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By email

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Dear Kenneth,

Thank you for your letter of 25 June 2024. I now seek to provide the clarity you requested about the Financial Memorandum for the Housing (Scotland) Bill. Specifically, I address the stakeholder concerns which you have highlighted on costs relating to the homelessness prevention duties and rent control, and the potential unintended consequences that have been suggested which may follow on from rent control implementation.

First, on homelessness prevention and the suggestion that the *"estimated costs provided significantly under-estimate the cost of effective implementation"* you asked:

- ***"how the estimates in the FM have taken into consideration the views provided by local authorities during consultations preceding the introduction of the Bill?", and***
- ***"how the Scottish Government expects these increased costs to be met, and by whom".***

The provisions in the Housing (Scotland) Bill which constitute the homelessness prevention duties are based on the recommendations of the expert Prevention Review Group published in February 2021. In addition to the organisations included within its membership, 108 organisations were consulted during the development of its recommendations, including 20 local authorities, ALACHO and COSLA.

Following the publication of the recommendations a public consultation took place between December 2021 and April 2022 as part of the policy development process leading to the provisions in the Bill. It was jointly undertaken by the Scottish Government and COSLA, in line with the approach to the Ending Homelessness Together Action Plan. It received 113 responses, of which 29 were from local authorities.

Further to this local authorities were surveyed specifically on the resource implications of the proposed changes in December 2023. A total of 19 replies were received. The survey sought a cross organisational response from each local authority taking account of the

potential impact of the prevention duties on services outwith housing and homelessness, recognising the role for education and social work for example, in preventing homelessness.

A wide variety of responses were received to that survey from which the Scottish Government sought to develop a uniform approach, based as much as possible on the methodologies put forward by the local authorities themselves. Due to the diverse approaches taken a range of estimates were developed in relation to staffing in particular, to demonstrate the potential breadth of impact of the changes.

The analysis of responses directly informed the approach set out in the Financial memorandum which was drafted for the point in time when the Bill was introduced to parliament, as required by Standing Order 9.2. It sets out the Scottish Government's "*best estimates of costs and savings... to which the provisions in the Bill will give rise*". The Scottish Government does intend to keep considerations relating to the homelessness prevention analysis as a live consideration as the Bill progresses through parliament particularly if/when stakeholders provide additional and robust evidence in support of alternative costings or which supports changes to the assumptions used.

The Scottish Government is also actively considering how to engage with the relevant bodies listed in the Bill in order to refine its understanding of the potential impact (positive and negative) of the changes on those organisations specifically. In order to reflect the dynamic and changing operating context of the housing sector, consideration is also being given to a follow up survey with local authorities to provide further opportunity to inform the Scottish Government's understanding of the impact.

While that is the case, the Financial Memorandum does not set out the future budget to support implementation of any changes following the completion of the Parliamentary passage of the Bill. Budgets will need to be considered in the round and as part of the annual Scottish Budget process taking account of the timelines identified for implementation. No date has yet been set for implementation of these provisions and discussions are planned with stakeholders including local authorities and the relevant bodies to inform considerations and to take account of their state of organisational readiness.

The changes included within the Bill will require local authorities and the relevant bodies to work differently. Existing practices which currently require resource will need to be replaced with new approaches. While there will likely be a period of transition from one arrangement to another it is not the case that all of the changes are additional actions. There is a clear cross sector understanding that a lot of effective prevention activity is already happening across the country and the changes in the Bill seek to build on that. There is also cross sector recognition that early intervention can result in savings – financial and more widely – over time and so the anticipated outcome of the homelessness prevention duties is to reduce public spend on homelessness crisis intervention and therefore not a need for sustained increased funding.

Secondly, on rent control and the suggestion that "*increased workload and bureaucracy for local authorities to collect data from landlords have not been properly assessed*" you asked:

- ***"what support will be provided to local authorities to enable them to undertake detailed assessments of the private rented sector for the purposes of designating and managing rent control areas?"***

I would like to stress that the Scottish Government is committed to working with local authorities on how best to deliver an effective system of rent controls, which allows local circumstances to be taken into account, including consideration of the powers and resources needed to support implementation.

To this end, my officials established a local authority working group to support the development of the approach to assessment of local conditions in relation to rent in local authority areas. As part of the preparation of the Financial Memorandum for the Bill, my officials sought information from local authorities to support consideration of additional costs to meet the new duties as part of the rent control measures, and indicative costs were estimated taking these responses into account.

