8 December **2022**

SCOTTISH GOVERNMENT CALL FOR EVIDENCE: COST OF LIVING (TENANT PROTECTION) ACT 2022 REVIEW DECEMBER 2022

Background

1. Thank you for your invitation of 18 November to comment on the impact of the Cost of Living (Tenant Protection) Act 2022, ahead of its first review point that arises on 31 December 2022. The Scottish Property Federation has consulted with our members ahead of compiling this reply to the government's questions and we are pleased to submit this evidence. As ever, we would be happy to discuss further any of the points we raise.

Introduction

2. The impact on investment in rented accommodation of the Cost of Living measures has been almost unprecedented and led to immediate reaction from investors, including those who support social housing with private finance facilities. Before replying directly to the questions posed by the government's letter calling for views, we would like to make the following points.

We urge the government to:

- **Reassure the investment markets to reinstall confidence to invest in Scotland, and identify a stable and sustainable path to securing future much needed new rented housing for both the private and public sectors.**
- **Provide a stable policy framework that will avoid unpredictable events such as the Programme for Government announcement that has in the words of many experts 'spooked' the market appetite for investment in Scotland.**
- **Establish a framework that will support evidence-based policy in this sector with a clear focus on improving the data on existing in-tenancy rental market changes.**

Question 1

Have the temporary measures had a direct effect on your planning and/or business models?

3. Yes. The evidence received from our members includes examples of significant and immediate loss of investor interest in Build-to-Rent opportunities in Scotland. This makes it unlikely that these new homes will be delivered within the short term and this will exacerbate upwards rental pressure in a situation where demand for rented housing significantly outweighs the supply of rented property in key locations, and not just within Edinburgh and Glasgow. This loss of investor confidence has also led to withdrawal from new planning proposals which puts at risk wider mixed use regeneration projects. It is important that the government realises that this policy has an impact that goes beyond the rented housing sector therefore and in fact undermines not just new Build-to-Rent but wider commercial development including critically needed additional modern student accommodation to support the higher education sector. These developments support the regeneration of urban centres and new construction jobs at a

time of a very weak economy. One social housing related company whose investors tend to be pension funds expressed the view that:

'Our investors tend to be risk averse (and in return seek a sensible rather than excessive return) and legislation introduced without due consultation and without the supporting evidence points to a riskier investment than they are comfortable with.'

4. Our members engaged within the social housing sector have also experienced a major loss of ability to finance or refinance either new development or retrofit of older housing stock as a result of the legislation. This funding was required to deliver on the government's targets for improving energy efficiency. Indeed, the loss of investment for social housing has led to a redirection of finance for this sector towards projects in England which may make it difficult to retrieve this lost funding.

5. The speed with which projects were either paused, dropped or funding redirected has been immediate. One project in central Edinburgh that was on the cusp of agreement reported that:

   Our client (an institutional fund who wishes to maintain confidentiality) decided against legal completion citing the legislation as one of the primary reasons.

   We understand that the institutional investor in this case was a pension fund. Members have likewise written to say that they are aware of pension funds, including those responsible for public service related pension funds, are reconsidering investments in Scotland or indeed have decided against considering investment in Scotland because of the introduction of the Cost of Living legislation and the manner in which the legislation was introduced.

6. The policy cannot be taken in isolation from other issues such as the inflation in construction costs and shortage of material and labour. But the Cost of Living legislation is another obstacle to the delivery of investment, jobs and homes. One respondent who will separately comment to the government noted:

   'As a significant contractor in the affordable housing market, there has been a noticeable impact on our Housing Association clients. Whilst the impact of inflation on construction prices was already a factor in inhibiting new projects coming to market, we are informed that the freeze on rental levels has exacerbated the situation, creating further obstacles to framework / tender opportunities.
   As a consequence, we are forecasting a reduction in our forecast activity and will have to take proportionate action in terms of headcount to protect our business, and remaining employees.'

   Another investor reported:

   On the Private rental side, we have walked away from a £60m deal which would have delivered just under 400 new homes for rent due to lack of funding support for a Scottish rental investment.

