

# Shelter Scotland

## Keeping rents reasonable and predictable in the private rented sector

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**Shelter**  
Scotland

## Summary

- The Scottish Government should act to enhance security of tenure in the private rented sector (PRS), as the sector continues to grow and plays an increasing role in providing homes for families and those priced out of home ownership. The PRS should move away from using short-term tenancies and provide open-ended tenancies which would provide tenants with a home for as long as they need.
- Tenants should be protected from unpredictable and unreasonable rent rises and a method for fixing rent which suits both landlords and tenants should be a key part of any tenure reform in the private rented sector. Shelter Scotland believes that rents should be reasonable, stable and predictable. Income through rent should continue to provide landlords with a reasonable return, encouraging investment in the sector.
- Shelter Scotland does not consider that the introduction of rent control by the way of rent caps is an effective method of keeping, or making, rents affordable. This can have a detrimental effect on the rental market: people at the very bottom of the market lose out as rents rise to meet the cap. At the same time landlords are given little incentive to invest in their rental properties and are put off from carrying out repairs, harming housing quality and supply in the PRS.

## Recommendations

Shelter Scotland considers that the method for fixing rents in tenancies with enhanced security of tenure should be set as follows:

- **Initial rents should be set by the market:** landlords and tenants would still be free to negotiate rent levels at the beginning of a tenancy.
- **No more than one rental increase per year:** this should be a statutory limit, similar to that in the full assured tenancy regime, but applicable across all tenancies.
- **Rent increases within the tenancy to be set in line with the local market:** landlords would be free vary rents in line with the local market, subject to an upper limit in line with CPI.
- **Three months' notice:** tenants should get three months' notice of any proposed rental increase.
- **Power to refer to the Rent Assessment Committee:** tenants should have the power to refer any dispute over rent increases to the Rent Assessment Committee.

## Introduction

Shelter Scotland wants to see a PRS that delivers stability and security, particularly for low-income households and families. If security of tenure for private tenants is increased<sup>1</sup> we need to consider how rents are varied during a tenancy. Shelter Scotland believes that enhanced security of tenure, coupled with a method of reasonably varying rent during a tenancy which has an element of predictability, is key to a well-functioning PRS. This briefing paper sets out the possible options for setting rent in open-ended and secure, private rented tenancies.

We know that the affordability in Scotland's PRS is also a key issue, however, this paper does not deal with affordability directly. At present there is no concrete evidence on the level of rent being paid across the whole of Scotland's private rented sector. However, the latest figures for September 2014 suggest that average advertised rents across part of Scotland's PRS currently stand at around £736 per month.<sup>2</sup> Some indicators suggest that rent increases have not kept pace with inflation, while others suggest that in some areas rent increases are outstripping inflation. Once in-depth data on rental levels across the whole of Scotland is published Shelter Scotland will undertake this work on affordability.

## Why are reasonable and predictable rents important for today's private rented sector?

The PRS has traditionally been seen as the sector of choice for those seeking flexibility, for example young people and students, however, this picture is changing rapidly. In Scotland, the private rented sector is currently home to 312,000 families and individuals with growth in the sector increasingly being driven by households with children – over a quarter of

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<sup>1</sup> Shelter Scotland, 'The case for enhanced security for private tenants in Scotland', September 2013

<sup>2</sup> CityLets, Quarterly Report, Quarter 3, 2014 <http://www.citylets.co.uk/research/reports/>

households renting privately now contains children (80,000).<sup>3</sup> This proportion is growing rapidly: the number of children living in private rented accommodation rose from 6% in 2004/5 to 16% in 2010/11.<sup>4</sup>

Another group who are driving the sector's growth is the so-called 'Generation Rent' – a younger generation of renters who, over the years, have effectively been blocked out of home ownership and social housing due to rising costs and falling supply. Currently around a third of the 16 to 34 age group rent privately, up from 13% in 1999.<sup>5</sup>

Having a stable home is particularly important for families with children; frequent moving has been shown to have a negative effect on the health of children.<sup>6</sup> Not only do unpredictable rents and insecure accommodation<sup>7</sup> push people into financial difficulty and impact on health, they also make it hard for people to challenge poor conditions and bad management standards. Tenants may be afraid that their rent will be increased, or that they will have to move, and struggle to find affordable accommodation locally.

