



Impact Assessment of regulation of letting and management agents by an independent body



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Summary: Intervention & Options

Department / Agency: Communities and Local Government		Title: Impact Assessment of regulation of letting and management agents by an independent body	
Stage: Consultation		Version: Partial	Date: 15 May 2009
Related Publications: The Private Rented Sector: Professionalism and Quality. The Government Response to the Rugg Review			

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

Industry sources suggest at least 8,000 letting and management agents (LMAs) in England. We estimate that around 4,000 belong to at least one of the professional bodies. The rest are completely unregulated, with no mandatory qualifications. The current regime provides no mechanism by which a consumer can check agents' expertise; financial backing; professional indemnity insurance (PI); or client money protection (CMP). There have been cases of misappropriation of client funds without CMP in place, and negligence not insured by PI. These have sometimes been linked to agents going bankrupt, but there is currently nothing preventing such agents re-opening for business at a later date.

What are the policy objectives and the intended effects?

Increased security of funds held in agents' client accounts. Greater security and redress for customers (both landlords and tenants). Better standards of conduct (including requiring basic standards of maintenance and facilities in properties to let). Greater skills and knowledge of markets to support landlords. Increased protection for agents and clients in case of losses resulting from negligence. An independent complaints procedure and linked redress.

What policy options have been considered? Please justify any preferred option.

1. Do nothing. 2. Independent, regulatory body for letting and management agents, with mandatory membership.

We already effectively have voluntary regulation, with around half the estimated numbers of letting and managing agents having chosen to join a professional body (RICS, ARLA, NAEA and NALS). The industry are keen that we should create a level playing field, so that those who are responsible are not penalised for being so. We are keen to draw on the existing frameworks in place when delivering the new regulatory framework.

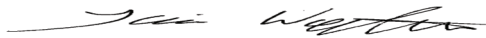
When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

During consultation we will work with stakeholders to ensure a proper balance of costs and benefits in developing a detailed, final policy proposal. A post implementation review framework will be developed, and outlined in the final impact assessment.

Ministerial sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



20 May 2009

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Date:

Summary: Analysis & Evidence

Policy Option: 1. Full regulation	Description: Full, mandatory regulation of all letting and managing agents
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' There are anticipated to be set up costs for a regulator of £650,000, and annual running costs of £750,000. These will be covered by initial admin fees and annual membership fees for LMA's. Costs of mandatory CMP across the sector are estimated at £1.2m per annum.	
	One-off (Transition) Yrs		
	£ 650k	1	
	Average Annual Cost (excluding one-off)		Total Cost (PV)
	£ 1.95m	Other key non-monetised costs by 'main affected groups' Associated costs of meeting basic membership hurdles. Costs in fees to agents for landlords currently using unregulated agents. However, the latter will be voluntary, as landlords may choose not to use agents. Increased costs of indemnity protection, and administrative costs.	

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' CMP claims may be around £1,400 per tenancy agreement affected. Across the estimated 900,000 tenancies to be brought under regulation, we assume around 0.2 per cent may be subject to such a claim per annum. There will be associated benefits in terms of avoided losses for landlords and tenants.	
	One-off Yrs		
	£ 0		
	Average Annual Benefit (excluding one-off)		Total Benefit (PV)
	£ 2.5m	Other key non-monetised benefits by 'main affected groups' Greater confidence in LMA's by landlords and tenants, and increased "soft" enforcement of basic standards. Improved enforcement will be backed up by common codes of conduct. Benefits to good agents through improvements in stature and a level playing field. Increased rates of indemnity protection.	

Key Assumptions/Sensitivities/Risks

Half of agents currently unaffiliated to a professional association. 900,000 additional tenancies to benefit from CMP protection. 0.2 per cent annual claim rate against CMP, from which benefits derived in form of avoided tenant/ landlord losses. Sensitivity testing with a 0.4 per cent p.a. CMP claim rate, and higher average annual costs of £4.2m.

