

Title: Transparency of Letting Agents Fees IA No: RPC14-FT-CLG-2120 Lead department or agency: Department for Communities and Local Government Other departments or agencies:	Impact Assessment (IA)		
	Date: 27/03/2015		
	Stage: Validation		
	Source of intervention: Domestic		
	Type of measure: Primary legislation		
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Summary: Intervention and Options	RPC Opinion: Awaiting Scrutiny
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Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out? Measure qualifies as
£-1.17m	£-1.17m	£0.10m	Yes IN

What is the problem under consideration? Why is government intervention necessary?

The problem under consideration stems from the opaque nature of the fee structure charged by letting agents to both tenants and landlords. The lack of transparency can hinder the efficiency of this market by increasing the transaction costs for both sides, often leading to sub-optimal economic decisions. Once a tenant has found somewhere suitable they can then be confronted with unexpected fees that would otherwise have prompted them to make a different rental decision had they known of the fees up front. This 'Drip-Pricing' coupled with the tendency to 'shop' for a property, not an agent, means that tenants feel exploited. This situation requires intervention because without simple and easy access to this information both renters and landlords do not have the full information required to make an informed choice, resulting in inefficiencies across both sides of the market and considerable loss.

What are the policy objectives and the intended effects?

The intended effect of this policy is to increase transparency which will allow both renters and landlords to have a clearer indication of costs, thereby facilitating a more efficient market based outcome through more effective competition between letting agents than would otherwise be the case. This policy will also make it easier for agents to demonstrate a level of service proportionate to the fees charged.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

1 - Do nothing.
2 - Require letting agents to display their fees, whether or not they are a member of a client money protection scheme and which redress scheme they have joined and introduce a fine where agents are not transparent.

The do nothing would result in hundreds of thousands of tenants continuing to be charged hidden and unexpected fees once they have decided to rent a property. Also, given that both renters and landlords tend not to have access to those fees charged to the other party, they are both at risk of double charging by an agent. The preferred option will increase effective competition between letting agents through transparency in how they price and charge fees. This should lead to a more efficient outcome than would otherwise be the case as costs are clear and transparent from the onset of the transaction and supports the majority of good letting agents

Will the policy be reviewed? It will/will not be reviewed. **If applicable, set review date:** Month/Year

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro Yes	< 20 Yes	Small Yes	Medium Yes	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded:		Non-traded:

I have read the 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 by the responsible
SELECT SIGNATORY:**

Brandon Lewis

Date: 25/03/15

Summary: Analysis & Evidence

Policy Option 1

Description: Require letting agents to display their fees and introduce a fine where agents are not transparent

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	Present Value Base Year 2015	Time Period Years 10	Net Benefit (Present Value) (£m)		
			Low: -1.36	High: -0.99	Best Estimate: -1.17

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0.4	0.1	1.0
High	0.6	0.1	1.4
Best Estimate	0.5	0.1	1.2

Description and scale of key monetised costs by 'main affected groups'

A total one-off cost of £0.52 million (range £0.44 million – £0.60 million) , which consists of: familiarisation cost £0.04 million; cost of setting set up web-pages of £0.46 million (range £0.39 million - £0.54 million) and time cost to display fees in branches of £0.02 million (range £0.02 million - £0.02 million).

An average annual cost of £0.08 million (range £0.06 million - £0.09 million), which consists of: cost of updating web pages of £0.06 million (range £0.05 million - £0.07 million) and cost of updating and displaying fees in branches of £0.02 million (range £0.01 million - £0.02 million).

Other key non-monetised costs by 'main affected groups'

No further costs anticipated

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low			
High			
Best Estimate	N/A	N/A	N/A

Description and scale of key monetised benefits by 'main affected groups'

No direct benefits identified

Other key non-monetised benefits by 'main affected groups'

Greater transparency of fees should enable both renters and landlords to benefit from a more efficient market which will in turn guard against sub-optimal choices being made. For renters this means no longer incurring extra search costs. Transparency should also lead to an increase in effective competition in the market as both landlords and renters will be better able to 'shop around' and will know from the outset what costs are associated with the services being provided. This could lead to downward pressure applied to fees charged by letting agents benefitting tenants and landlords. Shelter found that a household with an income of less than £25,000 paid an average of £401 in letting agent fees. Greater transparency of fees may lead to downward pressure on fees, if this led to a decrease of fees in the region of 5%-10% this would lead to estimated savings per household of £20-£40, scaled up by the number of households moving in the private rented sector each year (1.09 million) could lead to annual savings in the region of £22 million - £44 million each year. However this is just an estimate as we do not have evidence of whether fees will actually fall as a result of greater transparency and efficiency.

