

Title: The Redress Schemes for Lettings Agency Work and Property Management Work IA No: RPC13-FT-CLG-1927 Lead department or agency: DCLG Other departments or agencies:	Impact Assessment (IA)			
	Date: 17/03/2014			
	Stage: Final			
	Source of intervention: Domestic			
	Type of measure: Secondary legislation			
Contact for enquiries: Ruth Hayes ruth.hayes@communities.gsi.gov.uk 0303 444 3556				
Summary: Intervention and Options			RPC Opinion: GREEN	

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
£-6.23m	-£7.44m	£0.69m	Yes IN

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

The private rented sector is currently growing - up from 2.4m households in 2005 to 4.0m in 2011. The landlord sector is dominated by private individuals with 78% of landlords only owning one dwelling for rent many of whom choose to use agents - 66% of transactions involve an agent. An estimated 40% of agents are not covered under the existing voluntary redress schemes. Presently there is considerable vulnerability and dissatisfaction amongst both tenant and landlord consumers. Industry experts and consumer groups are calling for regulation on the lettings and management side to mirror that in place for sales agents and in particular for all agents to offer redress.

What are the policy objectives and the intended effects?

To improve standards in the Private Rented Sector and Leasehold Sector with the least regulatory burden by ensuring that landlords and tenants have mandatory access to an independent redress scheme. This provides a light touch route for landlords, tenants, freeholders and leaseholders to pursue a complaint against their agent so that overall standards in the sector are improved and the worst offenders are driven out.

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

Mandatory Redress (proposed). To require persons who engage in lettings agency and property management work to be members of an independent redress scheme for dealing with complaints in connection with that work. While still regulation, this offers a 'light touch' method where consumers can have their complaints resolved, which should standardise behaviour across the sector and subsequently drive up standards.

The alternatives of doing nothing or significant regulation have been rejected. The former on the grounds that offering independent redress on a purely voluntary basis is not working and it is confusing for the consumer to be guaranteed redress for sales and not for lettings when many companies offer both. The latter because of the high costs involved which could lead to significantly higher rents.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 11/2015					
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: N/A	Non-traded: N/A	

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:  **Date:** 29 August 2014

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2013	PV Base Year 2014	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: N/A	High: N/A	Best Estimate: -6.23

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Not quantified	Not quantified	Not quantified
High	Not quantified	Not quantified	Not quantified
Best Estimate	0.1	0.9	7.4

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

- A one-off cost to letting and managing agents of £102,000 plus annual expenses of £739,000, of which £102,000 of compliance costs are transfers and do not affect the value of the net benefit.
- A one-off cost to managing agents of leasehold properties of £15,000 plus annual expenses of £111,600, of which £18,000 of compliance costs are transfers and do not affect the value of the net benefit.

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

None

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Not quantified	Not quantified	Not quantified
High	Not quantified	Not quantified	Not quantified
Best Estimate	0	0.1	1.2

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

£120,000 of benefits to consumers in the form of compensation payment brought by successful complaints via the redress schemes. These are transfers and do not affect the value of the net benefit.

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

Landlords and tenants will see improved services offered by agents. They will have access to cheaper and quicker dispute resolution than use of the courts.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5%

We've assumed that all additional costs would be borne by letting agencies and managers of leasehold property. In reality some of these costs may be passed down to tenants and rents may increase. We have also assumed that annual membership fees do not increase as a result of the proposal, given that recent bids for the redress schemes suggest that existing schemes have not changed their current fee structure.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 0.7	Benefits: 0.0	Net: -0.7	Yes	IN

Detailed Background

The size of the Private Rented Sector

The Private Rented Sector in England accounts for 4.0 million households, or 18% of the total 22.0 million private accommodations. This is up from 9% of the total in 1991 (English Housing Survey 2012-13), 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', 2012) 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 2012) suggested around 1.09m households moving in the private rented sector every year. In terms of reasons for moving, the English Housing Survey (2011-12) suggest that 13% of private renters move is because the accommodation is unsuitable or that they had issues with the landlord (although – this does not discern whether the complaint is with the bona fide landlord, or agent acting on their behalf; in the eyes of the consumer, they are often synonymous), and 17% moved for job related reasons, compared to 2% and 5% respectively for owner occupiers. In part, comparatively high numbers of movers citing unsuitable accommodation or issues with the landlord could be to do with a tenant's needs changing, but it also likely reflects generally higher levels of consumer dissatisfaction, which will be discussed later on in this assessment.

