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# BUILD TO RENT IN SCOTLAND

## WHAT YOU NEED TO KNOW



# Build to Rent has arrived in Scotland

Build to Rent is finally happening in Scotland, albeit at a pace which continues to confound its supporters. The projects identified will deliver over 2,500 BTR units in the Scottish cities as BTR slowly becomes a feature of the Scottish real estate market.

The flexibility and mobility offered by the rental market means that rental living is fast becoming the tenure of choice for a generation of millennials, rather than simply a stop-gap for those who aspire to home ownership.

Throughout the UK, 25-35 year old 'renty-somethings' have been identified as the target market for Build to Rent. The Scottish cities – in particular, Edinburgh and Glasgow – are recognised as having strong levels of graduate professionals and this continues to fuel market demand for well-managed, modern, city centre rental accommodation. With rental levels nationally at 15%, over 25% of households in Edinburgh are in rented accommodation.

With the rental market in Scotland offering attractive locations, strong yields and growth potential, and with the Scottish Government target of 50,000 new affordable homes to be delivered over the next five years, it was inevitable that attentions would eventually turn northwards.

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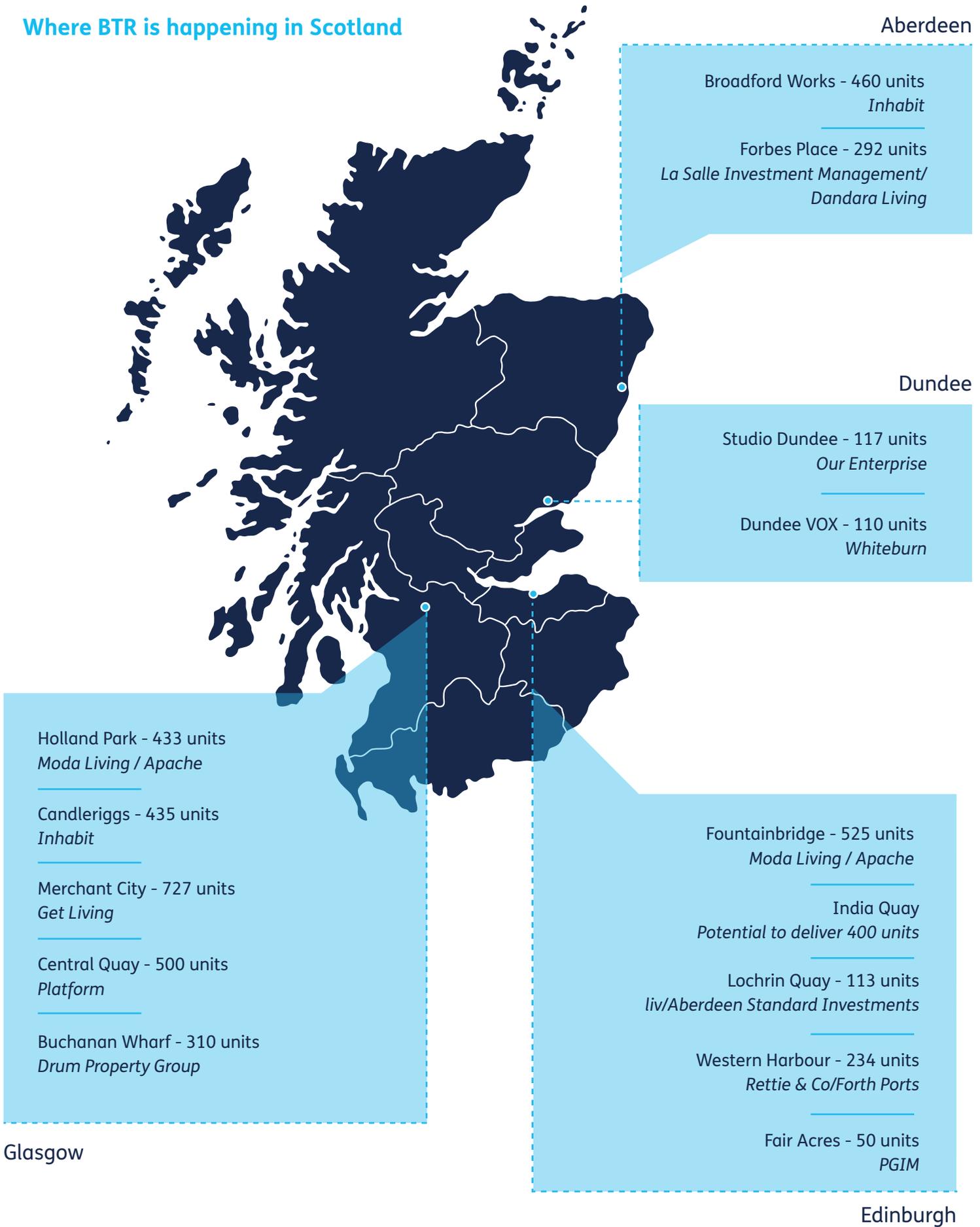
*\* (Scottish Government  
target)*



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## Where BTR is happening in Scotland



## BTR – What you need to know

The BTR market in Scotland is different - but how different when it comes to planning, buying, selling and managing BTR?