Price Base Year 2009	Time Period Years 10	Net Benefit Range (NPV) £ 4m – £6m	NET BENEFIT (NPV Best estimate) £ 4m
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What is the geographic coverage of the policy/option?		England		
On what date will the policy be implemented?		Subject to legislation		
Which organisation(s) will enforce the policy?		Subject to legislation		
What is the total annual cost of enforcement for these organisations?		£ covered by fees		
Does enforcement comply with Hampton principles?		Yes		
Will implementation go beyond minimum EU requirements?		No		
What is the value of the proposed offsetting measure per year?		£ n/a		
What is the value of changes in greenhouse gas emissions?		£ n/a		
Will the proposal have a significant impact on competition?		No		
Annual cost (£-£) per organisation (excluding one-off)	Micro £400	Small £400	Medium £400	Large £1000+
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)		(Increase – Decrease)
Increase of £	Decrease of £	Net Impact £

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

Introduction

This impact assessment is one of two covering key regulatory proposals in the Government's response to the Rugg Review. The response was issued for consultation on 12 May and the deadline for comments is 7 August 2009. The impacts of the proposals contained in the response will also be discussed in depth by key stakeholders as part of task and finish groups set up by Communities and Local Government to explore specific proposals set out in the response.

Background

Key facts

In 2008, just over 14 per cent of all English households were housed in the private rented sector (PRS)¹. The Rugg Review estimated that the PRS in England contained around 2.6 million properties in 2006, up from 1.8 million in 1988². The sector has continued its growth since 2006, and more recent estimates suggest that, by the end of 2008, there were over 3 million English households in the PRS.

The sector is dominated by small landlords – in 2006 73 per cent of all landlords were individuals or couples and a little over 70 per cent of all landlords owned less than 10 properties (84 per cent of individual/ couple landlords owned 10 or fewer properties)³.

In 2006, around 60 per cent of private landlords used one of the estimated 8,000 letting and/or managing agents in England⁴. There has been a general industry concern about the quality of the service offered by agents and lower tenant satisfaction levels (71 per cent) were recorded where a property was managed by an agent rather than a landlord (81 per cent satisfaction) (Rugg Review, p63). 71 per cent of agents that responded to the English House Condition Survey's landlord survey of 2006 were members of an existing professional body. Industry estimates suggest this approximates to an actual membership rate of around 50 per cent. In fact, a 50 per cent membership rate is an upper bound estimate, as approximately 4,000 letting and management agents belong to one or more of the existing professional bodies (RICS, ARLA, NAEA and NALS), whereas there are at least 8,000 letting and management agents in England.

¹ CLG analysis of ONS Labour Force Survey data.

² "The Private Rented Sector: its contribution and potential", Julie Rugg and David Rhodes, Centre for Housing Policy, University of York, 2008 (page 39).

³ See Rugg Review, tables 2.1 and 2.5, respectively.

⁴ See Rugg Review, table 3.8.

The Rugg Review

In January 2008, the Government commissioned an independent review of the private rented sector from Julie Rugg and David Rhodes at the Centre for Housing Policy at the University of York. The review was commissioned partly in response to concerns about the stock condition and the activities of some unscrupulous landlords and letting and managing agents in the sector expressed by reports from the CAB, Shelter, RICS and the Law Commission, and partly to complement Sir John Hills' review of the social rented sector.

The Rugg Review's findings were published on 23 October 2008. Overall, the review pointed to a sector that performs an important role in the housing market; a sector that is responding flexibly to changing circumstances, both for individuals and structurally; and a sector that continues to offer quality and choice for those choosing to rent, as well as a safety net for those unable to access other types of housing.

However, the Rugg Review also highlights weaknesses. Whilst it finds that most landlords are well-intentioned and deliver a good service, it also finds that some simply do not view their role professionally and, therefore, fail to obtain sufficient knowledge to provide a satisfactory level of service. Others – a minority – are ill-intentioned and seek to operate outside and against the current regulatory framework, often exploiting the most vulnerable and allowing anti-social behaviour to take place in neighbourhoods, causing misery for many households. At the same time, local authorities are not always able to focus their resources in order to use the extensive enforcement powers provided in the Housing Act 2004 against the worst landlords.

The review sets out a series of high level "policy directions of travel" to tackle the weaknesses it identifies in the sector. Proposals for full, mandatory and independently-led regulation of letting and managing agents form a key part of those in the review to improve the quality and professionalism of management within the sector

Regulation of letting and managing agents

The proposals for regulation of letting and managing agents in this Impact Assessment derive directly from the Rugg proposals. They also reflect proposals in the work by Professor Carsberg in a review of the subject commissioned by the Royal Institution of Chartered Surveyors and the Law Commission's report – *Encouraging Responsible Letting* – both published in 2008.

