

The Law Commission
Consultation Paper No 181

ENCOURAGING RESPONSIBLE LETTING

A Consultation Paper

The Law Commission was set up by section 1 of the Law Commissions Act 1965 for the purpose of promoting the reform of the law.

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This consultation paper, completed on 27 June 2007, is circulated for comment and criticism only. It does not represent the final views of the Law Commission.

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It would be helpful if, where possible, comments sent by post could also be sent on disk, or by email to the above address, in any commonly used format.

We will treat all responses as public documents in accordance with the Freedom of Information Act. Those who wish to submit a confidential response should contact the Commission before sending the response. We will disregard automatic confidentiality disclaimers generated by an IT system.

This consultation paper is available free of charge on our website at:

http://www.lawcom.gov.uk/housing_renting.htm

¹ This consultation paper was prepared while Professor Hugh Beale QC, FBA was a Commissioner. He was succeeded by David Hertzell on 1 July 2007.

THE LAW COMMISSION
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A CONSULTATION PAPER

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PART 1

INTRODUCTION

INTRODUCTION

- 1.1 In this consultation paper the Law Commission reaches the third stage of its programme on the reform of housing law.
- 1.2 The Renting Homes Report set out recommendations for a new legal framework to underpin the relationship between landlords and those who occupy rented accommodation.¹ Our recommendations were based on two principles:
 - (1) "landlord-neutrality", to facilitate the flexible provision and management of social housing; and
 - (2) "consumer protection", to ensure that both parties to the agreement have a clearer understanding of their respective rights and obligations.
- 1.3 The Housing Disputes project is developing proposals for dealing more proportionately with housing problems and disputes.² However clear and rational the underlying law is problems and disputes will continue to arise; even more so if the way it is applied is not reformed.
- 1.4 This project raises a number of questions, which arise from the first two projects. Does the current law work as effectively as it should? If not, are there better ways to regulate the landlord-occupier relationship? Can problems and disputes in relation to housing be prevented by encouraging better management practice? If so, how can this be done?

THE REGULATORY CHALLENGE

- 1.5 The private rented sector is subject to a great deal of regulatory law. Although enacted with the best of intentions, in many respects the law does not operate as Parliament hoped. Too much rented property is poorly managed. This is most evident in the gap between the minimum standards of housing condition that Parliament has prescribed and official data on the condition of accommodation in the private rented sector. (The evidence is discussed in Part 3; the relevant law is summarised in the supplement to this consultation paper outlining the current law.³) One consequence of poor housing management and housing standards is that the private rented sector continues to suffer from a poor reputation which, arguably, prevents it from playing as full a role in the housing market as it should.

¹ Renting Homes: The Final Report (2006) Law Com No 297, available at http://www.lawcom.gov.uk/docs/lc297_vol1.pdf.

² Housing: Proportionate Dispute Resolution: An Issues Paper (2006), available at http://www.lawcom.gov.uk/docs/issues_paper.pdf; Housing: Proportionate Dispute Resolution: The Role of Tribunals Law Commission Consultation Paper No 180, available at http://www.lawcom.gov.uk/housing_disputes.htm.

³ *Supplementary Paper 1: The Law on Housing Conditions and Unlawful Eviction*, available at http://www.lawcom.gov.uk/housing_renting.htm.

- 1.6 One of the reasons why the private rented sector presents such a regulatory challenge is because it is a sector of the economy in which there are large numbers of participants, providing rented accommodation for a wide variety of reasons to a wide variety of consumers. We discuss the varied characteristics of the modern private rented sector in Part 2.
- 1.7 Some, particularly economists, would question whether this sector of the market should be regulated by the state at all. They suggest that the operation of the market would, through competition, be more likely to achieve the aims of regulation than the imposition of regulation by Government. In Appendix 2 these arguments are considered in more detail. We have considered these arguments but have concluded that we should not propose complete abolition of housing regulation. To do so involves policy issues that are outside the proper remit of a law reform agency.
- 1.8 This paper assumes that the regulatory law affecting the private rented sector continues to exist. The central question considered here, which is proper for a law reform agency to raise, is: are there ways in which existing law could be made more effective?
- 1.9 Having identified this central question, and given that there is clear evidence that the current state of much rented accommodation is below the minimum standards set by Parliament, we realised that if a new regulatory structure were put in place, which encouraged greater compliance with those standards, considerable sums of money would need to be spent bringing accommodation up to standard. We also recognised that there is a cost to *not* taking action, for example in the social costs that arise from people living in accommodation that is not safe or weatherproof. Part 4 considers estimates of the costs and benefits that are associated with enhanced regulatory compliance, particularly on housing condition standards. Supplementary paper 2 considers these estimates of cost in greater detail.⁴
- 1.10 On the assumption that better management of housing in the private rented sector, including increased compliance with regulatory standards, should be encouraged, the rest of this paper explores ideas for achieving this. Part 5 discusses how ideas about regulation and regulatory practice have developed; Part 6 considers how these ideas have been applied to the private rented sector over the last 150 or so years.
- 1.11 With the lessons of Parts 5 and 6 in mind, in particular the importance of ensuring that the regulated community has as much influence as practicable on the development of standards and modes of enforcement, Part 7 sets out ways in which improved management and compliance with the law could be encouraged. We identify three possible options, and indicate our initial preference. Part 8 considers some of the practical issues that need to be addressed were there to be support for our preferred option. Part 9 considers a different, though related, idea – that there should be a process for certifying that rented accommodation meets minimum statutory standards.

⁴ *Supplementary Paper 2: Estimating the Costs and Benefits of Greater Compliance With Property Condition Standards*, available at http://www.lawcom.gov.uk/housing_renting.htm.

- 1.12 If a more effective regulatory regime were put in place, we anticipate at least two further beneficial consequences would result. First, Government might find that many of the rules currently on the statute book were not necessary and could be repealed without detriment. The smarter regulation we advocate would thus help to relieve the regulatory burden. Second, if enhancement of the reputation of the private rented sector can be achieved, both through adoption of our proposals in Renting Homes and in the ideas we develop here, this would lead to greater confidence in the sector and thus greater investment. Increased provision would increase competition, which would also have the effect of driving up standards.⁵

BACKGROUND TO THE PROJECT

- 1.13 From the start of our housing law reform programme, we intended to revisit some of the issues which fall under the general head of “encouraging responsible letting”, in particular the law on unlawful eviction and harassment. In that specific form, it would have been a very narrow project.

- 1.14 The original terms of reference for this project, as set out in the Commission’s Ninth Programme of Law Reform, were somewhat broader:

- (1) To review the relevant housing law, and proposals for reform of the law, and to make recommendations in relation to:
 - (a) the appropriate legal framework necessary to promote and secure compliance by both landlords and occupiers with their existing or proposed legal obligations;
 - (b) the procedures available to landlords, occupiers and affected third parties in relation to compliance, with particular regard to preventing or remedying anti-social behaviour; and
 - (c) such provisions of the criminal law as may be necessary to reinforce the above.
- (2) To consider the extent to which the principles and procedures available in connection with anti-social behaviour by rental-occupiers should also apply to similar behaviour by owner-occupiers.

- 1.15 However, having embarked on the project, we realised that simply looking at details of the law, and its possible amendment, would be unlikely to address the regulatory challenge set out above. There is already a vast amount of housing law.⁶ If it is not working as well as it might, then changing the detail of the law would, by itself, be unlikely to promote and secure better management practice.

⁵ There is evidence of this happening in the student rental market where there has been significant new private investment, leading to higher standards of provision.

⁶ For example, Sweet and Maxwell’s *Encyclopaedia of Housing Law and Practice* contains 5 substantial loose-leaf volumes.

- 1.16 We therefore moved away from a narrow focus on the rules themselves to consider the effectiveness of those rules. This project adopts an approach which the Law Commission has not used before. But we think that it is appropriate for a law reform body to consider not just the rules of law themselves but also wider questions relating to their effectiveness.

THE FOCUS OF THE PROJECT

- 1.17 To ensure the project remained manageable, we decided not to consider the regulation of the whole of the rented sector. In any event, the principal regulators of social housing – including central Government, the Audit Commission and the Housing Corporation – have already done a great deal of work on the better regulation of the social rented sector.
- 1.18 In deciding to concentrate on the private rented sector, we were aware from our earlier work that there are many in the private rented sector who think that consideration of the issues raised here would help to develop the professionalisation of the private rented sector and improve its reputation. This is closely aligned with central Government's general commitment to enhancing businesses' reputation by raising standards. This is often achieved through empowering consumers to make informed choices about the provision of services.⁷
- 1.19 As it happens, the timing of the publication of this paper is particularly fortuitous, as there is currently under way within Government an important review of policy related to rented housing. The reports that have been commissioned so far relate to the social rented sector⁸. However, there can be no comprehensive reappraisal of policy on renting without taking the contribution of the private rented sector into account as well. This paper will, therefore, inform discussion of important questions that might otherwise remain inadequately considered. The Government has also recently announced a review of the property sector to which this paper should be able to contribute.⁹

THE ISSUES

- 1.20 In thinking about the extent to which landlords and occupiers might need further encouragement to comply with their contractual obligations and with the law that underpins those obligations, we initially identified six issues:

⁷ See, in the context of estate agents providing services relating to the buying and selling of housing the statement of the Minister for Trade, Mr Ian McCartney during the Second Reading of the Consumers, Estate Agents and Redress Bill. Hansard (HC), vol. 458(63) col. 589, 19 March 2007, available at <http://www.publications.parliament.uk/pa/cm200607/cmhansrd/cm070319/debtext/70319-0005.htm#0703201000105> (last visited 22 June 2007).

⁸ *Review of the Regulation of Social Housing* led by Professor Martin Cave: see <http://www.communities.gov.uk/index.asp?id=1509497>. A more general review of social housing policy, by Professor John Hills, was published on 20 February 2007: see *Ends and Means: The Future Roles of Social Housing in England*, available at <http://sticerd.lse.ac.uk/dps/case/cr/CASereport34.pdf> (last visited 22 June 2007).

⁹ See note 7, above. The details of this are not yet clear; but as the announcement was made in the context of the Consumers, Estates Agents and Redress Bill, it is possible it will embrace issues relating to the regulation of letting agents.

- (1) provision of information about the letting contract;
- (2) tenancy deposits;
- (3) occupier compliance with the agreement;
- (4) anti-social behaviour;
- (5) repair and maintenance of the property; and
- (6) harassment and unlawful eviction.

1.21 For the purpose of this paper, we have decided to focus on (5) and (6). The reason for this is that these are both issues which lie at the heart of responsible management of rented property. If a new approach to regulation is to be justifiable, it must work in relation to both, and, most particularly in relation to housing conditions. That is not to say that, if a new regulatory scheme should be implemented, it could not be expanded to deal with other issues as well.

1.22 There are specific reasons why issues (1) to (4) are of less central importance at this time.

Provision of information about the letting contract

1.23 At present, the law relating to the provision of information about the letting contract is very weak and fragmented. However, this was a central issue in our Renting Homes report. There would be no point revisiting an issue on which we have so recently reported and on which we have yet to receive a final response from Government.¹⁰

Tenancy deposits

1.24 The Government legislated on tenancy deposits in the Housing Act 2004. There is little practical likelihood of their making significant changes to the scheme that has only recently reached the statute book. While people may have views on the scheme which has been enacted, it could not be a central priority for this project.

Occupier compliance with the agreement

1.25 Undoubtedly major problems in the relationship between landlord and occupier can arise from the occupier's non-compliance, particularly if the occupier seriously damages the premises or refuses to pay the rent. However, the landlord always has the ultimate sanction of being able to regain possession of the premises and to bring the contract to an end, albeit that this process can take time and involve some expense. Our Housing Disputes project is addressing many of those questions. For this reason we do not propose here to consider the issue of encouraging occupier compliance with the agreement.

¹⁰ See also the National Consumer Council's *A Consumer Audit of Social Housing* (2006), available at <http://www.ncc.org.uk/protectingconsumers/social-housing.pdf> (last visited 22 June 2007).

Anti-social behaviour

- 1.26 Anti-social behaviour has become a key issue for Government over the last few years. There has been much legislative change and there are proposals for more changes in the near future. With the formation of the Government's Respect agenda and the publication of the Respect Action Plan to push forward that agenda, there is no sign that this trend will abate.¹¹ We do not intend to add to this volume of legislation. Given the rapid development of the law in this area, and its highly political significance, it is not currently a suitable issue for work by the Law Commission.
- 1.27 Our approach to this project is that we do not wish to add more legal obligations, but rather that we wish to encourage better compliance with existing ones. Even so, if proposals for encouraging better management in the private rented sector are taken forward, this could have an impact in reducing anti-social behaviour.
- 1.28 For example, codes of practice could set out the responsibilities of landlords for tackling anti-social behaviour by tenants. This would not create new law, but would make landlords more aware of the current law regarding anti-social behaviour of tenants.

CONSULTATION ISSUES

- 1.29 The issues we would like respondents to consider are brought together in Part 10.
- 1.30 In this Part we set out our reasons for limiting the scope of the project to the private rented sector. We also set out our reasons for focussing on housing management issues, in particular relating to housing conditions and to a lesser degree unlawful eviction and harassment. Do you agree with the approach we have adopted? Are we right to concentrate on housing conditions, harassment and unlawful eviction? If not, what should we deal with in addition to, or instead of, these two issues, and why?

SUPPLEMENTARY PAPERS

- 1.31 Two supplementary papers supporting this consultation paper are being published on our website. Supplementary Paper 1 gives a more detailed explanation of the law on housing conditions and harassment and unlawful eviction than we have attempted in the main paper. Supplementary Paper 2 deals, again in more detail than we can in this paper, with the estimating of the costs of improving housing condition.¹²

¹¹ The Respect Action Plan states, amongst other proposals, that the Government will consult on a possible new power to allow the closure of any residential premises for a set period, regardless of tenure, which is causing significant, persistent and serious nuisance to local communities (Respect Task Force, *Respect Action Plan* (January 2006), p 33 available at http://www.respect.gov.uk/uploadedFiles/Members_site/Articles/About_Respect/respect_action_plan.pdf, (last visited 22 June 2007).

¹² These papers are available at http://www.lawcom.gov.uk/housing_renting.htm.

RESPONDING TO THIS PAPER

- 1.32 We are asking for responses by 12 October 2007. We are usually able to allow respondents some leeway in enforcing deadlines for consultation responses. In the case of this project, however, we are faced with a very tight schedule to produce a final report. We will not be able, therefore, to take into account responses received after the date set.

ACKNOWLEDGEMENTS

- 1.33 In preparing this paper we have already received substantial help from a number of people. We acknowledge and are most grateful for their assistance, which has been willingly and freely given to us. This acknowledgement does not, of course, imply that they agree with the proposals we advance here. The names of those who have helped us in this way are set out in Appendix 1.

PART 2

THE PRIVATE RENTED SECTOR TODAY

BACKGROUND

- 2.1 We start the discussion by considering the state of the private rented sector today. In 1910, around nine out of ten households rented from private landlords. By 1992, the figure was less than one in ten. Since then, the sector has expanded. It now houses some 11% of households. This equates to some 2.33 million dwellings (2004 figures for England).¹ In Wales and Scotland, the percentage figures are somewhat lower: there the sector accounts for, respectively, 8.9% and 7.5% of dwellings.²
- 2.2 The expansion of the private rented sector followed the introduction of assured shorthold tenancies in 1989, supported in the 1990s by the development of the buy-to-let mortgage market. By 2003/04 more than 63% of private lettings were assured shorthold tenancies.
- 2.3 During the period between 1993/94 and 2003/04, regulated Rent Act tenancies declined from 19% to 6% of the sector. Those with the most limited security – often living with a resident landlord on the basis of a licence – accounted for about 7% of the sector in 2003/04.³

FEATURES OF THE PRIVATE RENTED SECTOR

Local and regional variations in the provision of accommodation through the private rented sector

- 2.4 The number of privately rented dwellings differs markedly in different areas. For example, in London 17% of households rent privately. In each of the other English regions, the percentage is around 11%. But closer analysis of the data shows that, at the sub-regional level, there are wide variations; ten percent of local areas account for nearly a third of all private tenancies.⁴

Varied functions of the private rented sector

- 2.5 The private rented sector performs a variety of functions in the housing market:

¹ ODPM, *English House Condition Survey 2004 Annual Report* (2006), summary statistics table A, p 31, available at http://www.communities.gov.uk/pub/429/EnglishHouseConditionSurvey2004AnnualReport_id1502429.pdf (last visited 22 June 2007).

² S Wilcox, *UK Housing Review 2005/2006* (2005), table 17, available at <http://www.ukhousingreview.org.uk/> (last visited 22 June 2007).

³ S Wilcox, *UK Housing Review 2005/2006* (2005), table 54a, available at <http://www.ukhousingreview.org.uk/> (last visited 22 June 2007).

⁴ ODPM, *English House Condition Survey 2001: Private Landlords Survey* (2003), available at http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

- (1) It provides *easily accessible* accommodation for households who move frequently and those who have to move quickly.⁵
- (2) It provides housing during transitional periods in people's life cycles, for example housing for newly forming households and for those saving money in order to enter owner occupation. In many cases, accommodation or facilities are shared with others.⁶
- (3) It also continues to provide *lifetime housing*, particularly for older tenants whose properties are still rent protected under the Rent Act 1977, though the numbers in this group are declining.
- (4) Some employers provide *tied housing*. This was a significant component of the sector during the nineteenth century. It is less important today, although at the upper end of the market there are employers managing quality properties used, for example, by their highly mobile executives.
- (5) There are places where the private rented sector offers an *escape from social housing*. For some, the experience of living on some social housing estates can be extremely negative, and households can encounter discrimination on the basis of residence or postcode. In this context, some households prefer to rent privately in a non-stigmatised neighbourhood than access properties in the social sector at a lower rent.

2.6 The private rented sector plays also a significant role in the provision of accommodation for people in social need, who for different reasons cannot be accommodated, in the social rented sector.

- (1) In some areas, the private rented sector takes a *residual* role, accommodating households whose low incomes preclude entry into owner occupation and those, such as many single people, who are not accorded the priority under allocations policies needed to secure a social rented tenancy.
- (2) A more recent phenomenon is the use of the private rented sector to provide accommodation for those excluded from social housing, typically for persistent rent arrears or anti-social behaviour.
- (3) In some areas, local authorities make significant use of the private rented sector to provide housing for the homeless. The private rented sector is used also for those seeking asylum in this country.

⁵ This mobility is shown by the fact that in 2003/04, 41% of tenants had moved into their property within the last 12 months: see ODP, *English House Condition Survey 2003: Private Landlords Survey* (2006) http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

⁶ One specific form of such accommodation is houses in multiple occupation (HMOs). HMOs can take a number of forms – such as bedsits and shared houses – and they play an important role in the private rented sector. While it is difficult to assess how many HMOs are currently in operation, it was estimated that in England in 1996 there were 550,000 households living in 450,000 HMOs. DETR, *Houses in Multiple Occupation in the Private Rented Sector* (1999), available at <http://www.communities.gov.uk/index.asp?id=1155303> (last visited 22 June 2007).

Landlords

- 2.7 The supply side of the private rented sector is dominated by small scale and part-time landlords. In 2003 private individuals owned some 67% of private rented dwellings in England. It is estimated that there are 700,000 private landlords in England. The median number of lettings per landlord was between two and four in 2003, and 33% of landlords owned only one property.⁷
- 2.8 Landlords seek returns on their investment through a stream of revenue and/or capital growth. The sector is characterised by landlords who adopt different time horizons when thinking about their return on investment: some focus upon short term income maximisation, while a minority are looking for capital growth (for example to make provision for their retirement) and do not emphasise the income from rent. Research has demonstrated that landlords differ in the degree to which they can be considered “economically rational”. This matters when seeking to address questions such as who undertakes repairs.⁸
- 2.9 It is not easy to classify this large and disparate group. One classification used to provide empirical estimates of the profile of private landlords is by Crook and colleagues,⁹ who identify four types of landlord:
- (1) *business landlords*, who derive most of their income from renting and also view property as a long-term investment. The 2001 English Housing Condition Survey estimated that 15% of landlords fall into this category¹⁰;
 - (2) *sideline investor landlords*, who view property as an investment but derive a minority of their income from it. The 2001 English Housing Condition Survey estimated that 45% of landlords fell into this group;
 - (3) *sideline non-investor landlords*, who do not see their property as an investment and do not derive the majority of their income from it. The 2001 English Housing Condition Survey estimated that 18% of landlords were in this group; and

⁷ ODPM *English House Condition Survey 2003: Private Landlords Survey* (2006), table 3 http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

⁸ ADH Crook, J Henneberry, J Hughes and P Kemp, *Repairs and Maintenance by Private Landlords*, (2000); ADH Crook and JET Hughes “Market Signals and Disrepair in Privately Rented Housing”, *Journal of Property Research* (2001).

⁹ ADH Crook, J Henneberry, J Hughes and P Kemp, *Repairs and Maintenance by Private Landlords* (2000).

¹⁰ ODPM, *English House Condition Survey 2001: Private Landlords Survey* (2003), table 9 http://www.communities.gov.uk/pub/285/2001EnglishHouseConditionSurveyPrivatelandlordssurveyPDF300Kb_id1155285.pdf (last visited 22 June 2007).

- (4) *institutional landlords*, which encompasses corporate organisations that own property but not primarily with an investment motive, and which derive only a minority of their income from renting. The 2001 English Housing Condition Survey estimated that 22% of landlords were in this group.¹¹
- 2.10 A fifth of private rented dwellings have been acquired by the landlord since 1999. In 2003 some 16% of properties were owned by landlords who had been in the sector for two years or less. Around nine out of ten of these new landlords are private individuals. They tend to let newer properties that are in better condition than those already in the sector.¹²
- 2.11 A major influence in encouraging entry into the sector has been the development of the buy-to-let mortgage market. In the period from the end of 1999 to the end of 2005 the number of outstanding buy-to-let mortgages increased by 673,200 to 701,900, with the value of outstanding mortgages at the end of 2004 being in excess of £73 billion.¹³ However, overall, only a third of properties in the sector have an outstanding loan or mortgage attached to them.¹⁴
- 2.12 Most landlords are landlords by choice, although some acquire rented property inadvertently, for example through inheritance. Almost a third of the properties in the sector were not originally acquired for letting. Nearly one in five privately rented dwellings were once the landlords' own residence. 10% of dwellings are owned by landlords who expect that either they or their relatives will reside in them in future.¹⁵ Some people become resident landlords on a temporary and informal basis, such as when they accommodate friends in their own home.

¹¹ P Kemp, *Private Renting in Transition* (2005) pp 103-110, has offered a more recent, and more fine-grained, classification. Kemp distinguishes the following landlord types, each with a different motivation for being involved in the sector: stewardship, employer, informal, investor, commercial, financial institutions, property dealers, and property slump landlords. This gives an indication of the variety of actors supplying rented housing. There are, however, as yet no empirical estimates based upon this typology.

¹² ODPM, *English House Condition Survey 2003: Private Landlords Survey* (2006), tables 5 and 10
http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

¹³ Council of Mortgage Lenders, *Buy-to-let Mortgages, Market Summary*,
<http://www.cml.org.uk/cml/statistics> (last visited 22 June 2007).

¹⁴ ODPM, *English House Condition Survey 2003: Private Landlords Survey* (2006), p 3
http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

¹⁵ ODPM, *English House Condition Survey 2003: Private Landlords Survey* (2006), table 13 and p 3
http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

- 2.13 Although there are organisations that represent the interests of landlords and attempt to improve standards of management through codes of practice and other guidance,¹⁶ the vast majority of private landlords are not members of any representative body.¹⁷ Many individual landlords enter the market with only a limited understanding of their rights and obligations. In some cases, they lack the skills to identify and deal appropriately with issues when they arise.¹⁸

Agents

- 2.14 While the majority of private rented properties are owned by individuals, about half of all lettings in England are managed by residential letting agents.¹⁹ It is estimated that 12,000 such agents are currently operating. The services they offer vary from simply advertising properties and identifying tenants to providing a full management service. The letting agent sector has its own professional membership bodies, to which a substantial minority of agents belong.²⁰

Tenants

- 2.15 Private renting is a predominantly a tenure of the young.²¹ Indeed, the concentration of younger people in private renting has increased over the last decade. This may be in part a result of the rise in house prices leading to difficulties in accessing owner occupation.

¹⁶ For example the National Landlords Association (which has around 11,000 members), Residential Landlords Association and National Federation of Residential Landlords (which has around 14,000 members) all have codes of practice.

¹⁷ The best estimate we have suggests that only 2.2% of the 700,000 landlords in England and Wales belong to a professional association.

¹⁸ Surveys have shown, for example, that some landlords and agents do not appear well-equipped to identify problems such as disrepair and unfitness and that a substantial minority of landlords – particularly individuals and those new to the sector – feel that more information should be available about their obligations. On disrepair: ODPM, *English House Condition Survey 2001: Private Landlords Survey* (2003), p 28; on information: ODPM *English House Condition Survey 2003: Private Landlords Survey* (2006), tables 22 and 23
http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

¹⁹ ODPM, *English House Condition Survey 2001: Private Landlords Survey* (2003), table 15
http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

²⁰ For example, the Association of Residential Letting Agents (ARLA); National Association of Estate Agents (NAEA); and UK Association of Letting Agents (UKALA).

²¹ See DCLG/ONS *Housing in England 2004/05 A Report Principally From the 2004/05 Survey of English Housing* (October 2006), p 18, table 1.3 which showed that in 2005 51% of survey respondents aged 18 to 24 rented privately, as compared with 25% of those aged 25 to 34
http://www.communities.gov.uk/pub/870/HousinginEngland200405Areportprincipallyfromthe200405SurveyofEnglishHousing_id1503870.pdf (last visited 22 June 2007).

- 2.16 Two thirds of those in private rented housing are economically active, working either full- or part-time. This is a similar proportion to those in owner-occupation but double the proportion in social (council or housing association rented) housing. Retired households account for a relatively small proportion of the sector (11%). Some 31% of households renting privately in 2005 had no member in employment, compared with 68% of households in social rented housing.²² 17% of private tenants were not working, were retired or unemployed, or were otherwise economically inactive: for example, full-time students, the permanently sick/disabled, homemakers and carers.²³
- 2.17 Minority ethnic households are more likely to be living in private rented housing than white households. While 10% of white household reference persons²⁴ rent privately, 21% of those from minority communities live in the sector. All minority communities are over-represented in private renting, with the exception of those of Black/Caribbean origin (9%).²⁵

²² DCLG/ONS *Housing in England 2004/05 A report Principally From the 2004/05 Survey of English Housing* (October 2006), p 22, table 1.5, available at http://www.communities.gov.uk/pub/870/HousinginEngland200405Areportprincipallyfromthe200405SurveyofEnglishHousing_id1503870.pdf (last visited 22 June 2007).

²³ DCLG/ONS *Housing in England 2004/05 A Report Principally From the 2004/05 Survey of English Housing* (October 2006), p 22, table 1.5 and Appendix A, p 5, available at http://www.communities.gov.uk/pub/870/HousinginEngland200405Areportprincipallyfromthe200405SurveyofEnglishHousing_id1503870.pdf (last visited 22 June 2007).

²⁴ The “household reference person” is the concept which has replaced that of “head of household” in housing statistics. Unlike the old concept, it does not give automatic priority to male partners: see DCLG/ONS *Housing in England 2004/05 A Report Principally From the 2004/05 Survey of English Housing* (October 2006), Appendix A, p 5, available at http://www.communities.gov.uk/pub/870/HousinginEngland200405Areportprincipallyfromthe200405SurveyofEnglishHousing_id1503870.pdf (last visited 22 June 2007).

²⁵ DCLG/ONS *Housing in England 2004/05 A Report Principally From the 2004/05 Survey of English Housing* (October 2006), p 37, table 1.16, available at http://www.communities.gov.uk/pub/870/HousinginEngland200405Areportprincipallyfromthe200405SurveyofEnglishHousing_id1503870.pdf (last visited 22 June 2007).

- 2.18 In 2005, 9% of private renters and 10% of social renters had a gross income, including that of any partner, of less than £5,000 a year. For those with a gross income of less than £15,000 a year, 44% were in the private rented sector, compared with 27% of owner occupiers and 73% of those in social housing. While only 6% of those living in social housing had an income of more than £30,000 per annum, a quarter of those renting privately did. This includes the 8% of private renters with an income above £50,000. The income profile of private renters is therefore significantly different from that of social renters: while the private rented sector houses a similar proportion of the very poorest (the young or those in low paid employment), poverty is not nearly as concentrated. Indeed parts of the private rented sector accommodate the wealthiest.²⁶ In 2005, 21% of private tenants (442,000) received housing benefit, as compared with 60% of social renting tenants.²⁷

Return on investment in different sectors of the housing market

- 2.19 The rates of return available to landlords, and their source in either capital growth or revenue, differ between different sectors of the market. Gross and net rates of return tend to be highest in poorer quality sectors of the market.²⁸ In some market sectors the rate of return available to landlords compares well with that available on other investments, whilst in others low rates of return render private renting an economically marginal activity.²⁹

²⁶ DCLG/ONS *Housing in England 2004/05 A Report Principally From the 2004/05 Survey of English Housing* (October 2006), p 88, available at http://www.communities.gov.uk/pub/870/HousinginEngland200405Areportprincipallyfromthe200405SurveyofEnglishHousing_id1503870.pdf (last visited 22 June 2007).

²⁷ DCLG/ONS *Housing in England 2004/05 A Report Principally From the 2004/05 Survey of English Housing* (October 2006), available at http://www.communities.gov.uk/pub/870/HousinginEngland200405Areportprincipallyfromthe200405SurveyofEnglishHousing_id1503870.pdf (last visited 22 June 2007).

²⁸ A Crook, "Housing Conditions in the Private Rented Sector Within a Market Framework" in S Lowe and D Hughes (ed) *The Private Rented Sector in a New Century* (2002), p 169. Net rates of return are from rental income, while gross include capital value increases as well as income returns: see A Crook "Private Renting in the 21st Century" in S Lowe and D Hughes (eds) *The Private Rented Sector in a New Century* (2002), p 27. It is unclear what if any deductions have been made in arriving at "net" figures.

²⁹ D Rhodes and P Kemp "Rents and Returns in the Residential Lettings Market" in S Lowe and D Hughes (eds) *The Private Rented Sector in a New Century* (2002), p 51.

- 2.20 Landlords renting to households which receive housing benefit also have to take account of additional administrative considerations such as the level of local reference rents.³⁰ If housing benefit does not cover a higher rent, they may choose to hold down the rent, which constrains the rate of return that is achievable. Some local markets experience what has been identified as the “central dilemma” of private renting: that the rents required to give landlords an attractive return are higher than those that many of the households seeking accommodation in the sector are able or willing to pay.³¹
- 2.21 Approximately 9% of private rented dwellings in England are located in areas where demand is classified as limited or negligible.³² The profile of landlords (taking into account for example whether they are individuals or companies, the size of their portfolio, or their investment motivation) in markets with low demand and buoyant markets is quite similar. However, in low demand areas there is a higher proportion of full-time landlords and landlords who own more than one property.³³ Letting practices differ between low and high demand areas: those in high demand areas are substantially more likely to require references and a deposit from prospective tenants.³⁴
- 2.22 Concentrations of private renting (that is, a higher than average proportion of the housing stock in the area being private rented as opposed to other tenures) are more likely to be in areas with healthy housing markets but where house prices are not too high.³⁵ Concentrations of private renting are also associated with the existence of larger landlords: companies and other organisations who have built up portfolios of accommodation to let.³⁶

³⁰ The local reference rent is the amount the rent officer determines is generally paid for property with the right number of rooms in the same “locality” to the property for which housing benefit is being claimed. Housing benefit will be paid only for the local reference rent if this is lower than the “claim related rent” based on the actual rent for the property.

³¹ The central dilemma of private renting was identified by the House of Commons Environment Committee, *The Private Rented Sector Vol 1* (1982), p xlii, paras 85 to 88.

³² ODPM, *English House Condition Survey 2003: Private Landlords Survey* (2006), p 4, available at http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

³³ ODPM, *English House Condition Survey 2003: Private Landlords Survey* (2006), p 41, available at http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

³⁴ ODPM, *English House Condition Survey 2003: Private Landlords Survey* (2006), p 42: references were required for 53% of dwellings in areas of low demand, compared with 63% of dwellings in high demand areas. A deposit was required for 54% of lettings in low demand areas, and 71% of lettings in high demand areas: see http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

³⁵ ODPM, *English House Condition Survey 2003: Private Landlords Survey* (2006), p 10, available at http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

³⁶ ODPM, *English House Condition Survey 2003: Private Landlords Survey* (2006), p 4, available at http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007).

COMMENTS

2.23 The following points emerge from the discussion.

- (1) The private rented sector makes a significant contribution to overall housing provision. It provides flexibility and choice. It provides accommodation for those who cannot access social housing. It performs quite different functions in different parts of the country – reflecting local housing pressures and demands.
- (2) Over the last decade, it has increased in size, both as a percentage of the housing market, and more significantly (given the overall increase in the numbers of dwellings) in terms of absolute numbers.
- (3) While growth has been driven by the development of buy-to-let by individual landlords, this has not been matched, save in particular niche sectors of the market such as student accommodation, by build-to-let investments made by larger corporate landlords.
- (4) Rates of return on investment vary markedly in different parts of the private rented sector, as do the approaches to investment by different types of landlord.
- (5) Individual landlords are not typically members of a landlords' association.
- (6) Agents are better organised, but even here a significant number of letting agents are not members of any of the major representative bodies.
- (7) Tenants in the sector are likely to be young and mobile. They tend not to be well informed about their rights and obligations, even if provided with a written contract.³⁷ In any event, many want the accommodation for only a short time, and have little incentive to enter protracted negotiations with their landlord in order to enforce their rights. Some issues, perceived as problematic from a policy perspective (such as structural disrepair), may not worry the tenant if they have a cheap roof over their head. In any event, the lack of statutory security of tenure may discourage tenants from seeking to enforce their rights because of fear of eviction. For the significant minority of private tenants on low incomes, using private law remedies is not a realistic option.

CONSULTATION ISSUES

2.24 This Part sets out information about the private rented sector today. From this we draw certain conclusions about the role of the private rented sector in the housing market. Do consultees accept the broad picture that emerges from our description of the private rented sector? Are there important facts that we have overlooked? Are our conclusions about the nature of the sector justified by the facts?

³⁷ A key problem is that written tenancy agreements are often very unclear or positively misleading about landlords' and tenants' rights and obligations. This is the issue we address in our Renting Homes Report (Law Com No 297), available at http://www.lawcom.gov.uk/docs/lc297_vol1.pdf.

PART 3

THE REGULATORY DEFICIT

INTRODUCTION

- 3.1 As we noted in Part 2, the modern private rented sector is extremely varied in the types of accommodation it provides; in the range of people it accommodates; in the uses made of it; and in the areas of the country where it is provided. With the large numbers of landlords and agents involved in the letting business, it would not be surprising if there were significant variations in standards of housing management. As the data in this Part show, there is a significant problem with rented accommodation that falls below legal standards relating to housing conditions. The fundamental question posed in this paper is whether, and if so how, greater compliance with those standards, and by extension more general improvements of management standards, can be achieved.
- 3.2 The Government thinks that dealing with “problem” private rented housing is an issue that needs research.¹ The result of the research emphasises that compliance cannot be achieved solely by prosecution. Achieving enforcement through prosecution can reduce levels of trust between the local authority and the landlord community leading to greater compliance difficulties for the future.
- 3.3 Rather a “mix of supportive and enforcement activities” involving all stakeholders is needed to build trust and obtain successful solutions in the longer term.

Local authorities need to employ a mix of intervention strategies, designed to co-opt some stakeholders and coerce others, and to review regularly the balance of their interventions.²

This was best secured through collaboration and co-operation with both public and private actors.

- 3.4 Approaches that begin with encouragement and education were found to be more effective and to lessen the need for enforcement over time. The research identified that legal action should be used sparingly for this reason. The possibility of enforcement through this route remains necessary for those who refuse to co-operate. This consultation paper may be seen as building on and expanding the thinking underpinning that work.

¹ See CLG, *Dealing with ‘Problem’ Private Rented Housing, Housing Research Summary 228* (2006) http://www.communities.gov.uk/pub/869/228DealingwithProblemPrivateRentedHousing_id1501869.pdf. (last visited 22 June 2007).

² Above, p 10.

HOUSING MANAGEMENT: THE ESSENTIALS

- 3.5 The nature and scope of housing management cannot be defined with absolute precision. But there are enough guides to housing management for us to identify a central core of issues, which go to the heart of good housing management. Drawing on one of the most comprehensive and recently published guides,³ housing management embraces:
- (1) pre-tenancy issues, including who should manage the property, getting relevant permissions, dealing with tax and insurance;
 - (2) understanding the legal responsibilities of the landlord/agent for repairs and maintenance, ensuring the safety of gas and other fittings and (where provided) furniture, and knowing the particular rules relating to houses in multiple occupation;
 - (3) setting up the tenancy, including deciding which type of tenancy agreement to use, providing a written agreement, dealing with deposits, setting and raising the rent, and, where relevant, understanding housing benefit;
 - (4) keeping an eye on the premises, knowing how to deal with emergencies, preventing and controlling rent arrears, responding to nuisance and anti-social behaviour, and understanding different ways to resolve landlord-tenant relationship problems (going to court, using mediation, going to tribunals); and
 - (5) ending the tenancy, including taking possession proceedings and not engaging in unlawful eviction and harassment.
- 3.6 Although not all these involve the law, it can be seen that legal issues are central to a significant number of core housing management functions.
- 3.7 Our Renting Homes report⁴ has, to a large extent, dealt with issues arising under item (3) and many of the issues in item (5); our Housing Disputes project is examining issues in item (4). As explained in Part 1,⁵ here we consider issues relating to item (2) and specific issues in item (5), namely housing conditions and unlawful eviction and harassment.

³ Accreditation Network UK and the Improvement and Development Agency, *Landlord Development Manual* (2006): see <http://www.lacors.gov.uk/lacors/upload/12271.pdf> (last visited 22 June 2007). Another example of such a guide is the "Good Landlord Guide" produced by the Housing Advice Unit, Cardiff Council.

⁴ Renting Homes: The Final Report (2006) Law Com No 297 available at http://www.lawcom.gov.uk/docs/lc297_vol1.pdf.

⁵ Paras 1.20 to 1.22.

HOUSING CONDITION: THE LAW

- 3.8 For the purpose of the argument here, we focus on the two legal issues which essentially define landlords' management responsibilities in this area: section 11 of the Landlord and Tenant Act 1985 and the new Housing Health and Safety Rating System introduced in Part 1 of the Housing Act 2004.⁶

Landlord and Tenant Act 1985, section 11

- 3.9 Section 11 of the Landlord and Tenant Act 1985 implies a covenant into all leases of a dwelling house for less than seven years.⁷ Landlords must keep in repair⁸ the structure and exterior of the dwelling house (including drains, gutters and external pipes) and keep in repair and in proper working order the installations in the house for the provision of water, heating, electricity, gas and sanitation (including basins, sinks, baths and sanitary conveniences but not other fixtures, fittings and appliances for making use of the supply of water, gas or electricity).⁹ It is not possible to contract out of section 11: attempts to do so are void.¹⁰
- 3.10 At first glance, the terms of the covenant may appear strict and somewhat complex. But they are not in reality very demanding. They provide essentially that accommodation should be weatherproof and safe.¹¹
- 3.11 Even these obligations are limited in several important ways:
- (1) The landlord need not repair anything which the tenant must repair under the tenant's common law duty to use the premises in a "tenant-like manner"; or which the tenant can remove at the end of the lease.¹²

⁶ In *Supplementary Paper 1: The Law on Housing Conditions and Unlawful Eviction*, we set out a fuller summary of the law, available at http://www.lawcom.gov.uk/housing_renting.htm.

⁷ Landlord and Tenant Act 1985, ss 13 and 14. The provisions were first introduced in 1961. The reasons given for their introduction were to relieve weekly tenants of the onerous burden of repairing covenants, and to further the public interest in maintaining the stock of housing by putting the burden on landlords: Hansard (HC), vol 637, cols 974-975. They were introduced at a time when the Government was actively engaged in reducing rent control.

⁸ The present law does not require landlords to let premises that are in repair at the start of the letting; we recommended in *Renting Homes* (building on recommendations we made in *Landlord and Tenant: Responsibility for State and Condition of Property* (1996) Law Com No 238, available at <http://www.bailii.org/ew/other/EWLC/1996/238.pdf> (last visited 22 June 2007)) that landlords should ensure that there are no category 1 hazards present in the premises when the premises are rented: see *Renting Homes: The Final Report* (2006) Law Com No 297 para 8.7 at http://www.lawcom.gov.uk/docs/lc297_vol1.pdf.

⁹ Landlord and Tenant Act 1985, ss 11(1)(a) to (c). For leases granted after 15 January 1989 in respect of only part of a building, similar repairing obligations are imposed relating to other parts of the building or installations owned or controlled by the landlord, and which serve and affect the tenant's enjoyment of the part let: ss 11(1A) and (1B).

¹⁰ Landlord and Tenant Act 1985, s 12(1). It is possible for a landlord to obtain an order from the county court to exclude or modify the obligations imposed on landlords (s 12(2)).

¹¹ They are broadly analogous to the fundamental principle of consumer law, that goods should be of satisfactory quality: see *Sale of Goods Act 1979*, s 14(2).

¹² Landlord and Tenant Act 1985, ss 11(2)(a) and (c).

- (2) The implied covenant only applies to matters where there is lack of repair. A common problem is condensation arising from design defects, rather than lack of repair. These are outside the scope of the repairing covenant.¹³
- (3) The landlord need not rebuild or reinstate the premises if damaged or destroyed by fire, tempest, flood or other “inevitable accident”.¹⁴
- (4) The standard of repair required is tempered by the age, character and prospective life of the dwelling and the locality in which it is situated.¹⁵
- (5) Where the premises form only part of a building, the landlord need not carry out repairs if the landlord has insufficient rights over the other parts of the building to carry these out and has reasonably tried but failed to obtain those rights.¹⁶
- (6) Landlords need carry out their section 11 repairing obligations only when they have received actual notice of the disrepair, for example from the tenant, a third party (such as an environmental health officer) or by inspecting the premises.¹⁷ (No notice is required if the disrepair occurs in a part of the premises retained by the landlord.¹⁸)
- (7) Having received notice of the disrepair landlords have a reasonable time to carry out the necessary work. (The Office of Fair Trading considers unfair any term purporting to allow delay.¹⁹)

¹³ *Quick v Taff Ely Borough Council* [1986] QB 809.