These factors underline the importance of having a method of varying rent which provides for stability and predictability for both landlords and tenants. Households in the PRS should be able to effectively plan for their future. Those families and individuals who have been driving the sector's growth over the past ten years are the same people who, ten or twenty years ago, would have aspired to home ownership, or to a secure socially rented

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<sup>3</sup> 26% of households in the PRS have children, see Scottish Government, 'Scotland's People, Annual report: 2011, Scottish Household Survey 2011',

<http://www.scotland.gov.uk/Publications/2012/08/5277/downloads> - detailed breakdown of data made available on request

<sup>4</sup> Scottish Government, 'Growing up in Scotland: Birth Cohort 2, Results from the first year', p45

<sup>5</sup> Scottish Household Survey 2010 as cited in 'Private rented sector – Evidence Review', Scottish Government, April 2012

<sup>6</sup> Department for Communities and Local Government, 'Moving on – reconnecting with frequent movers', 2006

<sup>7</sup> Most private tenants rent under short assured tenancies, which offer a minimum of six months' security of tenure, see para. 4.56, Scottish Government, 'Review of the Private Rented Sector: Volume 1', 2009, <http://www.scotland.gov.uk/Resource/Doc/264996/0079349.pdf>

home. As securing these options becomes tougher for these groups, we must work to achieve similar levels of predictability and security that would have been offered to them in the past.

Stability and predictability matters for landlords too. Research commissioned by Lloyds Bank into the incidence of mortgage arrears among buy-to-let landlords<sup>8</sup> found that although lenders and regulators think of buy-to-let as a business it is not always operated as such. The reliance on rapid capital growth rather than rental income meant that less than a third of landlords had sustainable business models for their letting activities. They found that professional landlords believed that rental income should always cover the mortgage and the associated costs of letting. Regulation that ensures that landlords can get a stable and predictable return from letting property encourages the development of a more professional approach to letting and encourages landlords to plan to invest in the maintenance and repair of their properties.

## Background: rent regulation in Scotland

Rent controls were first introduced in Scotland in 1915<sup>9</sup> as a reaction to excessive rents being set by private landlords exacerbated by wartime economics. High rents led to rent strikes, the most significant of which took place in Clydeside.<sup>10</sup> The government intervened and fixed private rents at their 1914 levels, these controls lasted until the mid-1950s with modified restrictions. During this time rent control was given as one of the main reasons for the decrease in house building and the lack of repair work being carried out on PRS

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<sup>8</sup> Wallace, A. and Rugg, J. (2014) *Buy-to-Let Mortgage Arrears: Understanding the factors that influence landlords' mortgage debt*. University of York and Lloyds Banking Group, <http://www.york.ac.uk/chp/expertise/private-rented/publications/>

<sup>9</sup> Increase of Rent and Mortgage Interest (War Restrictions) Act 1915

<sup>10</sup> para. 9.01, Robson, 'Residential Tenancies', 3<sup>rd</sup> Edition, W. Green, 2012

homes, as landlords were unable to make a return on their properties.<sup>11</sup> However, the high cost of building and unavailability of building materials were also major contributing factors.

In an attempt to address this, controls were adjusted to allow landlords to pay for upkeep, although these allowances rarely translated into better standards for tenants. Eventually rents were gradually decontrolled in the mid-1950s.<sup>12</sup> It was thought that by allowing landlords to increase rent, this would translate into repairs for tenants. This did not take place to a great extent; landlords were keener to sell off old properties rather than invest and problems around quality persisted.<sup>13</sup>

In a response to this, and in an attempt to legislate in a more long-term way in relation to rents, a system of 'fair rents' was introduced to the United Kingdom in 1965.<sup>14</sup> This set out a formula for setting rent which made allowances for supply being out of kilter with demand in the rental market. The aim was to replicate a market where supply is equal to demand by deducting an amount to account for 'scarcity'. This attracted a significant amount of criticism, mainly due to inconsistency in decision-making and a lack of clarity. Many rents were considered too high, especially compared to historic controlled rents some of which still existed. Landlords also saw the system as being too cumbersome.<sup>15</sup>

During this period of control the size of the PRS shrank significantly. Before controls were introduced around half of the UK's housing stock was privately rented,<sup>16</sup> by the mid-1980s this had declined to around 10 per cent.<sup>17</sup> This was partly due to the unprofitability of

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<sup>11</sup> p.30, Kath Scanlon and Ben Kochan, 'Towards a sustainable private rented sector', LSE, 2011

<sup>12</sup> Rent Act 1957

<sup>13</sup> pp.62 - 64, J.B. Cullingworth, 'Essays on Housing Policy: The British Scene', 1979

