Letting the market down?

Assessing the economic impacts of the proposed ban on letting agents fees

A report for ARLA Propertymark (Association of Residential Letting Agents)

CAPITAL ECONOMICS

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Key findings

Capital Economics has been commissioned by ARLA Propertymark (Association of Residential Letting Agents) to produce this report looking into the impact of the proposed letting agent fees ban on landlords, letting agents, households, the buy-to-let sector and the wider economy.

Our key findings are:

- Total turnover in the residential lettings sector in England and Wales is around £4 billion and it employs around 58,000 workers
- Residential lettings activity is localised with at least 2,000 jobs supported in each region
- The introduction of a ban on letting agent fees charged to tenants would be the third hit to buy-to-let activity in recent years, which exacerbates downside risks to the private rented sector, wider property market and economy as a whole
- Fees charged for letting activities reflect real work to be undertaken and therefore, if the ban on fees goes ahead, the costs will need to be recovered
- On a comparable basis, fees for letting a property are lower than buying a house in the United Kingdom, while they are also lower than in some other major economies
- Landlords are likely to pass on higher agents' fees to tenants in the form of higher rent. In the most plausible outcome, letting agents lose £0.2 billion in turnover, landlords lose £0.3 billion in income and tenants pay an increased rent of £103 per annum
- The impact on letting agents is likely to result in a loss of jobs to the tune of 4,000 workers
- Although renters will benefit from a reduction in up-front fees, most of this will be passed back to them through increased rents; those tenants who move more frequently will enjoy a saving on overall costs but those who do so less frequently (which are likely to be lower income families) will see a loss

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Part A: Background and context

In this section we consider the outlook and risks for the economy and property market to provide context to the economic environment in which the potential ban on letting fees will be brought in.

Our key findings are:

- Although the general outlook is for reasonable economic growth and steady but subdued house price growth, there are significant downside risks to the property market including Brexit, Trump, interest rate rises and falls in prime London property
- The private rented sector has become increasingly important to the United Kingdom economy; as a share of dwellings it has risen from around nine per cent in 1999 to over nineteen per cent in 2014
- The withdrawal of mortgage interest rate relief puts extra strain on landlords and tenants, with a rent increase of eighteen per cent required on an average £200,000 property to maintain yields
- Additional stamp duty on the purchase of additional properties is likely to dent demand for new buy-to-let purchases
- The proposed ban on letting fees is the third policy change hitting the private rented sector in recent years and it exacerbates existing risks to the sector, wider property market and economy

Government has announced plans to ban letting fees charged to tenants

In the 2016 Autumn Statement, Philip Hammond announced the government's intention to put a ban on fees charged by letting agents to tenants. The statement read:

"The government will ban letting agents' fees to tenants, to improve competition in the private rental market and give renters greater clarity and control over what they will pay. The Department for Communities and Local Government (DCLG) will consult ahead of bringing forward legislation."

The details of the proposed change to legislation have not yet been announced with a consultation due in March or April 2017.

This would be the third significant policy change affecting the private rented sector in recent years after the introduction of:

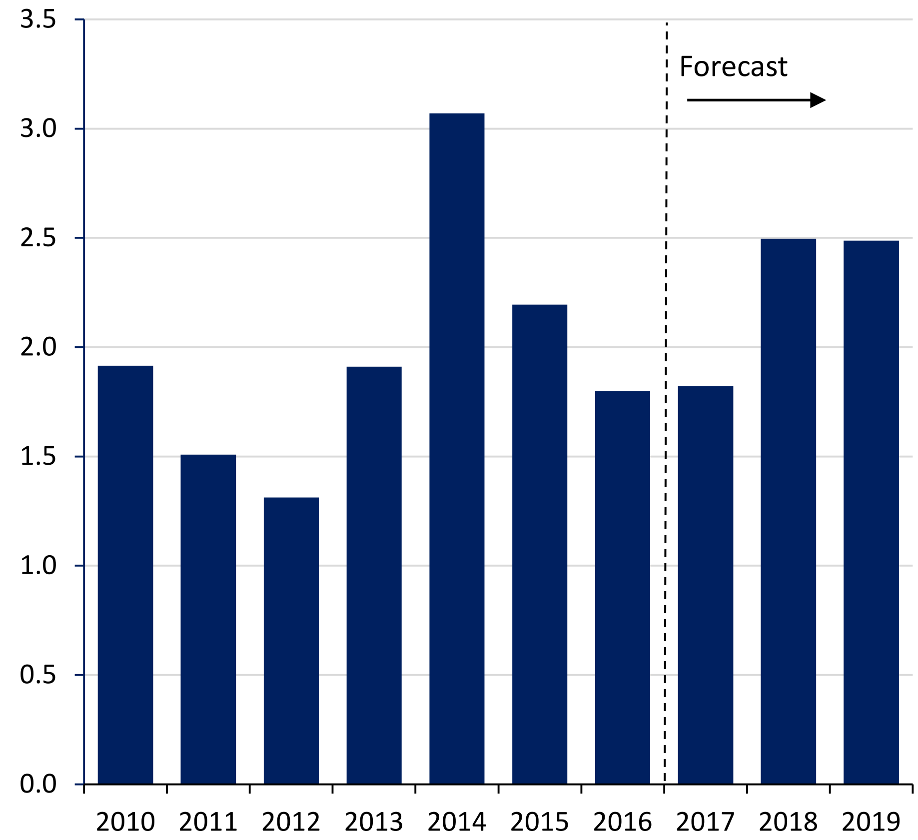
- The withdrawal of mortgage interest rate relief
- A three per cent stamp duty surcharge on purchases of additional properties

Economic growth set to rise in 2018

The economy has entered the New Year with considerable momentum. While there are still a number of uncertainties surrounding the economic outlook, we maintain our view that the damage from the United Kingdom's vote to leave the European Union will be smaller than most forecasters have anticipated. Admittedly, higher inflation and Brexit uncertainty are likely to slow growth in 2017. But we expect the economy to remain resilient, with above-consensus growth in gross domestic product of about 1.8 per cent in 2017, followed by growth of around 2.5 per cent in 2018.

While the triggering of Article 50 (now set for 29 March 2017) and political uncertainty in the United States and Europe could dampen United Kingdom growth, they are unlikely to bring the economy to a complete halt. We don't expect a repeat of the erosion of households' spending power seen after the pound's last major depreciation back in 2008. As such, household spending is likely to grow more slowly rather than fall outright.

The pound's decline after the Brexit referendum has already materially improved the competitiveness of United Kingdom goods on the international market and should continue to boost demand for British manufacturing exports in coming quarters. It will also incentivise consumers to substitute imports for domestically produced goods, the result being that net trade will provide a boost to gross domestic product further ahead. This should help growth accelerate in 2018.



Annual percentage change in gross domestic product

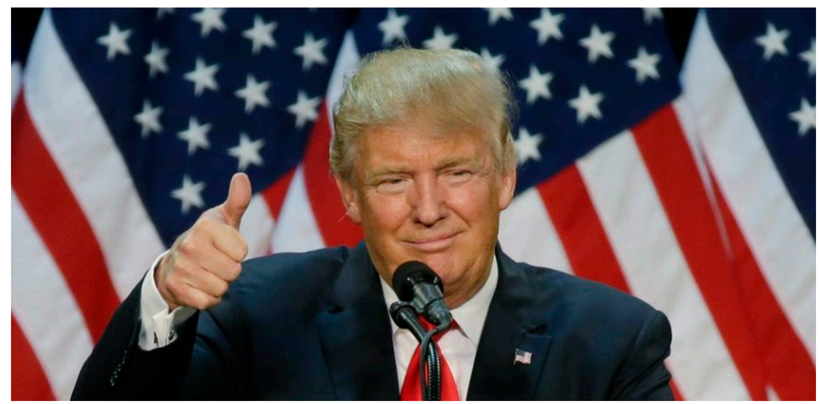
Sources: Thomson Datastream, Capital Economics

There are significant risks to the economic outlook

There are risks. An unanticipated slowdown in the economy would negatively impact the outlook for property. While we expect economic growth to be relatively healthy over the medium term, a number of things could derail the outlook:

- **'No deal rather than a bad deal'**: Brexit negotiations loom large for the next two years and, probably, beyond. The prime minister has raised the possibility of phased implementation in order to avoid a so-called "cliff-edge". But the tight timetable could nonetheless limit the scope of a trade agreement and potentially weaken the United Kingdom's bargaining position. If Theresa May chooses 'no deal rather than a bad deal' that would mean exports to the European Union would be subject to common European Union tariffs and, until new trade agreements are forged, British exports to elsewhere would be subject to normal World Trade Organisation rules.