¹⁴ Landlord and Tenant Act 1985, s 11(2)(b).

¹⁵ Landlord and Tenant Act 1985, s 11(3). The “prospective life of the dwelling” was considered by the Court of Appeal in *London Borough of Newham v Patel* (1978) 13 HLR 77. See also *Anstruther-Gough-Calthorpe v McOscar* [1924] 1 KB 716, *Wainwright v Leeds City Council* (1984) 13 HLR 117.

¹⁶ Landlord and Tenant Act 1985, s 11(3A).

¹⁷ *McGreal v Wake* (1984) 13 HLR 107.

¹⁸ *Melles & Co v Holme* [1918] 2 KB 100.

¹⁹ OFT, *Guidance on Unfair Terms in Tenancy Agreements* (2005) OFT356, para 3.29, available at http://www.offt.gov.uk/shared_offt/reports/unfair_contract_terms/oft356.pdf (last visited 22 June 2007). The Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999 No 2083) protect consumers against unfair standard terms in contracts they make with suppliers, including tenancy agreements, made after 1 July 1995. The OFT, together with trading standards and certain other bodies, can take legal action to prevent the use of potentially unfair terms.

- 3.12 Should the landlord fail to perform the landlord's repairing obligations, the legal remedy is an action for breach of contract. The housing disrepair pre-action protocol now regulates the timing and content of notices a tenant should send to the landlord before starting legal proceedings.²⁰ Damages for breach of section 11 obligations are designed to put tenants in the position they would have been in had the landlord carried out his or her repairing obligations.²¹ Tenants can also seek an order for specific performance of the landlord's section 11 repairing obligations.²²

Housing Health and Safety Rating System: Housing Act 2004

- 3.13 For years, successive Housing Acts contained rules relating to fitness for human habitation, and provided mechanisms for dealing with premises found not to be fit.²³ In a fundamental shift of approach, fitness for habitation is now judged according to the Housing Health and Safety Rating System introduced by Part 1 of the Housing Act 2004.²⁴ The legislation has been supplemented by operating guidance on the system issued by the Government.²⁵

²⁰ The housing disrepair pre-action protocol can be found on the Department for Constitutional Affairs website at http://www.dca.gov.uk/civil/procrules_fin/contents/protocols/prot_hou.htm (last visited 22 June 2007).

²¹ Encyclopaedia of Housing Law and Practice, para 1-2326.1. This includes the cost of alternative accommodation if the disrepair made the premises uninhabitable, redecorating costs, and compensation for loss of comfort and inconvenience.

²² Landlord and Tenant Act 1985, s 17.

²³ See for example D Hughes, M Davis, V Matthew, A Jones, *Text and Materials on Housing Law* (2005), pp 539 to 541.

²⁴ In force in England on 6 April 2006, and in Wales on 16 June 2006: Housing Act 2004 (Commencement No 5 and Transitional Provisions and Savings) (England) Order 2006 (SI 2006 No 1060); Housing Act 2004 (Commencement No 3 and Transitional Provisions and Savings) (Wales) Order 2006 (SI 2006 No 1535).

²⁵ ODPM, *Housing Health and Safety Rating System: Operating Guidance* (2006) available at http://www.communities.gov.uk/pub/843/HHSRSOperatingGuidancePDF914Kb_id1161843.pdf (last visited 22 June 2007); Welsh Assembly Government, *Housing Health And Safety Rating System: Operating Guidance (Housing Act 2004: Part 1) (English Only)* (2006 No. 45) available at <http://newydd.cymru.gov.uk/660245/660256/660274/housing/hhsrsperatingguidance?lang=en> (last visited 22 June 2007).

- 3.14 The new system involves assessing individual elements of dwellings (such as staircases, doors) for 29 types of hazard (such as cold, dampness, structural collapse, overcrowding), against an ideal, to see if they are worse than average for the property of that age and type.²⁶ If so, the likelihood of the hazard, and the severity of harm it could cause to the most vulnerable potential occupier,²⁷ are considered, and a score for the hazard calculated. This score determines whether the hazard is “category 1” or “category 2”.²⁸
- 3.15 Local authorities must review housing conditions in their area.²⁹ Inspections of premises for hazards may follow a review, or if the local authority thinks it is appropriate for any other reason, such as a complaint from a tenant or a member of the public, or on a complaint made in writing from a justice of the peace.³⁰
- 3.16 Local authorities *must* take appropriate enforcement action if they consider that any residential premises contain a category 1 hazard,³¹ and *can* (but need not) if there is a category 2 hazard.³² Enforcement actions available are:
- (1) improvement notices (requiring remedial work);
 - (2) prohibition orders;
 - (3) hazard awareness notices.
- 3.17 In relation to category 1 hazards only, four further remedies are available:
- (1) emergency remedial action;
 - (2) emergency prohibition orders;
 - (3) demolition orders; and

²⁶ ODPM, *Housing Health and Safety Rating System: Operating Guidance* (2006) Annex D and para 2.18, available at http://www.communities.gov.uk/pub/843/HHSRSOperatingGuidancePDF914Kb_id1161843.pdf (last visited 22 June 2007); Welsh Assembly Government, *Housing Health And Safety Rating System: Operating Guidance (Housing Act 2004: Part 1) (English Only)* (2006 No. 45), Annex D and para 2.18, available at <http://newydd.cymru.gov.uk/660245/660256/660274/housing/hhsrspperatingguidance?lang=en> (last visited 22 June 2007).

²⁷ ODPM, *Housing Health and Safety Rating System: Operating Guidance* (2006) paras 4.14 and 4.16, available at http://www.communities.gov.uk/pub/843/HHSRSOperatingGuidancePDF914Kb_id1161843.pdf (last visited 22 June 2007). Welsh Assembly Government, *Housing Health And Safety Rating System: Operating Guidance (Housing Act 2004: Part 1) (English Only)* (2006 No. 45), paras 4.14 and 4.16. A hazard from cold must be always rated even if it is the national average, available at <http://newydd.cymru.gov.uk/660245/660256/660274/housing/hhsrspperatingguidance?lang=en> (last visited 22 June 2007).

²⁸ Housing Health and Safety Rating System (England) Regulations 2005 (SI 2005 No 3208), reg 8; Housing Health and Safety Rating System (Wales) Regulations 2006 (SI 2006 No 1702) (W 164), reg 8.

²⁹ Housing Act 2004, s 3.

³⁰ Housing Act 2004, ss 4(1), (2) and (3).

³¹ Housing Act 2005, s 5.

³² Housing Act 2004, s 7.

(4) declaration of a clearance area.³³

It is an offence not to comply with an improvement notice or prohibition order.³⁴

- 3.18 The person who must receive any improvement notice varies, depending on the type of accommodation and whether or not it is the subject of a licence.³⁵ Where a landlord does not comply with an improvement notice, or where there is a category 1 hazard and an imminent risk of serious harm to health and safety, the local authority can undertake remedial action,³⁶ and recover its expenses.³⁷

Comment

- 3.19 It is often assumed that the two sets of provisions relating to, respectively, the implied covenant to repair and health and safety hazards, are seeking to define rather different standards. Many, including those involved in housing, assume that they represent a hierarchy – “fitness”, now the Housing Health and Safety Rating System, representing a basic absolute minimum standard, with the section 11 covenant giving tenants rights to a higher standard of physical wellbeing. In fact, they are broadly seeking to achieve the same objective – namely that rented housing should be safe and weatherproof. If anything, potentially higher standards are imposed by the Housing Health and Safety Rating System than section 11, though, for the individual case, that conclusion does depend on the risk assessment.³⁸
- 3.20 The principal difference between section 11 and the Housing Health and Safety Rating System lies in the mode of enforcement. Section 11 requires the occupier to take legal proceedings directly against the landlord. Enforcement of the Housing Health and Safety Rating System is by local authorities. Both of these are highly problematic. Legal proceedings are costly and stressful and may not be wise where an occupier has limited security of tenure or is only wanting to live there for a relatively short time. Local authorities have significant constraints on manpower. Many local authorities do not regard intervention in the private rented sector as their highest priority.

³³ Housing Act 2004, ss 5(2) and 7(2). Demolition and clearance area declarations are contemplated by ss 5(2)(f) and (g) and 7(2)(d) and (e), and would require the Secretary of State to prescribe conditions first. There are no current plans to make the more drastic enforcement measures available to tackle category 2 hazards.

³⁴ Housing Act 2004, ss 30 and 32. Failure to comply could lead to a £5,000 fine on summary conviction.

³⁵ Housing Act 2004, sch 1. For a licensed HMO, the notice must be served on the licence holder: see para 1.

³⁶ Housing Act 2004, s 40 and sch 3 part 2.

³⁷ Housing Act 2004, s 42 and sch 3 part 3.

³⁸ It is clear that more *forms* of housing problem linked to the building are covered by HHSRS than by s 11, since HHSRS focuses on the effect on the occupiers, rather than being solely concerned with the physical fabric of the building. It may be that some forms of disrepair which might, arguably, be actionable under s 11 are not covered by HHSRS – but these relate to situations where the disrepair has not (yet) occasioned any discomfort to the occupants, such as “sick nails” in roofs, or poor pointing, which will in time lead to leaks and other problems. In practice, we strongly doubt whether s 11 is much used in advance of actual discomfort becoming apparent. It could, therefore, reasonably be held that as a *standard*, the HHSRS absorbs s 11.

HOUSING CONDITION SURVEY DATA

3.21 The lack of compliance with the standards is shown in housing condition survey data. Despite the wide variations in the private rented sector in different regions and areas of the country, the data show that, when comparing the quality of accommodation in the sector with owner-occupied accommodation or social rented accommodation, the private rented sector generally comes out worst.³⁹

3.22 For England, the data show:

- (1) *Faults*⁴⁰: in 2004 only 21.5% of private rented dwellings had no faults (compared with 21.9% of local authority, 36.5% of registered social landlord and 32.2% of owner occupied dwellings). 44.4% of private rented dwellings had interior and exterior faults (as compared with 38.1% of local authority, 24.4% of registered social landlord and 28.2% of owner occupied dwellings).⁴¹ While only 8.5% of registered social landlord dwellings, 11.4% of local authority and 13.7% of owner occupied dwellings had structural faults, for private rented dwellings the proportion was 18.4%.⁴²
- (2) *Faults to services and amenities in flats*: although the proportion of flats with faults to services and amenities was highest for council flats (60.0% in 2004), private rented dwellings still scored worse than registered social landlord or owner occupied dwellings (55.7%, as compared with 43.6% and 43.2% respectively).⁴³

³⁹ Evidence in England comes primarily from the English House Condition Survey (EHCS). This includes interviews with occupiers, physical surveys of property and follow up surveys of the landlords owning and agents managing the private rented part of the sample of dwellings included in the EHCS. EHCS data over a number of years has shown that the condition of dwellings in the private rented sector is generally worse than the condition of dwellings in other tenures. The 2004 EHCS examined a number of variables relating to the quality of accommodation: the private rented sector scored relatively badly in all. For more information on the EHCS see the CLG website at <http://www.communities.gov.uk/index.asp?id=1155270> (last visited 22 June 2007).

⁴⁰ A fault is any problem which is not of a purely cosmetic nature and which either represents a health or safety hazard, or threatens further deterioration to the specific element or any other part of the building: CLG, *English House Condition Survey Technical Report (2004 Edition)* (2006) p 94, available at http://www.communities.gov.uk/pub/391/EnglishHouseConditionSurveyTechnicalReport2004Edition_id1505391.pdf (last visited 22 June 2007).

⁴¹ CLG, *English House Condition Survey Table DR1a: Type of Faults*, available at http://www.communities.gov.uk/pub/437/DR1aInteriorandexteriorfaultsbytenure_id1165437.xls (last visited 22 June 2007).

⁴² CLG, *English House Condition Survey Table DR2a: Incidence of Structural Faults by Tenure*, available at http://www.communities.gov.uk/pub/438/DR2aFaultstobuildingstructurebytenure_id1165438.xls (last visited 22 June 2007).

⁴³ CLG, *English House Condition Survey Table DR3a: Incidence of Faults to Services and Amenities by Tenure 2004*: the figures relate to faults relating to the whole plot, including boundary fences and walls. Even if boundary fences and walls are excluded, the private rented sector still does worse than the RSL and owner occupied sectors, but better than the local authority sector. See http://www.communities.gov.uk/pub/439/DR3aFaultstoamenitiesandservicesflatsonlybytenure_id1165439.xls (last visited 22 June 2007).

- (3) *Decent homes standard.* As regards the various components that make up the Government's decent homes standard,⁴⁴ in 2004 14.3% of private rented sector dwellings failed the repair criterion, as compared with 7.2% of owner occupied, 7.9% of local authority and only 4.1% of Registered Social Landlord dwellings.⁴⁵ The proportion of dwellings failing the fitness criterion was much higher than for other sectors: 9.8% of private rented dwellings fail as compared with 3.7% of owner occupied, 5.8% of local authority and 3.5% of Registered Social Landlord dwellings.⁴⁶

⁴⁴ For a dwelling to be considered "decent" it must: meet the statutory minimum standard for housing; be in a reasonable state of repair; have reasonably modern facilities and services; and provide a reasonable degree of thermal comfort: see <http://www.communities.gov.uk/index.asp?id=1152145> for more on decent homes (last visited 22 June 2007).

⁴⁵ CLG, *English House Condition Survey Table DH2a: Dwellings Failing on Each Decent Homes Criterion by Tenure 2004*, available at http://www.communities.gov.uk/pub/408/DH2aDwellingsfailingoneachdecenthomescriterionbysector_id1165408.xls (last visited 22 June 2007). The repair criterion "addresses elements of the property that need replacing or major repair and that are older than their expected lifetime" ODP, *English House Condition Survey 2003 Annual Report*, (2006) p 79, para 4.2, available at http://www.communities.gov.uk/pub/832/EnglishHouseConditionSurvey2003AnnualReport_id1164832.pdf (last visited 22 June 2007).

⁴⁶ CLG, *English House Condition Survey Table DH2a: Dwellings Failing on Each Decent Homes Criterion by Tenure, 2004*, available at http://www.communities.gov.uk/pub/408/DH2aDwellingsfailingoneachdecenthomescriterionbysector_id1165408.xls (last visited 22 June 2007).

- (4) *Repair costs data:* Repair costs, reflecting the extent of disrepair,⁴⁷ are highest for the private rented sector. Thus the median repair cost per square metre in 2004 was estimated at £29.30 for private rented dwellings, compared with £24.90 for local authority, £15.30 for owner occupied and £8.70 for registered social landlord dwellings.⁴⁸ Even after adjusting for dwelling age, both mean and median repair costs per square metre are still higher for the private rented sector than other tenures.⁴⁹ In 2003, the very worst 10% of private rented homes had much higher levels of disrepair than the worst 10% of the stock in the other tenure groups (£165 or more, per square metre, compared with £85-111 or more for other tenures).⁵⁰ The costs of bringing those dwellings which fail the decent homes standard up to standard are also higher for the private rented sector (£14,685) than for local authority dwellings (£8,031) and registered social landlord dwellings (£7,776), although in 2004 they were less than for the owner occupied sector (£14,928).⁵¹

3.23 In Wales, there is a similar story.⁵² Thus:

⁴⁷ For more on how repair costs were calculated see CLG, *English House Condition Survey Technical Report (2004 Edition)* (2006) pp 73 to 78, available at http://www.communities.gov.uk/pub/391/EnglishHouseConditionSurveyTechnicalReport2004Edition_id1505391.pdf (last visited 22 June 2007).

⁴⁸ CLG, *English House Condition Survey Table DR4: Key Summary Factors by General Repair Cost (Per Square Metre) 2004*, available at http://www.communities.gov.uk/pub/444/DR4aKeysummaryfactorsbygeneralrepaircostpersquaremetre_id1165444.xls (last visited 22 June 2007).

⁴⁹ CLG, *English House Condition Survey Table DR6a Mean and Median General Repair Costs by Tenure* for dwellings built pre 1945, 1945-1964, 1965-1980 and post 1980: see http://www.communities.gov.uk/pub/447/DR6aDwellingageandtenurebygeneralrepaircostpersquaremetre_id1165447.xls (last visited 22 June 2007).

⁵⁰ ODPM, *English House Condition Survey 2003 Annual Report* (2006) p 86, available at http://www.communities.gov.uk/pub/832/EnglishHouseConditionSurvey2003AnnualReport_id1164832.pdf (last visited 22 June 2007).

⁵¹ CLG, *English House Condition Survey Table DH8a: Non-decent Dwellings by Type, Tenure and Mean Costs to Make Decent*, available at http://www.communities.gov.uk/pub/414/DH8aNondecentdwellingsbytypetenureandmeancoststomakedecent_id1165414.xls (last visited 22 June 2007).

⁵² Data on housing conditions in Wales comes from the "Living in Wales Survey" commissioned by the Welsh Assembly Government, and the Welsh Housing Condition Survey 1998. Although the survey methodology was slightly different (in Wales only occupied first homes were examined while in England vacant dwellings were included, and different methods of calculating repair costs were used), they too revealed the worst conditions to be in the private rented sector. For more on the Living in Wales Survey see the Welsh Assembly Government website: <http://new.wales.gov.uk/topics/statistics/theme/living-wales/?lang=en> (last visited 22 June 2007).

- (1) *Unfitness*: In 2004 12.2% of private rented dwellings in Wales were unfit,⁵³ as compared with 4.3% of owner occupied, 3.4% of local authority and 2.3% of housing association dwellings.⁵⁴ Serious disrepair was a reason for unfitness in 28.3% of the 57,700 unfit dwellings.⁵⁵ The Welsh Housing Condition Survey 1998 found serious disrepair to be the most common reason why private rented dwellings were unfit.⁵⁶ Although, as in England, the private rented sector contained a higher proportion of older dwellings, the Welsh Housing Condition Study found that tenure had an independent influence on the incidence of unfitness: a private rented property of a particular age is likely to be in a worse condition than a property the same age in a different sector.⁵⁷ Even where private rented dwellings in Wales are not unfit, only 19.6% were found to be in satisfactory condition, compared with 41% of owner occupied, 23% of local authority and 60.9% of housing association occupied first homes in Wales.⁵⁸

⁵³ When assessed against the fitness standard for human habitation in s 604 of the Housing Act 1985, as amended by the Local Government and Housing Act 1989. This has now been replaced by the Housing Health and Safety Rating System in part 1 of the Housing Act 2004.

⁵⁴ Welsh Assembly Government, *Living in Wales 2004 – Report on Unfitness and Repairs* (2005), table 6: summary of condition by tenure. <http://new.wales.gov.uk/docrepos/40382/40382313/statistics/housing-2005/sdr126-2005.pdf?lang=en> (last visited 22 June 2007).

⁵⁵ Welsh Assembly Government, *Living in Wales 2004 – Report on Unfitness and Repairs* (2005), table 2: reasons for unfitness. <http://new.wales.gov.uk/docrepos/40382/40382313/statistics/housing-2005/sdr126-2005.pdf?lang=en> (last visited 22 June 2007).

⁵⁶ National Assembly for Wales, *Welsh Housing Condition Survey 1998*, p 8, and table 1.14, available at <http://new.wales.gov.uk/docrepos/40382/40382313/statistics/housing/housing-2001/whcs98/whcs98-ch1-e.pdf?lang=en> (last visited 22 June 2007).

⁵⁷ National Assembly for Wales, *Welsh Housing Condition Survey 1998*, Chapter 1: Unfitness, p 3, para 1.4.1, available at <http://new.wales.gov.uk/docrepos/40382/40382313/statistics/housing/housing-2001/whcs98/whcs98-ch1-e.pdf?lang=en> (last visited 22 June 2007).

⁵⁸ Welsh Assembly Government, *Living in Wales 2004 – Report on Unfitness and Repairs* (2005), table 6: summary of condition by tenure. <http://new.wales.gov.uk/docrepos/40382/40382313/statistics/housing-2005/sdr126-2005.pdf?lang=en> (last visited 22 June 2007).

- (2) *Repair costs*: average estimated repair costs were £2,855 per dwelling in the private rented sector in Wales, more than double the figure for owner occupied and local authority dwellings (£1,228 and £1,188 respectively) and five times the amount for housing association stock (£542).⁵⁹ The Welsh Housing Condition Survey 1998 had found, as in England, that tenure appeared to have an independent correlation with repair costs. Within any age band for both fit and unfit dwellings, private sector average repair costs tended to be higher than those for owner occupied dwellings, while social housing repair costs were similar or lower.⁶⁰
- 3.24 The variables, which these surveys examine, do not map precisely onto the legal tests relating to housing conditions. Nevertheless, bearing in mind our conclusion that the legal standard imposed is not a high one, we conclude that the data show that a significant amount of accommodation in the private rented sector is not, as regards its condition, meeting the legal standards prescribed by Parliament.

USE OF THE LAW

- 3.25 There is limited data on the extent to which enforcement action is taken in relation to allegations of failure to comply with the legal rules.

Court statistics

- 3.26 It is difficult to give an accurate estimate of how frequently disrepair claims are brought in the county court. The county courts in England and Wales heard 470 small claims relating to non-possession housing cases in 2004, which is likely to include some disrepair claims.⁶¹ Given the limit for small claims, some disrepair claims may also have been included in the 3,080 fast or multi-track claims heard by the county court for matters other than debt or negligence.⁶² Cases on breach of repairing covenants may also feature as a counter-claim to proceedings for possession, but separate data on these are not available.

⁵⁹ Welsh Assembly Government, *Living in Wales 2004 – Report on Unfitness and Repairs* (2005), <http://new.wales.gov.uk/docrepos/40382/40382313/statistics/housing-2005/sdr126-2005.pdf?lang=en> (last visited 22 June 2007).

⁶⁰ National Assembly for Wales, *Welsh Housing Condition Survey 1998*, p 13, available at <http://new.wales.gov.uk/docrepos/40382/40382313/statistics/housing/housing-2001/whcs98/whcs98-ch2-e.pdf?lang=en> (last visited 22 June 2007).

⁶¹ DCA, *Judicial Statistics for England and Wales for the Year 2004* (2005) Cm 6565, table 4.9, available at <http://www.official-documents.gov.uk/document/cm65/6565/6565.pdf> (last visited 22 June 2007).

⁶² DCA, *Judicial Statistics for England and Wales for the Year 2004* (2005) Cm 6565, table 4.13, available at <http://www.official-documents.gov.uk/document/cm65/6565/6565.pdf> (last visited 22 June 2007).

Occupiers' perceptions

- 3.27 It is commonly believed that private sector assured shorthold tenants' reluctance to enforce their landlords' repairing obligations is due to their lack of security of tenure. They fear that, in the absence of a law prohibiting "retaliatory eviction", such as exists in New South Wales, their landlords will serve a notice under section 21 of the Housing Act 1988 requiring them to give up possession.⁶³ However, when asked why they had not tried to enforce their rights, only 5% of the dissatisfied tenants and 8% of the very dissatisfied tenants who had not tried to enforce their repairing rights, gave as a reason that they "thought the landlord would end the tenancy". 21% of the dissatisfied, and 25% of the very dissatisfied "did not want to cause trouble with the landlord". This may be an indication that they fear the landlord will react negatively in a way that falls short of eviction. By contrast 33% of the dissatisfied and 31% of the very dissatisfied said that they "did not think it was worth the effort".⁶⁴
- 3.28 In Hazel Genn's survey of "justiciable" problems, 3% of the total sample reported having one or more problems relating to getting landlords to do repairs during the previous five years.⁶⁵ Nearly half (48%) of those reporting rented housing problems had experienced problems with getting landlords to do repairs. A further 20% reported unsafe or poor living conditions.⁶⁶ Genn's survey did not, however, reveal a disproportionate problem with disrepair in the private rented sector.⁶⁷ A higher proportion of people experiencing rented housing problems took action to try to solve them than for many other problem types surveyed.⁶⁸ But, of the 11% who took no action, 38% gave as a reason for their inaction that they "did not think the problem was very important."
- 3.29 The danger of relying on tenants' perceptions of disrepair is illustrated by the Living in Wales Survey. Over 24% of the unfit dwellings were considered by the occupier to be in good repair, and 50% of the unfit dwellings were considered to be in need of only minor or moderate repair. At the same time, 11.4% of occupiers of satisfactory dwellings considered that they needed major repair.⁶⁹

⁶³ Citizens Advice recently published a report on retaliatory eviction: D Crew, *The Tenant's Dilemma* (2007). It was published too late for us to give it any detailed consideration as part of drafting this paper. See http://www.citizensadvice.org.uk/tenants_dilemma_-_document.pdf (last visited 22 June 2007).

⁶⁴ CLG, *Survey of English Housing, Table S803 (C8C[99/00]): Whether Tenants Tried to Enforce Right to Repair and Reasons for Not Doing So*, available at http://www.communities.gov.uk/pub/223/S803Excel16Kb_id1155223.xls (last visited 22 June 2007).

⁶⁵ H Genn, *Paths to Justice: What People Do and Think about Going to Law* (1999), p 130.

⁶⁶ H Genn, *Paths to Justice: What People Do and Think about Going to Law* (1999), p 46.

⁶⁷ H Genn, *Paths to Justice: What People Do and Think about Going to Law* (1999), pp 65 and 130.

⁶⁸ H Genn, *Paths to Justice: What People Do and Think about Going to Law* (1999), p 47.

⁶⁹ Welsh Assembly Government, *Living in Wales 2004 – Report on Unfitness and Repairs* (2005), table 7: summary of condition by respondent's view of condition <http://new.wales.gov.uk/docrepos/40382/40382313/statistics/housing-2005/sdr126-2005.pdf?lang=en> (last visited 22 June 2007).

Tenant satisfaction

- 3.30 These specific comments on tenants' perceptions relate to another more general issue. On at least one measure – tenant satisfaction – the Survey of English Housing has consistently reported relatively high levels of satisfaction by private sector tenants with their landlords. Since 1994, around 75 to 80% of occupiers reported that they were “fairly” or “very” satisfied with their landlords.⁷⁰ Even on these figures, though, between a fifth and a quarter of private sector tenants are not satisfied.
- 3.31 However, “satisfaction” does not prove that standards set by Parliament are being met. Subjective perceptions do not necessarily accord with objectively defined standards. If it is agreed that, in enacting measures of tenant protection, Parliament was seeking to ensure that basic consumer protections – that accommodation should be safe and weatherproof – should be met, satisfaction on the part of tenants does not demonstrate that the legal standards are being met.

Landlords' and agents' perceptions

- 3.32 Landlords' and agents' perceptions of disrepair are not necessarily accurate either: 41% of dwellings which the landlord or agent rated as being in good or excellent condition failed to meet the decent homes standard.⁷¹ Only 3% of properties were rated as fairly or very poor by their landlord or agent in the 2001 English House Condition Survey Private Landlords Survey, and 97% of properties were owned by landlords who felt that they were able to keep on top of the necessary repair and maintenance work. Yet more than 10% of the properties owned by these landlords were found by a physical survey to be unfit. The commonest reasons for unfitness were dampness (38%), disrepair (33%) and poor food preparation areas (31%).⁷²

HARASSMENT AND UNLAWFUL EVICTION

- 3.33 By comparison with housing conditions, reliable data on the extent of harassment and unlawful eviction and on the use of these legal provisions⁷³ are much more scarce. If consultees can provide us with any further data on this issue, we would be very grateful.

⁷⁰ See CLG, *Survey of English Housing Table S821 Overall Satisfaction With Landlord* (2006) http://www.communities.gov.uk/pub/239/S821_id1155239.xls (last visited 22 June 2007).

⁷¹ ODPM, *English House Condition Survey 2003: Private Landlords Survey* (2006), p 21, available at http://www.communities.gov.uk/pub/226/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165226.pdf (last visited 22 June 2007).

⁷² ODPM, *English House Condition Survey 2001: Private Landlords Survey* (2003), p 28, available at http://www.communities.gov.uk/pub/285/2001EnglishHouseConditionSurveyPrivatelandlordsurveyPDF300Kb_id1155285.pdf (last visited 22 June 2007).

⁷³ For a summary of the legal provisions relating to unlawful eviction and harassment of tenants, see *Supplementary Paper 1: The Law on Housing Conditions and Unlawful Eviction*, available at http://www.lawcom.gov.uk/housing_renting.htm.

3.34 Anecdotal evidence from organisations such as the Association of Tenancy Relations Officers suggests that their members come across not insignificant numbers of instances of harassment and unlawful eviction. Similarly, instances of unlawful eviction and harassment are regularly reported by citizens' advice bureaux. There is a perception among housing law practitioners and advisers that harassment and unlawful eviction are most prevalent at the lower end of the market and in the houses in multiple occupation sub-sector – particularly affecting vulnerable households and those who are dependant on housing benefit.⁷⁴ But the data are not in a form that allows firm conclusions to be drawn about the annual incidence of unlawful eviction and harassment.

Court statistics

3.35 Insofar as criminal prosecutions are concerned, the number of offenders convicted or cautioned for the offence of unlawful eviction is negligible and declining. In 1994, the number was 108; in 2004, it was 26.⁷⁵ It may be that unlawful eviction and harassment are not a matter of top priority for the police. In any event, prosecutions cannot be brought unless both evidential and public interest considerations are satisfied.⁷⁶ It is not always easy to satisfy these standards. In the context of enforcing regulation criminal prosecution may not always be the most appropriate sanction to ensure that non-compliance is addressed, damage caused is remedied or that behaviour is changed.⁷⁷

3.36 Be that as it may, we suspect that where incidents involving landlords and tenants are investigated by the police, it is more likely that more familiar offences, like criminal damage or assault, will be charged.⁷⁸ It is impossible to identify such cases from the generality of these offences. So it may be that, even where the police and prosecuting authorities are involved in controlling harassment of tenants, it will not show up in the statistics. No data are available about use of civil proceedings.

⁷⁴ A Marsh, P Niner, D Cowan, R Forrest and P Kennett *Harassment and Unlawful Eviction of Private Rented Sector Tenants and Park Home Residents* (2000).

⁷⁵ Home Office Statistical Bulletin 19/05, *Criminal Statistics 2004* (England and Wales) (2005 2nd ed), available at <http://www.homeoffice.gov.uk/rds/pdfs05/hosb1905.pdf> (last visited 22 June 2007). From 2001-3, the equivalent numbers were 23, 23, 21.

⁷⁶ Crown Prosecution Service, *The Code for Crown Prosecutors 2004*, available at <http://www.cps.gov.uk/publications/docs/code2004english.pdf> (last visited 22 June 2007).

⁷⁷ Professor R B Macrory, *Regulatory Justice: Making Sanctions Effective Final Report* (2006), available at http://www.cabinetoffice.gov.uk/regulation/documents/pdf/macrory_penalties.pdf (last visited 22 June 2007).

⁷⁸ For an example, see *R v Pashmfouroush and Pashmfouroush* [2006] EWCA Crim 2330. The landlord tried to change the locks of the property in an attempt to illegally evict the tenants, which led to incidents as a result of which the landlord and his wife were prosecuted for assaults and affray.

- 3.37 Data on “attrition rates” (the relatively small number of court actions in relation to the number of problems or complaints) found in other areas of law, such as data relating to noise nuisance,⁷⁹ suggest that these small numbers do not tell the whole story.⁸⁰

Occupiers’ reported experiences

- 3.38 In Genn’s survey, just 3% of those people who had experienced rented housing problems reported “harassment” by the landlord (it is not clear what proportion of those respondents were in the private rented sector, nor how they defined harassment), while 9% reported problems of being evicted or threatened with eviction (whether this was lawful or unlawful eviction was not clear).⁸¹

Data from enforcement bodies

- 3.39 Local authorities are responsible for prosecuting unlawful eviction offences.⁸² Low rates of prosecution are the product of a range of factors. Particularly salient features of the current policy context are: the need to work in partnership with private landlords; and to reduce pressure upon the homelessness function and the local social housing stock by keeping private tenants in their current homes. This accounts in part for a strong orientation in many areas toward compliance and mediation rather than prosecution.⁸³ The low rate of prosecutions and convictions does not therefore reflect the extent of local authority activity in this field. For example, Sheffield City Council’s tenancy relations service, whose role includes preventing harassment and unlawful eviction of private sector tenants, makes around 500 interventions a year, with around 200 to 300 resulting in the landlord being made aware that they have served a legally ineffective notice to recover possession.⁸⁴

⁷⁹ For data on attrition rates in relation to noise nuisance complaints, see Chartered Institute of Environmental Health, *Noise Nuisance 2004/2005* (2006) http://www.cieh.org/library/Knowledge/Environmental_protection/CIEH_annual_noise_complaint_statistics.pdf (last visited 22 June 2007).

⁸⁰ In *Housing: Proportionate Dispute Resolution – Further Analysis* (2006) the Law Commission explored the processes by which problems are transformed into disputes brought before the courts, and the reasons for this attrition rate: see pp 6 to 17, available at http://www.lawcom.gov.uk/docs/further_analysis.pdf.

⁸¹ H Genn, *Paths to Justice: What People Do and Think about Going to Law* (1999), p 46.

⁸² Protection from Eviction Act 1977, s 6.

⁸³ D Cowan and A Marsh “There’s Regulatory Crime and Then There’s Landlord Crime: From “Rachmanites” to “Partners”” (2001) 64(6) *Modern Law Review* 831.

⁸⁴ Data provided to Law Commission in response to *Housing: Proportionate Dispute Resolution – An Issues Paper* consultation by D Hickling, Sheffield City Council.

COMMENT

- 3.40 Notwithstanding the data from the satisfaction surveys, we have concluded in the light of other available evidence, discussed above, that improved housing management is an issue which still needs addressing if the legislation that Parliament has enacted and other measures taken to improve good practice in the landlord-occupier relationship are to have their intended effect. Failure to improve housing management also impacts on wider social policy issues, such as social exclusion, poor health and environmental policies, which go beyond the individual landlord-occupier relationship.
- 3.41 The question to which we now turn is whether the law should be made to work more effectively. If the answer to this question is affirmative, the next question is how can this be done.

PART 4

ENCOURAGING COMPLIANCE: COSTS AND BENEFITS

INTRODUCTION

- 4.1 In this Part, we consider the costs and benefits of adopting a more proactive regulatory regime. As noted at the start of this paper, we take existing legal standards as those against which regulatory success should be tested. This does not imply that those tests are immutable. It may be appropriate for Government to re-assess their desirability in the light of both the costs and benefits of improving compliance. However, any reassessment of those standards involves policy considerations that fall outside our remit. This Part focuses primarily on housing conditions and the repair and maintenance of the property.
- 4.2 In Part 3, we argued that basic statutory standards relating to safety and the weather proofing of rented accommodation are not being met as fully as they should be. Thus, it might seem obvious that the solution is to encourage better compliance with those standards.
- 4.3 However, this solution is not cost free. Although in one significant respect the economics of the private rented sector has changed over the last twenty years through the almost complete removal of rent regulation and the move towards market rents,¹ at the bottom end of the market, where the most significant problems arise, low rents mean that landlords want to ensure profitability by tight controls on costs. This problem is even more acute where properties are rented to those in receipt of housing benefit, where the rents that can be met by benefit are capped at the “local reference rent”.²

¹ In many situations, therefore, private landlords can now receive, through rents charged, sums that should be adequate to pay for repairs.

² See the Housing Benefit Regulations 2006 (SI 2006 No 213), reg 13(6).

- 4.4 Academic research building on the English House Condition Survey and Private Landlords Survey data looked at the relationship between the different types of landlord³ and the state of the property. Dwellings in the best condition are more likely to be owned by sideline non-investor landlords (that is, those for whom renting is not their main source of income, and who do not see the property as an investment) and by institutional landlords. The properties in the poorest state of repair are more likely to be owned and let by business landlords and sideline investor landlords, both of whom see the rented property as an investment, either as a source of income or capital growth or both.⁴ Investment minded landlords seeking an income return (rather than just capital growth) are more likely to own properties in poor condition and spend less on repairs.⁵ These considerations suggest that any regulatory response to deal with poor standards must be flexible and tailored according to landlord type to achieve optimal compliance.

ESTIMATING THE COST OF IMPROVING CONDITIONS IN THE PRIVATE RENTED SECTOR

- 4.5 Using data from the English House Condition Survey, the Living in Wales Survey 2004 and Welsh Housing Statistics 2005,⁶ we have sought to make some broad estimates of the cost of improving the physical condition of private rented dwellings in England and Wales.

Costs of meeting the Housing Act 1985 s 604 unfitness test

- 4.6 Although the unfitness test in section 604 of the Housing Act 1985 is no longer the relevant statutory test, having been replaced by the Housing Health and Safety Rating System introduced in the Housing Act 2004, data are available on the numbers of private rented dwellings which failed to meet that test, and the costs of making them fit. The evidence suggests that the cost of making fit all the 229,000 unfit private rented dwellings in England⁷ is around £2.18 billion. The cost of repairs to the 14,030 unfit private rented dwellings in Wales is around £98 million. Thus the combined total is around £2.28 billion.

³ See paras 2.7 to 2.9, especially 2.9.

⁴ T Crook, J Henneberry, J Hughes and P Kemp, *Repair and Maintenance by Private Landlords* (2000), p 8.

⁵ OfDPM, *English House Condition Survey 2003: Private Landlords Survey* (2006), p 15 . http://www.communities.gov.uk/pub/221/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165221.pdf (last visited 22 June 2007). The research referred to is A Crook, J Henneberry and J Hughes, *Repairs and Improvements to Private Rented Dwellings in the 1990s* (1997), and A Crook, J Henneberry, J Hughes and P Kemp *Repair and Maintenance by Private Landlords* (2000).

⁶ Our detailed workings and underlying assumptions are explained in *Supplementary Paper 2: Estimating the Costs and Benefits of Greater Compliance With Property Condition Standards*, available at http://www.lawcom.gov.uk/housing_renting.htm.

⁷ CLG, *English House Condition Survey 2004 Table DH2a: Dwellings Failing on Each Decent Homes Criterion by Sector*, available at http://www.communities.gov.uk/pub/408/DH2aDwellingsfailingoneachdecenthomescriterionbysector_id1165408.xls (last visited 22 June 2007).

- 4.7 Accepting that however effective a reformed regulatory scheme may be adopted, not all unfit dwellings would be made fit, we think a more realistic target would be to reduce unfitness in the private rented sector to the level in the Registered Social Landlord sector. This would still result in significant improvements, reducing the proportion of unfit private rented dwellings from just under 10% to a mere 3.5% in England.⁸ In Wales, the improvement would be even greater; the proportion of unfit private rented dwellings would fall from over 12% to just over 2%.⁹ This would imply a substantial aggregate cost, of around £1.4 billion in England, and around £80 million in Wales, giving a combined total of £1.47 billion.

Costs of eliminating or reducing category 1 hazards

- 4.8 No detailed survey data are yet available on the incidence and costs of remedying hazards identified under the Housing Health and Safety Rating System.¹⁰ However the Office of the Deputy Prime Minister made some estimates in their Regulatory Impact Assessment for Part 1 of the Housing Act 2004.¹¹ Building on their approach, we estimate that the total cost of mitigating 15 major types of category 1 hazard in the private rented sector would be around £2.37 billion in England, and around £145 million in Wales, giving a total of about £2.51 billion.¹²
- 4.9 A very rough estimate (based on the relationship between the number of unfit dwellings and those with category 1 hazards identified by Office of the Deputy Prime Minister) suggests that the cost of reducing the proportion of private rented dwellings with category 1 hazards to the level assumed to exist in the Registered Social Landlord sector would be around £1.51 billion in England, and around £117 million in Wales. This gives a total estimate of £1.63 billion. These are very similar to the costs of making unfit housing fit.

⁸ CLG, *EHCS 2004 Table DH2a: Dwellings Failing on Each Decent Homes Criterion by Sector*, available at http://www.communities.gov.uk/pub/408/DH2aDwellingsfailingoneachdecenthomescriterionbysector_id1165408.xls (last visited 22 June 2007).

⁹ Welsh Assembly Government, *Living in Wales 2004 – Report on Unfitness and Disrepair*, table 6, available at <http://new.wales.gov.uk/docrepos/40382/40382313/statistics/housing-2005/sdr126-2005.pdf?lang=en> (last visited 22 June 2007); S Wilcox, *UK Housing Review 2005/06* (2006), table 17a, available at <http://www.ukhousingreview.org.uk/> (last visited 22 June 2007).

¹⁰ In footnote 1 on p 6 of the EHCS 2004 Annual Report, ODPM noted that “The EHCS began collecting data on the Housing Health and Safety Rating System from April 2005. Results will be presented as part of the 2006 EHCS report when the Housing Health and Safety Rating System will form part of the decent homes standard.” See http://www.communities.gov.uk/pub/429/EnglishHouseConditionSurvey2004AnnualReport_id1502429.pdf (last visited 22 June 2007).

¹¹ ODPM, *Regulatory Impact Assessment: Housing Act 2004 – Part 1: Housing Conditions*, available at http://www.communities.gov.uk/pub/846/RegulatoryImpactAssessmentHousingAct2004Part1HousingConditionsPDF389Kb_id1161846.pdf (last visited 22 June 2007). We understand that the estimates of the incidence of category 1 hazards were based on a significant amount of modelling and on assessments made by surveyors prior to the development of professional induction and training on the Housing Health and Safety Rating System, and should therefore be treated with some caution.

¹² More robust estimates of the incidence of, and costs of remedying, category 1 hazards will be developed using the 2006 English House Condition Survey.

- 4.10 Were expenditure of the order mentioned in the previous paragraphs to be incurred, this would also have the effect of bringing accommodation to the state of repair required by section 11 of the Landlord and Tenant Act 1985.

