Business and Regulatory Impact Assessment for the Rent Adjudication (Temporary Modifications) (Scotland) Regulations 2024

February 2024

Scottish Government
Riaghaltas na h-Alba

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This document is the **Business and Regulatory Impact Assessment** (BRIA) for the proposed modification to the rent adjudication system as part the transition out of the emergency rent cap that was introduced by the Cost of Living (Tenant Protection) (Scotland) Act 2022 (“the 2022 Act”).

Purpose and intended effect

The purpose and intended effect of this BRIA is to support the transition away from the rent cap, and protect tenants from excessively large rent increases which could be experienced if there is a sudden move to open market rent levels that have been supressed.

Background

The 2022 Act came into force on 28 October 2022 as a temporary response to provide increased support to tenants living in the rental sector through the cost of living crisis.[1] Currently the emergency rent cap remains in force; however, Part 1 of the Act cannot continue beyond 31 March 2024. The emergency rent cap currently limits rent increases for sitting tenants to a maximum of 3%; alternatively, landlords can apply for an increase of up to 6% on the grounds of certain prescribed property costs.

Under the Private Housing (Tenancies) (Scotland) Act 2016 (‘the 2016 Act’), tenants with a private residential tenancy may make an application to a Rent Officer (Rent Service Scotland (RSS)) for a rent adjudication assessment. The decision by RSS can be appealed to the First-tier Tribunal (FTT) by the landlord or the tenant. These provisions are suspended during the operation of the rent cap under the 2022 Act. A similar rent adjudication process exists for tenants with assured tenancies and short assured tenancies under the Housing (Scotland) Act 1988 (‘the 1988 Act’), although applications are made to the Tribunal rather than to a Rent Officer.

The determination on what the rent for the property should be will be made by the relevant decision-maker by comparing the rent to the market rent for similar properties in the same locality (‘open market rent’).

Once the rent cap expires, it is anticipated that many landlords will propose rent increases which will proceed as normal with tenants agreeing to pay the increased amount. Nonetheless, as a result of the suppression of rents during the rent cap, there could be situations where tenants could experience excessively large rent increases, even though the proposed rent would not exceed the market rent. The temporary change proposed is intended to smooth the transition out of the rent cap and offer protection to tenants from such increases, which could be experienced if there is a sudden move to open market rent.

In recognition of this, Schedule 3 of the 2022 Act provides Scottish Ministers with the ability to temporarily change the current rent adjudication process on or in anticipation of the expiry of the rent cap. When the rent cap expires on 31 March

[1] The 2022 Act was accompanied by a BRIA, as well other impact assessments, when it was introduced to the Scottish Parliament.

2024, the pre-2022 Act rent adjudication provisions will come back into force, unless a temporary modification is made using this power. Any change would be subject to the approval of the Scottish Parliament.

The proposed temporary changes to the adjudication process mean that rents would be determined on the basis of the lowest of three factors: open market rent, the rent requested by the landlord, and a new 'taper' that supports the transition away from the rent cap. The level of rent that will be set at adjudication can be summarised as follows:

- If the gap between the market rent and the current rent is 6% or less, then the rent will be set in line with the rent proposed by the landlord.
- If the gap between the market rent and the current market is more than 6%, then the rent will be increased by 6% plus one third of a percent for each percent that the gap exceeds 6%.[2]
- If the gap between the market rent and the current is 24% or higher, the rent increase will be capped at 12% of existing rent.
- All three cases are also subject to the requirement that the RSS and FTT cannot set a higher rent than that requested by the landlord.

Objectives

The overarching aim is to ensure a balanced and fair approach to rent adjudication, safeguarding the rights and interests of both tenants and landlords. Whilst it is anticipated that many rent increases will be agreed between landlords and tenants, the transitionary measures are intended to temporarily make a change to the rent adjudication process to facilitate a smooth transition away from the emergency rent cap measures currently in place in the private rented sector.

Rationale

The 2022 Act was introduced in response to extreme pressure on household incomes, with the Scottish Fiscal Commission (SFC) reporting a 2.5% fall in living standards in Scotland in 2022-23.[3] There has been some improvement in various economic indicators in recent months, in particular, increases in earnings and falls in inflation.[4] However, while the SFC expects that nominal average earnings growth in Scotland will rise by 6.6% in 2023-24 (compared to 4.5% in 2022-23), once other determinants of household income (such as taxes and transfer payments) and inflation are taken into account, they expect a further, albeit limited, fall in living standards of 0.2%. This would take the cumulative fall in living standards since 2021-22 to 2.7%, the largest reduction since Scottish records began in 1988.

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[2] So if the gap between the market rent and the current rent is 10%, the landlord can increase the rent by 6% + (10% - 6%) / 3 = 7.33% (rounded to 2 decimal places)

[3] Scottish Fiscal Commission, Scotland's Economic and Fiscal Forecasts – December 2023. The measure of living standards used is real disposable income per person

[4] See Section 4, Updated Economic Context in the latest Scottish Government three-monthly report to the Scottish Parliament under the 2022 Act.

The SFC expects that nominal average earnings growth in 2024-25 will slow to 3.6%, with nominal disposable household income per capita growing by a similar amount (3.5%). After taking inflation into account, this would leave living standards broadly flat (up only 0.1%) in 2024-25. Living standards are only expected to return to their 2021-22 level in 2026-27.

The position of lower-income households may be even more challenging. The Resolution Foundation expects that across the UK as a whole, after-housing-cost real incomes for poorer households will likely fall in 2024-25, in part because the impact of the uprating of benefits will be offset by the ending of targeted cost of living payments for pensioners and families on means-tested or disability benefits.[5]

Households in the rented sectors entered the cost of living crisis in a more vulnerable position than owner occupiers.[6] Across 2017 to 2020, the rented sectors had a higher proportion of people who were in relative poverty[7] as well as children in relative poverty.[8] Across 2018-2020, households in the rented sectors were also more likely to be financially vulnerable.[9]

According to recent YouGov polling for the Scottish Government,[10] in December 2023 private renting households continue to be more likely to report concern about paying mortgage/rent than households in all tenures,[11] more likely than households generally to say that they are struggling at least a little to pay for household bills, including energy bills, rent and mortgage payments,[12] and that they are managing less well financially.[13] A majority of private renters (66%) report that their mental health had been impacted negatively by the cost of living.[14]

A major challenge faced by households is the degree to which energy costs have risen, pushing more households into fuel poverty. Table 1 shows that the fuel poverty rate in the private rented sector is estimated to have risen by nearly 11 percentage

[5] Resolution Foundation (December 2023), From merry Christmas to a messy new year; see in particular P5 & P6 and Figure 5.
[6] See Cost of Living Bill: economic background, in particular Section 6, for further discussion and data sources.
[7] 34% of private rented households and 39% of social rented households, compared to 7% of households buying with a mortgage and 14% of households who own outright.,
[8] 40% of private rented households and 47% of social rented households, compared to 10% of households buying with a mortgage and 18% of households who own outright.
[9] 40% of private rented households and 63% of social rented households, compared to 24% of households buying with a mortgage and 9% of households owning outright.
[10] From YouGov online polling for Scottish Government. Total sample size was c 1,000 adults. Fieldwork was undertaken between 12-14 December 2023. The survey was carried out online. The figures have been weighted and are representative of all adults in Scotland (aged 18+). Base size for private renters is 146. Data tables for all adults can be found at Public attitudes to cost of living and other topics: tracker - data tables.
[11] 18% for private renters and 9% for all tenures. This was part of a prompted list of potential concerns in the next 2-3 months.
[12] 62% of private renters compared to 49% of all tenures. This is the sum of households who said they were “struggling a little” or “struggling somewhat” or “struggling a lot”.
[13] 30% of private renters compared to 21% for all tenures. This is the sum of households who said they were “not managing very well” or “having some financial difficulties” or “in deep financial trouble”.
[14] The sum of households reporting their mental health had been negatively affected either “to some extent” or “to a large extent”. The corresponding figure for all households is 50%.

points since 2019, prior to the cost of living crisis. Nearly half of privately renting households are estimated to be in fuel poverty, a level more than double that of owner occupiers.

Table 1. Estimated fuel poverty rates by sector[15]

	Fuel poverty rate (%)		Increase (% points)
	2019	January-March 2024	
Private rented sector	36	47	11
Social rented sector	37	53	16
Owner occupiers	17	23	6
All	25	34	9

As set out in Table 2, Scottish Government private rent statistics show high growth in rents across different bedroom sizes in the year to end September 2023. These statistics are based predominantly on advertised rents, and so reflect rents that landlords are charging when their properties become available for rent at the point of tenant turnover or when properties are new to the rental market.

Table 2. Average private rent levels and annual changes by bedroom size, Scotland, year to end September 2023[16]

	Average monthly rent	Annual change in £	Annual change in %
1-bed shared	£490	£64	15.1%
1-bed	£648	£68	11.7%
2-bed	£841	£105	14.3%
3-bed	£1,026	£121	13.3%
4-bed	£1,656	£196	13.4%

Average 2-bedroom rents (the most common size) increased in all 18 Broad Rental Market Areas of Scotland compared with the previous year. Increases in 11 of these areas were above the average 12 month UK CPI inflation rate for the corresponding period, of 9.0%. The increases ranged from 1.5% in Dumfries and Galloway up to 22.3% in Greater Glasgow.

