MORE THAN A ROOF

How incentives can improve standards in the private rented sector

AUGUST 2014

Resolution Foundation

ABOUT

Chartered Institute of Housing

The Chartered Institute of Housing (CIH) is the independent voice for housing and the home of professional standards. Our goal is simple – to provide housing professionals with the advice, support and knowledge they need to be brilliant. CIH is a registered charity and not-for-profit organisation. This means that the money we make is put back into the organisation and funds the activities we carry out to support the housing sector. We have a diverse and growing membership of more than 22,000 people who work in both the public and private sectors, in 20 countries on five continents across the world. Further information is available at: www.cih.org

The Resolution Foundation

The Resolution Foundation is a non-partisan and award-winning think-tank that focuses on improving the living standards of working households in low-to-middle income Britain. It is a leading authority on securing widely-shared economic growth and has successfully ignited a major public debate about the stagnation in living standards that started in the UK in the years prior to the financial crisis. It is recognised as a home of real expertise on a range of policy issues such as low pay and the minimum wage, employment, the tax and benefit system, childcare and housing policy.

Acknowledgements

We are grateful to the following organisations for their input into this publication:

- Association of Residential Letting Agents
- Birmingham City Council
- Chartered Institute of Environmental Health
- Crisis
- Department for Communities and Local Government
- The Dispute Service
- Exeter City Council
- Generation Rent
- Grainger
- Greater London Authority
- KPMG
- Landlord Accreditation Wales
- Local Government Association
- London Borough of Newham
- London Landlords Accreditation Scheme
- London School of Economics
- National Federation of ALMOs
- National Landlords Association
- The Property Ombudsman
- Residential Landlords Association
- RITA 4 Rent
- Shelter

CONTENTS

EXECUTIVE SUMMARY

The private rented sector (PRS) is a growing and increasingly important part of the country's housing market. It now houses 18 per cent of all households in England and is the second largest tenure in the country after owner occupation. As the sector expands, private tenants are becoming an increasingly diverse group including a higher proportion of people across every income decile and a growing number of families with children.

In meeting the needs of this diverse group of tenants the sector faces a number of challenges, specifically:

- variable property conditions – PRS homes are typically older and a higher proportion do not meet modern standards, when compared to those in other tenures
- variable standards of housing management – most private landlords are individuals with only one or two properties. For most it is a side-line activity and very few are full time professional landlords. As a result standards of housing management, while by no means universally poor, are inconsistent. There is also a particular issue at the bottom end of the market where unscrupulous landlords are able to exploit vulnerable tenants who have limited housing options
- concerns about affordability and some households' ability to access the sector – there are high upfront costs associated with securing a PRS tenancy and some households, particularly those in receipt of housing benefit, can have difficulty finding a landlord who is prepared to accommodate them. Research also shows that a growing number of tenants are struggling to afford their rent and maintain a decent standard of living
- a growing demand from some tenants for greater levels of security than is currently on offer – more and more private tenants are remaining in the sector for the long term, including an increasing number of households with children. This is leading to a growing demand from some tenants for a greater degree of security than is currently available.

The current policy framework is not effectively meeting these challenges. Although landlords are subject to a significant number of statutory obligations, these are complex and not widely understood, while the enforcement of them is under-resourced and uncoordinated. At a local level, some local authorities are addressing concerns about poor practice through licensing schemes. However, these can be resource intensive and there may not be an appetite to replicate this approach nationally. Letting agents are also entirely unregulated and there are insufficient sanctions available to deal with serious instances of malpractice in this part of the industry.

Current measures intended to drive up standards through increased competition, for example by attracting more institutional investment into the sector, are welcome but will take time to have a significant impact. Similarly, a number of different schemes have been established to accredit private landlords but the level of take-up remains relatively low. Furthermore, while in London these have been harmonised through the adoption of the London Rental Standard, nationally the approach to accreditation remains fragmented, with different schemes operating to different standards.

While wishing to avoid over-regulating the sector and discouraging further investment in it, we consider that an improved legal 'backstop' is needed to address the worst instances of poor practice in the PRS.