Costs of carrying out more extensive repairs

- 4.11 However, the Government has ambitions to improve the quality of housing in England and Wales beyond simply making unfit properties fit (the old test), or reducing category 1 hazards (the new test). Thus the English House Condition Survey contains calculations of what are called the comprehensive repair cost.¹³ (By definition, these do not match the cost of repairs for which the landlord would be liable under section 11 of the Landlord and Tenant Act 1985.) We estimate, using the English Housing Condition Survey data, that the total cost of comprehensive repairs to all private rented dwellings in England would be £12.57 billion, with the total cost of basic repairs being around £7.28 billion, and the total cost of urgent repairs being around £4.81 billion.
- 4.12 Looked at slightly differently, the total cost for England of bringing private rented sector properties up to the modernisation, fitness or disrepair criteria set out in the decent homes standards¹⁴ would be around £7.5 billion, based on a mean cost per private rented dwelling of £14,685.¹⁵
- 4.13 For Wales, the comprehensive repair cost for the 115,000 private rented sector dwellings is estimated at around £328 million, based on average estimated repair costs of £2,855 per private rented dwelling in Wales.¹⁶

¹³ See CLG, *English House Condition Survey Technical Report (2004 Edition)* (2006), pp 73 to 78 at http://www.communities.gov.uk/pub/391/EnglishHouseConditionSurveyTechnicalReport2004Edition_id1505391.pdf (last visited 22 June 2007).

¹⁴ This is the standard to which the Government is seeking to bring housing in the social rented sector. The criteria are defined in the *English House Condition Survey Technical Report (2004 Edition)* (2006) at pp 49 to 52 http://www.communities.gov.uk/pub/391/EnglishHouseConditionSurveyTechnicalReport2004Edition_id1505391.pdf (last visited 22 June 2007).

¹⁵ CLG, *EHCS Table DH7a: Main Reason for Non Decency and Mean Costs to Make Decent by Tenure*, available at http://www.communities.gov.uk/pub/413/DH7aMainreasonfornondecencyandmeancoststomakedecentbysector_id1165413.xls (last visited 22 June 2007). It may be noted that the average sum to bring accommodation in the social rented sector which fail to meet the decent homes standard on repair, fitness and modernisation criteria, up to the decent homes standards is around £14,500, very similar to the figure we estimate would apply in the private rented sector.

¹⁶ Welsh Assembly Government, *Living in Wales Survey 2004 – Unfitness and Disrepair*, p 5, available at <http://new.wales.gov.uk/docreposit/40382/40382313/statistics/housing-2005/sdr126-2005.pdf?lang=en> (last visited 22 June 2007).

Comparative costs

- 4.14 While these are substantial figures which cannot be ignored in considering the question of what improvements can be made to ensure that private sector landlords meet the standards prescribed by Parliament, it is worth noting that, Government expenditure on housing generally and raising housing conditions in particular, involves large sums of money. For example, in 1997 the Government estimated that the cost of repairs and improvements needed to bring local authority stock up to the decent homes standard was some £19 billion.¹⁷ The recent Hills Review of social housing shows that Government's financial support for housing in 2004-2005 amounted to £15.7bn in net tax advantages to owner occupiers and £3.2bn in means tested housing benefit to the private rented sector.¹⁸

¹⁷ See CLG, *From Decent Homes to Sustainable Communities* (2006), available at http://www.communities.gov.uk/pub/576/FromDecentHomestoSustainableCommunitiesAdiscussionpaper_id1500576.pdf (last visited 22 June 2007), referred to also by the Minister of Housing, Yvette Cooper MP, Hansard (HC), vol. 458 (71) col. 1729, 29 March 2007, available at <http://www.publications.parliament.uk/pa/cm200607/cmhansrd/cm070329/debtext/70329-0017.htm#07032955001113> (last visited 22 June 2007).

¹⁸ J Hills, *Ends and Means: The Future Roles of Social Housing in England* (2007) <http://sticerd.lse.ac.uk/dps/case/cr/CASEREport34.pdf> (last visited 22 June 2007).

THE BENEFITS OF MEETING THOSE COSTS

- 4.15 There is compelling evidence that, for example, those who live in accommodation that is not weatherproof or is not safe are more likely to become ill; they are more likely to suffer accidents in the home; the young are less likely to thrive at school; and in general all those in poor quality accommodation experience greater than average social exclusion.¹⁹ More generally it has been found that a failure to improve housing conditions has a major impact upon not only health but also economic and environmental policy.²⁰ Poor housing leads to communities becoming undesirable and unsustainable.²¹ Decent homes are often the key to sustaining thriving communities. General anti-poverty strategies are clearly designed to address these issues. So also are area-based initiatives, such as the New Deal for Communities.²² Thus, although the costs of improving private rented accommodation are substantial, there are significant social benefits that derive from making that expenditure. Put another way, there is a significant cost associated with doing nothing.
- 4.16 The difficulty is finding ways to measure the benefits to be derived from improving housing standards. This is an issue to which researchers are beginning to turn their attention. One important initiative we have considered is the Health Impact Assessment commissioned by Sheffield City Council and Sheffield's Primary Care Trusts of their Decent Homes programme.²³ This shows in particular that improvements to heating efficiency and ventilation are expected to reduce respiratory disease, heart disease and excess winter deaths. In addition, improved design of bathrooms and kitchens should reduce falls, scalding and burns and should therefore lead to substantial savings for the NHS.²⁴

¹⁹ See for example, ODPM, *Regulatory Impact Assessment: Housing Act 2004 – Part 1: Housing Conditions* (November 2005), p 7
http://www.communities.gov.uk/pub/846/RegulatoryImpactAssessmentHousingAct2004Part1HousingConditionsPDF389Kb_id1161846.pdf (last visited 22 June 2007).

²⁰ See *Response of the ODPM to the Comprehensive Spending Review 2002, Decent Homes Target Implementation Plan* (June 2003), p 7, available at
http://www.communities.gov.uk/pub/203/TheDecentHomesTargetImplementationPlanPDF207Kb_id1152203.pdf (last visited 22 June 2007).

²¹ See *Response of the ODPM to the Comprehensive Spending Review 2002, Decent Homes Target Implementation Plan* (June 2003), available at
http://www.communities.gov.uk/pub/203/TheDecentHomesTargetImplementationPlanPDF207Kb_id1152203.pdf (last visited 22 June 2007).

²² See P Ambrose, *The Costs of Poor Housing: Urban Regeneration and Non-Housing Outcomes* (2001), paper for presentation at the HAS conference on "Housing Policies for the New UK, York, 3 to 4 April 2002,
<http://www.york.ac.uk/inst/chp/hsa/papers/ambrose.pdf> (last visited 22 June 2007). This study evaluated the benefits of Single Regeneration Budget funded work regeneration of homes in Stepney, East London. Interviewees reported one seventh the number of days of sickness after the work than before.

²³ J Gilbertson, G Green, D Ormandy, *Decent Homes Better Health – Sheffield Decent Homes Health Impact Assessment* (July 2006) available at
http://www2.warwick.ac.uk/fac/soc/law/research/centres/shhru/sdh_hia_report.pdf (last visited 22 June 2007).

²⁴ The British Medical Association estimates that the cost to the NHS of accidents in the home is £450m each year.

- 4.17 The focus of that initiative is on the impact made by the investment of an average sum of £14,500 into improving dwellings in the social rented sector, not the private rented sector. But analysis of this kind demonstrates that, even in relation to this particular sector, there are benefits that should be balanced against the cost estimates we have set out above.
- 4.18 Health issues are now a component of regulatory impact assessment.²⁵ Indeed in the Regulatory Impact Assessment for Part 1 of the Housing Act 2004, the Office of the Deputy Prime Minister described a methodology which could be used to calculate the potential health benefits of mitigating category 1 hazards.²⁶ The Office of the Deputy Prime Minister did not, however, attempt to estimate the actual health benefits expected to result from the introduction of the Housing Health and Safety Rating System.

THE CURRENT POSITION: USING ENFORCEMENT TO RAISE LEVELS OF COMPLIANCE

- 4.19 The available data show that the minimum standards imposed by Parliament are not met in around one in five of properties in the private rented sector in England and Wales.²⁷ Although landlords of the majority of properties *do* comply with the standard and many do so voluntarily, the level of non compliance is high. In this section we look at the role that taking enforcement action currently plays in securing compliance.
- 4.20 Many factors influence landlord compliance with their legal obligations. Some landlords may have complied, because legal action was taken against them, or they feared it. Other may comply simply because they are aware of the content of those standards.
- 4.21 In relation to the properties which do not meet the standards, the landlords are by definition non-compliant. Enforcement has proved ineffective. In respect of those properties, the effects of non-repair are experienced by the occupier and his or her children. The costs of non-compliance fall on them and on the state.

²⁵ See the Government's White Paper, *Choosing Health: Making Healthy Choices Easier*, (2004) Cm 6374, available at http://www.dh.gov.uk/en/Publicationsandstatistics/Publications/PublicationsPolicyAndGuidance/DH_4094550 (last visited 22 June 2007).

²⁶ ODPM, *Regulatory Impact Assessment: Housing Act 2004 – Part 1: Housing Conditions* (November 2005), Annex C, available at http://www.communities.gov.uk/pub/846/RegulatoryImpactAssessmentHousingAct2004Part1HousingConditionsPDF389Kb_id1161846.pdf (last visited 22 June 2007).

²⁷ EHCS data showed there were 229,000 unfit private rented properties in England and 14,030 in Wales. ODPM estimated in *the Regulatory Impact Assessment: Housing Act 2004 – Part 1: Housing Conditions* (November 2005), p 4, that there were around 1.85 properties with category 1 hazards, for every one unfit under the old Housing Act 1985 s 604 fitness test: see http://www.communities.gov.uk/pub/846/RegulatoryImpactAssessmentHousingAct2004Part1HousingConditionsPDF389Kb_id1161846.pdf (last visited 22 June 2007). This would give 424,691 private rented properties in England with category 1 hazards, and 26,019 in Wales, giving a "hazard rate" in England of 18.2% and in Wales of 22.7%.

- 4.22 We think that the distinction between compliant landlords against whom enforcement steps are taken, and non-compliant landlords against whom such steps are not taken, is essentially arbitrary. There is no clear evidence showing that when the mechanisms currently available to enforce housing condition standards are used they actually achieve their objective.
- 4.23 It could be argued that it would be the worst offenders in terms of disrepair/poor condition who would be proceeded against, and that therefore the distinction between the compliant and non-compliant was at least to a degree rational. That in turn *could* lead to an argument that, in regulatory terms, there was a degree of efficiency in the outcome. But as an empirical matter, we do not think that this account is true.
- 4.24 As far as legal enforcement by the occupier is concerned, research shows that the difference between legal wrongs that are litigated, and those that are not, has more to do with the characteristics of the litigant than other factors. The other factors, including the availability of advice and assistance, may be more significant than the severity of the legal wrong concerned.²⁸
- 4.25 As for local authority enforcement, while we are not aware of any comprehensive research, experience leads us to believe that the amount of effort put into engagement with the private rented sector by local authorities is not wholly determined by levels of non-compliance with statutory condition standards. The approach is informed instead more by local factors, some of which suggest new ways to achieving "best practice" which are not enforcement centred and could be adopted more widely. Some of these practices involve active engagement with landlords' or letting agents' organisations or the use of accreditation schemes.
- 4.26 Many of these factors are unrelated to the actual state of the private rented sector in particular local authority areas, such as historical factors, and even the policy enthusiasms of officers or members. The way in which local authorities work with private landlords has been changing in response to changing priorities, which now puts less emphasis on enforcing obligations.²⁹
- 4.27 Our provisional conclusion on this factual issue, therefore, is that the compliance gap does not necessarily reflect strategic decisions by enforcement bodies related to the degree of disrepair present: to that extent it is essentially arbitrary.

²⁸ See Law Commission, *Housing: Proportionate Dispute Resolution: Further Analysis* (2006), pp 13 to 15 for a summary of the factors which affect whether a problem is transformed into a litigated dispute, and for references to academic work which discusses this further, available at: http://www.lawcom.gov.uk/docs/further_analysis.pdf. For example P Pleasance in *Causes of Action: Civil Law and Social Justice (2nd edition): Summary of Main Findings* (2006) reported that "Awareness of local services is a significant influence on whether action is taken to solve problems. A large number of people are unaware of local services and these people take action much less often."

²⁹ In *Chartered Institute of Housing, DCLG and Improvement and Development Agency, Ways and Means: Local Authorities' Work with the Private Rented Sector* (2006), p 6 it was noted that "...local authorities' work with the private rented sector is no longer necessarily driven by a need to enforce standards. Whilst work to address poor management and poor property conditions remains, it can also be undertaken because the sector is seen as a solution to a local problem, such as homelessness or lack of social housing. Work may be concentrated in an area where problems such as anti-social behaviour persist and the involvement of landlords is needed to support a coordinated response." See <http://www.cih.org/policy/WaysAndMeans.pdf> (last visited 22 June 2007).

- 4.28 The significance of this is that it leads us to the provisional judgment that leaving the problem of non-compliance to arbitrary settlement is *not* a rational way of distributing the costs associated with the condition standards.

THE ARGUMENT SO FAR

- 4.29 So far we have argued that

- (1) Parliament has sought to impose standards of housing conditions and repair. Broadly speaking, the standards imposed are relatively low; they focus on safety and whether premises are weatherproof. These are analogous to other measures of consumer protection that require goods to be of satisfactory quality.
- (2) The current system of enforcement of condition standards in the private rented sector is failing. Private enforcement by occupiers taking legal proceedings is in most cases not a realistic option. Achieving compliance through local authority enforcement is problematic for many reasons including lack of resources.
- (3) Leaders of landlords' and letting agents' organisations recognise the importance of meeting statutorily prescribed standards. But most private landlords and many letting agents are not members of any organisation or accreditation scheme.³⁰
- (4) The poor image of the private rented sector may be encouraged by the failure of landlords and agents to become engaged with either a professional organisation or an accreditation scheme.
- (5) In the context of housing conditions, if the current failure to meet prescribed standards was successfully addressed, it would be costly.
- (6) The social benefits of addressing poor housing are also very substantial, although they are currently more difficult to quantify.
- (7) The current system for the distribution of the costs and benefits of meeting the statutory standards for housing conditions and repair is not rationally sustainable.

LAW, REGULATION AND POLICY

- 4.30 This project sets out to ask, not what should the law be, but whether existing law could be made more effective. We consider that law reform can and does include the fruits of learning in fields such as regulatory theory, law and economics and socio-legal studies.

³⁰ We estimate that only 2.2% of the 700,000 private landlords in England and Wales are members of an association.

- 4.31 Thus we take the current law as a given; Parliament has laid down these standards. The regulatory challenge is to ensure that they are adhered to as efficiently and effectively as practicable. However, the magnitude of the costs involved, as demonstrated in this Part, suggests that moving to a higher degree of compliance may require political re-assessment of or re-commitment to the standards themselves. What the results of any such re-consideration would be go beyond the scope of this project. Decisions on spending and the distribution of resources on this scale go beyond the scope of what we as a law reform agency can properly recommend. They require a series of choices that are essentially political in nature that go to answering the question: who should pay? These are questions about which it is important to consult widely in order to seek, if possible, a consensus regarding future policy direction, which should rightly be placed in front of policy makers for decision.
- 4.32 What we can contribute are concrete proposals on how better regulation may be achieved, thus setting an appropriate context for any political reassessment of the current law. In what follows, we seek to tease out some of the issues about where increased costs would fall, including the costs of not increasing regulatory compliance.

WHERE THE BURDEN FALLS: THE COST OF IMPROVING HOUSING CONDITION

- 4.33 At first sight, expenditure on increased compliance with statutory housing condition standards appears to fall naturally on landlords. While we have not sought to provide a formal economic model of what the consequences would be of imposing such expenditure on the housing market, we have considered the implications of this happening.
- 4.34 As increased expenditure on repairs imposes additional costs on landlords' businesses, on simple economic principles, those costs will be shared between landlords and occupiers in the form of higher rents, in proportions set by market conditions. While the exact proportions cannot easily be predicted, landlords are likely to seek to pass on as high a proportion as they can of any cost increase in the form of rent rises.
- 4.35 But as many properties in poor condition are at the bottom end of the market, many occupiers rely on housing benefit.³¹ If housing benefit were to rise to cover the increases, then the burden of repair, initially imposed on landlords, would be transferred via the occupier, to the state. If it did not, and occupiers were not able to meet any additional costs, then landlords would either have to absorb the costs themselves, or exit the market.

³¹ A Crook found that in 1996, while there appeared to be no simple relationship between the mean value of outstanding repairs and tenants' receipt of housing benefit, "when repair cost quartile groups were compared, a statistically significant relationship with housing benefit receipt did emerge. This suggested that households in receipt of housing benefit were more likely to be found in the dwellings with the greatest disrepair and less likely to be living in those with the least disrepair. In other words, housing benefit recipients were relatively concentrated in the poorer properties": A Crook "Housing Conditions in the Private Rented Sector Within a Market Framework" in S Lowe and D Hughes (ed), *The Private Rented Sector in a New Century* (2002).

- 4.36 In making the calculation whether or not to exit the market much will depend on the time period over which a landlord seeks to recover the costs. Although there are likely to be some on-going higher maintenance costs, much of the expenditure would come in the form of a one-off payment on repairs to bring the property up to standard.³²
- 4.37 As rates of return in many parts of the housing rental market are far from high,³³ and as research indicates that the poorest condition dwellings were the most likely to be regarded as an investment and to belong to small-scale individual landlords,³⁴ increases in repair costs falling on landlords could lead to a proportion of them exiting the market.³⁵
- 4.38 At least two potentially undesirable outcomes may result.³⁶
- (1) First, where landlords do exit the market, and occupiers are made homeless, the result may well be additional costs imposed on the state.
 - (2) Second, where landlords exit the market, that in turn will restrict supply, leading to further pressure on rents to rise. Particularly hard hit in this situation would be occupiers who are low-paid but earn too much to qualify for housing benefit, and students. This would work against policies designed to expand the private rented sector.
- 4.39 The Government could choose to limit the impact on landlords by changing the tax treatment of such expenditures. (This is a reform long called for by landlords.)

³² The impact of a landlord seeking to recover, say, £10,000 spent on repairs over 12 months is far higher than seeking to recover them over 5-10 years.

³³ D Rhodes and P Kemp "Rents and Returns in the Residential Lettings Market" in S Lowe and D Hughes (ed.) *The Private Rented Sector in a New Century* (2002), p 51.

³⁴ A Crook, J Henneberry and J Hughes *Repairs and Improvements to Private Rented Dwellings in the 1990s* (2000) p 8; DTLR research summary 079 (1997), available at <http://www.communities.gov.uk/index.asp?id=1155847> (last visited 22 June 2007).

³⁵ DETR estimated that the stock elasticity of housing supply is 0.077. The stock elasticity of supply is defined as the % change in private rented stock due to rent change/ %change in rent and has been estimated comparing 1996 private rented sector data with 1991 data. For further information please refer to DETR (1999) *The supply responsiveness of the private rented sector: an international comparison*; p.57, a summary of which is available at <http://www.communities.gov.uk/index.asp?id=1155829> (last visited 22 June 2007). ODPM had also estimated in the *Regulatory Impact Assessment (RIA): Houses in Multiple Occupation and Selective Licensing and Management Orders* (March 2006), which related to the Licensing and Management of Houses in Multiple Occupation and Other Houses (Miscellaneous Provisions) (England) Regulations 2006, that a £60 licence fee (for four properties) would lead to a fall in supply of 129 units, and a £100 fee would lead to a 215 unit decrease in the private rented stock.

³⁶ Conversely, there might be at least one benefit from landlords exiting the market; it might provide an opportunity for potential first-time buyers to acquire a property at lower cost.

- 4.40 Alternatively, the Government might provide a more generous system of grants to assist landlords in getting their properties up to standard.³⁷ Designing such a system would not be easy. On the one hand, it would be important to avoid wasting public funds subsidising the majority of landlords who keep their properties in repair. On the other hand, it would be undesirable to reward miscreant non-repairing landlords by giving only them access to this state aid.
- 4.41 A third approach might be to use grant-aid (or a combination of grants and loans) in a more targeted way to achieve Government objectives. For example, a grant-aid budget could be deployed by an existing housing agency, such as the Housing Corporation and/or local housing authorities, to fund the provision of social housing in private sector accommodation. This would in effect be an expansion of the financial aid provided for meeting the decent homes standard in the social rented sector. It could be made a condition of receiving a grant for repairs and improvement that the landlord accepts nominations from the council or a housing association, or the grant could be part of a package under which the social housing provider rents the property from the private landlord for a period and sub-lets to those to whom it owes a homelessness duty or otherwise to accommodate those in housing need. There could be a minimum period – say five years – during which the accommodation would be made available to those in social housing need.

WHERE THE BURDEN FALLS: THE COSTS OF NOT IMPROVING HOUSING CONDITION

- 4.42 By contrast with the costs of making repairs, the costs of not making repairs do not fall directly on the landlord. Rather they fall on the occupiers themselves and agencies of the state.
- 4.43 The direct costs experienced by the occupier arise from the loss of comfort (which should be recognised as a cost of poor housing conditions); possible damage to property arising from damp, mould or infestation; and, if the only option is to leave the premises, the costs and disruption of moving. There is also the loss to the economy of productive capacity if people are unable to work because of the adverse impact on their health of poor housing.
- 4.44 Since a major component of the cost of bad housing is the contribution it makes to ill health,³⁸ there are also significant costs which fall on the state and thus all citizens – in costs to the NHS, in lost tax revenue, in expenditure on benefits.
- 4.45 More intangibly, poor quality housing contributes to social disadvantage, which leads to educational disadvantage and again, indirectly, to worse health outcomes. It contributes a “social policy cost” by exacerbating social exclusion.³⁹

³⁷ There have been grant aid schemes in the past; we understand that they are not currently operating to any significant degree.

³⁸ See, for example, B Ineichen, *Homes and Health: How Housing and Health Interact* (1993); H Thomson and others, *Housing Improvement and Health Gain: A Summary and Systematic Review*, MRC Social and Public Health Sciences Unit, Occasional Paper 5 (2002) available at http://www.nice.org.uk/media/hiadocs/52_housing_improvement_health_gain.pdf (last visited 22 June 2007); P Howden-Chapman and P Carroll, *Housing & Health: Research, Policy and Innovation* (2004).

CONCLUSION

- 4.46 This Part offers a preliminary assessment of the costs and benefits of better regulation of housing conditions (and by extension of other aspects of housing management). It acknowledges that a reconsideration of the policy behind the accepted standards might be appropriate. Although we find it difficult to imagine how existing statutory standards could be significantly reduced - indeed official statements of Government policy seem to point in the opposite direction – these are questions for Government.
- 4.47 On the assumptions that it would be desirable to ensure that more properties in the private rented sector meet the statutory standards, in the rest of this paper we put before consultees options, and a provisional proposal, for a reformed regulatory structure for the private rented sector.

CONSULTATION ISSUES

- 4.48 This Part raises a fundamental issue about what the costs of greater compliance with the law might be. It also asks what are the costs of not taking action. We seek to encourage all those, both within Government and outside, who are interested in the policy issues to let us have their views on the questions raised and the choices that might be made.

³⁹ See P Ambrose, *The Costs of Poor Housing: Urban Regeneration and Non-Housing Outcomes* (2001), paper for presentation at the HAS conference on “Housing Policies for the New UK”, York, 3-4 April 2002, <http://www.york.ac.uk/inst/chp/hsa/papers/ambrose.pdf> (last visited 22 June 2007).

PART 5

THE DEVELOPMENT OF REGULATORY THEORY: AN OUTLINE

INTRODUCTION

- 5.1 Assuming that further attempts should be made to encourage responsible letting, the question then arises how that might be done. This requires us to consider how approaches to regulation have developed. This Part offers a summary of the relevant literature. In Part 6, we examine how these basic ideas have been applied in the specific context of the regulation of the private rented sector over the last 150 years or so.
- 5.2 Most people do not like to be the subject of regulation. It is not therefore surprising that legislators seeking to impose regulation do not always achieve the outcomes they wish for. It is in this context that new ideas have emerged on ways in which the socially desirable outcomes of regulation can be achieved without encouraging those potentially the subject of regulation to find ways of avoiding those objectives.

COMMAND AND CONTROL

- 5.3 The traditional regulatory approach may be described as "command and control". This is regulation based on "the 'command' of law" and "the legal authority of the state" and controlled by agents of the state.¹ Standards are set in law, and enforced, in the main, by public authorities.
- 5.4 Command and control has formed the basis of much regulation in arenas including health and safety, food standards, environmental health, pollution control, and consumer protection. In the context of the private rented sector, legislation relating to housing fitness or the criminal offences created by the Protection from Eviction Act 1977 are examples of command and control regulation.
- 5.5 There are also circumstances in which the state sets standards, but leaves enforcement to the individual citizen. An example in the housing context is the covenants implied by statute into tenancy agreements regarding the landlord's repairing obligations.
- 5.6 Standard setting can be a powerful regulatory strategy. Regulation by command can have an immediate impact in the sense that where offending behaviour is identified, prosecution or other legal enforcement process can be begun. It signals the unacceptability of the offending conduct. It is potentially socially equitable because, at least in theory, it can provide clear and objective standards to be applied uniformly to the members of the regulated population.
- 5.7 But this approach has been criticised on a number of grounds.

¹ R Baldwin, "Regulation after Command and Control" in K Hawkins (ed) *The Human Face of Law: Essays in Honour of Donald Harris* (1997).

- (1) Regulation as command is sometimes treated as synonymous with excessive red tape, imposing unnecessary burdens.
- (2) Command and control has been widely criticised for both its legalism and its ineffectiveness – unclear or over-complex rules may not be targeted properly at those who should be regulated.
- (3) Command and control often assumes that Government has the capacity to formulate standards and, equally important, to oversee compliance. This assumption is often misplaced. If insufficient resources – whether organisational or financial – are devoted to enforcement, the control function is weakened and the effectiveness with which command and control can achieve its objective is undermined.
- (4) Where regulators lack resources they may choose to target simple cases rather than addressing more difficult violations. Regulators may also focus enforcement upon only the most severe or persistent breaches.² In either case, enforcement is patchy.
- (5) Regulation by command presupposes understanding and acceptance by the regulated of the content of the rules, their legitimacy, and the mode and severity of the enforcement regime. In reality, those regulated may breach the rules due to ignorance or misunderstanding or lack of resources. Breach may therefore not be perceived as wrongful behaviour by those targeted. Strict enforcement in these circumstances can be counter-productive, leading to unintended consequences including resentment, resistance and increased avoidance.
- (6) The general use of criminal sanctions to regulate behaviour is especially problematic when directed towards conduct that is not necessarily perceived as morally reprehensible. Whilst the goal may be to eliminate unacceptable practices, those with responsibility for regulatory enforcement may be ambivalent about using criminal law to control standards of behaviour.
- (7) Reliance on command and control may lead to “creative compliance”. Members of the regulated population adhere to the letter but not the spirit of the regulations.³
- (8) The control function can also be weakened if it is difficult or costly to collect the information necessary to ascertain whether those being regulated have complied with the relevant standards.

² K Hawkins, *Environment and Enforcement, Regulation and the Social Definition of Pollution* (1984) ch 10.

³ D McBarnet and C Whelan, “Creative Compliance and the Defeat of Legal Control: The Magic of the Orphan Subsidiary”, in K Hawkins (ed), *The Human Face of Law: Essays in honour of Donald Harris* (1997) pp 177 to 198, at p177.

FROM COMMAND AND CONTROL TO COMPLIANCE

- 5.8 The fundamental problem with command and control is that it does not work effectively or efficiently. Endless studies show that achieving 100% enforcement is rare if not impossible. In practice, enforcing agencies acquire and use considerable discretion. Recognising that many regulatory agencies use discretion to secure future compliance with the rules, rather than punish past breaches of them, analysts of regulatory practice argue for a shift in thinking from command and control to compliance. At the core of the compliance approach is negotiation and bargaining.⁴ Relevant factors include the size, structure and location of the regulatory agency and the regulated community,⁵ the attitudes of those regulated and their willingness to comply.⁶
- 5.9 It is possible to draw a distinction between regulatory strategies that focus upon compliance and those that focus on deterrence. Deterrence is concerned with securing conformity with the law through a process of detection and ultimately punishment; a compliance approach sees regulatory activity as a means to prevent violations without necessarily pursuing legal action.⁷ While compliance strategies may be adopted out of necessity because, for example, regulators lack resources,⁸ the flexibility offered by that approach means that it can be a more effective route to changing behaviour so as to secure future adherence to regulation. Some compliance strategies offer regulators greater scope for fostering responsibility among the regulated population. This has been identified as particularly desirable among small firms in some sectors.⁹ In this sense, compliance-oriented regulatory strategies offer the possibility of achieving outcomes that cannot necessarily be achieved through formal legal process.
- 5.10 Recognition that compliance strategies represent the dominant practice of regulatory agencies has been accompanied by complementary developments in ideas about regulation. Implicit in the compliance literature is the idea that Government lacks the capacity to define and enforce regulation single-handedly. One of the key consequences of accepting this point is that regulation may be more effective if Government moves away from public sector-focused regulatory regimes based upon command and control and starts to consider how it might harness the regulatory capabilities of others.

⁴ P Grabosky and J Braithwaite, *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies* (1986); K Hawkins *Environment and Enforcement, Regulation and the Social Definition of Pollution* (1984).

⁵ B Hutter, *The Reasonable Arm of the Law? The Law Enforcement Procedures of Environmental Health Officers* (1988).

⁶ K Hawkins, *Environment and Enforcement, Regulation and the Social Definition of Pollution* (1984) p 127; R. Baldwin *Rules and Government* (1995).

⁷ A J Reiss, "Selecting Strategies of Social Control Over Organizational Life", in K Hawkins and J Thomas (eds), *Enforcing regulation*, pp 23 to 36.

⁸ Local authority officers report that they are sometimes unable to prosecute even in cases where there is strong evidence of unlawful eviction or harassment by landlords, due to insufficient resources.

⁹ C Yapp and R Fairman, "Assessing Compliance With Food Safety Legislation in Small Businesses" (2005) 107 *British Food Journal* 150.

- 5.11 Similarly, moving beyond command and control means recognising that relying on punitive criminal sanctions alone to address a failure to perform to standard is not necessarily the best way to achieve positive outcomes in social regulation. Regulators need to consider a wider range of tools, including education and training, licensing, and economic regulation. It can also include private forms of ordering where Government harnesses or steers the capacities of others to generate beneficial effects for society as a whole. These forms include self-regulation, oversight by third parties such as industry bodies, and co-operative strategies that work with, as opposed to against, the interests of those regulated.¹⁰
- 5.12 Critics argue that any move away from command and control constitutes deregulation and a signal that Government is “going soft”.¹¹ Furthermore, in many cases alternative regulatory mechanisms do not remove problems such as how to secure effective enforcement.¹² A move away from command and control may represent no more than the deregulatory impulse in policy. But it can also signal a commitment to develop structures and processes that are better able to deliver on policy objectives.¹³

ECONOMIC REGULATION

- 5.13 Another approach to regulation may be described as economic regulation, forms of regulation which use economic means to shape the way in which markets work to deliver politically acceptable outcomes without the necessity for more intrusive direct intervention. Examples are:
- (1) Using competition law or franchising or licensing mechanisms to control market entry or market behaviour.
 - (2) Using taxes and subsidies to influence competition and shape the volume and distribution of outputs.
 - (3) Recent innovations in the field of environmental protection creating new property rights, such as permissions to emit sulphur dioxide that can be traded, which offer the potential to reduce emissions through harnessing the self-interest of producers without the requirement for detailed regulation of production processes.

¹⁰ N Gunningham and P Grabosky with D Sinclair, *Smart Regulation: Designing Environmental Policy* (1998), pp 123 and 124.

¹¹ S Tombs, “Understanding Regulation?” (2002) 11(1) *Social and Legal Studies* 113; C Parker, “The “Compliance” Trap: The Moral Message in Responsive Regulatory Enforcement” (2006) 40 *Law & Society Review* 591.

¹² It has been argued that the contrast between the structure of command and control and self-regulation, and the extent to which they are necessarily mutually exclusive, as regulatory techniques should not be overplayed. D Sinclair “Self-regulation Versus Command and Control? Beyond False Dichotomies” (1997) 19(4) *Law and Policy* 529-559.

¹³ Similar arguments have been made in criminology more broadly in the context of restorative justice and applied in regulatory contexts about the benefits of “reintegrative shaming” rather than deterrence. See, for example, C Parker, *The Open Corporation* (2002); T Makkai and J Braithwaite, “Reintegrative Shaming and Regulatory Compliance” (1994) 32 *Criminology* 361.

- (4) Disclosure regulation, that is regulation requiring the disclosure of certain information to the other party to a proposed transaction. This is a technique of economic regulation through which limited intervention can have a major impact upon market outcomes. Disclosure regulation is aimed at allowing those most at risk from participation in the market to make informed choices. Key examples can be found in consumer and financial services regulation. Disclosure regulation can also be directed at providing citizens with information to avoid potential hazards or risk, a strategy used in the context of food safety or other health-related risks such as smoking.

SELF-REGULATION

5.14 Yet another approach is self-regulation. Here responsibility for regulating behaviour is delegated to industry-level bodies such as trade associations.¹⁴ It offers the possibility of utilising the greater knowledge of those in an industry to develop more effective mechanisms for achieving regulatory goals. The advantages of self-regulation are as follows.

- (1) It can be more flexible and sensitive to market circumstances.
- (2) It may be seen as having greater legitimacy than state regulation by those being regulated.
- (3) It offers the potential for utilising positive peer group effects to deliver a culture of compliance.

5.15 Self-regulation is found in a number of forms.

- (1) “Voluntary”, where the process of establishing codes of practice or appropriate standards and enforcement is left to those within the industry.
- (2) “Mandated”, where there is reference to standards or requirements that have been set out by Government.
- (3) “Enforced”, where organisations develop their own rules, which are then approved by an external regulator (for example, the Office of Fair Trading).¹⁵ In some cases where the standards are formulated through collaboration between the state and the industry it can be better to think of the process as “co-regulation”.

¹⁴ An approach recently recommended by the Law Commission in its report on Trustee Exemption Clauses Law Com No 301(2006) paras 1.24 and 6.51 to 6.60, available at <http://www.lawcom.gov.uk/docs/lc301.pdf>.

¹⁵ J Rees “Self-Regulation: An Effective Alternative to Direct Regulation by OSHA (1988) 16(3) *Policy Studies Journal* 602.

- 5.16 Self-regulation has attracted much criticism, in particular for low standards and ineffective enforcement. The commonality of interest between regulators and regulated is such that the sanctions for contravention may be mild. There is concern that relying upon self-regulation risks conceding too much to the private interests of the regulated.¹⁶ These risks are greatest where the private and public interest diverge most sharply. Hence, its effectiveness as a regulatory strategy varies with the context.
- 5.17 However, while it may be naïve to rely upon self-regulation alone, it may be possible to reap the benefits of self-regulation while avoiding the problems if it is embedded in a broader regulatory strategy based upon a mix of policies.

RESPONSIVE REGULATION

- 5.18 Responsive regulation is one of the most influential ideas to have emerged over the last twenty years.¹⁷ The core concepts within responsive regulation are
- (1) the regulatory pyramid, which relates to both regulatory techniques and regulatory sanctions, and
 - (2) the principle of escalation or descent of the pyramid in response to the behaviour of those being regulated.

Also, under responsive regulation a significant regulatory role is envisaged for third parties.

- 5.19 The central idea is that effective regulation can include a mix of mechanisms ranging from voluntary self-regulation, at the base of the pyramid, to mandatory licensing at the top. Regulators should deploy a range of responses to contravention from the provision of information, through to licence revocation and punitive criminal sanctions at the top of the pyramid. The precise mix of mechanisms and sanctions appropriate to a particular context depends on the characteristics of the industry.
- 5.20 Most regulatory activity takes place at the base of the pyramid, but regulators should be willing to move up the pyramid using more formal mechanisms and tougher sanctions if those being regulated fail to respond to softer measures. Conversely, if tougher measures are successful then this can lead to regulation returning to lower tiers on the pyramid. Because regulators have access to, and can threaten use of, the “benign big gun” of severe sanctions, the potential effectiveness of softer approaches such as self-regulation is increased.

¹⁶ J Braithwaite, “Responsive Business Regulatory Institutions” in C Cody and C Stampford (eds), *Business, ethics and the law*, p.91.

¹⁷ I Ayres and J Braithwaite, *Responsive Regulation: Transcending the deregulation debate* (1992).

- 5.21 Critics argue that while the notion of a benign big gun might be appealing in principle, the credibility of such threats in practice is a separate question. Empirical studies have questioned whether regulators act responsively in the manner envisaged by the theory and, if they do, whether this is helpful in the long run.¹⁸ Similarly, the plausibility of the sort of tit-for-tat regulatory strategy envisaged under responsive regulation is questioned. While it is possible to escalate sanctions, this in itself can destroy the relationship between the regulator and those being regulated. As a consequence, it is less clear that it is possible to return to a regime of lesser sanctions and a more trusting relationship.
- 5.22 The process of progressive escalation means that responsive regulation is more suitable for achieving changes in behaviour in the longer term. It is less relevant where agents' participation in an industry is relatively short-term or where contact with the regulator is infrequent.

SMART REGULATION

- 5.23 Smart regulation, developed initially in the context of addressing environmental pollution,¹⁹ extends and broadens insights from the compliance and responsive regulation approaches. Under smart regulation the key regulatory task is to discover the most effective mix of regulatory techniques, whether they involve monitoring the situation, informing, advising, making threats, or hard enforcement in the form of prosecution. Smart regulation is an approach that highlights the need to consider a regulatory structure in its entirety, including the provision of mechanisms for feedback and review to allow learning.²⁰ Thus, in designing a regulatory structure, the following principles should be borne in mind:²¹

- (1) *Prefer policy mixes incorporating a broader range of instruments and institutions.* Reliance upon a single regulatory instrument is unlikely to be efficient or effective; each has its weakness. It is sensible use of complementary instruments that will be more effective.
- (2) *Prefer less interventionist measures.* Where possible it is more efficient to use less interventionist measures because administrative costs will be lower. It is more effective to do so because those being regulated are more likely to perceive themselves as volunteers than conscripts.

¹⁸ PJ May and RS Wood, "At the Regulatory Front Line: Inspectors' Enforcement Styles and Regulatory Compliance" (2003) 13 *Journal of Public Administration Research and Theory* 117; V Nielsen, "Are Regulators Responsive?" (2006) 28(3) *Law & Policy* 395.

¹⁹ N Gunningham and P Grabosky with D Sinclair, *Smart Regulation: Designing Environmental Policy* (1998).

²⁰ M Lodge and K Wegrich, submission to the Scottish Parliament. Subordinate Legislation Committee Report (2005) *Inquiry Into the Regulatory Framework in Scotland* SP 397. <http://www.scottish.parliament.uk/business/committees/subleg/reports-05/sur05-31-04.htm> (last visited 22 June 2007).

²¹ N Gunningham and P Grabosky with D Sinclair, *Smart Regulation: Designing Environmental Policy* (1998) pp 387 to 422.

- (3) *Climb the regulatory pyramid to the extent necessary to achieve policy goals.* This draws upon the responsive regulation idea of escalation. But smart regulation argues more strongly also for the use of the second and third phases of the regulatory pyramid: that is, harnessing the regulatory capacities of not just Government but business and commercial and non-commercial third party organisations.
- (4) *Empower participants who are in the best position to act as surrogate regulators.* If the range of regulatory bodies is expanded beyond the state to include second- and third-party organisations then this can overcome some of the shortcomings of more traditional approaches.²² With Government resources constrained, it may be wise to focus the available resources upon situations where direct regulation is the only viable approach and use other tools where these can deliver acceptable policy outcomes.
- (5) *Maximise opportunities for win-win outcomes.* Smart regulation seeks to provide incentives to improve performance (for example by demonstrating that adopting enhanced environmental standards can lead to increased profits), rather than being satisfied with simple compliance with current legal standards.

BETTER REGULATION

5.24 Government policy on regulation in recent years has frequently been expressed in terms of “Better Regulation”. All proposals for new legislation now have to go through a process of regulatory impact assessment to satisfy Government that they deliver an adequate net benefit to society. The process of assessment should be made with reference to the five principles of good regulation.²³ These are:

- (1) *Proportionality.* Intervention should only occur when necessary and the remedies should be appropriate to the risk posed. The costs associated with regulation should be identified and minimised. An educational rather than punitive approach should be taken where possible.
- (2) *Accountability.* Regulators should be able to justify decisions. Their actions should be subject to public scrutiny.
- (3) *Consistency.* The rules and standards set by Government should be “joined up”. Regulators should be consistent with each other. Rules and standards should be implemented fairly.

²² As Gunningham and others argue: “There are many areas of commercial activity ... where direct government influence is impractical. For example, where there are a myriad of small players, such that it is impossible even for government to identify, let alone regulate all of them” N Gunningham and P Grabosky with D Sinclair, *Smart Regulation: Designing Environmental Policy* (1998) p 409. This is clearly particularly pertinent in the context of the private rented sector.

²³ Better Regulation Task Force, *The Principles of Good Regulation* <http://www.brc.gov.uk/downloads/pdf/principlesleaflet.pdf> (last visited 22 June 2007).

- (4) *Transparency.* Regulations should be kept simple. The purpose and need for regulation should be clearly defined. Proposals for regulatory change should be consulted on.
 - (5) *Targeting.* Regulation should be focused upon particular activities causing the most serious risks. Where appropriate it should be “goals-based” rather than “process-based” – leading to actual improvements in behaviour, not simply the completion of forms. Further, regulation should always be kept under review.
- 5.25 These incorporate some of the ideas that can be found in discussions of responsive and smart regulation, for example preferring less interventionist measures. However, there are other aspects of the smart regulation approach – such as relating to the desirability of using a mix of regulatory instruments or the principle of escalation – that are not so clearly identifiable.²⁴

RISK-BASED REGULATION

- 5.26 Since the 1980s, there has been a shift towards including risk-management strategies and initiatives into regulation. Government now sees assessments of risk as fundamental to regulatory effectiveness: they are advocated as the foundation for all aspects of regulation and not just enforcement programmes.²⁵
- 5.27 Risk-based approaches to regulation emphasise the tensions between imposing additional burdens on the regulated community (which may have little practical effect) and ensuring that the underlying objectives of the regulatory strategy are achieved. Thus they emphasise the uncertainties associated with regulating and are often used as a way of justifying the taking of a more selective approach to regulation so that only those activities and actors most likely to have adverse impacts on the public are targeted.²⁶
- 5.28 Risk-based regulation represents a logical progression from Better Regulation principles. Given that regulatory resources are scarce, risk-based regulation can inform enforcement programmes by providing for the systematic prioritisation of enforcement activity.²⁷

²⁴ R Baldwin, “Is Better Regulation Smarter Regulation?” [2005] *Public Law* 485.