### Planning

The planning system has been evolving to cope with the expansion in BTR applications. Similar to England, BTR does not inhabit its own use class in Scotland. To date, the treatment of BTR applications by planning authorities has fallen squarely into the category of residential development, although some planning authorities have been willing to adopt different approaches in dealing with issues specific to BTR – such as being asked to consider concessions on the minimum size of units, reduction in car parking requirements and the like.

Naturally some planning authorities have been cautious about this ‘new kid’ on the housing block and will need continued encouragement to embrace this new form of housing tenure. The Scottish Government wants to encourage a growing BTR sector, and has said that planning authorities can play a crucial supporting role by providing a positive approach to BTR developments in their area (Scottish Government Planning Delivery Advice Build to Rent September 2017).

With supporting evidence available that confirms the key role BTR is playing in ‘placemaking’, those authorities that adopt a more pragmatic attitude to BTR may well be rewarded with more affordable housing solutions, particularly in areas identified for regeneration.

Applying for planning permission for BTR schemes will not always be straightforward but Brodies can offer advice on the approaches likely to be adopted by different planning authorities and the key parameters leading to a successful application.



### Taxation matters

#### Land and Buildings Transaction Tax (LBTT)

LBTT (the Scottish equivalent of SDLT) is charged according to progressive rate bands, with different rates and bands applying to residential and non-residential properties. At higher property values, residential LBTT is significantly higher than the equivalent rates for non-residential property.

LBTT will arise at different stages in the development of a BTR scheme. It will be payable on the purchase of development sites at the non-residential rate. It will also be payable on the purchase of completed BTR properties. The purchase of six or more individual BTR dwellings in a single transaction is treated as non-residential property and will be subject to the lower non-residential rates.

As with SDLT, additional LBTT is payable (the additional dwelling supplement or ‘ADS’) on the purchase of certain dwellings. However, the LBTT ADS rules are more favourable for BTR than the equivalent SDLT charge. There is a specific relief from LBTT ADS for purchases of six or more dwellings in a single transaction. While under SDLT, the higher rates can apply to BTR purchases.

If a BTR scheme is let to a management company, who will then sublet to tenants, then the lease to the management company will be treated as a commercial lease and subject to LBTT. Leases to residential occupiers will not be subject to LBTT.



## VAT

It is essential that BTR schemes are properly structured to allow developers and funders to maximise VAT recovery on project costs. VAT costs can arise on:

- the acquisition of the development land, if it has been opted to tax and it is not possible to disapply the seller's option, or to structure the purchase as a transfer of business as a going concern (TOGC);
- construction costs (potentially at the reduced rate of 5%) if the scheme involves a conversion rather than the effective construction of a new building. VAT at 20% would be payable on any construction costs relating to commercial units (such as ground floor retail) within the scheme; and
- professional fees (agents, architects and professional advisors).

Direct lets to BTR occupiers are exempt from VAT. If VAT costs do arise, these can be recovered by making a zero-rated supply of the scheme, either by disposing of or leasing the scheme under a long lease of over 20 years.

There are a number of technical conditions around making a zero rated supply that need to be looked at in each instance. Zero rated supplies of BTR schemes should be carefully planned to ensure that the structuring does not give rise to an LBTT charge and meets the ongoing commercial objectives of the parties involved.



### Structuring

Restrictions in Scotland on lease term for residential properties mean that the preferred model for investors is to buy the freehold / ownership of the property and to either lease directly to tenants or employ a managing company to do so. Open ended private residential tenancies are now granted to new occupational tenants (see below).



### Rental Income Guarantee Scheme (RIGS)

The Scottish Government has set an ambitious target of 50,000 new affordable homes to be delivered over the next five years and has recognised that this will necessitate new housing across all tenures and price points.

BTR is a key element of the housing mix. Through collaboration and work with the Scottish property industry, the Scottish Government acknowledged that a government-backed guarantee was needed to build investor confidence and assist delivery of this sector in Scotland.

And so, following public consultation, the Rental Income Guarantee Scheme was launched by the Scottish Government's commercial partner, Scottish Futures Trust in October 2017. The Scheme offers a Scottish Government guarantee of a slice of the core rental income forecasted to be generated by eligible units during the first 3 to 5 years of the operation of a BTR development.