Market expectations are that rental growth will slow over the course of 2024. For example, Zoopla expect UK rental growth on new lets at a UK level to slow from 9.7% in October 2023 (based on Zoopla data) to 5% by December 2024.[17] Similarly, both Knight Frank[18] and JLL[19] expect UK rental growth of 5% in 2024. Meanwhile,

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[15] See Section 4, Updated Economic Context in the latest Scottish Government three-monthly report to the Scottish Parliament under the 2022 Act for more details on the modelling approach.
[16] Private Sector Rent Statistics, Scotland, 2010 to 2023.
[17] Zoopla, Rental Market Report: December 2023.
[18] Knight Frank, UK house price forecasts: October 2023.
[19] JLL, Residential Forecasts 2024-2028.

the CBRE expects the annual growth on new let rents in 2024 to be 5.7% in the UK and 7.4% in Scotland.[20]

However, even if new let rental inflation moderates from recent levels, continued growth in market rents in 2024-25 needs to be considered in the context of the period over which rents for sitting tenants have been capped. Table 6, Table 7 and Table 8[21] below show the potential gap between the existing rent for tenants and the market rent, under different rental growth scenarios. These estimates illustrate that if market rent were the only rent adjudication criterion, some existing tenants, especially those who have been in their current tenancy throughout the period of the rent caps (which will have been in place for almost 19 months when they expire on 31 March 2024), could face excessively large increases in rents due to the rate of growth in open market rents, which could be extremely difficult for them to absorb given the ongoing pressure on household budgets.

Consultation

Consultation within Government

A wide range of directorates within the Scottish Government, agencies and non-departmental public bodies were consulted during the development of the transitional provisions, including:

- More Homes Division
- Communities Analysis Division
- Scottish Courts Services
- First Tier Tribunal (Housing and Property Chamber)
- Rent Service Scotland

Consultation with business and organisations representing tenants

A Call for Evidence to support the reporting on the 2022 Act in May 2023 included a number of questions on possible changes to rent adjudication. The Scottish Government received twelve responses to the questions, with the majority of respondents in favour of the proposal to temporarily prevent rents from being increased above the rent proposed by the landlord at adjudication.

A consultation with key rental sector stakeholders (issued on 15 December 2023) sought views on the proposed approach to temporarily modify the rent adjudication process, as part of the transition away from the rent cap.

Table 3 provides a summary of the types of organisations who received the consultation directly, and a breakdown of respondents by organisation type:

[20] CBRE, UK Residential Forecasts Q4 2023.
[21] See column labelled “gap to market rent” in each table.

Table 3. Type of consultee/respondent in December 2023 consultation

Type of organisation	Consulted	Responded
Local authorities and their representative bodies	34	5
Housing associations, social landlords and their representative bodies	144	4
Private landlord, investor and letting agent representative groups and membership organisations	8	18
Tenants' representative groups	8	2
Other housing, legal or financial professional or representative bodies	8	3
Public body or agency	14	
Religious group or body	1	
Third sector organisation	32	2
Educational representatives	8	
Individuals (including private landlords)	0	27

A total of 64 responses[22] were received, representing the views of landlords (including organisations such as the Scottish Association of Landlords, Scottish Land and Estates and Propertymark who represent landlords and letting agents of varying sizes), tenants (including representative groups such as Living Rent and Generation Rent), investors, local authorities and Registered Social Landlords[23].

A number of broad themes emerged from the responses:

Tapered Approach

- Opinions on the proposed tapered approach to rent adjudication were mixed. Some preferred a return to the pre-2022 Act process, while others welcomed the change as a necessary shift from emergency measures. The tapered approach was seen as a positive move towards market rates, potentially boosting landlord support and investor confidence.
- There were differing views regarding the maximum limit of the taper. The consultation set out two options for the maximum limit, of either 10% or 15%. Both individual landlords and landlord membership organisations tended to favour a higher threshold, with some private landlords suggesting an upper limit

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[22]Aberdeen City Council; Aberdeenshire Council; Age Scotland; Association of Local Authority Chief Housing Officers (ALACHO); Apache Capital; BMF Group; Buccleuch Property; Chartered Institute of Housing Scotland; Citizens Advice Scotland; Cullen Property Ltd; Dormont Estate; Dowbrae Real Estate Consultancy; Generation Rent; Glasgow City Council; Homes in Scotland; Kingcausie Estate; Kingsford Group; KR Developments; Let Tech Solutions; Lettingweb Ltd; Living Rent; Manor Estates Housing Association; Moda Living; PayProp UK; Platform_; Propertymark; Scottish Association of Landlords; Scottish Federation of Housing Associations (SFHA); Scottish Land and Estates; Scottish Property Federation; South Lanarkshire Council; Stirling Council; Summix Capital Ltd; UK Finance and 27 individuals.

[23] It should be noted that a few respondents provided more than one response to the consultation.

of 20% or 25%. Conversely, tenant groups and a third sector organisation favoured a lower threshold than 10%, with one option suggested being to cap rent increases at the rate of inflation. Those advocating a higher limit argued that it would help take account of below-market rents and encourage property investment and maintenance. Those favouring a lower limit cited wage growth statistics and cost of living pressures.

- A number of respondents highlighted a lack of robust data available on actual rents within tenancies.

<u>Communication</u>

- There was a consistent view among stakeholder responses that the proposals are complex, and that the process may only help a limited number of tenants who are aware of, and empowered, to exercise their rights. Suggestions included making it mandatory for landlords to provide guidance on referring a rent increase notice to Rent Service Scotland for adjudication.
- Landlords' representative bodies felt that it will be difficult for many landlords and tenants to understand how rent increases will work beyond 1 April and that this could lead to frustrations and ultimately a break-down in the landlord/tenant relationship.

<u>Resourcing</u>

- Landlord representative bodies considered that the changes could lead to a significant increase in RSS referrals compared to levels received prior to the 2022 Act being introduced, and raised the need for the RSS to be adequately resourced to meet such an increase in demand.
- Landlord representative bodies similarly expressed concern over the impact on the existing workload of the FTT and the overall length of time any referral to the Tribunal would take to be concluded.

<u>Market Rent</u>

- Concern was expressed that relying on market rent as part of determining rents will make the process unpredictable for both the landlord and tenant, with calls for more transparency about the factors considered in the assessment of market rents by Rent Officers. (It should be noted in the context of this BRIA that any concerns about how market rent is determined would equally apply if the pre-2022 Act procedures were to come back into force without any modification.)
- Landlord representative bodies referred to information they had received from their members, which they consider suggests that the tenants of nearly three-quarters of those members may be paying rent below market value and any continued move to cap rents further penalises landlords whose outgoings have continued to increase and could lead to many landlords exiting the market.

In addition, the proposals have been discussed with the private rented sector stakeholder group, which was set up in March 2023. This group comprises key sector stakeholders, representing the interests of tenants, landlords and investors and developers. Members of the group include Scottish Property Federation, Crisis

Scotland, Citizens Advice Scotland, PropertyMark, UK Finance, Living Rent, Scottish Land and Estates, and the Chartered Institute of Housing.

Options considered

The two options considered were the 'do nothing' (or 'business as usual') option (Option 1) under which the pre-2022 Act rent adjudication procedures would come back into force unchanged; or the introduction of a transitional change to rent adjudication approach (Option 2). Within Option 2, different values for thresholds in the rent adjudication formula were consulted on.

The main sectors and groups which will be affected by the choice of regulatory option include:

- Tenants in the private rented sectors
- Private and social landlords[24]
- Investors and developers (including build to rent provision)
- Letting agents
- Scottish Courts and Tribunal Service
- Rent Service Scotland
- Local authorities
- Support organisations for housing and homelessness

Option 1: Do nothing (Business as Usual)

This option would see no new temporary measures put in place to smooth the transition out of the emergency rent cap. On the expiration of the emergency measures at the end of March 2024, the route for tenants to refer rent increases for determination would revert to that prior to the 2022 Act. As set out in the Rationale, since rents for sitting tenants will have been capped for nearly nineteen months by the end of March 2024, in some cases the level of the rent currently paid by a sitting tenant could be significantly below the market rent level, particularly as some rents for sitting tenants may have been below the market rent level even prior to the 2022 Act and will have fallen further behind the market in the period the measures have been in place. As a result, some tenants could face excessively large rent increases if gap between market rent and current rent is allowed to be closed in a single increase. For this reason, this option is not considered to be suitable.

Option 1 – Benefits

The main beneficiaries of Option 1 would be landlords who could raise rents to market rent level. However, where the increase is very high, this could result in rent arrears and potentially eviction, with an impact on the benefit to the landlord from the rent increase, where there is a need to re-let the property. Since Option 2 is

[24] Social landlords are affected in their capacity as providers of mid-market rent housing.

analysed relative to Option 1 (business as usual), the benefits of Option 1 are the costs of Option 2, so for more detailed analysis refer to the section Option 2 - Costs.

Option 1 – Costs

The costs under Option 1 would be borne largely by tenants where landlords raise rents significantly, particularly when the gap between existing and market rent is large. Since Option 2 is analysed relative to Option 1 (business as usual), the costs of Option 1 are the benefits of Option 2, so for more detailed analysis refer to the section Option 2 - Benefits.

Option 2 (Preferred): Implement Transitional Measures through Regulations

This option is intended to aid the transition away from the current measures by temporarily modifying how rent increases referred to a Rent Officer by a tenant are adjudicated, in order to limit excessively large increases for tenants.