²⁵ P Hampton, *Reducing Administrative Burdens: Effective Inspection and Enforcement* (March 2005) <http://www.hm-treasury.gov.uk/media/7/F/bud05hamptonv1.pdf> (last visited 22 June 2007) paras 2.13, 2.16, 2.38.

²⁶ D Vogel, “The Politics of Risk Regulation in Europe and the United States” *The Yearbook of European Environmental Law*, Volume 3, (2003).

²⁷ M Sparrow, *The Regulatory Craft: Controlling Risks, Solving Problems and Regulatory Compliance* (2000); J. Black, “Managing Regulatory Risks and Defining the Parameters of Blame: A Focus on the Australian Prudential Regulatory Authority” (2006) 28(1) *Law and Policy* 1.

- 5.29 Adopting a risk-based approach to regulation and its enforcement entails a shift in the way that regulators have traditionally thought of their roles. It is one that promotes a greater reliance upon the provision of advice and education rather than as one report has suggested, “enforcement for its own sake”.²⁸

CONCLUSION

- 5.30 With this introduction to regulatory theory in mind, we turn in Part 6 to a discussion of how principles of regulation could apply to the private rented sector.

²⁸ R B Macrory, *Regulatory Justice: Making Sanctions Effective Final Report* (November 2006) p 5, available at http://www.cabinetoffice.gov.uk/regulation/documents/pdf/macrory_penalties.pdf (last visited 22 June 2007).

PART 6

REGULATING THE PRIVATE RENTED SECTOR: THE APPROACH TO DATE

INTRODUCTION

6.1 Having considered how general regulatory theory developed, we now discuss its application in the specific context of housing. Looking at the development of housing law, there appear to be four broad stages in the development of thinking about the regulation of the private rented sector:

- (1) the mid-nineteenth century to 1915;
- (2) 1915 to 1957;
- (3) 1957 to 1988; and
- (4) 1988 to the present.

THE MID-NINETEENTH CENTURY TO 1915

The focus on public health: powers for local authorities

6.2 During the mid-nineteenth century a number of reports raised concern over the state and condition of housing, particularly the slums, taking account of the prevailing concerns of the time about cholera and other epidemics.¹ The belief that better ventilation, drainage and sanitation would prevent cholera was, at least in part, responsible for the subsequent focusing of minds on housing.²

6.3 Attempts to persuade the courts to develop the law so as to impose obligations on landlords to attend to housing conditions did not bear fruit, notwithstanding the appalling conditions revealed in the first report of the Poor Law Commission in 1835.³

¹ See, for example, JP Kay, *The Moral and Physical Condition of the Working Classes Employed in the Cotton Manufacture in Manchester* (1832); E Chadwick, *Report on the Sanitary Condition of the Labouring Population of Gt. Britain* (1842).

² See, for example, M Flinn, *Report on the Sanitary Condition of the Labouring Population of Gt. Britain/by Edwin Chadwick, 1842*, (1965); see also C Hamlin, *Public Health and Social Justice in the Age of Chadwick Britain, 1800-1854* (1998).

³ J Reynolds, "Statutory Covenants of Fitness and Repair: Social Legislation and the Judges" (1974) 37(3) *Modern Law Review* 377, 379; the author notes three cases in this regard: *Arden v Pullen* (1842) 10 M & W 322; *Sutton v Temple* (1843) 12 M & W 52; *Hart v Windsor* (1844) 12M & W 68 ("It is much better to leave the parties in every case to protect their interests themselves by proper stipulation": *Hart v Windsor* (1844) 12 M & W 68, by Parke B).

- 6.4 Notwithstanding the laissez-faire ideology of the time, Parliament began to intervene.⁴ The focus of the legislation was more on public health than the landlord-tenant relationship.⁵ Public health legislation created powers over new building, and (less comprehensive and more difficult to exercise) powers to prevent the unhealthy use of existing houses and to remedy conditions that were dangerous to health. It created powers to close or demolish individual houses that were unfit for human habitation and to demolish and clear areas of insanitary housing.⁶ Although powers to make and enforce orders were given to local authorities, their effects were limited.⁷ In short, there was more command than control.
- 6.5 It was only in the Housing of the Working Classes Act 1885 that Parliament started to intervene in the contractual obligations existing between landlord and tenant. Again, though, it did so on the basis of concerns about sanitation. It implied into lettings of unfurnished property a condition that the property be fit for human habitation. This was an early example of “commands” being issued by the state, with enforcement being left to the individual tenants.⁸

1915 TO 1957

Direct control of rents and security: intervention by statute into contract

- 6.6 In 1915 the state started to intervene much more directly in the contractual relationship between landlord and tenant. This was the year in which rent control and security of tenure were first brought to the statute book.⁹ Rent control meant that rents (and any increases) were set according to centrally prescribed formulae. Security of tenure meant that the ability of landlords to evict tenants was severely circumscribed.¹⁰ It should be noted that these controls did not apply to all rented housing, only to those homes at the cheaper end of the market.

⁴ This development is discussed in housing policy texts such as A Holmans, *Housing Policy in Britain* (1987) and A S Murie and P Malpass, *Housing Policy and Practice* (5th ed 1999).

⁵ In particular, the Public Health Act 1848.

⁶ A Holmans, *Housing Policy in Britain* (1987), p 27.

⁷ During this subsequent period, there were a host of publications and statistical surveys of the “housing question”, of which the most famous was A Mearns, *The Bitter Cry of Outcast London* (1883) and the *Royal Commission on the Housing of the Working Classes* (1885).

⁸ See now Landlord and Tenant Act 1985, section 8 and *Quick v Taff Ely BC* [1986] 1 QB 809.

⁹ Increase of Rent and Mortgage Interest (War Restrictions) Act 1915. A more detailed history of the development of the Rent Acts is found in *Renting Homes 1: Status and Security* (2002) Law Commission Consultation Paper No 162, Part 2.

¹⁰ Although governments were unwilling to intervene in private, open market transactions, it did so because of the overriding necessity brought about by the Great War. Munitions towns experienced rapidly rising rents and evictions as local housing markets, in which new supply was constrained or non-existent, responded to excess demand caused by the influx of new workers by sharp increases in rent levels. The broader need to minimise industrial unrest and maximise munitions output as part of the war effort was seen as justifying housing intervention. See generally P Watchman, “The Origin of the 1915 Rent Act” (1980) 5(1) *Law and State* 20; S Damer, “State, Class and Housing: Glasgow 1885-1919”, in J Melling (ed), *Housing, Social Policy and the State* (1980); but see also Ministry of Reconstruction, *Committee on the Increase of Rent and Mortgage Interest (War Restrictions) Acts* (1919), para 4.

- 6.7 Though originally conceived as an emergency wartime measure, the legislation remained in force, subject to detailed changes, until 1957. Despite continuing unease about legislative intervention in private contractual relationships, reflected in a number of reports that expressed concern about the continuance of the law, the time never seemed quite right for the Government to repeal it.
- 6.8 During the period, there was limited decontrol of some properties,¹¹ justified either on the basis of growth in the production of new properties (generally for sale) or on
- “the psychological factor ... the aversion to statutory control of any kind ... The primary investor, the property owner, dislikes the prospect of increasing interference by the State in the relations between himself and his tenant ...”¹²
- The exact formula for the control of rent was also amended. But though the precise coverage of the legislation changed and the details were altered,¹³ the key principles of the 1915 Act remained in force.¹⁴ Indeed, general controls were re-imposed during the Second World War.
- 6.9 This period also saw the enactment of other controls on landlord behaviour, in particular controls on the asking of premiums.
- 6.10 There is not a great deal of empirical evidence about how these statutory provisions applied in practice. But one thing is certain; one significant consequence of the regulatory regime was that many landlords sought to exit the market. Their inability to set market rents and the loss of ability to regain possession meant that many left the sector, preferring to invest in other parts of the economy.¹⁵ This emphasises the point that any decisions about what regulatory strategy to adopt should take into account the extent to which it will drive people from the relevant market.
- 6.11 The first step towards decontrol was the enactment of special provisions relating to the renting of furnished accommodation in 1946.¹⁶ A more general measure of decontrol was enacted in the Rent Act 1957.

¹¹ See, in particular, the Final Reports of the Departmental Committee on the Increase of Rent and Mortgage Interest (Restrictions) Act, 1920 (1923); Ministry of Health, Report of the Inter-Departmental Committee on Rent Restrictions Acts (1931).

¹² Final Reports of the Departmental Committee on the Increase of Rent and Mortgage Interest (Restrictions) Act 1920 (1923), p 7.

¹³ For example, the Increase of Rent and Mortgage Interest (Restrictions) Act 1920.

¹⁴ The controls were retained because of the risk of high rents in a decontrolled market, in which there was an under-supply of accommodation as well as a lack of building materials for repairs and production of new accommodation. *Committee on the Increase of Rent and Mortgage Interest (War Restrictions) Acts* (1919), para 25.

¹⁵ We do not suggest that rent control was the sole cause of the decline of the private rented sector; increasing prosperity and tax advantages were also powerful factors encouraging the growth of the owner-occupied sector. The private rented sector was also increasingly replaced by social housing provided principally by local housing authorities, including as part of policies directed at urban slum clearance.

¹⁶ The Furnished Houses (Rent Control) Act 1946.

1957 TO 1988

A period of transition: decontrol and the introduction of new regulatory approaches

- 6.12 From 1957 the focus was initially on decontrol. The Conservative Government of the day determined to end rent control. But this was not to happen overnight. The Rent Act 1957 provided that decontrol would occur when landlords took vacant possession of their property. This resulted in a number of landlords engaging in activities that were designed to “encourage” tenants to move out, as, through the removal of tenants with long-term security of tenure, the move from controlled to decontrolled status offered the landlord the prospect of significant capital gain.
- 6.13 One landlord, Perec Rachman, was subject to particular criticism.¹⁷ Rachman began his activities by offering tenants financial inducements to leave. Subsequently, however, he obtained vacant possession by harassing tenants:
- “what perhaps began naturally, Rachman began to exploit, seeing, perhaps, no point in paying controlled tenants to go if they could be persuaded to do so by other means”.¹⁸
- 6.14 This led to a number of changes in regulatory practice. First, the mechanisms that had been used until this time – with enforcement either by tenants taking advantage of statutory amendments to the terms of their letting agreements or by local authorities exercising public health powers – were supplemented by a new focus on use of the criminal law. In particular, the Protection from Eviction Act 1964 created criminal offences relating to the unlawful eviction and harassment of tenants.
- 6.15 Second, although the Labour Government that was elected in 1964 (and re-elected in 1966) did not return to strict rent control, it sought to use rent regulation to prevent what it saw as the exploitation of housing shortages. The Rent Act 1965 provided that only “fair rents” should be charged by landlords. Contractual rent levels could be subject to review by Rent Officers, whose decisions were appealable to Rent Assessment Committees, not to the courts.¹⁹ One of the key differences about the fair rent regime was that it applied to the vast majority of rented accommodation (excepting only accommodation right at the top end of the market), not just to that at the bottom end of the market.

¹⁷ For discussion, see P Kemp, “The Ghost of Rachman”, in C Grant (ed), *Built to Last* (1997).

¹⁸ *Report of the Committee on Housing in Greater London*, Cmnd 2605 (1965), p 252. The focus was on Rachman because he had been involved, indirectly, in the political scandal surrounding the Profumo Affair.

¹⁹ For discussion, see M Partington, *Landlord and Tenant*, 2nd ed (1980). Access to Rent Assessment Committees was cost-free to the parties, unlike access to the courts.

- 6.16 Third was the introduction of changes to the way in which financial support for the cost of rented housing was provided. Building upon initiatives taken at the local authority level in the 1960s, a national system of means-tested assistance to tenants was established. Initially introduced only in relation to the cost of accommodation rented from public landlords, assistance was extended by the Conservative Government to rents charged by private landlords in the Housing Finance Act 1972.²⁰ For the first time there was a national scheme designed to supplement the incomes of the poor – in work, as well as out of work – in order to help them meet the cost of renting. This at least partially recognised the argument that, if the housing costs of the poor were to be subsidised, this should be paid for by the taxpayer, not by penalising the landlord through enforcing below-market rents.
- 6.17 It should also be noted that during this period, a number of small but significant deregulatory initiatives were taken to reduce statutory protection for some rental agreements, for example temporary lettings by owner-occupiers.²¹ These can be seen as the forerunner to the more general deregulation that took place in the 1980s. This period, which led to the consolidation of the law in the Rent Act 1977, arguably represents the high water mark for regulation of private sector security of tenure and rents, after which deregulation increased.

1988 TO THE PRESENT

Regulation through the market and the arrival of licensing

- 6.18 When the Conservative Government came to power in 1979, the initial focus of housing policy was on the public sector. The Housing Act 1980 introduced both the right to buy and statutory security for tenants of local authorities. In this context, a raft of new regulatory mechanisms (many involving the potential for enforcement through the criminal courts) were introduced into a sector of the housing market that had hitherto been largely unregulated.
- 6.19 With the enactment of the Housing Act 1988 (followed by the Housing Act 1996) key regulatory provisions relating to the private rented sector were removed. Rent control and regulation was largely ended; and statutory security of tenure was drastically curtailed. Indeed, a political consensus emerged that there was a need to encourage private renting as an intermediate tenure and a channel through which to meet housing need. This is reflected in the fact that the arrival of the new Labour Government in 1997 was not accompanied by a decision to reverse the market reforms of the Thatcher era.
- 6.20 Private landlords were henceforth able to charge market rents; and those who let under assured shorthold tenancies were able to do so subject to only very limited restrictions on their ability to regain possession of their premises.

²⁰ The legislation referred to the payment of rent “allowances” for private tenants and rent “rebates” for local authority tenants. Rent allowances were also paid to housing association tenants. The two systems were brought together in a single housing benefit system in 1983.

²¹ Rent Act 1974, s 3.

- 6.21 Despite these changes, private landlords remained subject to considerable regulation, particularly in relation to housing conditions (as has been considered in Part 3 above). Landlords could now charge full (that is unregulated) market rents. It was argued that they should, at least in areas of reasonable housing demand, be able to set rents at a level that could include an element for maintenance and repair. Yet, it was evident that a market that was functioning more effectively in general was not able to deliver accommodation of a minimum acceptable standard to all. As a consequence, it could be argued that the case for retaining regulation in this area was strengthened.
- 6.22 Private landlords also remained subject to rules about the process of lawfully regaining possession of their property. Failure to abide by these rules could lead, at least in theory, to proceedings for unlawful eviction and harassment.²² This could also be justified on the basis that as, in many cases, a court was bound to order possession, it was reasonable to expect a landlord to abide by the rules and wait the relatively limited time needed for a possession order to be obtained.
- 6.23 Largely as a consequence of the success of the right to buy, the social housing stock in many areas has been under acute pressure for more than a decade. In the mid-1990s the scope of local authorities' duties to meet housing need were rethought and the private rented sector assumed a more important role in housing vulnerable households who approached a local authority for assistance. Those within local authorities who are seeking to raise standards in the private rented sector are therefore operating in the context of competing policy priorities.
- 6.24 This comes across clearly in relation to harassment and unlawful eviction, where stronger enforcement can increase the demands upon social housing by creating additional homeless households.²³ To the extent that more active enforcement of a regulation leads to a reduction in housing supply, the problem is general. Seeking to accommodate these competing priorities can lead to caution in enforcement and a greater emphasis being placed upon compliance strategies.
- 6.25 Regulation of different parts of the market was also conducted more subtly through economic means. Despite the abolition of rent regulation, there were indirect controls over rent levels at the bottom end of the market through limits on the amounts of rent that would be met by housing benefit.²⁴ This would obviously limit the extent to which the state was willing to subsidise the housing costs of the poor.

²² See *Supplementary Paper 1: The Law on Housing Conditions and Unlawful Eviction.*, available at http://www.lawcom.gov.uk/housing_renting.htm.

²³ D Cowan and A Marsh, "There's Regulatory Crime and Then There's Landlord Crime: From "Rachmanites" to "Partners"" (2001) 64(6) *Modern Law Review* 831.

²⁴ M Partington, "The Re-introduction of Rent Control? The Effect of Changes to the Housing Benefit Scheme" (1997) 1(1) *Journal of Housing Law* 6.

- 6.26 At the same time, though, some incentive to undertake repairs was provided through the payment of (discretionary) grants to landlords.²⁵ These were designed to help especially in poorer areas where, even with market rents, the level of profit would never be sufficient to justify expenditure on repair and maintenance on purely economic grounds.
- 6.27 Although the new Labour Government accepted the broad thrust of the changes made in the Housing Acts 1988 and 1996, the publication of the 2000 Housing Green Paper²⁶ showed that it remained troubled by a number of issues concerned broadly with the quality of property, management and behaviour in the private rented sector.²⁷ These issues were translated into legislative form in the Housing Act 2004.
- 6.28 The Housing Act 2004 is the first piece of housing legislation to be passed after the emergence of the Government's commitment to the Better Regulation agenda.²⁸ It might therefore be expected that it would engage with regulatory approaches that move beyond traditional forms of command and control. The Act contains three initiatives that have particular significance for the regulatory approach to the private rented sector:
- (1) the replacement of the housing fitness standard by a Housing Health and Safety Rating System;
 - (2) the introduction of mandatory licensing for houses in multiple occupation and selective area-based licensing; and
 - (3) the establishment of tenancy deposit schemes with a statutorily prescribed form.

²⁵ See, for example, M Bevan, P Kemp and D Rhodes, *Private Landlords and Housing Benefit* (1995). The availability of these grants was, however, always limited: local authorities never had the resources to meet demand. M Ellison comments that "Both before and after the introduction of the 1996 Housing Grants, Construction and Regeneration Act, Councils made grants hard to obtain because of their concerns over a lack of resources. One South East district authority stated "... the Council wishes to use grant aid as an inducement to landlords to improve properties for letting ... the ability of the Council to fund such grant aid is unlikely to be available in the foreseeable future, due to capital resource constraints": M Ellison, "The Impact of the Local Authority Grant System" in S Lowe and D Hughes *The Private Rented Sector in a New Century* (2002).

²⁶ DETR/DSS, *Quality and Choice: A Decent Home For All* (April 2000), available at http://www.communities.gov.uk/pub/243/QualityandchoiceadecenthomeforallTheHousingGreenPaperprintedPDF594Kb_id1150243.pdf (last visited 22 June 2007).

²⁷ The Housing Green Paper demonstrated a positive general attitude towards the sector: "We believe that most private landlords are basically well-intentioned and anxious to do a good and responsible job" (para 5.8). Furthermore, many of the problems in the sector are not viewed as a product of malice: many "good and well-intentioned landlords" face a "great mass of legislation" and "fall foul of the law ... more often than not ... through inadvertence" (para 5.10). Nonetheless, the Government takes the view that there is "a small minority of private landlords [who] set out to exploit their tenants and the community at large in flagrant disregard of the law" (para 5.4).

²⁸ For more on the Government's Better Regulation initiative see the Better Regulation website <http://www.betterregulation.gov.uk/> (last visited 22 June 2007).

- 6.29 The shaping of these initiatives appears to have been influenced by contemporary regulatory thinking: they embody greater acknowledgement of concepts such as risk, proportionality, targeting and use of a pyramid of sanctions. However, they are not without problems and have not departed completely from the world of command and control.
- 6.30 A further significant development that has gathered momentum under the current Government is the recognition by policy makers of the role that voluntary codes adopted by non-state actors can play in the regulation of the private rented sector. The codes of practice and good practice guidance by which landlord associations seek to shape the conduct of their members have come to be viewed as an important resource in ensuring that the management of private rented property is of an adequate standard. We illustrate the scope and nature of the requirements embodied in codes in Supplementary Paper 1. Alongside an increased emphasis upon trade associations, voluntary local accreditation schemes have been established by a number of local authorities.²⁹

CONCLUSION: REGULATING THE PRIVATE RENTED SECTOR

- 6.31 The diverse regulatory techniques in operation in today's private rented sector have their origins in different eras, and reflect different ideas about the nature and scope of regulation. They encompass:
- (1) measures of command and control,
 - (2) licensing,
 - (3) codes of practice and the promulgation of standards, and
 - (4) softer forms of regulation such as requirements on the provision of information.
- 6.32 More recently, recognition has been given to the valuable role that non-state actors can play in regulation. Some of the initiatives reflect attempts to embody the principles of better and responsive regulation.
- 6.33 The presence of regulatory variety is attributable in part to overriding policy concerns. Thus, a deregulatory ideology may be overridden when practical demands and understandings require this. In the Victorian period, the dominance of public health concerns created coalitions of those in favour of regulation by those who, otherwise, were against it.³⁰

²⁹ DETR, *Voluntary Accreditation for Private Landlords* (2001), available at http://www.communities.gov.uk/pub/747/144VoluntaryaccreditationforprivatelandlordsPDF28Kb_id1155747.pdf (last visited 22 June 2007).

³⁰ For discussion, see C Hamlin, *Public Health and Social Justice in the Age of Chadwick Britain, 1800-1854* (1998).

- 6.34 Similarly, concerns about standards of fitness and housing condition have underpinned modern approaches, which have gone against the broader deregulatory impulse. Whilst early regulatory styles might now appear crude, they were innovative at the time, first of all by encroaching upon the contractual relationship between landlord and tenant, and then using external actors (often local authorities) to enforce regulatory standards.
- 6.35 The means by which the sector is currently regulated is the result of a complex mixture of historical policy legacy and contemporary currents in regulatory thinking. The policy legacy reflects long-standing political distrust of private landlords, which led to an acceptance of the need to regulate certain aspects of the sector. This is now mixed with a broader commitment to deregulate the sector in order to facilitate growth.
- 6.36 The application of regulatory theory to the private rented sector is also disorganised, incorporating regulatory techniques that have their origins in different eras and understandings of effective regulation. These range from a heavy reliance upon the criminal law and sanctions to the use of the contractual relationship between landlord and tenant to regulate landlord activity.
- 6.37 Given the piecemeal way in which the current regulatory structure has evolved, we think that there is scope for reforming at least some of its components.
- 6.38 One reason why newer approaches to regulation are needed results from the changing composition of the sector itself.³¹ There has been a significant rise in the number of private landlords who have started to let accommodation, often supported by the "buy-to-let" mortgage market. There has also been significant new investment in specific "niche" sectors of the market, in particular the provision of units of accommodation for students. To that extent, a lighter and more flexible regulatory approach has stimulated the supply side of the private rented sector. Nevertheless, there has not been any significant institutional investment in more broadly based "build-to-let" schemes.
- 6.39 At the same time, bodies representing landlords and managing agents have played an increasingly prominent role in the sector and have increased their emphasis on the importance of good management practice in the rental market. They have developed important codes of practice relating to the letting of rented accommodation.³²

³¹ ADH Crook, J Henneberry, J Hughes and P Kemp, *Repairs and Maintenance by Private Landlords* (2000).

³² These are discussed in *Supplementary Paper 1: The law on Housing Conditions and Unlawful Eviction*, available at http://www.lawcom.gov.uk/housing_renting.htm.

6.40 Despite all these developments, two particular regulatory challenges remain. First, large numbers of private landlords and many letting agents are not members of any professional or representative body. Mechanisms for spreading good management practice to those who might benefit from it are not as strong as they should be. Second, there are still reputational problems that affect the private rented sector. While there have been important attempts to discover the considerable common ground that exists between landlords and those who rent from them,³³ sceptical voices are still heard that the private rented sector is riddled with abuse and problems.³⁴ Whether justified or not, these voices remain part of the political context within which housing policy has to be set.

CONSULTATION ISSUES

6.41 Part 5 set out basic information about regulation. In this Part we apply this analysis to four key periods in the development of the regulation of the private rented sector. Consultees are invited to comment on the development of regulatory theory and the lessons this may have for the operation of the private rented sector.

³³ See the report of the Shelter and Joseph Rowntree Commission on the Private Rented Sector, *Private Renting: A New Settlement* (2002), available at <https://www.landlordlaw.co.uk/content/PRSmediareport.pdf>.

³⁴ See for example the *Hansard* reports of debate on 12 January 2004 on the Bill which became the Housing Act 2004. David Clelland MP referred to “absentee landlords who let to antisocial and sometimes criminal elements to reduce property values and build up their empires” while “decent people are either driven out or made subject to the criminal racist behaviour of such people”, concluding that this was a “cancer in some of our urban areas” *Hansard* (HC), vol 416, cols 536 to 537, available at http://www.publications.parliament.uk/pa/cm200304/cmhansrd/vo040112/debtext/40112-07.htm#40112-07_spnew5 (last visited 22 June 2007). Gerald Kaufman commented that “We have a much smaller private rented sector than during the Rachmanite period 40 years ago, but in a way private landlords behave worse than Rachman ... using houses not simply for antisocial purposes but often for criminal purposes.” *Hansard* (HC) vol 416, cols 553 to 555, available at http://www.publications.parliament.uk/pa/cm200304/cmhansrd/vo040112/debtext/40112-12.htm#40112-12_spnew1 (last visited 22 June 2007). Frank Dobson MP referred to “Nasty absentee private landlords” who “establish themselves in a street or neighbourhood, and gradually spread like a virus, making life intolerable for lots of other people” *Hansard* (HC), vol 416, cols 574 to 575, available at http://www.publications.parliament.uk/pa/cm200304/cmhansrd/vo040112/debtext/40112-17.htm#40112-17_spnew1 (last visited 22 June 2007).

PART 7

PROPOSALS FOR CHANGE

INTRODUCTION

- 7.1 In Part 4, we noted that major resources would be needed to improve compliance with existing management standards particularly those relating to housing condition and repair. Assuming that there is agreement that such improvements should be made, this Part considers what form of regulatory regime would be optimal.

THE POSSIBLE OPTIONS

- 7.2 We have identified three possible options for reforming regulation of the private rented sector:
- (1) enhancing voluntary self-regulation;
 - (2) enforced self-regulation; and
 - (3) licensing.

The first two build on recent policy developments with the existing infrastructure of professional associations and accreditation schemes. The third posits a general licensing system.

- 7.3 Our provisional preference is for (2). At this stage, this seems to offer the most promising balance for ensuring greater compliance without imposing disproportionate regulatory burdens upon the regulated community.
- 7.4 Before considering each of the options in more detail, we think it important to state the general principles which should underpin any proposals for reforming the regulatory structure which applies to the private rented sector.

GENERAL PRINCIPLES

- 7.5 If the regulatory regime for the private rented sector is to be reformed, the following issues must be borne in mind.

Prevention: better provision of information

- 7.6 Any new regulatory framework must be concerned as much with prevention as with enforcement: encouraging adherence to standards to avert relatively more costly and ultimately less effective enforcement action. One preventive measure that can be taken, regardless of whether any reformed scheme is pursued, is the better provision of information. If those letting property in the private rented sector were more aware of their obligations then the level of non-compliance through inadvertence would be reduced.¹
- 7.7 The problem in the private rented sector is not a lack of available information² but finding ways to deliver it in a digestible form to landlords, agents, and occupiers who would not actively seek it out. One means of doing this, which we recommended in *Renting Homes*, is to ensure that rental contracts contain a clear and comprehensive written statement of both parties' rights and responsibilities.³
- 7.8 Another potential route through which to provide information could be tenancy deposit schemes.⁴ Because landlords who take deposits must join an approved scheme,⁵ scheme operators could be effective conduits for transmitting information to landlords, agents and occupiers about their respective rights and obligations.
- 7.9 It may be possible to make greater and more creative use of other existing channels of communication such as through the provision of housing benefit or other local authority means of communication.
- 7.10 Occupiers are crucial targets for information provision. They must be aware of their landlord's or agent's obligations, and how they can lodge a complaint if those obligations are breached. Provision of basic information is essential.

Encouraging compliance: the smarter option

- 7.11 By giving a central role to industry associations and accreditation schemes, our first two options are "smarter".⁶ By allowing industry self-regulation to carry much of the regulatory burden, Government agencies could concentrate upon those tasks which can only be achieved through sanctions available to the state agencies.

¹ The most recent private landlords survey highlights lack of information and advice as a problem for landlords and agents: ODPM, *English House Condition Survey, Private Landlords Survey 2003* (2006) p 39, available at http://www.communities.gov.uk/pub/226/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165226.pdf (last visited 22 June 2007).

² The Internet alone is a relatively comprehensive and up to date source of free information on housing law obligations: see for example <http://www.landlordzone.co.uk/> (last visited 22 June 2007) and <http://www.letlink.co.uk> (last visited 22 June 2007).

³ *Renting Homes: The Final Report* (2006) Law Com No 297, Part 3, available at http://www.lawcom.gov.uk/docs/lc297_vol1.pdf.

⁴ H Carr, S Cottle, T Baldwin, M King, *The Housing Act 2004: A Practical Guide* (2005) p 219.

⁵ Housing Act 2004, ss 212 to 215 and sch 10.

⁶ See above, para 5.23, for discussion of smart regulation.

- 7.12 The approach also aligns market incentives and private interests with the public interest to encourage compliance. For example, some accreditation schemes currently offer two-tiers of accreditation.⁷ Landlords can choose to obtain a second (higher) level of accreditation by agreeing to abide by tougher condition and management standards. This enhanced status can give the landlords a market advantage in the form of increased demand and/or the ability to charge higher rents. Similarly, professional associations could choose to adopt higher standards than those required by Government. Landlords and agents could gain market advantage from membership in these enhanced schemes.

Scope

- 7.13 The appropriate scope for a reformed regulatory framework must also be considered. Should all private landlords and letting agents be subject to the reformed regulatory regime? If not, on what basis should categories of landlord and agent be excluded?
- 7.14 The private rented sector is very diverse, from individual resident landlords to large corporate landlords managing thousands of properties. This diversity is one reason for the private rented sector's capacity to accommodate a range of housing needs. Regulation should not have the effect of limiting that capacity. On the other hand, exclusions introduce complexity into the system and can potentially create unfairness.
- 7.15 One potential category for exclusion is based on the type of landlord. For example, resident landlords who share accommodation with their occupiers already have a strong personal interest in maintaining their property in at least minimum condition and in accord with safety standards. Could they appropriately be left outside any new regulatory framework? At the other end of the scale, the Crown, a large landlord of, for instance, service staff, has traditionally been excluded from some regulatory regimes. Although on the face of it there is no obvious reason why the Crown should not be required to behave as a good landlord, is this an exemption that should be retained?
- 7.16 Are there other categories of landlord that should be excluded from regulation? We would like consultees' views on this point.
- 7.17 A second potential category for exclusion is family lettings or lettings for no monetary consideration.⁸ In these cases the relationship between landlord and occupier lacks the contractual base that exists between landlord and occupier in an arm's length economic transaction.

⁷ See for example the Reading Landlord Accreditation Scheme, <http://www.reading.gov.uk/adviceandbenefits/housingadviceforlandlords/landlordaccreditation/> (last visited 22 June 2007).

⁸ Where accommodation is provided as an act of generosity. We anticipate that service lettings, where accommodation is provided free by an employer, would not fall within this possible exclusion.

- 7.18 A third category is based on the length of the letting. Long leases (over 21 years) are already regulated by a separate regime that takes into account the different nature of these tenancies.⁹ Alternatively, fixed term tenancies for seven years or more might be an appropriate cut off, as this is currently when they can be registered at the land registry with their own title.¹⁰ At the other end of the spectrum, very short-term hotel, hostel, bed and breakfast and holiday lettings should be excluded because the brevity of the relationship brings them outside the property management and property condition issues with which we are concerned. We would like to hear consultees' views on whether other lengths of agreement should be excluded.
- 7.19 That said, our view is that any list of exclusions should be very limited. A reformed regulatory framework should apply broadly to landlords and agents in the private rented sector.¹¹ It should apply regardless of whether the landlord is an individual or corporation; whether the occupier occupies under a tenancy or a licence; the length of the lease (although excluding long leases and holiday lettings); whether the letting is at a market rent; and whether it is tied to employment.¹²
- 7.20 These considerations do not apply to letting agents. Agents are involved in the business of letting. They are not one off or casual participants in the private rented sector. There is already a relatively high degree of professional affiliation amongst agents. There seems little reason to suggest exclusions of any class of letting or managing agents.

The policy context

- 7.21 In thinking about the future of regulation of the private rented sector, we accept the following basic propositions, which we understand lie at the heart of current Government policy.¹³
- (1) The private rented sector plays an important role in many local housing markets.
 - (2) In many areas, it is desirable that the private rented sector is encouraged to expand its presence, rather than the reverse.

⁹ See the Leasehold Reform, Housing and Urban Development Act 1993.

¹⁰ Land Registration Act 2002, ss 3(3) and 4(1)(c).

¹¹ See Part 1. Regulation of the private rented sector should not encompass long-term (longer than 21 year) leases.

¹² Similar considerations informed the identification of the scope of our recommendations for tenure reform in *Renting Homes*, and it would appear that the same conclusions would have similar force. See *Renting Homes: The Final Report* (2006) Law Com No 297, paras 3.1 to 3.17, available at http://www.lawcom.gov.uk/docs/lc297_vol1.pdf.

¹³ For some of the issues facing Government, see CLG, *Dealing with "Problem" Private Rented Housing: Housing Research Summary 228* (2006), available at http://www.communities.gov.uk/pub/869/228DealingwithProblemPrivateRentedHousing_id1501869.pdf (last visited 22 June 2007).

- (3) Although increased regulatory effort could lead to some of the very poorest accommodation being taken from the market, it is important that, in general, accommodation currently available in the private rented sector should remain in the market.
- (4) It remains important to enhance the reputation and professionalisation of those who provide an important social benefit, namely the provision of accommodation.

More effective regulation to encourage more responsible renting goes also to the heart of the recommendations we made in *Renting Homes*, that legal regulation of residential renting should be based on principles of consumer protection.¹⁴

The role of local authorities

7.22 Local authorities already have considerable powers available to them to regulate the private rented sector; we discussed these in Part 3. It might therefore be suggested that, rather than develop a new approach to regulating the private rented sector, Government should simply ask local authorities to work even harder to secure the compliance with legislative standards. Given the empirical evidence on housing conditions in the private rented sector, however, we doubt whether such an approach would be particularly effective. Indeed, more extensive and firmer action by local authorities could be counter-productive by undermining the collaborative approach to use of the sector that many local authorities currently promote.

7.23 This is not to say that local authorities have no role to play in regulating the private rented sector. On the contrary, local authority powers are an important regulatory resource. However we think that use of these powers is better suited to addressing the exceptional or the worst cases and in providing “leverage” to others who work closely with landlords so as to ensure that they take their responsibilities seriously.

Enforcement and sanctions: responsive regulation

7.24 Any reformed scheme would be made more effective by including a variety of available sanctions. The flexibility this would provide is more in line with modern thinking about regulation outlined in Part 5. The ability to select an appropriate response from a range of sanctions is an important aspect of better regulation and offers the prospect of fairer and more proportionate enforcement.¹⁵ This enhances the probability of future compliance.

¹⁴ *Renting Homes: The Final Report* (2006) Law Com No 297, paras 1.25 to 1.38, available at http://www.lawcom.gov.uk/docs/lc297_vol1.pdf.

¹⁵ P Hampton *Reducing Administrative Burdens: Effective Inspection and Enforcement* (2005), available at <http://www.hm-treasury.gov.uk/media/7/F/bud05hamptonv1.pdf> (last visited 22 June 2007).

- 7.25 Sanctions could include requiring landlords or agents to attend training courses; awarding compensation to the aggrieved party; requiring the use of a managing agent (if a landlord is involved in the non-compliance); or imposing an administrative fine. Ultimately, these sanctions could be reinforced with the possibility of expulsion from or revocation of membership or a licence (under the licensing option), and criminal prosecution. A use of punitive sanctions would only occur once lesser sanctions had been demonstrated to be ineffective or for instances of gross breach of the regulatory instrument.
- 7.26 When it comes to enforcing the core requirements of the scheme there is less scope for flexibility. Whilst the scheme may require the joining of a professional association or accreditation scheme under our proposed enforced self-regulation option, discretion remains with the enforcement officials as to whether or not to bring proceedings or to monitor activities in conjunction with imposing requirements for training.
- 7.27 Bearing these general principles in mind, we turn to consider the three options we have identified for reforming the regulation of the private rented sector.

OPTION 1: ENHANCING VOLUNTARY SELF-REGULATION

- 7.28 This option involves reforming regulation of the private rented sector by expanding existing voluntary initiatives. Professional associations and accreditation schemes already seek to encourage responsible behaviour amongst landlords and agents. They provide alternative means of enforcing standards through internal complaints and disciplinary procedures. An expansion of such activities offers the potential to address many of the current inadequacies in the regulation of the private rented sector.
- 7.29 This proposed reform would require finding new benefits for those landlords and agents who are not currently signed up to a scheme to join either an existing scheme, or new ones if they are developed.
- 7.30 Some benefits already exist for landlords to become a member of an association or accreditation scheme. Currently, barriers to entry are quite low – membership fees in landlord associations are often less than £100 a year and many accreditation schemes are free to join. But, as we have seen, the proportion of landlords who have voluntarily joined associations or schemes is currently small,¹⁶ though the figures for agents are more promising.¹⁷
- 7.31 New benefits would therefore have to go well beyond those currently on offer to affect significantly rates of affiliation and accreditation. What sort of benefits might make a difference? For landlords, they might include:

¹⁶ Our best estimate is that only 2.2% of landlords are members of associations.

¹⁷ Approximately 4,000 letting agents belong to a professional association, while 6,000 to 8,000 do not: ODPM, *Tenancy Money: Probity and Protection Consultation Paper* (2002), p 27, para 42, available at http://www.communities.gov.uk/pub/53/TenancymoneyprobityandprotectionconsultationpaperPDF317Kb_id1152053.pdf (last visited 22 June 2007); and ODPM, *Tenancy Deposits Implementation Scoping Study Report* (2005) para 9.12.

- (1) access to fast-tracked court procedures (accelerated possession hearings could be limited to members, for instance);
- (2) exemption from the “six months’ moratorium”, which prevents landlords from obtaining an order for possession before six months;¹⁸
- (3) access to a local authority administered “rent guarantee bank” that could compensate landlords for rent arrears;
- (4) access to local authority tenancy deposits bond schemes;¹⁹
- (5) access to free dispute resolution/mediation services;
- (6) improved access to local authority home improvement grants;
- (7) exemption from selective licensing or mandatory houses in multiple occupation licensing under the Housing Act 2004, on the grounds that they would already be regulated by an association’s code of practice;
- (8) better return on interest from tenancy deposits held under a custodial tenancy deposit scheme;
- (9) reformed tax treatment, aligning the tax treatment of small landlords more closely with that of other small business enterprises;²⁰
- (10) improved access to Housing Health and Safety Rating System evaluations, including financial help for remedying hazards;
- (11) local authority funded gas safety inspections – the responsibility for obtaining an annual safety certificate would remain with the landlord, but the local authority could pay for the inspection.

7.32 Some of these would require legislative change; others would only require administrative change. Most would require additional resources.

7.33 Letting agents would not be directly affected by many of these benefits, but would be key actors in the regulatory framework. Non-affiliated or non-accredited landlords could still be allowed to take advantage of these benefits so long as the property was managed by an agent who belonged to a recognised association or scheme.

¹⁸ As we have already recommended that the six-months’ moratorium be abolished (see Renting Homes (2003) Law Com No 284, para 6.3, available at <http://www.lawcom.gov.uk/docs/lc284.pdf>) this would not be an incentive should the recommendations in that report be adopted by Government.

¹⁹ Some schemes already exist but they mostly cover a tenant’s deposit only: see for example http://www.richmond.gov.uk/home/housing/advice_for_owners_and_landlords/schemes_for_private_landlords/rent_deposit_guarantee_scheme.htm (last visited 22 June 2007).

²⁰ Examples of what might be involved were given by the Commission on modernising the private rented sector: see Shelter and Joseph Rowntree Foundation, *Private Renting: A New Settlement* (2002) p 7, available at <https://www.landlordlaw.co.uk/content/PRSmediareport.pdf> (last visited 22 June 2007).

Who would be the self-regulatory organisations?

7.34 We think it important that there be a variety of self-regulatory organisations able to compete for membership from landlords and agents. Different landlords and agents already have a range of organisations available for them to join. We think there would be more industry acceptance of proposals that built on existing arrangements, rather than required the creation of new ones. (New ones could still evolve, if that is what the industry wanted.) Thus we would see the categories of organisation as being:

- (1) *existing or new landlords' associations*. These would be membership bodies, which would act also as trade associations and lobbying organisations. These could operate at national, regional or indeed local levels.
- (2) *existing or new local authority organised accreditation schemes*. Although such schemes have in the past developed on the basis of a single local authority area, there are now moves to having more regionally based accreditation schemes, such as the London Landlord Accreditation Scheme.²¹ The development of a single national scheme for Wales is under discussion.²²
- (3) *existing or new agents' associations*. Where an agent was already a member of a self-regulatory organisation, landlords who used the management services of the agent would not themselves have to be a member of another self-regulatory organisation; and
- (4) *other sectoral organisations*. Particular market sectors could provide the opportunity for differently organised bodies to emerge. For example, in the student market, there exist a number of arrangements similar to accreditation schemes organised by or with educational institutions. An example is the scheme run by Unipol, a charitable organisation set up by the University of Leeds and the then Leeds Polytechnic in the 1970s to improve student accommodation in the private rented sector. Landlords agree to abide by Unipol's Code of Standards, which is linked with the City of Leeds accreditation scheme, In return Unipol advertises their properties to the Leeds student market.