- **Trump's trade ideas**: Donald Trump's inauguration as the 45th president of the United States has added another layer of uncertainty. In particular there is a risk that protectionist rhetoric leads to policies that start a global trade war. As an open economy, the United Kingdom would not be immune to such a shock and economic growth would slow as a result.



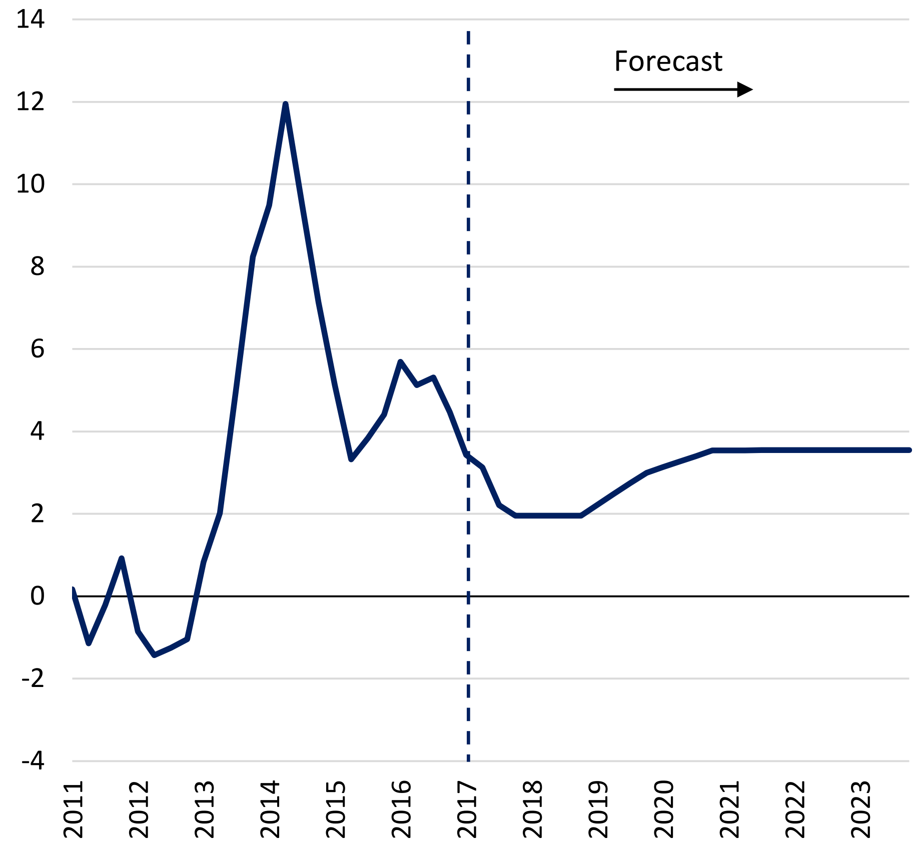
Property market set to cool in coming years with some downside risks

Despite an improving economic outlook, we expect the United Kingdom property market to cool.

House price growth has slowed sharply since the Brexit vote. We expect the property market will continue to cool off as buyers' ability to bid up prices is now limited by already stretched price to earnings ratios and regulatory restrictions placed on mortgage providers are starting to bite.

There are four main risks that could lead to a more sizeable correction in house prices:

- A downturn in the economy, triggered by Brexit, Trumpism or other shocks
- Interest rates rise faster than the market currently anticipates
- Falls in prime London property prices, lead to a wider market downturn
- In reacting to policy changes, investors trigger a more substantial downturn



Annual percentage change in United Kingdom house prices

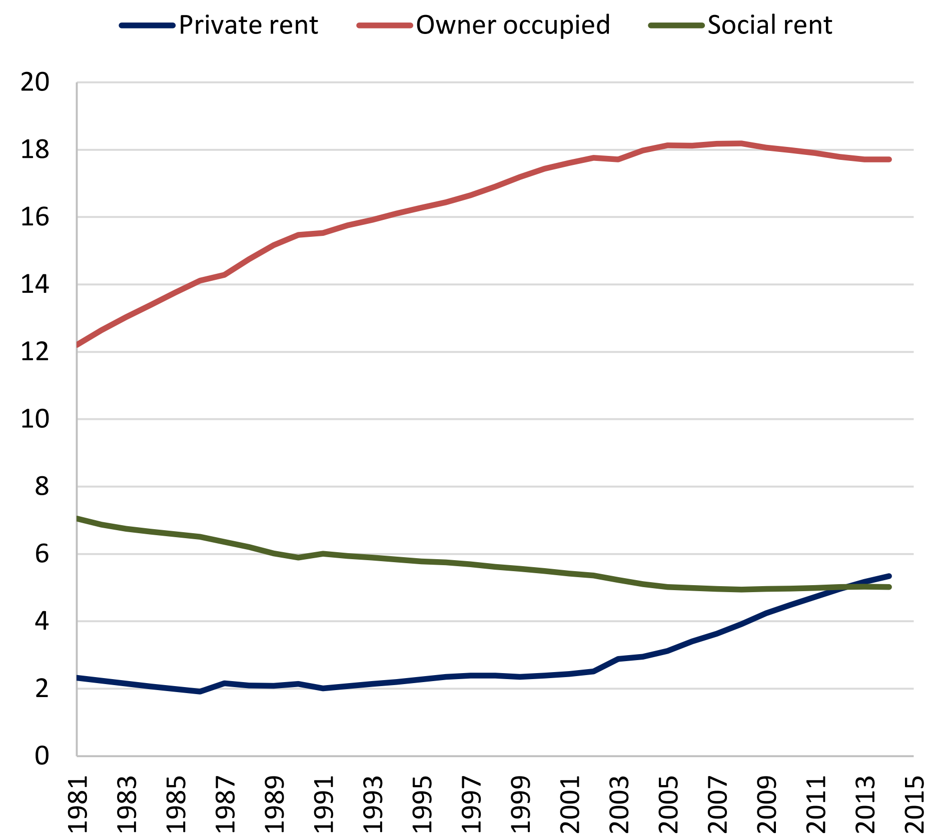
Sources: Capital Economics and Thompson Datastream

The private rented sector has become increasingly important

The private rented sector in the United Kingdom has become increasingly important. The sector's share of dwellings has risen from around nine per cent in 1999 to over nineteen per cent and with a total of 5.3 million properties in 2014.

There were around 1.5 million landlords in 2010. Most landlords were individuals (71 per cent) and half of them had been landlords for between four and nine years; 78 per cent of private individual landlords owned just one property.

London has the largest private rented sector of any region in England. It accounted for over one fifth of all privately rented properties in 2011.[1] The second and third largest markets, the South East and North West, held over fifteen per cent and around twelve per cent of the total respectively. Within London, there were 880,000 properties being rented privately, equivalent to over a quarter of all dwellings in the capital.



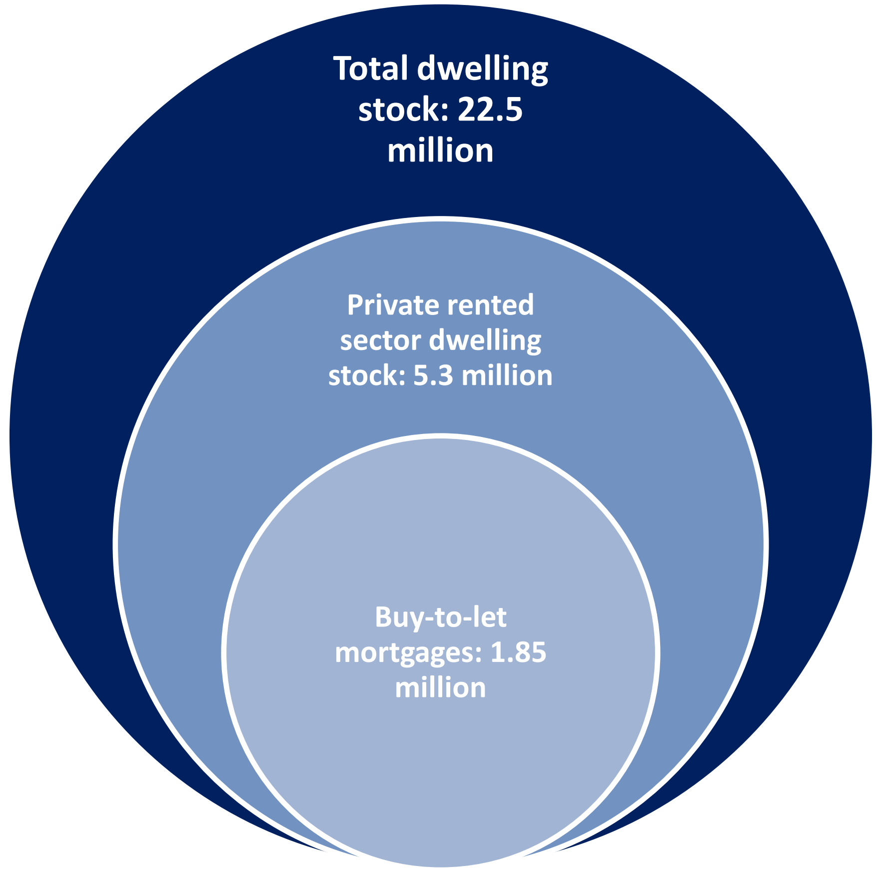
Dwelling stock by tenure in the United Kingdom, millions

Source: Department for Communities and Local Government

[1]The latest year for which these data are available.

