

Coversheet: Prohibiting letting fees under the Residential Tenancies Act 1986

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|---------------------|---------------------------------------------------------|
| Advising agencies | Ministry of Business, Innovation and Employment (MBIE) |
| Decision sought | Amend the Residential Tenancies Act to ban letting fees |
| Proposing Ministers | Hon Phil Twyford |

Summary: Problem and Proposed Approach

Problem Definition

What problem or opportunity does this proposal seek to address? Why is Government intervention required?

Under the Residential Tenancies Act 1986 (the RTA), tenants can be required to pay a fee or other charge for services rendered by a solicitor or letting agent relating to the granting of a tenancy. Letting fees are commonly charged as an additional lump sum up-front cost to tenants for services that are provided to the landlord. The fee can act as a barrier to accessing a tenancy for some tenants. Tenants of properties that are directly managed by the landlord do not pay letting fees, creating inequity in the tenancy system.

Proposed Approach

How will Government intervention work to bring about the desired change? How is this the best option?

Charging letting fees to tenants is established as common practice in the rental market and, in the current tight rental market, tenants have limited bargaining power or consumer choice in relation to the payment. Therefore the only way to ensure the administrative costs associated with advertising and letting a rental property are not passed on to the tenant directly, and rest with the appropriate beneficiary, is to explicitly prohibit such practice in legislation.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?

The primary beneficiaries of the proposal are new tenants of residential rental properties. Letting fees are typically charged by letting agents as a lump sum of one week's rent plus Goods and Services Tax (GST) prior to moving into a property. Therefore removing letting fees will reduce the up-front costs for those tenants moving into a new tenancy arranged by a letting agency by the equivalent of one week's rent. This will be of particular benefit to renters on low incomes who may struggle to pay the lump sum letting fee in addition to other moving costs.

Removing letting fees is intended to reduce some of the financial stress faced by tenants in securing a rental property. Lower up-front costs may also increase tenants' choice of

property by reducing the cost difference between properties let by landlords and those by agents. The proposal is also expected to result in more equitable outcomes in the market by ensuring that renters receive a consistent experience regardless of whether it is a letting agent or private landlord that rents out the property. In doing this, it will also ensure that the costs of providing the letting service rest with the beneficiary for whom that service is provided.

Where do the costs fall?

The costs fall to letting agents or landlords. The services provided by letting agents include listing and advertising a rental property, conducting open homes and vetting prospective tenants. The beneficiary of these services is the landlord. If letting agents cannot charge tenants directly, the letting costs will be charged to landlords or absorbed by the letting agents.

It is possible that it may not be a straight transfer of the current cost of the standard fee from tenant to landlord. Landlords have bargaining power and consumer choice in the selection of a letting agent. Leaving landlords responsible for paying the letting fees may provide an incentive to exercise that consumer choice and result in a more efficient market. This could occur by encouraging letting agents to charge letting fees that more closely reflect the real costs associated with letting a property in order to compete in the property management market. This in turn may encourage a more transparent business model for letting agents.

Currently, industry practice is for letting agents to charge one week's rent plus GST, which varies from property to property, for the same service. A more efficient market may encourage letting agents to be more transparent about the actual costs of the services they provide and set fees accordingly. A fee structure directly related to the cost of service may result in fees lower than one week's rent, particularly where market rents are high. On the other hand, it is possible that fees in areas of relatively low market rent may be more than one week's rent.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?

As there has been no consultation on the proposal, the full extent of impacts cannot be identified. There are, however, a number of risks apparent in the proposal.

There is a risk that landlords will pass the letting fee on to tenants through increased rent over the term of the tenancy. However, experience in other countries shows no clear evidence that banning letting fees will lead to increased rents. In the event letting fees were passed on in the form of increased rent, at the current national average weekly rent of was \$452¹ for tenancies managed by property managers, \$9.99 per week would be added to rents over a one year tenancy.

While not necessarily desirable, tenants are likely to find the cost easier to pay when spread over the course of the tenancy rather than in a lump sum along with all the other costs associated with moving into a rental property. The proposal would still meet the goal

¹ Based on bonds data held by MBIE.

of reducing up-front costs for tenants and creating an equitable experience for renters. However, if the tenancy is extended beyond the initial term, it is unlikely that the rent would be adjusted once the costs of letting the property were covered. Tenants could then end up paying a greater amount than the initial letting fee over the course of the tenancy. Transparency in how rents are calculated and increased could help to mitigate this risk. As part of a broader review of the Residential Tenancies Act 1986 that MBIE is currently undertaking, it will consider and consult on the provisions and options for setting, increasing, and articulating rents.

