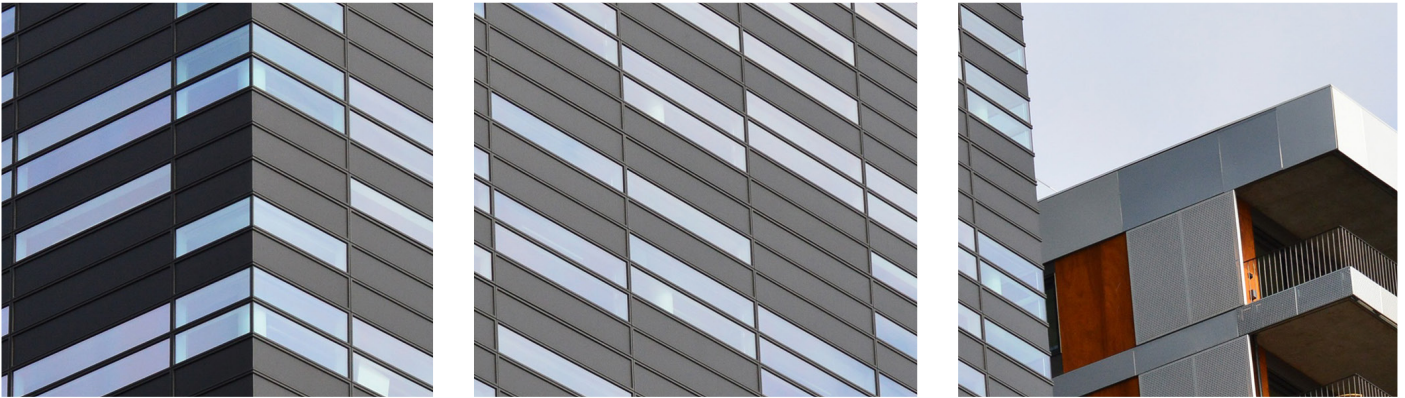


Rent Pressure Zones: What next for PRS investors?



Scott Ritchie

scott.ritchie@shepwedd.com

Edinburgh City Council has recently indicated an intention to seek a 'rent pressure zone' (RPZ) within its council area. Councillors at Aberdeen City Council have also noted that they will be monitoring rental levels in the Aberdeen area to assess whether an RPZ is required in that part of Scotland.

What is an RPZ?

An RPZ is an area designated by the Scottish Ministers under the *Private Housing (Tenancies) (Scotland) Act 2016* (set to come into force in December 2017). Its intended purpose is to protect tenants situated in rental 'hotspots' from excessive rent increases in areas showing higher than average rental increases.

Under the new form of residential tenancy to be introduced under the 2016 Act (the private residential tenancy), a landlord will be entitled, every 12 months, to increase the rental payable under the tenancy to match any increase in the open market rental value of the rented property. If an area is designated as an RPZ, then the amount by which a landlord will be entitled to increase the rent at such an annual review will be 'capped' at an amount set by the Scottish Ministers. This cap must allow rents in an RPZ to rise by at least the same amount as any increase in the Consumer Price Index (CPI), plus at least an additional percentage point (i.e. CPI plus 1%). When introducing an RPZ, the Scottish Ministers will have the power to add an additional percentage to this cap if they consider this appropriate (e.g. the cap could be set at CPI plus 2%).

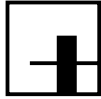
Good news for tenants, bad news for PRS investors?

Are the recent council announcements all good news for residential tenants, and bad news for those that have

invested in the private rented sector? The answer lies in the 2016 Act, and also the draft supplementary guidance for councils published earlier this year.

The following points should be noted by any PRS investors:

1. The rent controls applying to an RPZ area restrict only the amount by which a landlord can increase the rent annually under a subsisting private residential tenancy. In other words, the controls only protect 'sitting tenants' relative to rent reviews, and do not therefore limit the initial rent that a landlord may seek to achieve from time to time on any new letting in the open market. There will be no restriction on landlords seeking to achieve the highest possible rent for their properties when they are letting for the first time or re-letting their accommodation.
2. As mentioned above, an RPZ will still allow rents for subsisting tenancies to be increased annually (if supported by increases in open market rents). An RPZ will simply cap the annual open market increase by no less than the amount by which CPI has increased since the last annual rent increase (plus at least 1%, possibly more). Investors will therefore still retain the benefit of rental growth within this limit.



3. Whilst it is open to a council (such as Edinburgh) to apply for the introduction of an RPZ, the Scottish Ministers may only create an RPZ if all of the following circumstances exist:
 - rents payable within the proposed RPZ are rising by too much;
 - the rent rises within the proposed RPZ are causing undue hardship to tenants; and
 - the local authority within whose area the proposed RPZ lies is coming under increasing pressure to provide housing or subsidise the cost of housing as a consequence of the rent rises within the proposed RPZ.
4. Draft Scottish Government guidance indicates that 'robust evidence' will be required to support an RPZ application, together with an explanation as to how that evidence leads the local authority to believe that the criteria set out at paragraph three above has been met. In addition, the draft guidance also notes that rents must be shown to be rising excessively across most PRS properties, including different property sizes, within the proposed RPZ. In order to designate an area as an RPZ, the guidance indicates that Ministers must be satisfied that most existing tenants within the proposed RPZ area are experiencing excessive rent increases. If the proposed area contains various property sizes, the guidance notes that Ministers are unlikely to designate the area as an RPZ if rents are only increasing excessively across one or two particular property sizes.
5. An RPZ area will not necessarily cover the entirety of the local authority area. Instead it might be certain streets or postcode areas. Again, rents within the proposed RPZ must be shown to be rising excessively across most PRS properties within the proposed RPZ area.

6. Before introducing an RPZ, the Scottish Ministers must first consult with representatives of landlords and tenants within the proposed RPZ area to hear their views.
7. In the event that an RPZ area is introduced, then the RPZ will cease to have effect after five years (unless revoked earlier by the government).

What next?

It remains to be seen what will actually happen when the 2016 Act comes into force at the end of this year. Are the recent announcements by councillors simply 'political' in nature, or is there clear evidence that an RPZ is merited under the new legislation?

What is clear is that the introduction of an RPZ is not solely within the gift of local councils. An application for an RPZ needs to be approved by the Scottish Ministers, and in order to be a valid application, the various matters highlighted above require to be addressed.

An RPZ must be justified by reference to 'robust evidence' and cannot therefore simply be introduced on the basis of anecdotal evidence. An RPZ must also be targeted, and not simply apply to an entire council area without reference to the variety of properties and local housing markets within that area.

Even if the various tests/checks for an RPZ are satisfied, rental increases will only be 'moderated' rather than prevented. In the case of new lettings, there will be no restriction at all on the initial rent agreed.

Whilst the property industry will follow the rent pressure zone discussion with interest, the possible future introduction of an RPZ is far from being a leap in the dark.

Key contacts



Scott Ritchie

Partner

T +44 (0)131 473 5761

M +44 (0)751 531 5226

E scott.ritchie@shepwedd.com



Michael Henderson

Partner

T +44 (0)131 473 5189

M +44 (0)781 806 1003

E michael.henderson@shepwedd.com