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Rental Income Guarantee Scheme Market Engagement

Analysis of market responses, May 2016

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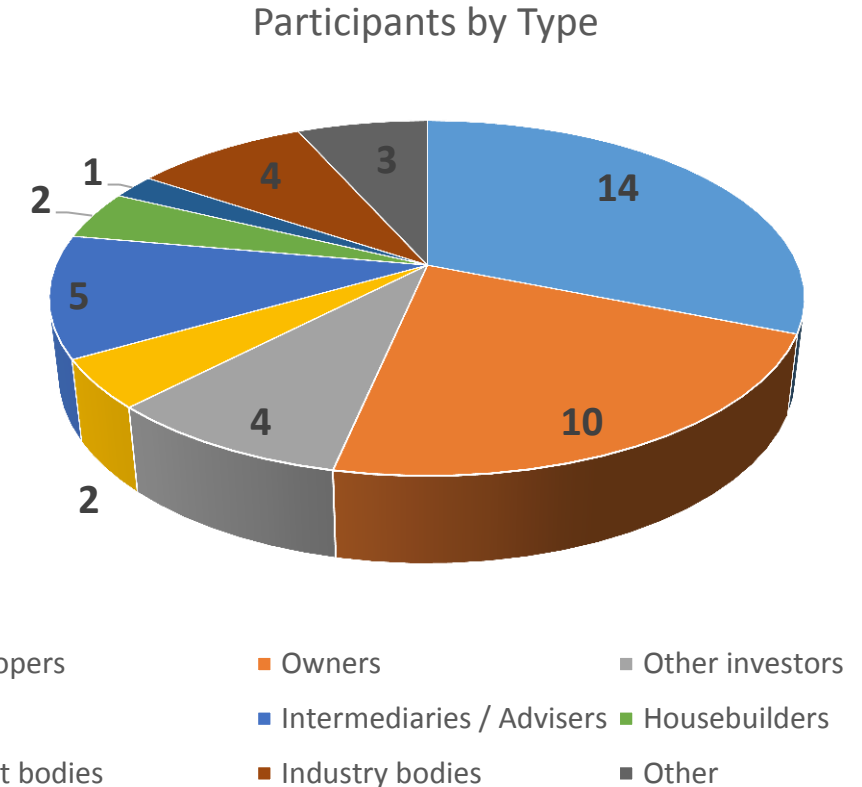
Background

- The PRS Working Party developed a proposal for a rental income guarantee scheme (“RIGS” or “the Scheme”), intended to accelerate the growth of the Build to Rent Private Rented Sector (BTR PRS). This was discussed and modified in conjunction with the Scottish Government.
- The Scottish Government, supported by the PRS Champion, has now completed an engagement exercise to test the market appetite for the Scheme.
- The rationale for the engagement exercise was to test specific elements of the Scheme with the primary objectives of establishing (a) whether the Scheme was likely to be attractive to market players; and (b) whether implementation of the Scheme was likely to have a positive impact on the rate of development of BTR PRS in Scotland.
- The exercise consisted of an online survey open to anyone, together with a number of targeted face to face meetings with selected market participants. Meetings were covered by a team from the Scottish Government, together with the PRS Champion.
- Where stakeholders indicated a desire to meet face to face, this was incorporated into the process wherever possible.
- A number of stakeholders whom the team met also completed an online survey. This was actively encouraged.
- The meetings took place between 29th March and 10th May.
- The online survey closed on 6th May 2016, although submissions by email have also been accepted and will be accepted until 13th May.