The Profile of Landlords

In terms of the landlords in the sector, 89% of private landlords are private individuals, accounting for 71% (or 2.1 million) 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 and interactions 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 – in the case of landlords, (and given the profile described in the previous section), these costs can be significant. Letting agents significantly reduces the search costs for both landlords and prospective tenants by matching them together. The Property Ombudsman estimates there are approximately 11,560 agents involved in letting property (either combined sales & lets, or purely letting – *The Property Ombudsman [TPO] Statistics*).

The OFT set out this structure of letting agents acting as an intermediary in their report "The Lettings Market" (February 2013). They explain that the lettings market has many similarities to a two-sided market – but that the most significant difference is that there is a direct relationship between the landlord and tenant. Therefore, "*fees charged by the letting agent to the landlord are likely to be recovered from the tenant directly by means of higher rents*". At the same time, agents can also set fees which the tenant pays for certain services. There are economic efficiencies in this arrangement, which are described in detail 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, and discussed later.

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. However, information asymmetries may occur in the market because landlords are not necessarily able to effectively monitor the quality of the letting agent's activities. The letting agent, in this case, may choose to act in pursuing its own goals, rather than in the best interests of the landlord – giving rise to a principal-agent problem.

Consumer dissatisfaction in the sector – the tenant

In a recent report by Which? ("The Lettings Market", November 2012) 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 analysis¹ 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.

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.

Furthermore, where tenants end up with a bad agent, (in the case they have proceeded through to the tenancy) they may be reluctant to complain without risking the loss of their home. Just 24% of tenants in the Which? Survey that ended up renting through a letting agent had a preference to do so from the outset. 73% of tenants said they approached whichever agent was listing a particular property. Just 6% had done research into different agents. Finally, only 17% of tenants checked for membership of a professional body – and 62% did not know whether their agent was a member of one.

Tenants are often also unsatisfied with the level of service that they receive from lettings agents during the tenancy – which includes complaints about delayed or substandard repairs. The Citizens Advice Bureau in their 2009 report "Let Down: CAB evidence on letting agents and their charges" reported that 73% of tenants that they interviewed were dissatisfied with the service provided by the letting agent. This is an example of the principle-agent problem on the part of the tenant and agent, a problem which is also apparent with respect to the landlord-agent relationship.

¹ See Annexe D, 'The lettings market', OFT, February 2013

Consumer dissatisfaction in the sector – the landlord

Consumer dissatisfaction is not restricted to prospective tenants in the sector. As previously stated, landlord customer satisfaction was sixth from bottom across 50 markets in the Which? survey, with 17% of landlords stating they were dissatisfied with their agent. Whilst landlords' and agents' incentives tend to be better aligned than that for tenants and agents, there are still significant problems in the market arising from the landlord-agent relationship (the principal-agent problem).

Such problems extend to: agents not passing on rent to landlords and disappearing, agents not putting tenant's deposit in protection scheme and then the landlord being liable, agents not carrying out tenant vetting procedures resulting in bad tenants, and agents not carrying out inspections of the property. 60% of landlords surveyed in the Which? study claimed to have fully or partially carried out activities which the agent was paid to do.

Information asymmetries arise in the market due to landlords being unable to effectively monitor the quality of the letting agent when acting on their behalf. Letting agents may therefore pursue their own interests, rather than those of the landlord. For example, it is well documented that landlords may receive tenants of a lower quality than they would like or would expect (see OFT report) – and that prospective tenants can often be inadequately vetted in advance of tenancy commencement. 84% of landlords or agents required a written reference on the part of the tenant (Private Landlords Survey 2010). Prima Facie this would appear to be quite high, but on the part of the agent it would be bad practice not to, as it is almost essential in order to demonstrate fulfilling its role in sourcing a high-quality tenant when the landlord will have no face-to-face interaction. The Property Ombudsman, in its Annual Report 2012, noted poor referencing as a common issue.

Few landlords consider the level of consumer protection their agent offers. Only 37% of landlords check whether their agent was a member of a professional body. (Which? The Lettings Market, November 2012). 45% of landlords did not know whether or not their agent was a member of a particular professional scheme, yet 60% thought they'd be able to access independent redress. It is estimated by The Property Ombudsman (Annual Report 2012) that 40% of agents are not signed up to a professional body.