<sup>14</sup> By Richard Crossman's government through the Rent Act 1965

<sup>15</sup> pp.67 - 69, *Ibid*

<sup>16</sup> p.37, *Ibid*

<sup>17</sup> p.58, Chartered Institute of Housing, 'Housing in Scotland', 1996

private landlordism at the time, which was not only linked to rent control but also to the wider housing market. Since the First World War there had been a boom in council house building and during this period home ownership was often cheaper than private renting. The council properties on offer were of a higher standard than much of the private rented housing, so these were preferred by low income tenants. And for those on higher incomes the various benefits offered to homeowners at the time, e.g. exemption from capital gains tax and tax relief on mortgage interest, meant that these households on the whole opted to buy.<sup>18</sup>

The private rented sector needed some kind of boost and this was attempted through deregulation in the late 1980s and the introduction of the assured tenancy. Rents were to be set by the market, and landlords had the option of giving their tenants little in the way of security of tenure by using the short assured tenancy. While this deregulation is often attributed to the recent boom in private renting, the boom also took place over time when other forces have been at play in the wider housing market. Over the past ten years we have seen home ownership become increasingly unaffordable for many. Alongside this we've seen a boom in buy-to-let mortgages which has brought a new generation of private landlords into the market. Therefore, the view that rent regulation and security of tenure effectively killed the private sector, and deregulation in the 1980s instantly boosted it, is not the whole picture.

## Rent regulation in today's private rented sector

In areas where private rents are rising particularly sharply – for example where rents are rising faster than wages – rent regulation, in the form of rental caps, may seem like an attractive option, but it is Shelter Scotland's view that this would not be the correct

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<sup>18</sup> Paul Spicker, 'The private rented sector' as published in C Jone, P Robson (eds), 'The health of Scottish housing', Aldershot: Ashgate, 2001



solution to the problem. A rent cap could fix rents at their current levels for a prolonged period of time, or impose upper limits on rents, depending on the size and location of a property. However, caps can often throw up unintended consequences – they can act to price out those at the very bottom of the rental market as rents rise to meet the cap. They can also act to discourage investment in rented property by landlords. In extreme cases even the most basic repairs may not be carried out, as was the case in 1930s Britain.

In the context of today's buy-to-let market – where rental income can often be more important to landlords than capital return – this could have significant consequences. If rent levels fail to cover landlords' mortgage payments to an adequate level then they will most likely be discouraged from investing in the property, with properties being kept to a very basic level of repair at best. Further, most landlords in Scotland own only one or two properties<sup>19</sup> and have limited capital to invest in their properties. Severely limiting their rental income has the potential to impact significantly on the standard of rented accommodation in the long-run. The lifting of any cap, should the market get to a point where it is able to provide affordable rents for tenants, also has side effects. Landlords seeking higher profits from their rented accommodation may attempt to force out sitting tenants to take advantage of a more relaxed rental controls. If rent caps are relaxed within a tenancy new rents may become unaffordable for tenants who are currently renting, and they will have no choice but to find other accommodation.

While Scotland's history of rent regulation does provide useful context for discussing rents today, it is important that we recognise that much of the regulation and its impact took place when the UK's housing market functioned entirely differently to how it functions today. Social housing was far more prevalent and markets were pressured for different reasons. The recent boom in private renting in the UK has been driven by the buy-to-let market, in turn fuelled by the increase in house prices coupled with stricter approaches to

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<sup>19</sup> Scottish Government, 'Evidence review of the private rented sector', April 2012

borrowing from lenders since the credit crunch in 2007-08. It has also become increasingly difficult in to secure a socially rented home.

This is the context within which we need to consider how rents are to be set today, and in the immediate future. Given the unwieldy nature of introducing rent caps, and the unintended consequences associated with it, Shelter Scotland does not consider this to be an effective tool to ensure rental affordability in today's PRS.

## How do landlords set rent in Scotland's private rented sector?

Currently, a market rent should be agreed between the landlord and tenant at the beginning of a short assured tenancy. Private landlords are then free to increase rent once a short assured tenancy reaches the end of its fixed term. The frequency for rent increases if a tenancy enters a rolling month-to-month arrangement should be written into the lease agreement. This must not constitute an unfair contract term, otherwise it may be open to challenge by the tenant. (If a landlord wishes to increase rent during the fixed term this must be explicitly laid out in the tenancy agreement). Technically, this gives landlords the legal power to increase rents every month where a short assured tenancy enters a rolling period.