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Participation

- In total, 57 interactions were assessed
- This covered 18* meetings and 39 written submissions
- 12 of the meeting participants also submitted written proposals, leaving a net 45 organisations and individuals participating in the exercise
- There was a broad cross-section of participant type, although the bulk of the responses came from developers or “asset owners” (including institutional investors and fund managers).
- 2 submissions were made on an individual basis, 1 from a tenant representative body and 1 from a local authority.
- The breakdown is illustrated in the pie chart opposite



* There were 19 scheduled meetings. Within the survey period up to 6th May, 17 took place and 1 was cancelled. 1 further meeting took place on 10th May

Draft Analytical Methodology

Each of the meeting notes and the written submissions was reviewed against a series of themes, namely:

- **Response to policy:** what did the stakeholder feel in general terms about the approach?
- **Commercial structure:** stakeholder views on specific aspects of the Scheme
- **Key issues:** what needed to be addressed to encourage the growth of new BTR PRS accommodation?
- **Alternative support mechanisms:** what else did stakeholders think could be done?
- **Data:** what kind of data is appropriate and where should it be sourced from?

While the meetings were inevitably less structured than the written responses, the analysis attempts to achieve comparability and take into account relevant input where possible. Certain specific questions did not feature in the meetings, although there was a lot of common ground. The analysis also takes into account the significant overlap between meetings and written submissions by adjusting to avoid double counting of responses on key questions. The analysis focused on where participants made specific, attributable statements.

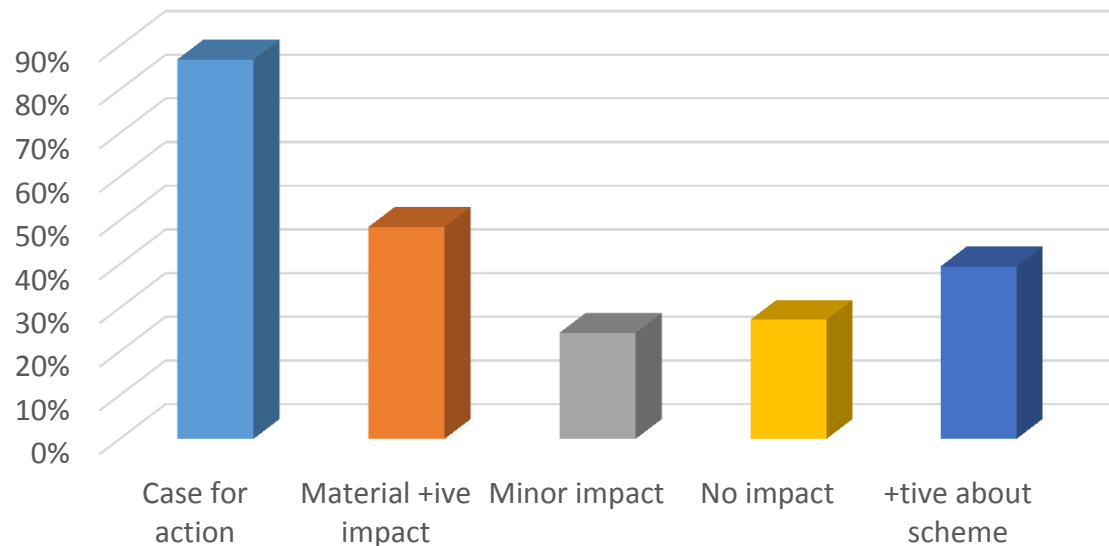
Response to Policy

The key questions in this area were about whether:

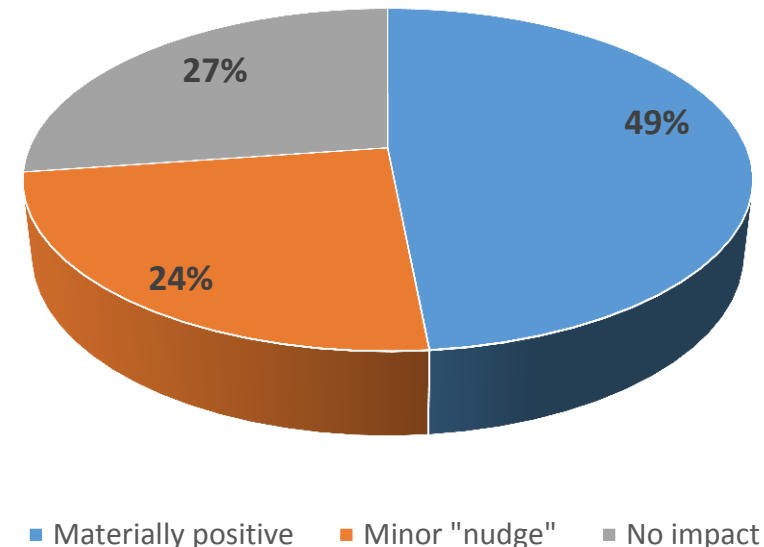
- There is a case for SG action in the sector
- The Scheme is likely to make difference