Problem under consideration

At present there is considerable vulnerability and dissatisfaction amongst both tenant and landlord consumers. Fees levied by the letting agent are deemed unfair by tenants and the high levels of churn in the market mean the potential to exploit consumers and extract excess profits by agents is high. This is exacerbated by the fact that tenants rarely choose an agent, instead they choose a property and although nationally there is good competition some local markets are dominated by relatively few players. Information asymmetries in the market also mean that letting agents may pursue their own interests rather than landlords'.

Rationale for intervention

In 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 (TPO estimates 11,560) which would suggest a high degree of competition in the sector. However, in the Carsberg Review of "Residential Property: Standards, Regulation, Redress and Competition in the 21st Century" (June 2008), he 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*".

The lack of mandatory redress is inconsistent with the sales sector, (despite that fact that many estate agents also offer a lettings and management service, they currently only have a duty to offer redress for sales). However, given

the longer term nature of lettings and management it can be argued that there is a greater necessity for mandatory redress in lettings and management, and industry experts have welcomed wider regulation.

Under current legislation, estate agents have to provide compulsory access to a redress scheme, whilst the same is not true for the lettings market. This is a cause for considerable disparity in the housing market, whereby agents may be involved in both lettings and sales. If the OFT banned an estate agent from operating in the sales market, there would be nothing to stop them from operating in the lettings market – a distinction that is not necessarily appreciated by consumers. Of complaints to The Property Ombudsman in 2011, 7,641 were about lettings, and 25% of these could not be dealt with because they related to agents who were not a member.

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 join a redress scheme 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 2013).

Policy objective

The Government wishes to improve standards in the Private Rented Sector and Leasehold Sector with the least regulatory burden by ensuring that landlords and tenants have mandatory access to an independent redress scheme. Currently, unlike agents who help with buying and selling property, agents who let or manage residential property do not have to offer independent redress. By making it a requirement that all lettings and property management agents in England join an approved redress scheme the remaining 40% of agents will have a duty to join. This will mean that landlords and tenants will be able to quickly and easily pursue complaints, they will not need to involve the courts and if the complaints are upheld they may receive compensation.

Description of options

Option 1: Do Nothing - No mandatory redress scheme

The evidence suggests that agents' offering independent redress on a purely voluntary basis is not working. Although around 60% of agents have joined a redress scheme, there is no incentive for the remaining 40% to join unless it is mandatory and we know that there are high levels of dissatisfaction amongst tenants and landlords. The current situation is also inconsistent as many agents offer both sales and a lettings and management service and redress is mandatory for sales but currently not for lettings and property management.

Option 2 (preferred option): Mandatory redress scheme

The proposal is to require persons who engage in lettings agency and property management work to be members of an independent redress scheme for dealing with complaints in connection with that work. This provides a light touch route (compared to the greater regulation called for by consumer and industry groups) for landlords, tenants, freeholders and leaseholders to pursue a complaint against their agent, bringing the rest of the industry in to line with what is currently a voluntary practice.

Option 3: Significant new regulation

The Government does not believe that significant new regulation is needed. A Royal Institution of Chartered Surveyors report in January 2013 – “Better regulation of sales and letting agents: an impact assessment of costs and benefits” concluded that bringing letting agents within the scope of the Estate Agents Act 1979 would have a one off set up cost of £46.5 million. This compares unfavourably with the estimate of mandating redress - a set up cost of £0.1million yet we anticipate that many of the benefits identified in the report will be achieved by the mandatory introduction of redress. In addition, introducing significant burdens to the industry, particularly to smaller agents, runs the risk of losses to landlords if their agents were unable to continue operating within the regulatory regime, while introducing significant extra cost could lead to higher rents and reduce supply. Letting agents are already subject to consumer protection legislation. Where agents are in breach of this legislation, such as by charging unfair fees, action can already be taken against them by trading standards who can take them to court.