### **Rents under short assured tenancies: the legal framework**

There is no strict limit on the frequency of rental increases under a short assured tenancy. Usually landlords will wait until the end of the fixed term to increase the rent, although provisions for rent increases during a fixed term can be written into a tenancy agreement. Where a tenancy enters a rolling month-to-month arrangement landlords are technically free to increase as frequently as they want, so long as this is written into the tenancy contract and does not

constitute an unfair term under the Unfair Contract Terms Act 1977. Similarly there is no set period of notice to be given to a tenant in relation to rent increases, however, a very short notice period may also constitute an unfair term. In reality it is unlikely the majority of landlords would want to push up a tenant's rent very frequently, for example every single month, even though the legal framework allows a landlord to do this. In practice the level by which rent is increased is also up to the landlord, although tenants do have the option to apply to the Private Rented Housing Panel to have a market rent fixed if they think the rent set by the landlord is above market level. If the tenant is unable to pay an increased rent then the landlord has the power to serve a notice to quit, ending the tenancy agreement without the need to provide reasons, ultimately forcing the tenant to find accommodation elsewhere.

Rent increases during the term of a tenancy usually follow the principle of market rent, although landlords are, in reality, free to increase the rent to any level they wish. Where a tenant feels that the rent set is above the market rent, they can refer the increase for consideration by the Rent Assessment Committee (a part of the Private Rented Housing Panel) who will determine a market rent.<sup>20</sup> In practice tenants rarely exercise this right; during 2012 the Private Rented Housing Panel received 12 applications in relation to the rents of assured tenancies and made 12 determinations.<sup>21</sup> The reality is that in most cases tenants will accept the increase in rent or move. Where tenants are coming to the end of their contractual term and they cannot afford the increased rent, their landlord can legally bring the tenancy to an end without providing a reason.

The structure of the short assured tenancy is such that the ability for landlords to seek a higher rent from their tenant – one which is not necessarily in line with the market – is built into the standard tenancy agreement. If the tenant can't pay the increased rent, the

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<sup>20</sup> s.25 Housing (Scotland) Act 1988

<sup>21</sup> Private Rented Housing Panel, Annual Report 2012, <http://www.prhpscotland.gov.uk/prhp/128.html>

landlord has the power to end the fixed term and seek a new tenant. This leaves tenants in a poor bargaining position. Not only are they unable to accurately predict how their rent will vary over the course of the tenancy but, if they are unable to pay an increased rent, they have little choice but to move to a cheaper home.

Most landlords do act reasonably and landlords should be able to expect rental levels to increase over time to keep pace with the costs of financing and maintaining the property. However, what tenants need is cast iron guarantee of predictability reflected in their tenancy agreement. A method of fixing rents which builds in predictability and stability – for both landlords and tenants – would achieve this.

## What justifiable motives might private landlords have to vary rent?

There are various factors which influence how and when private landlords set and vary rents in Scotland:

- **Maintenance** – it is generally accepted that landlords will need to factor in maintenance costs to cover general wear and tear when they are working out how much rent they will charge a tenant. As the costs of ensuring properties are kept up to the required standard rise – e.g. the cost of employing tradesmen etc. – so too will rents.
- **Mortgage costs** – if interest rates rise then landlords may be forced to account for this by way of a rental increase.
- **Supply** – another obvious driver of rents is local supply. Where the supply of housing is low and demand is high rents will rise. Where this is the opposite, rents

may fall or rent increases may slow – underlining the importance to allow for both upward and downward changes in rent.

- **Property management fees** – costs associated with the management of property are also likely to change over time. If a letting agent is used and their fees increase landlords may wish to account for this by an increase in rent. Likewise if the landlord handles factoring fees, and these fees increase, the result may well contribute to an increase in rent.

Shelter Scotland wants to see a healthy rental market, one which makes sure that landlords have sufficient income from their rental properties to be able keep them to a high standard of quality. Any method of setting rent should ensure that landlords make reasonable returns on their rental income and will always have the resources to invest in their properties. Research by Jones Lang La Salle has shown that landlords' business models can handle long-term tenancies, with the longer the tenancy the greater the return for the landlord.<sup>22</sup>

## Getting the balance right: ensuring rents are predictable

Rental predictability is the key factor that must be considered if we want to see greater security of tenure in the PRS. Private tenants should be able to make effective plans for their future taking into account their finances – how and when rents are increased is an important factor in this. Some methods of rent regulation focus on setting upper limits on rent increases, rather than setting an overall cap, and Shelter Scotland considers these to be the best way of ensuring predictability for private renters.