## Operating BTR Tenancy agreements

A new tenancy agreement called the Private Residential Tenancy (PRT) was introduced in Scotland on 1 December 2017 giving tenants increased security of tenure.

The providers of purpose built student accommodation (more than 30 beds with planning permission for student accommodation), are excluded from having to provide PRTs to their student occupiers, as are the providers of social housing. PRTs apply to the BTR sector.

Under the PRT regime, there is no minimum and no maximum term of tenancy. The circumstances under which a landlord can seek to remove a tenant who is paying rent and complying with its tenancy obligations are prescribed. It is envisaged that this will increase the number of tenants who will treat renting as their tenure of choice, rather than as a stop gap to home ownership.

Under the PRT, rents can be increased once per year.

### Rent Pressure Zones

Under the PRT regime, a local authority can apply to Scottish Ministers for a rent pressure zone to be created in an area where rents are considered to be rising too rapidly across most rented properties. Whilst this might sound like bad news for BTR investors, importantly rental growth is still achievable. The following should be borne in mind:

- The existence of a Rent Pressure Zone will not prevent a landlord from seeking to achieve the highest rental it can on a first letting or re-letting of a property; it can only affect subsequent increases in rent for that tenancy;
- If an area is designated as a RPZ, rents for existing properties can still be increased annually (assuming there has been growth in open market rent), with this increase capped at a minimum of CPI + 1%;
- RPZ's are likely to be targeted, rather than a blanket RPZ being applied over an entire local authority area.

The Scottish Government guidance on the criteria to be met to support the creation of an RPZ explains that "Evidence of rent rises alone will not be sufficient to prove that they are rising by too much. Authorities also need to prove that rent rises in the proposed RPZ are causing undue hardship to tenants; and the rises are having a detrimental effect on the local authority's broader housing system".

A RPZ can only be put in place to cap increases in rent so none are likely to appear until the PRT is over one year old. So far, the biggest reported hurdle for local authorities interested in setting an RPZ is obtaining the necessary data on rent increases.

## Landlord administrative duties

Every landlord of residential property in Scotland must register with the relevant local authority. Landlords lodge tenancy deposits with an approved provider under the Tenancy Deposit Scheme in Scotland and must provide tenants with key information about the tenancy and any deposit. The deposits will be returned to the appropriate party by application through the TDS.

Landlords who carry out any letting agency work in connection with residential lettings have to comply with the Letting Agents Code of Practice, which came into force in Scotland in January 2018. Letting agents also had to apply to register in the Register of Letting Agents by 30 September 2018. Before they could do so, they had to meet certain training requirements and pass a fit and proper person test. Any new letting agents will also have to follow the Code and apply to be registered.

## Our experience

### Springside, Edinburgh

In early 2017 Brodies was delighted to help Moda Living and Apache Capital secure a strategic city centre site at Springside, Edinburgh and kick off their fantastic BTR vision for Edinburgh. At that time the deal was the biggest to date in the Capital, with the highest GDV in Scotland (well over £200 million). The project involves the construction of 525 rental homes on a five acre site in blocks of five to eight storeys, covering approximately 600,000 sq ft. The transaction also included the joint venture buying an existing 46 unit block from Grosvenor.

Brodies was at the heart of the transaction, both on the legal and leading on the project management of the wider due diligence, driving the deal to a successful conclusion in late February 2017.

Brodies' expertise (lead by Richard Whyte) across a spectrum of specialisms (including real estate, tax, planning, construction, corporate, employment and IP) was utilised to best effect in realising optimal outcomes for our clients, not least giving critical commercial advice against the backdrop of a turbulent political climate across the UK and evolving Scottish residential tenancy legislation.

Construction should commence in the next few months. Brodies will be helping the joint venture develop out the scheme and realise their ambitions, advising on planning, construction and real estate, as well as giving wider structuring advice.

Gross Deal Value - Over £200m  
Number of Units - 525

“Richard and the [Brodies] team provided a comprehensive range of services and expertise in a timely manner working to a very strict timetable. It was important to be represented at the highest professional level when responding to the vendors. It was a great performance all round.”

**Tony Brooks, Managing Director,  
Moda Living**

“We appreciated not only Brodies' ability to bring to the deal a variety of technical expertise but also to overlay with commercial sensitivity and perspective.”

**Mark Peck, Transactions & Structuring,  
Apache Capital Partners**



## About Brodies

Brodies LLP is a leading commercial law practice, with 97 partners and more than 600 staff across offices in Edinburgh, Glasgow, Aberdeen, Dingwall and Brussels. We have an uncompromised ability to deliver the highest level of legal services to a diverse private and public sector client base across Scotland, the UK and overseas.