Many of the measures proposed in the government's response to Rugg are designed to encourage landlords to become more professional. However, it is important to accept that some will simply not have the resources to act as full-time landlords or have become landlords through circumstances not of their choosing. For these 'amateur' or 'reluctant' landlords, letting and managing agents have a vital role in providing the professional input and support that the landlords lack. In many cases, even where a landlord has the basic skills and

knowledge needed to carry out his or her business, there will still be advantages in using an agent because of the increased resources and coverage they can offer and, most importantly, the additional expertise they bring to the process of letting and managing a property. However, as the key facts above highlight, whilst this is true of the best letting and managing agents, it is unfortunately far from the norm, particularly in the current economic climate.

It is still possible to set up a letting or management agency with no qualifications whatsoever, with no need to conform to requirements as to conduct or to provide mandatory safeguards for the consumer. We do not think that this is desirable or appropriate in the modern age. We are aware of cases where quite large and well-established agencies have run into difficulties and, because they had no client money protection, both landlords' and tenants' money was lost. In some cases, this has not prevented those associated with the defunct business subsequently resuming their activities. At the same time, even where agents are not at financial risk they do not necessarily offer the type of service that it is perfectly reasonable for consumers to expect – for instance, the 2006 English House Condition Survey of landlords found that 41 per cent of dwellings where a landlord had used an agent were non-decent.

The absence of regulation for letting and managing agents also does not seem right both in the context of the regulatory framework already in place for estate agents (who often also act as letting and management agents) or in the context of the greater consumer focus and transparency which underpin the general thrust of the government's proposals for the private rented sector.

Policy objectives

Full regulation is likely to comprise a number of elements:

- entry requirements
- code of practice for members
- requirements to have in place business and consumer protection measures (such as client money protection (CMP), independent complaints procedures and linked redress, professional indemnity insurance(PI))
- monitoring of compliance by the regulatory body
- enforcement powers and the ability to put in place sanctions.

We would envisage that the regulatory regime for letting and management agencies would encompass all these elements.

We do not wish create unnecessary additional bodies to carry out these functions. We would rather draw on existing frameworks to deliver the new regulatory framework and we would wish to work closely with the industry as we develop our proposals within the parameters set out here.

Through the requirements of full, mandatory, independently-led regulation we could ensure that:

- all agents had the proper consumer protections in place
- they could no longer let and manage sub-standard properties
- in working with landlords to bring potential lets up to a basic standard, they could also take some of the burden of enforcement away from local authorities
- in cases where things go wrong, there would be a transparent and independent means for consumers to complain and obtain redress; and
- those without the expertise or experience to offer a proper service to consumers would no longer be able to trade.

Links to other policy areas

Our proposals link closely with the work that the Department of Work and Pensions has been doing as part of its internal review of housing benefit and with the Department of Energy and Climate Change's work to improve the energy efficiency of the private rented sector.

Options

Given the findings of the Rugg Review and the concerns of our stakeholders, making no change to the current arrangements is not a sensible option. As already explained, "voluntary" forms of regulation do not achieve the take up levels that we would need in order to ensure that landlords and tenants are not put at risk.

Cost/benefit analysis (where quantifiable)

Coverage

1. Industry sources suggest there to be at least 8,000 letting and management agents in operation in England, of which 4,000 are members of at least one professional body (RICS, ARLA, NAEA and NALS).
2. The 4,000 letting and management agents who are currently members of a professional body all currently have client money protection (CMP) and professional indemnity insurance (PI) in place. They are therefore assumed not to incur additional costs as a result of the CMP and PI that would be mandatory under an independent regulatory body.
3. The remaining, 4,000 currently unaffiliated agents do not currently have CMP (although most are likely to have PI at present). We therefore assume all 4,000 incur additional costs in the form of CMP premiums⁵.