As the charts show, support for the case for action was unequivocal; whether the Scheme would make a material difference was less clear, although there was a reasonably positive reaction to the design

Response to Policy



Expected impact of RIGS



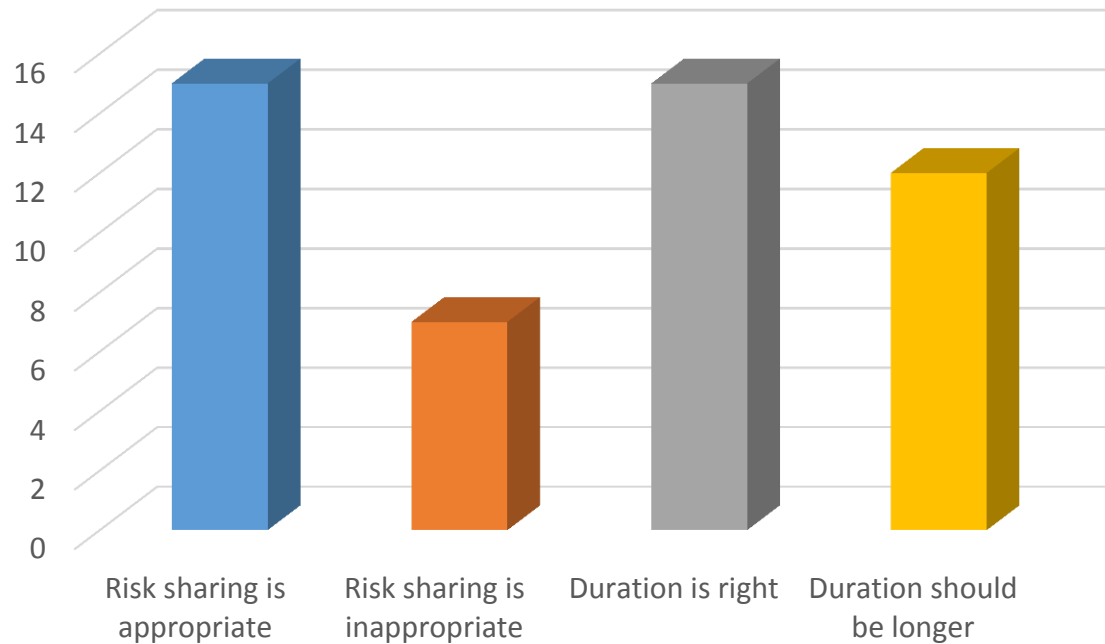
Note: the view on impact shifted significantly in a positive direction between the interviews and the written submissions