   The reference to a lack of funding support is related to private led funding which is critical to delivering social housing. This also threatens private led housing investment which will often be required to deliver a proportion of affordable housing. There is a further danger that we may lose the key supply chain supporting housing developments and this will itself add further costs to future housing investments of all tenures.

7. Scotland has seen significant reforms in the wider PRS market in the last five years and this has contributed to a slower than expected delivery of new build for rent homes. The potential extension of the rent freeze policy and associated risk and uncertainty with policy is threatening to further inhibit the development of new rental properties via the modern 'build to rent' approach that is increasing significantly elsewhere in the UK. This new, exciting market which is adding choice to those who need or choose rented accommodation and a greater level of professionally-managed and serviced accommodation for Scotland, is proving enormously successful. A recent Glasgow scheme was reported to be 93% let in just 13 weeks, the fastest take-up rate in the UK. In a different part of Scotland, a recent mid-market project was oversubscribed in a matter of days with over 300 applicants having to be turned away because of the over-subscription of interest in renting these homes.

8. In short, the longer there is uncertainty in respect of government rental sector policy, the more likely it is the pipeline of projects to deliver much needed new homes, jobs and investment will become unviable. This is not just an issue for the private build to rent market – the industry has noted that in England there is a social housing rental cap of 7%, in Wales we understand the related policy is a cap of 6.5%, and we fear this will add to the pressures already noted above that will see investment for social housing driven towards England.

Question 2

What has been the impact of these temporary measures on your perception of risk associated with involvement in the rental sector in Scotland?

9. The risk of investing in Scotland has increased significantly since the introduction of the Emergency legislation. In the words of more than one of our investor agent members they are 'not finding one fund' willing to invest in Scotland since the legislation was passed. Other direct evidence received since the call for comments included an expectation by one developer that the capital investment earmarked for Scotland by their investors would be 'redeployed' (this involves £100m.s of investment and hundreds of new homes of all tenures). This has translated into the risk premium associated with Scottish investments. One highly respected market commentator noted succinctly:

   'The freeze has, however, increased the risk premium of institutions looking to invest in Scotland.'

   We cannot emphasise enough that the government's policy decision to introduce the Cost of Living (Tenant Protection) Act has directly caused uncertainty in the market about longer term policies towards investment in Scotland. By itself, this factor has increased the risk associated with Scottish based real estate investment and this is not just confined to the residential market.

10. A developer directly active in the market who has successfully sourced international investment for affordable housing projects in Scotland and who had an active pipeline in excess of £100m told us that:

    'putting a rent freeze in place, even for a temporary period, destroys confidence and generates uncertainty especially during a period of high inflation.'

11. We are informed by the evidence received that this increase in risk associated with Scottish investment is not confined to UK based investors. Residential investors based in Europe and familiar with rent regulation policy have also fed back to say they will not invest in Scotland due to the lack of consultation of the emergency measures. For example, one institutional investor

respondent based in Europe with experience of UK city centre build to rent investment, who an SPF member invited to comment with experience of UK city centre build to rent investment noted:

‘the imposition of the rent cap without consultation or prior warning, albeit with a specific time period, has directly affected the attractiveness of Scotland in terms of ability of developers to secure funding. The prospect of further ‘surprise’ interventions in the market by the Scottish Government diminishes the ability of developers to fund their projects and is weighed in the current ‘flight to quality’, with the result Scotland is increasingly becoming less attractive as a destination for development.’

12. Many commentators, including the Scottish government, have noted the existence of rent controls in other counties. The government should be cautious however of drawing too close a parallel with other jurisdictions. The evidence of rent control policies in Sweden and Ireland suggests this has led to a restriction in the supply of new homes for rent which can lead to upwards pressure on rents for newer properties.

Question 3

Do you have evidence of behavioural changes as a direct result of the temporary measures coming into force?

13. Yes – immediate withdrawal of investor interest leading to loss of new homes as well as investors diverting finance from Scottish social housing to projects based in England. One senior executive from a private developer recently publicly cited the new legislation as a reason it was harder to deliver new rented housing in Scotland, with the subsequent loss of a new 300 home project and the likely diversion of PRS investment again to England.