There is a risk that property managers could seek to recoup the lost revenue from letting fees through other charges to tenants such as overheads and an administration fee for background and reference checks. The proposed mitigation for this risk is to include an amendment to the RTA clarifying that only bond and rent in advance can be charged to a tenant at the commencement of a tenancy.

Alternatively, letting agents may reduce the level of service they provide in letting a rental property. They may reduce the level of advertising, impacting prospective tenants who are unaware of the availability of a property or impacting on landlords and letting agents by limiting their ability to find the 'right' tenant for a property. Landlords could also be impacted by poorer quality advertising materials or the withdrawal of some services such as background and reference checks which could create an increased risk for landlords in renting their properties. To mitigate this risk, landlords may choose to cut out the letting agent and conduct their own background checks on prospective tenants. There is a low risk that if vetting tenants and getting them into rentals becomes too cumbersome for landlords, they may remove themselves from the market which could reduce the number of available rental properties more generally. However, it is considered that this is unlikely.

An unintended impact of landlords letting rental properties themselves is that some may not vet prospective tenants as rigorously as letting agents do. As a result they may end up with a churn of tenants that create additional costs and effort in managing tenancies. Landlords can mitigate this risk through upskilling or engaging professional services.

Should landlords reduce their use of letting agencies to avoid the fees, or the fees are reduced in response to market competition, there may be an unintended impact on the property management sector through lost revenue. It is not known what proportion of turnover is made from letting fees, or the extent to which landlords would be prepared to cover these costs from their rental revenue stream, but it is likely that the bulk of their revenue comes from the ongoing management of tenancies. This is estimated to be charged at around 8 percent of weekly rental. Property managers can mitigate the risk of lost revenue through reviewing their business model.

Identify any significant incompatibility with the Government's 'Expectations for the design of regulatory systems'.

Consultation on the specific proposal has not been undertaken. However, the expectations for the design of regulatory systems guidance by the Treasury states that we should seek to remove or redesign an existing regulatory system or system component if it is no longer delivering obvious net benefits. The regulatory system for allocating costs of letting a tenancy within the rental market is arguably no longer delivering net benefits for New Zealanders, in particular renters who now make up around a third of all households. As tenants receive no net benefit by being required to pay a letting fee, and that the charging

of letting fees is inconsistent across the country indicating that letting fees do not reflect the real costs incurred as part of letting a property, the regulatory system should be updated to improve transparency and allocation of costs.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?

MBIE's bond database contains data on the bonds lodged by property management companies by territorial local authority, from which average rents and letting fees can be calculated. However, MBIE does not know how many property management companies actually charge letting fees. There is little available evidence on the potential impacts on the property management sector of banning the letting fees practice.

Quality Assurance Reviewing Agency:

MBIE

Quality Assurance Assessment:

MBIE's Regulatory Impact Analysis Review Panel (RIARP) has reviewed this Regulatory Impact Statement. RIARP consider that the information and analysis summarised in the RIS partially meets the criteria necessary for Ministers to fairly compare the available policy options and take informed decisions on the proposals in this paper.

Reviewer Comments and Recommendations:

While this RIS does provide preliminary analysis of the likely impacts of taking action now, it makes a more convincing case for the preferred option of considering this in the broader context of the RTA review.

The RIS does not fully meet the standard because no consultation has taken place and the time constraints have meant that the analysis is somewhat repetitive. Clarity would be improved if time were available to address this.

Impact Statement: Prohibiting letting fees under the Residential Tenancies Act 1986