We therefore recommend:

- ***a review of the statutory minimum standards to which landlords are subject and the arrangements for enforcing them.*** *This should be aimed at ensuring that there is a single, easily understood set of minimum standards (covering both property conditions and housing management) for landlords and that sufficient resources are made available for enforcement to effectively tackle unscrupulous landlords*

- ***regulation of letting agents and an end to the practice of charging tenants fees for their services.*** *Regulation could most easily be implemented by extending the arrangements already in place to regulate estate agents to the lettings industry.*

To improve performance beyond this minimum, we would also encourage government to explore the options to make greater use of incentives to encourage more landlords to professionalise and to commit to a higher set of standards.

To achieve this, we recommend:

- ***the development of a nationally agreed set of standards for accreditation*** *(covering both property conditions and housing management). Accreditation could still be awarded and administered by a range of different bodies, however a nationally agreed set of standards would ensure greater consistency between them*

- ***greatly increasing the number of landlords who sign up to a recognised accreditation scheme by adding an element of conditionality to the tax relief currently available to landlords – a 'something for something' deal. Enhanced tax relief should be available to accredited landlords compared to those who remain unaccredited.*** *This could include:*
  - *giving accredited landlords a more generous tax allowance for 'allowable expenses' (where landlords deduct the cost of repairs from their profits for income tax purposes), compared to unaccredited landlords*
  - *allowing landlords to treat any improvement that is necessary to bring a property up to accreditation standard as an allowable expense (instead of deducting it from the landlord's capital gains tax liability at the point that they sell the property). This would mean that there would be a more immediate tax benefit for the landlord from this kind of investment*
  - *allowing accredited landlords to benefit from capital gains tax rollover relief (meaning that if a rented property is sold and the proceeds are immediately reinvested in another, the landlord can defer the payment of capital gains tax on any profit they had made). We suggest adopting a system whereby the proportion of the gain which benefits from rollover relief is linked to the length of time for which the property has been rented out and the length of time for which the landlord has been accredited.*

- ***considering the options to offer 'unconditional incentives' to all private landlords to encourage them to make physical improvements to their properties and to help address concerns about security and access to the sector.*** *These could include:*
  - *reviewing the options to reinvigorate the Green Deal*
  - *allowing landlords to treat property improvements not funded by the Green Deal, but that result in a higher Standard Assessment Procedure (SAP) rating, as an allowable expense*
  - *supporting, potentially by providing funding for, local authorities to increase their provision of basic tenancy support services to PRS tenants and landlords. These could be targeted at those at high risk of tenancy failure and provided at the beginning of a tenancy. Providers of accreditation schemes may also wish to supplement this by offering, where needed, a higher level of ongoing support to their accredited landlords.*

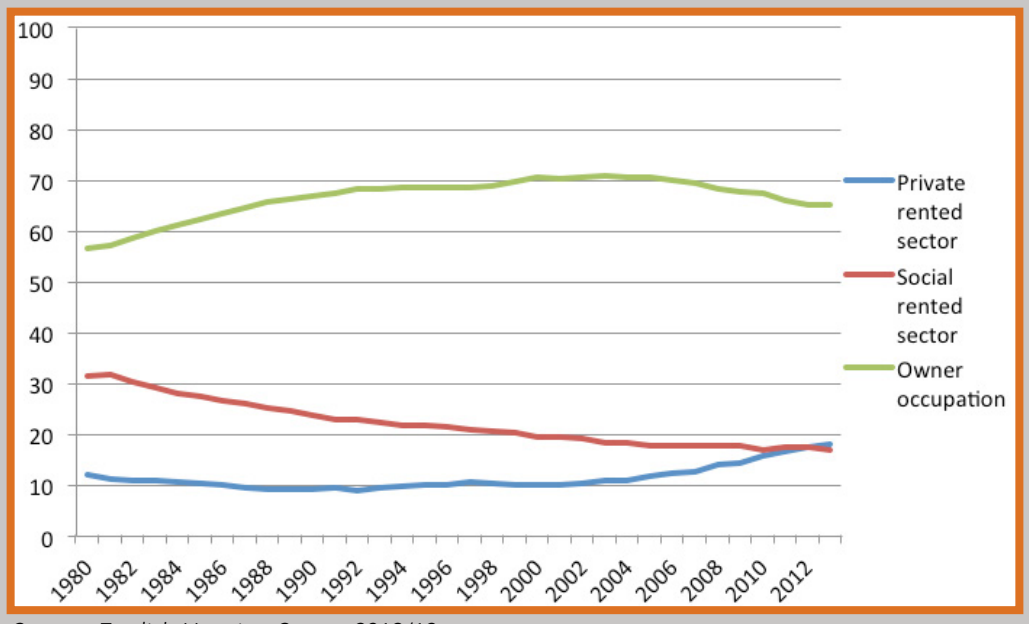
SECTION 1 Where are we now?