Buy-to-let mortgages are an important part of the private rented sector

The current stock of nearly two million buy-to-let mortgages makes up roughly 40 per cent of the private rented sector dwelling stock. The majority of buy-to-let landlords are private individuals, with only around one tenth operating through a corporate structure. Combined they hold over £225 billion of mortgage debt.



Size of the private rented sector in United Kingdom

Sources: Department for Communities and Local Government and Council of Mortgage Lenders

Private rented sector has seen three potentially damaging policies recently

Higher rate of stamp duty on purchases of additional properties such as buy-to-let properties and second homes (three percentage points above current rates)
Announced: Autumn Statement 2015
Date effective: 1 April 2016

Restriction of finance cost relief for landlords
Announced: Summer Budget 2015
Date effective: Gradual introduction from 6 April 2017

Ban on letting agents fees to tenants
Announced: Autumn Statement 2016 (23 November 2016)
Date effective: Consultation period set for March-April 2017

Sources: Capital Economics, HM Revenue and Customs and HM Treasury

Tax relief cut set to dampen buy-to-let activity

In his last budget the then chancellor George Osborne announced the measures to restrict relief for finance costs on residential properties to the basic rate of income tax.

Currently buy to let landlords pay no tax on mortgage interest, which is regarded as a business expense. From April 2017, this relief will be gradually withdrawn by a quarter each year until all financing costs incurred by a landlord will be given as a basic rate tax reduction in 2020/21. This will effectively mean that higher rate tax payers will pay twenty per cent tax on the amount of their mortgage interest and additional rate tax payers will pay 25 per cent.

The policy change will hit post-tax rental yields. In the case of a 40 per cent taxpayer buying a buy-to-let property with an interest-only 75 per cent loan-to-value mortgage and an interest rate of 3.5 per cent, and if the change were suddenly implemented in one go, rents would have to rise by around eighteen per cent to maintain the same after-tax yield.

To demonstrate this, we consider the case of a £200,000 property generating a gross rental yield of five per cent. The after-tax income is £8,100 and so after-tax yield is 4.05 per cent. After the change, only basic income tax relief can be deducted. Tax paid therefore rises to £2,950, after-tax income falls to £7,050 and the after-tax yield drops to 3.53 per cent. To bring that yield back up to 4.05 per cent, rents would need to increase.

	With relief	With only basic relief	To achieve same after tax yield by rent increase
House price (£)	200,000	200,000	200,000
Gross rental yield (%)	5.0	5.0	5.9
Rent received (£)	10,000	10,000	11,750
Mortgage (£)	150,000	150,000	150,000
Mortgage payment (£)	5,250	5,250	5,250
Gross income (£)	10,000	10,000	11,750
Net income (£)	4,750	4,750	6,500
Tax paid (£)	1,900	2,950	3,650
After tax & mortgage income (£)	2,850	1,800	2,850
After tax, before mortgage income (£)	8,100	7,050	8,100
After tax & mortgage yield (%)	1.43	0.90	1.43
After tax, before mortgage yield (%)	4.05	3.53	4.05

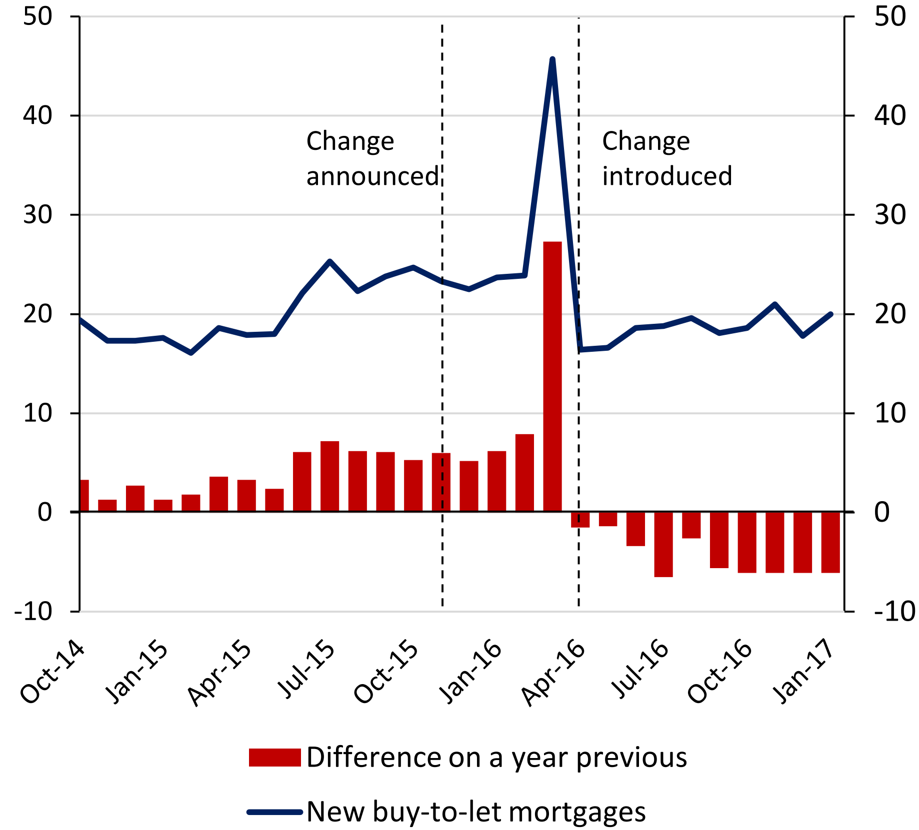
Exemplars for impact of tax relief cut

Source: Capital Economics

Stamp duty changes will further deter entry to the buy-to-let sector

Mortgage advances data indicate that the buy-to-let market has been the primary driver of the peak and subsequent fall in home sales for buy-to-let purposes around the introduction of the three per cent stamp duty hike on purchases of additional property.

This policy has distorted the market by shifting demand. Buy-to-let mortgage applications rose in volume compared to a year previously from March 2015 when the policy was announced and peaked in March 2016, the month before the change took effect. Buy-to-let mortgage advances remain above levels before the policy was announced.



New buy-to-let mortgage advances, thousands

Source: Council of Mortgage Lenders

Part B: Importance of residential lettings sector

In this section we consider the economic contribution of real estate activities in the United Kingdom before focusing more specifically on residential lettings activity that will be directly affected by the proposed ban on fees.

Our key findings are:

- Real estate activities, including commercial and residential lettings and sales, as well as management, support 240,000 jobs and add £13 billion of value added to the United Kingdom economy
- Residential lettings activity undertaken by agents turns over around £4 billion each year and adds £2 billion to the economy
- Residential lettings activity provides 58,000 jobs, which generate employee taxes in the order of £400 million for the exchequer each year
- Activity is spread across the country, with at least 2,000 jobs supported in every region of the United Kingdom
- The spending of agents on suppliers supports a further 17,000 jobs while the spending of employees within the sector supports 20,000

Wider real estate activities provide nearly a quarter of a million workers

Official statistics are not readily available on the scale of residential letting activities. The Office for National Statistics produces statistics on 'real estate activities', which is a wide and diverse sector including residential and commercial lettings and sales, surveyor activities and property management activities.

Official statistics show that real estate activities in England and Wales provided employment for 241,000 people in 2015. These ranged from those in real estate agencies to those conducting work managing real estate on a fee or contract basis. These activities generated £23 billion of turnover and added £13 billion to the economy.

Real estate activities pay out around £5 billion in wages and pay a total of £5 billion in taxes.