Two options for the formula underpinning the rent adjudication were presented in the consultation with key stakeholders. Both options proposed that the lower threshold at which the taper starts to have an impact should be set at 6%.[25] That means that the taper will only start to have an impact above the maximum increase currently permitted under the 2022 Act (the 6% relates to the ground of prescribed property costs; the rent cap is lower at 3%). It should also be noted that 6% is above SFC forecasts for average nominal wage growth (3.6%) and nominal disposable household income per capita growth (3.5%) in Scotland in 2024-25.[26]

Any additional gap between the existing rent and market rent in excess of 6% is split between the landlord and the tenant. This provides additional rental income for the landlord, in recognition of the gap between their current rent and the market rent, while also protecting the tenant.

The consultation set out two options for the upper threshold of 10% and 15%, which would be the level above which the Rent Officer cannot set rent irrespective of the gap between the market and current rent. It was proposed that the 10% cap would be reached when the gap between market and current rent is 20%, implying a gradient for the taper of 0.286,[27] while the 15% cap would be reached when the gap is 30%, implying a gradient of 0.375.[28] Taking account of the mixed views that were expressed in the consultation on the options of 10% and 15%, the upper threshold of the taper has been set at 12% to ensure that the threshold achieves a balance between the rights of tenants and landlords. Similarly, the gap between market and current rent at which this upper threshold will be reached has been set at 24%,

[25] i.e. if the gap between the market rent and current rent is 6% or less, in an adjudication the rent will be set at the market level (provided this does not exceed the rent asked for by the landlord).
[26] See Rationale.
[27] The gradient is the additional rent increase permitted for each percent that the gap between market and current rent exceeds 6%, and is calculated as (10%-6%)/(20%-6%) = 0.286.
[28] (15%-6%)/(30%-6%) = 0.375

because this results in a gradient for the taper of one third,[29] again achieving a balance between the gradients presented in the consultation.

It should be noted that 12% is over three times higher than the SFC forecasts for average nominal wage growth and nominal disposable income per capita growth in 2024-25. It could therefore be extremely challenging for some privately renting households, especially those on lower incomes, to absorb rental increases above this level. However, 12% is also below the average level of increases seen in advertised rents in the 12 months to September 2023, for most bedroom sizes (Table 2), so setting an upper limit lower than this level would increase the average gap in rents paid by new and existing tenants.

The main impact of the proposed tapered approach will be to limit the rental increase relative to the business as usual option. This increase represents both the benefit to the tenant as well as the cost to the landlord, so before turning to the benefits and costs of Option 2, estimates of this foregone rent are set out in the next section.

Estimates of foregone rent under Option 2

Approach to estimating foregone rent

Measures under Option 2 apply to the rent adjudication process only, and do not directly restrict the rent increase that a landlord can propose. It is only if the tenant refers the rent increase to adjudication that the formula set about above will apply when the RSS or FTT decides the case. Therefore, to assess the outcome of Option 2 in terms of foregone rental income, there are a number of scenarios relating to rent-setting behaviour by landlords which need to be considered:

1. Some landlords will not wish to raise the rent for their sitting tenant, irrespective of the rent adjudication process. Evidence (discussed in the next section) suggests that not all landlords raise rents for sitting tenancies each year. In such cases, there is no foregone revenue due to the proposed measures. This possibility is taken into account in the estimates of foregone rental income presented below, through different scenarios relating to the shares of landlords who wish to raise rent.

2. Some landlords will propose a rent increase which is below the maximum level that would be permitted if the increase is referred to the RSS/FTT and would have done so even without the changes to the rent adjudication process. For example, the landlord may be content with the sitting tenant, and is happy to agree a rent increase which is acceptable to the tenant, helping them avoid the costs of a change in tenancy, such as loss of rent while the property is empty and the possibility that the next tenant would not be as satisfactory. In such cases, there is no foregone rental income as a result of the proposed change to the rent adjudication process. We do not have reliable information on how likely this is, and so cannot make a quantitative adjustment for this. To the extent that this

[29] (12%-6%)/(24%-6%) = 1/3

does occur, the estimates of foregone rental income presented below would be overestimates.

3. The landlord requests a rent increase above the maximum level that would be permitted if the increase is referred to the RSS/FTT, but the tenant accepts that increase because they regard it as reasonable or are willing to agree to it. The Scottish Government will undertake awareness raising and provide clear information to tenants to support them to access the adjudication process. However, not all tenants will choose to refer a rent increase for adjudication, even when aware of their rights. This could be for a range of reasons, including the tenant's personal financial situation and satisfaction with the rental property or that the landlord may have chosen not to increase rents in previous years and the rent will, therefore, still be below the market rent for a similar property. We do not have reliable information on how likely this is, and so cannot make a quantitative adjustment for this. To the extent that this does occur, the estimates of foregone rental income presented below would be overestimates.

4. The landlord requests a rent increase above the maximum level that would be permitted if the increase is referred to the RSS/FTT, and the tenant decides to refer the increase to the RSS or FTT, which sets the rent in line with the proposed rent adjudication process. Such instances are included in the costings presented below, both the foregone rental and also the costs to the RSS and FTT of hearing the application or appeal.

5. The landlord would have wished to increase the rent above the maximum level that would be permitted if the increase is referred to the RSS/FTT, but decides to reduce it so that it is line with the proposed rent adjudication process. Such cases are included in the costings presented below. In costing this scenario, it is assumed that, without the change to the adjudication process, the landlord would have requested an increase in line with the market rent of the property. However, it is possible that the landlord would have asked for an increase below market rent (although above the level that would be set under the proposed rent adjudication process), for reasons such as those set out under category (2) above; however, we do not have reliable information on how likely this is, and so cannot make a quantitative adjustment for this. To the extent that this is the case, the estimates of foregone rental income presented below would be overestimates.

The following sections look in more detail about the particular assumptions used to calculate the estimates of foregone rent.

Probability of rent increase for sitting tenant

If a landlord experiences a change in tenancy during the period when the temporary changes to rent adjudication apply, then the proposed regulations will not impact on the rent that can be set for their new tenant. The latest data from the Scottish Household Survey suggests that in 2022 around 32% of adults in the private rented sector had been at their current address for less than a year. As 2022 covers only the first months that the emergency rent cap was in operation, it is possible that the rate of turnover has reduced since then, if sitting tenants have become more reluctant to move due to the protection afforded to them. However, in the absence of more recent, comprehensive evidence, it is assumed that for 32% of properties there will be a change in tenancy during the period when the changes are in force. As a result, there will be no foregone rental income as a result of the proposed measures.

With respect to the remaining 68% of privately rented properties where no change in tenancy is anticipated, a variety of anecdotal and survey evidence suggests that a significant share of sitting tenants do not experience a rent increase each year. Table 4 sets out data from a survey of tenants undertaken for RentBetter in December 2019 and mid-March 2020.[30]

Table 4. Frequency of rent increases reported by tenants in survey for RentBetter

How often has rent increased since tenant moved in?	As share of all respondents	As share of respondents resident for at least a year and who provided a response
Rent has stayed the same	59%	51%
Once a year increase	18%	26%
Once every couple of years	9%	13%
Rent increases less often than once every two years	7%	10%
Not stated	6%	
Prefer not to say	1%	
Total	**100%**	**100%**

The data in the second column reports the figures as provided in the research, while the data in the third column has been rescaled to remove those who had been in their property for less than a year as well as those who did not provide information.[31] This shows that around half of respondents who had been in their property for a year or more had not experienced a rent increase.

Data from a survey of landlords and letting agents, also for RentBetter, on how frequently rents are increased is broadly consistent with the tenant data set out above.[32] Table 5 shows that around half of landlords/letting agents reported not increasing rents for sitting tenants, either because they never increase rents (17%) or because they only increase rents when the tenant changes (32%).

[30] Indigo House (2020) RentBetter: Wave 1 tenants survey analysis report. See Section 4.7; the data in the second column of Table 1 is sourced from Figure 20.

[31] The research identified that of those tenants reporting that their rent has stayed the same, 39% had been resident for less than a year. To remove this group, the share of respondents in this category was adjusted to 59% * 61% = 36%. The categories “not stated” and “prefer not say” were also removed. Shares were then rescaled relative to the total share of respondents who answered the question and who had been resident for longer than a year (this effectively assumes that respondents who did not reply had the same pattern of rent increase frequency as those who did reply).

[32] Indigo House (2020) RentBetter: Wave 1 Landlord and letting agent survey findings. See Section 3.3; the data in Table 2 is taken from the chart in this section of the report. Note that since the exact figures are not provided in the chart, they have been estimated by visual inspection.

Table 5. Frequency of rent increases as reported by landlords and letting agents in survey for RentBetter

Frequency of rent increases	Share of respondents
Never	17%
Only when the tenant changes	32%
Once a year	15%
Once every couple of years	25%
Another approach	10%

While the survey data above suggests that around half of sitting tenants would not experience a rent increase at all during their tenancy, the share of tenants who would expect to receive an increase in any particular year would be less than this. The tenant survey data suggests that this share would likely be somewhat below 36%.[33] This again is broadly comparable to the landlord/letting agent survey data, for which the corresponding figure is somewhat below 31%.[34]

The RentBetter surveys were undertaken prior to the cost of living crisis. In the BRIAs accompanying the Cost of Living (Tenant Protection) Act and subsequent extensions, the central assumption was that 50% of sitting tenants would experience a rent increase. This central assumption therefore already made an allowance that a greater share of sitting tenants would receive a rent increase each period. This is because:

Even in the absence of legislation, rent increases for sitting tenants may be more frequent when market rents are rising faster.[35]

This may particularly be the case when cost pressures (such as increases in mortgage rates) are a key contributor to increases in market rents.
Landlords may wish to make up for previous caps on rental increases, and/or raise rents when they can because they are concerned about future rent controls.