Key assumptions/sensitivities/risks

3.5

This policy will not affect all agents as some already clearly present their fees and charges. We have used data from Shelter and Which? to provide us with a range for the number of agents and branches which will be affected by this policy (41% to 57%), a best estimate of 49%. We have taken the conservative estimate of assuming all branches will take 15 minutes to read and become familiar with the regulation. Agents and web designers wage rates are based on 2014 Annual Survey of Hours and Earnings hourly wage rates which have been uplifted by 30% as per HMT Green Book methodology

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0.1	Benefits: 0.0	Net: -0.1	Yes	IN

Evidence Base (for summary sheets)

Detailed background

The size of the Private Rented Sector

The Private Rented Sector in England accounts for 4.0million households, or 18% of the total 22.0 million private accommodations in 2012. This is up from 9% of the total in 1991 (English Housing Survey 2012-13¹), demonstrating the rapid growth of the sector and its increasing importance in meeting the country's housing needs. The Resolution Foundation ('Housing in transition: understanding the dynamics of change', 2012²) suggest that the private rented sector will account for 22% of all stock by 2025, and as much as 37% in London.

The rented sector not only represents a significant proportion of housing stock, but it also exhibits a high degree of household churn. Around a third (34%) of private rented households have lived in their home for less than one year, compared with only 4% of owner occupiers and 10% of social renters (English Housing Survey 2012-13). 81% of movers in the private rented sector who have moved recently (defined as those who have not lived in their current property for more than three years) moved to another property in the rented sector. (English Housing Survey 2011-12)

Professor Michael Ball (Regulating Residential Letting Agents: The Issues and the Options, October 2012³) suggested around 1.09 million households moving in the private rented sector every year.

The Profile of Landlords

Industry representatives estimate the landlord population as approximately 1.4million (Private Landlords Survey 2010⁴). 89% of private landlords are private individuals, accounting for 71% (or 2.1million) of dwellings in the Private Rented Sector, and 78% of landlords only owned a single dwelling for rent (Private Landlords Survey 2010). 'New landlords' – counted as those letting property for 3 years or less, consisted almost entirely of private individuals (98%) – only 3% of which counted themselves as 'full time' landlords.

The Private Landlords Survey 2010 also describes the profile of landlords in terms of their qualifications and income from letting. Almost four-fifths of landlords (who control 61% of privately rented dwellings) earned less than a quarter of their income from rent. 63% of private individual landlords had no relevant experience or qualifications, and only 6% are members of a relevant professional body or organisation.

It is unsurprising therefore that many landlords of properties wishing to rent out, choose to do so through a letting or managing agent. The Private Landlords Survey suggests that agents were involved in approximately 66% of all private rented tenancies.

The role of Letting and Managing Agents in the market

Letting agents provide a valuable service for both landlords and tenants. In any particular area, there are landlords seeking tenants for properties and also tenants looking to rent a property. Both tenants and landlords spend time and resource looking for each other, these costs can be significant. Letting agents significantly reduces the search costs for both prospective tenants and landlords by matching them together. The Property Ombudsman estimates there are approximately 11,560 branches involved in letting property⁵ (either combined sales & lets, or purely letting).

¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/335751/EHS_Households_Report_2012-13.pdf

² <http://www.resolutionfoundation.org/publications/housing-transition-understanding-dynamics-tenure-change/>

³ http://www.tpos.co.uk/downloads/reports/TPO_Report_v2.pdf

⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/7249/2010380.pdf

⁵ Figure used in The Redress Schemes for Lettings Agency Work and Property Management Work based on The Property Ombudsman Statistics: <http://www.tpos.co.uk/>

In their report “The Lettings Market” (February 2013⁶) the OFT explain that the lettings market has many similarities with a two-sided market – but that the most significant difference is that there is a direct relationship between the tenant and landlord. Therefore, “*fees charged by the letting agent to the landlord are likely to be recovered from the tenant directly through higher rents*”. At the same time, agents can also set fees which the tenant is required to pay for certain services. There are economic inefficiencies in this arrangement, described fully in the OFT’s report.

Overall, the tenant considers the total cost of the rental; that is, the amount of rent that they pay, plus any fees that are levied by the agent. As long as the fees are transparent, this allows the tenant to make an informed choice – and therefore maximises efficiency in the matching process. However, in some cases the lack of transparency can hinder this process and often mean tenants end up paying more than they expect to, meaning that once the full cost of the transaction is revealed a sub-optimal decision has already been taken. This is one of the primary causes for high levels of consumer dissatisfaction in the sector.

On the other side, the landlord wants to maximise the amount of rent that they receive, minus anything they have to pay to the agent and other costs they might incur through letting of the property. Implicitly, this includes finding high quality tenants as soon as possible to minimise voids in rental income – as well as ensuring that the tenant will not go into any rental arrears. The landlord, where they use a letting or managing agent, entrusts them to do this on their behalf. This will include the vetting of potential tenants, dealing with problems during the tenancy, and chasing up payments.

The sector is mostly self-regulated by membership of trade bodies. On the whole, this means that the general reputation and standards in the sector are generally high. However, this also means that agents who choose not to join a trade body, or to not publish their fees have the reputation benefits without the associated cost. The proposal to regulate would eliminate this free-riding problem (see RICS research, “Better Regulation of sales and letting agents: An impact assessment of costs and benefits” – January 2013⁷).

Tenant dissatisfaction in the sector

In a report by Which? (“The Lettings Market”, November 2012⁸) showed that 1 in 5 tenants were dissatisfied with their letting agent, and letting agents ranked second bottom in Which?’s customer satisfaction score across 50 consumer markets. Landlord customer satisfaction was sixth from bottom across 50 markets, with 17% stating they were dissatisfied with their agent.