14. The impact of the emergency legislation on the new ‘build to rent market cannot be underestimated. This market has been slower to develop in Scotland but had recently gained significant momentum towards delivering much needed supply of new rented homes. The emergency legislation has stymied the development of this new market and this will stop the market enhancing the scope of its product as we have seen the BTR sector develop in England for example. This progress has seen the delivery of new rented houses, as opposed to ‘apartments’, or indeed of wider discounted market rental opportunities for new homes.

15. On top of this sector slowdown, a range of investors have left potential working partnerships intended to deliver new affordable homes in Scotland. This means less interest for potential new construction sites and the loss of jobs and homes that entails. We have also had limited feedback by businesses engaged with the social housing sector that there has been an increase in non-payment of rent and anti-social behaviour by tenants, who know they cannot be evicted.

Question 4

Is there any other evidence (qualitative or quantitative) you can provide at this stage about the impact of the temporary measures to date?

16. We note the announcement of a pause in proposed £1bn investment by City Facilities (Glasgow) in affordable housing. We have seen accumulated figures below from a range of projects in Scotland, both for BTR and affordable housing which are additional to the pause in investment highlighted by City Holdings.

17. In addition, we believe that since the legislation was announced on 6 September 2022 new build rented housing proposals have been reduced (or 'paused') by some **3,954 homes** of which we are aware. In financial numbers, we understand the pause in investment, or loss of investment, **is worth at least £717m** at this early stage since the announcement of the Cost of Living legislation.

18. The government should be aware that the impact on investor perspectives will not be limited to just the provision of rented housing for either public or private purposes. The uncertainty and loss of investor confidence associated with the policy has the potential to feed into perceptions of other forms of market activity. However, as we stated in our formal submission to a New Deal for Tenants we understand and suggest that investors and the wider market would be more than willing to discuss the need to address price inflation, supply and sustainable financial investments. We would also stress to Ministers the need to recognise the interlinked nature of the property markets across all forms of residential investment. Continued loss of supply in the lack of build to rent product, the continued loss of traditional PRS homes and a lack of private investment that is critical to support social housing, will act together to delay other housing developments (particularly given changes to the mortgage markets), and ultimately this will apply further pressure on housing prices in sought after areas. We see the restoration of certainty and predictability for the rented housing sector as vital if long term issues of affordability and improvement of homes of all tenures is to be achieved.

19. The government itself has accepted that there is very limited data on existing in tenancy rental increases. The SPF has supported this view consistently and our members remain willing to work with the government to address this data gap. The industry has noted that the limited evidence available suggests annual increases of in-tenancy rents at around 3.6% up to August 2022. We are concerned that on too many occasions the rental evidence cited to support policy initiatives is based on advertised rents for new tenancies entering or returning to the market, rather on actual changes in existing rental tenancies.

20. The SPF is not the only organisation to have raised concern not just with the detail of the Cost of Living legislation but also with the manner and concept of policy development in this area. We have referred to our earlier concerns related in a New Deal for Tenants and noted that we felt investors could be reassured by a constructive discussion with the government on the future of rent regulation. Shortly after the New Deal for Tenants consultation closed a prescient report for the RentBetter Research project supported by the Nationwide Foundation made the following points:

    "In relation to the PRS supply, there are clearly unintended consequences of layer on layer of regulation from different legislators on different things – tax, tenancy law, climate change, Coronavirus legislation. As legislators in Scotland plan to introduce more regulation, they should consider the findings of this research and the potential negative impact on supply and access to the PRS. Reduced supply and access to the PRS will have a disproportionate impact on lower income and other demand groups in housing need, compared to the general PRS population"

21. We conclude by underlining that we feel there is a genuine desire among long term private sector institutions to invest in a better rented housing stock across all tenures in Scotland, but the recent announcements have clearly deterred this critically needed private investment at this

point. We repeat as we have said publicly before that we understand and welcome the motivation of the government to support people during this cost of living crisis. Unfortunately, we must conclude from the clear and unequivocal evidence that we have received from our members, that the negative unforeseen consequences of the emergency legislation for investment of all tenures, makes it inevitable that far more people will be negatively impacted by the measures as they stand, rather than be protected. We urge the government to consider the ‘asks’ we make in paragraph 2 to revitalise investment in rented housing in Scotland.

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