The changing role of the PRS in the housing market

In recent years the PRS has been growing rapidly, both in absolute numbers and in terms of its share of the housing market as a whole. From a low point of just nine per cent in 1992 this has doubled to 18 per cent, reversing a trend of decline which had lasted for much of the latter 20th century.

The latest figures, published in the English Housing Survey, show that the sector currently houses 4m households in England, making it the second largest tenure in the country after owner occupation. Despite this recent expansion, it remains relatively small by international standards but projections suggest that it will continue to grow. For example, Savills predict that by 2020 it will house around 25 per cent of all households.

Changes in the percentage of households living in each of the three main tenures over time



Source: English Housing Survey 2012/13

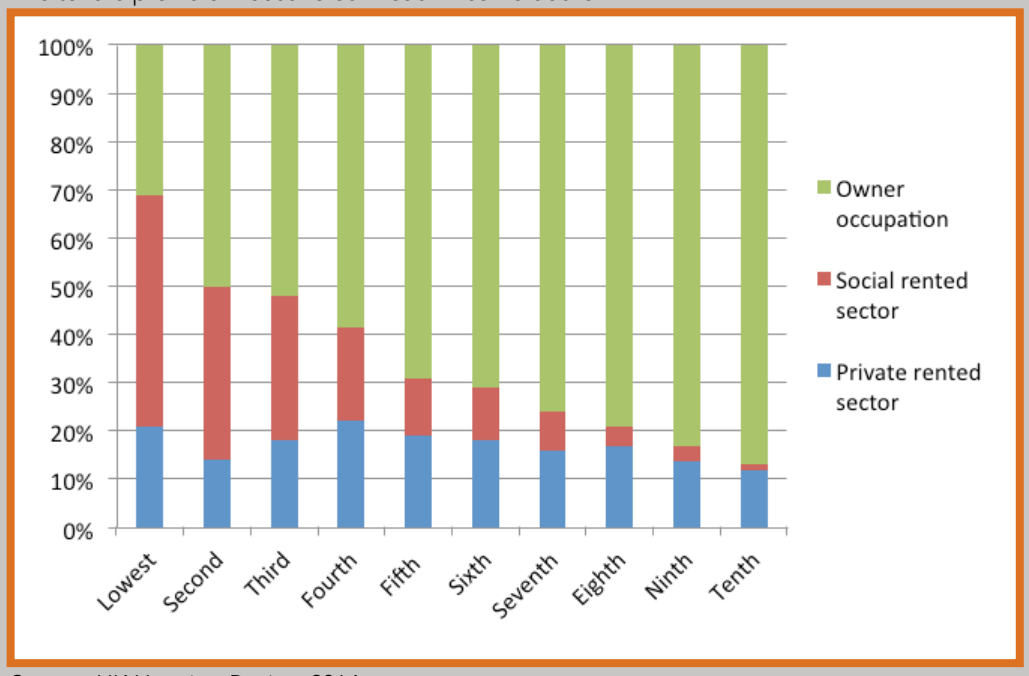
Currently the sector is dominated by small scale individual investors. According to a 2010 survey carried out by DCLG 89 per cent of landlords are individuals (as opposed to organisations), most of whom have very small portfolios. Only three per cent own five or more properties, while 78 per cent own only one. Single property landlords let 40 per cent of all homes in the sector.