	Real estate activities
Employees (thousands)	241
Turnover (£ billions)	23
Gross Value Added (£ billions)	13
Gross wages and salaries (£ billions)	5
Business rates (£ billions)	0.3
VAT (£ billions)	2.8
Employee taxes (including income tax and national insurance, £ billions)	1.7

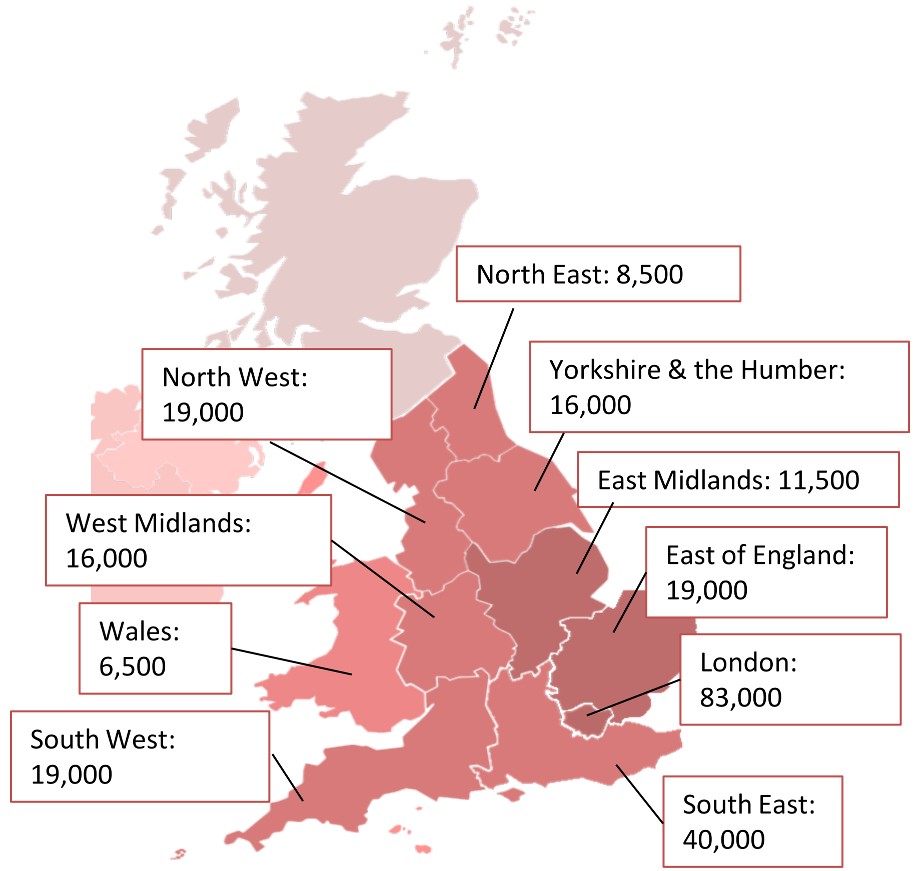
Note: SIC codes used 68.31(Real estate agencies) and 68.32 (Management of real estate on a fee or contract basis). These totals were scaled down to England and Wales using these countries share of total United Kingdom gross value added.

Estimated size of total real estate activities in England and Wales, 2015

Sources: Capital Economics, Annual Business Survey, NOMIS and Office for National Statistics, HM Revenue and Customs

Jobs are supported all over the country

These real estate activities employ workers across the country. Many (35 per cent) are employed in London and the South East, but this partly reflects a higher share of commercial activity in these areas.



Regional breakdown of jobs in real estate activities, 2015

Sources: NOMIS and Capital Economics

Residential lettings forms part of the wider real estate activities

Residential lettings are conducted by estate agents, either as a part of their wider services or as specialist letting agents. We focus on the activities directly relating to the letting of residential properties in any type of business.

Residential letting agents offer a variety of services to potential tenants and landlords. These services and the fees charged for them are not uniform across businesses. (See slide 20.)

Letting agents provide a range of services for prospective tenants

Service	Agents' task
References	• Chase tenants and landlords to fill in forms with who their references are • Sending references to the right people • Checking employer and credit references all whilst liaising with external referencing companies
Tenancy agreements	• Negotiating tenant requirements and drafting the agreement and making any amendments if needed • Logging the information into the letting agency's database
Inventory checks and check in /check out	• Room-by-room checks to ensure standard of the property to be rented as well as record gas meter and electricity meter readings. This is done before move-in (or on move-in day) and at the end of the tenancy. Outcomes of these checks to be written up in a report with photos for proof in case of later disputes. • Sometimes done by an external third party firms and so the agency's role is to commission this firm and ensure all parties have a copy of the inventory report written up by the third party firm
Administration	• Logging of information for viewings (and more generally) on the database. • Ensuring the websites are up to date with the latest information of all the properties including the floor plan if the letting agents offers this service.
Application / set up fees	• Administering new tenants and calculating the cost of referencing checks
Credit checks/ right to rent checks	• Contacting tenants for employment information and liaising with the tenant's previous landlord as well as checking passports and other Visa documents and checking credit history of tenants. This is more-often than not done by an external third party firm. When this is the case the agency's role falls to commissioning the third party firm.
Amendments, deposits and viewings	• Registering the deposit with a deposit scheme if the landlord is not doing this. • Conducting multiple viewings with tenants

Services letting agents offer and associated tasks

Sources: ARLA Propertymark and Capital Economics

Residential lettings activities provide 58,000 jobs in England and Wales

In lieu of official statistics, we have made indicative estimates of the scale of residential letting agents' activity in England and Wales. We have used two methods to do this:

1. **Top-down approach**: using Office for National Statistics data on the number of employees and using an assumption for the share of the activities that are lettings (based on a ratio found from fees analysis) and within this those that are residential (based on segmental revenue of the largest letting agents in the United Kingdom as per their annual reports)

2. **Bottom-up approach**: based on estimates of fees received by real estate agents

Total turnover in the residential lettings sector is around £4 billion on the top-down approach, and it employs around 58,000 workers. Our bottom-up approach yields a turnover of £5 billion. We will use £4 billion to provide the most conservative analysis.

The sector provides the exchequer with annual tax revenues of around £1 billion, from value added tax, business rates and employee taxes.

	Real estate activities	Residential lettings
Employees (thousands)	241	58
Turnover (£ billions)	23	4
Gross Value Added (£ billions)	13	2
Gross wages and salaries (£ billions)	5	1
Business rates (£ billions)	0.3	0.1
VAT (£ billions)	2.8	0.4
Employee taxes (including income tax and national insurance, £ billions)	1.7	0.4

Indicative estimates of the size of the residential lettings sector in England and Wales in 2015

Sources: Capital Economics, Annual Business Survey, NOMIS and Office for National Statistics, HM Revenue and Customs

The sector supports other businesses and jobs through its spending on suppliers

The economic value of the residential lettings sector does not stop at its direct activities; it supports other industries through its purchases of goods and services in the supply chain. Using government data, we estimate that letting agents spend around £1.4 billion annually on goods and services such as accountancy and legal fees, building supplies and government services.

This stimulates further economic activity in the upstream supply chain. It supports jobs and generates value added at the firms at which the money is spent, who then also spend a proportion of the income on their own suppliers where similar benefits accrue. This continues through the supply chain until the amount re-spent on suppliers diminishes.

Overall, the spending on suppliers supports around 17,000 jobs indirectly across the United Kingdom and £1.1 billion of value added.

£1.4 billion

Estimated total spend of lettings sector on goods and services in the supply chain

17,000

Estimated jobs supported by spend of lettings sector on goods and services in the supply chain

£ 1.1 billion

Estimated additional gross value added supported by spend of lettings sector on goods and services in the supply chain

Indicative impact of estimated total spend of lettings sector on goods and services in the supply chain

Sources: Capital Economics, Office for National Statistics and Annual Survey of Hours and Earnings

Spending of employees within the sector supports jobs elsewhere

Employees within the sector also go out and spend their wages and contribute further to the economy. Their total spend is somewhere in the region of £1.4 billion. This translates to around 20,000 jobs being supported across the United Kingdom and around £1.0 billion in gross value added.