The Scottish Government will continue to work with local authorities in developing the detailed approach to implementation, including to understand the resources required to support their role in delivering a long term rent control system that works for Scotland.

Finally, turning to the concerns regarding the potential unintended consequences that may follow rent control implementation you requested:

- ***"the Scottish Government's reflections on the issues raised in evidence in relation to the potential loss of investment arising as an unintended consequence of the Bill [...] what assessment the SG has undertaken of the financial impact of a potential downturn in the private rented sector."***

The Scottish Government recognises the vital role that private landlords have in providing the homes Scotland needs now and in the future, and also the importance of private sector investment in housing to underpin quality, supply and affordability in this part of our housing system.

An assessment of the potential effects of rent controls on the sector, along with an assessment of potential cumulative impacts of rented sector reforms, has been carried out as part of the comprehensive Business and Regulatory Impact Assessment (BRIA) for the rented sector reform measures in the Housing (Scotland) Bill. We will be publishing this document shortly, along with the BRIA for the Bill.

The framework for introducing rent control brought forward in the Bill has been designed taking account of the need to balance our aim of stabilising rents with supporting landlords to continue to provide good quality rented homes. We will continue to work with stakeholders across tenants, landlords and investors as we develop a system of rent control that works for Scotland. The legislation needs to be robust and fit for purpose, and the issues stakeholders are raising about the potential impact of rent control on investment will be an important consideration in the implementation of rent control measures.

The preparation of the BRIA was informed by engagement with a broad range of stakeholders as part of developing the measures proposed in the Bill, including targeted engagement with a range of key business stakeholders including social and private landlord

representative bodies, letting agent representatives, housing investors including build to rent providers, and UK Finance. Consideration has also been given to existing evidence on international experience of rent controls. A summary of some of the issues considered in the BRIA is set out below.

The literature on international experience of rent controls shows that the impact of a rent control system is likely to be highly context dependent, influenced not only by the specific features of the design of each system, but also by local factors such as the overall regulatory context, cultural attitudes toward renting, the prominence of the private rented sector and the nature of the welfare system.

However, possible unintended consequences have been identified, such as

- reduced incentives to invest in new supply,
- reduced incentives to invest in property maintenance,
- reduced labour mobility (particularly if rent controls operate differentially with respect to geography and/or type of tenant covered), and
- spill-over impacts on neighbouring markets, or non-controlled segments of the market.

Rent control systems have sought to mitigate potential unintended consequences in a variety of ways which are intended to achieve an appropriate trade-off between the competing goals of stabilising rents and minimising any unintended consequences, and we have taken this into consideration when designing an appropriate system of rent control for Scotland.

A key lesson from the literature is that, because the impacts of a rent control system on different groups depends on how the rent control system as a whole operates in its particular regulatory, financial and economic context, it is generally not possible to say that a given rent control system will work in all international contexts. Similarly, it is not possible to say that any particular element of a rent control system is beneficial in all contexts. Generally, each element will have costs and benefits for tenants and landlords, and choosing the optimal trade-off needs to consider how these costs and benefits vary in the light of other elements of the framework and the wider context.

The impact of a rent control system needs to be considered in the round. However, international experience from countries such as Germany, Ireland, France, Norway and Sweden shows that strong regulatory regimes are not incompatible with a sizeable private rented sector.

With respect to the PRS in Scotland, the Scottish Government has noted the evidence from recent research and engagement that some landlords may be considering partially or completely divesting from the sector in response to proposed regulatory changes, and we have also considered these as part of the BRIA for the Bill measures. There are, however, some important caveats which apply to such data. Firstly, as is typically the case with qualitative studies, although the research design tries to reach a range of landlords, the results are not designed to be statistically representative of the PRS as a whole. In particular, those who are motivated to engage with such research may be disproportionately likely to be concerned about the proposals. Furthermore, landlord concerns may also reflect factors beyond the specific proposals from the Scottish Government, such as changes to the tax regime such as the restriction of tax relief on

mortgage costs to the basic rate of tax, which is a UK Government rather than Scottish Government policy.