The PRS is often seen as providing relatively short term housing to 'young professionals' – highly mobile tenants who make the most of the flexibility it offers to move around and take advantage of employment opportunities, but who may aspire to own their own home in the

future. There is some evidence to support this view, with data from the English Housing Survey showing that private renters have a substantially younger profile than those in any other tenure. Fifty one per cent of private tenants are aged under 35 and just eight per cent are 65 or over. In addition 61 per cent are in full time employment, compared to 23 per cent of those living in social housing.

However, in practice the sector houses a much more diverse range of households than this suggests and, as it grows, it is housing an increasing proportion of households across all income brackets. This not only includes those who have been priced out of homeownership, but also many households who might traditionally have been able to access social housing. For example, figures published in the UK Housing Review 2014 show that as many as one in five (21 per cent) of those in the lowest income decile now rent privately.

The tenure profile of households in each income decile

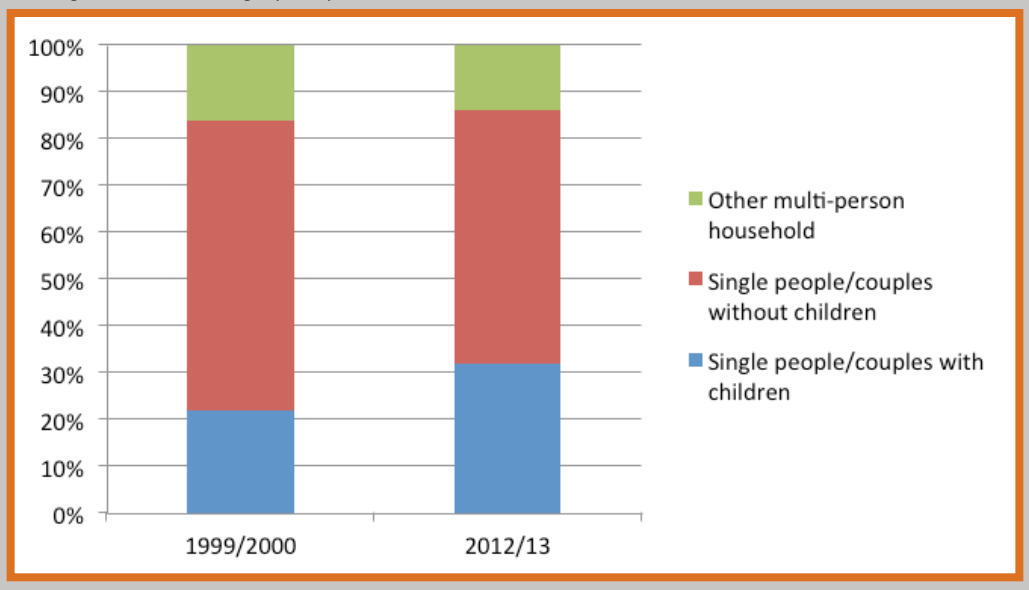


Source: UK Housing Review 2014

Therefore as tenants increasingly rent for longer than they might have in the past, more and more are seeing themselves not as young professionals, for whom private renting is a positive choice, but as members of 'generation rent' – households who continue to rent because they have been priced out of owner occupation by high house prices and are also unable to access social housing.

This includes a growing number of households with children. Between 1999-2000 and 2012-13 the percentage of private renters who were households with children increased from 22 per cent to 32 per cent. According to Shelter, this means that as many as one in five families with children now lives in privately rented accommodation.

Changes in the demographic profile of PRS tenants over time



Sources: Survey of English Housing 1999/2000 & English Housing Survey 2012/13

The challenges facing the sector

As the PRS grows and its role in the housing market changes, a number of challenges are emerging, each of which is discussed in more detail below. These include:

- variable property conditions
- variable standards of housing management
- concerns over affordability and some households' ability to access the sector
- a growing demand from some tenants for greater levels of security than is currently on offer.

Variable property conditions

In recent years the standard of properties has improved considerably across all three tenures. However the highest proportion of substandard homes is still to be found in the PRS. Figures published in the UK Housing Review show that 33 per cent of privately rented properties do not meet modern standards, compared to just 15 per cent of social rented homes.

English Housing Survey data also shows that 19 per cent of homes in the PRS do not have central heating and are less likely to possess features intended to improve energy efficiency, such as energy efficient boilers, cavity wall insulation and loft insulation, than homes in other tenures. Overall nine per cent fall into either category F or G (the two poorest categories) when assessed for their energy efficiency. Although standards have improved considerably since 1996 when 40 per cent were rated F or G, this is still poorer than in other tenures.