The reasons for consumer dissatisfaction are many and varied, and well documented across many separate and independent studies into the topic. On the part of tenants, most complaints focus on fees levied by the letting agent being unfair (which extends to not being transparent about the purposes of the fee or conditions attached to the fee itself). The OFT’s Intelligence Report based on Consumer Direct complaint analysis identified fees and charges represented the main topic of a third of total complaints, whilst ‘agents providing a poor service’ made up 23%. They identified ‘drip pricing’ i.e. where landlords and tenants do not know up-front about all the fees that may be charged, is a particular problem and exploits tenants’ behavioural biases. Often, fees can be introduced after a tenant has paid a non-returnable deposit so that they have a financial commitment – creating switching costs for the tenant. The OFT state that ‘*fees that are not clear up front may not be exposed to effective competitive pressure*’. Furthermore, ‘*prospective tenants’ likelihood to reassess based on additional fees that are presented after they have made a decision to rent a particular property, even if not yet contractually committed, is likely to be reduced*’ – which may lead to ineffective or reduced searching by tenants for properties.

⁶ <http://webarchive.nationalarchives.gov.uk/20140402142426/http://www.of.gov.uk/OFTwork/markets-work/othermarketswork/lettings/>

⁷ <http://www.clangordon.co.uk/media/50615/RICS%20Regulations%20of%20Letting%20Agents%20Report%20Feb%2013.pdf>

⁸ <http://www.which.co.uk/documents/pdf/renting-roulette-consumer-experience-of-the-lettings-market-303394.pdf>

As discussed in the previous section, this can lead to a sub-optimal decision on the part of the tenant in terms of the final property they choose to rent at a given price level. The Which? Report highlighted that 36% of tenants didn't think fees were value for money, and 41% thought fees were unfair. This is somewhat exacerbated by the high turnover of households in the sector. Opaque and variable fees charged, paid more frequently because high levels of churn in the market mean the potential to exploit consumers and extract excess profits by agents is high. Only 3% of tenants reported paying no fees at all. 32% of tenants said they may have considered using a different agent if they had found out about fees earlier.

These high levels of consumer dissatisfaction on the part of the tenant might be reduced if fees were transparent, and therefore could choose on the basis of the agent marketing the property. However – tenants tend to 'shop' for a property, not an agent. This is apparent through the rise of online search engines. Consumers will contact whoever happens to market the property they like (and most properties tend to be marketed by a single agent). The likelihood of a prospective tenant changing their mind about a property, even in light of 'drip pricing', is low. This is because of the significant amount of emotional and time investment given by the tenant in viewing a property and deciding to live in it. Drip-pricing exploits this bias.

The current regulatory environment

Regulatory barriers to entry in terms of the lettings agency sector are low. There is currently no statutory licensing of landlords or letting agents within England. This compares with Scotland, where all private landlords must register with their local authority to ensure they are a 'fit and proper person' to let property. Similarly, whilst there are currently no regulations around the charges and fees levied by agents in England, the Scottish Government has legislated to clarify what 'upfront charges' may be levied.

There are many active firms in the market (The Property Ombudsman estimates 11,560) which would suggest a high degree of competition in the sector. However, the Carsberg Review of "Residential Property: Standards, Regulation, Redress and Competition in the 21st Century" (June 2008⁹), concluded that, in deciding the case for active regulation "*active competition among numerous firms does not necessarily amount to effective competition. Competition is usually most effective if participants in a market are well informed*".

The report goes on to further state that "*the markets for estate agencies, letting agencies and managing agencies are not working well because clients are not well informed about the qualifications of different agents and about what to expect from them in the way of service ... processes are complex and most consumers do not understand the normal processes or alternatives that may be more expeditious*". It concludes that "*Professionals in the industry have not been doing a good enough job in informing consumers so that they can exercise their choices effectively*".

The main case for further regulation in the sector would be requiring provision of information in order to make the market work effectively. Indeed, the OFT state in their February 2013 report that "*effective competition and compliance with consumer protection legislation only goes so far in tackling the issues*".

In March 2013 the Advertising Standards Authority ruled that all letting agencies need to make clear what compulsory fees are charged when letting a property. If the fee cannot be calculated in advance because of, for example, an individual's circumstances, then the adverts must make clear that compulsory fees and charges are excluded and provide adequate information for consumers to establish how additional fees are calculated. However, there is no financial penalty for failure to comply with the Advertising Standards Authority ruling and because it is on the advertisement, there is often insufficient room for these fees to be comprehensive and clear.

Consumer Protection Regulations already stipulate that firms must inform consumer what their fees and charges are before contracts are signed. However, there is no current requirement for how or where these fees are displayed leading to the drip feeding of fees once a tenant is interested in a property and again there is no financial penalty for failure to comply. Drip feeding is discussed more in the following section.