²¹ This involves the collaboration of all 33 London boroughs, together with private landlord organisations and London universities, and is currently administered by the London Borough of Camden. It seeks to be a "pan-London scheme" which "will not affect in any way property standards or other accreditation schemes operated by individual Boroughs, but it is intended to be entirely complementary to them": see <http://www.londonlandlords.org.uk/accreditation/home> (last visited 22 June 2007).

²² See the All Wales Accreditation Meeting Minutes of 16 January 2006 on the Accreditation Network UK website: <http://www.anuk.org.uk/news/walesmeetingminutes.asp> (last visited 22 June 2007).

Advantages

- 7.35 The advantage of enhancing voluntary self-regulation (option (1)) is that it preserves the voluntary basis of current self-regulatory regimes. It avoids imposing further mandatory requirements on landlords and agents, while at the same time potentially increasing the reach of a positive regulatory influence. Landlords and agents would have to comply with the code of practice of the association or scheme that they chose to join, but the motivation for doing so would be to access benefits rather than to avoid penalties or as a result of compulsion. They would be entering the regulatory network freely and, therefore, should be more willing to comply with codes of practice and the like.²³
- 7.36 The benefits could be tailored to different types of landlords or different local market conditions, and they could be changed when the need arose. Leaving the structure of benefits to be developed locally would allow the scheme to tap into the greater knowledge of market conditions and innovative potential of the industry associations.

Disadvantages

- 7.37 Despite these advantages, enhancing voluntary self-regulation suffers a number of disadvantages.
- 7.38 First, the very flexibility listed as an advantage above, could lead to unevenness in implementation. This would become apparent particularly where landlords let in different local authority areas.
- 7.39 Second, and more important, for voluntary self-regulation to be effective in encouraging responsible renting, professional associations and accreditation schemes would need to be willing and able to enforce their codes of practice and management standards against members. Who would regulate the regulators? Without regulatory oversight,²⁴ professional associations may be unwilling to police their members vigorously, especially when they are charged with representing them and receive subscription fees from them.²⁵ It would, therefore, require a central regulator of a similar nature to that required by option (2), to decide that, if a particular self-regulatory organisation set its standards too low, or failed to ensure its members adhered to its code of practice or management standards, that organisation's members would no longer qualify for the various benefits.

²³ Department of the Treasury, Commonwealth of Australia, *Industry Self-Regulation in Consumer Markets* – Report prepared by the Taskforce on Industry Self-Regulation (August 2000) http://www.treasury.gov.au/documents/1131/PDF/final_report.pdf (last visited 22 June 2007).

²⁴ This would be one of the functions of an arm's length regulator, which we discuss more fully below in the context of option 2 below.

²⁵ This concern is not unique to regulation of the private rented sector. Sir David Clementi in his final report of the review of the regulatory framework for legal services in England and Wales (December 2004) recommended the separation of regulatory and representative functions of "front-line regulators" such as the Law Society: see paras 10 to 25, available at <http://www.legal-services-review.org.uk/content/report/index.htm> (last visited 22 June 2007).

- 7.40 Third, the encouragement of self-regulatory strategies without more could be seen as a less than stringent approach to protection that effectively gives too much deference to business interests as opposed to those of the consumer.
- 7.41 Fourth, enhancing voluntary self-regulation could be costly. As can be seen from our speculative list of benefits, it would require extra resources, most of which we anticipate would ultimately come from the public purse.
- 7.42 Fifth, it is unclear whether additional benefits would significantly increase affiliation and/or accreditation rates or what level of benefits would have to be offered to have such an effect. As the barriers to joining a self-regulatory regime are already low, those landlords and agents who are not currently part of a scheme might not respond to further incentives. Voluntary accreditation schemes do not seem to function well in areas of particularly high demand.²⁶
- 7.43 The central question therefore is – could we ever identify incentives that were sufficiently attractive to entice into the self-regulatory organisations the substantial numbers of landlords who are not currently signed up, and in particular that recalcitrant minority who are particularly prone to disregarding their legal obligations? We suspect that the speculative list of benefits set out above goes well beyond what central or local government would be willing to pay for. Even so, we fear it would still not make enough economic and practical difference to bring all or nearly all landlords into the system.
- 7.44 Thus the primary disadvantage with enhancing voluntary self-regulation is that the suggested benefits would offer too many incentives to the majority of landlords who do not need them, without providing sufficient incentives to the problem minority to improve their letting behaviour.

OPTION 2: ENFORCED SELF-REGULATION

- 7.45 In order to address the problem of landlords and agents failing to respond to incentives to participate in voluntary associations or schemes, the second option we have identified is enforced self-regulation. This combines self-regulation with external regulation. It would formalise existing good self-regulatory practice by imposing a legal requirement on landlords and agents to be part of a professional association or accreditation scheme. (We acknowledge that accreditation schemes may not be, strictly speaking, self-regulatory regimes. Nevertheless we include them here.) Landlords and agents would be able to choose which association or scheme they wanted to join. But they would have to be part of at least one association or scheme.

²⁶ In Chartered Institute of Housing, DCLG and Improvement and Development Agency, *Ways and Means: Local Authorities' Work with the Private Rented Sector* (2006), p 18 it was noted that "Some councils with consistently high demand also felt that property accreditation conferred no advantage as properties would be let whatever their condition or status of the landlord. However, some high demand areas did have successful schemes in operation." See <http://www.cih.org/policy/WaysAndMeans.pdf> (last visited 22 June 2007).

- 7.46 Recognising the practical difficulties of ensuring that every individual landlord signs up to an association or scheme, we think that landlords would not personally have to be members of a professional association or accreditation scheme so long as they used an affiliated or accredited agent to manage the rented accommodation they provide.
- 7.47 The central goal of enforced self-regulation would be to ensure that the day-to-day management of rented accommodation was undertaken by those who had received appropriate training. In addition, the organisation or scheme would take responsibility for enforcing good practice. An external regulator, such as the Office of Fair Trading would approve associations and schemes.
- 7.48 After an appropriate transitional period, letting property not managed by a member of an appropriate association or scheme would be punishable by sanction, which could include a prohibition on that person engaging in the activities of a landlord or letting agent.
- 7.49 The idea of enforced self-regulation is not new. It is a familiar feature of many trades and professions. Enforced self-regulation in the private rented sector, as we envisage it, would, however, have some novel characteristics. In particular:
- (1) It would be based on multiple – and competing – self-regulatory organisations and schemes, not just one.²⁷ Membership of *any* approved professional association or accreditation scheme would be sufficient.
 - (2) It would require an independent organisation to approve and externally oversee self-regulatory activity by establishing minimum standards (if necessary by approving codes of practice), and ensuring appropriate disciplinary procedures were in place.
 - (3) There would have to be some degree of independent oversight of the regime to ensure accountability and thus secure its credibility.
 - (4) Appropriate sanctions would be imposed on landlords and agents who did not comply with the obligation to be affiliated or accredited.
- 7.50 The Office of Fair Trading has experience of encouraging industry groups to develop codes of practice under its Consumer Codes Approval Scheme.²⁸ To gain Office of Fair Trading approval, codes have to be developed by the industry group and address the following core issues:
- (1) content

²⁷ For a discussion of competition in self-regulation see A Ogus “Rethinking Self-regulation” (1995) 15(1) *Oxford Journal of Legal Studies* 97. A recent analogy is the approval of electrical self-certification schemes under the Building Regulations. In order to carry out certain electrical work in dwellings, contractors must either be a member of an approved self-certification scheme or notify the local authority before carrying out the work. Self-certification schemes are approved by the Building Regulations Advisory Committee and compete amongst themselves for members. See <http://www.tee.org/Publish/WireRegs/BR-PartP-dwellings.cfm#Q9> (last visited 22 June 2007).

²⁸ See http://www.offt.gov.uk/oft_at_work/consumer_initiatives/codes/ (last visited 22 June 2007).

- (2) complaint handling
- (3) monitoring
- (4) enforcement
- (5) publicity.

- 7.51 Each of these could readily be adapted to the specific requirements of codes of practice relating to the management of rented accommodation.
- 7.52 Enforced self-regulation goes beyond existing or enhancing voluntary self-regulation. Compulsion alters the motivations for joining a professional association or accreditation scheme. The evidence suggests that the majority of landlords and agents would join because they were required to, rather than from a desire to adopt better management practices. Associations and schemes would therefore have to be proactive in ensuring compliance with their standards.
- 7.53 This approach would entail a change from the way professional associations and some accreditation schemes currently operate. While associations have disciplinary procedures in place, they rely entirely on occupiers to bring complaints.
- 7.54 Occupiers would need sufficient information to establish that their landlord is a member of a professional association and the appropriate channels through which to take up the complaint. Thus steps would need to be taken to ensure that occupiers are made aware of complaint procedures.²⁹
- 7.55 The self-regulatory and external monitoring procedures themselves must be robust and effective. The existence of regulatory sanctions for organisations not operating appropriate systems for monitoring compliance with their codes, and dealing appropriately with complaints, would be the major incentive for ensuring the effectiveness of the self-regulatory process.
- 7.56 Mechanisms would be needed to ensure that landlords and agents who fell within the scope of the scheme were properly affiliated or accredited. Given the sheer number and diversity of actors in the private rented sector this could potentially be difficult. However, there is a large range of other local social and economic actors – for example local authority tenancy relations officers, trading standards officers and environmental health officers, local advice agencies, even competing landlords and agents, as well as occupiers – who could bring to the attention of the regulator a landlord's or agent's failure to be accredited or affiliated.
- 7.57 Good regulation should only use punitive sanctions as a last resort. Thus great stress should be placed on the provision of support for those found to be in breach of standards in any code of practice or accreditation scheme, to enable them to improve their housing management practices.

²⁹ Much of this could be easily achieved if our recommendations in Renting Homes were enacted.

- 7.58 There would also need to be quick and effective disciplinary proceedings to deal with instances of serious non-compliance when they are discovered. These proceedings would have to be procedurally fair and transparent. Careful consideration would need to be given to the allocation and exercise of supervisory and disciplinary functions as between any central regulator and the self-regulatory bodies themselves.³⁰
- 7.59 While financial³¹ or procedural³² sanctions would play a key part in ensuring participation, in the last resort, they may need to be reinforced by criminal sanction.
- 7.60 We envisage that in practice the imposition of any sanctions for failure to participate would be tailored to the circumstances. Landlords or agents who demonstrated good faith would be given time to comply. Landlords might be ordered to employ an affiliated managing agent until such time as they obtain affiliated status or joined an accreditation scheme.

Advantages

- 7.61 The advantages of enforced self-regulation are multiple. First, in contrast to voluntary self-regulation, even in its enhanced form, it has the potential to introduce comprehensive reform in the sector. It would apply equally to all landlords and agents that fell within the scope of the scheme. Its implementation and impact would not be limited to specific market, including local market, conditions. It would bring all landlords and agents into the regulatory framework, not just those willing to accept standards. If successful, it would raise the condition of rented accommodation and property management standards across England and Wales.

³⁰ These issues have also been considered in the context of legal services reform. See R Baldwin, J Black and M Cave, *A Legal Services Board: Roles and Operationalising Issues* (July 2005), which discussed relationships between the Legal Services Board and the front-line regulators: see <http://www.dca.gov.uk/legalsys/baldwin-black-cave.pdf> (last visited 22 June 2007).

³¹ See for example, the Housing Act 2004, s 214(4), which requires that a court must order that a landlord who has not complied with a tenancy deposit scheme pay to the tenant a sum three times the amount of their deposit. Tenants could also be given the ability to not pay rent if they discovered that their landlord or agent was not properly affiliated or accredited: see Renting Homes, Final Report, Volume 2: Draft Bill (2006) Law Com No 297 cl 34, available at http://www.lawcom.gov.uk/docs/lc297_vol2.pdf.

³² See for example, the Housing Act 2004, s 215, which provides that a landlord who has failed to comply with the requirements of a tenancy deposit scheme is unable to serve a notice under section 21 of the Housing Act 1988 to recover possession after the expiry of a fixed term shorthold tenancy.

- 7.62 Second, like option (1), enforced self-regulation would harness the capabilities of existing schemes and non-state organisations to set and enforce standards within an approved framework. Landlords and agents would be complying with standards generated by their own associations or schemes provided that they accorded with the principles set by an external regulator.³³ This would give a greater sense of ownership to those to whom they were going to apply because the detailed rules would be set by the organisations themselves. They would also be founded in the practical realities of good letting practice. Landlords and agents would also gain access to the information, advice, and training that associations and schemes currently offer.
- 7.63 Third, by obliging landlords to join a self-regulatory organisation which has its own incentives to ensure that its code of practice is effective and complied with, enforced self-regulation offers the scope for tapping into positive peer group effects. Landlords will develop a clearer appreciation of the expectations associated with being a good landlord and will be made aware of how well-informed and well-intentioned landlords operate. It has the potential to have a positive impact upon their behaviour. Membership, therefore, could go a long way to dealing with problems currently caused by amateurism or inadvertence, and shape the behaviour of landlords whose failure to meet obligations is the result of weakly held negative attitudes. In this sense the scheme would promote a compliance culture rather than simply compliant outcomes and go far to address the negative views that some still have of private landlords.
- 7.64 Fourth, our vision of enforced self-regulation is not a one-size-fits-all approach. Landlords and agents could choose which approved national or regional organisation or scheme to join, depending on which one suited them best. Organisations, and to some extent accreditation schemes, could, as they do currently, compete for members on the services and benefits they offer to their members and membership fees.
- 7.65 While all landlords would not be required to join the same regulatory body, enforced self-regulation would create a finite pool of approved self-regulatory organisations. These associations and schemes are likely to be relatively substantial. Importantly, they will be large and visible. This makes the job of central regulatory oversight feasible.
- 7.66 It also means that there is scope for reputational effects to begin to have an impact in the sector. Such organisations would potentially have much to lose if they were not seen – by the central regulator, the media or potential occupiers – to be fulfilling their role. This includes the ultimate sanction of having their status as an approved self-regulatory organisation removed, thereby effectively putting them out of business.

³³ Although the central regulator would set *minimum* standards for all approved associations and schemes: see paras 8.4 to 8.8.

- 7.67 Fifth, occupiers would benefit from improved management standards and access to the complaints procedures run by their landlord's or agent's association or scheme. If a landlord or agent was found to be deviating from the relevant standards, a range of sanctions could be applied, from requiring additional training to expulsion from the association or scheme.³⁴ While complaints procedures would not be a replacement for a tenant's private law rights, they would offer an alternative and often more proportionate³⁵ mechanism for ensuring compliance. Assuming the complaints procedures were sufficiently efficient and effective, they could become the preferred option for dispute resolution, with a consequent reduction in the burden upon the courts.
- 7.68 Ultimately, enforced self-regulation would have to be backed up by a range of sanctions at a number of levels. Self-regulatory organisations would bear primary responsibility for monitoring their schemes, disciplining members who were not abiding by the code of practice, and, if necessary, advising the central regulator about rivals thought to be not adhering to "best practice". This would be reinforced by the (default) powers of a central regulator, where the self-regulatory organisations were not delivering upon their agreed code. All of this would require the creation of a system of monitoring and information provision that should be independent of the self-regulatory organisations.

Challenges

- 7.69 Obviously, the biggest question is whether enforced self-regulation would actually work in practice. There are three main challenges that must be faced: capacity, authority and costs.

Capacity

- 7.70 The first is the capacity of professional associations and accreditation schemes to regulate the numbers of landlords and agents that operate in the private rented sector. The best estimate we have suggests that only 2.2% of the 700,000 private landlords in England and Wales currently belong to a professional association. While not all 700,000 would necessarily fall within the scope of the regulatory framework,³⁶ the number of landlords that would have to be regulated would still be substantial. Would existing landlords' and agents'³⁷ associations, and accreditation schemes be able to absorb the significant number of unaffiliated landlords?

³⁴ We discuss the importance of maintaining a flexible array of sanctions regardless of which option is adopted above at paras 7.24 to 7.26.

³⁵ See Law Commission, *Housing: Proportionate Dispute Resolution: An Issues Paper* (2006) for criticisms of current dispute resolution methods, and in particular, Part 5 which refers to complaints procedures, available at http://www.lawcom.gov.uk/docs/issues_paper.pdf.

³⁶ See the discussion on scope above at paras 7.13 to 7.20.

³⁷ It is estimated that agents are involved in letting 55% of dwellings in the open market portion of the private rented sector (excluding tied accommodation), and are responsible for managing 48% of those dwellings: ODPM, *English House Condition Survey, Private Landlords Survey 2003* (2006) p 36, available at http://www.communities.gov.uk/pub/226/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165226.pdf (last visited 22 June 2007). As such, agents could play a significant role in enforced self-regulation by acting for landlords who did not wish to become affiliated.

7.71 This raises the further question whether the existing bodies and schemes need to take on all the extra work. If all relevant landlords were required to join an association or accreditation scheme, in exchange for a fee, this could represent a significant market opportunity for new entrants into the market. As long as the regulatory regime allows for the entry of new self-regulatory organisations then a robust view would be that sufficient new associations would emerge to meet demand for membership. Indeed, some existing associations might, in the long term, turn out not to be those best suited to acting as effective self-regulatory organisations under the reformed regulatory regime.

Authority

7.72 The second argument is that associations and accreditation schemes might not have sufficient authority to enforce standards against their members adequately. The question of numbers aside, enforced self-regulation would require industry associations and accreditation schemes to regulate their members actively. This could entail a significant change from the way associations currently operate. The organisations would need to demonstrate that they can deal effectively with less committed members of their organisation, whether landlords or agents. Occupiers would need to know which organisation their landlord was a member of, and to whom, and how, to complain.

7.73 A regime of enforced self-regulation could also be criticised for stifling competition by not allowing landlords to offer properties at quality levels below the standards required by the relevant codes of practice, even where there was a demand for such properties. In policy terms, it could be argued that property offered below that quality represents a danger to health and safety and hence has no place in the market. Whether landlords could make an adequate return by letting property which does meet the standards of the code of practice under enforced self-regulation, and which would be affordable to those on lower incomes, is a separate question.

7.74 Enforced self-regulation is likely to be popular with those who already voluntarily submit to codes of practice because it is seen as removing "unfair" competition from those offering lower quality products and services and who do not incur the financial overheads currently associated with voluntary self-regulation. Sceptics can view such arguments as self-serving in that they can be about removing competition per se.

7.75 However, in the current context there is no proposal to restrict the number of landlords and the requirements for membership of one or more self-regulatory organisations is likely to represent no more than adherence to minimum legal obligations.

7.76 It would fall to the central regulator to police the membership of industry associations and accreditation schemes. This will be an important function since the most problematic landlords are those most likely to be unwilling to join a self-regulatory organisation. How a national level body might implement an effective system for policing and disciplining what is often a very local phenomenon would require careful consideration. If the regime does not reach these most problematic landlords then this would represent a significant weakness.

Costs

- 7.77 These proposals involve additional costs. Some of these additional costs will bear on landlords or their agents, though in some market conditions these can be passed on to occupiers in the form of higher rents. In some instances the additional costs may have ultimately to be borne by the taxpayer in the form of housing benefit. In Part 4, we discussed the costs of bringing properties up to the required standards. Here we consider the costs of the regulatory system itself.
- 7.78 At present, the costs of membership of an association or accreditation scheme are modest, for example £70 per year, or £175 for three years, plus an £18 joining fee, for the National Landlords Association; £47 for five years' membership of Chester City Council's accreditation scheme,³⁸ and £65 per year for the Association of Residential Letting Agents.³⁹ If the 97.8% of landlords who are not currently members all joined an association with an annual membership fee of £70, it would cost around £48 million per year. Costs are likely to be less as some landlords would be outside the scope of our proposals, some would join lower cost accreditation schemes, and some would employ accredited agents.⁴⁰
- 7.79 Associations and accreditation schemes might well have to charge higher membership fees to cover the cost of actively enforcing their codes of practice, though competition between associations and schemes should ensure that any such increases were well controlled.⁴¹ As we show below, the size of any fee increase is far more likely to depend on the scheme's approach to property inspection than on the number of complaints received and investigated and the number of additional staff needed in investigatory and enforcement roles.

³⁸ See <http://www.chester.gov.uk/main.asp?page=654> (last visited 22 June 2007).

³⁹ Other organisations' fees are similar, for example membership of the National Federation of Residential Landlords costs between £70 and £100: £65 for the East Midlands Property Owners Association; £85 including a one-off £20 joining fee for Eastern Landlords; and £100 in the Liverpool area. The Residential Landlords Association charges £85 for online membership (reducing to £75 for continuous card payments) and £95 otherwise. The Guild of Residential Landlords charges £70 per year for individuals and couples for and £120 for letting agents. Some accreditation schemes are free to join, such as the one operated by Pendle Borough Council (http://www.pendle.gov.uk/site/scripts/documents_info.php?categoryID=946&documentID=352 (last visited 22 June 2007). National Association of Estate Agents membership costs from £75 for non-corporate (student or affiliate grades) and £95 for associate corporate status to £175 for full corporate membership (all excluding VAT). The National Approved Letting Scheme charges £100 for each firm and £50 for additional offices. The United Kingdom Association of Letting Agents charges £135 with a one off processing fee of £45.

⁴⁰ The different charging regimes that have been put in place in the context of the new regulatory scheme for tenancy deposits provides an indication of how the market might respond.

⁴¹ There may also be additional costs, eg of attending up-dating sessions.

COSTS OF COMPLAINTS HANDLING

- 7.80 We have been unable to estimate how many complaints landlords' associations and accreditation schemes receive, and the extent of their current enforcement activity.⁴² The National Landlords Association told us that complaints against their members are "very low"⁴³ and they could recall only one or two expulsions of members following complaints.⁴⁴ In contrast, Unipol told us that 39 formal complaints, against 24 owners, were made between 1 September 2005 and 31 August 2006 (out of 391 Unipol members that year). We would expect such organisations to receive more complaints if all landlords had to join.
- 7.81 We have looked at other external complaints handling bodies to estimate the caseload and costs of complaints handling which would be met by self-regulatory organisations, where membership is compulsory. For example, registered social landlords in England⁴⁵ must join the Independent Housing Ombudsman scheme (which can investigate complaints against them). 2,170 out of 2,264 scheme members in 2005-06, accounting for 2,209,920 housing units, were Registered Social Landlords, and only 94 members, accounting for 50,729 housing units, were private landlords (who can choose to join the scheme). The Housing Ombudsman Service received 5,205 complaints and disputes between 1 April 2005 and 31 March 2006, (of which 556 required formal consideration), and issued 503 final decisions.⁴⁶ Only 2% of the complaints were from assured shorthold tenants.

⁴² We would be very grateful for any further information consultees can provide on current complaints levels and enforcement activity by associations and accreditation schemes.

⁴³ E-mail from Michelle Harris to the Law Commission 3 January 2007.

⁴⁴ At a meeting at the National Landlords Association office on 12 September 2006.

⁴⁵ Housing Act 1996, s 51 and sch 2. The Housing Ombudsman Service does not investigate Welsh RSLs. The Social Housing Ombudsman for Wales in its brief existence between 15 July 2005 and 31 March 2006, when it was replaced by the Public Services Ombudsman for Wales, received 28 complaints: see Public Services Ombudsman for Wales, *The Annual Report for 2005/06 of the Commissioner for Local Administration in Wales, The Welsh Administration Ombudsman, The Health Service Commissioner for Wales, The Social Housing Ombudsman for Wales* (2006), p 66, available at <http://www.ombudsman-wales.org.uk/uploads/publications/161.pdf> (last visited 22 June 2007).

⁴⁶ Housing Ombudsman Service, *Annual Report and Accounts 2005-06*, p 29, available at http://www.ihos.org.uk/downloads/common/HOS_Annual_Report_2006.pdf (last visited 22 June 2007).

- 7.82 Assuming that all the complaints not from assured shorthold tenants were made against Registered Social Landlords, there was 1 complaint for every 433 housing units owned by Registered Social Landlords,⁴⁷ and 1 complaint for every 487 housing units owned by private landlords.⁴⁸ Such complaints to stock ratios would give between 5,025 and 5,653 complaints per year in relation to the 2,334,986 private rented dwellings in England,⁴⁹ and 115,000 private rented dwellings in Wales. The higher estimate is likely to be more accurate, since it is based on compulsory membership, not self-selection by the potentially more responsible landlords
- 7.83 If the new regulatory system won tenants' confidence, complaints could be expected to increase, since not all unhappy tenants currently complain. Of the 457,000 tenants who were reported to be very or slightly dissatisfied with the way their landlord dealt with repairs in 1999-2000, only 25% tried to enforce their rights.⁵⁰ 10% of private tenants were slightly or very dissatisfied with their landlord in 2003/04.⁵¹ If every dissatisfied private tenant complained to a self-regulatory organisation, there could be over 240,000 complaints each year.⁵²

⁴⁷ 2,209,920 divided by (5,205 x 0.98).

⁴⁸ 50,729 divided by (5,205 x 0.02).

⁴⁹ ODPM, *English House Condition Survey 2004 Annual Report* (2005) p 7, available at http://www.communities.gov.uk/pub/429/EnglishHouseConditionSurvey2004AnnualReport_id1502429.pdf (last visited 22 June 2007).

⁵⁰ CLG, *SEH Table S803 (C86[99/00]) Whether Tenants Tried to Enforce Right to Repair and Reasons For Not Doing So*, available at http://www.communities.gov.uk/pub/223/S803Excel16Kb_id1155223.xls (last visited 22 June 2007).

⁵¹ CLG, *SEH Table S823: Overall Satisfaction With Landlord by Household Characteristics: Private Sector Tenants*, available at http://www.communities.gov.uk/pub/241/S823_id1155241.xls (last visited 22 June 2007).

⁵² Given the 2.4 million tenancy groups in the private rented sector reported in ODPM, *Housing in England 2003/04: Social Renters and Private Renters* (December 2005), p 9, available at http://www.communities.gov.uk/pub/227/HousinginEngland20032004PDF429Kb_id1162227.pdf (last visited 22 June 2007).

- 7.84 The Housing Ombudsman Service in 2005/06 charged its members £1.11 per housing unit for membership. Its total income was £2,549,236 that year, compared with administrative expenses of £2,321,381,⁵³ and it employed on average 34 staff. The cost per decision issued was £4,615.⁵⁴ By contrast, in the same financial year, the 983 staff of the Financial Ombudsman Service (which investigates complaints against 26,000 financial services providers such as banks and insurance companies) handled 672,973 initial inquiries, and completed 119,432 cases at a unit cost per case completed of £433.⁵⁵ PricewaterhouseCoopers advised the DCA on the costs of the Legal Services Bill proposals to regulate the legal profession.⁵⁶ It estimated that operating costs for the “Office for Legal Complaints” would be around £16.8 million. It would need 319 staff to handle around 18,000 complaints each year, at a cost of £933 per complaint.
- 7.85 If each landlords’ association or accreditation scheme received and investigated complaints against its own members, we would expect the total and per case cost of complaints handling to be slightly higher than for the Housing Ombudsman Service to handle the same number of complaints, since they would be unable to take advantage of any economies of scale which benefit the latter and consideration also needs to be given to variations in the substance of complaints. The total cost of handling between 5,025 and 5,653 complaints is therefore likely to exceed the £2.32 million administrative expenses of the Housing Ombudsman Service. A “complaints handling levy” of £1.50 or even £2 per dwelling (as opposed to £1.11 for the Housing Ombudsman Service) would not, however, be a significant additional expense for private landlords, compared with association membership fees of around £70, given the small size of most landlords’ stock portfolios.⁵⁷ A fee of £1.50 per dwelling would raise around £3.7 million for complaints handling.

⁵³ Housing Ombudsman Service, *Annual Report and Accounts 2005-06*, p 46, available at http://www.ihos.org.uk/downloads/common/HOS_Annual_Report_2006.pdf (last visited 22 June 2007).

⁵⁴ £2,321,381 divided by 503.

⁵⁵ Financial Ombudsman Service, *Annual Review and Report and Financial Statements 1 April 2005 to 31 March 2006* (June 2006) <http://www.financial-ombudsman.org.uk/publications/ar06/ar06.pdf> (last visited 22 June 2007). The cost was calculated by dividing total costs before financing charges and any bad debt charge by the number of cases completed.

⁵⁶ PricewaterhouseCoopers, *Financial Analysis to Support the Draft Legal Services Bill* (May 2006) http://www.dca.gov.uk/legalsys/pwc_finanalysis_060524.pdf (last visited 22 June 2007).

⁵⁷ See para 2.7 above.

COSTS OF PROPERTY INSPECTION PRIOR TO JOINING

- 7.86 The costs of joining a landlords association or accreditation scheme would increase more significantly if the self-regulatory organisations chose, or were required by the central regulator, to carry out property inspections before allowing a landlord to join. Some accreditation schemes inspect only a sample of a landlord's stock, and not necessarily before accepting someone as a member. The costs of houses in multiple occupation licences in England (where the property condition is relevant) vary between £100 in Wigan and £1,750 in Dartford, averaging £528.⁵⁸ This is significantly higher than the costs of landlord registration in Scotland (which focuses on whether the landlord is a fit and proper person), for which the principal registration fee is £55, with an additional £11 for each property owned.⁵⁹

COSTS OF THE CENTRAL REGULATOR

- 7.87 The central regulator would also require resources sufficient to enable it to exercise its functions. One question that would need consideration is the degree to which Government, anxious to secure the advantages of the scheme in terms of improvements to the management of the private rented sector, would be prepared to subsidise these additional costs.
- 7.88 To estimate the costs of a central regulator for the private rented sector, we have looked at the costs of other "central" regulators. Any estimates should be treated with caution, as the costs of similarly sized regulators can vary greatly, which may reflect different functions, methods and enforcement strategies.⁶⁰ We would therefore be very grateful for any assistance consultees can give us in producing a more accurate estimate of these costs.
- 7.89 One function for the central regulator, under option 2, would be to approve the self-regulatory organisations and their codes of conduct. The Office of Fair Trading Annual Report 2005-2006 (covering the period 1 April 2005 to 31 March 2006) states that £2.27m was spent on achieving self-regulation under the Consumer Codes Approval Scheme, with 28 applications being dealt with and five codes completing stage 1 and two codes being approved.

⁵⁸ *Inside Housing*, 1 September 2006: see <http://www.insidehousing.co.uk/news/article/?id=1448039> (last visited 22 June 2007).

⁵⁹ The Private Landlord Registration (Information and Fees) (Scotland) Regulations 2005 (SSI 2005 No 558).

⁶⁰ PricewaterhouseCoopers noted that establishment staff costs for the Office of Fair Trading in 2005 were £30.2 million (for 717 staff) compared with £53.9 million for Ofcom (which had 753 staff): see PricewaterhouseCoopers, *Financial Analysis to Support the Draft Legal Services Bill* (May 2006) p 128, available at http://www.dca.gov.uk/legalsys/pwc_finanalysis_060524.pdf (last visited 22 June 2007).

- 7.90 The Legal Services Bill proposals would establish a Legal Services Board to authorise, monitor, and take enforcement action against front-line regulators regulating lawyers. PricewaterhouseCoopers made several estimates of the Legal Services Board's annual running costs (depending on its location, staff and level of activity), ranging from £3,558,000 to £5,587,000, with between 39 and 57 staff.⁶¹ The Legal Services Board would replace the Office of the Legal Services Complaints Commissioner, which is currently responsible for investigating the handling of complaints by the Law Society (and which had a total expenditure of £1.51 million in 2005/06, employing 18 staff).
- 7.91 The Council for Healthcare Regulatory Excellence has regulatory oversight of nine regulators such as the General Medical Council,⁶² which together regulate 1.16 million healthcare professionals.⁶³ It promotes best practice and regulatory consistency, and can refer to court cases where the regulatory bodies were unduly lenient. While it can recommend changes to regulators' rules, it does not have express sanctioning powers. In the year ending 31 March 2006, its revenue expenditure was approximately £2.5 million, and it handled 764 complaints.
- 7.92 Even if the central regulator cost as much as the higher estimates for the Legal Services Board, for example £5.6 million per year, this would equate to only around £2.28 for each private rented dwelling in England and Wales. £2.28 per dwelling for the central regulator, plus around £1.50 for complaints handling, is still relatively insignificant compared with the basic membership fees for landlords' associations, of around £70 per year, let alone when compared with the costs of improving property standards outlined in Part 4.
- 7.93 As the overall regulatory costs might be seen as sufficiently large as to discourage certain landlords, such as those letting rooms in their own home casually on a temporary basis, from entering the private rented sector entirely, this might add to the argument that certain landlord-types should be excluded from the reformed regulatory regime.

OPTION 3: LICENSING

- 7.94 The third option we consider is licensing. Compulsory licensing of houses in multiple occupation was introduced in the Housing Act 2004. The same Act also introduced the possibility of selective licensing in areas of low demand or where anti-social behaviour is a problem. This may lead some to suggest that better regulation of the private rented sector could be achieved by the creation of a national licensing scheme applicable to all renting.
- 7.95 We are not convinced that such an approach would be either desirable or effective. Indeed, we think it does not satisfy the tests set out in para 7.24, namely that any new regulatory scheme should not have undesirably adverse impacts on the private rented sector.

⁶¹ PricewaterhouseCoopers, *Financial Analysis to Support the Draft Legal Services Bill* (May 2006), Executive Summary p 9, available at http://www.dca.gov.uk/legalsys/pwc_finanalysis_060524.pdf (last visited 22 June 2007).

⁶² See the National Health Service Reform and Health Care Professionals Act 2002.

⁶³ Council for Healthcare Regulatory Excellence, *Annual Report and Accounts 2005/2006* (2006), www.chre.org.uk/Website/news_and_publications/report/2005-06%20AR.pdf (last visited 22 June 2007).

Mandatory licensing

- 7.96 The central feature of a mandatory licensing scheme would be the requirement that all landlords would need to be licensed to act as a landlord, unless exempt. Like the current HMO and selective licensing regimes, local authorities would be the primary candidates to run the scheme, although the creation of a national level⁶⁴ central regulator would remain a possibility.
- 7.97 On this basis, landlords would apply to the local authority, or central regulator, who would determine whether they met the initial entry requirements (usually referred to as the “fit and proper” person standard but essentially focused on whether the landlord has previously breached any housing or criminal law obligations). Landlords who met these initial requirements would be granted a licence to let their property or properties. The licence would impose conditions relating to management of the property and/or the state of the property. Breach of licence conditions, or any housing obligations, could result in sanctions, which again could range from mandatory training to a prohibition on acting as a landlord. Operating without a licence would be an offence.
- 7.98 Landlords would not have to show that they were fit and proper persons if they employed a registered agent, but agents would still require a licence. In practice, this would mean that all letting and managing agents would have to be registered with the licensing authority.
- 7.99 Enforcement of licence conditions and of the requirement to obtain a licence would be undertaken by the local authority central regulator through a mix of active monitoring and occupier complaints. A similar kind of mandatory licensing of the private rented sector has been implemented recently in Scotland.⁶⁵

Advantages and disadvantages

- 7.100 The advantages of licensing are that it is a centralised and relatively straightforward way, at least conceptually, to encourage more responsible behaviour by landlords.
- 7.101 It allows local authorities or other regulators to set standards for all landlords within their jurisdictional boundaries. Standards can be tailored to local conditions and problems. Local authorities are in theory well placed to carry out the enforcement of these standards because licence requirements relating to property conditions and health and safety obligations dovetail with existing local authority enforcement responsibilities under the Housing Act 2004 and consumer protection legislation.

⁶⁴ In practice two, one for England and one for Wales.

⁶⁵ See Part 8 of the Anti-Social Behaviour (Scotland) Act 2004. The scheme is described as a registration scheme rather than licensing, but “licence” conditions are in effect imposed through a Letting Code, issued by the Scottish Executive that must be complied with in order for a landlord to remain a “fit and proper person”, the central requirement for registration: Anti-Social Behaviour (Scotland) Act 2004, s 85.

- 7.102 In addition to driving out the ill-intentioned landlords from the sector, licensing affords occupiers another avenue of redress against landlords who do not comply with their obligations. Occupiers can complain to their local authority if their landlord does not have a licence or is in breach of one or more of their licence conditions. In Scotland, tenants can search the registration database to see whether their landlord (or prospective landlord) is in good standing with their local authority.
- 7.103 The problems with mandatory licensing are with implementing it in practice and the costs it imposes on a growing and important sector of the rented housing market. In contrast to the other options, licensing has negative connotations. The requirement for a licence suggests some form of probation or conditionality to becoming a landlord.
- 7.104 As can be seen from the example of the Scottish registration scheme, implementation is not easy. The sheer number and diversity of landlords in the private rented sector make administering the scheme difficult. In Scotland, one report suggests that the number of private landlords was severely underestimated, resulting in the system being overloaded.⁶⁶
- 7.105 If the estimate of 700,000 landlords in England and Wales is accurate, there is also the major question of whether local authorities have the resources to regulate so many landlords. It could be done at a price, but what that price would be would depend crucially on such questions as what precisely was required to obtain a licence, and how often licences would need to be renewed.
- 7.106 Apart from the severe administrative costs and difficulties of setting up a mandatory licensing regime there are potentially other drawbacks. Licensing can be seen as an outmoded and impractical regulatory form particularly where there are many actors to regulate.⁶⁷ It is not oriented towards a more proportionate and targeted approach to regulation. It may deter entry into the sector and some landlords may be driven away from a sector that has just begun to show modest growth, which from a policy perspective is seen as desirable and to be encouraged.
- 7.107 It is difficult to assess exactly what the economic impacts of mandatory licensing might be. It is too early in the implementation of the Scottish scheme to tell. But it is likely that, if licensing were to impose significant additional costs on landlords, it would have a dampening effect on the supply of private rented accommodation. Landlords' perceptions of the risks associated with renting are likely to be much greater for licensing over which they have little control, than for enforced self-regulation, over which they would have greater control.

⁶⁶ Chris Partridge, "Out of Control" (21 June 2006) *The Independent* (property section) p 19.

⁶⁷ Current policy initiatives have tended to move away from blanket licensing towards more selective regulation that accommodates notions of risk. This can be seen in the context of the regulation of food safety.

- 7.108 Furthermore, licensing provides greater difficulties for the setting of appropriate standards. One point to note is that if licence conditions vary from local authority to local authority this would cause considerable difficulties for large-scale landlords who operate in a number of different local authority areas (as is the case with houses in multiple occupation and selective licensing). This could be countered by the production at central Government level (that is, by the Department for Communities and Local Government and by the Welsh Assembly Government) of standard sets of conditions, which could act either as guidance or be mandatory. But that would undermine the advantages which might be thought to flow from giving the function to local Government in the first place.
- 7.109 Perhaps more importantly, the self-regulatory options work by co-opting the expertise and knowledge of the regulated in the drawing up of the standards to be imposed on the industry. While consultation can, of course, help a Government agency (whether central or local) to access information, licence conditions would still be essentially an externally imposed set of standards.⁶⁸

Implied, or “negative”, licensing

- 7.110 The joint Shelter – Joseph Rowntree Foundation Commission on modernising the private rented sector, has proposed a variation on the mandatory licensing option considered above.⁶⁹ Their proposal was to impose a requirement that any person (or company) managing rented accommodation be a “fit and proper person”. Unlike mandatory licensing, landlords and agents would not have to apply for a licence or register with the local authority. Rather, there would be a presumption that every person managing a property was a fit and proper person until shown otherwise. A determination that someone was not a fit and proper person would only be made after an investigation by the local authority, triggered either by the local authority’s own initiative or an occupier or third party complaint.
- 7.111 This proposal can be thought of as implied (sometimes called negative) licensing. While local authorities do not actually issue licences or give express approval, they have the power to impose sanctions if a landlord or agent does not meet statutory criteria for a fit and proper person, including the power to exclude landlords and agents from the private rented sector.

Advantages and disadvantages

- 7.112 Implied licensing would share most of the benefits of mandatory licensing while not being as administratively complex or as costly to implement. Additionally, it would not necessarily exclude the operation of voluntary accreditation schemes and professional associations aimed also at encouraging improved management standards.

⁶⁸ This is by no means an absolute point – given that the underlying legal obligations on landlords are a given, to some extent any set of standards must, to provide the regulatory advantages we envisage, encompass externally set standards. But the self-regulatory approaches provide the opportunity for the industry (in collaboration with the regulator) to determine the means by which obligations are subsumed into good practice.

⁶⁹ Shelter and Joseph Rowntree Foundation, *Private Renting: A New Settlement* (2002) pp 14 to 15, available at <https://www.landlordlaw.co.uk/content/PRSMediareport.pdf> (last visited 22 June 2007).

- 7.113 Local authorities would still have to set management standards and be responsible for their enforcement. It is not clear that local authorities have the capacity to carry out the enforcement activities that would be required by such a scheme. There would be similar political and economic considerations of imposing local authority generated standards on landlords and agents. If “fit and proper” person standards varied across local authorities then this might dissuade large landlords from investing in the sector.
- 7.114 Local authorities would also need to allocate resources for inspections, investigation of complaints, and the enforcement of sanctions for this proposal to work. Unlike mandatory licensing, these additional resources could not be obtained through licence fees since there would be no formal licensing process. Local authorities would have to divert existing resource streams to ensuring compliance with the fit and proper person standard.
- 7.115 A final problem would be that the framework may drive out those landlords who consider its requirements too onerous. Some of the more conscientious landlords may fear they will not be viewed as a “fit and proper person” by the licensing authority when in fact they would be compliant. By contrast, wilfully non-compliant landlords or agents may remain within the sector because they may view the risks of formal enforcement as being slight. The absence of a formal application process would be unlikely to encourage the ill-intentioned landlord or agent to leave the sector or improve compliance.
- 7.116 Finally, policing such a scheme would arguably be more difficult than with compulsory licensing, under which landlords would be required to produce a licence on commencement of a letting. If licences were implied, then previously disciplined landlords might find it easier to avoid detection than unlicensed landlords under the mandatory system.

CONCLUSION

- 7.117 Despite the challenges associated with option (2), we think that it is to be preferred to option (1). We think option (2) provides a mechanism for encouraging responsible letting by getting those who currently may not take management standards seriously to change their approach. We also prefer it to option (3), which we think does not satisfy the general principles set out in the opening paragraphs of this Part.
- 7.118 In Part 8 we consider how a scheme of enforced self-regulation might operate in practice.