Rationale and evidence that justify the level of analysis used in the Impact Assessment

The proposed regulation has been deemed low cost by the RPC 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. We have not carried out sensitivity test as the magnitude of changes are likely to be small given the proposed regulation is low cost, and that any potential sensitivity tests carried out would be based on an arbitrary % deviation from the current set of assumptions as further evidence to inform such ranges are unavailable. We have not monetised potential benefits given the difficulty in monetising qualitative measures, such

as increased consumer satisfaction. These benefits are, however, discussed in the sections below. However, RICS, in their published impact assessment “Better regulation of sales and letting agents: An impact assessment of costs and benefits” have separately estimated potential benefits to consumers and landlords (see p37 – 39 in their report), which gives a broad indication of the potential magnitude of benefits to consumers.

Assessment of costs and benefits for preferred option

Benefits

Research from RICS’s published impact assessment “Better regulation of sales and letting agents: An impact assessment of costs and benefits” has identified the potential benefits to tenants as follow: protection from rogue landlords, time saving as a result of agents adopting better procedures, and reduced losses (e.g. loss of deposits) incurred by tenants at present from agents that have no redress mechanism. These benefits are estimated to be around 421k per annum (p37).

Potential benefits to landlords are estimated to be around 820k per annum to landlords, this includes time savings as a result of agents adopting better procedures and handling of queries from tenants (p39). There will also be potential benefits to letting agents arising out of efficiency gains as a result of reviewing and formalising systems leading process and productivity improvements, although these have not been monetised in the report.

Although we have not monetised the benefits of increased customer trust we expect that mandatory redress will improve the services offered by agents as they are faced with the choice of either improving standards or repeatedly paying compensation when complaints against them are upheld. Currently as there is no quick and cheap route to settle disagreements, low level dissatisfaction can quickly escalate as sides become entrenched. This can then lead to court cases and significant financial burden for all involved. The guarantee of access to independent redress offers a means of resolving these low level issues quickly and cheaply before they escalate into more serious problems. In addition we anticipate that the redress schemes will work with the sector to improve standards and share best practice which will have the potential to identify cost savings for agents.

There will be some benefits to consumers in the form of compensation payment brought by successful complaints via the redress schemes. They are transfers and do not affect the value of the net benefit. The monetised value of this benefit is equal to the monetised compliance costs for businesses.

Costs

The costs to business for letting and managing agents, and managing agents of residential leasehold properties include:

- A one-off cost, consisting of one-off joining fees for redress schemes plus familiarisation costs
- Annual membership fees
- Annual administration plus further costs for dealing with specific claims.
- Annual compliance costs – whilst this is a cost to business, it will not impact the overall net benefit of the proposal, as this is a transfer from businesses to consumers

Costs to business will depend on the number of agents that the new legislation will affect and the cost to each agent of joining and maintaining membership of a redress scheme. Government only intend to approve redress schemes which have an unrestricted membership requirement. This means that redress schemes will not be able to mandate compliance with a code of practice or demand other changes to the way the agent operate as part of the membership conditions.

This policy introduces no changes to existing consumer protection legislation, so beyond joining a scheme there are no further costs for businesses.

Calculation of costs

Costs to letting and managing agents

a. One-off joining fees and annual membership fees for letting and managing agents

The Property Ombudsman estimated that there are currently 11,560 lettings agents n.b. this refers to **branches**. RICS, in their impact assessment in January 2013, suggest that of these, 7,126 were engaged in both sales and lettings activities, and 4,434 were involved in lettings only.

Table 1 – number of letting agents in the sector

Agent activities	Total population - branches
Sales and lettings agents	7,126
Lettings only	4,434
Total lettings agents	11,560

In order to determine the number of branches affected by the proposal, the Department obtained primary research which underpinned (and approved by) the RICS analysis from Economics consultancy TBR (attached alongside this document). This suggested that 18% of branches involved in both sales and lettings activities, and 48% of branches solely involved in lettings, **were not** members of a voluntary redress scheme. This suggests a total of 3,411 branches affected by the proposal who will need to sign up to an approved redress scheme.

Similar information on the number of firms not members of a voluntary redress scheme is not available. However, TBR's report suggests the ratio of firms: branches in the market is 0.82 to 1. We can therefore use this to estimate the number of firms not voluntarily members of a redress scheme associated with a given number of branches:

Table 2 – number of letting agents not voluntarily enrolled in a redress scheme

Agent activities	Not voluntarily members of a redress scheme (%)	Not voluntarily members of a redress scheme (branches)	Not voluntarily members of a redress scheme (firms)
Sales and lettings agents	18%	1,283	1,052
Lettings only	48%	2,128	1,745
Total lettings agents		3,411	2,797

There are currently two approved industry redress schemes, run by The Property Ombudsman (TPO), and Ombudsman Services: Property (OSP). The cost of membership can be split into **upfront cost** i.e. one-off and subsequent annual membership fees. TPO offer redress on a per branch basis, whereas OSP offer redress on a per firm basis.