However, it is also possible that in some cases landlords may be less likely to increase rents than prior to the cost of living crisis because they are concerned whether a tenant with whom they are satisfied would be able to afford the increase and remain in the property.

[33] This is calculated as the sum of 26% for those who have a rent increase every year, 6.5% (13%/2) for those who have a rent increase every second year, and 3.3% (10%/3) for those who have a rent increase less frequently than every two years (the assumption for this final category that it will be every 3 years is made to give an upper bound for this estimate; to the extent that it is less frequent than this, the estimate will be somewhat lower).
[34] This is calculated as the sum of 15% of landlords/letting agents who report raising rents each year, 12.5% (25%/2) of those who raise rents every second year, and 3.3% (10%/3) of those who follow another approach (again, the assumption for the final category that rents increase every three years is made in order to calculate an upper bound).
[35] The RentBetter research notes that in Edinburgh, which had higher rental growth than the Scottish average prior to the survey, more frequent rent increases were reported by landlords/letting agents, with 30% of respondents indicating that they applied rent increases annually and a further 31% that they did so once every couple of years.

To reflect this uncertainty relating to how landlords would respond to the cost of living crisis, high and low estimates of 70% and 30% were also tested around this central assumption. The same approach will be followed in this BRIA.

Trends in market rents

As set out in Table 2, for two-bedroom properties (the most common size) in Scotland, the average increase in market rents was 14% in the year to September 2023.

In the Rationale section, market forecasts for rents were set out, with the majority of forecasters expecting rental growth across the UK to slow in 2024 relative to 2023, and with the CBRE forecasting 7.4% growth in new let rents in Scotland. Therefore, when choosing scenarios for rental growth in Scotland, we assume as a central scenario that rental growth will be lower than in the year to end September 2023. We set the high scenario in line with the current level of rental growth of 14%, the central scenario at 8% and the low scenario at 2%.

Since the foregone rent will also depend on how long a tenant has been resident (as discussed in the next section), we also take into account historic trends in rents over the period of the emergency legislation, in order to calculate the gap between current rent and market rent.

How long the tenant has been resident

The degree to which a landlord's current rent is below the market rate also depends on how long their tenant has been resident, since when a tenant moves the landlord has an opportunity to reset the rent to the market level. The longer the tenant has been resident, the further below market rent the capped rent is likely to be. In the estimates for foregone rental income set out below, the foregone rent is calculated for different lengths of tenure, and the share of landlords in each category is estimated based on Scottish Household Survey data on length of time at current address.[36]

Other assumptions

Since the proposed regulations apply to increases for sitting tenants, the amount of foregone rental income will depend on the current level of rents charged by landlords to sitting tenants, and also by how much landlords would like to increase rents for sitting tenants. However, in the absence of data specifically on sitting tenants, we have used data on the level and increase in new let rents to calculate foregone revenue.[37] This is likely to overstate the foregone rent, because evidence suggests

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[36] In order to simply the modelling, it is assumed that each year there is 32% probability that a tenant will move (based on Scottish Household Survey data for share of adults in private rented sector who have been at their address for less than a year), and that this probability is statistically independent of the length of tenure.

[37] The database underlying the Scottish Government private rent statistics is largely drawn from new-let rents.

that, even in the absence of legislation, landlords tend to charge lower rents for sitting tenants.[38]

We also estimate foregone rent based on rent data for a two-bedroom property, since this is the most common size in the private rented sector, and assume that the rent grows in line with the average rent across Scotland for this property size. Foregone rental growth will of course vary across different property size and different geographies in Scotland.

The analysis is broken down into 6-month periods, because the emergency legislation was extended for two additional periods of 6 months.[39] For the initial period of October 2022 to March 2023, rents were capped at 0%. For the two subsequent periods of extension (April 2023 to September 2023 and October 2023 to March 2024) it is assumed that landlords have increased their rent in line with the general rent cap of 3%. It should however be noted that some landlords have utilised the prescribed property cost ground and have applied for a rent increase of up to 6.%.[40]

The estimates also take into account that the rent can only be increased once in a twelve-month period. It is therefore assumed that landlords for whom the anniversary date fell in the period October 2022 to March 2023 (and so were not able to raise rents due to the 0% cap that applied during that period), instead increased rents by 3% during the period April 2023 to October 2023.

Estimates of foregone rent

The different assumptions set out above are brought together to estimate the foregone rent. The first set of tables estimate the foregone rent for a landlord who would have wished to raise the rent to the market level, but where the rent is potentially lower either because it is referred to adjudication, or because the landlord reduces the amount of rent they propose in line with the rent formula. The estimates are broken down by the length of time the sitting tenant has been resident. Later in this section the probability that a landlord wishes to raise the rent will also be taken into account in order to calculate estimates of total foregone rent across the market.

Table 6 presents estimated foregone rental growth for the central scenario of 8% future rental growth. The average expected loss for a landlord who wishes to raise rents to the market level is calculated as the loss for each category of tenure length weighted by the share of tenancies which are estimated to fall in each category.

[38] A key reason for this is because landlords do not raise rents for sitting tenants each year (as discussed above).

[39] The initial period was somewhat over 6 months, since the rent increase notices served from 06 September 2022 were subject to the cap, but for modelling simplicity we treat the initial period as running from October 2022 to March 2023.

[40] Over the period 1 April 2023 to 31 December 2023, 1,366 applications were received for prescribed property costs.

Table 6. Estimated foregone rent for a landlord who increases rent, under central assumption for future rental growth of 8%

Date tenancy started	Share of tenancies	Gap to market rent	Increase permitted by taper	Foregone rent (monthly)	Foregone rent (annual)
Oct 21 - Mar 22 or same months in earlier years	19%	25%	12%	£94	£1,125
Apr 22 - Sep 22 or same months in earlier years	23%	20%	11%	£70	£843
Oct 22 - Mar 23	7%	15%	9%	£52	£621
Apr 23 - Sep 23	9%	7%	6%	£6	£67
Oct 23 - Mar 24	10%	9%	7%	£17	£199
New tenancy starts in 24-25	32%	0%	0%	£0	£0
Average	**100%**	**12%**	**7%**	**£40**	**£479**

Table 7 undertakes the same analysis for the high scenario of market rental growth of 14%.

Table 7. Estimated foregone rent for a landlord who increases rent, under high assumption for future rental growth of 14%

Date tenancy started	Share of tenancies	Gap to market rent	Increase permitted by taper	Foregone rent (monthly)	Foregone rent (annual)
Oct 21 - Mar 22 or same months in earlier years	19%	33%	12%	£159	£1,909
Apr 22 - Sep 22 or same months in earlier years	23%	28%	12%	£126	£1,517
Oct 22 - Mar 23	7%	28%	12%	£135	£1,625
Apr 23 - Sep 23	9%	14%	9%	£46	£553
Oct 23 - Mar 24	10%	16%	9%	£60	£722
New tenancy starts in 24-25	32%	0%	0%	£0	£0
Average	**100%**	**18%**	**8%**	**£79**	**£951**

Table 8 repeats the analysis for the low rental growth scenario of 2%.

Table 8. Estimated foregone rent for a landlord who increases rent, under low assumption for future rental growth of 2%

Date tenancy started	Share of tenancies	Gap to market rent	Increase permitted by taper	Foregone rent (monthly)	Foregone rent (annual)
Oct 21 - Mar 22 or same months in earlier years	19%	16%	9%	£49	£591
Apr 22 - Sep 22 or same months in earlier years	23%	11%	8%	£26	£309
Oct 22 - Mar 23	7%	3%	3%	£0	£0
Apr 23 - Sep 23	9%	0%	0%	£0	£0
Oct 23 - Mar 24	10%	2%	2%	£0	£0
New tenancy starts in 24-25	32%	0%	0%	£0	£0
Average	**100%**	**6%**	**4%**	**£15**	**£184**

It should be emphasised again that the tables above present the foregone revenue for a two-bed property (which is the most common property size) whose rent is growing in line with the Scottish average for properties of this size. For some combinations of property size and location, foregone rental income will be larger than the estimates presented above, while for others it will be smaller or zero. Moreover, as set out in the tables, there will be no foregone revenue, regardless of location and property size, if there is a change in tenancy.

The estimated foregone rent for an individual landlord is now grossed up to the level of the Scottish private rented sector. In doing so, the probability that a landlord raises the rent for a sitting tenant is taken into account. However, there are other reasons why this approach might overestimate foregone rent, which were discussed above (such as that the landlord may have proposed a rental increase below the market rent even without the change in rent adjudication process),[41] for which there is insufficient data to make a robust adjustment.

In Table 9, for each rental increase scenario, the average foregone rent (across all tenure-length categories) where the landlord does raise the rent is multiplied by the share of landlords who are estimated to increase rents, and then multiplied by the number of private rented properties in Scotland (approximately 340,000)[42] to produce an estimate for total foregone rental income.

[41] See section on Approach to estimating foregone rent.

[42] For example, the total foregone income for the central assumptions of 8% future rental growth and 50% share of landlords who raise rents for sitting tenants is calculated as £479 (the average annual foregone rental income across different tenure lengths for a landlord who raises the rent when future rental growth is 8%, taken from Table 4) * 50% (share of landlords who raise rent for sitting tenant) * 340,000 (total privately rented properties in Scotland) = £81 million, as set out in Table 9.