⁹ <http://cdm16064.contentdm.oclc.org/cdm/ref/collection/p266901coll4/id/2883>

Current Practice with Fees

The majority of renters using letting agencies are charged some fees: The Which? Renting Roulette, Consumer experience of the lettings market 2012 found just 3% of tenants had paid no fees and Citizens Advice (Let Down 2009¹⁰) found that 94% of agencies imposed fees on top of rent and a deposit/rent in advance. Citizens Advice's research summarised why this is cause for concern, finding that some agencies hide their fees, double-charge landlords and renters and that fees for some services are unrelated to the actual cost of providing this service. Shelter's Private Rented Sector Census found fees were common but not as universal as previous studies indicated. Tenants renting from a letting agency are most likely to be charged an admin fee (70%), initial contract fee (62%), or credit check (52%). A You Gov survey for Shelter in November 2012¹¹ found that only a minority of tenants reported being charged fees for references (35%), protecting a deposit (14%), and contract renewals (26%) – although these services may have been covered by a generic "administration" fee. There are widespread concerns that fees are not made clear enough to tenants early enough in the lettings process. Fewer than half (43%) of all renters surveyed for Shelter said that their letting agency was open and transparent about the fees they would be asked to pay. Mystery shopping by Which? found no letting agencies who displayed a breakdown of fees on their website¹². This means that renters are unlikely to be given the full details of the fees they are liable for until they have invested considerable time in viewing and deciding on a home to rent. As a result, such charges are not exposed to the competitive pressures typical found in other consumer markets.

The YouGov Shelter survey found that there is also evidence of drip pricing, which is fuelled by unclear fee structures and increases overall costs. Tenants are charged an average of three fees each by letting agencies and 38% pay four or more separate fees. Tenants are unable to compare letting agencies' costs if fees are not disclosed early on in the process and in full. This means an agency have little incentive to compete on costs to tenants, or apparently reasonable headline fees may be undermined by additional costs that only emerge after the tenant is committed to their new home.

As well as unexpected fees, a frequent concern of renters is that the fees charged are out proportion to the service received. Levels of charges certainly vary widely. Mystery shopping research commissioned by Shelter found examples of fees for reference checks ranging from £30 to £220 and of renewal fees ranging from £35 to £150¹³. The Office of Fair Trading has also noted the wide range of fees charged and argued that this could be indicative of problems in the market.

There is widespread suspicion that many agencies are charging both landlords and tenants fees for the same service, such as drawing up a tenancy. This has led to concerns that agencies may be exploiting their unique market position between tenants and landlords to maximize their fee income. This double pricing occurs even though it is the landlord that has contracted the agency to perform a service on their behalf. A transfer of some of this cost to renters has become common and it may be that agencies are fairly splitting costs between landlords and tenants. But this cannot be demonstrated without clear benchmarks for the actual cost of services charged for and transparency of fee structures. The OFT and others also note that high tenant fees may act against the interest of landlords if they deter potential tenants, creating voids. Given landlords' low awareness of tenant fees it is not at all certain that they would identify this as a cause of void periods and consequently will not be able to challenge letting agencies on their pricing structures.

In addition to issues associated with hidden fees, there is little consumer awareness of whether agents offer client money protection or whether client money is at risk if the agent goes bankrupt. Government supports the SafeAgent kite marks which denotes that an agent is a member of a client money protection scheme but there is little consumer awareness.

¹⁰ http://www.citizensadvice.org.uk/index/policy/policy_publications/er_housing/let_down.htm

¹¹ http://england.shelter.org.uk/__data/assets/pdf_file/0006/671649/Letting_agencies_-_The_price_you_pay.pdf

¹² <http://www.which.co.uk/documents/pdf/renting-roulette-consumer-experience-of-the-lettings-market-303394.pdf>

¹³ http://england.shelter.org.uk/__data/assets/pdf_file/0006/671649/Letting_agencies_-_The_price_you_pay.pdf

Problem under consideration

The problem under consideration stems from the opaque nature of the fee structure charged by letting agents to both tenants and landlords. Lack of transparency can hinder the efficiency of this market by increasing the transaction costs for both sides, often leading to sub-optimal economic decisions. The nature of the existing regulation also gives an opportunity for rogue agents to free-ride on the back of the reputation of decent, transparent ones.

From a tenant's perspective there are large search costs associated with finding somewhere to rent and decisions are made based predominantly on the price of the rent. Letting agents help to reduce these costs but once a tenant has found somewhere suitable they can then be confronted with unexpected fees – often after paying a non-refundable deposit - that would otherwise have prompted them to make a different rental decision had they known of the fees up front. This 'Drip-Pricing' coupled with the tendency to 'shop' for a property, not an agent, means that tenants feel exploited with 32% saying they may have considered using a different agent if they had found out about fees earlier and 41% who thought that the fees charged were unfair¹⁴.

In addition, there is often a wide range of the fees themselves charged to both landlords and renters, leading many to suspect that they are being charged disproportionately for services.

Landlords have a tendency to pass these unexpected and sometimes disproportionate fees on to renters. Going forward, these inefficiencies within the market will continue to result in a large amount of sub-optimal decisions meaning a significant loss of utility and resources for both renters and landlords.

It is also important when landlords are choosing an agent that although price is an important consideration, it might reflect the level of service provided. Ensuring all agents declare whether or not they are a member of a client money protection scheme will help landlords choose an agent based on cost effectiveness and not just the cheapest.