Section 1: General information

| Purpose |
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| <p>The MBIE is solely responsible for the analysis and advice set out in this Regulatory Impact Statement, except as otherwise explicitly indicated. This analysis and advice has been produced for the purpose of informing final decisions to proceed with a policy change to be taken by or on behalf of Cabinet.</p> |
| Key Limitations or Constraints on Analysis |
| <p>While it is known anecdotally that it is common practice for letting agents to charge tenants a letting fee of one week's rent, data on the prevalence and amount of letting fees is not collected. MBIE holds data on bonds lodged by property managers and can use this data to estimate the average rent and total revenue from letting fees.</p> <p>The Government committed to banning letting fees as part of its election manifesto to improve the experience of renters. MBIE has considered a targeted selection of alternative options. There are other programmes of work underway, such as KiwiBuild and the broader review of the RTA, that will help to address more systemic issues in the rental market. However, these are expected to take significantly more time for benefits to be realised. The Government is committed to reducing the up-front costs of moving into a rental property and this approach frames the criteria used to assess the proposal. Further options to address issues with renting may be incorporated as part of a broader review of the RTA, which is due to be consulted on in the middle of 2018.</p> <p>The key limitation on the consultation and testing of the approach is the accelerated legislative timeframe. Proceeding with the legislative change now will ensure the amendments are in force as soon as possible, providing relief to renters at the earliest opportunity. Interested stakeholder will have the opportunity to provide their perspective on any proposal to address letting fees during the select committee process,.</p> <p>There are a number of other policy changes underway affecting the housing and tenancy system. These include the increasing the supply of houses, the Healthy Homes Guarantees Act 2018 (HHGA) and associated standards and regulations currently under development to improve the quality of rental houses, and a targeted review of the RTA to modernise the legislation so that it can respond to the changing trends and patterns in the rental market.</p> <p>All of these initiatives will affect landlords, tenants and the rental market but it is not possible at this point to assess what the cumulative impacts will be. Nor is there sufficient information or time available to fully consider the impacts of prohibiting letting fees or what, if any impacts, it may have on other initiatives.</p> |

Responsible Manager (signature and date):

Claire Leadbetter

Construction and Housing Policy

Business, Resources and Markets

Ministry of Business, Innovation and Employment

Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

As rising house prices relative to income have caused a decrease in home ownership in New Zealand, more people are living in rented dwellings and are renting for a longer portion of their lives. There are approximately 576,000 households renting, comprising 33 per cent of all households. Of these, 87 per cent rent from the private market and 11 per cent from public housing providers under contract with the Ministry of Social Development (MSD). The remainder rent from local government, other central government agencies (eg defence housing) or community housing that is not under contract with MSD.

In the 2013 Census, half of the total New Zealand population was living in rental accommodation.² People on low incomes are more likely to rent and some groups are over-represented in the renting population. For example 53 per cent of Maori and 67 percent of Pacific people rent and disabled people are more likely to be renting than non-disabled people. Families with children account for 63 percent of the renting population.

The average length of tenancy has increased from one year and four months in 1995 to two years and three months in 2017. There is a level of insecurity in renting as tenancies that are not subject to a fixed term can be terminated for a variety of reasons. These include the sale of the property, the landlord requiring the property as their own residence, or with no reason given at all.

Tenants who are required to move are faced with the stress of finding another suitable property from limited available stock. As competition for rental properties grows, the ability of tenants to choose where they live reduces. They may be forced to move to another community away from existing family and friend networks. The mobility of tenant households often results in repeated changes of school for children and puts them at risk of poor educational outcomes.

Moving into a new property comes with significant up-front costs including bond and rent in advance. Added to this, where letting agencies are involved in the establishment of a tenancy, there is the standard industry practice of charging a letting fee of one week's rent plus GST to the tenant.

A letting fee is charged to a tenant for the costs associated with advertising a rental property, conducting open homes, and vetting prospective tenants. However, these services are provided by letting agents for the benefit of the landlord. Charging a tenant for these services creates an inequitable distribution of costs within the rental market. In 2017, of the total 175,081 bonds lodged, 53.6 per cent were lodged by property management companies and it is likely that a large proportion of them charged a letting fee.

As the costs are incurred at the beginning of the tenancy they are charged as a lump sum rather than spread over the course of the tenancy. For tenants, this can add an average

² The Ministry of Business, Innovation and Employment previously used this figure in its analysis of the impacts of the proposed action. It has since been determined that the figure is incorrect and should instead have been stated that in the 2013 Census, 36.3% of the total New Zealand population was living in rental accommodation. It should be noted that because the analysis focussed on the distribution of costs relating to letting fees, this figure did not have a material impact on the analysis.

\$519.60 to the cost of moving into a rental property.

Tenants have little choice or bargaining power with regard to paying the letting fee in the current competitive rental market. They are unable to shop around for a cheaper price because it is the landlord that chooses the letting agent. As consumer choice is not available to moderate the market, the resulting inefficiency is likely to persist.

Average rents in New Zealand have risen by 3.7 per cent per year, outpacing growth in earnings. This increase will be reflected in increased letting fees, with no change in service. Rents vary across the country and within a particular location. Letting fees, therefore, also vary and it is not clear how the fees relate to the actual cost of services delivered.