Table 3 – Costs of joining the existing redress schemes: joining fee, membership fees

Joining fees for current redress schemes		Annual membership fees for current redress schemes	
TPO	OSP	TPO (per branch)	OSP (per firm)
£ 20	£ -	£ 170	£ 150

Future membership is assumed to follow in equal proportions to that suggested by the industry and in TBR's assessment for RICS i.e. 85:15 for TPO:OSP. This results in the following joining fees and annual membership fees below.

Table 4 – Costs for firms not signed up to redress schemes

Agent activities	Branches not in voluntary redress scheme	Firms not in voluntary redress scheme	(i) One off cost (TPO only)	(ii) Annual costs (TPO)	(iii) Annual costs (OSP)
Sales and lettings agents	1,283	1,052	£21,811	£185,394	£23,670
Lettings only	2,128	1,745	£36,176	£307,496	£39,263
All			£57,987	£492,890	£62,933

Where:

The one off cost for firms joining TPO (i) is calculated by multiplying the joining fee (£20) by the number of branches, by the joining rate (85%).

The annual costs for firms joining TPO (ii) is calculated by multiplying the annual fee per branch (£170) by the number of branches, by the joining rate (85%).

The annual costs for firms joining OSP (iii) is calculated by multiplying the annual fee per firm (£150) by the number of firms, by the joining rate (15%).

The total costs are summarised in Table 5 below i.e. (i) + (ii) + (iii).

Table 5 – Total annual costs for firms not signed up to redress schemes through membership fees

Activity	Year 1	Year 2 onwards
Sales and lettings	£ 230,875	£ 209,064
Lettings only	£ 382,935	£ 346,759
All lettings agents	£ 613,810	£ 555,823

b. Administration costs

Firms will also incur some administration costs in order to familiarise themselves with the membership schemes on offer. This will be accrued by staff of letting agents that must take the time to apply for their chosen scheme having researched which scheme they intend to join. The costs were estimated on the basis that the amount of time spent on this additional administrative work will replace productive work for the firm which is valued at the employees pay, assuming this represents the marginal product of their labour. Further assumptions were as follows:

- the process of choosing a scheme and applying for membership takes approximately 2 hours to complete in the first year, and 1 hour in all years thereafter. These assumptions are consistent with industry assessment (TBR's analysis for RICS); and
- the Annual Survey of Hours and Earnings (ASHE) 2012 median hourly wage for estate agents (£10.22) is used as a suitable proxy for letting agents' cost of time. This is then being uplifted by a factor of 1.3 to account for non-wage labour costs as suggested by the HMT Green Book (£13.29).

Table 6 – Costs of joining the existing redress schemes: administrative costs to agents.

Agent active*ties	Agent hours - year 1	Agent hours – year 2 onward	Time cost – year 1*	Time cost – year 2 onward
Sales and lettings agents	2,496	1,248	£ 33,172	£ 16,586
Lettings only	4,142	2,071	£ 55,047	£ 27,524
Total			£ 88,219	£ 44,110

*The difference in time cost between year 1 and year 2 represent the one-off familiarise costs, ie, 44k

c. Compliance costs

Finally, those businesses that do not operate to the standard expected will potentially lose rulings and face fines if consumers bring valid complaints before the redress scheme. Both the change of behaviour and the sanction are costly to the firm, however in estimating the likely indirect cost, it was assumed that the current level of complaints (per member) of TPO redress scheme, apply to the agents who as yet haven't voluntarily joined a redress scheme. The current average payout was also applied to the projected level of settled complaints to estimate the full cost. The payment of compensation is a cost to business but it will not impact the overall net benefit of the proposal, as this is a transfer from businesses to the recipients of payment.