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<sup>22</sup> Jones Lang La Salle, 'Can landlords' business plans sustain stable, predictable tenancies? A report for Shelter', June 2012, [http://england.shelter.org.uk/\\_data/assets/pdf\\_file/0004/569641/Jones\\_Lang\\_LaSalle\\_PRS\\_Shelter\\_report.pdf](http://england.shelter.org.uk/_data/assets/pdf_file/0004/569641/Jones_Lang_LaSalle_PRS_Shelter_report.pdf)

We believe that fixing an initial market rent and limiting subsequent rent increases to no more than the Consumer Prices Index (CPI) would provide an element of predictability for private tenants. Rents would still be free to rise in line with the market, so long as this does not outstrip CPI.

For example, CPI rose by 1.9% in the year to June 2014,<sup>23</sup> while rents across Scotland rose by only 1.1% over the same period.<sup>24</sup> Under this model rents would continue to rise by the market as the market is increasing below the rate of inflation. However, according to one lettings hub advertised rents in Aberdeen rose by 6.8% in one year.<sup>25</sup> In circumstances such as this an upper limit on mid-tenancy rental increases to CPI would benefit existing tenants.

Shelter Scotland considers that the method for fixing rents in tenancies with enhanced security of tenure should be set as follows:

- **Initial rents should be set by the market:** landlords and tenants would still be free to negotiate rent levels at the beginning of a tenancy.
- **No more than one rental increase per year:** this should be a statutory limit, similar to that in the full assured tenancy regime, but applicable across all tenancies.
- **Rents increases within the tenancy to be set in line with the local market:** landlords would be free vary rents in line with the local market, subject to an upper limit of CPI.
- **Three months' notice:** tenants should get a minimum of three months' notice of any rental increase.

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<sup>23</sup> Office for National Statistics, Statistical bulletin: Consumer Price Inflation, June 2014

<sup>24</sup> Experimental statistics from the Office for National Statistics as cited in Scottish Government, 'Scottish Housing Market Review', September 2014 <http://www.scotland.gov.uk/Topics/Built-Environment/Housing/supply-demand/chma/statistics/housingreviewsept2014>

<sup>25</sup> CityLets, Quarterly Report, Quarter 3, 2014 <http://www.citylets.co.uk/research/reports/>

- **Power to refer to the Rent Assessment Committee:** tenants should have the power to refer any dispute over rent increases to the Rent Assessment Committee.

This approach would benefit both tenants and landlords in the following ways:

Tenants	Landlords
<ul style="list-style-type: none"> <li>• All PRS tenants would be safe in the knowledge that the property would remain at the current rent for at least one year.</li> <li>• With three months' notice sitting tenants would not face unexpected increases in rent at short notice.</li> <li>• Tenants will be clear as to when their rent may go up, and how this will be calculated.</li> </ul>	<ul style="list-style-type: none"> <li>• Landlords would be able to more accurately predict what their future rental yield will be. Encouraging investment in the PRS.</li> <li>• Landlords would have a clear legal framework within which to adjust rents on existing tenancies.</li> <li>• Tenants who stay for longer allow landlords to make more effective investments in their properties.</li> </ul>

A clear framework for adjusting rent is an essential part of a private sector tenancy regime with increased security of tenure. It is important that such a framework provides tenants with stability and allows landlords a reasonable return on their property. This would allow both tenants and landlord in the PRS to make long term plans. Families with children – one of the key groups driving growth in the PRS – would be guaranteed that their rent would remain stable for at least 12 months. Landlords would also be able to plan long term investment in their properties, in the knowledge that they have clear framework within which to work. This would be a step in the right direction for Scotland's PRS; ensuring it is

well placed to deliver secure homes for the increasing number of young people and families setting up home in the sector.

## Conclusion

- The Scottish Government should act to enhance security of tenure in the private rented sector, moving away from short-term tenancies to open-ended tenancies with an emphasis on the private rented sector supplying long-term homes for tenants who need them.
- Enhanced security of tenure should also be coupled with finding a method of varying rent levels which ensures reasonableness and predictability for tenants.
- Rents should be set by the market at first, with subsequent variances being in line with the market and subject to an upper limit of CPI. This would make the sector more attractive to households who are looking for a long-term home.

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