£1.4 billion

Estimated total spend of employees in the lettings sector

20,000

Estimated jobs supported by spend of employees in the lettings sector in other industries

£ 1.0 billion

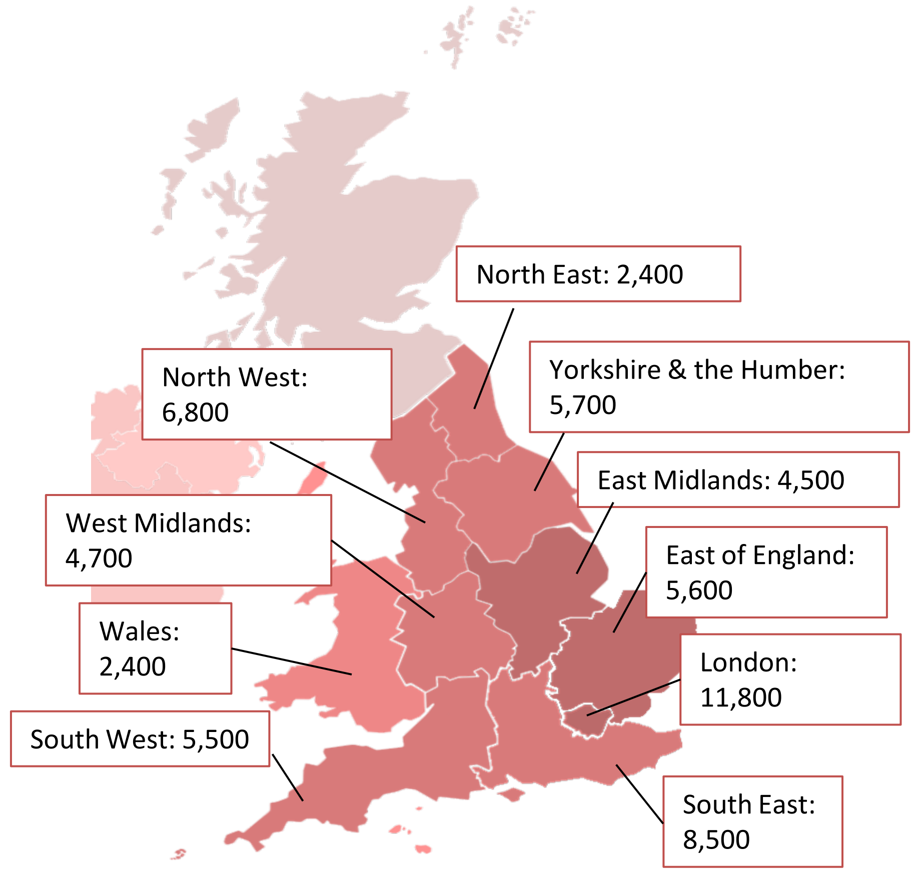
Estimated additional gross value added supported by spend of employees in the lettings sector

Indicative impact of estimated spending by employees in the lettings sector

Sources: Capital Economics and Office for National Statistics

Residential lettings activity creates jobs all over the country

The residential lettings sector is localised to urban property markets and spread across all regions and nations of England and Wales. Although official statistics on the breakdown of employment are not available, we have produced indicative estimates which suggest that all regions have over 2,000 employees in the sector.



Indicative regional breakdown of jobs in residential lettings sector, 2015

Sources: NOMIS and Capital Economics

Part C: Letting fees in the United Kingdom

In this section we consider the structure of the residential lettings sector, how the fees fit into this and how it compares to other sectors and countries.

Our key findings are:

- The majority of letting agents are small-scale businesses serving local markets
- Most agents derive income from landlords to manage their properties and fees charged to tenants, although these are not uniform across businesses
- Fees are charged to tenants to reflect real work that is undertaken on behalf of them, including checking references, drawing up tenancy agreements, conducting credit checks and general administration
- The average total fee paid by tenants to letting agents is just over £400 per move which compares favourably with other large developed countries
- The share of fees paid by tenants compared to buyers, in relation to their total rent and mortgage payments, is lower for tenants
- Similar fees are charged in other sectors where the seller has to conduct services on behalf of the buyer, including car sales and air travel

The majority of the lettings sector is comprised of small firms

There were 1,464,000 landlords in the United Kingdom in 2010. Some landlords deal directly with tenants but it is estimated that nearly 60 per cent of properties in the private rented sector are managed by lettings agents.

The letting agency market is localised and official data on overall market shares are not publically available. In order to assess the structure of the market we have analysed eight exemplar 'case study' locations by identifying the agents present within a one mile radius of a given point. We used their individual company websites to determine their size as measured by the number of branches that they run.

ARLA Propertymark (Association of Residential Letting Agents), a regulatory institution for letting agents and agencies in the United Kingdom, defines a 'small' agent as one with three or fewer branches. Our analysis suggests that on average, 60 per cent of the market is comprised of small firms. In our sample of eight locations the share of small firms ranged from 50 to 76 per cent. A further thirteen per cent was accounted for by mid-sized regional firms with between four and ten branches. The analysis suggests that just one quarter of the market is made up of large national letting agents.

	Sample	Small agents (1-3 branches)	Mid-sized agents (4-10 branches)	Large agents (more than 10 branches)
Clifton Dow, Bristol	32	63%	13%	25%
Chippenham, Swindon	17	53%	18%	29%
Solihull, Birmingham	20	55%	35%	10%
Plymouth, centre	27	63%	7%	30%
Southampton, centre	20	55%	5%	40%
Altrincham, Manchester	10	50%	20%	30%
Aylesbury, centre	16	69%	6%	25%
Chillingham Road, Newcastle	17	76%	0%	24%
Weighted average	**159**	**61%**	**13%**	**26%**

Indicative market structure by size of agent

Source: Capital Economics' analysis of google maps and company websites, 2017

Over 9,000 agents are ARLA Propertymark Protected in the United Kingdom

There are currently over 9,000 ARLA Propertymark Protected branches in the United Kingdom.

Earning the ARLA Propertymark Protected designation allows business owners to demonstrate that they meet certain standards. They must meet certain obligations before they become members, which are:

- The business must have a **client money protection scheme** to ensure that, in the event that they miss-handle tenants' or landlords' money, these can be compensated;
- What's more, if they do handle client money, they must provide **an accountant's report annually** to Propertymark;
- It must **follow The Property Ombudsman's code of practice**;
- Hold **professional indemnity insurance**;
- **Belong to an independent redress scheme approved by the Department for Communities and Local Government**;
- (For those businesses which also undertake estate agency activities) be **registered with HM Revenue and Customs for anti-money laundering supervision**.

After they become members, businesses must comply with Propertymark's conduct and membership rules which cover ongoing standards for the above mentioned aspects of agencies' business.

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Fees charged reflect real work to be undertaken

The services provided by letting agents and the fees charged for those services are not uniform across businesses.

Letting agents offer a myriad of services ranging from viewings to collecting references or organising credit checks and putting together tenancy agreements. A recent survey conducted by ARLA Propertymark highlights the time staff required to deliver these services and the extent to which many services conducted are not explicitly charged for.

Many of these services may not seem burdensome at first but a survey conducted by ARLA Propertymark finds that letting agents spend, on average, eight hours on undertaking credit checks, conducting viewings and collecting and checking references per contract.

The survey shows that 96 per cent of agents charge for collecting references, which they sometimes need to employ a specialised third party to do, 89 per cent charge for drafting the tenancy agreement and making any amendments and nearly two out of three agents charge for the inventory check. However, less than half of agents surveyed charge for any other service despite still needing to conduct them.

Service	Share of agents that charge for this (per cent)	Time spent on these tasks (hours)
Credit checks	19	8.3
Viewings	8	7.9
References – collecting and checking them	96	7.8
Administration – paperwork and database input	30	7.5
Application/set up – administering new tenants	17	7.3
Inventory – checks and report	56	5.8
Deposits – organizing for deposit scheme	10	5.6
Tenancy agreements /renewals	89	5.0
Check in/check out	40	4.6
Amendments	10	4.0
Updating utility providers	3	2.5
Fines	7	1.7
Other	7	1.9

Services letting agents charge for, how many charge for it and how long they spend on it

Sources: ARLA Propertymark, *Our Findings: Letting agent fees research* (ARLA Propertymark, Warwick), January 2017 and Capital Economics

Not all agents offer the same services for the same fees

To undertake these services agents charge fees. The most frequently charged fee is an administration fee. One survey found that this fee was charged by 588 of the agents it surveyed and averaged around £315.

On average, the most expensive fees charged by letting agents are agency fees, administration fees and fees for early termination of a contract which average £377, £315 and £300 respectively.

This same survey found that the average total fee charged to two tenants in the United Kingdom before getting the keys is £412.

	No. of agents that charge this fee (out of 920)	Average fee* (£)
Admin fee	588	315
Tenancy renewal	427	109
Reference check	399	148
Guarantor check	396	149
Check out	278	121
Tenancy agreement	222	243
Ongoing reference	165	49
Check in	142	96
Tenancy amendment	120	152
Inventory report	57	115
Late rental payment	52	43
Deposit protection	33	39
Permitted occupier	33	171
Early termination	26	300
Agency fee	25	377

Top 15 fees charged by letting agents in the United Kingdom

Source: lettingfees.co.uk (as at March 15 2017). *Average fee for two tenants

Fees in the United Kingdom are lower than in some other major economies

Fees charged by letting agents in the United Kingdom are lower to those in other countries.

In the **United States**, letting agents, known as 'realtors' and 'real estate brokers', charge letting fees. These are usually one month's rent or fifteen per cent of the annual rent of the property.

In **France**, letting agent fees, known as agency fees, have been capped since September 2014. These were generally equivalent to one month's rent.