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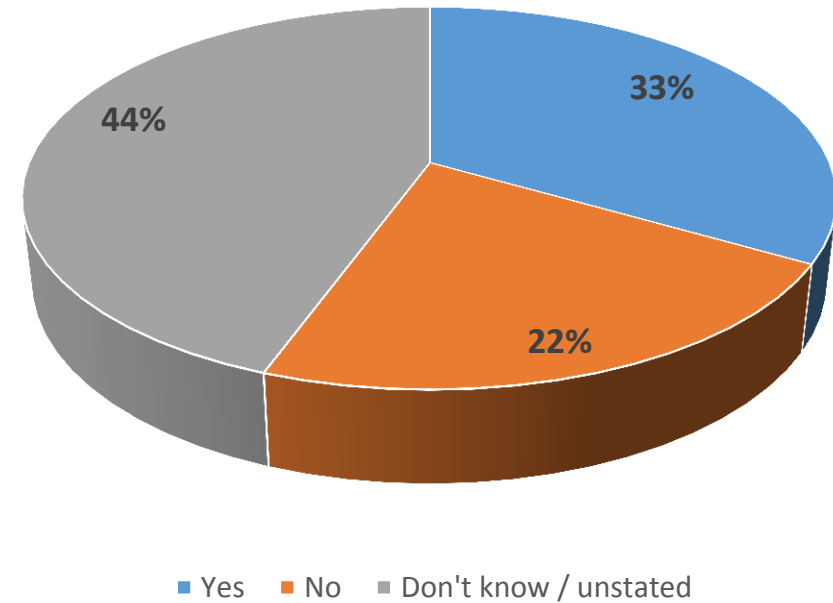
Commercial Structure

While there was a division of views, there was generally a majority in favour of the proposed risk share and the length of the guarantee, although there were a number of alternative proposals for different guarantee lengths and a different cap & collar regime. On the other hand, respondents stating positively that the scheme was addressing the right risks were in the minority.

Risk Profile of RIGS



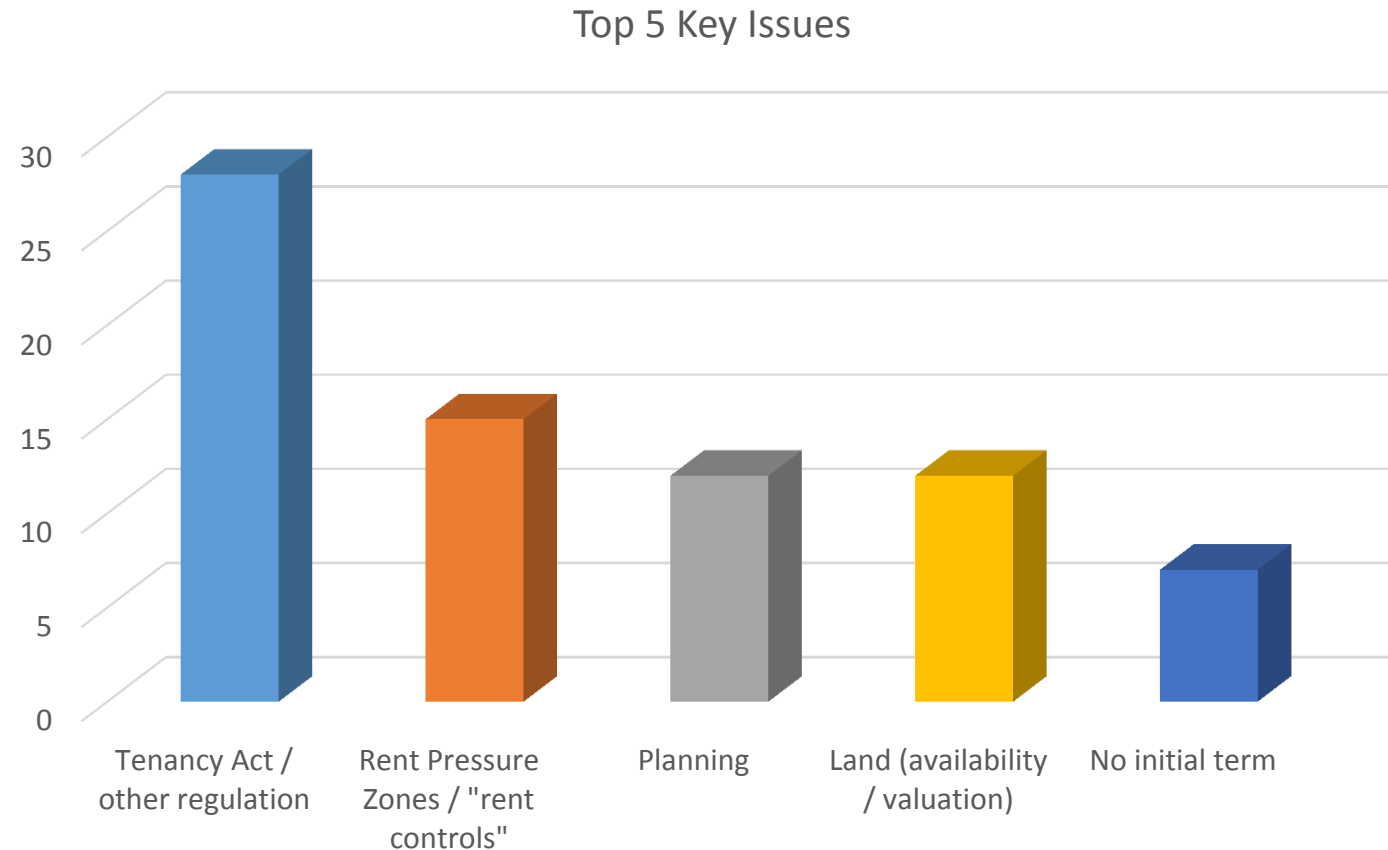
Does RIGS address the right risks?