A key issue is the age of the stock, as properties in the PRS are typically older than those that are owner occupied or managed by social landlords. However in many cases market forces also do not provide a strong incentive for landlords to maintain these homes to high standards. Particularly in areas where demand for rented accommodation significantly outstrips supply, landlords can often avoid long void periods and achieve attractive returns on their investment while still minimising spending on repairs and maintenance.

Variable standards of housing management

Standards of housing management are also currently very variable. Most landlords are private individuals with very small portfolios, and very few are full time 'professional' landlords. DCLG's survey of landlords showed that 79 per cent receive less than a quarter of their income from rent, suggesting that being a landlord is a side-line activity for most. Many are 'accidental landlords' - individuals who have become landlords through inheritance or a change of circumstance which has left them with a property that they do not intend to live in and do not want, or are not able, to sell.

Many of these landlords provide good quality services to their tenants. However some are not familiar with all of their legal obligations and/or lack the time, skills and knowledge to actively manage their properties effectively. In theory, high street letting agents should offer a potential solution to this problem, however concerns have also been raised about the way in which some elements of this industry operate. For example a recent House of Commons Select Committee report suggested that agents should be regulated, with the committee having heard evidence of a wide variety of problems arising in some parts of the industry. These included aggressive sales tactics, poor customer service, a lack of transparency with regards to fees and failure to carry out services as promised to landlords, such as regular property inspections.

There is a particular problem at the very bottom of the PRS where both property and housing management standards can be very poor. Here vulnerable households with very few alternative options can find themselves housed in overcrowded or unsafe conditions by unscrupulous landlords. Tenants at this end of the market frequently report instances of landlords refusing to carry out essential repairs and express concerns about illegal or retaliatory evictions - whereby a landlord ends a tenancy in response to a request for a repair to be carried out or a complaint. Shelter estimates that as many as 700,000 renters may be living with electrical hazards while 300,000 report that poor property conditions have affected their children's health.

Concerns over access and affordability

There are also significant concerns about the extent to which the PRS remains affordable for many of the households who need it. Although, in most parts of the country, rents have not risen rapidly in recent years, average incomes have fallen in real terms and many renters are now struggling to afford their housing costs. Previous research carried out by the Resolution Foundation shows that 1.3m renters now spend more than 35 per cent of their disposable income on rent. In many cases these households have very few other housing options and some are cutting back on essentials in order to continue to meet their housing costs. Research carried out by Generation Rent suggests that as many as 39 per cent of tenants have had to cut back on heating to make sure that they can pay the rent and a further 33 per cent have had to cut back on food.

Of course this problem is not confined to the PRS and is symptomatic of a wider problem with the cost of housing across all tenures. However there are also specific up-front costs associated with obtaining a PRS tenancy, which often involves paying for a credit check, letting agent fees and putting down a security deposit, as well as paying the first month's rent in advance. In particular the House of Commons Select Committee was highly critical of letting agents' approach to setting fees, having found evidence of opaque charging, 'drip charging' (where charges are only revealed gradually to tenants over the course of the transaction) and double charging (where both landlords and tenants are charged for providing the same service).

Combined with some landlords' reluctance to house tenants in receipt of housing benefit, these up-front costs mean that it can be very difficult for some households to access the PRS in the first place. There is also some evidence that this is being exacerbated by welfare reform which is now encouraging more landlords to adopt a 'no tenants in receipt of housing benefit' policy.

Greater security

At present PRS properties are typically let using an assured shorthold tenancy (AST) for an initial period of either six or 12 months. After this they are allowed to roll on until either the landlord or the tenant gives notice that they intend to end the tenancy. In total the National Landlords Association estimates that tenants currently remain in a property for an average of two and a half years.

It is often argued that this flexibility is one of the sector's greatest strengths and that, in particular, young and mobile tenants benefit from the ability to move around easily to maximise their employment opportunities. It is

certainly true that many tenants do value and benefit from this flexibility. However as the PRS grows and it houses a broader range of tenants, including an increasing number with children, there is a growing minority which requires a greater level of security than is currently available. For example, research carried out by Shelter suggests that 10 per cent of children living in the sector have had to change schools as a result of an AST being ended by a landlord.