With over 100 lawyers who work exclusively on real estate, Brodies has the largest Scottish resource dedicated to real estate of any firm. Our real estate practice is ranked top tier by independent legal industry guides The Legal 500 and Chambers & Partners for core real estate work, planning and real estate litigation.

Brodies is at the forefront of advising on BTR in Scotland. We have the experience and the expertise to advise on all aspects of a BTR scheme from planning to site assembly, construction, funding, leasing, managing and sale, as well as tax planning.

“Brodies LLP’s [real estate] team is ‘commercial and responsive’, and provides ‘a level of service that is unrivalled in Scotland’.”  
*Legal 500 UK*

“They [Brodies’ real estate team] have the ability to produce commercial solutions to complex problems, often working to tight timescales”.  
*Chambers UK*

## Recognition of excellence



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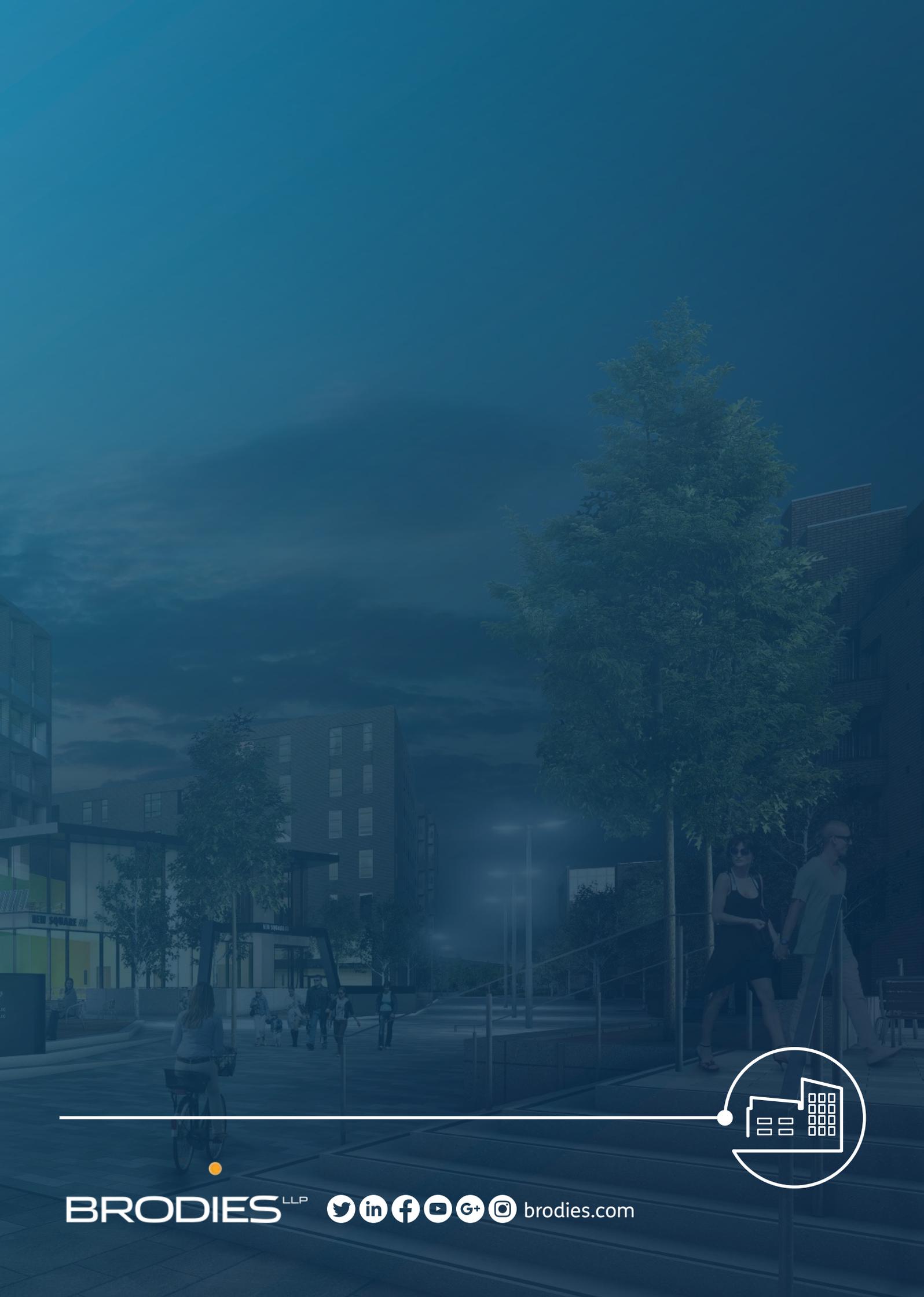
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