Table 9. Indicative total annual foregone rental income across Scotland for scenarios relating to future rental growth and share of landlords who raise rent for sitting tenants (£ million)

		Share of landlords who increase rent for sitting tenant		
		30%	50%	70%
Future rental growth	2%	19	31	44
	8%	49	81	114
	14%	97	162	226

The estimated total annual foregone rental income across Scotland presented in Table 9 is labelled as indicative because, due to the way the tapered approach operates, total foregone income will not exactly equal forgone income on a typical property multiplied by the size of the sector. However, in the absence of detailed distributional data on existing rents, the estimates should provide some indication of the order of magnitude of total foregone rent.

The estimates of foregone rental income set out in Table 9 can be scaled to the estimated total rental income across the Scottish private rented sector. Taking the central estimate, which assumes that future rental growth will be 8% per annum and that half of landlords with sitting tenants wish to raise rents in any given year, the indicative estimate of £81m foregone rental income is equivalent to around 2.1% of estimated total rental income of £3.867bn in 2024-25.[43]

Option 2 - Benefits

Benefits to tenants

The main beneficiaries of Option 2 are tenants, who would have additional protection from excessively large rent increases. The potential amount of this protection is set out above in the estimates of foregone rent as a result of the operation of the tapered approach. As discussed in the Rationale section, while there has been some improvement in economic data in recent months, the financial situation facing households in the private rented sector remains challenging. Therefore, it is likely that privately renting households would find it difficult to afford large rent increases that could arise from a move back to market rent in a single step, without having to cut back spending on other necessities, which may result in a build-up in rent arrears, potentially resulting in eviction and homelessness. Alternatively, tenants might have to move, with all the attendant disruptive effects (which could include having to change jobs or their children’s school).

Such financial stresses would also like have a detrimental effect on tenants’ physical and mental health and wellbeing. A majority of private renters (66%) already report that their mental health had been impacted negatively by cost of living pressures.[44]

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[43] Total rental income is estimated based on average two-bedroom property rents (the most common size). Under 8% per annum future rental growth, the average monthly rent in 2024-25 is estimated to be £948 (see Table 16), giving a total rental income of £948 * 12 months * 340,000 privately rented properties = £3.867bn.
[44] See YouGov polling discussed in Rationale section.

Even for those tenants whose landlord does not ask for a large rent increase during the period of operation of the proposed measures, the prospect that this could happen is likely have a negative impact on their physical and mental health.

Benefits to local authorities and third sector organisations

Avoiding the adverse outcomes for tenants set out above could help to reduce the pressure on local authority housing support and homelessness services. Third sector organisations could also benefit from reduced pressures on housing, homelessness and financial services. While it is plausible that there will be some savings to local authorities and thirds sector organisations, it is difficult to quantify these robustly.

Benefits to NHS Scotland

With nearly two-thirds of privately renting households reporting that their mental health has been negatively affected by cost of living pressures, reduced anxiety due to the greater financial protection under Option 2 could potentially have a benefit for mental health. This could help reduce pressure on NHS Scotland services. Again, though, it is difficult to quantify such savings robustly.

Option 2 - Costs

Costs to private landlords

Foregone rent

The main costs to landlords of the proposed measures would be foregone rent due to the operation of the proposed changes to rent adjudication. The potential amount of foregone rent has been estimated above. This cost is equivalent in size to the financial benefit to tenants from the proposed changes to the rent adjudication process.

It should be noted that in many cases, landlords may not propose that the rent for a sitting tenant should be raised to the full market level. For example, if the tenant would struggle to manage the rent increase, the landlord may be faced with the costs associated with increased rent arrears, and potentially also due to the eviction process, as well as lost revenue from a void period if the tenant has to move. Moreover, they may be satisfied with the tenant and prefer to agree an increase which means they do not need to find a new tenant who might not be as satisfactory. As was discussed earlier, to the extent that this happens, the landlord might not be affected by the proposed changes, or only to a reduced extent, and therefore the estimated cost to landlords from foregone rent presented above will be overstated.[45]

Properties with a mortgage

Large increases in interest rates have been one of the features of the cost of living crisis. This section therefore examines the issue of higher mortgage costs for landlords in the context of the proposed temporary rent adjudication approach.

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[45] See also discussion in section Approach to estimating foregone rent.

There has been a degree of stabilisation in mortgage rates recently, with Bank of England data showing that the average quoted two-year fixed rate, 75% loan to value (LTV) Buy-to-Let (BTL) mortgage rate has moderated from 6.22% at the end of July 2023 to 5.56% at the end of November.[46] Meanwhile, the average five-year fixed rate, 75% LTV BTL mortgage rate has moderated from 5.87% at the end of July 2023 to 4.93% at end of December 2023. However, interest rates remain much higher than their levels prior to the cost of living crisis, when the two-year fixed rate, 75% LTV BTL rate averaged around 2%.

It is estimated that around 36% of private rented properties in Scotland have an outstanding BTL mortgage. Of these around a quarter are estimated to be on variable mortgage rates. The remaining three-quarters on fixed rates will only be subject to a potential rate change if they reach the end of their fixed period. It is estimated that around half of BTL mortgages could experience a rate change over a period of 12 months due to having a variable rate or a fixed rate which has reached its end of term. Furthermore, around a third of properties are expected to experience a change of tenancy each year, which will allow the landlord to reset the rent to the market level. Taking all these factors into account, it is estimated that just over a tenth of all Scottish privately rented properties have an outstanding BTL mortgage which could experience a rate change over the period the measures are in place and which will not have a change in tenancy during that year.

If mortgage rates continue to ease as currently expected, landlords with variable rate BTL mortgages may experience a reduction in mortgage costs. However, those who have a fixed rate BLT mortgage which reaches its end of term will likely experience an increase in mortgage costs, because even if fixed rates on new lending have eased in recent months, they are likely higher than when the landlord last fixed. The amount of the increase can vary significantly depending exactly when the mortgage was taken out, the length of term, LTV, etc, but on average it is estimated that the increase in fixed rate mortgage costs could be in the region of £200-£300 per month, which is around 30% to 40% of an average two-bed property rent. This would also be the estimated cumulative increase in monthly mortgage costs for variable rate mortgages since the period of higher interest rates began, and properties with fixed rate mortgages which reached their end of term in the past two years may also have experienced a similar increase while being subject to previous rent restrictions.

However, when assessing the relationship between mortgage costs and rents, the following considerations are relevant:

- Even in normal market conditions, a seller (the landlord in this case) is unlikely to pass anywhere near a 100% of a cost increase onto buyers (the tenant), since the market price is constrained by the buyers' responsiveness to price increases. In the current rental market, tenants are particularly affected by cost of living pressures, which will limit their ability to pay higher rents, and in turn limit how much the market rent can increase by.
- This is particularly the case when very large cost pressures affect only a segment of the market, since the market rent is determined in competition with other landlords who have made different financing decisions.

[46] Data sourced from Bank of England Statistical Database.

- Assuming, as the market currently expects, that the current interest-rate tightening cycle has reached its peak, it should be borne in mind that the increase in mortgage costs set out above is the cumulative, not annual, impact of the higher rates, and can be recouped through annual rental increase over a number of years.
- Properties which have experienced an increase in mortgage costs have been able to benefit from a higher cap applying to the prescribed property cost ground under the 2022 Act – up to 3% in the period 6 September 2022 to 31 March 2023 (when the rent cap was 0%), and up to 6% in the period 1 April 2023 to 31 March 2024 (when the rent cap was 3%).
- The average increase in private rents reported in the Scottish Government's statistics of a 14% average annual increase in 2-bed market (largely new-let) rents in the year to September 2023, which is used to cost the foregone rental income for landlords under Option 2, includes the impact of higher mortgage costs on market rents.

While UK Finance data show that the number of buy-to-let mortgages in arrears of 2.5% or more of the outstanding balance in the UK stood at 11,540 at the end of Q3 2023, a 29% increase from the previous quarter and twice the level a year ago (equivalent to 0.57% of all outstanding buy-to-let mortgages across the UK), because the Scottish private rented sector is estimated to constitute only around 7% of the UK private rented sector, these trends reflect wider UK and not specifically Scottish trends. Meanwhile, UK Finance data show there were 450 buy-to-let possessions in the UK during Q3 2023, the same level as the previous quarter, and 13% higher than a year ago. However, across the first 3 quarters of 2023, BTL mortgages taken into possession as a share of all BTL mortgages (0.02%) was below the level across 2019 (0.03%), prior to the covid pandemic.

<u>Impact on landlord incentives for investment</u>

The transitional measures may have an impact on certain incentives to invest. New supply will not initially be affected because the proposed temporary rent adjudication measures do not apply to new lets, although it is possible that concerns about the impact of possible future rental controls on rent increases may be a factor in investment decisions.