How well is current policy addressing these challenges?

The current policy framework is made up of a combination of both national and local initiatives and a mix of:

- statutory obligations
- licensing schemes
- accreditation schemes
- encouraging competition.

Statutory obligations

The PRS was substantially de-regulated in the 1980s, however there are still a variety of obligations with which landlords are required to comply. These have been introduced piecemeal over a period of time and as a result are enforced by a range of different bodies in an uncoordinated manner. They are also often not widely understood by either landlords or tenants.

They include basic obligations on landlords to:

- carry out repairs
- give tenants reasonable notice when access is required
- give appropriate notice of any rent increase
- provide tenants with an Energy Performance Certificate
- place tenants' deposits with a tenancy deposit protection scheme.

There are minimum safety standards for properties and these are assessed using the Housing Health and Safety Rating System (HHSRS). Local authorities have powers to carry out inspections and to take appropriate action, including issuing improvement notices, to address these. However it is not currently an offence to rent out a property with serious hazards. Unless a notice has been issued and not complied with, no offence has been committed. Crucially, local authorities frequently do not have the resources required to ensure that all rented properties in their area meet even these basic standards, or to take effective action against the owners of those that do not.

There are additional requirements relating to gas safety. Landlords have a legal duty to ensure that all gas appliances, fittings and flues are maintained in safe working order with annual safety checks being carried out by a fully qualified and competent Gas Safe registered engineer. These requirements are enforced by the Health and Safety Executive. However there are no similar obligations relating to smoke alarms and periodic safety checks are only required for electrical installations and appliances in Houses in Multiple Occupation (HMOs).

Overall these arrangements do not seem to be working effectively or meeting the needs of either tenants or landlords. A failure to enforce minimum standards means that there are still serious concerns about the actions of a small minority of landlords who consciously act unlawfully, often letting properties that do not meet basic safety standards to vulnerable tenants with very few other housing options. At the same time, the majority of landlords who act responsibly are subject to a myriad of complex regulations which are not widely understood.

Letting agents are currently entirely unregulated, although they will shortly be required to join a recognised redress (ombudsman) scheme. This is a welcome change which should provide tenants with access to some recourse where they are affected by malpractice. However the government has so far stopped short of extending arrangements already in place for the regulation of estate agents to the letting and managing of PRS homes, despite pressure from industry bodies. This means that serious sanctions, such as the ability to bar unscrupulous agents from practising, will still not be available and it will remain possible for an individual who has been banned from acting as an estate agent to operate as a letting agent instead.

Landlord licensing schemes

In Scotland there is a national registration scheme for all PRS landlords. This requires them to pass a basic 'fit and proper persons test' and to provide each relevant local authority with details of all the properties that they own in their area. Wales will introduce a similar registration scheme in 2015 as well as requiring landlords that manage their own properties to obtain a licence to do so. To obtain a licence, landlords will be required to attend a training course and to adhere to a code of conduct.

In England there are fewer requirements of this nature. There is no national landlord registration scheme, although landlords are required to obtain a licence from their local authority to let a HMO in some circumstances. Individual authorities also have discretion to extend this requirement to other properties. For example, in the London Borough of Newham all private landlords are required to obtain a licence in order

to let any property, letting a property in the borough without a licence is a criminal offence. Barking and Dagenham will also introduce a similar scheme from September this year.

Such local authority licensing schemes are generally introduced as part of a sanctions-based approach to driving up standards in areas where the authority has particular concerns. A common criticism of them is that they 'punish' conscientious landlords (who would have been likely to adhere to reasonable property and housing management standards anyway) by requiring them to pay for a licence, while those who act unlawfully sometimes continue to do so by evading the local authority's attention. In some areas, particularly those where the sector is smaller and returns are less attractive for investors, there may even be a danger that if the cost of a license is too high it could drive some landlords out of the sector.