Rationale for intervention

Under the do nothing scenario, hundreds of thousands of tenants will continue to be charged hidden and unexpected fees as once they have invested the time to view and decide to rent a property their likelihood to change based on newly available information is reduced. Also, given that both renters and landlords tend not to have access to the fees that they will be charged, or access to those charged to the other party, they are both at risk of double charging by an agent.

This is an inefficient arrangement that imposes increased costs on all tenants and landlords resulting in sub-optimal economic outcomes for both parties and contributes significantly to the negative perception and distrust of lettings agents.

Policy objective

The policy objective is to increase transparency of fees, reduce search costs for renters and make it harder for rogue agents to operate. Renters can currently be charged additional unexpected fees, after placing a non-refundable deposit, which may have altered their decision if they knew of the fees in advance. It is hoped that the increased transparency will increase effective competition in the market as both landlords and renters will be better able to 'shop around' and will know from the outset what costs are associated with the services being provided. This should lower the time it takes to conduct a transaction, lessen the likelihood of a sub-optimal decision being made – through the imposition of post-decision fees - and it is hoped increase the efficiency of the market. The policy should also benefit reputable agents as the increased transparency of fees should 'level the playing field' by making it harder for rogue agents to operate and thereby damage the reputation of the industry and its members.

¹⁴ <http://www.which.co.uk/documents/pdf/renting-roulette-consumer-experience-of-the-lettings-market-303394.pdf>

Description of options considered (including do nothing):

Do nothing.

Hundreds of thousands of tenants will continue to be charged hidden and unexpected fees as once they have invested the time to view and decide to rent a property their likelihood to change their minds based on newly available information is reduced.

Also, given that both renters and landlords tend not to have access to the fees charged to the other party, they are both at risk of double charging by an agent.

This approach will extend an inefficient arrangement that imposes increased costs and results in sub-optimal economic outcomes for all involved.

Impose regulation (proposed).

This approach will increase effective competition between letting agents through transparency in how they price and charge fees and whether or not they are a member of a client money protection scheme. It will allow both renters and landlords to have a clearer indication of costs from the outset of their activity in the market, thereby facilitating a more efficient outcome than would otherwise be the case. This policy will also make it harder for letting agents to operate using excessive and hidden fees, levelling the playing field for those providing an agency service and increasing competition. By requiring agents to publicise which redress scheme they have joined will not only make it clearer where an agent hasn't joined it will also remind tenants and landlords that they have access to an Ombudsman if required.

Ban letting agents from charging fees to tenants.

The banning of letting agents fees was an additional option, but the Department has chosen to regulate for the transparency of fees. Due to this no analysis has been carried out so we do not know the impacts of this option.

Rationale and evidence that justify the level of analysis used in the IA

The proposed regulation has been deemed low cost by the Regulatory Policy Committee following the Regulatory Triage Assessment. This assessment has been focused on the cost to business for the purposes of calculating the Equivalent Annual Net Cost to Business(EANCB). Following the Regulatory Policy Committee's confirmation of the Regulatory Triage Assessment we have carried out the following updates to our analysis:

- Instead of assuming all branches will be affected by this policy, as we did for the Regulatory Triage Assessment, we have used a range for the number of letting agents who will be affected and need to ensure that their fees and charges are prominently displayed in each branch (a range of 41% to 57% of branches used). These ranges are based on surveys by Shelter and Which? who surveyed renters on whether they found fees clear and transparent. The reason we assumed all firms would need to take action and display their fees in the Regulatory Triage Assessment, was to show that even in the worst case scenario the policy was a low cost regulatory policy.
- We have separated the familiarisation costs from the administration costs associated with ensuring fees are prominently displayed in each branch. The familiarisation costs were simply included in the administrative costs associated with making fees prominently displayed in each branch in the triage assessment. But as we are now not assuming all branches will need to incur the costs of displaying their fees we needed to separate the familiarisation cost as this will still affect all firms.