CONSULTATION ISSUES

- 7.119 This Part presents the case for reform of the regulatory structure for the private rented sector.
- 7.120 We set out some general propositions, which we think must be borne in mind if the regulatory structure is to be reformed. Do consultees agree with these general propositions? Are there others we should have taken into account?

- 7.121 We then set out three options, which we think might be the basis for a reformed regulatory framework: enhancing voluntary self-regulation; enforced self-regulation; and licensing. We make clear that our provisional view is that enforced self-regulation is preferable to the others.
- 7.122 Do consultees agree with our analysis? Do consultees consider that we have properly assessed the advantages and disadvantages of the three principal options? What alternative approaches or variations might be considered? What other options should we consider? Or are there variations on our options that would make them more attractive?
- 7.123 This part also discusses the costs that might be involved in moving to a reformed regulatory framework. Do consultees agree that costs of the order suggested seem likely? Are they a price worth paying for encouraging more responsible renting?

PART 8

ENFORCED SELF-REGULATION IN PRACTICE

INTRODUCTION

- 8.1 In this Part, we set out, in a little more detail, how enforced self-regulation – our provisionally preferred option – might operate in practice.

THE CENTRAL REGULATOR

- 8.2 At the centre of the proposed scheme, there would be a need for a central regulator, an independent third party to oversee the overall regulatory framework.¹
- 8.3 The central regulator would assume overall responsibility for the activities of the self-regulatory organisations. This could be achieved in many ways, whether by having significant residual powers to step in when things go wrong or adopting a more active role that would:
- (1) approve professional associations and accreditation schemes for inclusion in the regulatory framework, including setting minimum standards;
 - (2) oversee the enforcement of standards by self-regulatory organisations; and
 - (3) police the requirement that all landlords and agents were members of an approved self-regulatory organisation.

Setting standards

- 8.4 The first function of approving self-regulatory organisations would involve the central regulator assessing professional associations' and accreditation schemes' codes of practice and disciplinary procedures to ensure they met the appropriate standards. This would include approving proposed new associations and schemes.
- 8.5 Because a number of professional associations would be competing for membership² there may be a danger that there would be a "race to the bottom" with individual associations lowering standards in a bid to increase their membership at the expense of other bodies. The central regulator through the approval mechanism would have a clear role to play in ensuring that any such risk was minimised.

¹ A similar two-tiered regulatory structure is currently being developed for legal services. A central Legal Services Board will oversee professional bodies such as the Law Society and the Bar Council, which regulate solicitors and barristers. See the White Paper produced by the DCA, *The Future of Legal Services: Putting Consumers First* (2005) Cm 6679, available at <http://www.dca.gov.uk/legalsys/fofwp.pdf> (last visited 22 June 2007).

² This would not be so much of a danger for accreditation schemes, which are generally operate exclusively within defined geographical boundaries: however, there would still be a need to ensure a minimum standard for all accreditation schemes.

- 8.6 The central regulator could have control over the minimum content of codes of practice and disciplinary procedures by establishing the framework to which codes must adhere and approving individual codes. The regulator would determine what areas codes would need to cover and to what extent. For example, the central regulator would have to decide whether standards must deal with property conditions directly, as in some accreditation schemes,³ or indirectly through management standards, as in most professional associations currently.
- 8.7 The Office of Fair Trading provides a good example of how regulatory supervision of this type can operate in practice. It approves consumer codes promulgated by trade associations in a number of distinct consumer markets under its Consumer Codes Approval Scheme.⁴ Each code seeks to offer higher levels of consumer protection than are required by law. They serve to help consumers in “identifying businesses with higher levels of customer care.”⁵ The idea of promulgating and approving a code is to raise consumer awareness and overcome the problems associated with information deficiencies by enhancing trust and reputation.
- 8.8 To gain approval, codes must meet criteria on which the Office of Fair Trading has issued detailed guidance.⁶ The scheme is voluntary. Trade associations choose to become code sponsors and so develop and adopt the codes. Businesses in the relevant industry do not have to be members of the association (although the Office of Fair Trading will expect a substantial market penetration before accepting a body as a code sponsor). Nevertheless, codes are seen as providing members of the association with a competitive advantage. Codes proposed are subject to rigorous oversight and review. Although the voluntary nature makes the regime significantly different in regulatory terms, the functions of the Office of Fair Trading in approving codes of practice, and ensuring that they are enforced, provide a useful template for identifying the functions and powers of a central regulator.

Monitoring practice

- 8.9 The second function of the central regulator would be to guard against failures by an association or scheme properly to enforce its standards and discipline its members. This is another function performed by the Office of Fair Trading in its consumer code scheme.

³ See, for example, the Unipol Code of Standards 2006-2007 for Shared Student Housing in the Student Private Rented Sector in Leeds, pp 7 to 8 (<http://www.unipol.leeds.ac.uk/Bradford/COS/Full%5FCOS/> (last visited 22 June 2007)).

⁴ See http://www.offt.gov.uk/oft_at_work/consumer_initiatives/codes/ (last visited 22 June 2007).

⁵ OFT, *Consumer Codes Approval Scheme Frequently Asked Questions* (April 2007) http://www.offt.gov.uk/shared_offt/consumer_codes_approval_scheme/codesfaq.pdf (last visited 22 June 2007).

⁶ OFT, *Consumer Codes Approval Scheme: Core Criteria and Guidance* (November 2006) OFT390, available at http://www.offt.gov.uk/shared_offt/consumer_codes_approval_scheme/oft390.pdf (last visited 22 June 2007).

- 8.10 The central regulator would have the power to receive complaints directly from occupiers, advice agencies or others about alleged failures in the operation of a self-regulatory scheme. It could impose financial penalties on self-regulatory organisations that did not comply with its requirements for fair and transparent enforcement and disciplinary proceedings. In exceptional cases, it could remove the approved status of an association or scheme.
- 8.11 A further issue is whether the central regulator should be able to take enforcement action directly against the landlord or agent where a self-regulatory organisation had not acted in accordance with its agreed codes and procedures.⁷ Our preliminary view is that the central regulator could reasonably act as a clearing house for individual complaints, but would expect to pass them to the relevant self-regulatory organisation for handling, rather than have an extensive central complaints handling function itself. The receipt of complaints, even on a clearing house basis, would have a useful information function for the central regulator.

Identity of the central regulator

- 8.12 Our proposal for the creation of a central housing regulator would not necessarily imply the creation of a new administrative body. The functions outlined here could be grafted on to an existing organisation. Candidates for performing the role would be:
- (1) central Government (that is, the Communities and Local Government department and the Welsh Assembly Government);
 - (2) local authorities; or
 - (3) an arm's-length agency (such as the Office of Fair Trading or the Housing Corporation).
- 8.13 Our provisional view is that the first two candidates are not likely to be acceptable. Hands-on administration directly by central Government is unlikely to be considered appropriate, certainly in Westminster (although it might appear more in keeping in Cardiff, where the Welsh Assembly Government has abolished a number of non-departmental public bodies and brought their functions into the Assembly Government itself).
- 8.14 More importantly, central Government would not be seen as appropriately independent and disinterested by industry stakeholders. There is a considerable literature on the advantages of separating regulators from the every-day political and resource pressures apparent in central Government departments.
- 8.15 We note that although central Government has undertaken similar roles in the past in relation to state-funded housing, it now employs arms-length agencies itself for this purpose, such as the Housing Corporation and Audit Commission.

⁷ The Legal Services Bill, clause 41 (in the Bill 108 06-07 as brought from the Lords and ordered to be printed in the Commons), will give the central regulator for the legal profession (which will be called the Legal Services Board) power to issue "intervention directions" which may direct that the Board itself exercises the functions of the approved regulator (such as the Law Society), or that the approved regulator must comply with the Board's instructions.

- 8.16 Local authorities have the most direct experience of working with private landlords. However, current relations between the local authority and local private landlords can vary substantially from area to area. More importantly for our purposes, there is no clear way that local authorities could adequately deal with self-regulatory organisations operating beyond their boundaries, whether at national or regional levels. (Cross boundary issues could result in requiring differing standards from an organisation's members within a particular local authority area). Finally, there may well be a conflict of interest between their own accreditation schemes and other self-regulatory organisations. It would be potentially problematic for local authorities to act as central regulator of their own scheme.⁸
- 8.17 We think an arm's-length agency is the better option for the central regulator role. It would have the necessary independence as well as the ability to provide national oversight.
- 8.18 The Office of Fair Trading already has experience acting as a central regulator. It also has familiarity with the rented housing market through its jurisdiction over unfair terms in consumer contracts.⁹ We have drawn heavily on the Office of Fair Trading model in developing this paper.
- 8.19 The Housing Corporation has extensive experience regulating registered social landlords. The role of central regulator for the private renting self-regulatory regime would be different but not beyond its capabilities. It might emerge as a general "Office for Fair Housing".¹⁰
- 8.20 Other options that might be considered could include expanding the power of the Audit Commission to take on this function; though this might obscure the focus of the Commission's current work. Alternatively, consideration could be given to a specially created body.

⁸ This might suggest that accreditation schemes should be excluded altogether, an option we do not favour because of their potential for disciplining the regulatory marketplace.

⁹ This jurisdiction is another key aspect of our "consumer protection approach". We recommend in *Renting Homes: The Final Report* (2006) Law Com No 297 extending the principles underlying the Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999 No 2083) to all landlords and occupiers: see http://www.lawcom.gov.uk/docs/lc297_vol1.pdf. Contractual terms which reflect mandatory statutory provisions are not subject to those regulations: this will be an incentive for landlords to use the model occupation contracts incorporating unmodified versions of the terms we prescribe in our draft Rented Homes Bill.

¹⁰ We are aware that, at the time of writing, the Government intends to merge the Housing Corporation with English Partnerships to create a new body called Communities England; however as the details of the new body are not yet clear, for the present we continue to refer to the Housing Corporation.

THE REGULATORY INSTRUMENT

- 8.21 The aim of these proposals is to streamline the current regime rather than add more substantive obligations to those already existing. The key to achieving this, we think, is to ensure that the regulatory instrument – the codes of practice¹¹ – is comprehensive.
- 8.22 Currently the codes of practice being operated by existing landlords and lettings agents and other professional bodies vary. Some provide guidance on legal requirements,¹² while others focus on “good practice”, over and above legal requirements.¹³
- 8.23 Our aim is that the regulatory instrument should provide a comprehensive statement of practice which, if adhered to, would ensure that in all normal circumstances landlords met their legal obligations and delivered sensible and effective management of property. In some cases, the code could simply incorporate by reference other obligations – for instance, requiring that a landlord’s gas appliances have CORGI certification.
- 8.24 Satisfaction of the requirements in the instrument would ensure that legal standards were met. For example, if landlords behaved towards their tenants in the manner set down in the code, they would necessarily not be acting contrary to the Protection from Eviction Act 1977. Landlords seeking guidance on what they could or could not do need only look to the regulatory code.¹⁴
- 8.25 If a landlord breached a standard specified in the code, the primary route for challenge and remedy would be through the operating procedures set by the self-regulatory organisation. This would be so regardless of whether the breach concerned related to a default in “good practice” or one that also amounted to a breach of a legal obligation. The route of legal redress would remain however. While the possibility of court action would not be removed, the bulk of problems would be resolved through the self-regulatory organisation’s mechanism. The primary objective of the regime would be to ensure that landlords understood and acted upon best practice so as to minimise the risk of enforcement being pursued by other agencies.

¹¹ Codes of *practice* becomes a less useful term if the regulatory instrument is conceived as a comprehensive guide, including or subsuming legal obligations. Regulatory code might be a better term.

¹² The Royal Institution of Chartered Surveyors (RICS) code of practice for property managers (landlords and agents) in the private rented sector (RICS, Rent Only Residential Management Code (2nd ed 2004)), in addition to laying down guidance on best practice, sets out most of the main legal obligations for property managers in one document, making clear which obligations are legal requirements (with reference to statutory provisions).

¹³ The Residential Landlords’ Association code of practice requires members to comply with relevant law, without going into detail about the contents of that law. It imposes other requirements as to how landlords should conduct their business.

¹⁴ This is one aspect of our “consumer protection approach” to landlord and tenant law. Likewise, in Renting Homes: The Final Report (2006) Law Com No 297 we recommended that landlords and occupiers should have a written statement of their occupation contract setting out their rights and obligations (for example the landlord’s repairing obligations, and the contract-holder’s duties not to engage in conduct likely to cause nuisance) rather than needing to refer to numerous statutes and case law to discover them. See http://www.lawcom.gov.uk/docs/lc297_vol1.pdf.

APPEALS AND REVIEWS

- 8.26 The self-regulatory organisations would be taking important decisions affecting the livelihoods of landlords as well as the living conditions of tenants. There would clearly have to be a process of appeal or review of their decisions. There are broadly two options. First, in the absence of any specially created procedure, the decisions of a self-regulatory organisation would be subject to judicial review in the Administrative Court on general public law principles. On those general principles, the court would review the decision to ensure that it was properly taken and in accordance with the rules of natural justice; and that it was a decision that a reasonable self-regulatory organisation could properly take.
- 8.27 The second option would be to create a specific right of appeal. A precedent for this would be the right of appeal to the residential property tribunal which was created in the Housing Act 2004 in respect of the licensing regimes established by that Act.¹⁵ There is a right of appeal against the decision of a local housing authority to grant or refuse to grant a licence; and the revocation and variation of a licence already granted. Rather than merely reviewing the decision, the tribunal gives the matter a full re-hearing.¹⁶ The Tribunal can confirm, reverse or vary the decision. It also has the power to direct the local housing authority to grant a licence on such terms as it thinks appropriate.¹⁷
- 8.28 We provisionally consider the second of these two options to be the most appropriate.

THE UNDERLYING LEGAL OBLIGATIONS

- 8.29 We have argued from the start of this paper that the problem with encouraging responsible renting is not the lack of legal obligations, but rather the failure to use the law already available particularly in the context of enforcement. For the new regulatory regime to work as intended, however, consideration must be given to the question: is there too much law which gets in the way of effective enforcement?
- 8.30 Housing law is replete with duplication, obscurity and irrationality. For example, unhealthy housing conditions are addressed not only by the Housing Health and Safety Rating System in the Housing Act 2004 and the implied covenants in the Landlord and Tenant Act 1985 (discussed above), but also by the statutory nuisance provisions in the Environmental Protection Act 1990 and other measures summarised in Supplementary Paper 1. No doubt the introduction of each individual measure can be explained by its historical context, but, as with our review of the law of housing tenure, this does not promote a coherent regulatory framework.
- 8.31 The creation of a comprehensive code of guidance, underpinned by law, and enforced by self-regulatory organisations, supported by a central regulator could enable Government to remove some of the legislation from the statute book that, in practice, serves no purpose.

¹⁵ Housing Act 2004, sch 5, Part 3.

¹⁶ Housing Act 2004, sch 5, Part 3, para 34(2).

¹⁷ Housing Act 2004, sch 5, para 34.

- 8.32 For example, there are two different harassment offences under the Protection from Eviction Act 1977, which involve “persistently” withdrawing or withholding services (one of which can only be committed by landlords and agents), and harassment offences under the Protection from Harassment Act 1997 (which involve a “course of conduct” or person being led to fear violence “on at least two occasions”).¹⁸ There seems clear scope for rationalisation of these rules to simplify and clarify their effect.
- 8.33 If our ideas for improving the regulation of the private rented sector find support, we also think that some existing regulatory mechanisms may need to be revisited. We are seeking to shift the emphasis from enforcement to ensuring that those who act as landlords understand what their obligations are, and are provided with additional tools (through the mechanism of the self regulatory organisation) to ensure that these are met. This is part of an ongoing project that seeks to restructure the process of regulation so as to include both public and private actors.¹⁹
- 8.34 Finally, if our proposals were adopted, then we would expect that the primary route of redress for an occupier who suffers from poor management behaviour by a landlord would be through the regulatory scheme and not through the magistrates’ court, the county court or residential property tribunal. If, after hearing the views of consultees, we conclude that this would not be the case, we will have to look in more detail at mechanisms to ensure that it did happen. Our proposals could increase rather than decrease the regulatory burden on landlords, if legal proceedings were brought in courts or tribunals simultaneously with complaints to the self-regulatory organisation, unless one route of redress automatically excluded recourse to others. This does not happen under the Office of Fair Trading scheme.

CONSULTATION ISSUES

- 8.35 This Part considers the need for a central regulatory authority and offers some ideas as to which agency might on take this role. Is our account of the central regulator persuasive? Should it be configured in a different way? Are there other and better options for the body to undertake this function?
- 8.36 This Part also suggests that a new regulatory framework might enable Government to reduce some of the law, which currently applies to the private rented sector. This is not considered in detail in the paper, but we would welcome views on whether consultees agree with these general sentiments and whether they have ideas as to which regulatory burdens might be removed.

¹⁸ See *Supplementary Paper 1: The Law on Housing Conditions and Unlawful Eviction*, available at http://www.lawcom.gov.uk/housing_renting.htm.

¹⁹ There is some anecdotal evidence and press reporting suggesting that the initial impact of the introduction of HMO licensing has been to cause a number of landlords to exit the market: see *Inside Housing*, 20 April 2007 at p 3 citing research published by ARLA. We cannot judge how widespread these effects are. We think the objectives of the schemes introduced in the Housing Act 2004 might be met more effectively through the approach we provisionally propose.

PART 9

HOME CONDITION CERTIFICATION

INTRODUCTION

- 9.1 The options we have considered so far in this paper have focussed on the landlords and agents themselves. The options are designed to ensure that landlords and agents understand what good property management involves. In cases where they seem unable to ensure that their properties are properly managed, there is the ultimate sanction of refusing them membership of a self-regulatory organisation or accreditation scheme, without which they cannot act as landlord or agent.
- 9.2 Here we introduce an alternative tool to regulate the physical condition of rented property. This idea has been raised with us at the pre-consultation stage by people coming from both the landlords' and the occupiers' perspective.

CERTIFICATION OF CONDITION

- 9.3 The idea builds on the current practice that there should be regular inspections of gas appliances, in particular central heating boilers, to ensure they are safe. This seems to be working relatively satisfactorily.
- 9.4 Part of the problem with the current regulatory framework as it relates to property conditions is that, in dealing with health and safety issues, it is (with the exception of gas inspections) reactive rather than preventive. Standards are enforced, if at all, only after a breach has been uncovered. Thus, it is argued, a better way to ensure that rented accommodation meets the basic minimum standards for health and safety and property conditions is to devise a mechanism for guaranteeing the condition of a property before it is let.¹
- 9.5 One means of doing so would be to require that privately rented accommodation be inspected and certified before it can be rented. (A well-known example of this sort of certification scheme is the MOT test, requiring vehicles over 3 years old to have an annual inspection and certification.)

¹ This would support the recommendation in para 8.7 of Renting Homes: The Final Report (2006) Law Com No 297 that accommodation should at least be free of "category 1 hazards" at the time of the letting: see http://www.lawcom.gov.uk/docs/lc297_vol1.pdf.

- 9.6 Certification would be centred around the main legal obligations relating to health and safety and property condition: the Housing Health and Safety Rating System, the Gas Safety (Installation and Use) Regulations 1998,² other safety regulations made under the Consumer Protection Act 1987,³ and those repairing obligations under section 11 of the Landlord and Tenant Act 1985.⁴ Certification would be a means of ensuring that these obligations have been complied with before a property is occupied.
- 9.7 Certification, as we envisage it, would work as follows. Before a landlord could let a property, it should be inspected to certify that the property complied with the relevant obligations. The inspection would ensure that there were no category 1 hazards on the premises; that the installations, which are the landlord's responsibility under section 11 of the Landlord and Tenant Act 1985, were in repair and proper working order; the gas safety certificate was up to date; and that electrical installations had been tested and were working satisfactorily. If these conditions were met a certificate would be issued that stated that the property was in an appropriate condition for letting and complied with the obligations at the time of the inspection.
- 9.8 Given the rate of turnover in parts of the private rented sector it would be impractical to require an active process of recertification prior to each new letting. A certificate would therefore need to last for a set period of time (say three years).
- 9.9 If the property could not be certified as safe and in compliance then the landlord would have to bring it up to the required standards before it could be let. Letting without having first obtained a certificate would be an offence. Transitional arrangements would be required for those properties that were occupied when the scheme came into effect, including what would happen to the occupiers of properties that did not meet the required standard and failed to be subject to a certificate.
- 9.10 The cost of obtaining a certificate would be borne by the landlord, but, where market conditions allowed, these would be passed on to the occupier as part of the rent.

² SI 1998 No 2451.

³ See *Supplementary Paper 1: The Law on Housing Conditions and Unlawful Eviction*, available at http://www.lawcom.gov.uk/housing_renting.htm.

⁴ For a description of the obligations, see paras 3.9 to 3.12.

Process

- 9.11 The certification process could take a number of different forms. At present, a number of people with different expertise are needed to carry out different inspections. Typically, environmental health officers, either employed by a local authority or in private practice, undertake Housing Health and Safety Rating System surveys; CORGI gas fitters undertake gas safety inspections; electricians undertake inspections of electrical appliances. This suggests that it would not be possible to have a single inspection by a single inspector. Rather inspections would need to be undertaken by a team of inspectors with relevant expertise. This could take place at a single point in time, the preferred option; or by different inspectors coming to the property at different times, a much more cumbersome option.
- 9.12 However, were the concept to be adopted, it is perfectly possible that a market would develop to enable those currently with specialist expertise (for example in gas fitting) to acquire the other relevant skills needed to enable them to complete the whole certification process with one person making a single visit.⁵ A body such as the Chartered Institute of Environmental Health could oversee this.
- 9.13 If inspection took place at a single point in time, it would be possible for the inspector(s) to issue the relevant certificate on the spot. The details would be held in a central computer database.
- 9.14 If the component inspections occurred at different times then the different inspectors would feed their individual reports into the central database. When all the required statements were collected, the central regulator would automatically generate the required certificate, which would be sent to the landlord and his agent.
- 9.15 Once certified, the central database could generate notices to remind landlords and agents of the need to renew their certificate, say once every three years.

The regulator

- 9.16 Such a scheme would require a regulatory body to oversee the certification process and enforce its requirements. The regulator would be responsible for making inspections as simple and efficient as possible for landlords and agents. This system might require the creation of a new regulatory body, or it could be co-ordinated by the Health and Safety Executive, or local authorities using environmental health officers and other suitably qualified technicians and enforcement officers. The inspection process itself would bring together the existing expertise of housing inspectors, surveyors, local authority officers, CORGI engineers and electricians.

⁵ One possibility would be for a certification scheme for people who would carry out the inspections, just as the Home Information Pack Regulations 2006 (SI 2006 No 1503), until they were revoked by the Home Information Pack (Revocation) Regulations 2007 (SI 2007 No 1525) following the Minister's announcement that the introduction of the home information pack scheme was to be delayed until 1 August 2007) provided for the Secretary of State to approve certification schemes for people to carry out inspections of properties in order to prepare "home condition reports" to be included in the home information packs to be provided by sellers of homes.

- 9.17 Active monitoring of the requirement to obtain a certificate for each property would not be feasible given the number of rented properties in England and Wales.⁶ Enforcement would therefore primarily be based on occupiers raising instances of non-compliance or on accidents bringing to light non-compliance (as is currently the case with the enforcement of gas safety regulations).⁷
- 9.18 The effectiveness of the scheme would be enhanced by requiring that a copy of the certificate must be provided with the rental agreement together with wide publicity for this requirement. It could also be a requirement that a landlord could not initiate court or tribunal proceedings without the presentation of a current valid certificate.

Advantages and disadvantages

- 9.19 The certification scheme sketched out above seeks to ensure that rented property meets current legal requirements as to condition, health and safety – requirements with which landlords should be complying in any event. The scheme would be a simple and transparent way of reinforcing that. It would be comprehensible to landlords and agents. If organised effectively the inspection system need not be unduly burdensome.
- 9.20 On the other hand, it is unclear how much such a scheme would cost. Government estimates for the cost of home condition reports, which were to have been a mandatory part of the proposed home information packs to be supplied by sellers of property and which would involve an assessment of the condition of a dwelling, were put at £350.⁸ But home condition reports were to be prepared by a single inspector and did not involve assessment of health and safety hazards or gas safety (or indeed other health and safety regulations). There would also be the costs associated with a body to carry out the regulatory functions associated with administering and enforcing a certification scheme. Ultimately, these costs would have to be borne by occupiers and/or taxpayers.

⁶ English House Condition Survey data showed that there are around 2,334,000 private rented dwellings in England: see http://www.communities.gov.uk/pub/429/EnglishHouseConditionSurvey2004AnnualReport_id1502429.pdf (last visited 22 June 2007), and Welsh Housing Statistics 2005 show 115,000 private rented dwellings in Wales: see <http://new.wales.gov.uk/docrepos/40382/40382313/statistics/housing-2005/whs2005/whs2005-ch1.pdf?lang=en> (last visited 22 June 2007).

⁷ See *Supplementary Paper 1: The Law on Housing Conditions and Unlawful Eviction*, available at http://www.lawcom.gov.uk/housing_renting.htm.

⁸ ODPM, *The Home Buyer and Seller's Guide to the Home Information Pack* (October 2005), available at <http://www.homeinformationpacks.gov.uk/pdf/15,%20Consumer,%20Consumer%20Publications,%20Home%20buyer%20&%20sellers%20guide%20to%20the%20HIP%20download.pdf> (last visited 22 June 2007). Opponents of the HIP scheme estimate the costs to be much higher: the Conservative Party stated that “The Government’s estimate of the cost of a pack for its “average” semi-detached home is £776 including VAT, but admits that the location, size and condition of the property could mean even higher prices. Experts predict £1,000 will be the actual cost for many homes, and even higher for complex or larger properties.” http://www.conservatives.com/tile.do?def=news.story.page&obj_id=130995 (last visited 22 June 2007). As is well known, the HIP scheme is not going to be implemented as originally envisaged.

- 9.21 A further potential disadvantage of the certification scheme would be the fact that landlords would be prohibited from letting their properties, risking prosecution, pending the inspection and certification. The effect of delay could be serious, certainly if there was a need for several different inspectors to examine the property before a certificate could be granted. Landlords would lose rental income during this period and might seek to increase the rent for those months when they are able to let the property to compensate. This would be mitigated by the fact that, once obtained, the certificate would last three years.
- 9.22 These issues of cost and delay would, however, depend on how the inspection market responded. At present, there is no significant delay in obtaining a gas report, nor is the cost that great (around £50). With a very large pool of properties requiring inspection, there would be opportunities for a new cadre of inspectors to be created.
- 9.23 There is a danger of poorer tenants being priced out of the private rented market (putting even greater pressure on social housing). However, given the fact that the poorest housing conditions are found in the poorest properties, it might be reasonable for the public purse to meet the cost of these certificates, for example for landlords housing those in receipt of housing benefit. One problem with this idea would be that landlords might claim they were going to rent to those in receipt of housing benefit simply in order to obtain a free certificate.⁹ An alternative approach might be to allow the landlord to claim the costs of the certificate only after they have let the premises and the occupier is claiming housing benefit. The housing benefit authority could be the body to which the landlord made application.
- 9.24 Under the Housing Health and Safety Rating System, even where a local authority finds a category 1 hazard, it is not required to serve a prohibition order in every case, but the authority can take other enforcement action such as serving an improvement notice requiring remedial work. If, under the certification system, landlords were to be prohibited from letting their properties until the certificate was obtained, this outcome is arguably not compatible with the present system.
- 9.25 If local authority environmental health officers were required to undertake additional inspections covering all private rented sector properties in their area for the existence of category 1 hazards under the Housing Health and Safety Rating System, they may be unable to cope with demand for their services, adding to delays. This call on their services could jeopardise their ability to target inspections on properties posing potentially greater risks (including those in the owner-occupied or social rented sectors). This would reinforce the view that inspections would best be undertaken by a new cadre of specially trained inspectors, operating privately.

⁹ Landlords who claimed they would rent to housing benefit claimants without any intention of so doing would be guilty of fraud. Once it was clear they had not rented to such a person, they could be required to pay retrospectively the cost of the certificate plus a penalty charge.

- 9.26 A certification system of this type is primarily directed at achieving compliance at a particular point in time, rather than an ongoing commitment to compliance. (This point would be made clear on the certificate itself.) Were the intervals between inspections to be too lengthy, landlords might not pay attention to ensuring compliance except when their certificate is due for renewal. Nevertheless this would be an improvement on the current system whereby there is little incentive to comply. The system could even be supplemented, for example by allowing for additional random inspections.¹⁰
- 9.27 The scheme focuses upon individual properties rather than the certification of landlords and agents as competent to manage property responsibly. For those owning and/or managing several properties this will multiply the regulatory burden. Indeed, this may be particularly burdensome where the landlord lets properties in different geographical areas, in which the regulatory requirements may be different.
- 9.28 One trade-off that could be considered would be that landlords and agents who were signed up to a self-regulatory scheme would be exempt from the need to obtain the certificate.
- 9.29 Analogously with the MOT, it might be reasonable to exclude newly built dwellings from the requirement to possess a valid certificate. Thus certification might not be required for premises built within, say, the last 10 years. Of course landlords would still be subject to the normal repairing and health and safety obligations imposed by the general law.

CERTIFICATION AS A REGULATORY TOOL

- 9.30 Although the idea of home condition certification has been suggested to us as an alternative, general system, it could supplement the powers available to an independent central regulator, rather than function as a stand-alone system. It could constitute the regulator's "benign big-gun". In this variant, the central regulator would have the power to introduce certification in specific areas, or in relation to specific descriptions of properties (houses in multiple occupation, for instance).
- 9.31 The starting, and ideal, position would be that the regulatory regime would be a system of enforced self-regulation. However, if it became apparent that this approach was simply not working in some areas or sectors – that the self-regulatory organisations were operating for the benefit of landlords or agents, not occupiers, or, indeed, no self-regulatory organisation was prepared to deal with landlords or agents in a particular area or sector, then the central regulator would have the option of imposing certification on the relevant areas or sectors. If it appeared that self-regulation could again work (for instance, after certification had forced up standards as a one-off effort), then certification could be removed and its place taken by more effective self-regulatory organisations taking matters back into their own hands.

¹⁰ As happens with respect to health and safety compliance among small food and catering outlets. See the Food Standards Agency, *Strategic Plan 2005-2010 "Putting Consumers First"* (2004) p 33, available at <http://www.food.gov.uk/multimedia/pdfs/stratplan0510.pdf> (last visited 22 June 2007).

CONSULTATION ISSUES

- 9.32 This Part considers an alternative or perhaps supplementary idea relating to the certification of housing condition. We welcome consultees' views on these ideas. Are there either theoretical or practical advantages or disadvantages to the suggestions made in this Part? Are there useful parallels elsewhere that would help us to assess the practicability of this option?

PART 10

RESPONDING TO THIS PAPER

INTRODUCTION

10.1 Consultation has always been fundamental to the methodology of the Law Commission. In the context of this paper, we are consulting for two principal reasons:

- (1) to discover new facts. We will never know everything important that there is to know in advance of consultation. There are always limits to our resources and expertise. So we rely on consultees to help us by uncovering that which we have overlooked or of which we have not been aware. In particular, in a project of this breadth, where we need to understand how a market works in practice, the factual knowledge of those who are engaged in or observe that market is invaluable.
- (2) to glean new insight. Just as we have no monopoly of knowledge, we have no monopoly of wisdom. Our understanding of the law and of other obligations on landlords is not infallible. More importantly, we will not be unerringly right in our understanding of how the law and the world interact, and how the latter might behave should the former be changed. In this project in particular, we are drawing on cross-disciplinary learning in regulatory theory, and understanding the impact of that learning on our chosen subject is crucial, and open-ended.

The purpose of this Part is to assist consultees in formulating their responses.

10.2 In some consultation papers in the past, we have asked numerous questions throughout the paper, creating in effect a lengthy questionnaire. That approach is right for those projects where much hangs on the specific choices to be made in arriving at a detailed legislative proposal.

10.3 In this project, however, we are proposing a broad systematic approach to our subject matter. Asking a large number of detailed questions feels to us less useful. We therefore urge consultees to take a similarly broad approach by engaging with our thinking, but not feeling limited by it. All parts of this project are open for reconsideration. Consultees who wish to take a completely different approach and argue it are most welcome.

10.4 One of the disadvantages of the questionnaire approach is that some potential consultees may take from it an expectation that they should answer all the questions. This is a false view. If we consult to uncover facts and glean insights, that is just as likely to come from a partial as a full engagement with the issues. We positively welcome responses that take on one part of the subject matter, to tell us new things and help us to understand them better.

THE KEY ISSUES

- 10.5 However, it still seems to us that it may be helpful if we suggest to consultees some of the key issues that we feel arise. In the paragraphs that follow, we outline some of the questions that consultees might like to address. Consultees might find it helpful to read and consider the questions we set out below before responding on a particular Part of the paper. In that way, we hope that the questions will help consultees in their own thinking about the issues – but we are not specifically asking for precise answers to each question. Rather, we hope it will stimulate consultees' own thinking, without determining a particular content or structure to responses.

Part 1

- 10.6 In Part 1, we set out our reasons for limiting the scope of the project to the private rented sector. We also set out our reasons for focussing on housing management issues, in particular relating to housing conditions and to a lesser degree unlawful eviction and harassment.
- 10.7 Do you agree with the approach we have adopted? Are we right to concentrate on housing conditions, harassment and unlawful eviction? If not, what should we deal with in addition to, or instead of, these two issues, and why?

Part 2

- 10.8 This set out information about the private rented sector today. From this we draw certain conclusions about the role of the private rented sector in the housing market.
- 10.9 Do consultees accept the broad picture that emerges from our description of the private rented sector? Are there important facts that we have overlooked? Are our conclusions about the nature of the sector justified by the facts?

Part 3

- 10.10 Part 3 analyses the “regulatory deficit” and argues that, particularly in relation to housing conditions, the law is not working as Parliament intended.
- 10.11 Do you agree with these conclusions?

Part 4

- 10.12 Part 4 raises a fundamental issue about what the costs of greater compliance with the law might be. It also asks what are the costs of not taking action.
- 10.13 We seek to encourage all those, both within Government and outside, who are interested in the policy issues to let us have their views on the questions raised and the choices that might be made.

Parts 5 and 6

- 10.14 These parts set out some basic information about regulation and apply this to four key periods in the development of the regulation of the private rented sector.

- 10.15 Consultees are invited to comment on the development of regulatory theory and the lessons this may have for the operation of the private rented sector.

Part 7

- 10.16 This Part presents the case for reform of the regulatory structure for the private rented sector.
- 10.17 We set out some general propositions, which we think must be borne in mind if the regulatory structure is to be reformed. Do consultees agree with these general propositions? Are there others we should have taken into account?
- 10.18 We then set out three options, which we think might be the basis for a reformed regulatory framework: enhancing self-regulation; enforced self-regulation; and licensing. We make clear that our provisional view is that enforced self-regulation is preferable to the others.
- 10.19 Do consultees agree with our analysis? Do consultees consider that we have properly assessed the advantages and disadvantages of the three principal options? What alternative approaches or variations might be considered? What other options should we consider? Or are there variations on our options that would make them more attractive?
- 10.20 This Part also discusses the costs that might be involved in moving to a reformed regulatory framework. Do consultees agree that costs of the order suggested seem likely? Are they a price worth paying for encouraging more responsible renting?

Part 8

- 10.21 Part 8 considers the need for a central regulatory authority and offers some ideas as to which agency might on take this role.
- 10.22 Is our account of the central regulator persuasive? Should it be configured in a different way? Are there other and better options for the body to undertake this function?
- 10.23 Part 8 also suggests that a new regulatory framework might enable Government to reduce some of the law that currently applies to the private rented sector. This is not considered in detail in the paper, but we would welcome views on whether consultees agree with these general sentiments and whether they have ideas as to which regulatory burdens might be removed.

Part 9

- 10.24 This Part considers an alternative or perhaps supplementary idea relating to the certification of housing condition.
- 10.25 We welcome consultees' views on these ideas. Are there either theoretical or practical advantages or disadvantages to the suggestions made in this Part? Are there useful parallels elsewhere that would help us to assess the practicability of this option?

CONCLUSION

- 10.26 We hope consultees will find the paragraphs above of assistance in compiling responses. As we hope we have made clear, the selection of these issues does not mean that other questions are in any way closed, or that we would not be happy to receive responses that tackle the issues in quite different ways or from quite different starting points.

APPENDIX 1

ACKNOWLEDGEMENTS

A.1 We are most grateful for the assistance and contributions we received from numerous people involved in letting homes. In particular we acknowledge help from the following people who participated in preliminary discussions. They are not responsible for any comments or proposals made in this consultation paper.

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- (2) Professor Julia Black, London School of Economics
- (3) Sarah Blandy, University of Leeds
- (4) Professor Susan Bright, University of Oxford
- (5) Colin Brown, Office of Fair Trading
- (6) Mark Butterworth, Residential Landlords Association
- (7) Helen Carr, University of Kent
- (8) Professor Martin Cave, University of Warwick
- (9) Professor Tony Crook , Durham University
- (10) Ian Fletcher, British Property Federation
- (11) John Gallagher, Shelter
- (12) Janice Houghton, Better Regulation Executive
- (13) Professor Robert Lee, Cardiff University
- (14) Sam Lister, Chartered Institute of Housing
- (15) Wilma Morrisson, Law Centres Federation
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APPENDIX 2

THE ECONOMICS OF THE PRIVATE RENTED SECTOR

PART 1

REGULATING THE PRIVATE RENTED SECTOR

INTRODUCTION

- 1.1 This appendix discusses the economic perspective on regulation of the rented sector. Its objective is to examine the nature of the market, the justifications for regulatory intervention, and the nature of the costs associated with intervention.
- 1.2 Debates over the regulation of the private rented sector have been a recurrent feature in the history of British housing policy since the nineteenth century. Changes in the regulation of the sector are central to understanding key periods in the development of active housing policy. The earliest state interventions into the housing market, in the first half of the nineteenth century, focused upon the public health implications of poor quality urban housing which was, given its overwhelming dominance of the housing market of the age, typically private rented housing. Since that time the nature and extent of state activity in the private rental market has waxed and waned in line with changing understandings of the functioning, role and desirability of private renting in the context of the operation of the broader housing system.
- 1.3 Since the 1980s the broad thrust of policy towards the private rented sector has been market-oriented and deregulatory. Yet the start of the twenty-first century has seen aspects of the private rented sector subject to greater regulation. In particular, the Housing Act 2004 introduced greater mandatory regulation of houses in multiple occupation, a statutory tenancy deposit scheme, and opened up the possibility of area-based licensing on a selective basis. The measures in the 2004 Act are seen by policymakers as necessary to address specific and/or localised problems.
- 1.4 There remain questions regarding the standard of properties and management in the private rented sector more broadly, and these are the questions addressed by the consultation paper.

REGULATORY REFORM

- 1.5 The current period is one in which there is a general commitment, at a policy level, to critical engagement with existing regulation (Is it necessary? What purpose does it serve?) and close scrutiny of proposals to change regulatory structures or introduce new ones (Will they be effective in achieving their stated objectives? Is it clear that the change will, on balance, be beneficial?). To this end, the regulatory impact assessment – a form of cost benefit analysis – has become a key stage in shaping thinking on future directions for policy. All policy development and proposals must be framed in the light of the Better Regulation agenda.

- 1.6 The current regulatory agenda needs to be viewed in the light of two broader intellectual currents. The first is the way in which economic thinking has become engrained in policy discussion and analysis. The second is the critique of the effectiveness of well-established regulatory structures.
- 1.7 To frame policy questions in terms that are derived, whether directly or indirectly, from economic analysis is now unexceptional. To seek policy solutions that accord with, or at least are not at too great a variance with, the prescriptions of standard economic analysis is taken to be highly desirable. The motivation for this appendix is to ensure that the Law Commission's proposals for reform in the private rented sector are informed by an explicit consideration of the relevant economic issues. While this has not typically been at the heart of the Law Commission's approach to law reform, in the current instance economic questions are so central to the project that it was felt to be essential to engage with them directly.
- 1.8 The second intellectual current is the critique of well-established modes of regulatory intervention. When Government has sought to intervene directly in markets in order to regulate price, quantity or quality it has traditionally relied upon command and control mechanisms. Such mechanisms use often punitive regulatory policing by Government or its agencies to enforce compliance with standards established through primary or secondary legislation. An extensive critique of this method of regulation has developed since the 1970s, with a much greater emphasis now being placed upon alternative regulatory strategies relying on compliance. Reform of regulation to make it "smarter" is advocated. The Better Regulation agenda draws inspiration in part from these developments in regulatory thinking. The proposals developed during the Encouraging Responsible Letting project have been informed by consideration of the state of the art in regulatory thinking.¹

THE STRUCTURE OF THE APPENDIX

- 1.9 This appendix comprises five parts. In Part 2 we review the argument that a market economy can deliver a socially optimal allocation of resources and the range of reasons why this may not occur in practice. Part 3 summarises the reasons of efficiency and equity that can be used to argue that the state should adopt a more active and interventionist role in relation to market provision. In Part 4 we turn to focus upon the housing market more specifically and consider the extent to which these arguments can be applied to the private rented sector. In the final Part we review economic arguments regarding state intervention in the housing market. The topic of rent control has traditionally been the main focus of concern for economists and consequently that is where our discussion starts. We then consider the regulation of quality.

¹ These themes are further explored in Parts 5 and 6 of the main body of the consultation paper.

PART 2

MARKETS AND MARKET FAILURE

INTRODUCTION

- 2.1 The starting point of much contemporary regulatory reform is a presumption in favour of market-based provision of goods and services. This is because a decentralised market economy can have the very desirable property of allocating resources efficiently. But for a market economy to deliver an outcome that maximises social welfare requires that it has certain characteristics and certain conditions are met. From this perspective, it is only when an individual market, or a market economy more generally, diverges significantly from these characteristics – that is, suffers from one or more significant “market failures” – that it may be appropriate to consider an alternative social arrangement that entails a more active role for the state. Yet the desirability of adopting an alternative to market-based provision does not follow of necessity: greater state activity should only be preferred if it can deliver an outcome that is socially preferable to that achieved through use of even an imperfect market mechanism. Since the 1970s there has been a growing appreciation that the possibility of “Government failure” needs to be set alongside concerns about market failure. The unintended consequences and inherent inefficiencies of Government action mean that a more active role for Government may result in less, rather than more, efficient resource allocation. In this Part we review, first, the reasons why market-based provision is seen as desirable and, second, in what ways markets may fail to deliver in full the benefits ascribed to them.