Licensing schemes are therefore generally most effective in high demand areas and must be introduced with a strong commitment to carry out associated enforcement work. This includes identifying and prosecuting both landlords who do not engage with the scheme and those who obtain a license but do not subsequently adhere to their obligations under it. For example Newham estimates that 20 per cent of private landlords operating in their area remain unlicensed. They have successfully prosecuted a number of these for breaches of their scheme and consider that this is helping to address the very poorest standards in the area. However enforcing the terms of a licensing scheme as well as identifying and, where appropriate, prosecuting unlicensed landlords can be costly and resource intensive.

Accreditation schemes

There are also a large number of voluntary accreditation schemes operated by local authorities, trade bodies and other organisations.

However getting landlords to engage with these schemes can sometimes be challenging. In many areas the demand for rented housing greatly outstrips supply and so there is little need for landlords to seek the competitive advantage that accreditation might bring. As such, accreditation schemes are often used as part of an incentives-based approach to encouraging improvement. In practice this often means accrediting organisations offering incentives, such as access to advice and training, to encourage take-up.

For example, in Wales landlords who join the Landlord Accreditation Wales (LAW) scheme:

- attend a one day development course
- have the opportunity to advertise their properties on the LAW website
- can access discounts from a range of service providers, covering areas such as landlord insurance, legal advice and gas maintenance.

Similarly, members of the Barnsley Accreditation Scheme receive free advice relating to tenancy support and (subject to availability) grants to improve their properties of up to £500. However despite this, these voluntary schemes still cover a relatively small proportion of the total number of landlords operating in the PRS.

Different schemes also often operate to different standards, although there have been some attempts to address this at a regional level. For example, the London Rental Standard acts as a single set of agreed minimum standards for landlords operating in the capital, despite being administrated and implemented by a total of seven separate accrediting organisations. However at a national level, arrangements for accreditation remain fragmented and inconsistent and the absence of a clearly agreed set of national standards, over and above the legal minimum, continues to present a challenge for landlords who are operating across a wider area.

Encouraging competition

Current government policy is largely focused on improving standards by encouraging greater competition in the sector. The government intends to achieve this through a combination of improving tenants' understanding of their rights and by encouraging new entrants into the sector.

DCLG have now published a guide entitled 'How to rent' to help tenants understand what they should be able to expect, and will also produce a code of practice for landlords. These are welcome, given that the rights and responsibilities of both landlords and tenants are not widely understood. However they may not, on their own, be sufficient to empower tenants who have very few other housing options and who are most vulnerable to being exploited by unscrupulous landlords.

Similarly, DCLG will also develop a model three year tenancy agreement to support landlords and tenants who would like to enter into a longer term agreement. Again, this is welcome but it is not yet clear how widely it will be used in practice as those tenants who have very limited housing options may not feel able to ask for a longer tenancy.

Anecdotal evidence also suggests that there is often a lack of trust between landlords and tenants, which leads many on both sides of the relationship to favour longer term tenancies in principle, while in practice still wanting to retain the ability to easily walk away from their own agreement if problems emerge.

The government is also seeking to attract more institutional investment into the PRS. It feels that if large scale, professional landlords can be enticed to enter the sector, they will 'raise the bar' and help to drive improvement through increased competition. To encourage this they have introduced a number of measures such as the Build to Rent Fund, which provides loans to help finance the development of new, purpose built homes managed by professional landlords. This also includes an enhanced role for social landlords who are increasingly establishing their own portfolios of PRS properties and/or acting as managing agents for existing landlords.

These measures are also welcome and are already beginning to deliver some additional high quality, well managed homes into the sector, many of which are being let using longer term tenancy agreements. However the extent to which they will also deliver improved standards among existing landlords is unclear, and it is likely that it will take some time for them to have the transformative effect on the sector the government envisages.

SECTION 2 The potential for a greater role for incentives

Why not achieve change through regulation alone?

The PRS is an inherently complex area of the housing industry. It is made up of a number of distinct submarkets, and there are also substantial regional variations. Specific submarkets include (but are not limited to):

- 'young professionals' - working people who are seeking high quality short term lets to meet their career needs
- a growing number of lower and middle income families who are seeking long term lets with reliable maintenance services
- an unscrupulous, exploitative element, where poor quality properties are let to economically vulnerable groups, for example new migrant workers or single people with low incomes.