More importantly, the Scottish Government considers that caution should be exercised when assessing whether stated intentions in surveys will translate into action. Respondents can be seeking to signal their dissatisfaction with the proposed measures to policymakers, and they might not follow through (either completely or partially) when measures are enacted, perhaps because the changes do not have as negative an impact on them as they feared. Even if some landlords do partially or fully exit the sector, the impact on the overall size of the sector will depend on the size of this disinvestment – there is always a degree of churn, with new entrants replacing those who leave.

It is therefore instructive to look at previous periods of increased regulation. There has been considerable growth in the PRS in Scotland during the last two decades, a period which has seen significant regulatory intervention (although most of this regulation has not been price related).

While the available data shows the size of the sector is somewhat below its peak, it remains significantly larger than it was in the early 2000s. There are a number of factors other than regulation which affect the size of the private rented sector (for example, market conditions which affect access to home ownership such as the level of house prices, mortgage interest rates and loan to value ratios, will in turn affect demand for private lets), but the data does suggest that a greater degree of regulation is compatible with a sizeable PRS.

Temporary price regulation was introduced in Scotland in October 2022 in the form of a cap on rent increases, initially set at 0% for 6 months and then at 3% for a further 12 month period, as part of the Cost of Living (Tenant Protection) (Scotland) Act 2022. According to Scottish Landlord Register (SLR) data¹, there has in fact been a small increase (2.1%), in the number of properties on the register from 339,632 in August 2022, immediately prior to the legislation, to 346,767 in April 2024.

Rent control is designed to help stabilise rents in areas where market rents have been increasing particularly steeply, whilst ensuring there can be a balanced approach that provides appropriate protection for the property rights of landlords, and the Scottish Government has sought to choose an appropriate framework to achieve this aim.

The Scottish Government acknowledges that uncertainty around where rent controls may be applied in future, and the form controls could take in any specific area, may impact landlord and investor considerations. There is a possibility that this may influence decisions reached by landlords who are considering leaving the sector, and those considering investing in the PRS in Scotland. If this uncertainty drives decisions that result in landlords exiting the sector or limiting investment, it could impact on the availability of rented property and increase rents in the long term, if former rental properties were removed from supply chain in sale to owner occupiers, which could have wider impacts on tenants and on the sector.

¹ There are some limitations in the SLR data, such as the fact that registrations last for a period of three years and there could be a time lag in landlords de-registering properties no longer available for rent, also data for 2018 and 2019 was affected by changes in the underlying IT system and is not used in this summary.

The Bill therefore includes a duty to consult with stakeholders (including landlord and tenant representatives) before a final decision is made on whether rent controls should be imposed in any area, including on the level of the rent cap that would apply. The legislation is designed so that any cap applied would only be in place for a specified time, barring changes in the local circumstance. Scottish Ministers are under a duty to keep the operation of rent control areas under review and to vary or revoke the measures if no longer necessary or proportionate. Any decision to continue to apply rent control in an area will require to be subject to a new assessment and designation process and it is considered that this should give a degree of certainty to the sector.

The wider impacts of any rent controls applied are difficult to quantify, as they will depend on the circumstances in specific local areas, and the level of rent increase permitted in light of that.

The Scottish Government considers it essential that there is a balanced approach with safeguards for landlords. The Bill includes a power that allows for Scottish Ministers to make provisions for rent increases above the rent cap for specified properties, based on the circumstances of the tenant, landlord, or description of the property. Scottish Ministers also have a separate power to exempt certain categories of property from the requirements of rent control, again based on the circumstances of the landlord, tenant, or description of the property.

The details of any such safeguards would be set out in secondary legislation to ensure that delivery and implementation of the measures is sufficiently flexible to take account of emerging issues, current market conditions and pressures. Scottish Ministers would be required to consult on proposals for safeguards to ensure transparency and allow those affected to have their views considered.

The purpose of the rent control measures in the Bill is to stabilise rents for PRS tenants, as people who rent their homes are more likely to live in poverty, be financially vulnerable and live on low incomes, compared to those who own their home either outright or with a mortgage. We have always been clear that efforts to stabilise rents must ensure a balanced approach that provides appropriate protection for the property rights of landlords.

I am also very clear that continuing to attract private investment is a priority to maintain the vital supply of new homes for rent that our communities need.

The Scottish Government are listening to the information shared by stakeholders on what needs to be considered to support investor confidence, and I will continue to consider this as I look to ensure Rent Control supports investment in a quality, affordable and thriving PRS.

I trust my reply will help inform the committee's considerations.

Yours sincerely,

PAUL MCLENNAN
Minister for Housing