If no action is taken it is very likely that the costs of moving into a rental property will continue to rise until the supply of housing eases tension in the rental market. Tenants will continue to have virtually no bargaining power while competition for rental housing is high.

2.2 What regulatory system, or systems, are already in place?

Residential tenancies are regulated by the RTA, which prescribes:

- the rights and responsibilities of tenants and landlords
- the form, content and termination provisions of tenancy agreements
- limitations on and handling of bonds
- the setting and increasing of rent
- special provisions for boarding houses
- the establishment of a trust account to hold bond money.

The RTA prohibits the requirement of key money for the granting, continuance, extension, variation, or renewal of any tenancy agreement. However, the RTA does allow landlords to direct the tenant to pay any fee or other charge for services rendered by a solicitor or letting agent relating to the grant or assignment of a tenancy. The RTA does not prescribe a particular structure, formula or upper limit for the letting fee.

The majority of rental houses are in the private market. Government regulation is preferable as there is currently a housing shortage, creating strong competition for rental properties. In this market, consumer choice and bargaining power is constrained. Renters have no choice over whether they pay a letting fee and no influence or consumer choice over the cost as the letting agent is engaged by the landlord.

Eleven per cent of rental houses are provided by Housing New Zealand or community housing providers. Letting fees do not apply for these properties.

A targeted review of the RTA is being undertaken as part of the Government's commitment to improve the experience of renters. Legislative amendments are due to be introduced by the end of 2018. The Government is committed to reducing price barriers to tenants accessing suitable rental properties. It has identified letting fees as a price barrier as, the RTA places the burden of this fee on the tenant rather than the landlord.

Along with the review of the RTA, the Government has introduced legislation to improve the quality of rental houses. The HHGA provides for the development of healthy homes standards and regulations to ensure rental homes are warm, dry and healthy. The current

proposal aligns with these other regulatory initiatives and the Government's overall objective to improve the experience of renters.

2.3 What is the policy problem or opportunity?

More people are renting and they are renting for a greater proportion of their lives. Along with high house prices, the rising costs of renting are contributing to the reducing rate of home ownership in New Zealand. At the same time, the highly competitive rental market in many cities is driving up costs for renters through rising market rents.

Renters face significant up-front costs to move into a rental property. Along with the cost of transporting their household goods, renters can pay an average of \$3,231 on signing a new tenancy agreement. This is based on the latest bond data held by MBIE where the average rent in New Zealand is \$452 per week. The total up-front costs include bond of four weeks' rent, two weeks' rent in advance, and a letting fee of \$519.60 (one week's rent plus GST).

The significant up-front cost of moving into a rental home can limit tenants' choice of house and act a barrier to securing a property that meets their needs. As much of the cost is based on weekly rent, it may restrict the size of home they can rent and the location they can live in. With the average length of tenancy being two years and three months, renters are regularly faced with finding a new tenancy. As rents rise faster than incomes, they may need to downscale and/or move to a cheaper suburb. Families with children comprise the majority of renting households and they may end up in houses too small or unsuitable for their needs and children may need to change school repeatedly.

For low income earners the letting fee can be a considerable financial burden for no clear benefit to the tenant. In addition, a tenant who rents from a private landlord would not be required to pay a letting fee despite a private landlord invariably providing the same services as a letting agent and incurring the same costs. This creates an inequitable outcome for tenants depending on the person or entity that they rent their property from, despite tenants not experiencing a difference in the service provided.

According to bonds information, there is only a marginal difference between the average price of rentals between property management companies and private landlords. This indicates that letting agents may operate across the entire rental market; however, low income earners would be disproportionately hurt where their property is rented out by a letting agent due to paying a letting fee, in comparison to if they rented from a private landlord.

The other up-front costs carry a return to the tenant. Bonds are refundable or can be transferred to a subsequent property and the rent in advance is recouped at the end of a tenancy. Rent is also an on-going cost faced by tenants that is incurred to secure the right to occupy a rental property for the coming weeks. Where a tenant is already paying rent, and assuming no cross-over of an old tenancy ending and a new tenancy starting, a tenant would not experience any additional cost from paying rent in advance – only a continuation of existing expenses. The letting fee, on the other hand, is non-refundable and the primary beneficiary of the service is the landlord rather than the tenant.