The Property Ombudsman (TPO), as of 31 December 2012, had 9,748 registered offices for lettings. Overall, there were 8,334 enquiries leading to 738 decisions, of which TPO settled 545 'in favour' of the complainant. This implies a ratio of upheld complaints to 0.06 per member. 54% of complaints were made by the landlord, 45% by the tenant, and 1% by a third party. The average award by the TPO in favour of complaints upheld was £325. It is possible that the number of upheld complaints per new member may be higher than that seen for existing members. To take account of this, we have considered a scenario where the new firms are twice as likely to have a complaint upheld as existing members, which would indicate a ratio of upheld complaints per new member of 0.11. **This is again, a conservative assumption due to lack of further evidence but is judged to be sensible.** Applying this ratio of upheld complaints to the number of new firms joining the redress schemes, and multiplying it by the average award given by TPO provides the annual estimates below.

Table 7 – Estimated costs of settled claims as a result of joining redress scheme

	Number of agents	Number of settled claims	Cost of settled claims (£)
Sales and lettings agents	1,283	141	45,825

Lettings only	2,128	234	76,050
All lettings agents	3,411	375	121,875

d. Costs of dealing with claims

Dealing with complaints brought to the redress scheme is also likely to require staff time. This applies regardless of whether or not the complaint is upheld. Again, we have considered the total caseload (regardless of outcome) using statistics from TPO. In 2012, there were a total of 934 cases considered, which implies 0.2 cases per member. Again, considering that the number of cases may be higher for new members, we have considered a scenario where there is twice the caseload than that seen for existing members. Assuming that each case would require up to 2 hours of staff time to provide an overview and collate the correspondence from both parties (and using the same wage and non-wage costs as before) provides the following estimates of administrative cost for **all** cases. In estimating these costs, there is an underlying assumption that in the absence of the proposal, none of the lettings agents would have spent any time dealing or resolving complaints. The estimated costs are therefore conservative but we judge that this is a sensible approach given the potential disproportionate costs involved in getting further data.

Table 8 – Estimated administrative costs of dealing with complaints brought to the redress scheme

New members	Workload per new member	Hours per case	Caseload hours	Time costs (per annum)
3,411	0.19	2	1,307	£ 17,219

Finally, the proposal also impacts on the managers of leasehold property. The information on leasehold property is very limited, and the cost of obtaining better information is likely to be disproportional to any improvement in this impact assessment that the additional information would provide. The CentreForum (“A new lease of life”, 2012) estimate that there are approximately 2.5 million leasehold properties in England. The Association of Residential Managing Agents (ARMA) has over 260 corporate members managing 900,000 leasehold homes. The Association of Retirement Housing Managers (ARHM) represents 55 member organisations who manage 105,000 retirement properties in the UK (believed to be upwards of 80% of leasehold properties in the retirement sector). However, we do not know the total number of managing agents in the residential leasehold sector – but we expect the number to be relatively small (TPO have 119 Residential Leasehold Management members). Accounting for the other 1.5million residential leasehold properties which are managed by firms not members of ARMA or ARHM, and assuming they manage similar numbers of properties to members of ARMA / ARHM might suggest just under 500 leasehold management companies who might be subject to redress. While this is an estimate, in the absence of firm evidence, it is based on very cautious assumptions since:

- It ignores the fact that about 0.5 million of the 2.5 million leasehold properties in England have the freehold owned by local authorities (as ex right to buy stock). Local authorities are exempt from the requirement as they already have a duty to belong to the Housing Ombudsman Scheme.
- It will include some double counting, as some letting agents also manage residential leasehold properties. Again there is limited evidence on the numbers but one industry expert put the figure as high as 20%, although others suggested that the figure would be lower.

As the information on leasehold property is very limited we have applied the same methodology and the same assumptions which were used for letting agents to leasehold agents. This means that we have again broken down the likely costs into a direct cost of joining and maintaining membership of a redress scheme and an indirect cost of responding to complaints. Given that leasehold agents will be joining the same schemes as the letting agents then the direct costs can reasonably be expected to be similar.

Assuming the indirect costs to be similar will, if anything, overestimate the likely cost to leasehold agents because it is reasonable to assume that redress schemes will receive fewer complaints about leasehold agents than their letting agent counter parts. This is for two reasons, the first is that leaseholders already have a mechanism for complaints and determining their liability to pay service charges, other than the courts, which is well established and well used – this is the First Tier Tribunal (Property Chamber). We expect leaseholders to continue to use the First Tier Tribunal (Property Chamber) for service charge disputes rather than switch to the redress scheme. There is no equivalent for letting agents, so all complaints will be channelled to the redress schemes.