From September 2014 fees have been set based on the size of the apartment based on a fixed rate dependent on its location. In some localities the fee is equal to eight euros per square metre. In localities where the population is above 50,000 inhabitants it will cost ten euros, and in high-end areas where demand far outstrips supply of rentals (such as Paris), the rate is twelve euros.[2]

At the same time, the government decided to legalise fees for move-in inspections. Whereas this was previously banned, it can now be charged at three euro per square metre.

Country	Average total fee tenants pay to letting agent	Monetary equivalent (£)
United Kingdom	£412 (lettingfees.co.uk)	**412**
United States	One month rent or 15% of property annual rent	**1,132** (US average rent of $1,404 in January 2017)
France	8/10/12 euro per square metre dependent on location	**416** (Based on average apartment size in Paris of 40m^2)
Germany	Banned since 2015. Previously equal to one month's rent.	-

Average letting agent fees in different countries

Sources: Zillow, Brame, G., *Chez Vous en France - Living and working in France 3rd Edition*, London, Kogan Page Limited, 2004, p163. Dollar and euro values converted to pound sterling using exchange rates on 19 March 2017.

[2] *Fédération nationale de l'immobilier* (FNAIM) website, *Honoraires de location : que doit payer le locataire?, http://www.fnaim.fr/3774-honoraires-de-location-que-paie-le-locataire-.htm* (accessed 15 March 2017)

Germany's experience is not reflective of what will happen in England and Wales

In 2015, the **German** government banned letting agent fees, which were on average equal to one month's rent. At the same time, it also set a rental price brake – *mietpreisbremse* – in a number of its largest cities including Berlin and Düsseldorf. This introduced a limit on increases in rent when rental contracts are renewed.[3,4]

The changes have not affected the Germany private rental sector significantly and some commentators have suggested that therefore the same letting fees ban in England will not materially impact the market here. However, there is a significant difference between the markets; in Germany tenancies are significantly longer. The average tenancy lasts eleven years, compared to around 2½ years in England. This suggests that, letting agents do not need to offer services as often as in England.

	Germany	England
Length of tenancy (years)	11	2.5 (UK)
Average age of tenants	51.9 years	75% of tenants are below the age of 45 (England and Wales)
Proportion of income spent on rent (%)	25	40 (UK)
Tenants associations protecting tenants' rights?	✓	×
Rent control	Rental price brake since 2013 and tighter rules since 2015	No practical form of rent control
Deposit	3 months' rent to be invested by landlord	1-2 months' rent put in deposit protection scheme

German private rental sector versus England private rental sector

Source: Davies, B., Snelling, C., Turner, E., Marquardt, S., *Lessons from Germany* (Institute for Public Policy Research, London), January 2017.

[3] F. O'Sullivan, 'Berlin figured out a way to bring rental prices down in only one month', *Business Insider*, 12 July 2015, http://www.businessinsider.com/berlin-announced-a-rental-price-brake-last-month--and-its-already-working-2015-7?IR=T , (accessed 14 March 2017)
[4] J. Eley, 'A Germany lesson in rent controls', *The Financial Times*, 12 June 2015, https://www.ft.com/content/7e682660-1019-11e5-bd70-00144feabdc0, (accessed 14 March 2017)

On a comparable basis, fees for renters are lower than for buyers

When thinking about other sectors with which to compare fees, the most obvious choice is that for property sales. Given the difference in the average time spent in a rental property and that spent in a purchased property, comparing annual fees directly would be spurious.

If we take into account the share of fees paid by tenants and buyers, in relation to their total rent and mortgage payments, fees are lower for renters. Average fees in the rental sector are just under three per cent of the tenant's total annual rent. This is lower than the 3.7 per cent of fees due by buyers compared to their annual mortgage payments.

Tenants	
Average fees paid by tenant per move	£412
Average annual fees paid by tenant	£275
Average annual rent paid by tenant	£9,600
Share of tenant fees to rent	**2.9%**
Buyers	
Average fees paid by buyer per move	£6,030
Average annual fees paid by buyer	£287
Average annual mortgage payments by buyer	£7,700
Share of buyers fees to purchase a property	**3.7%**

Comparison of the share of fees paid by tenants and buyers to the annual cost of their rent and mortgage payments, England and Wales, 2015/16

Sources: Capital Economics, Office for National Statistics and English Housing Survey

Lettings agents are not the only ones charging fees to cover costs of services offered

We can also look into other industries to see if there are similar fees charged. We find that other industries offer similar fees to the lettings industry; we list and expand on some of these here below:

1. **Buying a vehicle**. Car sales companies offer a myriad of services which, similar to those in the letting industry, make purchasing the item simpler for the client. Car dealers charge administrative fees for paperwork transferring ownership of the car if the car was pre-owned, or, if the car is brand new, for paperwork related to its registration.

2. **Airplane tickets**. Airlines charge fees for services such as changes on the name of a ticket if this was originally misspelt. This is akin to fees for changing the names on a tenancy agreement within the context of lettings.

Part D: Impact of fees ban

In this section we consider the potential impact of the proposed letting agent fees ban.

Our key findings are:

- On average, fees charged to tenants account for around one fifth of letting agents' revenue
- Landlords are likely to pass on higher agents' fees to tenants in the form of higher rent. In the most plausible outcome, letting agents lose £0.2 billion in turnover, landlords lose £0.3 billion in income and tenants pay an increased rent of £103 per annum
- The impact on letting agents is likely to result in a loss of jobs to the tune of 4,000 workers
- Although renters will benefit from a reduction in up-front fees, most of this will be passed back to them through increased rents; those tenants who move more frequently will enjoy a saving on overall costs but those who do so less frequently (which are likely to be lower income families) will see a loss

There are a number of estimates of average fees paid by tenants

There are a number of estimates of the average fees charged by letting agents to tenants.

ARLA finds that the average fee charged by ARLA Propertymark Protected agents is £202 per tenant.

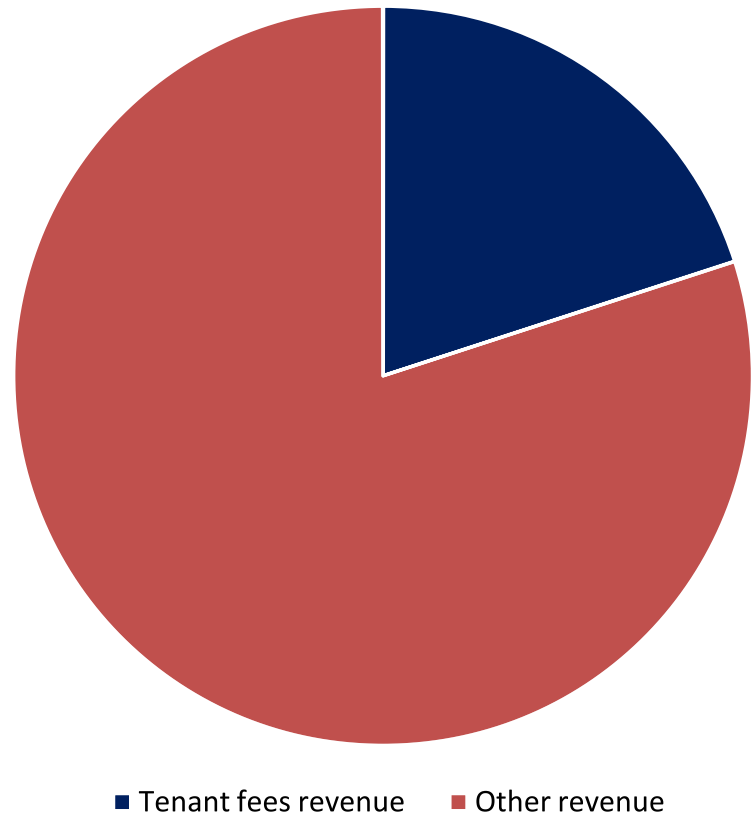
The Department for Communities and Local Governments (DCLG) estimates that the mean fee paid by tenants on entering their accommodation was £223 in 2014-15 and the median fee £200. This included a non-returnable fee for finding the property, a fee for references, contracts and inventories (administration fee), a holding fee to ensure no-one else viewed or rented the property and a returnable version of this last as well as 'other' fees.

Shelter, the homelessness charity, argues average fees are higher and that one in seven tenants have been charged more than £500.

Meanwhile, lettingfees.co.uk which looks at fees quoted by 902 letting agents across the United Kingdom on their website finds that for a simple contract for two tenants, average fees total £412. We use this estimate of average fees as it is the one based on the widest sample across the market.