THE BENEFITS OF A MARKET ECONOMY

- 2.2 A market economy comprising a large number of buyers and sellers, none of whom is large enough to influence the price level, engaged in free competition will result in productive resources being allocated to their most highly valued use. In such an economy resources will be allocated between competing uses in line with opportunity costs, which in turn depend on the structure of effective demand. Effective demand is a product of consumer preferences and income levels. In a perfectly competitive market resources are therefore allocated to the production of different goods in accord with consumers’ relative valuations of those goods, and the resulting allocation will maximise social welfare.² Broadly speaking, in such an economy all goods and services for which there is a net social benefit – the benefits outweigh the costs of provision – will be supplied up to the level at which the net social benefit of providing an additional unit is zero.³

² On the assumption that social welfare can appropriately be represented as the sum of the consumption-based welfare of all individuals in society.

³ That is, the equilibrium quantity in each market is the quantity at which marginal social cost, which increases as the quantity produced increases, equals marginal social benefit, which decreases as the quantity produced increases.

- 2.3 It has been demonstrated theoretically that a perfectly competitive economy of this type can maximise social welfare. The social maximum is defined in terms of an allocation of resources that is Pareto-optimal⁴ – resources are allocated in such a way that it is not possible to reallocate them to make one consumer better off, without correspondingly making another consumer worse off. A perfectly competitive economy would deliver a Pareto-optimal allocation of resource.⁵
- 2.4 There is a (different) Pareto-optimal outcome associated with each initial distribution of wealth among consumers. That is, an economy with a very unequal wealth distribution will result in a different outcome when compared to an economy with a more egalitarian wealth distribution, but both outcomes could be Pareto-optimal. In principle, an economy in which many consumers are unable to purchase any goods and services can be Pareto-optimal, if that outcome reflects the fact that those consumers lack sufficient wealth to participate in the economy. That does not mean that such an economy would necessarily be viewed as socially desirable.
- 2.5 It has been shown in theory that if society (or in practice, Government) deems a particular outcome – such as some consumers being unable to participate in the economy as a consequence of lack of wealth – to be undesirable then it is possible to achieve any alternative more desirable Pareto-optimal outcome, using a perfectly competitive economy to allocate resources, by appropriately redistributing consumers' initial wealth endowments. This assumes that the Government can effect such redistribution costlessly.⁶
- 2.6 On the basis of this theoretical understanding of the way that a perfectly competitive market would operate, it is argued that the most appropriate role for Government is to restrict itself to income redistribution to ensure that households have the resources at their disposal to participate in market processes. Government should not succumb to the temptation of seeking to interfere directly with, or replace, market mechanisms.
- 2.7 The theoretical case for the market economy delivering a social optimum rests on a wide range of assumptions about the nature of markets. If these conditions do not obtain in practice then the presumption that a market economy is to be preferred to other social arrangements for distributing resources is not secure. Market allocation may still be the best mechanism for achieving social objectives, but this cannot be assumed.⁷ Hence it is important to explore the nature of these assumptions.

⁴ Named after the Italian economist Vilfredo Pareto, 1848 to 1923.

⁵ This is known as the first fundamental theorem of welfare economics.

⁶ This is a version of the second fundamental theorem of welfare economics.

⁷ Leach recently observed: "These conditions ... are not satisfied in the economies of this world. Consequently, the theorems have no direct relevance to our economies. A system of competitive markets would not, in our world, generate a Pareto optimal allocation. A central authority would not be able to guide the economy to the Pareto optimal allocation of its choice by transferring purchasing power between people ... The theorems are interesting precisely because they do not describe our economies ... we study them to discover why our economies fall short of the ideal and what can be done about it": J Leach, *A Course in Public Economics* (2004) p 36.

CONTRACTING IN A PERFECT MARKET

- 2.8 Two fundamental conditions need to hold in order for a market economy to function successfully.
- 2.9 First, property rights need to be clearly defined and protected. If property rights are not clearly defined then they cannot easily be bought and sold. Contracting becomes difficult. If property rights are not protected so there is no penalty for stealing, the incentive to contract is limited.
- 2.10 Second, for contracts to be an effective regulatory mechanism the obligations placed upon both parties to a contract should be both enforceable and enforced. If there is no way to be clear whether a party has or has not fulfilled their obligations under a contract then those obligations are effectively unenforceable. If there is no effective mechanism by which to make one party to a contract fulfil their obligations to the other party then this provides little incentive to contract. If, for example, there is no way of making a supplier provide goods that have been paid for or, alternatively, for the consumer, in the event of non-delivery, to recover the money already paid then there is little incentive to contract.
- 2.11 The state has a key role in underpinning successful market functioning through the operation of a legal system that defines and protects property rights and provides effective contract enforcement mechanisms.
- 2.12 Yet contracting activity is not reliant upon the actions of the state alone. More informal social mechanisms can operate to see that property rights and contracts are honoured. One such mechanism is reputation. Reputation can have an important role in influencing the way in which markets function. If, for example, a supplier holds a reputation for good quality provision and this is a key influence upon the demand for his or her product then he or she has an incentive to ensure that good quality provision continues so the reputation is not lost.
- 2.13 The competitive process itself can act as a second mechanism to shape the way in which suppliers behave. If there is genuine competition among a range of alternative suppliers for a customer's business, and the costs of switching supplier are low, then the threat of consumers exiting to another supplier can act as an incentive for the supplier to fulfil their obligations to their consumers.
- 2.14 The power of informal mechanisms to deliver the desired outcomes can be debated, and should not be overstated. The industrial structure of individual markets and the characteristics of individual goods mean that it is greater in some markets than others. It is clearer that the absence of effective systems of law enforcement can lead to dysfunctional markets – as was discovered during the 1990s in some countries that went through the transition to a market economy without paying sufficient attention to these underpinning institutions.

- 2.15 No successful economy operating in the real world can be characterised as a “market economy” without the state taking a close interest in and providing support for the operation of markets. All contracting, and attempts to resolve contractual disputes without recourse to formal legal process, can be seen as “private ordering in the shadow of the law”.⁸
- 2.16 Complete contracts under which performance can be readily verified by a third party and non-performance can be costlessly enforced are at the heart of the model that draws the conclusion that market processes can deliver socially optimal outcomes. Incomplete contracts are contracts under which it is either difficult to specify required performance, difficult to verify the level of performance required or costly to enforce performance.⁹ In a world of incomplete contracts market equilibrium will not coincide with that predicted by the perfectly competitive model. There is a wide class of transactions that are governed by incomplete contracts.¹⁰

SOURCES OF MARKET FAILURE

- 2.17 There are several technical reasons why a market might in practice fail to deliver a Pareto-optimal allocation of resources. We can identify the following five market failures:¹¹
- (1) imperfect competition;
 - (2) public goods;
 - (3) externalities;
 - (4) incomplete markets; and
 - (5) information problems.

⁸ A Dixit, *Lawlessness and Economics: Alternative Modes of Governance* (2004).

⁹ An incomplete contract in this economic sense may or may not be a legally valid contract.

¹⁰ Bowles notes that “[t]here are many reasons why contractual incompleteness is the rule rather than the exception”: S Bowles, *Microeconomics: Behaviour, Institutions and Evolution* (2004) p 236. Bowles reviews the experimental economics evidence that demonstrates the importance of contractual completeness for delivering socially optimal outcomes of the type assumed by the perfectly competitive model. Without contractual completeness market outcomes can look very different.

¹¹ A further category of market failure comprises macroeconomic disturbances such as unemployment. While these are undoubtedly important real world phenomena they are of greater relevance to an appraisal of the overall performance of a market economy so we do not discuss them further here.

Imperfect competition

- 2.18 The standard theoretical results regarding the desirable properties of a market economy depend upon an economy comprising perfectly competitive markets. There should be many buyers and sellers and no economic agent should be able to influence the price that prevails in the market.¹² It is not only the markets for consumer goods and services that should be perfect, but also capital markets and markets for factor inputs.
- 2.19 As a result of (among other factors) barriers to entry and production technology, markets in practice can be monopolistic (characterised by one supplier), oligopolistic (a small number of suppliers), or, less commonly, monopsonistic (one consumer). Such markets give economic agents power to influence output levels and prices. Markets can also be monopolistically competitive which means that, while individual firms may be small and technical barriers to entry and exit may be low, individual firms face a downward sloping demand curve: not only do they have scope to set their own price, but the demand for their product depends on the price they set. This situation can obtain in markets for heterogeneous products or spatially bounded markets in which transportation costs are significant.
- 2.20 In all industries with a structure other than perfect competition the equilibrium output level is likely to be below that which would obtain in a perfectly competitive market. Hence, it is below the socially optimal level.

Public goods

- 2.21 A pure public good can be contrasted with a pure private good. Whether a good is public or private is a function of its characteristics, not whether it happens to be provided by the public or private sector. A public good has three characteristics. It is *non-excludable*: it is difficult to stop others consuming it once it has been produced. A radio station broadcast using conventional analogue technology would be an example: once the station is transmitting it is very difficult to stop anyone with access to an appropriate receiver from listening. A public good is *non-rivalrous* in consumption: if it is consumed by one person this does not reduce another person's opportunity to consume. Again, a radio broadcast has this characteristic – there is no limit to the number of people within the range of a transmitter who can listen to it. A pure public good is also *non-rejectable*: once it is provided consumers cannot stop consuming it. The example of broadcast radio does not fit this characteristic because it is possible simply not to own or operate a radio receiver and hence reject the service. A good such as national defence or a nuclear deterrent would be an example of one that is hard for individual consumers to reject once it has been provided.

¹² An alternative theoretical approach, which removes the requirement that there should be a large number of sellers for a market to be competitive, is the *contestability thesis* first proposed by Baumol and colleagues: W Baumol, J Panzar, and R Willig, *Contestable Markets and the Theory of Industrial Structure* (1982). Contestability theory focuses upon the role of *potential* competitors in disciplining the behaviour of existing providers. This body of theory is still somewhat controversial.

- 2.22 A fourth feature characteristic of some public goods is *congestibility*. A congestible good is one that exhibits public good characteristics only for certain levels of use. For example, when a bridge with a capacity of 50 cars a minute is being crossed by 10 cars then the bridge is effectively a public good because the consumption of the bridge by one user does not affect its consumption by another. But if 60 cars are trying to cross the bridge, then it exhibits private good characteristics because consumption becomes rivalrous: each car affects the possibility of another car making use of the bridge and they cannot all make use of the bridge at the same time.
- 2.23 There are relatively few pure public goods, but there is a relatively large group of goods that display some public good characteristics.¹³
- 2.24 Public goods are problematic for the theory of the market economy because there may be some goods for which there is a net social benefit but the market under-provides or does not provide at all. This is because it is difficult for providers to identify those who are willing to pay for their use and, perhaps more importantly, to exclude those who are unwilling to pay – so-called *free riders* – from consuming. For some public goods the socially optimal price to charge could be zero. Such goods illustrate the problem clearly. There will either be a charge for use – in which case they could be privately provided, but the level of consumption would be below that which is socially optimal – or they will not be charged for – in which case no private supplier will be interested in supplying them without some form of subsidy.

Externalities

- 2.25 The basic theory of the market economy assumes that the private costs and benefits – that is, the costs to the provider and the benefits to the paying consumer – coincide with the social costs and benefits associated with a transaction.
- 2.26 There are, however, a range of circumstances in which there are either costs or benefits – or both – associated with a transaction that accrue to neither the producer nor the consumer but to a third party. A negative externality means that a cost is borne by a third party, while a positive externality occurs when a third party receives a benefit as a by-product of the transaction. Externalities can take various types and can exist on the supply or the demand side, or in the interaction between the two. Pollution is a typical example of a negative externality, as is congestion on a busy road. Positive externalities can arise from activities such as vaccination programmes – the more people who are vaccinated the less chance I have of contracting the disease, regardless of whether I get vaccinated myself – or education – it is not only the student that benefits from education but also employers, the national economy, and society more broadly.

¹³ See D L Weimer and A R Vining, *Policy Analysis* (2005) pp 72 to 91 for a comprehensive classification and extended discussion.

Incomplete markets

- 2.27 The theory of the market economy is based upon an economy in which there is a market for all goods and services for which there is a net social benefit. This includes comprehensive forward markets. In practice, economies exhibit incomplete or missing markets. That is, there are some goods or services for which there is a positive net social benefit but which are not available to consumers. The absence of a market can often be associated with information problems. The absence of a market can also be a product of a lack of clearly defined property rights (there is no market in clean air, for example, even though some would be willing to pay for it and thereby improve their welfare). It can be the result of pervasive uncertainty and lack of knowledge (particularly regarding the future), which makes pricing certain types of good difficult. This is particularly an issue in markets for certain financial products.

Information problems

- 2.28 Consumers and suppliers need to be well-informed about both products and potential trading partners for all potentially beneficial trades to take place, thereby moving the economy to the social optimum. However, imperfect information may mean that people are unwilling to trade because they cannot have confidence in what they are buying or with whom they are trading.
- 2.29 The problems of asymmetric information – one side of a potential transaction having more information relevant to the transaction than the other – have been a major focus of attention in economics for three decades. They raise significant questions regarding the extent to which it is possible for market processes to deliver a social optimum in practice.¹⁴ The problems of adverse selection (hidden information) and moral hazard (hidden action) have been explored in a range of contexts, particularly insurance, capital and labour markets, as an explanation for the failure of markets to deliver desirable products, such as affordable and comprehensive health insurance.
- 2.30 Lack of sufficient, timely and comprehensible product information may impede the functioning of a market because consumers are unable to make informed choices and hence are not well placed to purchase the goods and services that best satisfy their preferences.

OTHER POTENTIAL IMPERFECTIONS AND CONCERNS

- 2.31 There are four further factors to consider when examining whether resource allocations in a real world economy depart from those expected in theory from a perfectly competitive economy. While economists might debate whether they are best classified as “market failures”, they are nonetheless of considerable practical significance.

¹⁴ See, for example, J E Stiglitz, "The Contributions of the Economics of Information to Twentieth Century Economics" (2000) 115 *Quarterly Journal of Economics* 1441.

Adjustment lags and disequilibrium

- 2.32 The conclusion that a market economy will deliver a socially optimal allocation of resources rests on the assumption that the economy is in equilibrium. Equilibrium is a central concept in economic theory. Broadly, it means that at the prevailing price all mutually beneficial trades between buyer and seller have occurred and the plans of buyers and sellers are therefore in accord. Dynamic theories often assume, either implicitly or explicitly, that markets are in continuous equilibrium, which typically requires the assumption of instantaneous adjustment (market clearing) – buyers and sellers adapt their plans instantaneously to ensure that they are co-ordinated in each time period.
- 2.33 In practice many markets will exhibit less than instantaneous adjustment. This can result in sustained periods of disequilibrium, when the plans of buyers and sellers are not in accord: either suppliers wish to sell more product than consumers wish to purchase at the prevailing price (a position of excess supply); or consumers wish to purchase more than suppliers are willing to offer (a position of excess demand).
- 2.34 The dynamics of markets out of equilibrium can be complex and their path back to equilibrium, if it is ever achieved, not always well understood.¹⁵ An upward shift in demand would typically result in an initial upward adjustment in prices, which is taken to be the signal for an expansion of supply and a partial downward price correction. However, if the supply response is sluggish this can lead to prices being elevated for sustained periods, limited additional supply, and excess demand. In disequilibrium resources are not likely to be allocated in line with consumers' willingness to pay and hence the standard results about the efficiency of market outcomes cannot be assumed to hold.

Transaction costs

- 2.35 There are costs associated with participating in the market economy. Costs can be incurred before a transaction occurs: one may have to incur search costs to identify available and appropriate products and suppliers, and there may be costs associated with specifying an appropriate contract. Costs may occur after entering into a contract: there may be costs associated with monitoring whether the other party has fulfilled their obligations under the contract and there may be costs associated with enforcing the contract or seeking redress. These costs are known broadly as transaction costs. Significant transaction costs can impede the functioning of a market. For example, a consumer may stay with an existing unsatisfactory supplier because the transaction costs associated with switching to a supplier offering a more suitable product outweigh the benefits. If transaction costs are large enough they can mean that a market does not function at all.

¹⁵ A more fundamental concern about the logic of the model of an economy based upon perfectly competitive markets, highlighted by Nobel laureate Kenneth Arrow, is that if all economic agents are price takers, and cannot therefore influence the market price, then there is no clear account of how prices actually adjust from one equilibrium to another. Price adjustment would seem to require some agents to have the power to move the market.

Failures of rationality

- 2.36 The above conception of the market economy as able to deliver a socially optimal outcome is based on the view that economic agents are motivated by self-interest. Producers are driven by a self-interested concern to maximise their own profits and consumers are well-informed, have clearly ordered preferences, and are able to make decisions in line with those preferences that maximise their welfare through consumption.
- 2.37 The question of whether suppliers can be characterised as seeking to maximise profit has periodically been addressed in industrial economics over the course of several decades. Even if one accepts that “profit maximisation” is an adequate characterisation of the motivation for the actions of suppliers, it is not always clear what that means as a guide to practical action. This is particularly the case in industries characterised by dramatic technological change and a highly uncertain environment.
- 2.38 The question of how economic agents, particularly consumers, make decisions and whether this accords with the notions of rationality that are conventionally employed in economics is an area of research that has expanded dramatically over the last two decades. The literatures on economics and psychology and behavioural economics are vibrant areas of research activity. They have highlighted a number of ways in which decision making, particularly decision making under uncertainty, can depart significantly and systematically from the predictions of standard theory. Economic agents frequently display behaviour that is “irrational” or hard to account for from the perspective of the standard theory.¹⁶ This has led to the argument that alongside “market failure” and “Government failure” we need to consider “individual failure” and its implications for policy making.¹⁷ Building theory on an alternative theoretical conception of the way economic agents behave can, it is argued, produce more accurate accounts of aggregate market phenomena.¹⁸
- 2.39 The argument is not necessarily that economic agents do not make “reasonable” decisions for which they can offer plausible justifications, it is that such decisions do not always accord with the prescriptions of conventional theory. Decisions that are rationalised on the basis of moral principles, for example, sit uncomfortably with standard economic understandings of rationality.¹⁹

¹⁶ The issues are briefly reviewed in M Rabin, “Behavioral Economics” in M Szenberg and L Ramrattan (eds), *New Frontiers in Economics* (2004). See also I Brocas and J Carrillo (eds), *The Psychology of Economic Decisions vol 2: Reasons and Choices* (2004).

¹⁷ P Jones and J Cullis, ““Individual failure” and the Analytics of Social Policy” (2000) 29 *Journal of Social Policy* 73.

¹⁸ See, for example, the contributions in C Camerer, G Loewenstein, and M Rabin (eds) *Advances in Behavioral Economics* (2004).

¹⁹ R H Frank, *What Price the Moral High Ground? Ethical Dilemmas in Competitive Environments* (2005).

- 2.40 The literature on individual failure focuses on the limits of rationality: the extent to which typical decision makers – even relatively analytical individuals – can depart from the predictions of standard theory. A separate question is whether there are subsets of individuals who are not well placed to make rational decisions – that is, choosing between outcomes in accord with a clear preference ordering. At one level it is clear that there are certain groups – young children and those with dementia, for example – whose capacity to make rational decisions may be constrained. The question then becomes whether such groups are relatively small and easily identifiable or is the issue more widespread?
- 2.41 In situations where there are failures of rationality someone may be empowered to make decisions on behalf of the ultimate consumer: parents on behalf of their children, for example. This creates a principal-agent relationship: while the agent (in this instance, the parent) may act fully in the best interests of the principal there is the possibility that this will not be the case because the objectives of parent may diverge from the long-term interests of the child.

Endogenous preferences

- 2.42 The standard theory of the market economy treats consumer preferences as exogenous.²⁰ Consumers optimise their consumption of goods and services in the light of fixed preferences, which are independent of and determined outside the standard model. From this perspective advertising is merely an activity that provides consumers with information about the goods and services that are available to satisfy their preferences.
- 2.43 However, if consumers' preferences are malleable and subject to manipulation then this strikes at the heart of the standard account. Endogenous preferences are those which may be subject to change as a result of actions of economic actors within the parameters of the model. Economic inefficiency would arise if consumption occurs as a result of preferences being changed by advertising rather than optimisation of consumption against existing preferences. The scope for a market economy to deliver a socially optimal allocation of resources is limited by the fact that the social optimum ceases to be well-defined. The possibility of endogenous preferences has attracted increasing attention among economists over the last decade.²¹

²⁰ A view forcefully stated in G Stigler and G Becker, "De Gustibus non est Disputandum" (1977) 67 *American Economic Review* 76.

²¹ Different approaches to the issue can be found in, for example: S Bowles "Endogenous Preferences: the Cultural Consequences of Markets and other Economic Institutions" (1998) 36(1) *Journal of Economic Literature* 75; G Becker and K Murphy *Social Economics: Market Behaviour in a Social Environment* (2000).

- 2.44 Alternatively, relative position in society could enter into an individual's utility function.²² If that were the case, the notion of identifying Pareto improvements becomes more difficult. For example, it cannot be assumed that a reallocation of resources that makes one person better off while not reducing the resources available to others will be an improvement: it will depend on who is receiving the additional resources and the way that this relates to the individuals' welfare. So if the person receiving more resources is already relatively rich this means that the relative position of others deteriorates, even though their own consumption does not change. If this has a negative impact upon the welfare of the poor then the net impact of the change on social welfare may well be negative.

THE PREVALENCE OF MARKET FAILURE

- 2.45 There are thus a number of factors that can potentially influence the functioning of a market such that the outcome departs from that which would obtain under perfect competition. The sources of market failure have been treated separately above, but they can interact (information problems leading to incomplete or missing markets is a clear example). Where more than one problem is present, this can result in a market that may not function meaningfully: significant information asymmetries and high transaction costs can be a recipe for a very thin or non-existent market.
- 2.46 How important are these issues in shaping the functioning of markets in practice? The characteristics of the markets for some goods and services are such that it is safe to consider that market failures are not an issue of practical significance. This is the case for many simple, homogeneous goods that are purchased frequently. In contrast, there are other goods or services for which it is reasonably clear that a range of market failures are significant and market provision alone is likely to be unsatisfactory. Economists often place services such as health care in this category.
- 2.47 Even where a market may be subject to market failures it is possible that these failures are not severe and that a secondary market may develop to provide effective solutions. A frequently used example of a market that suffers from significant market failures as a consequence of information asymmetries is the second-hand car market. Yet this is a market where a range of devices such as certification, warranties, and third party inspection services have been developed by the private sector as a means of overcoming information problems, building supplier reputations and allowing the market to function.
- 2.48 Whether market failure is a significant issue in the way markets function is therefore something that needs to be considered on a case by case basis. Whether market failure necessitates greater activity on the part of the state is a separate question. In Part 4 we consider the nature of the private rented sector with a particular focus on the extent of market failure.

²² As discussed at length in R H Frank, *Choosing the Right Pond* (1985).

- 2.49 It is worth noting, however, that there are no widely agreed metrics within economics by which to determine whether market failures are sufficiently serious to reject the perfect competition model as an appropriate characterisation of how a particular market functions. What is required is a detailed and objective consideration of both the theoretical and empirical arguments.
- 2.50 Before we turn to consider the private rented sector in more detail, in Part 3 we review the range of justifications that have been advanced for state activity to reshape the allocations delivered by market economy.

PART 3

STATE INTERVENTION

INTRODUCTION

- 3.1 In this part we review the rationales for activity on the part of the state to reshape the allocation of goods and services produced by a market economy. In broad terms the state can intervene for reasons of efficiency and equity. Finally, we briefly consider the forms of intervention available to the state.

INTERVENTION FOR EFFICIENCY REASONS

- 3.2 Market failures of the type discussed in Part 2 can result in an equilibrium output for a good that does not coincide with the socially optimal level of consumption. Market failures are not necessarily sufficiently severe to justify state intervention, either because satisfactory private solutions can evolve or because the unintended consequences of Government intervention mean that state activity moves the economy further from the social optimum. However, the correction of market failures is typically seen, in economic analysis, as an appropriate justification for active state involvement in markets. This is seen as a matter of positive rather than normative economics: it relates to the technical characteristics of the economy rather than to value positions.

The theory of second best

- 3.3 One important refinement to arguments about the rationale for Government action is offered by the theory of second best.²³ Following the theory of second best it is argued that the removal of the imperfection or distortion from a market can only be seen as welfare enhancing if it is the only significant distortion that the economy, or at least a group of related markets, is experiencing. That is, removal of a market distortion will enhance welfare if the other markets in the economy can be considered perfectly competitive. If, in contrast, several market imperfections or distortions exist then the removal of one distortion may result in the economy moving further from, rather than closer to, the perfectly-competitive social optimum. The theory of second best recognises the scope for distortions – of which, state intervention is particularly relevant in the current context – in one part of the market to compensate for imperfections elsewhere in the economy. It counsels the need to consider regulatory reform in context.

²³ R Lipsey and K Lancaster, "The General Theory of Second Best" (1956) 24 *Review of Economic Studies* 11.

INTERVENTION FOR EQUITY REASONS

- 3.4 Equity, or social justice, can be defined in a number of different ways. Economic discussions of the issue have considered it in terms of equality of outcome, minimum standards of access/provision and in some instances Rawlsian theory.²⁴ These are different objectives for, or ways of thinking about, vertical equity – that is, (re)distribution between the more advantaged and the less advantaged. Horizontal equity is also relevant: horizontal equity refers to the degree to which households have, for example, equality of opportunity or equal access.

Interdependent utility functions

- 3.5 The standard theory of the market economy assumes that individuals derive wellbeing (utility) from their own consumption of goods and services and not from consumption by others. Their utility functions are independent.
- 3.6 If, in contrast, individuals have preferences over the level of wellbeing achieved by others then that means that their wellbeing could be negatively affected by low levels of, or a negative change in, the wellbeing of others, even if their own consumption does not change. In this sense utility functions would be interdependent.
- 3.7 Rather than deriving utility from the level of wellbeing achieved by others, it may be that utility is derived from their consumption of specific goods or services. This can be argued to provide a basis for ensuring that everyone has access to a minimum level of these specific goods or services. For example, if the presence of street homeless people in society causes considerable disutility among the housed then this could be seen as providing a reason for active policy to tackle homelessness. This argument is referred to as *specific egalitarianism*.
- 3.8 Interdependent utility functions can be used as an explanation for voluntary redistribution from rich to poor. They have been used by economists as a theoretical basis for justifying redistributive Government policies in situations where the amount of voluntary redistribution would be socially suboptimal because of, principally, free-riding. However, interdependent utility functions do not represent a particularly firm basis for Government-sponsored coerced redistribution because if the rich show no concern for the poor then it would appear that the mandate for redistribution disappears.²⁵

²⁴ Originally proposed by J Rawls, *A Theory of Justice* (1972). The argument is that if people were required to make decisions without knowing their place in the social hierarchy then they would be acting as if “behind a veil of ignorance”. As a consequence they are likely to favour an allocation of resources that maximised the allocation going to the least advantaged. Hence this is referred to as a “maximin” theory.

²⁵ D Hausman and M Mcpherson, *Economic Analysis, Moral Philosophy and Public Policy* (2006).

Valuing human life and dignity

- 3.9 Arguments for redistribution can be framed more securely if we start from the premise that everyone has intrinsic value by virtue of being human, regardless of their social status. As a consequence there is a need to ensure that all have access to a minimum standard of those goods and services necessary to sustain life. Also, if it is accepted that humans have an equal, positive right to be treated with dignity and to realise their potential and capabilities then this can be used as an argument for ensuring access to a further range of services, such as education.

The trade off between equity and efficiency

- 3.10 Standard economic analysis indicates that there is a trade off between efficiency and (vertical) equity. The argument is that state intervention to reallocate resources from the rich to the poor would lead to a blunting of incentives to productive effort. Those who were highly productive when they were able to keep the rewards of that effort may be less inclined to exert the same amount of effort if they know that some of those rewards will be removed by the state and passed to others. As a consequence the overall output of the economy could be reduced. The net result of redistribution therefore could be greater equality of outcome but a reduction in efficiency overall.
- 3.11 This trade off is clearly a possibility. To a large extent whether it is an issue in practice is an empirical question. The impact of redistribution in practice depends upon the normative framework within which redistribution occurs and, in complex ways, upon the labour supply decisions of individual households. Nonetheless, from an economic perspective proposals for redistribution are often viewed with caution because of their potential to be well-intentioned but counterproductive.

Equal access

- 3.12 In the standard theory the only reason that households would not have equal access to the market is a lack of income. However, problems such as information imperfections may not only be a characteristic of a particular good but may also affect consumers to differing degrees. A key concern here is “know how”.²⁶ If, as seems likely, consumers have differing degrees of “know how” with respect to, for example, their legal rights or having appropriate professional contacts and being able to take advantage of them, then this can lead to different outcomes in respect of consumer welfare for otherwise similar households. If consumers differ in this way then that may be grounds for state activity to redress the balance by providing some form of assistance to those who are relatively disadvantaged.

THE FORM OF INTERVENTION

- 3.13 There are primarily four courses of action available to the state when looking to influence the allocation of goods:
- (1) income redistribution through taxation and subsidy;
 - (2) the use of taxes and subsidies to influence the consumption of specific goods or services;

²⁶ N Barr, *The Economics of the Welfare State* (4th ed 2004) at p 87.

- (3) regulation of quality, quantity or price; and
- (4) direct Government provision of goods and services.

Cash versus in-kind assistance

- 3.14 There is a general presumption in economic analysis that it is preferable to provide assistance to households in the form of cash rather than “in kind” that is, in the form of goods and services. This is in accord with the first theorem of welfare economics. Providing assistance in cash preserves the scope for consumers to participate in markets, exercise choice and therefore signal relative valuations to suppliers. It also, it is argued, typically allows consumers to achieve a higher level of welfare for a given value of assistance, when compared with providing assistance in kind, because consumers may value other goods and services more highly than that which is being offered in-kind.
- 3.15 The preference for cash over in kind assistance is challenged by the notion of specific egalitarianism. Before considering the form that assistance might take, it is necessary to consider why assistance is being given. It may be that Government has a mandate to ensure that all members of a society have access to a level of consumption of specific goods and services, such as health care or education, on specific egalitarian grounds. If this is the case then the Government does not have a mandate to give individuals cash transfers that they are free to spend on anything they choose.²⁷
- 3.16 If the motivation for policy is specific egalitarianism it may be appropriate to offer tied subsidies – money that has to be spent on, or is only received in respect of, specific goods or services – rather than providing goods directly. But the form in which tied subsidies are delivered must be such that they cannot be “untied” or traded and the money spent on other things.
- 3.17 From this perspective, the claim that cash transfers will allow households to achieve a higher level of welfare is not contested but rather seen as irrelevant because it is not an option that the Government has in its choice set.

Merit goods

- 3.18 Arguments related to specific egalitarianism can be framed in economic analysis in terms of *merit goods*. A merit good is one that a third party (“society” or “Government”) considers should be consumed to a given minimum level regardless of the preferences of consumers.

²⁷ See S Kelman, “A Case for In-Kind Benefits” (1986) 2 *Economics and Philosophy* 55.

- 3.19 Merit good arguments therefore link to equity arguments regarding minimum standards, but also to questions of market and other failures. This is because if we consider why consumers would not choose to consume a socially optimal amount of a good the answer must lie either in the nature of the good or the nature of the consumer. The nature of the good would be a problem if consumers do not take account of the full benefits of the good to society when making consumption decisions, either because there are information problems or externalities, and hence under-consume. The nature of the consumers would be an issue if they were not able to rationally decide upon what is in their best interests and hence their right to make their own decisions should be abrogated.²⁸
- 3.20 Many economists tend to be cautious about merit good arguments because they run the risk of shading in to paternalism and the unwarranted removal of consumer choice, thereby reducing the efficiency of the economy.²⁹
- 3.21 Finally, the preference for cash over in-kind provision cannot be considered entirely in the abstract and separately from the mechanisms by which income redistribution would occur in practice. Rather than the lump-sum taxes favoured by theory, income redistribution in practice entails some combination of direct and indirect taxation, on the one hand, and negative taxation or subsidy through the benefit system, on the other.
- 3.22 These real world redistributive mechanisms embody incentives that may be perverse. These can affect not only those whose incomes are being taxed but also those in receipt of assistance. Distributing money in the form of means-tested assistance has the negative features of poverty trap effects, stigmatization and inadequate take-up. If these effects are sufficiently serious then it could in principle engender greater inefficiency and a smaller positive increment to social welfare than provision in-kind. Hence, the debate over cash versus in-kind provision to assist households with the consumption of a particular good needs to be both set in the broader context of the impact upon other markets and informed by an understanding of the detail of the redistributive mechanisms to be used.

²⁸ These are arguments explored critically in the context of housing by P King, *Housing, Individuals and the State* (1998).

²⁹ In this respect Cuyler refers to merit goods as “bossy” goods: A J Cuyler, *The Economics of Social Policy* (1973). Many economists have both a technical and a political/philosophical objection to paternalism, although arguments against paternalism are being refined by some of those working in the field of behavioural economics. The key reference is R Thaler and C Sunstein, “Libertarian Paternalism” (2003) 93 *American Economic Review* 175. For a restatement of more conventional concerns see J Klick and G Mitchell, “Government Regulation of Irrationality: Moral and Cognitive Hazards” (2006) 90(6) *Minnesota Law Review* 1620.

The preference for fiscal mechanisms

- 3.23 Similarly, the use of fiscal mechanisms in the form of taxes and subsidies as the means of shaping the quantity of goods and services produced and consumed is generally preferred to regulation through standard setting or direct provision. This is because fiscal mechanisms are seen as less of an impediment to individual choice and generally represent a less severe impairment of the functioning of the market. However, whether fiscal mechanisms will be an appropriate mechanism for moving the economy closer to the social optimum depends on the diagnosis of the nature of the problem with market-based allocations. If the problem is, for example, the provision of particular types of public goods then it may be that non-state providers are not in a position to provide the good, even with the assistance of subsidy.

PART 4

THE NATURE OF THE PRIVATE RENTED HOUSING MARKET

INTRODUCTION

- 4.1 The previous Parts have summarised a range of economic arguments regarding market functioning, market failure, and state intervention. The discussion has been conducted largely in the abstract. In this part we turn to focus on the housing market and examine the relevance of these arguments to the private rented sector. In the course of this discussion it will be relevant at various points to contextualise the discussion of the private rented sector in terms of the housing market more broadly.
- 4.2 We can summarise the questions that concern us in this Part as follows:
- (1) To what extent is market provision of housing sub-optimal because the housing market suffers from market failures and other imperfections?
 - (2) How might we conceptualise the nature of the private rented sector?
 - (3) To what degree are housing problems a result of the distribution of income?
 - (4) To what extent do imperfections in sectors other than housing render the outcomes of a market economy sub-optimal, even if the housing market itself approximates the market ideal?³⁰

CONTRACTING IN THE PRIVATE RENTED MARKET

- 4.3 Does contracting in the private rented sector conform to the model of a complete contract that underpins the social optimality of the perfectly competitive market? In important respects it does not. Recall that complete contracts require that the standard of performance be clear; that performance under the contract be verifiable by a third party; and that non-performance be costlessly enforceable.
- 4.4 In respect of the standard of performance required under the contract, it can be argued that there is ambiguity regarding required standards and timeliness of repair; the standards of management that accord with notions of quiet enjoyment or non-harassing behaviour; and, with the exception of the timely payment of rent, there is ambiguity regarding requirements upon tenants to act in a tenant-like manner. The precise scope of provisions allowing for reasonable wear and tear can lead to differing views over a tenant's liability for making good at the end of tenancy, and hence is the source of much dispute over the inappropriate withholding of deposits. It is important not to overstate the issue, but there is scope for dispute on each of these grounds: there is case law associated with each area as the boundaries of the relevant obligations are delineated, contested and renegotiated.

³⁰ These questions are a modification and extension of those posed by B Walker, *Welfare Economics and Urban Problems* (1981) at p135.

- 4.5 While some aspects of performance under the contract are verifiable by a third party – such as the state of repair of the dwelling or whether the landlord has gained entry to the property by force – there are important aspects of the obligations for which this is not the case. Whether a landlord has engaged in behaviour that constitutes harassment is not only difficult to document and for a third party to verify, but is also complicated by the lack of clarity as to what constitutes harassing behaviour in the first place.
- 4.6 Non-performance under contracts in the private rented sector is not costlessly enforceable. Recourse to the courts, by either landlord or tenant, will entail not only financial costs but also costs in terms of stress (which economists would consider a “psychic cost”) and time. Many tenants, but also landlords, are neither familiar with legal process nor necessarily in possession of the spare resources to pursue an action, even in the small claims court. It is a particular type of tenant who is willing to pursue court action for unlawful eviction, for example, when the action could run for anything up to 18 months after the tenant has moved from the property and moved on with their life, particularly when any resulting punishment is unlikely to be viewed as appropriate compensation for the original wrong.
- 4.7 Indeed, it is arguable that in respect of important covenants in many tenancies, the contract is not, in practice, enforceable *at all* by the tenant. A tenant of a periodic or short fixed-term assured shorthold tenancy knows that he or she can be removed with relative ease by the landlord on two-months notice or on the expiration of the fixed term. A tenant who does not want to leave the premises (despite, for instance, significant disrepair) would only be wise to seek to enforce repairing covenants if it would be in the (profit-maximising) landlord’s interests to do the repairs to keep the tenant, rather than evict him or her and find another. This is clearly a difficult, or impossible, calculation for many tenants to make.³¹ So a prudent tenant will assume that the landlord will evict if he or she seeks to enforce the covenants. The tenant who stays in residence despite the disrepair is better off than if he or she simply left, certainly (otherwise he or she would leave); but nevertheless the tenant will have been deprived of the actual bargain made when the agreement was entered into.

³¹ Indeed, one could argue that if it is in the landlord’s self-interest to carry out the repairs then it would not be necessary for the tenant to perform this calculation because the landlord would carry out the repairs on request. Hence, where there is disrepair it could be assumed that it is never in the tenant’s interest to try to force the issue, if they wish to remain in the property.

Informal mechanisms for contract compliance: the role of reputation

- 4.8 Reputation looms large in policy discussions relating to private renting: what can be done to improve the reputation of the tenure as a whole and of landlords as a class of economic actor? In contrast, at present the reputation of landlords and occupiers plays only a modest role in the way the private rented sector functions. The sector comprises a large number of small scale landlords and a relatively transient occupier population. Both sides of the market have limited means by which to disseminate information about relevant negative experiences. Most individual landlords are too small and low profile for a negative assessment of their performance – in relation to repairs or harassment, for example – to impact significantly upon their reputation and therefore their ability to attract occupiers in the future.
- 4.9 Reputation is likely to be more of an issue among letting agents, who typically have a higher profile and, in most cases, a longer term commitment to the sector.³² But unless there are effective mechanisms for disseminating information to prospective occupiers or resident populations then there is a limit to the reputational risk associated with behaviour that is not in accord with the law.³³
- 4.10 Third parties who remain active in relation to the market for extended periods of time – such as student accommodation agencies, advice agencies or local authority environmental health departments – are likely to be able to build up a better profile of local actors who engage in recurrent problematic behaviour. However, they may have limited scope for disseminating such information to consumers and would need to be cautious about doing so.
- 4.11 Those letting agents and landlords who belong to professional bodies will see this membership as a means of signalling quality of service to prospective occupiers. If such membership effectively signals higher quality then it may allow higher rents to be charged. However, this mechanism will only work if consumers have appropriate knowledge of the significance of membership of an association. The low proportion of landlords who are members of professional organisations suggests this is unlikely to be a significant factor. It is also worth noting that this signal will only work while membership is voluntary and/or can exclude certain landlords. If membership of such bodies were to be made compulsory, for example, this would remove the signalling value of membership.
- 4.12 This has been offered as one general reason for a preference among suppliers for voluntary industry-based regulation. However, in the private rented sector there is in fact strong support among industry bodies for industry-wide regulation. One possible explanation for this is a concern with their competitive position compared to non-regulated independent providers.

³² For theoretical discussion in a related context see B M Arvin and R G Murphy, "A Model of Reputation Acquisition in Real Estate Brokerage" (1996) 5 *Journal of Housing Economics* 133.

³³ The role that reputation plays in a market is not, however, fixed over time. Social innovations such as the rise of tenant accreditation schemes can start to increase the flow of information about tenants' reputation to landlords. Technology also plays a role in overcoming the problem of retaining and disseminating information in a highly decentralised market.

MARKET FAILURE IN THE HOUSING MARKET?

- 4.13 To what extent are the standard market failures identified in Part 2 relevant to the housing market generally, and the private rented sector more specifically?

Imperfect competition

- 4.14 There is little evidence of economies of scale in private landlordism. Nearly two thirds of properties in England are owned by landlords with only one property.³⁴ The barriers to entry to and exit from the market are relatively low. Capital constraints on the part of landlords have the potential to impede the supply response to any uplift in demand, but this does not seem to be a significant issue. Indeed, Ball has argued that the gearing of landlords in England is too low: only a minority have a mortgage outstanding on their property.³⁵ Hence, on the face of it there are no structural barriers to the private rented sector being competitive.
- 4.15 However, it is increasingly accepted that the characteristics of housing as a good – its durability, spatial fixity and heterogeneity, in particular – mean that the housing market requires analysis of a different type to that applied to many other markets. Economists have developed a range of partial models that address one or more of these characteristics, but there is still progress to be made in addressing them all simultaneously.³⁶ However, the analysis rapidly becomes extremely complex and is not necessarily amenable to closed solutions.
- 4.16 One of the key points that has been broadly recognised is that housing markets can fruitfully be analysed using search theory. Markets in which consumers have to search can lead to outcomes that differ from those of the competitive model. Markets for search goods can, for example, generally sustain price dispersions that are not competed away, even when products are homogenous. This tendency is reinforced if goods are heterogeneous. These outcomes are sensitive to assumptions about the nature of the search process and to the state of the local market.³⁷

³⁴ ODPM, *English House Condition Survey 2003: Private Landlords Survey* (2006), available at http://www.communities.gov.uk/pub/226/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165226.pdf (last visited 22 June). This structure is not peculiar to the UK. See for example M Shroder, "What Makes a Landlord? Ownership of Real Estate by US Households" (June 2001) 38 *Urban Studies* 1069.