In this context, it is worth looking at trends in the overall number of properties on the Scottish Landlord Register. There are some limitations of this data source, 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 which are no longer available for rent. In the case of any landlords looking to leave the sector or reduce their portfolio, it should also be recognised that the process could take several months from freeing up properties to completing sales. Nevertheless, subject to these limitations, Table 10 shows that the overall number of registered properties across Scotland has been relatively steady across the period January 2022 to December 2023, with the number of properties registered in December 2023 (345,214) being 1.6% higher than in August 2022 (339,632), immediately prior to the announcement of the emergency measures. There are however differences at the local authority level, with more rural local authorities showing a decline in private rented sector properties, whilst others are showing an increase.[47]

Table 10. Number of registered properties on the Scottish Landlord Registration System, January 2022 to November 2023

Jan-22	**Feb-22**	**Mar-22**	**Apr-22**	**May-22**	**Jun-22**	**Jul-22**	**Aug-22**
339,525	339,309	338,768	337,325	336,705	338,237	338,721	339,632
Sep-22	**Oct-22**	**Nov-22**	**Dec-22**	**Jan-23**	**Feb-23**	**Mar-23**	**Apr-23**
340,033	339,574	338,933	340,149	340,108	340,193	340,154	341,110
May-23	**Jun-23**	**Jul-23**	**Aug-23**	**Sep-23**	**Oct-23**	**Nov-23**	**Dec-23**
341,417	341,556	341,898	342,542	343,635	344,276	344,590	345,214

Source: Scottish Landlord Registration System monthly monitoring figures. May-23 figures were based on a snapshot taken on 6 June 2023

With respect to incentives to invest in the quality of an existing private let, the ONS produces estimates of the costs of regular repair and maintenance of a dwelling as part of the CPI. Annual growth in this series, which had reached 7.5% in September 2022, has decreased to 0.2% in December 2023.[48] Furthermore, repair and maintenance costs from only a portion of the landlord's total costs: data from HMRC for non-incorporated landlords[49] in the UK show that in 2021-22, repairs and maintenance comprised 23% of total allowable expenses, and 11% of total income declared.[50]

Familiarisation by landlords with regulations

Landlords will need to familiarise themselves with the regulations. However, it should be noted that the proposed change does not amend the administrative process for rent adjudication. The Scottish Government will provide information on the amended approach to rent adjudication to support tenants, landlords and letting agents understanding of how rent increases will be considered where the tenant makes a referral to a Rent Officer or the FTT.

Costs to Rent Service Scotland

With respect to the cost of an individual rent adjudication application to the RSS, the proposed transitional measures involve the application of a formula which uses the current rent, the rent proposed by the landlord and the market rent as inputs. The first two elements will require to be provided by the applicant, and therefore the main work required from the RSS is to determine the market rent for the property, as per the rent adjudication process prior to the 2022 Act. Therefore, the cost per case is likely to be very similar for these two processes.

[47] This is based on an analysis of Scottish Landlord Register data between January 2022 and August 2023.
[48] ONS, Consumer price inflation time series, time series code D7GR.
[49] These are individuals and partnerships.
[50] HMRC, Property rental income statistics: 2023.

Overall costs to RSS could be higher if there are more applications under the transitional measures than there would be if the rent adjudication measures as they applied prior to the 2022 Act were in force. There is significant uncertainty about how many applications for adjudication will be received under the proposed temporary measures. It may be the case that there will be similar levels of applications, but landlord representative bodies raised concerns during consultation that the amendments to the rent adjudication process could prompt more tenants to apply.

The potential additional costs to RSS are therefore estimated as follows. Firstly, the cost per case is set out in Table 11. As discussed above, this is based on the costs of rent adjudications under the pre-2022 Act procedures.

Table 11. Estimated cost per rent application to RSS

Caseload that costs are based on	125
Staff costs[51]	£82,120
Travel & subsistence, plus stationery costs	£5,000
Total cost	£87,120
Cost per case	**£697**

Next, the total cost is estimated under different caseload scenarios. The first scenario assumes that the caseload is the same as would be expected under the pre-2022 Act rent adjudication procedures (the business as usual). RSS received 96 applications in the eight months from 1 January 2022 to 6 September 2022 when the pre-2022 Act procedures were suspended. This is approximately 144 cases at an annual rate. It is assumed that the level of applications under the business as usual would be somewhat higher than this, at around 150 cases, because the share of the market with a private residential tenancy will increase over time.[52] The total cost to RSS under the baseline is then estimated as the cost per case (as set out in Table 11) multiplied by 150 cases. Medium and high cost scenarios are then estimated by assuming that the caseload is twice and four times as high as the business as usual. The potential additional costs to the RSS are then calculated as the difference between the total costs under each caseload scenario and the total cost in the business as usual.

Table 12. Total costs for RSS under different caseload scenarios

Caseload	Low (business as usual) – 150 cases	Medium – 300 cases	High – 600 cases
Total cost	£104,550	£209,100	£418,200
Additional cost	£0	£104,550	£313,650

[51] Comprising 0.5 FTE (full-time equivalent) administrative staff member, 1 FTE rent officer, 0.125 FTE market evidence base rent officer, and 0.5 FTE (B2 band) senior rent officer.
[52] RSS only deals with rent adjudication applications where the tenancy is a private residential tenancy.

Costs to the First Tier Tribunal

Under the proposed measures, where the tenancy is a private residential tenancy, there will be the right to appeal a rent adjudication by the RSS to the FTT, as per the pre-2022 Act processes. Furthermore, the proposed rent adjudication process will also apply when tenants on applicable statutory assured and short assured tenancies apply directly to the FTT under section 24(3)(a) of the Housing (Scotland) Act 1988.

With respect to the cost per application, it is assumed (as discussed above in relationship with RSS costs) that the process of adjudication under the temporary measures will require a similar level of resource to rent applications under the pre-2022 Act procedures. Table 13 sets out the indicative cost per case. Note that this estimate is based on the assumption that the number of cases is of a similar order of magnitude to the caseload scenarios set out below, so that the total caseload can be absorbed within existing arrangements without the requirement for additional FTT staffing or office costs.

Table 13. Indicative cost per rent adjudication application to the FTT

Type of cost	Cost per case
Members Fees: [53]	
Legal	£543
Surveyor	£447
Sub-total	**£989**
Expenses	£99
Employer National Insurance Contribution	£99
Sub-total	**£1,187**
Corporate Overhead	£309
Upper Tribunal	£16
Grand Total	**£1,511**

As for rent adjudication applications to the RSS, the impact of different caseload scenarios on total costs for the FTT is estimated. Again, the low scenario assumes that the caseload will be in line with the business as usual (i.e. the caseload if the pre-2022 Act provisions were to come back into force). In 2021-22, the FTT received a total of 15 rent adjudication applications for assured (6), short assured (1) and private residential (8) tenancies. It is assumed that this would be the caseload in the

[53] This assumes a full day fee for both the legal and the surveyor member for the hearing, as well as a 50% fee for the legal member to write-up the decision and a 50% fee for the surveyor member to take account of pre-hearing work required.

business as usual.[54] In line with the approach to RSS costing, the medium and high caseloads are based on twice and four times the baseline caseload. These caseloads are then multiplied by the indicative cost per case set out in Table 13 to derive total case costs. The potential additional costs to the RSS are then calculated as the difference between the costs under each scenario and the cost in the business as usual.

Table 14. Total costs for FTT under different caseload scenarios

Caseload	Low (business as usual) – 15 cases	Medium – 30 cases	High – 60 cases
Total cost	£22,667	£45,334	£90,669
Additional cost	£0	£22,667	£68,001

Regulatory and EU Alignment Impacts

Due to the location-specific nature of the rented sector, the proposals outlined in the transitional measures are not expected have a significant impact on intra-UK and international trade. They are also not expected to have an impact on maintaining alignment with the EU.

Scottish Firms Impact Test

The Scottish Government issued a targeted consultation to principal stakeholders in the rental sector in December 2023. The purpose was to gather views on the proposed approach to temporarily modify the rent adjudication process, as part of the transition away from the emergency rent cap. The consultation represented the views and perspectives from Scottish firms of all sizes, including landlords, tenants, investors, local authorities and Registered Social Landlords.[55] In addition, the proposals have been discussed with the private rented sector stakeholder group. These actions demonstrate the Scottish Government's ongoing efforts to understand the impact of the proposed measures and provide clear and comprehensive information to all stakeholders.

Due to the location-specific nature of the private rented sector, the majority of landlords are Scottish firms or individuals. The impacts on landlords set out above therefore set out the expected impact on Scottish firms.

Impact on Small Businesses

The proposed transitional measures apply on a per-property basis, and are therefore automatically scaled to the size of the landlord's business, which means they therefore do not directly need to differentiate between landlords with differently sized portfolios.

[54] Note that there might be expected to be a higher share of applications from private residential tenancies, as this form of tenancy becomes more common over time, but this not expected to affect the total caseload.
[55] For more detail, see section on Consultation with business and organisations representing tenants.

It could be the case that landlords with larger portfolios are able to pool the impacts across their properties, e.g. properties located in different areas may be subject to different trends in market rents and thus affected by the tapered approach in different ways. The larger the portfolio, the more likely it is that at least one of the landlord's properties will experience a change in turnover, allowing rents on that property to be reset to the market level.[56] However, much of this impact is a by-product of the risk diversification opportunities provided by operating at a larger scale, rather than the direct result of the regulation.

In terms of the costs of familiarisation with the legislation, as set out above these are expected to be relatively small, especially as the Scottish Government will provide clear information. Furthermore, smaller-scale landlords can make use of letting agents, who are able to pool the fixed cost of familiarising themselves with this and other regulatory and legal requirements across their letting business.

Competition Assessment

The implementation of transitional measures is anticipated to have an impact on a segment of private landlords (those with sitting tenants), although the impact will differ based on individual situations.