In total, fees account for around one fifth of revenue from residential lettings activity

We calculate that the total revenue from fees charged to tenants is around £0.7 billion for letting agents in England and Wales annually. Based on our estimates for turnover in the residential lettings sector, this means that around a fifth of turnover is at risk if a ban on all letting agent fees is drawn into law.[5]



Sources of revenues from residential lettings activity

Source: Capital Economics

[5] This is based on a calculation on the number of residential private rented properties in England and Wales and using the average length of a tenancy, estimated to be eighteen months by ARLA Propertymark

The impact of the Scottish ban on fees is ambiguous

In Scotland 'premiums' or fees over and above rent and the deposit paid by tenants to letting agents have been banned since 1984 (Rent Act 1984). However, fees were still being charged as the definition of 'premiums' was unclear. The Scottish government decided to clarify the definition in the Private Rented Housing Act of 2011 – only rent and deposit was owed by the tenant, everything else was to be charged to the landlord.

The impact of the ban on letting agent fees to tenants in Scotland has been unclear. Less than 40 per cent of landlords there agreed that the clarification improved the rental sector. The law clarification didn't deter some agencies from charging fees and whilst some letting agents did not increase fees to landlords nearly one in five did. What's more, agencies decreased the services they offered – one in four said they no longer undertake credit checks as standard and some agencies ended up closing as a result.

It was found that landlords in Scotland were no more likely to raise rents than landlords elsewhere in the United Kingdom, which isn't surprising given that rent cannot be raised to the same level across different geographic areas with different rental markets. Rents rose following the ban. One study[6] shows that there was an increase in rents in Scotland following the clarification, of around one to two per cent although they were unable to explain whether this was down to market forces.

[6] Rettie, *The impact of legislation on letting agents fees in Scotland Quantitative Analysis* (Rettie, Edinburgh), March 2014.

'1 in 5 Scottish tenants said they were charged fees on top of their rent and deposit the last time they moved. This rises to just under a third among those who used a letting agent.'

'17% of agencies claim to have increased fees to landlords as a result of law clarification'

'just over a quarter of renters in Scotland (27%) agreed that letting agents were finding loopholes and making other charges, but a large majority were neutral or did not know'

Some findings of a report by BDRC for Shelter on the impact of the letting agent fees ban in Scotland

Source: Long, D., *The impact of clarification on letting agent fees in Scotland* (BDRC Continental, London) March 2014.

Agents see the ban leading to a fall in employment and increase in rents

40%

think the ban will result in a fall in employment in the medium to long term

Forty per cent of agents think that the ban on lettings fees will result in a decrease in employment in the medium to long term. This is because they will grapple with lower revenues and at the same time face an increase in training costs to meet legislative requirements.

Meanwhile, nearly 90 per cent expect it to lead to a rise in rents and six in ten letting agents report that the quality of properties will deteriorate as a result of the letting fees ban both in terms of the management of the property and also the condition of the property.

90%

think that the ban will lead to a rise in rents

6/10

think that the quality of properties will decline as a result of the letting fees ban

Source: ARLA Propertymark, *Our Findings: Letting agent fees research* (ARLA Propertymark, Warwick), January 2017

Landlords likely to raise rents if their cash flow is impacted

If landlords' cash flow position worsens, the most commonly cited coping strategy is an increase in rents for both new and existing tenants. A large share suggest that they would engage in some sort of deleveraging and maybe decrease reliance on debt.

Answers to this question also highlight the impact a hit to landlords' cash-flow will have on other business supported by the lettings sector and private rented sector more generally. Eight per cent of landlords said they would reduce the use of lettings agents and/or spend less on property maintenance. This suggests that the standards of properties rented to tenants may fall. The English Housing Survey (2015/2016) shows that almost a third of private renters in 2015 were living in 'non-decent' dwellings.

Coping-strategy	Share of landlords
Increase rents for new tenants	41%
Increase rents for existing tenants	34%
Not buy any more rental properties	27%
Sell some rental properties	20%
Sell all rental properties	18%
Use income from other sources	16%
Refinance buy-to-let loans to reduce mortgage costs	16%
Reduce reliance on mortgage debt	15%
Don't know	10%
Reduce usage of letting/full management agents	8%
Prioritise certain property types/tenant types	8%
Spend less on property maintenance	7%
Slow down purchase of rental properties	5%
Other	2%

Share of landlords that will use different coping strategies if their cash-flow position is worsened

Source: Council for Mortgage Lenders, *The Profile of UK Private Landlords*, December 2016

There are two scenarios and three possible outcomes of the letting agent fees ban

The impact of the ban on letting fees will be felt by either agents, tenants or landlords. There are two scenarios and three possible outcomes from the proposed ban on the letting agents' fees:

1. **Letting agents take the hit**. This may result in a number of branch closures and/or jobs losses.

   Outcome:

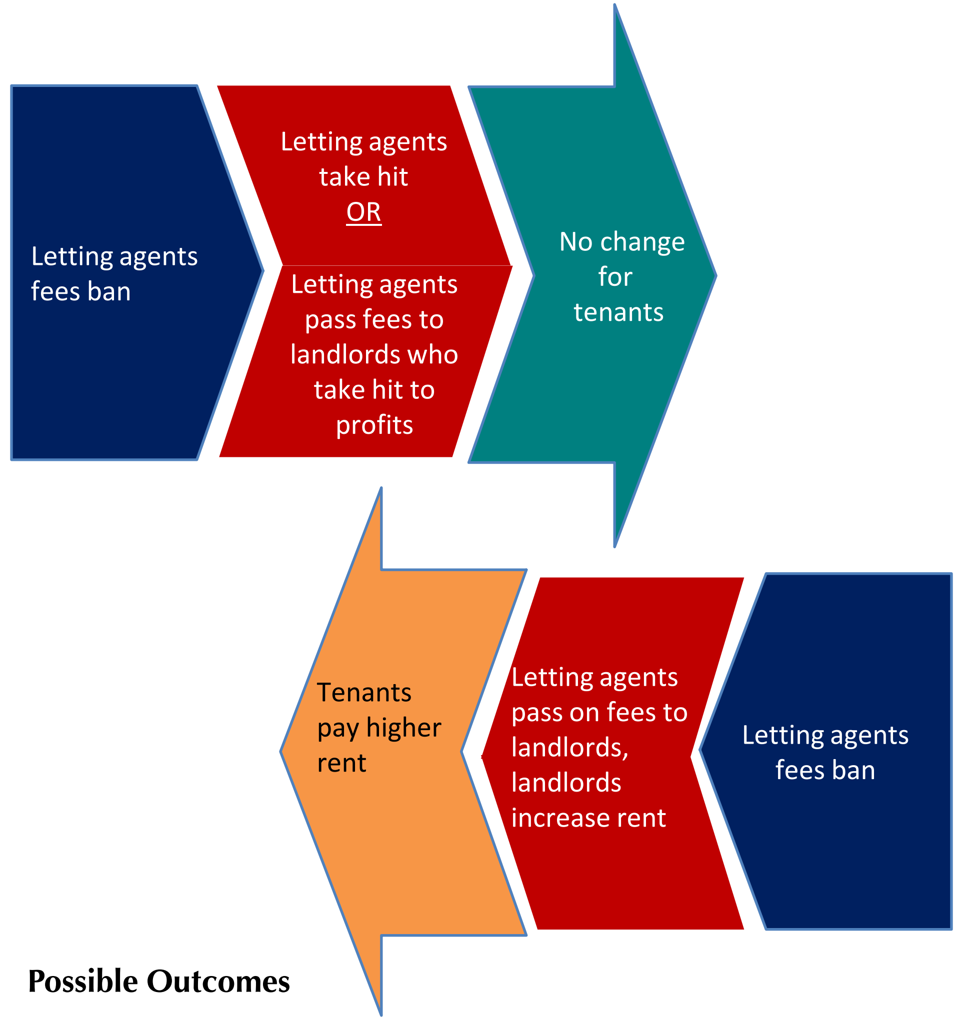
   No change for tenants, no change for landlords, jobs losses in lettings and estate agencies

2. **Letting agents pass on fees to landlords**. Landlords can do one of two things – take the hit to income or increase rents as they face higher costs.

   Outcomes:

   a) If landlords take the hit to income: no change for tenants or the letting agencies, fall in income for landlords

   b) If landlords increase rent: tenants will face higher rents and there will be no change for letting agencies



Possible Outcomes

Source: Capital Economics

The extent to which fees ban will be passed on depends on market structure

Letting agents are unlikely to pass on the full loss in fees to landlords. Similarly, landlords are unlikely to pass on the full increase in their costs to tenants.

Economic theory suggests that the level of competition in an industry or sector is an important determinant for the ability of a firm to pass-through cost increases to consumers.

Theory suggests that weaker competition leads to a low pass-through rate. In a market where there is perfect competition (large number of firms and homogenous goods being sold) the pass-through rate would be expected to be 100 per cent. Meanwhile, in a monopolistic market (a single large firm dominates the market and offers a variety of differentiated goods) the pass-through rate would be around 50 per cent.