Key Issues

The Top 5 issues cited (by number of respondents) clearly showed that the principal concerns of industry participants are about regulation, planning and land availability. Finance (with 6 responses) was just outside the Top 5, followed by emphasis on this sector commanding a premium rental (5) and cultural / perception issues around PRS (4). Only one respondent cited the need to support rent levels as an issue. In some cases, reference was made to the Tenancy Act and regulation in general; in others, RPZs and no initial term were specifically referenced.

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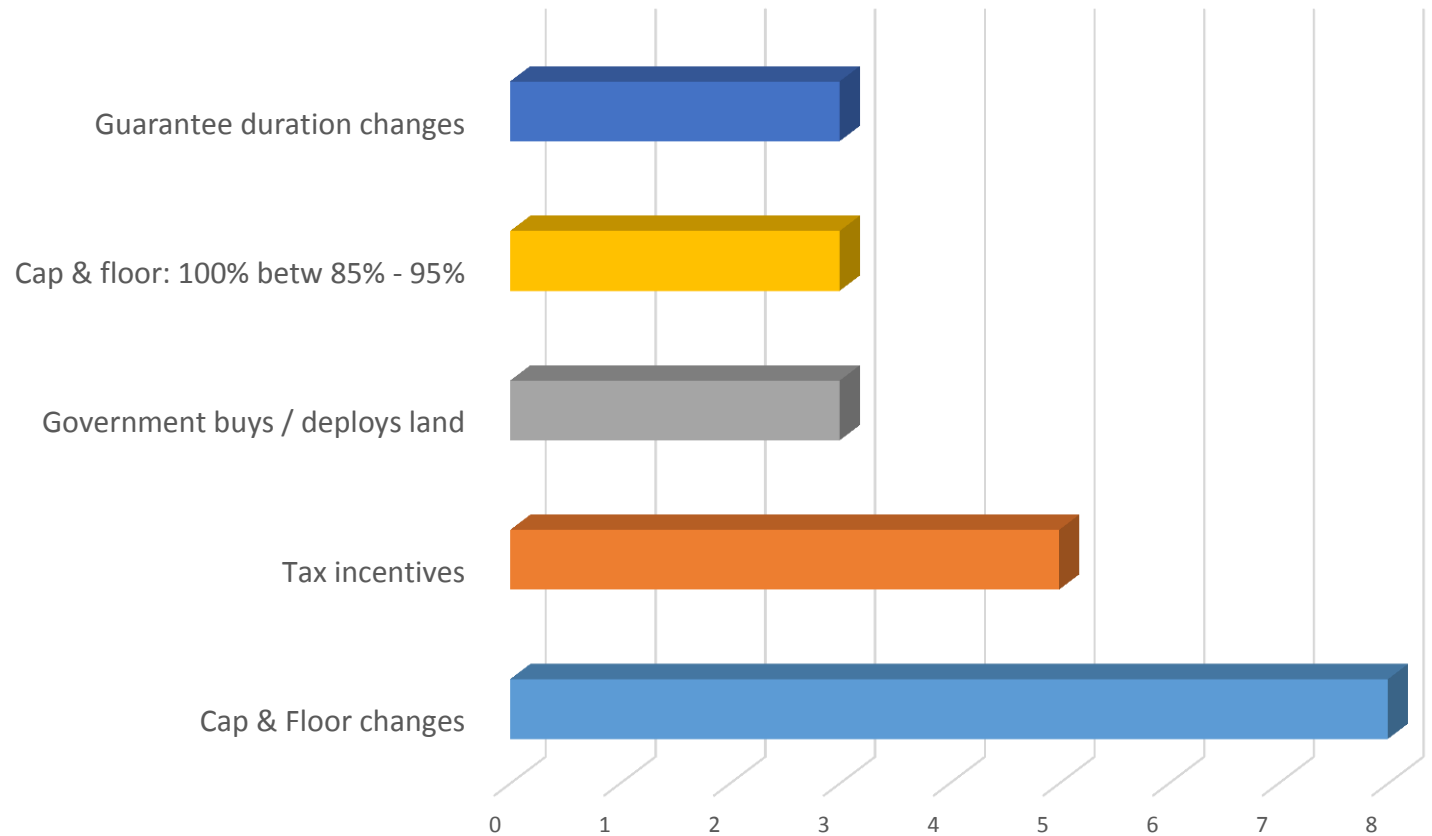