The transitional arrangements should not hinder the capacity of new landlords to compete in the rental market as they pertain only to rent increases during an existing tenancy and not to rent setting for new tenancies or rent setting between tenancies. Landlords have expressed concerns that these measures might result in a decrease in the overall availability of rented accommodation in the private rented sector due to landlords exiting the sector as a result of the impact on the overall profitability of offering properties for rent. This could potentially lead to diminished competition among landlords and an increase in rents over time. Given these concerns, it is crucial to assess the potential effects of these measures on competition within the rental market, as per the Competition Assessment. This leads us to the following questions:

<u>Will the measure directly or indirectly limit the number or range of suppliers?</u>

There are anecdotal reports of landlords in the private rented sector contemplating exiting the market, which could potentially decrease the supply of properties. However, to the extent that landlords are actually taking this step, the net impact on supply will depend on whether their properties are sold to other landlords or are removed from the sector. It will also depend on the size of inflows to the sector. These could come from newly built properties, such as from build to rent projects (although again there have been anecdotal reports of build to rent investors pausing projects), or from existing properties in other tenures which are switched into the private rented sector.

However, as illustrated by Table 10, over the period of the operation of the 2022 Act, the total number of properties registered on the Scottish Landlord Register has slightly increased. Although there are some limitations of this data (discussed above), this would suggest either that the anecdotal reports have not translated into a significant exit of existing properties or reduction in build to rent, or that any such effects have been offset by the other factors discussed above.

Based on this experience, we similarly do not expect that the transitional measures will have a substantial negative impact on the number of properties in the sector, particularly as the level of rent increases permitted will be raised from the current level of 3% (or 6% on the grounds of prescribed property costs) under the 2022 Act.[57]. The adjudication limit of between 6%[58] and 12% would only apply if the rent is referred to adjudication. Furthermore, these higher nominal rent increases will take place in what is expected to be a lower-inflationary environment,[59] meaning that in real-terms rent increases on existing lets could be significantly higher in the period the measures are in force than in the preceding nineteen months.

<u>Will the measure limit the ability of suppliers to compete?</u>

The measures apply across all property types and locations, so we do not anticipate that it will limit the ability of existing suppliers to compete with one other. Furthermore, as set out in the answer above, we do not expect the proposed measures to have a significant negative impact on new suppliers entering and competing in the sector.

There could be an impact on the incentives for landlords to compete through offering different combinations of quality and price, because restrictions on rent increases may limit a landlord's ability to recoup the cost of improving the quality of some existing tenancies. However, we believe that the level at which the rent taper has been set achieves the right balance in terms of preserving incentives for landlords to invest in existing lets while providing a degree of protection from large rent increases for tenants, who still face challenging financial conditions.

<u>Will the measure limit suppliers' incentives to compete vigorously?</u>

For the reasons set out above, we do not expect there be a significant impact on suppliers' incentives to compete vigorously.

<u>Will the measure limit the choices and information available to consumers?</u>

New supply will be protected because initial rents are not capped, and incentives to invest in existing property are largely maintained, so we do not anticipate that the measures will materially limit the choices available to consumers.

We will also provide information to tenants through a range of channels, to raise awareness of the proposed changes. Such communication may also help increase general awareness amongst tenants about their rights.

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[57] On the grounds of prescribed property costs; the general rent cap is set at 3%.
[58] Provided the proposed rent does not exceed market rents.
[59] The SFC expects that CPI inflation will moderate to 3% in 2024-25, from 10% in 2022-2023 and around 6% in 2023-24.

Consumer Assessment

The Scottish Government defines a consumer as “anyone who purchases goods or digital content, or uses goods or services in the private or public sector, now or in the future”. In the rental sector, the tenant is typically the consumer. However, landlords could also be consumers of services provided by letting agents.

Does the policy affect the quality, availability, or price of any goods or services in a market?

Controls on rents could reduce the incentives to invest in new supply, as well as in the quality of existing properties. Furthermore, while existing tenants could benefit from lower rents in the short term, this could lead to higher rents in the long term due to a fall in supply.

However, taking into account that rents for newly let properties or tenancy changes are not affected, as well as the level at which the adjudication taper has been set, we do not anticipate that the proposed measures will have a significant negative impact on this. Trends in the number of properties on the Scottish Landlord Register over the period of the 2022 Act support this view. Sitting tenants will benefit from the additional protection in respect of the ability to challenge excessively large rent increases during a period of ongoing pressure on household budgets.

Does the policy affect the essential services market, such as energy or water?

No.

Does the policy involve storage or increased use of consumer data?

No.

Does the policy increase opportunities for unscrupulous suppliers to target consumers?

No. Under the 2016 Act, tenants have protection in terms of when and how their rent can be increased and a right to adjudication of proposed rent increases by a Rent Officer and, if necessary, the FTT.

- Rents for sitting tenants can only be increased once per year
- If a landlord wants to increase the rent, they must give at least three months’ written notice.
- Tenants can refer a proposed rent increase to a rent officer for adjudication within 21 days of receiving the notice.
- The rent officer has the power to decide what the rent for the property should be with reference to the relevant legislative provisions.
- If the landlord or tenant disagrees with the rent officer’s decision, they can appeal to the FTT, who will make a final decision.

Access to rent adjudication is available to applicable tenants under the 1988 Act through referral direct to the FTT. The procedure for seeking an increase in rent under a 1988 Act tenancy may vary depending on the terms of the tenancy type.

<u>Does the policy impact the information available to consumers on either goods or services, or their rights in relation to these?</u>

No, as set out above, we will communicate the changes to tenants.

<u>Does the policy affect routes for consumers to seek advice or raise complaints on consumer issues?</u>

No, as discussed above, tenants will be able to apply to the Rent Service Scotland, or the First-tier Tribunal as the case may be, to review their rent increase. Tenancies with a PRT would be able to appeal any Rent Service Scotland decision to the First-tier Tribunal, in line with pre-2022 Act practice.

Test Run of Business Forms

The transitional arrangements will not introduce any new statutory forms.

Digital Impact Test

Changes in terms of processes are not anticipated in the period when the proposed regulations will be in place.

Legal Aid Impact Test

There is no anticipated impact on Legal Aid as this measure does not create new procedures or rights of appeal to a court or tribunal, nor does it change such a procedure or right of appeal.

Enforcement, Sanctions and Monitoring

Enforcement & Sanctions

The right to refer a rent increase will already available (from 1 April 2024 when the rent cap expires) to tenants who feel a proposed rent increase should be adjudicated by a rent officer or the First-tier Tribunal, as the case may be, with the change proposed here only amending the basis on which the decision by a rent officer/Tribunal will be taken. There is no change to the existing processes aside from applying a new calculation; there would not be any new compliance or enforcement routes.

Monitoring

Monitoring data will be available through the usual reporting routes from the RSS and the FTT. The Scottish Government will continue to engage with landlords, tenants and investors.

Implementation and delivery plan

To support the implementation of the proposed changes, the Scottish Government will undertake a range of activities to raise awareness of the changes to support both tenants and landlords. This will help ensure that those affected have the information they need to navigate the changes brought about by the expiration of the emergency rent cap and the associated change to rent adjudication. Key activities will include:

- A marketing campaign ahead of the expiry of the 2022 Act, targeted at tenants to raise awareness of the changes;
- Provision of information for both landlords and tenants on government web pages that will provide up to date information on the changes;
- Publication of tools that will assist tenants and landlords to understand the effect of the changes in their specific circumstances;
- Work with stakeholders to disseminate information on the proposed changes;
- Dissemination of information direct to landlords and letting agents to raise awareness and support understanding of the changes.

This work will be undertaken ahead of the expiry of the 2022 Act to ensure that information is available ahead of the change to rent adjudication taking place. The Scottish Government will monitor the implementation of the change and continue to engage with stakeholders update communications where that would be beneficial.

Post-implementation review

The proposed measures are temporary and will apply for 12 months. While they are in force, the Scottish Government will keep the operation of the regulations under review through regular monitoring of cases referred to the RSS and the FTT.

Summary and Recommendation

The power to modify the approach to rent adjudication on, or in anticipation of, the expiry or suspension of the temporary rent cap was included in Schedule 3 of the 2022 Act in order to support the transition away from the emergency rent cap. The proposed use of this power has been informed by the potential for the suppression of in-tenancy rents during the rent cap to give rise to situations where tenants could experience excessively large rent increases, even though the proposed rent would not necessarily exceed the market rent. The Scottish Government does not consider that the pre-2022 Act approach to rent adjudication, which is based on market rents, would protect tenants from excessively large rent increases if there is a sudden move to open market rent in a single step. This temporary protection is essential given the very challenging financial situation that privately renting households continue to face.

Table 155 summarises the benefits and costs for Option 2, which has been costed relative to the business as usual (Option 1).