Assessment of costs and benefits for preferred option

Key assumptions

1. The number of letting agent branches and letting businesses affected by this policy is based on data from the Property Ombudsman. This data shows there are a total of 11,560 letting agent branches, and this equates to 6,993 letting businesses. These figures have also been previously used in 'Redress Schemes for Lettings Agency Work and Property Management Work' Impact Assessments.
2. All letting branches (11,560) will need to become familiar with the policy. A familiarisation time of 15 minutes has been used.
3. There will be a time cost for a proportion of letting branches of having to display their fees in a prominent location. In all years of the policy we expect it to take 15 minutes for the fees to be clearly displayed in the branch. The proportion of branches affected is explained in assumption 5.
4. There will be a cost for letting businesses having to update their websites to comply with the regulation. As some branches are part of a wider business it is unlikely that each branch has its own website. This is the reason the number of letting businesses (6,993) is lower than the number of letting branches (11,560). The proportion of branches affected is explained in assumption 5.
5. Not all branches and business will be affected by this policy, this is because some branches and businesses already clearly present their fees. A survey by Shelter found that 43% of renters they surveyed felt their letting agent was open and transparent, implying that 57% of the renters surveyed felt that their letting agent was not open and transparent. A report by Which? found that 41% of renters thought fees were unfair and unclear. This data gives us a range of 41% to 57% of agents who do not clearly present their fees, and are therefore affected by this regulation.
6. Given this is a low cost regulation we believe that using existing research is the most cost effective and proportionate method of informing us of how many branches and businesses will be affected by the policy.
7. The use of a range of businesses affected is a key change from the evidence submitted in the Regulatory Triage Assessment. In the Regulatory Triage Assessment we assumed that 100% of branches and businesses would incur time costs and need to update their website. This was to show that this policy was a low cost regulation even under a worst case scenario of all firms affected. As this is now a final Validation Impact Assessment we have used the evidence available to us to present the most accurate estimate of the costs to business.
8. The familiarisation and time costs are based on the hourly wage rate of an estate agent, which is taken from the Annual Survey of Hours and Earnings. The 2014 median hourly wage for estate agents (£10.27) has been uplifted by 30% to account for non-wage labour costs as suggested by the HMT Green Book, this gives an hourly wage rate of £13.35.
9. In the first year of the policy 41%-57% of businesses will need to update their website. It is assumed it will take a web designer one full day to update each website in the first year. The median hourly wage for IT web designers is £19.36. This has also been uplifted by 30% to account for non-wage labour costs as suggested by the HMT Green Book. In practice this work will not necessarily be carried out by IT operators, and where it is we expect the work to be carried out by more junior IT operator, but to present the most conservative estimate possible the full salary of a web designer has been used.
10. In subsequent years we expect a web designer to need one hour per business to maintain a website and update any costs.

Costs

The direct costs to business will depend on the number of agents that the new legislation will affect and the cost to each agent of publishing their list of fees and charges. The Property Ombudsman estimated that there are a total of 11,560¹⁵ lettings agent branches and it is estimated that this equates to approximately 6,993 lettings businesses¹⁶.

Existing consumer rights regulations require letting agents to be upfront about their fees. However, the new regulations will stipulate what is meant by being upfront and introduce a fine where agents are not transparent. As a result we expect the costs to be limited to the administrative processes that will be required to ensure fees are set out clearly in both branches and on websites, along with a very small amount of time to become familiar with the changes. Those letting agents that already provide fees in a clear and transparent way will not need to take any action as they already comply with the regulations.

To quantify the number of agents who do not currently clearly present their fees, and will need to take action to comply with the regulation, we have used a range based on research carried out by Shelter and Which?. A survey by Shelter found that 43%¹⁷ of renters they surveyed felt their letting agent was open and transparent, implying that 57% of the renters surveyed felt that their letting agent was not open and transparent. A report by Which? found that 41% of renters thought fees were unfair and unclear. This data gives us a range of 41% to 57% of agents who are perceived to not clearly present their fees, and are therefore affected by this regulation. Given this is a low cost regulation we believe using existing research is the most cost effective method of informing us of how many agents will be affected by the policy and that carrying out our own research would not be necessary. The types of cost that result from this regulation are:

- An initial 15 minutes for all letting agents (11,560) to read and become familiar with the change in the regulation. Given the change in regulation is a small clarification, and not all firms will need to take action as they already display their fees, we believe 15 minutes is a very conservative estimate of the time taken for all firms to become familiar with the change. The Annual Survey of Hours and Earnings¹⁸ 2014 median hourly wage for estate agents (£10.27) is used as a suitable proxy for letting agents' cost of time. This has been uplifted by 30% to account for non-wage labour costs as suggested by the HMT Green Book, this gives an hourly wage rate of £13.35.
- The changes required in making the fees available prominently within the branch are expected to be minimal as all firms must already be in a position to inform clients of their charges. We expect it to take an affected branch a maximum of 15 minutes to ensure their fees are prominently displayed¹⁹. The Annual Survey of Hours and Earnings²⁰ 2014 median hourly wage for estate agents is again used here (£13.35). Based on evidence from Shelter and Which? we believe that 41%-57% of the 11,560 branches will incur this cost as they do not currently clearly present their fees.
- The time taken to update the website in the first year is assumed to be the full time equivalent of 1 day²¹. While all branches will be required to display the list of fees in a prominent location, branches that are part of a wider firm are unlikely to have their own website. It is likely that a larger firm will have a single website covering all its branches. For this reason, familiarisation costs and the time costs associated with displaying fees prominently in branches will be assumed to occur in the 11,560 branches (the time cost for displaying fees will only affect 41%-57% of branches). The updating of a website is assumed to take place for each agency/business, rather than each branch. Again we will use a range of 41% to 57% of the 6,993 agencies who will be

¹⁵ http://www.tpos.co.uk/annual_reports.htm

¹⁶ This is based on calculations from the 'Redress Schemes for Lettings Agency Work and Property Management Work' Impact Assessment: table 2 of this impact assessment showed there were 2,797 letting firms not members of a redress scheme. We know from industry contacts that 40% of letting firms were not members of a redress scheme, so dividing the number of letting firms (2,797) by 40% results in the total number of letting firms of 6,993.