Draft Alternative Support Mechanisms

There was a wide range of proposed alternative support mechanisms (over 20 different suggestions were made – in some cases respondents made more than one suggestion).

The most common ones focused on changes to the cap and floor in the Scheme, together with suggestions for tax incentives and for Government to intervene in the acquisition of land. Other proposals included a debt or equity guarantee (3), development finance support (2) and changes to the planning system (2).

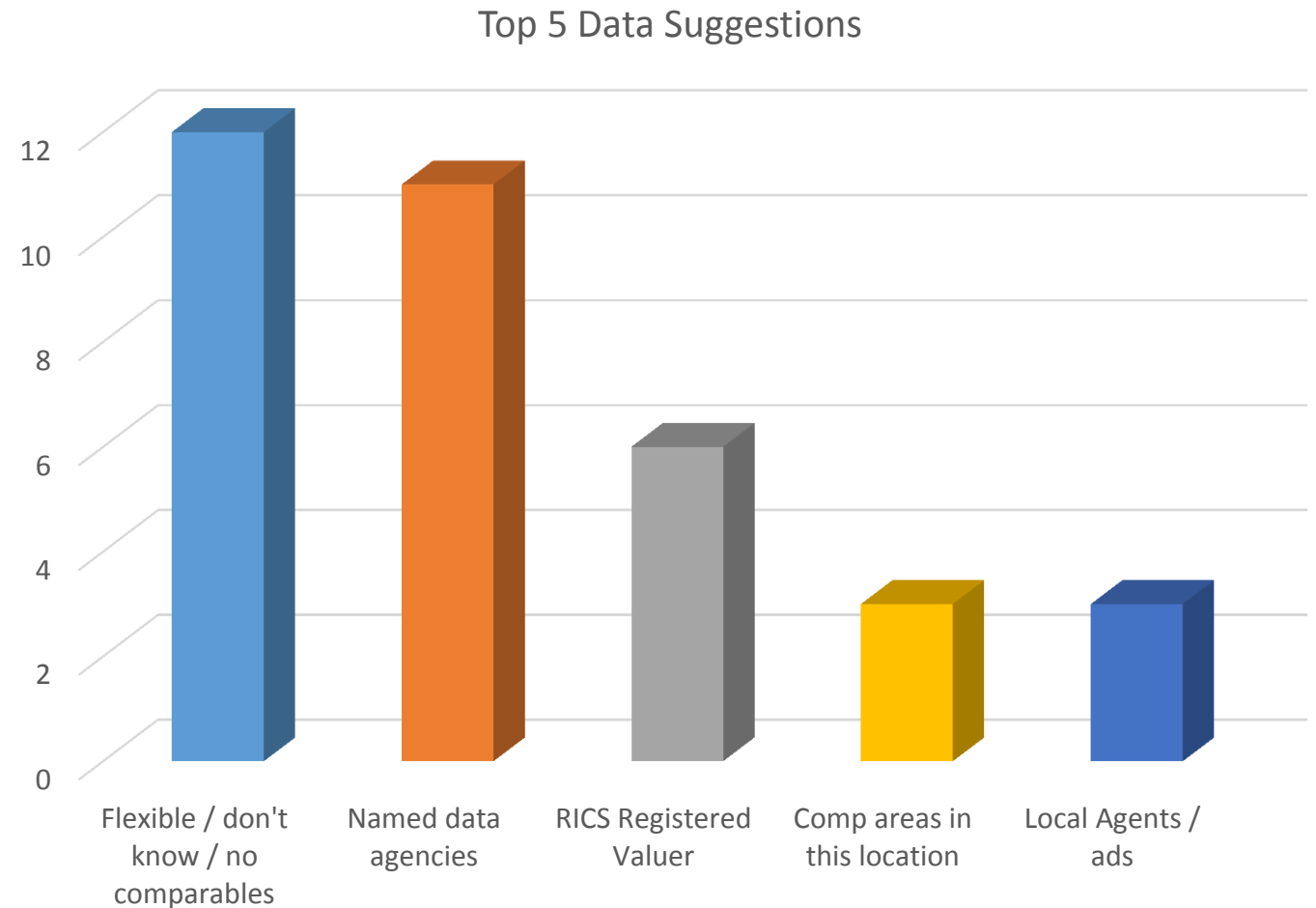
Top 5 Support Mechanisms



Data

Survey responses underlined the embryonic state of the market. The majority of responses were either non-specific or recommended a case by case approach. A large number of data agencies (Zoopla, CityLets, etc) were name-checked. Respondents frequently made more than one suggestion.

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Other Issues

- The process and timing of securing a Government commitment under the RIGS, following an application for support, was a recurring concern. Around 20 respondents in meetings and surveys covered this issue in some way.
- The cost of the guarantee was also of significance to many respondents (c.14). This was linked, in a number of cases, to a view that as the benefit was relatively low in financial terms, the cost must also be low or it would not be worthwhile. Two respondents also commented that they could buy commercial insurance to cover this risk but chose not to.