4. Sixty per cent of landlords currently make use of a letting or management agent. We have no intelligence to suggest these are disproportionately large or small landlords, with some cases of very large landlords using management agents for their properties. We therefore assume the regulatory body will cover 60 per cent of tenancies.
5. At the end of 2008, there were just over 3 million English households in the PRS. 1.8 million (60 per cent) of these would therefore be covered by the new regulatory body, given the 60 per cent of landlords estimated to use letting and management agents. Given that existing professional bodies cover at most half of letting and management agents it is therefore assumed that an additional 900,000 tenancies will be covered by the mandatory regulatory body.

Costs

6. There are a number of options regarding the final form of an independent regulatory body, and exact costs will depend upon the final decision following consultation. Current estimates suggest net up-front set up costs could be around £650,000, with annual running costs in the range £600,000 - £900,000 (central assumption: £750,000).
7. These cost estimates are consistent with a joining fee of around £180 for agents who are not currently members of a professional body (the 4,000 who are currently members of a professional body would be "passported" in without additional charge), and an average annual fee of £120 for all the estimated 8,000 letting and management agents. Both these figures are inclusive of VAT, and may vary by size of firm.
8. Industry sources suggest client money protection (CMP) costs around £300 per annum for small and medium sized agents. For the 4,000 agents for whom mandatory CMP would apply under this policy proposal, this equates to an annual cost of £1.2m. For larger firms with greater numbers of branches, CMP premiums may be considerably higher, and are generally upon application to an insurer. However, the numbers of such firms who do not currently have CMP are expected to be small. Where claim rates are higher, costs of CMP are also likely to rise (see sensitivity testing).

Benefits

9. From consultations with industry, an estimate of client funds misappropriated per tenancy is £1,400, when claims against CMP are made, typically a combination of both landlord and tenant funds. By making CMP mandatory, protection against such instances of misappropriation can be extended across the sector.

⁵ It is likely that CMP providers will require PI as a pre-condition for coverage

10. For the 900,000 tenancy agreements we estimate to not currently be protected by CMP, a conservative assumption would be that 0.2 per cent per annum may be subject to fraud or misappropriation, CMP would cover claims of $900,000 * \pounds 1,400 * 0.2\% = \pounds 2.5\text{m}$ per annum. Of course, given this is a 'grey' area of the lettings and management sector, this figure may in fact be higher, especially given potentially higher fraud risks in the current economic climate. Sensitivity testing is carried out with a claim rate of 0.4 per cent per annum, with higher associated benefits from CMP.

Generic assumptions

11. The appraisal time frame is 10 years.
12. All one-off costs incurred up-front, with annual costs and benefits accruing over years 1 to 10.
13. Costs and benefits are expected to rise with inflation over time, and are therefore expressed in real terms.
14. These are then discounted at a real discount rate of 3.5 per cent to derive net present values (NPV's).

Key unquantified costs and benefits

15. Given the widespread existing use of PI in the industry, meaning the additional coverage brought about will be small, costs and benefits are not quantified. Nonetheless, where agents are uncovered by PI, they may be left unable to pay claims awarded against them, forcing them in to bankruptcy, leaving the landlord and/ or tenant out of pocket. There is a reasonable degree of choice for agents in respect of PI, and a competitive market is assumed to operate. In such a situation, insurers are likely to price premiums in line with expected claims. Such a market delivers the usual benefits of insurance, given that agents, tenants and landlords are reasonably assumed to be risk and loss averse. It will also help ensure that landlord and tenant interests are adequately protected, helping overcome issues caused by information asymmetries between agents and their clients. There will therefore be offsetting benefits to the additional costs of PI.
16. Improvements in the quality of stock, letting and management practices arising from members' code of practice.
17. Reduced dispute costs and fairer outcomes due to an independent complaints service and improved redress. Improved management of risk for agents, tenants and landlords.
18. A more level playing field, whereby those agents practicing higher standards (e.g. taking protection in the form of CMP and PI) are not

Table 1a: Option 1, central assumptions

Year	0	1	2	3	4	5	6	7	8	9	10
Regulator set up costs, £m	-0.7										
Annual running costs/ CMP premia £m		-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0	-2.0
Annual benefits - losses covered by CMP, £m		2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Net annual cost/ benefit, £m	-0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6

Implementation arrangements

The proposal is set out in the government's response to the Rugg Review (The private rented sector: professionalism and quality). It is subject to a full public consultation process, including detailed discussion of key proposals by task and finish groups set up for that purpose and involving representatives of all key stakeholders. A central task for these groups will be consideration of costs and benefits.

