do you consider that the estimated costs and savings set out in the FM are reasonable and accurate?**

SPF Comments: No.

As stated above there are significant financial consequences for our investor, landlords and manager members with a knock-on effect to tenants. Our members are firmly of the view that the Financial Memorandum that accompanies this Bill does not reflect the true costs arising from the provisions in the Bill and we question the robustness of the information included.

There is frequent reference in the Financial Memorandum to no costs, de minimis costs or costs that are not significant, the extent of which have not been set out in the summary table or elsewhere in the Memorandum.

The Financial Memorandum states that there will be no cost to the Scottish Administration, but this is based on historical approaches to the First Tier Tribunal on rental grounds that mainly relate to repairs. This Bill creates an incentive to tenants to apply to the tribunal as it would delay any increase in rent, which would not apply until after the application to the Tribunal was decided.

Our members are also concerned that the Scottish Courts and Tribunal Service does not hold the data to support the assumptions made in the Memorandum. It is also a concern that the cost of a case going to the First-Tier Tribunal is not known. We would expect to see an estimate of the margins of uncertainty associated with the Bill's estimated costs, based on limited use of the First Tier Tribunal, as reflected in the Memorandum as well as the worst-case scenario.

The Memorandum states that there would be no costs on local authorities and that any costs would be de minimis. It would be helpful to know what is deemed de minimis as this will add to the cumulative costs of duties placed on local authorities such as the introduction of licenses for short-term lets.

The costs on other bodies, individuals and businesses are based on only two areas and averaged over time. Paragraph 14 shows a saving in Glasgow but does not examine savings or increases elsewhere. Chart 1 shows that only Glasgow and Lothian shown an increase in the cumulative % change in average rents from 2010 to 2019 above the cumulative increase in CPI in the same period. This highlights that rents need to be considered on an area by area basis which is already provided for in the Private Housing (Tenancies) (Scotland) Act 2016.

<u>Question 6</u> If applicable, are you content that your organisation can meet any financial costs that it might incur as a result of the Bill? If not, how do you think these costs should be met?

SPF Comments: No. Please see our response to question 4

<u>Question 7</u> Does the FM accurately reflect the margins of uncertainty associated with the Bill's estimated costs and with the timescales over which they would be expected to arise?

SPF Comments: No. Please see our responses to questions 4 and 5 above and also question 8 below.

<u>Question 8</u> Do you believe that the FM reasonably captures any costs associated with the Bill? If not, which other costs might be incurred and by whom?

SPF Comments: No.

Impact on the Scottish Consolidated Fund

The unintended consequences of the proposals present risks to both tenants and landlords and has the potential to add to the workload of the First tier Tribunal. The estimates given in relation to the number of cases going to the First Tier Tribunal on rental grounds mainly relate to repairs and not the level of rent charged. However, the new proposals actively encourage tenants to apply to the Tribunal, which can ultimately delay any rent increases with no risk of rent being increased. The First Tier Tribunal also does not hold the necessary data on the costs of cases to allow a reasonable estimate of potential costs.

In order to consider the proposals in the Bill fully, there needs to be an estimate of costs on a limited and worse case load scenario of potential applications, specifically for rent increases going to the First Tier Tribunal. Their also needs to be an estimate of the costs to collect the rental data centrally.

Impact on Tenants

There would be an incentive to increase rents on an annual basis to ensure that rent levels do not fall behind market levels. Currently, a sitting tenant might not have their rent raised for some time. If the First Tier Tribunal is only able to agree rent increases or reduce rents, there is an incentive on tenants, at no risk to themselves, to challenge increases in order to delay any future increase. This is likely to put additional pressure on the First Tier Tribunal and create further delays in the process.

Notwithstanding the ability for landlords to appeal, the introduction of blanket rent controls or localised rent cap zones may limit a landlord's ability to improve the quality of their property, including for any new standards in the future.

Impact on Sustainability and Carbon Agenda

As stated above, the introduction of blanket rent controls or localised rent cap zones may limit a landlord's ability to improve the quality of their property, including for any new standards in the future. It would also give no protection from any increased borrowing costs, which may also discourage further investment, including from institutions, to grow the sector and build more new homes for private rent. Some institutional members have already confirmed that Scotland has been, or will be, given an added 'risk premium'.

Impact on Local Authorities

The Financial Memorandum states that there will be no additional costs to local authorities. However, there will be substantial upfront costs relating to technology and training to support changes to systems and processes for local authorities. The cost of the collection and publication of the data collected centrally will also create a cost to the Scottish Consolidated Fund.

Question 9 Do you believe that there may be future costs associated with the Bill, for example through subordinate legislation? If so, is it possible to quantify these costs?

SPF Comments:

As stated above, a key tenet for financial institutions to invest in the sector is both capital and rental growth. Empowering the Scottish Ministers to vary the additional percentage to be applied as detailed in new subsection (10) of section 22 of the 2016 Act, would discourage investment by pension funds and other institutional investors in the PRS sector in Scotland, as the pension or investment returns to their members/investors could effectively be negatively eroded.

Pension Funds and other financial institutions have a duty to invest to obtain long term returns for their members/investors and will not wish to invest in assets where there is a risk that Government intervention could effectively impact on these returns. This could also lead to a lack of new investment and possible disinvestment by existing pension funds and institutional investors, which is contrary to the Government's strategic aim to grow the PRS market in Scotland. It could also undermine the positive encouragement which investors took to investing in the sector in Scotland when the Government introduced the UK's first Rental Guarantee Scheme in October 2017.

Please also see our comments at question 4 above.

Contact: Mandy Catterall
Government Relations Manager
Scottish Property Federation
Tel 07738 437 789
E-mail: mcatterall@bpf.org.uk