The second reason we would expect fewer complaints is that as leasehold agents can be appointed to manage a block of flats covering many leaseholders rather than a single property it is not unreasonable to believe that freeholders for whom this is a business may not be driven by cost as much as individual landlords and may take greater care in selecting the agent to preserve their reputation ensuring that overall standards may be higher in the leasehold sector.

To ensure that this assessment reflects the maximum costs we have therefore used the same methodology for letting agents above. This yields the following potential costs.

Table 9 – Annual estimated costs for managers of residential leasehold property (cost after year 1 shown in brackets)

Number of managers for residential leasehold	Potential (upper bound) cost of membership	Time costs for administration / familiarisation	Costs of dealing with complaints	Costs of settled claims
500	£92,000 (£83,500)	£13,290 (£6,645)	£2,525	£17,875

Where:

Annual cost of membership in year one= $500 * £20 * 0.85 + 500 * £170 * 0.85 + 500 * £150 * 0.15 = £92,000$

Annual cost of membership in year two thereafter = $500 * 0.85 * £170 + 500 * 0.15 * £150 = £83,500$

Time costs for administration and familiarisation in year one = $£13.29 * 2 * 500 = £13,290$

Annual time costs for administration and familiarisation in year two thereafter = $£13.29 * 1 * 500 = £6,645$

Annual costs of dealing with claims= $£13.29 * 2 * 0.19 * 500 = £2,525$

Annual costs of settled claims = $500 * 0.11 * £325 = £17,875$

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

Overall costs to business, rounded to nearest 1000s

The total anticipated cost to business for letting and managing agents is as follows:

- A one-off cost in year 1 to letting and managing agents of £102,000, consisting of £58,000 of one-off membership joining fees (see table 4), plus £44,000 of familiarisation costs (see table 6).
- Annual membership fees for letting and managing agents of £556,000 (see table 4).
- Annual administration costs to letting and managing agents £44,000 (table 6) plus a further £17,000 for dealing with specific claims (table 8).
- Annual compliance costs for letting and managing agents of £122,000 (table 7).

In terms of costs to managing agents of residential leasehold properties, we expect the maximum possible costs to be as follows:

- A one-off cost in year 1 of £15,000 (rounded), consisting of £8,500 of one-off membership joining fees, plus £6,600 of familiarisation costs.
- Annual membership fees of £84,000.
- Annual administration costs of £6,600 plus a further £3,000 for dealing with specific claims.
- Annual compliance costs of £18,000.

Therefore, the highest gross cost to business in any one year is estimated to be £970,000. The equivalent annual net cost to business (ENACB) is estimated at **£0.69m**. Annex 1 presents the inputs used in calculating the ENACB.

Risks and assumptions

We've assumed that all additional costs would be borne by letting agencies and managers of leasehold property. In reality some of these costs may be passed down to tenants in the form of higher rents.

We have also assumed that annual membership fees do not increase as a result of the proposal, given that recent bids for the redress schemes suggest that existing schemes have not changed their current fee structure.

Summary and preferred option

The private rented sector is currently growing - up from 2.4m households in 2005/06 to 4.0m in 2012/13, and agents are involved in 66% of transactions. An estimated 40% of agents are not covered under the existing voluntary redress schemes. Presently there is considerable vulnerability and dissatisfaction amongst both tenant and landlord consumers.

The lack of mandatory redress is inconsistent with the sales sector, despite the greater apparent necessity in lettings, and industry experts have welcomed wider regulation.

The preferred option will require persons who engage in lettings agency and property management work to be members of an independent redress scheme for dealing with complaints in connection with that work. While still regulation, this offers a 'light touch' method where consumers can have their complaints resolved, which should standardise behaviour across the sector and subsequently drive up standards.

Annex 1: Direct impact on business

Year	0	2	3	4	5	6	7	8	9
Transition Cost - Best Estimate (£m)	0.1								
Annual Costs (£m)									
Annual Cost 1 - Joining fees for redress scheme	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Annual Cost 2 - Administrative cost of joining redre	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Annual Cost 3 - Compliance costs	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Annual Cost 4 - Time costs for dealing with claims	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02