- Certain respondents drew attention to the distinction between basic rental costs and the overall charge to tenants (including charges for other services), implying in most (if not all) cases that there would be a preference for the guarantee to cover the latter, as this was more reflective of the expected market norm in charging for PRS.
- Views were regularly expressed that the Government was being risk averse or not taking very much risk.
- Particularly in meetings, participants wanted to explore how the guarantee would ramp up in the early phase of a development as units came on-stream over a period of time.
- A few respondents expressed the view that the survey was too narrowly drawn.

Survey Ratings (where completed)^{Draft}

Rating	Number
Very satisfied	11
Slightly satisfied	6
Neither satisfied nor dissatisfied	1
Slightly dissatisfied	4
Very dissatisfied	1

Conclusions

- There appears to be strong support for Government to play an active role in growing the sector
- While the response to the RIGS proposals was, on balance, favourable, the market sees other issues as more important.
- The impact of the new private tenancy legislation remains a major (if not the major concern), followed by availability of land and the planning regime.
- Views on the balance of risk profile are mixed – there is understanding of the Government’s approach, but also views that it is not offering enough of an incentive.
- Views were regularly expressed that the Government was being risk averse or not taking very much risk.
- There is no prevailing view on what data is relevant or where to source it from.
- Implementation details (such as price, ramp-up and timing of commitment) are likely to be important factors affecting the attractiveness of the Scheme.