We welcome comments from all consultees on the costs and benefits of our proposals. The deadline for responses to the consultation exercise is 7 August 2009. A summary of responses will be published following that deadline and more detailed proposals emerging from that process will be published for consultation in a White Paper in the autumn. Full regulation of letting and managing agents would require primary legislation which would not be in place until 2011 at the earliest.

Enforcement arrangements

Detailed enforcement arrangements are yet to be developed. The current consultation exercise will form an important input to that process. The Hampton Principles will also be a key input to consideration of enforcement activity.

Post implementation review/post legislative scrutiny arrangements

Rigorous arrangements will be put in place to review any legislation and measures once they have been finalised and implemented. Given the early stage of these policy proposals, full details are not yet available. A framework for post implementation review will be included in the final IA.

Specific Impact Tests: Checklist

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	Yes
Sustainable Development	No	Yes
Carbon Assessment	No	Yes
Other Environment	No	Yes
Health Impact Assessment	No	Yes
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	Yes
Rural Proofing	No	Yes

Annexes

Results of specific impact tests – these should all be seen in the context of the overall outcomes associated with the regulation of letting and managing agents of improved protection for consumers (both landlords and tenants); a more level playing field for responsible letting and managing agents; and better enforcement against poor landlords leading to improved stock quality.

Competitive assessment – no impact. Proposed measure will apply across the sector and bring poor letting and managing agents up to the standard of those who already provide safeguards for their customers.

Small firms impact test – impact. There are considerable numbers of small firms that would be affected by these proposals in the form of both letting/ management agents and landlords. There will be both costs and benefits for these. Small landlords, for example, are presently more likely to be caught out by a poor letting or managing agent either through the agent offering an inadequate service or, in some cases, through the agent running into financial difficulties. The proposed regulation would provide better safeguards for small landlords allied with redress across the sector. However, the proposed policy may increase agents' costs, and care needs to be taken in the final policy design to ensure that small agents are not disproportionately affected. However, there will be offsetting benefits for firms currently performing best practice, as there will be a level playing field to ensure they are not competitively disadvantaged. There will be a full small firms' impact test at the final impact assessment stage, drawing on evidence gathered during consultation.

Legal aid – no impact/possible reductions in costs. Neither landlords nor letting and managing agents are generally eligible for legal aid. So changes in the legal framework for them would have no impact on legal aid payments. Where a tenant is engaged in a dispute with an agent (or a landlord using an agent) we would expect the improved complaints and redress processes to mean a reduction in court activity with matching reductions in legal aid where it is supporting a tenant's involvement.

Sustainable development – positive impact. Not the main focus of these proposals. But would expect improvements in the quality of the stock that they are intended to deliver to impact positively on sustainable development outcomes.

Carbon assessment – positive impact. Marginal but, where this measure secures improvements in stock quality, we would expect this to be linked to improved energy efficiency and reduced carbon emissions.

Other environmental – positive impact. Again, marginal but improved stock quality and more professional management should mean improvements in other environmental outcomes such as other greenhouse gas emissions, water consumption and noise pollution.

Health impact assessment – positive impact. Marginal, but improved stock quality would lead to better health for tenants.

Race equality – positive impact. Marginal. Ethnic minority groups tend to be disproportionately represented in lower quality rented stock. Landlords in this sub-market tend not to use agents, but, where they do, we would expect this measure to secure improvements for this group.

Disability equality – neutral. The proposed measure is neutral towards those with disabilities. We are not currently aware of evidence that they are disproportionately represented in the sector. Securing improvements in agents will have no specific impacts on this group.

Gender equality – Neutral. The proposed measure is gender neutral. We do not have any evidence to suggest that specific genders are disproportionately represented within that part of the private rented sector that is let or managed by agents. Therefore impacts flowing from the proposed measure should not have gender specific outcomes.

Human rights – positive impact. By securing better redress and more professional management standards, will improve tenants' right to suitable accommodation and to undisturbed enjoyment of their home. Reduced client exposure to unanticipated and unfair financial losses.

Rural proofing – neutral. There are relatively fewer private rented properties in rural areas than in urban ones. However, we would expect the same impacts as outlined elsewhere to emerge.

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