In areas with high competition for rental properties, it could be argued that the tenant benefits

as they were selected over other candidates through the service of the letting agent. However, all the consumer choice around the engagement of letting agents and bargaining power on the fees charged lies with the landlord.

Letting agents provide a legitimate service and are entitled to charge a fee for the costs associated with providing that service. However, the RTA allows letting agents to charge tenants for that service, rather than charging a landlord. This approach can make the letting agent more competitive in the property management market by not charging the landlord (the ultimate beneficiary of the service of letting) as much. Following the convention for other payments under the RTA, letting agents base the fee on the weekly rent with no requirement to relate it to the actual costs incurred. Given the wide variation in rents it is likely that many tenants are significantly overpaying the cost of the service.

Letting fees also differ across the country as common practice is to base the letting fee on the weekly rent for a property. As different properties are rented out for different weekly rents, this means letting fees differ despite the service provided not changing. This indicates that the letting fee does not reflect the real cost of letting a property.

There is currently no incentive to change how letting fees are charged. They are permitted under the law, renters have no bargaining power in the current highly competitive rental market and, as landlords do not pay the fee, there is no need for letting agents to compete on price.

The proposal provides an opportunity to reduce the up-front costs that tenants must pay to move into a rental property and reduce the inequalities between tenants of private landlords and those in properties managed by property management companies. It will also support more equitable outcomes in the rental market by minimising disparities experienced by renters between renting from a letting agent or private landlord, as well as ensuring that costs are appropriately allocated to the beneficiary to whom the service is provided.

2.4 Are there any constraints on the scope for decision making?

The proposal implements the Government's manifesto commitment to ban the charging of letting fees to tenants as part of its policy to improve the experience of renters. The time frame for decision making has limited meaningful analysis of alternative options, including non-regulatory options, has been limited.

The broader review of the RTA is relevant to this proposal but legislative amendments are not expected to take effect until early 2019 (at the earliest). The rental market is seasonal with turnover of tenancies peaking from November to February. The immediate introduction of this change is sought to try and have legislative amendments in force by the end of 2018 so that tenants moving over the next peak will not face letting fees.

A number of initiatives are underway to improve the housing situation in New Zealand. These include increasing the supply of houses through KiwiBuild, improving rental house quality through the healthy homes regulations, and modernising the RTA.

2.5 What do stakeholders think?

The main stakeholders for the proposal are tenants who are required to pay letting fees, landlords who use the services of letting agents and pass the fee on to tenants, and letting agents who provide the service.

Tenants are most likely to support the proposal as it will reduce the costs of moving into a rental property. Letting agents and landlords are less likely to support the proposal. Based on bond data, letting fees could have potentially generated \$46.9 million in revenue. While letting agents will still be entitled to charge for their services they may need to change the way they do it. Landlords will need to take responsibility for the fee and pay it themselves or consider how they might seek to recoup it.

The proposal was part of the Government's election manifesto and no consultation has been undertaken or is planned. However, stakeholders will have an opportunity to present their views during the select committee process, which is expected to take six months.

Section 3: Options identification

3.1 What options are available to address the problem?

The following options were considered in the development of the proposal.

Status quo

Description

Take no action on letting fees. Letting agents would continue to charge letting fees to the tenant for a service provided for the benefit of landlords.

Benefits

This approach would result in minimal disruption to a sector that is experiencing multiple legislative reforms and reviews (e.g. Healthy Homes Guarantee Act, broader review of the RTA). Letting agents would continue to provide the letting service and the quality of the service would not reduce.

Negatives

Some tenants would continue to be charged letting fees, which means that they would face high up-front costs in accessing a rental property. Tenants would continue to experience disparate outcomes depending on whether they rent from a letting agent or from a private landlord (i.e. some would have to pay a letting fee, some would not). The tenants will continue to bear the cost of services incurred that are ultimately for the benefit of the landlord.

Ban up-front letting fees but allow agents to charge other fees to tenants

Description

Ban the charging of explicit letting fees to tenants to establish a tenancy through legislation but allow agents to charge fees for other services. This may include fees for activities associated with the letting of the property, such as advertising and photography, or they may be for services that they provide to tenants throughout the course of the tenancy. Examples include breaking a tenancy agreement early and sub-letting a property on behalf of the tenant.

Benefits

Tenants would no longer face letting fees for entering a property. Letting agents would still be able to charge for costs reasonably incurred during the tenancy e.g. with sub-letting a property. There will be no change in experience for landlords.