Table 15. Summary of benefits and costs for Option 2 (relative to Option 1)

Benefits
Lower rental payments for tenants (estimated between £19m and £226m across Scotland, with a central estimate of £81m) as a result of protection against very large rent increases.
Reduced costs for local authorities and third sector organisations (non-monetised) as a result of reduced pressure on housing and homelessness services since easier for tenants to sustain tenancies.
Reduced pressure on NHS Scotland (non-monetised) due to reduced negative mental and physical health impacts on tenants as a result of concerns about very large rent increases.
Costs
Foregone rent for landlords (similarly estimated between £19m and £226m across Scotland, with a central estimate of £81m which is equivalent to 2.1% of the estimated total rental income in 2024-25 of £3.867bn) due to the operation of the tapered approach, although this will be an overestimate to the extent landlords would set a below-market rent even without the change in adjudication process.
Familiarisation costs for landlords (small) – Scottish Government communication will help ensure any such costs are mitigated as much as possible.
Reduced incentives for landlords to invest in new supply and housing quality (small) – such costs are expected to be limited since new let rents are not controlled, and the level of the taper has been set so as to allow landlords a sufficient increase in rental income (between 6% and 12% if the gap to market rent justifies it, and this increase is expected to take place in the context of lower inflation) to cover costs related to housing quality.
Higher adjudication costs for RSS and FTT (estimated between £0m and £0.31m for RSS and £0m and £0.07m for FTT) if caseloads increase.
Net benefit
In economic terms, foregone rent represents a transfer from landlords to tenants. Since tenants continue to face challenging economic conditions, this transfer is expected to result in a net social benefit. Avoiding the financial, housing and health impacts of excessively large rent increases could also reduce pressure on public and third sector organisation budgets. Familiarisation costs are expected to be limited due to Scottish Government communication and the negligible change in the existing processes, as are wider costs from reduced incentives to invest in new supply and the quality of existing homes due to the design of the temporary changes to the adjudication process. Administrative costs for the rent adjudication process (estimated to be less than £0.4m in total) are expected to be small in comparison to the net social benefit of the regulations.

After careful consideration, the Scottish Government recommends implementation of option 2, as this proposed change to the rent adjudication process would balance the rights of landlords and tenants. The change proposed under Option 2 still takes account of market rents in the adjudication process and allows for rent increases up to 6% to go forward without any modification (provided the new rent does not exceed the market rent value). Rent increases above 6% can also go forward, but the tapered approach means that they will take account of the gap between the existing rent and the market, with the additional gap between the existing rent and market above 6% split between the landlord and the tenant, up to a maximum of 12% of existing rent. This allows for rents to increase, and to move back towards the market level as part of the transition away from the rent cap.

Declaration and publication

I have read the Business and Regulatory Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed:

Date: 31 January 2024

Minister's name: Patrick Harvie
Minister's title: Minister for Zero Carbon Buildings, Active Travel and Tenants' Rights

Scottish Government Contact point: Alice Hall, Interim Deputy Director, Better Homes

Technical Annex

Table 16 sets out the detailed calculations which underlie the estimates of foregone rent as summarised in Table 6, i.e. for the central estimate of future rental growth of 8% per annum. Similar calculations underlie the estimates of foregone rent for the high (Table 7) and low (Table 8) future rental growth scenarios.

The following assumptions were used to produce this analysis:

- The calculations are broken down by six-month periods because the 2022 Act was subject to two six-month periods of extension. It should be noted that the first period of the 2022 Act was slightly longer, as it applied to rent increase notices served from 6 September 2022, but this is also treated as a six-month period to simplify the analysis.

- The foregone rent is calculated assuming that the landlord sets the rent to the market level when they increase rents. Evidence suggests that rents for sitting tenants are on average below market rents. To the extent that this is due to landlords not raising rent each year for sitting tenants, this is subsequently factored into total foregone rent across the Scottish private rented sector by assuming different share of landlords who raise rent (see Table 9). However, it could also be due to the landlords not raising rent fully to market levels when they do raise rents – there is insufficient evidence to make a robust adjustment for this, but to the extent that this is true, foregone rent is likely to be below the estimates presented here.

- It is assumed that landlords only raise rents every 12 months.[60] This is shown in the table by greying out the 6-month period when they cannot raise rent due to this restriction. Note that for tenancies where a rent increase was due in the October 2022 to March 2023 period, due to the 0% rent cap in force at that point, it is assumed that landlords increased rents in the following 6-month period.

- During the period of the 2022 Act, it is assumed that when landlords raise rent they do so in line with the general rent cap. However, some landlords were able to raise rents by more on the prescribed property cost ground.

[60] For a Private Residential Tenancy, it is legal requirement that the rent cannot be increased more than once in a twelve-month period.

- Rents are based on average Scottish 2-bed rents as published in Scottish Government statistics.[61] This is the most common bedroom size. Average foregone rent is likely to be lower for 1-bedroom properties, and higher for 3-or-more-bedroom properties. These are only available on an annual basis, so six-monthly average rents are interpolated.[62] The most recent statistics are available for the year to end September 2023, so after that point, rents are grown in line with the relevant rent scenario (8% in the case of Table 6).

Worked Example

The following steps show how the foregone rent estimates were derived when the tenancy started in the October 2021 – March 2022 period, or in the same months in earlier years. It is assumed that when the tenancy started (or when the rent was increased when an annual increase was applied for tenancies which started in earlier years) the rent was set in line with the market rent, which is estimated to be £721 in that period. After a year, when the next increase was due, the 2022 Act was in force, and a 0% general rent cap applied in the October 2022-March 2023 period. It is therefore assumed that the landlord raised the rent in the following 6-month period (April 2023-September 2023) when the rent cap was raised to 3%, so the rent set was £721*(1+3%) = £743. After a further 12 months has elapsed, the next rent increase will take place in the April 2024-September 2024 period, when the proposed rent adjudication process will be in force. At that time, it is estimated that under the central rent growth scenario, the market rent will be £926. This is 24.6% above the current rent. Applying the rent taper, the permitted rent increase on adjudication is 12.0%, which means the rent can be raised to £832. The foregone rent is the difference between this and market rent, which amounts to £94 per month (£926-£832).

[61] Scottish Government, Private Sector Rent Statistics, Scotland, 2010 to 2023.
[62] The criterion used was to constrain the average of six monthly rents to the published annual average, and then choose the six-monthly rents so as to minimise the sum of the squares of the 6-month on 6-month change – this smooths the 6-month rents around the annual averages.

Table 16. Detailed calculations of foregone rent which underlie Table 6

Period	Oct 21 - Mar 22	Apr 22 - Sep 22	Oct 22- Mar 23	Apr 23 - Sep 23	Oct 23 - Mar 24	Apr 24 - Sep 24	Oct 24 - Mar 25
Legal regime relating to rent setting or adjudication	Prior to CoLA	Prior to CoLA	0% rent cap	3% rent cap	3% rent cap	Taper	Taper
Average (2-bed) monthly market rent (year to end September)	£736		£841		£909		
Interpolated monthly market rent each 6-month period	£721	£751	£817	£866	£891	£926	£970
Tenancy started Oct 21 - Mar 22 or same months in earlier years							
Capped rent increase under CoLA (until 31 March 2024)				3%			
% market rent exceeds rent in 2024-25						24.6%	
Rent increase under taper						12.0%	
Monthly rent charged on tenancy	£721			£743		£832	
Monthly foregone rent due to taper						£94	
Tenancy started Apr 22 - Sep 22 or same months in earlier years							
Capped rent increase under CoLA (until 31 March 2024)				3%			
% market rent exceeds rent in 2024-25						19.6%	
Rent increase under taper						10.5%	
Monthly rent charged on tenancy		£751		£774		£856	
Monthly foregone rent due to taper						£70	

Period	Oct 21 - Mar 22	Apr 22 - Sep 22	Oct 22- Mar 23	Apr 23 - Sep 23	Oct 23 - Mar 24	Apr 24 - Sep 24	Oct 24 - Mar 25
Legal regime relating to rent setting or adjudication	Prior to CoLA	Prior to CoLA	0% rent cap	3% rent cap	3% rent cap	Taper	Taper
Average (2-bed) monthly market rent (year to end September)	£736		£841		£909		
Interpolated monthly market rent each 6-month period	£721	£751	£817	£866	£891	£926	£970
Tenancy started in Oct 22 - Mar 23							
Capped rent increase under CoLA (until 31 March 2024)					3%		
% market rent exceeds rent in 2024-25							15.2%
Rent increase under taper							9.1%
Monthly rent charged on tenancy			£817		£842		£918
Monthly foregone rent due to taper							£52
Tenancy started in Apr 23 - Sep 23							
Capped rent increase under CoLA (until 31 March 2024)							
% market rent exceeds rent in 2024-25						7.0%	
Rent increase under taper						6.3%	
Monthly rent charged on tenancy				£866		£920	
Monthly foregone rent due to taper						£6	

Period	Oct 21 - Mar 22	Apr 22 - Sep 22	Oct 22- Mar 23	Apr 23 - Sep 23	Oct 23 - Mar 24	Apr 24 - Sep 24	Oct 24 - Mar 25
Legal regime relating to rent setting or adjudication	Prior to CoLA	Prior to CoLA	0% rent cap	3% rent cap	3% rent cap	Taper	Taper
Average (2-bed) monthly market rent (year to end September)	£736		£841		£909		
Interpolated monthly market rent each 6-month period	£721	£751	£817	£866	£891	£926	£970
Tenancy started in Oct 23 - Mar 24							
Capped rent increase under CoLA (until 31 March 2024)							
% market rent exceeds rent in 2024-25							8.8%
Rent increase under taper							6.9%
Monthly rent charged on tenancy					£891		£953
Monthly foregone rent due to taper							£17

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Any enquiries regarding this publication should be sent to us at

The Scottish Government
St Andrew's House
Edinburgh
EH1 3DG

ISBN: 978-1-83521-947-8 (web only)

Published by The Scottish Government, February 2024

Produced for The Scottish Government by APS Group Scotland, 21 Tennant Street, Edinburgh EH6 5NA
PPDAS1410194 (02/24)