There are a large number of letting agents in England and Wales. However, given the differences in the services they offer and the localised nature of the work, the market is likely to be somewhere between the theoretical constructs of a monopoly and perfect competition. As such, the plausible pass-through rate of letting agents onto landlords is likely to be between 50 and 100 per cent, for which we have assumed 75 per cent.

Meanwhile, landlords, if they continue to use agents, can pass on the rise in fees to their tenants in the form of higher rent. Again, whilst there are many landlords, they do offer differentiated products. Since homes are nearly always unique (bar for those in mega complexes) the pass-through rate of landlords is assumed to be closer to that in a monopolistic market at around 50 per cent.

Paper	Findings
Jeremy Bulow and Paul Pfleiderer, 'A Note on the Effect of Cost Changes on Prices [Measurement of Monopoly Behaviour: An Application to the Cigarette Industry]', Journal of Political Economy, Vol. 91, issue 1, 1983, pp. 182-185	• A monopolist facing a linear demand curve and constant marginal cost will always pass through 50 per cent of the change in the level of marginal cost • When all competitive firms realise the same change in marginal cost, the industry-specific pass-through is 100 per cent
Paul Zimmerman and Julie Carlson, 'Competition and cost pass-through in differentiated oligopolies', Munich Personal RePEc Archive, Paper No. 25931, 2010	• In the case of monopoly, cost pass-through rate is 50 per cent • In the case of perfect competition, pass-through is complete (100 per cent) • Under perfectly differentiated output, pass-through is 50 per cent • At the other extreme, with homogenous output (all available insurance policies are the same), the pass-through rate is equal to (n/n+1) where 'n' is the number of firms in the market

Academic literature analysing theoretical pass-through rates under different levels of competition

Source: Capital Economics

If letting agents take 100 per cent of the hit, 16,000 jobs would be at risk

The first possible outcome is that 100 per cent of the letting fees ban is felt by the letting agents and they take on the hit i.e. they do not pass on the fees to landlords.

The impact of the ban on revenue from residential lettings activity will be a reduction of around one fifth. In turn, this will have an impact on employment levels as letting agents will need to cut costs to maintain profit margins. If the impact on employment in the industry is directly proportionate to that on turnover, the number of employees in lettings will fall by around 11,000 jobs.

In reality, the impact of the letting fees ban on employment is likely to be disproportionately higher than that on turnover. We think it reasonable to assume that the letting fees ban could put around 16,000 jobs in the lettings sector in jeopardy.

Estate agents who provide lettings within the wider housing market will be impacted. For every job lost in the lettings sector we can assume that 0.5 jobs will be lost in other activities these agencies undertake because of their impact on profit margins. As such, around 8,000 additional jobs at such 'hybrid' agencies will also be at risk.

	Lettings sector
Jobs in jeopardy (thousands)	16
Turnover at risk (£ billions)	0.7

Impact on letting agents of letting agent fees ban if letting agents take full hit

Source: Capital Economics

If landlords take the hit, their incomes may be significantly hit

In the second possible scenario letting agents pass on the loss of fees to landlords.

Letting agents charge two types of fees to the landlord: a one-off fee if they are simply used to find a tenant or a one-off fee for finding the tenant plus a monthly commission, if the landlord wants the agent to fully manage the property.

If letting agents pass on the full loss in fees to landlords and landlords take the hit to their income by leaving rent unchanged, income from rents to all landlords that use letting agents in England and Wales, will fall by £412 every time their property is rented, or the annual equivalent, £275 per year per property.

Given our analysis of pass-through rates, the more plausible scenario is that letting agents pass on 75 per cent of the loss from the fees ban to landlords. In this case, landlords will see a cut of £206 annually per property rented.

This can be a significant hit to the total income for many landlords. For around 320,000 landlords, rental income accounts for over 25 per cent of their total income, according to the DCLG's private landlords survey of 2010.

If letting agents pass on 75 per cent of costs to landlords, they will lose 25 per cent of £0.7 billion income from tenant fees (£0.2 billion) and around 4,000 jobs will be at risk.

	Lettings sector
Jobs in jeopardy (thousands)	4
Turnover at risk (£ billions)	0.2
	Landlords
Income at risk (£ billions)	0.5

Impact of letting agent fees ban if letting agents increase fees to landlords and landlords take the hit (plausible scenario)

Source: Capital Economics

If landlords pass the cost to tenants, rents could rise by up to £275 per year

Landlords could on the other hand raise rents to cover their higher costs.

In the worst case scenario for tenants, letting agents pass on 100 per cent of the loss from the fees ban and landlords pass on 100 per cent of this to tenants in the form of higher rents. In this scenario tenants' rents will need to increase by, on average, £275 per year to cover higher landlords' costs.

However, we don't believe that agents or landlords will be able to pass through the entirety of the costs. In our more plausible outcome rents will rise by £103 per year. In this outcome landlords, in aggregate lose £0.3 billion in rent income.

In addition, landlords who do not use letting agents may also increase prices, once they see rents have risen elsewhere. This means that rents could increase by between £103 and £275 for all tenants and not just those who rent from landlords that use agents.

	Lettings sector
Jobs in jeopardy (thousands)	4
Turnover at risk (£ billions)	0.2
	Landlords
Income at risk (£ billions)	0.3
	Tenants
Change in tenants' average annual gross rent (£)	103

Impact of letting agent fees ban if letting agents increase fees to landlords and landlords take the hit (plausible scenario)

Source: Capital Economics

The letting fees ban promotes displacement and favours the wealthy

The net impact on tenants of the letting fees ban, if landlords pass on an increase in fees to tenants in the form of higher rent, will depend on how frequently tenants move.

The letting fees ban favours those tenants who move more regularly. This is because both short-term tenants and long-term tenants (who move less frequently) will see a rise in rent equivalent to £103 per year under our plausible outcome. However, those that move more often will now save more compared to previously. For example, over a period of ten years those that move every six months will see savings of £5,493 whereas those that move every five years will see a saving of £549 compared to a time when they paid tenant fees rather than the landlord paying more fees and passing these on in the form of higher rents.

As rents will increase by less than the average tenant fees this will be positive for tenants. However, those that move property less often will not reap the same benefits in savings. Typically, these are likely to be lower income families who will probably move less often than younger, wealthier millennials. For savings to accrue to tenants from the change in policy they would need to move as often as every two-and-a-half to three years.

	Frequency of moves, every …				
	6 months	**1 years**	**2 years**	**5 years**	**10 years**
Savings (as not paying letting agents fees)	5,493	2,747	1,373	549	275
Rise in rent (if increase £103 per year)	1,030	1,030	1,030	1,030	1,030
Net impact on savings	**4,463**	**1,717**	**343**	**- 481**	**- 755**

Net impact on savings for tenants over a ten-year time period, by how often they move

Source: Capital Economics

Impacts will be felt by agents, landlords or tenants

	Letting agents take the hit	Letting agents pass on fees, landlords take the hit	Letting agents pass on fees, landlords raise rents
Assumptions	*Letting agents do not pass on loss in fees to landlords*	*Letting agents pass on 75 per cent of loss in fees to landlords*	*Letting agents pass on 75 per cent of loss in fees to landlords, landlords pass 50 per cent of their increase in costs to tenants*
Lettings sector turnover	- £0.7 billion	- £0.2 billion	- £0.2 billion
Jobs at risk in lettings sector	16,000	4,000	4,000
Landlords' income	£0	- £0.5 billion	- £0.3 billion
Tenants' average annual gross rent	0	0	+ £103

Indicative impact of different outcomes of letting fees ban

Source: Capital Economics

Letting fees ban has implications for the wider economy

Impact	Description
Direct job losses	• If letting agents pass on 75 per cent of costs of the ban to landlords, which we believe is a plausible scenario, they will lose 25 per cent, or £0.2 billion income from fees and around 4,000 jobs in letting agents across the country will be at risk.
Jobs at risk in wider economy	• The activity of letting agents supports jobs through spending on suppliers, such as maintenance workers or legal firms, which will be put under pressure if activity falls in letting agents.
Fall in housing investment	• Private landlords are an important source of investment in housing stock and a worsening of their financial position will likely result in less investment.
Deter market entrants	• Some would-be landlords are likely to be put off by the increased cost that may be demanded by letting agents, and together with the withdrawal of mortgage interest rate relief and additional stamp duty, this will likely reduce the number of new entrants. This will put upward pressure on rents.
Increase in rents	• Although tenants will benefit from the up-front reduction in fees, this will largely be offset by an increase in rents. Those that move less frequently, that tend to be families with lower incomes, will be hit hardest by this change.

Summary of wider impacts of ban on letting fees to tenants