³⁵ M Ball, *The Future of Private Renting in the UK* (2004).

³⁶ Major reviews of housing market models include: R Arnott, "Economic Theory and Housing", in E S Mills (ed) *Handbook of Regional and Urban Economics Vol 2* (1987); L B Smith, K T Rosen and G Fallis, "Recent Developments in Economic Models of Housing Markets" (1988) 26 *Journal of Economic Literature* 29; C M E Whitehead "Urban Housing Markets: Theory and Practice" in E S Mills and P Cheshire (eds), *Handbook of Regional and Urban Economics vol 3* (1999).

³⁷ G Turnbull and J Dombrow, "Spatial Competition and Shopping Externalities: Evidence from the Housing Market" 32 *Journal of Real Estate Finance and Economics* 391.

- 4.17 These characteristics of the housing market have been argued to confer some degree of monopoly power on landlords: each property on the market will offer a unique bundle of characteristics that will match some consumers' preferences better than others. This does not give landlords the power to set rents at whatever level they wish because consumers are willing to make trade-offs regarding housing characteristics and price, but it does mean that properties are not perfect substitutes and hence price differences will not necessarily be competed away.
- 4.18 This characterisation of the housing market leads to the view that models that assume monopolistic, rather than perfect, competition can provide greater insight into the operation of the housing market.³⁸ It has been argued that, while empirically it may be of limited applicability, something can be learnt about the way rental markets operate from the study of the theoretical behaviour of private monopoly landlords.³⁹
- 4.19 While there may be limited technical barriers to competition in the rental market, and in aggregate the figures suggest that the market is competitive, we know relatively little about the structure of ownership in local private rented markets. In a brief review of studies on ownership structure in the US, Basu and Emerson note that in a number of local housing markets high concentrations of ownership have been detected: in Thousand Oaks California in the early 1980s for example, one person controlled 30% of rentals. It has also been suggested that even when individual landlords do not own significant numbers of properties there is scope for non-competitive pricing, as a result of collusion, in areas where strong landlord associations have developed.⁴⁰ There is no evidence, it must be said, of landlords' associations operating as cartels in the UK.

³⁸ R Arnott and M Igarashi, "Rent Control, Mismatch Costs and Search Efficiency" (2000) 30(3) *Regional Science and Urban Economics* 249; P Raess and T von Ungern-Sternberg, "A Model of Regulation in the Rental Housing Market" (2002) 32 *Regional Science and Urban Economics* 475. See S Bowles, *Microeconomics: Behaviour, Institutions and Evolution* (2004), ch 7 for an argument to a similar conclusion using an approach based upon evolutionary game theory.

³⁹ K Basu and P M Emerson, "Efficiency Pricing, Tenancy Rent Control and Monopolistic Landlords" (2003) 70(278) *Economica* 223.

⁴⁰ K Basu and P M Emerson, "Efficiency Pricing, Tenancy Rent Control and Monopolistic Landlords" (2003) 70(278) *Economica* 223. The review draws heavily on J I Gilderbloom, "Socioeconomic Influences on Rentals for US Urban Housing" (1989) 48(3) *American Journal of Economics and Sociology* 273.

- 4.20 There is some limited English evidence on the distribution of ownership in the private rented sector. The stock in the sector is quite heavily spatially concentrated. In the areas with the highest levels of ownership the sector is more likely to feature large scale landlords. In areas of relatively low demand – which are likely to be poorer quality environments – there is a greater representation of landlords who own multiple properties.⁴¹ Therefore it would be possible to argue that there is some scope for prices to depart from the perfectly competitive level in some localities, including the areas in which some of the most vulnerable tenants live.
- 4.21 The role of market intermediaries in the pricing of private rented properties also requires further attention. While most properties are owned by landlords with small portfolios, around half of letting occurs through letting agents. Many small landlords, particularly those without detailed knowledge of the current state of market in the areas in which they let property, will be reliant upon agents for information on prevailing prices. The pertinent question then becomes not how many landlords hold properties in a locality but what proportion of properties are being handled by agents, how many agents are operating locally, and whether the letting agent market is segmented in ways that means that individual agents have market power.⁴² The extent of competition in the residential letting agency market is not an issue that has been explored empirically in great detail.
- 4.22 It is important not to place too much emphasis on these points, given the evidence currently available. Indeed, an important general point is that empirical work lags well behind theory. There have been few direct tests of the competitiveness of the rental market.⁴³ There is a role for future research in examining more closely whether and under what conditions assumptions about market competition can be said to hold to a reasonable level of approximation.⁴⁴ The most plausible conclusion to draw is that the assumption that the private rental market can be characterised as perfectly competitive in all localities should be treated as neither trivial nor self-evident.
- 4.23 A rather different argument is that a substantial minority of households living in the sector rely upon housing benefit for assistance with their rent. The current rules of the housing benefit system mean that an external body can have a direct influence over the prices that prevail in the benefit-dependent sub-sector of the market. While in some localities the benefit sub-sector accounts for a relatively modest proportion of the market, in other areas it dominates. In the latter situation it would be difficult to argue that a genuine market was operating.

⁴¹ ODPM, *English House Condition Survey 2003: Private Landlords survey* (2006), available at http://www.communities.gov.uk/pub/226/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165226.pdf (last visited 22 June).

⁴² For example, where agents either specialise in or refuse to handle student accommodation.

⁴³ F J Cronin, "Market Structure and the Pricing of Housing Services" (1983) 33(10) *Urban Studies* 1807 offers an exception.

⁴⁴ See B Turner and S Malpezzi, "A Review of Empirical Evidence on the Costs and Benefits of Rent Control" (2003) vol 10 *Swedish Economic Policy Review* 15.

- 4.24 In this sense one could argue that the institutional structure of the private rented sector in some localities renders the assumption of competitive behaviour inappropriate: prices are set by, or, at the very least, in the light of, a set of administrative rules.

Public goods

- 4.25 Housing is a private good because it is excludable and rivalrous in consumption. It could, however, be argued that its supply and exchange value are fundamentally influenced by the production of public and quasi-public goods such as roads, parks and other environmental amenities, sewerage and utility supplies. This is not an issue that will be explored further here.

Externalities

- 4.26 Attempting to address externalities has been the most consistent justification for housing market interventions rooted in concerns with economic efficiency. Externalities can take different forms. At the broadest level they may affect consumption, production or both sides of the market. The social costs of poor quality housing can be considerable, although estimates of the magnitude of these costs are rare.⁴⁵
- 4.27 Poor housing can have a significant impact upon health. Households living in damp, poorly heated or overcrowded housing are exposed to increased risks of a number of health problems such as asthma and respiratory disease, allergies, heart problems, infectious disease and accidents in the home. Inadequate facilities for food preparation and sanitation can increase the risk of poor nutrition and gastrointestinal problems. Poor sanitary conditions also increase the risk of consumer on consumer externalities if disease is spread locally. Early public health interventions in housing markets drew their justification from concerns of this type.
- 4.28 Some of the most serious housing-related health problems which relate to issues of sanitation are not, generally, likely to be a major issue in relation to the contemporary housing stock.⁴⁶ However, compared to other tenures, the current private rented sector contains a higher proportion of properties that are in disrepair or are unfit, dwellings without a satisfactory level of thermal comfort, and dwellings with shared and inadequate facilities. It also provides temporary accommodation for homeless households and in these circumstances the risks to health can be acute.

⁴⁵ See *Supplementary Paper 2: Estimating the Costs and Benefits of Greater Compliance With Property Condition Standards*, available at http://www.lawcom.gov.uk/housing_renting.htm.

⁴⁶ Although they are not entirely absent in contemporary society. They arose prominently in the 1990s in debates about the impact of water privatisation upon public health in poorer areas, where household disconnections from supply led to concerns about the re-emergence of serious communicable diseases. Contemporary concerns about the management of the rat population in the face of cuts to pest control budgets and user charging for services are another example.

- 4.29 Housing-related illness in childhood can lead to impaired performance at school. Overcrowding which means that there is nowhere appropriate to carry out homework can have a similar effect. Hence, poor housing in childhood can impact upon overall life chances. It has similarly been shown that poor housing conditions in childhood increase the risk of ill-health in adulthood, even when housing conditions in adulthood are satisfactory.⁴⁷
- 4.30 In addition to direct externalities of this type we can also identify property on property or “interactive” externalities. The upkeep of a property not only affects the value of that property but, particularly in urban areas, because its appearance is part of the environment of neighbouring dwellings, it also impacts upon the value of surrounding dwellings.⁴⁸ The owner of a property neither reaps all the benefits of expenditure on upkeep nor bears all the costs of failing to keep the property in good repair. For this reason, it can be rational for all owners in a locality to decide not to incur the costs of maintenance. This could result in a process of neighbourhood decline and, in the extreme, the development of slums.⁴⁹
- 4.31 A third type of externality – intergenerational externalities – can also be identified.⁵⁰ Individual consumers take decisions in the light of their own consumption, while suppliers will provide that which is valued in the market. If consumers are not concerned about, for example, the viability of a dwelling in the long term then they are not willing to pay a premium for properties that are kept in good repair. There is therefore little incentive for suppliers to provide such properties.
- 4.32 Yet from the perspective of society it is important that properties are kept in good repair. The rate at which new supply augments the housing stock in the UK is typically of the order of 1% to 2% per annum and much of this is needed to keep up with the pace of new household formation. Therefore most people live in second hand and old properties, most of which will need to be providing accommodation long after the current generation of consumers has gone. This is a situation in which the private and social costs associated with decisions about current housing consumption diverge.

⁴⁷ For example, A Marsh, D Gordon, P Heslop, C Pantazis, “Housing Deprivation and Health: a Longitudinal Analysis” (2000) 15 *Housing Studies* 411; Shelter, *Against the Odds: An Investigation Comparing the Lives of Children on Either Side of Britain’s Housing Divide* (November 2006).

⁴⁸ See D Sims, “Out of Control: What Can We Learn From the End of Massachusetts Rent Control?” (2007) vol 61 *Journal of Urban Economics* 129 for a related argument regarding the negative spillover from poorly maintained rent-controlled properties to the rents charged for non-rent controlled properties in a locality.

⁴⁹ B Walker, *Welfare Economics and Urban Problems* (1981) at p141.

⁵⁰ C M E Whitehead, “The Economics of Social Housing”, in T O’Sullivan and K Gibb (eds), *Housing Economics and Public Policy* (2003) at p 139.

- 4.33 This is a general argument about housing consumption. However, the problem is more acute in the private rented sector than elsewhere. If tenants are only going to be living in a property for a short time⁵¹ they have little incentive to be concerned about problems with the structure of their property that do not affect their own consumption, but will undermine the integrity of its fabric over a period of years. Hence they have limited incentive to seek to ensure that the landlord maintains the property.⁵²

Incomplete markets

- 4.34 The problem of market failure as a result of incomplete markets is more an issue for the welfare maximising properties of the market economy as a whole than specific markets.
- 4.35 In the housing field it can be argued to be most relevant to questions regarding the availability of financial products such as mortgages or mortgage indemnity insurance. These are areas in which there are questions as to whether private suppliers are willing and able to offer a range of products to meet the variety of consumers' circumstances. These are not issues of direct relevance to the current discussion. They are, however, closely related to the issue of the information requirements of the housing market.

Information problems

- 4.36 The most obvious way in which information problems affect the housing market is the fact that consumers are not typically well qualified to appraise the physical condition and integrity of a property. The seller will have a lot more information about the property and its problems than the buyer: a classic case of asymmetric information.⁵³
- 4.37 This is a particularly acute issue in the owner occupied sector, where consumers and lenders are looking to commit significant sums of money for the purchase of an asset and so need to be sure that the property is worth it. This is a good example of a situation in which a potential market failure can be solved satisfactorily, if not completely, by the private sector without extensive state involvement. There is clearly a strong secondary market associated with surveying properties as part of the house purchase process in order to allow consumers and funders to overcome the information problem.

⁵¹ The average private sector tenancy in 2003/04 was 1.6 years: ODPM, *Housing in England 2003/4: Part 3 Social Renters and Private Renters* at p12 (table 3), available at http://212.100.250.130/pub/227/HousinginEngland20032004PDF429Kb_id1162227.pdf (last visited 27 June 2007).

⁵² See A D H Crook and J E T Hughes, "Market Signals and Disrepair in Privately Rented Housing" (2001) 18 *Journal of Property Research* 21, for an empirical discussion of general relevance to these points.

⁵³ It is also the case that landlords may not be well placed to assess objectively the quality and state of repair of their dwelling. A significant minority rate their properties as at least satisfactory, when the properties have been assessed by a surveyor as failing to meet fitness or decent homes standards: ODPM, *English House Condition Survey 2003: Private Landlords survey* (2006), ch 3, http://www.communities.gov.uk/pub/226/EnglishHouseConditionSurvey2003PrivateLandlordsSurvey_id1165226.pdf (last visited 22 June).

- 4.38 In the rental market, information issues are particularly important in relation to questions of safety. There is a limited amount that a prospective tenant can do prior to contracting to establish whether, for example, the heating, electrical or fire safety systems installed in a property are adequate, safe and operational. It would be uneconomic to pay for the relevant installations to be tested, as an owner occupier might do. Hence, there is an argument for regulation in these areas for consumer protection purposes.
- 4.39 In the private rented sector there is also the question of the accessibility of information about rights and obligations relevant to the agreement between landlord and tenant. This is a topic to which the Law Commission has already devoted considerable attention. It is clear that the current structures – under which the rights and obligations of the parties to the contract are governed by explicit and implied terms, statute and case law – do not result in sufficient transparency to facilitate the enforcement of rights. The Renting Homes proposals were directed at addressing these issues.
- 4.40 It is generally accepted that housing is a search good and therefore that the acquisition of information is central to the way the market functions. When looking for accommodation it is costly to investigate options thoroughly. Whether a consumer has the opportunity to engage in an extended period of search will depend on the state of the market: in a market where property is at a premium it may be necessary to accept whatever is available. In the context of a costly search consumers will typically appraise in detail a limited number of options before deciding. This opens up the possibility that the consumer will not identify the property that would meet their preferences most completely, and hence that the option chosen represents a local rather than the global welfare-maximising bundle of goods. Whether these issues are worse in the housing market than in other markets is debatable.
- 4.41 However, in addition to being a search good there is a sense in which housing consumption is also an experience good. Housing consumption is not just about the physical structure inhabited, which can be appraised (at least superficially) through a relatively brief visit, but also the neighbourhood facilities and amenities and social environment, which is intangible. It is not possible to assess fully each housing option available prior to actually living in a particular location. This is a more significant issue in the owner occupied sector both because the process of house purchase carries with it greater transaction costs and because home owners are typically looking to settle for longer in a particular location.

- 4.42 While these types of problem are not as important in the private rented sector because mobility is easier and transaction costs lower, information is important to the rental relationship in a way that does not exist for owner occupiers. Unlike house purchases, renting implies an on-going relationship between the contractors. Both landlord and occupier therefore face information asymmetries with respect to the type of person offering to contract with them. Is this a good or a bad occupier? Is the landlord someone who will fulfil their obligations in full and with alacrity? Or someone who will engage in harassing behaviour or be negligent of repairs? This is an adverse selection problem. But there is also a sense in which rental housing is an experience good in a way that owner occupation is not. As an owner occupier you know what type of management service will be provided to the dwelling because you are self-provisioning. As the occupier of a rental property you only discover what type of management service you will receive once you receive it.
- 4.43 One of the key conclusions to follow from the recognition of this problem is that there is a ready explanation for such practices as discounting the rent for long-standing occupiers: once a property is let the landlord discovers whether the occupier is a good or a bad occupier. If the occupier is good – imposes a low service cost upon the landlord – then the landlord will seek to retain the occupier through effectively discounting the rent in order to avoid the costs of having to find another. For a bad occupier, however, the landlord will wish to ensure that the property is priced in a manner that reflects the full costs associated with the occupier's continuing residence. In theory this can lead to landlords offering tenancies of different durations as a means of inducing self-selection by tenants.⁵⁴ How important these behaviours are in practice has not been examined fully. Rent discounting can act as a barrier to residential mobility because such discounts are not portable between tenancies. At any one point in time the profile of rents will therefore represent a mix of rents being offered to good and bad occupiers of differing vintages.
- 4.44 Following Hubert, we can think of tenants as imposing a “service cost” on the landlord. This service cost can be modelled as exogenous: there are tenants who impose high costs on the landlord and tenants who impose low costs. This might be thought relevant when high and low cost are being used as a shorthand for “good” and “bad” tenants or tenants who are likely to impose high levels of wear and tear on the property and those that are not. The problem is then one of adverse selection. However, it is perhaps more interesting for our purposes to think of this service cost as endogenous. If the landlord can influence the size of the service cost associated with a tenant then this could reshape the landlord's strategic options. Here the issue of contract termination becomes relevant.

⁵⁴ F Hubert, “Contracting With Costly Tenants” (1995) 25 *Regional Science and Urban Economics* 631; T J Miceli and C F Sirmans, “Tenant Turnover, Rental Contracts and Self-selection” (1999) 8 *Journal of Housing Economics* 301. The argument is that tenants with different characteristics will have systematically different preferences across tenancies of different durations and hence will self-select into their preferred tenancy type.

- 4.45 A landlord can use the threat to terminate a tenancy to control undesirable tenant behaviour. From the landlord's perspective, undesirable behaviour can be behaviour that is considered anti-social, in which case this disciplinary effect of termination would also be seen as beneficial from a social perspective. However, from the landlord's perspective, a tenant seeking to enforce their rights can also be seen as undesirable behaviour and the landlord can use the threat of termination to discourage this.⁵⁵ From a social perspective this is not desirable, and from the perspective of the simple theory of contracting in the market economy it is problematic. As we suggested above, it allows a landlord to deprive a tenant of his bargain.

THE SIGNIFICANCE OF OTHER CONCERNS AND IMPERFECTIONS

- 4.46 In addition to market failures, we identified a number of other ways in which real markets can depart from the perfectly competitive ideal. What is the relevance of these concerns to the housing market?

Adjustment and disequilibrium

- 4.47 One of the biggest challenges that the housing market presents to the perfectly competitive model is the slowness of its adjustment mechanisms and the consequent widespread existence of disequilibrium. Prices in the market adjust much faster than quantities. Neither new construction nor property conversion responds to changes in demand rapidly enough to prevent an upturn in demand being reflected in prices that are elevated for extended periods. It may be of some relevance in terms of second best solutions that at least part of the reason for slow and incomplete supply adjustment is the existence of land use planning. Although no doubt justified on the grounds of various environmental and social externalities, state intervention via planning restrictions seems likely to contribute to supply restrictions, and hence higher prices, in the housing market. Tenure conversion is not a powerful enough mechanism to mitigate the problem, particularly in periods of strong growth in the owner occupied sector. Widespread housing market mismatch at regional and local level can arise as a result of changes in demographics and economic fundamentals. In contrast, downturns in demand are likely to be reflected initially in an increased vacancy rate rather than downward flexibility in rents.⁵⁶

⁵⁵ As noted by Hubert, a model of terminations of potential relevance to this question is offered by J Stiglitz and A Weiss, "Incentive effects of terminations: applications to the credit and labour markets" (1983) 73 *American Economic Review* 912. The model uses a principal-agent framework and argues that terminations can overcome some of the moral hazard problems associated with contingent contracts.

⁵⁶ Poor supply response was a major concern of the recent Barker review for the Treasury: K Barker, *Review of Housing Supply – Delivering Stability: Securing our Future Needs* (2004), available at http://www.hm-treasury.gov.uk/media/E/3/barker_review_report_494.pdf (last visited 27 June 2007). See also C M E Whitehead, "Housing Demand, Supply and the Geography of Inequality" in P Malpass and L Cairncross (eds), *Building on the Past: Visions of Housing Futures* (2006). For a more technical discussion identifying slow adjustment to changing fundamentals in the more flexible US market see: D Blackley and J Follain, "In Search of Empirical Evidence that Links Rents to User Costs" (1996) 26 *Regional Science and Urban Economics* 409.

- 4.48 The consequences of slow adjustment for the way the market functions in practice are considerable. There is no necessity that trades between landlord and tenant will occur at market-clearing prices.⁵⁷ If the result is a sustained period of excess demand then this places considerable “short side” power in the hands of landlords. Occupiers know how difficult it will be to obtain alternative (comparable) property and hence will be willing to tolerate conditions or treatment that, in a less hostile market environment, they may have rejected by relocating.

Transaction costs

- 4.49 In addition to the transaction costs associated with contract enforcement discussed above, the fact that housing is a search good means that the transaction costs associated with identifying alternative providers and consumption opportunities are not negligible. The financial costs associated with changing dwelling can also be significant. While the absolute costs of house purchase are typically greater than those for securing a new rental property, the costs of securing a rented property can be significant when viewed relative to the income levels of the relevant households. In addition to the financial costs, there are also the psychic costs associated with the upheaval of leaving one’s home.
- 4.50 Here again occupiers may be willing to tolerate behaviour that, in the absence of transaction costs, they would reject by moving to another property. In the private rented sector there is a particular concern about the unjustified withholding of deposits. This is not just legally questionable but can present tenants with significant practical difficulties if they do not have a deposit to take to their next dwelling. Hence, poor landlord behaviour during the tenancy can be endured if there is an expectation that ending the tenancy will lead to similarly poor treatment.

⁵⁷ A recent model that considers the implications of trading in the private rented sector at non-market clearing prices can be found in: R Bradburd, S Sheppard, J Bergeron, and E Engler, “The Impact of Rent Controls in Non-Walrasian Markets: an Agent-Based Modelling Approach” (2006) 46 *Journal of Regional Science* 455.

Failures of rationality

- 4.51 The assumption that landlords, both in the UK and elsewhere, are profit-maximising and respond to economic incentives in the way assumed by theory has been scrutinised. It has been suggested that the motivations and behaviour of at least a significant minority of landlords cannot be approximated by standard assumptions of economic rationality.⁵⁸ Those landlords who have been characterised as possessing a “stewardship” motive towards their property are more likely to invest in its maintenance. Conversely, those landlords whose characteristics most closely approximate the profit maximising model of theory are more likely to let properties in less good repair because the rental premium for providing better quality does not offer sufficient incentive to invest. To the extent that growth in the private rented sector is the result of an increase in the proportion of investor landlords, this may have significant implications for the longer term quality of the stock, unless it is possible to encourage a more professional attitude towards property management.⁵⁹
- 4.52 The rationality of private rented sector consumers has not, in contrast, been a source of debate.⁶⁰ A significant issue that has attracted attention, however, is the question of equal access, which is raised in the context of a concern for horizontal equity. The private rented sector draws its residents from a full cross-section of society, with a strong representation of those from minority communities, young people and poorer households, those with lower levels of literacy and lack of familiarity with legal process. There will therefore be considerable differences in occupiers’ access to “know how” relevant to managing their relationship with their landlord. This can be the basis of an argument for regulation to enhance the transparency and accessibility of information and the provision of assistance with the enforcement of rights. This has been used as the basis for arguing for the move to a system which would allow circumstances in which professionals, such as tenancy relations officers, could pursue cases against landlords, whether or not a complaint has been initiated by an occupier.⁶¹

⁵⁸ See A D H Crook and J E T Hughes, “Market Signals and Disrepair in Privately Rented Housing” (2001) 18(1) *Journal of Property Research* 21; H S Anderson, “Motives for Investment in Housing Rehabilitation Among Private Landlords under Rent Control” (1998) 13 *Housing Studies* 177. See also M Shroder, “What Makes a Landlord? Ownership of Real Estate by US Households” (2001) 38 *Urban Studies* 1069.

⁵⁹ Crook and Hughes, *above*.

⁶⁰ There is, however, limited evidence that there may be issues for certain groups. For example, Lister presents evidence that young people often do not read their tenancy agreements and so do not know their rights. This is not because the information is too difficult to understand: they often had not tried to read the contract. Eg D Lister, “The Nature of Tenancy Relationships: Landlords and Young People”, in S Lowe and D Hughes (eds), *The Private Rented Sector in a New Century* (2002).

⁶¹ A Marsh, P Niner, D. Cowan, R Forrest and P Kennett, *Harassment and Unlawful Eviction of Private Rented Sector Tenants and Park Home Residents* (2000).

Endogenous preferences

- 4.53 Given that housing is a key indicator of social position and that consumption norms in housing are not fixed, the endogeneity of preferences is likely to be relevant to the housing market. However, this is an area in which there remains a considerable need for theoretical development, and we do not consider that we can usefully draw any lessons here.

ARE MARKET FAILURES SIGNIFICANT IN THE HOUSING MARKET?

- 4.54 Does the housing market suffer from significant market failures? Or rather, we have identified a number of characteristics of the housing market that diverge from those assumed by the basic model of the market economy: are they significant in practice?
- 4.55 On this point there is a divergence of opinion. Economists who do not have a specialist research interest in the housing market would tend to argue that the market is broadly competitive and that any distortions or inefficiencies identified are a product of wrongheaded state intervention rather than technical market failures or similar concerns. At its broadest, the fact that four out of five households in the UK manage to secure housing through private provision is taken as an indication that the housing market is not subject to the sort of problems that afflict the provision of health or education, for example.
- 4.56 Some of those with more focused research interests in housing share this robust view of the housing market. However, there are other specialists who conclude that problems of externalities, slow adjustment, search and information asymmetries, and unequal access are a sufficient departure from the competitive market model to be of concern. Whitehead, for example, concludes that:

there is no doubt that housing is subject to significant market failures. These generate lower than optimal levels of housing investment and management as well as distortions in the provision, take inadequate account of the wider benefits of good quality accommodation as well as the wider costs of bad housing and neighbourhoods, make it difficult to address problems of risk and financing to the individual, and do not allow available economies of scale and scope to be realised in order to minimise the costs of production.⁶²

- 4.57 However, apart from concerns about externalities and the impact of poor housing on public health, it is also the case that market failures alone have rarely been seen by policy makers as sufficiently serious to warrant a more active role for the state. Much of housing policy has been more concerned with addressing what can be broadly considered as distributional or equity issues.

⁶² C M E Whitehead, "The Economics of Social Housing" in T O'Sullivan and K Gibb (eds), *Housing Economics and Public Policy* (2003) at p 141.

IS HOUSING A MERIT GOOD?

- 4.58 In this respect housing policy in the UK for much of the period up to the late 1980s has been characterised as formulated on the basis that housing is a merit good. That is, that all households should consume a minimum quantity of housing that may be more than they would have chosen for themselves.⁶³ After the 1980s it has been argued that this concern for minimum standards for all was replaced by a policy concern with affordability,⁶⁴ although since 1997 there has arguably been a return to a greater concern with “a decent home for all”.⁶⁵
- 4.59 The idea that housing is a merit good has been challenged from a libertarian perspective.⁶⁶ The argument is that, first, unlike health or education, it is not the case that housing is a complex commodity about which it is difficult for consumers to be well-informed or make rational decisions in their own interests. Second, there is limited evidence that consumers do not know that good housing is desirable. Housing is a normal good.⁶⁷ From these observations it is concluded that there is little to commend the argument that housing is a merit good.
- 4.60 To defend the argument that housing is a merit good would require the argument that the costs of poor housing, or the aspects of housing that are deleterious, are not transparent to consumers and hence they are not well placed to make informed decisions. Alternatively, one could argue that the social benefits of good housing considerably outweigh the private benefits, perhaps in terms of interdependent utility functions, and hence private decisions regarding housing will result in suboptimal levels of consumption.
- 4.61 However, the argument that housing is a merit good is not necessary to the argument that Government policy seeks to ensure that all households achieve an adequate level of housing consumption. This can simply be an equity argument. But switching the basis of the argument to equity may shift the nature of state intervention it entails.

INCOME REDISTRIBUTION

- 4.62 If one rejects the view that the housing market suffers from significant market failures and housing is not a merit good then that leads to the conclusion that if there are households that are not consuming sufficient housing then this is a product of a deficiency of income rather than a housing market problem as such. Increasing household income would allow demands for better quality accommodation to become effective.

⁶³ For example, G Bramley, W Bartlett and C Lambert, *Planning, the Market and Private Housebuilding* (1995) at p 198.

⁶⁴ C M E Whitehead, “From Need to Affordability: an Analysis of UK Housing Objectives”, *Urban Studies* (1991), vol 28.

⁶⁵ DETR/DSS, *Quality and Choice: a Decent Home for All – The Housing Green Paper* (2000).

⁶⁶ P King, *Housing, Individuals and the State* (1998); P King and M Oxley, *Housing: Who Decides?* (2000). See also M Oxley, *Economics, Planning and Housing* (2004) at p 82.

⁶⁷ That is, housing has a positive income elasticity so households demand and consume more housing as their income increases.

- 4.63 Hence, if assistance were felt to be necessary for equity reasons then it would be more appropriate to provide it in the form of a supplement to income than greater state activity in the housing market. This is the position taken by many economists both within and beyond the specialist field of housing economics.

CASH VERSUS IN-KIND PROVISION

- 4.64 The dominant view is now that it is more appropriate to subsidise people and properties and a key role for Government is to put resources in the hands of the disadvantaged so they can exercise choice in the housing market. State provision of housing or subsidy of prices is seen as less desirable because it either overrides consumer choice or distorts market incentives.
- 4.65 While providing demand subsidies is typically seen as more appropriate,⁶⁸ for the reasons outlined in Part 3, subsidies are likely to be tied to housing – reflecting concerns embodied in the idea of specific egalitarianism. It is also a recognition, perhaps implicitly, that while housing is a normal good it has a low income elasticity. This means that to achieve a given improvement in housing consumption through untied cash subsidies would require a substantial amount of income redistribution because recipient households would only spend a small proportion of additional income on housing and the majority of it on other things. Tying demand subsidies to housing means that the amount of redistribution required to achieve a given level of housing consumption is reduced.
- 4.66 There is, however, a contrary, more cautious view. The argument is that while cash benefits may be preferred in the abstract, the detailed operation of the mechanisms available to deliver them have unfortunate disincentive effects. Equally importantly, providing benefits in cash – whether tied or not – assumes that the housing market can respond to an increase in effective demand by supplying greater quantity and quality, rather than just absorbing the increase in higher prices. Yet it is precisely the problems of slow adjustment and inadequate premium for quality that are the key problematic characteristics of the market in the first place.
- 4.67 Hence, there may be situations in which in kind provision is a more efficient mechanism for distribution in practice. In a world where all alternatives are imperfect, policy selection needs to be grounded in detailed knowledge of alternatives.⁶⁹

⁶⁸ See G Galster, “Comparing Demand-Side and Supply-Side Housing Policies” (1997) 12 *Housing Studies* 561, for a clear statement of this position.

⁶⁹ This argument is developed by: J Yates and C M E Whitehead, “In Defence of Greater Agnosticism: a Response to Galster’s “Comparing Demand-Side and Supply-Side Subsidies”” (1998) 13 *Housing Studies* 415.

SECOND BEST ARGUMENTS: IMPERFECTIONS ELSEWHERE

- 4.68 In principle, there may be arguments for intervention in the housing market and pricing at something other than marginal social cost in order to counteract distortions in the prices of other products. The most relevant such products would be substitutes for housing or complements. However, there are no clear substitutes for housing. The complements for housing – such as transportation – may well be priced at other than marginal social cost.⁷⁰ Yet the practicalities of seeking to price housing to compensate would present a formidable barrier and would be subject to major incentive problems. If anything, adjustments would be easier to implement in the transportation sector. These considerations lead to the conclusion that there is no clear case for using second-best arguments to argue that housing should be priced in a way that departs from efficient pricing.⁷¹

ASSESSMENT

- 4.69 While no single factor in isolation points to the conclusion that the housing market departs from the perfectly competitive ideal, it has a number of characteristics that taken together point to the conclusion that seeking to minimise state activity in the sector and relying on markets alone is unlikely to succeed as a strategy for achieving a socially optimal level of housing consumption. That is not necessarily an argument for state or not-for-profit provision of housing, although that should not be ruled out by assumption because there are circumstances in which it may be a more effective way of achieving social objectives. Rather, at a minimum, there is a case for regulatory intervention to combat information asymmetries and ensure equal access and horizontal equity. This is particularly relevant to the current project.

⁷⁰ In the case of private transportation, below marginal social cost; and in the case of public transportation at or above marginal social costs.

⁷¹ B Walker, *Welfare Economics and Urban Problems* (1981) at p136. There may, however, be a case for adjusting pricing to account for the impacts of distortions in the land market as a result of the planning system, although there have been few attempts to quantify the overall welfare effects of land use planning, as noted by M Oxley, *Economics, Planning and Housing* (2004).

PART 5

INTERVENTION IN THE PRIVATE RENTED SECTOR

INTRODUCTION

- 5.1 In this Part we briefly review economic analyses of regulatory intervention in the private rented sector. The main focus of economic concern has been the impact of rent control, and this is the topic we consider first. We then consider the issue of regulating quality.

THE PROBLEM OF RENT CONTROL

- 5.2 Across the globe rent control is one of the most frequently deployed housing policies, with the aim of stopping landlords charging rents that are seen as unjust or unaffordable.
- 5.3 In the UK at least some part of the private rented stock has been subject to rent control or rent regulation since 1915, when it was introduced as a temporary measure to cope with the effects of the war effort upon housing demand. The proportion of the stock covered has subsequently waxed and waned in line with shifting political and policy concerns.⁷² The proportion of the private rented sector with regulated rents has declined sharply since 1989, at which point it was no longer possible to create tenancies covered by the 1977 Rent Act.
- 5.4 Rent control is one of the few topics upon which economists have traditionally agreed. There has been near consensus regarding its negative impact. Indeed it is used in many textbooks as an illustration of the way in which Government attempts to suppress prices, however well-intentioned, lead to consequences that ultimately frustrate policy objectives.⁷³ It is also a topic about which many economists hold strong views. Most famously, Assar Lindbeck stated that “next to bombing, rent control seems in many cases to be the most efficient technique so far known for destroying cities”.⁷⁴
- 5.5 The economics of this argument are very simple. At a rent set below the market rate, more people will want to consume than will be prepared to supply. Such an excess of demand is usually the signal for a price rise (which would attract increased supply). But rent control prevents rents going up.

⁷² The long term policy history of rent control can be found in various places including: J Doling and M Davies, *Public Control of Private Rented Housing* (1984); P Kemp, *The Private Provision of Rented Housing* (1988).

⁷³ See, for example, R Frank, *Microeconomics and Behaviour* (6th ed 2006).

⁷⁴ A Lindbeck, *The Political Economy of the New Left* (2nd ed 1977) at p39.

- 5.6 A range of undesirable consequences are argued to follow. One is that access to rental accommodation will need to be rationed by some mechanism other than price, and this opens the way both for the inefficient allocation of properties among consumers⁷⁵ and for landlords to engage in discrimination. A second consequence is that letting outside the law will occur, with practices such as asking for “key money” to access a tenancy. A third consequence will be that a value gap will open but between the value of the property with an occupier and its open market value. This creates incentives for landlords to sell their property once it becomes vacant. This in turn creates an incentive for the unscrupulous landlord to expedite the exit of existing occupiers. Rent controls are typically accompanied by conferring enhanced security of tenure upon occupiers as additional protection from the threat of eviction to obtain vacant possession. Some landlords will nonetheless seek to secure vacant possession by whatever means they can, lawful or unlawful. Hence, rent control would be expected to reduce the supply of rented properties over the medium term.
- 5.7 It is, however, worth noting that there has been something of a fragmentation of opinion on the effects of rent control since the late 1980s. A number of models of the rental market have been developed which suggest that in certain circumstances rent control, at least in mild form, can have beneficial effects on overall social welfare.⁷⁶ This has led one prominent author to pose the question whether it is time to revise our view of rent control.⁷⁷ In this respect it is perhaps safest to conclude that:

Regulation per se is neither good nor bad. What matters are the costs and benefits of specific regulations under specific market conditions.⁷⁸

⁷⁵ See, most recently, E L Glaeser and E F P Luttmer, “The Misallocation of Housing under Rent Control” (2003) 93 *American Economic Review* (2003) 1027.

⁷⁶ The most prominent studies include: R Arnott and M Igarashi, “Rent Control, Mismatch Costs and Search Efficiency” (2000) 30(3) *Regional Science and Urban Economics* 249; R Raess and T von Ungern-Sternberg, “A Model of Regulation in the Rental Housing Market” (2002) 32 *Regional Science and Urban Economics* 475.

⁷⁷ R Arnott, “Time for Revisionism on Rent Control?” (1999) 9(1) *Journal of Economic Perspective* 99.

⁷⁸ B Turner and S Malpezzi, “A Review of Empirical Evidence on the Costs and Benefits of Rent Control (2003) 10 *Swedish Economic Policy Review* 11 at p 15.

REGULATING QUALITY

- 5.8 While not explored as regularly, similar arguments can in principle be applied to the regulation of quality. The regulation of quality places a floor on the quantity of housing services that can be offered by a property. The impact of such a floor depends on where it is set relative to the equilibrium quality that would be established without regulation. If regulation is effective and landlords of properties that are currently below standard are compelled to upgrade their properties then this will either suppress their rate of return and/or increase the rent the tenants are charged, depending on market conditions. As a consequence such regulations may render renting either a marginal or uneconomic activity for some landlords or unaffordable for some tenants. If, on the other hand, the quality threshold is set below that currently demanded in the market then the regulation will not materially affect market functioning, but would be pointless, except perhaps as a safety net against the eventuality of market conditions driving quality down.
- 5.9 In contrast, requiring all landlords to hold some form of licensing fee or compulsory membership of a professional association, as a means of ensuring or encouraging provision of a minimum standard, is equivalent to increasing the fixed costs of provision across the board. The effect of this change on market equilibrium – whether it will be reflected in prices, quantities or both - will depend on the elasticity of demand.
- 5.10 It has also been argued that introducing or extending direct regulation of quality, as the Government has recently done, will increase the political risk associated with private landlordism. This could increase rents or suppress returns more generally. The return on rental housing is calculated on the basis of an assessment of the risk involved in renting. If landlords perceive the possibility of creeping or increasing regulation then this can lead them to increase their assessment of market risk and hence the relative attractiveness of renting declines compared with investment in other assets. Landlords may try to deal with this perceived increase in risk by seeking a higher return in the short term.⁷⁹
- 5.11 However, there is an alternative perspective that can be applied to quality regulation that is not relevant in the case of rent control. Rent control is unlikely ever to make private landlordism a more attractive proposition for investors. Hence the impact of rent control on supply can at best be neutral. In contrast, the regulation of quality offers the potential to improve the reputation of the sector overall and thereby encourage new investment into the market. Any losses in supply could be offset by the arrival of new landlords. This has in fact been a concern of policy towards the sector – placing emphasis upon the need for landlords to “professionalise” – for the last twenty years.

THE IMPACT IN PRACTICE

- 5.12 While quality regulation may have a negative impact upon the supply of housing, it is important to recognise that the impact in practice will depend upon the state of the market and the gap between existing standards and those imposed by new, or, for that matter, better enforced, regulation. The magnitude of any positive impact of regulation upon new investment is fundamentally uncertain.

⁷⁹ M Ball, *The Future of Private Renting* (2004).

- 5.13 The received wisdom regarding the private rented sector is that the rate of return landlords require to provide decent accommodation is beyond that which tenants are willing or able to pay. This has been identified as the “central dilemma” of the sector.⁸⁰ However, it may be that real returns are of sufficient magnitude that landlords are able to comply with quality regulations and still earn a return that compares favourably with that available through alternative investments.⁸¹
- 5.14 This does not mean that landlords would not exit the sector as a result of regulation, but the explanation would not be one that rests primarily in changes in the economics. Rather one would have to look towards landlords’ perceptions of greater political risk.
- 5.15 The potentially negative impact upon the supply of rental housing will also be contingent upon whether any more rigorous regulatory regime is implemented in isolation or whether there are offsetting changes in the financial treatment of private renting that puts resources into the market to neutralise any increase in costs. Or, alternatively, whether provision in other sectors is expanded to absorb those who may be displaced as a result of landlords exiting the private rental market. Hence, to understand the impact of regulatory change requires not only a clear understanding of the details of the proposed change but also the context in which the change is implemented. Even then there will inevitably remain a considerable degree of uncertainty surrounding any estimate of likely impact.
- 5.16 It can be demonstrated in theory that many, if not most, types of regulatory intervention into housing markets will have a negative impact upon supply. Whether we can expect a negative supply response in practice, and if so how substantial it will be, is an empirical matter. It depends upon the current rates of return and levels of competition in the market to which it is applied, as well as the price expectations, time horizons and, potentially, motivations of landlords. If, as argued in Part 4, a substantial minority of landlords do not respond strongly to economic incentives then this may attenuate any impact.
- 5.17 The supply response is not independent of the design of the regulatory policy. Policies that entail substantial compliance costs are likely to result in a more significant negative impact than those that do not. Hence, the scope for reading across from the impact of one intervention to the likely impact of another needs to be considered carefully. If one intervention has a negative impact and a second intervention with a higher compliance cost is being considered then we might be confident that the supply response to the second intervention will be at least as substantial. However, if the initiative under consideration is relatively light touch then a negative supply response to an initiative with high compliance costs does not offer a very good guide to its likely impact.

⁸⁰ House of Commons Environment Committee, *The Private Rented Housing Sector, vol 1* (1982).

⁸¹ That returns are competitive with alternative investments, at least at certain points in the house price cycle, is suggested by the discussion in D Rhodes and P Kemp, “Rents and Returns in the Residential Lettings Market” in S Lowe and D Hughes (eds), *The Private Rented Sector in a New Century* (2002).