¹⁷ http://england.shelter.org.uk/__data/assets/pdf_file/0006/671649/Letting_agencies_-_The_price_you_pay.pdf

¹⁸ <http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-328216>

¹⁹ Based on conversations with a professional and regulatory body for letting agents

²⁰ <http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-328216>

²¹ Based on conversations with a professional and regulatory body for letting agents

affected by the regulation. The median hourly wage for IT web designers is £14.89. This has also been uplifted by 30% to account for non-wage labour costs as suggested by the HMT Green Book, resulting in an hourly wage of £19.36. In practice this work will not necessarily be carried out by IT operators, and where it is we expect the work to be carried out by more junior IT operator, but to present the most conservative estimate possible the full salary of a web designer has been used.

First Year costs – transition costs

The costs per branch and agency in the first year of the policy are displayed in table 1.

Table 1 – Costs of making fees transparent in the first year

Action	What	Cost per affected branch or agency	Number of affected branches or agencies
Familiarisation cost	15 minutes of familiarisation time	£3.34	All branches (11,560)
Ensuring fees are prominently displayed in each branch	15 minutes of administrative time	£3.34	41%-57% of branches (4,740 – 6,589)
Updating Website	7 Hours	£135.50	41%-57% of agencies (2,867 – 3,986)

Therefore, the total cost (in 2014 prices) of these measures in the first year will be:

Familiarisation cost in all branches

$£3.34 \times 11,560 = £38,610$

Prominently displaying fees in 41% to 57% branches

Low estimate: $£3.34 \times 4,740 = £15,832$

High estimate: $£3.34 \times 6,589 = £22,007$

Best estimate: $£3.34 \times 5,664 = £18,918$

Displaying fees on web-pages for 41% to 57% agencies

Low estimate: $£135.50 \times 2,867 = £388,536$

High estimate: $£135.50 \times 3,986 = £540,183$

Best estimate: $£135.50 \times 3,426 = £464,292$

Total

Low estimate: $£38,610 + £15,832 + £388,536 = £442,978$ (£0.44 million)

High estimate: $£38,610 + £22,007 + £540,183 = £600,800$ (£0.60 million)

Best estimate: $£38,610 + £18,906 + £464,267 = £521,820$ (£0.52 million)

Costs in subsequent years – on-going costs

Table 2 – Costs of making fees transparent in the subsequent years

Action	What	Cost per affected firm	Number of firms affected
Ensuring fees are prominently displayed in each branch	15 minutes of administrative time	£3.34	41%-57% of branches (4,740 – 6,589)
Updating Website	1 Hour	£19.36	41%-57% of agents (2,867 – 3,986)

Given the same assumptions regarding the number of branches and agents, the costs (in 2014 prices) associated with the policy for each subsequent years (years 2 to 10) are as follows:

Prominently displaying fees in branches

Low estimate: $£3.34 \times 4,740 = £15,820$

High estimate: $£3.34 \times 6,589 = £21,991$

Best estimate: $£3.34 \times 5,664 = £18,904$

Updating the display of fees on web-pages for agencies

Low estimate: $£19.36 \times 2,867 = £55,505$

High estimate: $£19.36 \times 3,986 = £77,169$

Best estimate: $£19.36 \times 3,426 = £66,327$

Total cost in each of the subsequent years

Low estimate: $£15,820 + £55,495 = £71,325$ (£0.07 million) – average annual cost £0.06 million²²

High estimate: $£21,993 + £77,152 = £99,160$ (£0.10 million) – average annual cost £0.09 million

Best estimate: $£18,906 + £66,324 = £85,231$ (£0.09 million) – average annual cost £0.08 million

Therefore, for every subsequent year the total cost to agents and branches of complying with the guidelines range from £0.07 million to £0.10 million at a best estimate of £0.09 million. Over the 10 years of the policy the total present value cost of the policy over 10 years (including transition and on-going costs) range from £0.99 million to £1.36 million, at a best estimate of £1.17 million. These costs are all costs to business.

Benefits

It is anticipated that both renters and landlords will have access to a more efficient market which should in turn guard against sub-optimal choices being made through the transparency associated with the above measures. Rogue agents will also find it harder to operate in such an environment.

For renters this means no longer incurring extra search costs associated with, often after placing a non-refundable deposit, being charged unexpected fees and therefore having to go through the process of looking for, viewing and then deciding to live in a flat which may also have considerable hidden fees attached. Landlords will also have a better idea of what fees they are liable to be charged but also what their tenants are being charged. This will allow landlords to guard against being unfairly charged for services that should either be shared i.e. a tenancy agreement, or charged to one party instead of the other. This will deter agents who charge both parties for the same service.

The transparency that this measure is anticipated to increase effective competition in the market as both landlords and renters will be better able to 'shop around' and will know from the outset what costs are

²² The average annual cost is an average over 10 years, as there are only 9 year's worth of costs here the average annual cost is lower than the total cost in each year of the policy from years 2 to 10.

associated with the services being provided. This should lower the time it takes to conduct a transaction, lessen the likelihood of a sub-optimal decision being made – through the imposition of post-decision fees - and thereby increase the efficiency of the market.