Negatives

Letting agents may charge fees for specific services up-front to tenants and justify it as they do not represent a letting fee (e.g. a photography fee). This option could also result in a range of other fees being charged to tenants over the course of the tenancy that do not reflect the level of service. For example, a letting agent might charge a week's rent each time someone moves in or out of the premises during the tenancy period, or on renewal of the tenancy, or to approve a modification of keeping a pet.

Thus additional fees may be for services provided to the tenant but they are not charged for now. The tenant could end up paying more than the cost of the letting fee over the course of the tenancy. Furthermore they would only be charged for tenancies managed by property management companies. Tenants in rental properties managed directly by the landlord would not incur such fees.

Ban all fees associated with letting a rental property

Description

Ban the charging of letting fees, and any other fee, to tenants through legislation. Letting agents would be required to absorb the costs of letting a property or pass these on to landlords.

Benefits

This would ensure up-front costs of moving into a rental property are reduced as soon as possible and tenants would not be paying for a service they do not receive. It would also remove the imbalance between tenancies managed by private landlords, with no letting fee, and those managed by property management companies that charge a letting fee.

Negatives

The fees are likely to be charged directly to landlords some of whom may in turn pass it on to tenants in increased rent. The cost of spreading the letting fee through rent over the course of the tenancy may result in some tenants over-paying the cost of the service. The specific behavioural response of landlords is difficult to forecast as time for consultation has been limited and the full extent and nature of impacts are unable to be assessed.

Address letting fees and other up-front costs through the review of the RTA

Description

Consider the issue of letting fees through the review of the RTA, due for completion in early 2019.

Benefits

This approach will allow the proposal to ban letting fees to be considered alongside other proposed changes to the RTA and allow MBIE to understand the cumulative impact of all changes on tenants. This will ensure that the proposed changes are not counter-productive or will not work against other goals of the rental market such as tenure security.

This approach would enable a more detailed analysis of options and potential impacts. The current proposal would be consulted on as part of the review and the approach could be modified as a result. As part of the RTA review, letting fees would be able to be considered in the context of wider changes to the housing and tenancy systems.

Negatives

Tenants will have to continue paying letting fees and experience a disparity of outcomes depending on the person or entity they rent their property from until the Bill developed as a result of the review is passed.

There is limited international experience of banning letting fees. They have been banned in Scotland since 1984 but a loophole enabled tenants to be charged a range of other fees. In 2012, the law was clarified so that only rent and the deposit were to be paid by the tenant and all other charges were to be paid by the landlord. Rents in Scotland increased in the years following the 2012 law change but there is no clear evidence that the fees ban was the cause. Two reports suggested that the rise in rents was the result of market increases.

Letting fees were banned in Germany in 2015 but at the same time limits on rent increases were introduced in a number of major cities. There has been no significant impact on the German rental sector, however, with the average length of tenancy being 11 years any impacts will take considerable time to become apparent.

In France, letting fees have been capped since September 2014 and are based on the size of the dwelling and its location. In the United States, letting fees are charged and usually set at one month's rent or fifteen per cent of the annual rent of the property.

England, Wales and Northern Ireland are in the process of banning letting fees.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The key criteria for assessing the options are:

1. it reduces up-front costs to tenants when moving into a rental property,
2. it improves the equitable distribution of costs
3. the benefits can be achieved quickly.

3.3 What other options have been ruled out of scope, or not considered, and why?

Options that have been considered but ruled out are as follows.

Increase supply of rental houses.

This would reduce competition among tenants for rental properties and giving them greater consumer choice in tenancy. Letting agents may be forced to stop charging letting fees in order to stay competitive. This option was ruled out as housing supply is being progressed through other initiatives and it would also require a significant amount of time for the benefits to be realised and this would significantly work against this option under the criteria for assessment.

Reduce other upfront costs such as bond

The most significant up-front cost is the bond. The RTA enables landlords to charge up to four weeks bond and this maximum could be reduced through amending the legislation. However, a reduced bond may not be sufficient to cover potential damage caused by tenants and force landlords into protracted debt recovery processes. The increased risk for the landlord is also a significant concern and such a proposal would require significant consultation. The bond is transferable from one tenancy to the next so is not necessarily a new cost each time a tenant moves. The letting fee on the other hand is a non-recoverable lump sum required for each new tenancy.