Agents themselves should benefit through a ‘levelling of the playing field’ making it harder for rogue agents to operate and thereby damage the reputation of the industry and its members.

If the regulation leads to greater transparency and efficiency in the market for fees, this may lead to more competition on fees charged by agents. Shelter found that a household with an income of less than £25,000 paid an average of £401 in letting agent fees. If greater competition led to downward pressure of fees this could lead to a monetary benefit for tenants. We do not have the evidence to know how much fees might fall, or if they would fall at all, but if for example fees fell by 5%-10% this would mean a saving in the region of £20-£40 per household. A report found that 1.09 million households move in the private rented sector every year²³, if each transaction saved between £20 and £40 this could equate to a benefit ranging from £22 million to £44 million every year. But given the lack of evidence this is only an indicative estimate of the benefits and has not been included in the cost and benefit analysis.

Direct costs and benefits to business calculations (following OITO methodology)

Overall costs to business, rounded to nearest 1000s

A one-off cost of £0.52 million (range £0.44 - £0.60 million) for letting agents to comply with proposed legislation, which consists of:

- £39k familiarisation time.
- £19k (range £16k- £22k) of time costs for 41% - 57% of branches ensuring their fees are displayed prominently in branches.
- £464k (range £389k – £540k) of costs to display fees on web-pages for 41% - 57% of agencies.

An annual cost of £0.09 million (range £0.07 million - £0.10) in years 2 to 10 for letting agents to comply with proposed legislation, which consists of:

- £19k (range £16k- £22k) of administration costs for 41% - 57% of branches – ensuring fees are displayed prominently in branches. Equates to an average annual best estimate cost of £17k.
- £66k (range £56k - £77k) of costs to update the display of fees on web-pages for 41% - 57% of agencies. Equates to an average annual best estimate cost of £60k.

Equivalent Annual Net Cost to Business Calculation

Type of cost	Who incurs cost	Total Present Value (millions)
One off costs	Familiarisation cost	£0.04
	Administrative time cost	£0.02
	Putting fees on website	£0.46
On-going costs	Administrative time cost	£0.14
	Putting fees on website	£0.50
Total present value cost to business		£1.17

²³ http://www.tpos.co.uk/downloads/reports/TPO_Report_v2.pdf

Dividing the Present Value cost to business (£1.17 million) by the annuity rate²⁴ results in an Equivalent Annual Net Cost to Business of £0.14 million in 2014 prices. Using the Gross Domestic Product deflator²⁵ we get an Equivalent Annual Net Cost to Business of £0.12 million in 2009 prices. Dividing this by the discount factor of 1.188²⁶ gives a 2010 base year cost to business of £0.10 million.

Risks and assumptions

We've assumed that all additional costs would be borne by letting agents. Some of these costs may be passed down to tenants or landlords in the form of higher fees. There is a potential risk that rulings from the Advertising Standards Authority in March 2013 lead to a greater number of letting agents clearly presenting their fees, which may not be reflected in the assumptions used in our analysis. However, we are using the most up to date evidence available and believe commissioning our own research would be disproportionate given the likely impact of the policy. If the Advertising Standards Authority ruling leads to more agents presenting their fees it will mean that the analysis used here is likely to be overestimating the costs.

Summary and preferred option

For the private rental market to function it is essential that there is effective competition between all parties. Currently this is not the case as there is no requirement for letting agents to publicise fees that are associated with their services. This means that both renters and landlords do not have the full amount of information required to make an informed choice regarding their participation in the market, resulting in inefficiencies and considerable loss to both parties.

Under the do nothing scenario, hundreds of thousands of tenants will continue to be charged hidden and unexpected fees, and neither landlords or tenants will be able to easily account for double charging by rogue agents who also often inflate fees and 'free-ride' off the back of a good reputation earned by the majority. This will continue to cause expensive and sub-optimal housing solutions for landlords and tenants in the market unless the preferred option is implemented.

The preferred policy will increase effective competition between letting agents through transparency by having their fees listed in their offices and on their websites. This will allow both tenants and landlords to have a clearer indication of costs, thereby facilitating a more efficient market-based outcome than would otherwise be the case.

Small and Micro Business Assessment

This legislation has not exempted small and micro businesses because small and micro businesses account for a large proportion of letting agents. Data from the Office for National Statistics²⁷ reveals that there are 16,565 businesses in the UK (note this is an England policy) involved in 'real estate agencies', which does not disaggregate for the different types of real estate activities, such as intermediation in buying, selling and renting of real estate on a fee or contract basis. But this data suggests that 99% of estate agents are small and micro businesses, showing that if small and micro businesses were exempt a large proportion of the benefits of this policy would not be achieved.

²⁴ 10 year policy at a 3.5% discount rate. Annuity rate = 8.61

²⁵ Divide by 1.107. GDP deflator:

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/362193/GDP_Deflators_Qtrly_National_Accounts_September_2014_update.xls

²⁶ $1.035^{(2015-2010)}$

²⁷ UK Business: Activity, Size and Location, 2013: <http://www.ons.gov.uk/ons/rel/bus-register/uk-business/2013/rft---table-1.xls>