This option would also require a significant amount of adjustments to the Government's existing bond system including transitional provisions for existing bonds, what to do with non-claimed bonds. There could be a significant increase in work for the Tenancy Tribunal in the first instance with dealing with existing bonds as landlords may try to minimise their risk, and in the second instance following any future claims for damages incurred during the tenancy by landlords. The costs of this option would likely significantly outweigh the benefit of reducing the up-front cost to tenants, especially over a longer period of time. In addition, this option would do nothing to address the disparity currently faced by renters depending on whether they rent their property from a letting agent or a private landlord.

Capping letting fees

A maximum cap could be set on letting fees through amendment to the RTA. However, it would be difficult to determine an appropriate basis for the limit as the value of the service would change over time. Again, this option would not address the disparity in outcomes between renters, and would also signal that the charging of letting fees to tenants is the correct allocation of costs despite the benefit resting with the landlord.

Section 4: Impact Analysis

Marginal impact: How does each of the options identified at section 3.1 compare with the counterfactual, under each of the criteria set out in section 3.2?

| | No action | Option 1 Ban up-front letting fees now but allow agents to charge other fees to tenants | Option 2- Ban all fees associated with letting a rental property | Option 3 - Address letting fees and other up-front costs through the review of the RTA |
|---------------------------------------------------------------------|-----------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Criterion 1 Reduces up-front costs | 0 | ++ No letting fee on the granting of a tenancy but a range of other fees could be charged for specific services associated with letting the property or over the course of the tenancy . | ++ The only up-front costs would be bond and rent in advance. | ++ Options for addressing letting fees would be consulted on as part of the review and will align with the Governments priority to reduce up-front costs. |
| Criterion 2 Improves the equitable distribution of costs | 0 | + Tenants could be charged fees for services provided that are of benefit to them such as extending a tenancy but that are currently free. | ++ Tenants would not pay for a service provided to landlords. Costs would be equitable with tenants moving into properties without the involvement of a letting agent. | ++ The up-front costs of moving into a rental property could be specifically included in the review and a wider range of options considered. |
| Criterion 4 Benefits are realised quickly | 0 | ++ Benefits to tenants would be realised by the end of 2018 in time for the peak summer tenancy turnover period. | ++ Benefits to tenants would be realised by the end of 2018 in time for the peak summer tenancy turnover period. | + Benefits will not be realised until some time in 2019. There is a greater risk of delay due to the complexity of a larger review. |
| Overall assessment | 0 | + | ++ | ++ |

Key: ++ much better than doing nothing/the status quo; + better than doing nothing/the status quo; 0 about the same as doing nothing/the status quo'
- worse than doing nothing/the status quo; -- much worse than doing nothing/the status quo

Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

The current proposal to immediately amend the RTA to ban letting fees meets all the criteria as does the option to address letting fees and other up-front costs through the broader review of the RTA.

MBIE’s preferred approach is to consider letting fees as part of the wider review of the RTA. This would enable a more detailed consideration of letting fees as part of the wider changes to the housing and tenancy system. It would be included in the consultation process of the RTA review allowing stakeholders to provide feedback. As part of the RTA review, there would be time for a detailed analysis of options and impacts.

5.2 Summary table of costs and benefits of the preferred approach

| Affected parties (identify) | Comment: nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks | Impact \$m present value, for monetised impacts; high, medium or low for non-monetised impacts | Evidence certainty (High, medium or low) |
|-----------------------------|----------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|------------------------------------------|
|-----------------------------|----------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------|------------------------------------------|

Additional costs of proposed approach, compared to taking no action

| | | | |
|------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|--------|
| Regulated parties (letting agents) | On-going costs of letting properties, assume all property managers charge one week letting fee, cost for all property managers; however, assume 50 percent cost passed on to landlord | (\$23.5m) | Low |
| Regulated parties (landlords) | Absorb letting fee or increased weekly commission charge, one-off for each new tenancy, assume one property per landlord, one turnover per 12 month period, and based on average rent from 2017 | (\$23.5m) | Low |
| Regulated parties (tenants) | Potential increased rent; however, attached to pass-over from landlords | Low | Low |
| Regulators | Enforcement (absorbed by business as usual funding) | \$0 | Medium |
| Wider government | Ministry for Social Development (MSD) may have to provide | Low | Medium |

| | | | |
|-----------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|--------|
| | increased accommodation support etc if rents increase | | |
| Other parties | N/A | N/A | N/A |
| Total Monetised Cost | | (\$47m) | Low |
| Non-monetised costs | | Medium | Medium |
| Expected benefits of proposed approach, compared to taking no action | | | |
| Regulated parties (letting agents) | Recoup some costs by passing costs on to landlords | | Low |
| Regulated parties (landlords) | N/A | | Low |
| Regulated parties (tenants) | No letting fees, assume all property managers that lodge bonds charge a letting fee, assume all letting fees are one weeks rent based on average rent in 2017 | \$47m | Low |
| Regulators | N/A | | |
| Wider government | MSD will have reduced costs associated with providing assistance for letting fees | \$180,000 | |
| Other parties | N/A | | |
| Total Monetised Benefit | | \$47.18m | Low |
| Non-monetised benefits | | | |

5.3 What other impacts is this approach likely to have?

Landlords

- Will likely bear the costs associated with letting the property. As this service is for the benefit, it is justifiable that costs should rest with landlords.
- May incur additional cost if they absorb the letting fee and pay the agent directly for the service they receive.
- May benefit financially if they pass the letting fee on in increased rent and the tenancy is extended. The rent is likely to continue at the same level after the letting fee has been reimbursed i.e. greater returns over time.
- Letting agents may reduce the level of service in order to be price competitive.

Letting agents

- Likely to charge the letting fee directly to landlords who may demand greater transparency in the fees and that they be more directly related to the actual service. This could result in a reduced fee and thus reduce profits for letting agents.
- Landlords have bargaining power and letting agents may need to compete on price or other factors e.g. reducing quality of service provided.

Current tenants

- Tenants currently in a rental property will not benefit as the letting fee applies only to the establishment of a tenancy; however, it may mean that tenants that would like to move (e.g. to better quality rental) may do so because one of the costs associated with moving has been reduced.

New or relocating tenants

- Will benefit through reduced up-front cost when moving into a new tenancy
- Will not experience a disparity depending on whether they rent from a letting agent or a private landlord
- May pay a higher rent than they would otherwise if letting fee is passed on

5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?

The expectations for the design of regulatory systems guidance by the Treasury states that we should seek to remove or redesign an existing regulatory system or system component if it is no longer delivering obvious net benefits. The regulatory system for allocating costs within the rental market is arguably no longer delivering net benefits for New Zealanders, in particular renters who now make up around a third of all households. As tenants receive no net benefit by being required to pay a letting fee, and that the charging of letting fees is inconsistent across the country indicating that letting fees do not reflect the real costs incurred as part of letting a property, the regulatory system should be updated to improve transparency and allocation of costs.

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?

The proposed change will be implemented through an amendment to the RTA. The amendments will come into effect by the end of 2018. This time frame allows sufficient time for letting agents and landlords to prepare for the change.

A communications plan will be developed to inform stakeholders of the change so that landlords and letting agents are aware of the ban and its implications.

6.2 What are the implementation risks?

The main risk is that the letting fee will be charged directly to the landlord, who will then recoup it from the tenant in the form of increased rent. The purpose of the proposal is to reduce the up-front costs to renters at the start of a tenancy. Recouping the letting fee through rent is not against the policy intent and would be more affordable to tenants than a lump sum on top of the other up-front costs.

Letting services are typically part of ongoing property management services engaged by the landlord. It is not considered likely that the change will have a significant impact on the willingness of landlords to engage property managers.

Property managers may seek to add other fees to tenants. The proposed change will include amendment to the RTA to prevent any new fees being charged to tenants for services provided to landlords. Where new fees are charged to landlords, the main mitigation will be their ability to shop around for property management services.

There is also a risk that, in the current competitive rental market, tenants may offer to pay the letting fees despite the ban to improve their chances of securing the tenancy.

There is a risk that letting agents may charge a higher rent for the first few weeks to recoup costs and then decrease rent to the actual level. Should this happen, tenants can take a complaint to the Tenancy Tribunal.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

A monitoring and evaluation plan will be developed once the legislative amendments have been agreed.

7.2 When and how will the new arrangements be reviewed?

The new arrangements will be reviewed as part of the monitoring and evaluation of the wider RTA review, which will be conducted by MBIE. This will be an opportunity for stakeholders to raise concerns or provide feedback on the ban. Given that no consultation has been undertaken as part of the development of the proposal, it is possible that subsequent feedback provides information suggesting that banning letting fees is not the best approach. Reversing the change at a later date might prove difficult.

An earlier review might be prompted if there are a large number of complaints to the Tenancy Tribunal from tenants that they have been charged letting fees or other additional fees as part of the tenancy.