Any interventions in the sector need to recognise this diversity, otherwise there is a danger that policy is designed with one particular submarket in mind and is only partially effective, or could even provoke unintended consequences elsewhere. In the past, this has sometimes been the case when broad interventions have been introduced across the whole sector specifically to combat poor practice at the lower end of the market.

For example, historically, heavy regulatory intervention has had a dampening effect on the sector, with the introduction of rent controls and security of tenure often being cited as one of a number of factors which contributed to its decline up until the 1990s. This came at the expense of a thriving investment culture, where landlords felt they could make adequate returns on their investment. Consequently many left the sector. Particularly at a time when the government is seeking to attract new investors to enter the market, it is important to learn the lessons from this.

Additionally, there are already concerns that existing regulations are not always enforced effectively due to a lack of resources and this may pose a challenge to any attempt to improve standards by significantly increasing regulation. A number of reviews, including the highly influential Rugg Review, also suggest that this kind of intervention, on its own, has not been shown to bring about any notable improvements in standards. Similarly, improvement grants and compulsory purchase also achieved very little, according to the Evaluation of English Housing Policy 1975-2000.

There remains however a clear case for instigating positive change but we argue that, given the diversity of the sector, a package of different measures is required to adequately address the issues set out in section one of this document. We do not argue that regulation and sanctions have no role to play. An effective 'backstop' of sanctions is certainly needed to address the worst instances of poor and unscrupulous practice and it is clear that in many cases existing arrangements fail to do this effectively, with many of the worst landlords continuing to evade sanctions.

Although this is not the main focus of this document, we consider that the following are required:

- a review of the regulations to which private landlords are subject, in order to set out a clearly defined, easily understood set of minimum standards
- properly resourced arrangements for enforcing these minimum standards and for taking action against landlords who do not adhere to them
- regulation of letting agents and an end to the practice of charging tenants fees for their services.

The role of incentives

We feel that this enhanced backstop of regulatory intervention should also be combined with:

- measures (such as those already being pursued by the coalition government) to encourage greater levels of institutional investment into the sector, in order to drive up standards through increased professionalism and competition
- an incentive-based approach to promoting positive practice among existing landlords by encouraging and supporting them to go beyond merely meeting minimum standards.

There are a number of benefits of incentive-based approaches, including that:

- they can be very low cost compared to some other policy interventions especially, but not only, in the case of 'micro' incentives (also known as 'nudge' techniques) aimed at altering behaviour on a small scale. This type of incentive can in fact cost nothing to administer
- they could encourage smaller landlords to grow, perhaps squeezing out poor performers. This is the opposite effect to a regulatory-led approach which, taking into account the associated licensing fees and checks, has the potential to dissuade smaller or less experienced landlords from entering the market
- in order to benefit from the incentive, landlords have to make themselves known to the body providing it. In other approaches, for example licensing schemes, it is the responsibility of the licensing body to locate landlords, which can be challenging and resource intensive. Offering incentives can therefore be an effective way of freeing up resources for enforcement, so that these can be targeted at the very worst offenders.

SECTION 3 Options for incentives

Incentives can be either 'conditional' (i.e. landlords need to meet a set of qualifying criteria in order to benefit from them) or 'unconditional' (i.e. available to all landlords). This section considers some options for both conditional and unconditional incentives which could be used to address the challenges identified in section one of this document.

Conditional incentives

As has previously been noted, at present there are a large number of separate accreditation schemes operating in different regions and administrated by different bodies. Locally arranged conditional incentives are used to encourage landlords to sign up to these schemes. However it would currently be difficult for national policy makers to link incentives to local schemes due to the widely differing expectations placed on participating landlords.

We therefore consider that for conditional incentives to have greater impact there is first a need to create a nationally agreed set of standards for landlord accreditation, over and above the legal minimum. These would need to be developed with the involvement of a range of different organisations, including those which already run major schemes. However we consider that any agreed set of standards should cover both property conditions and housing management standards and should aim to ensure that accredited landlords:

- keep their properties in a good state of repair, above statutory minimum standards
- ensure their properties achieve good standards of energy efficiency and are easy and affordable to keep warm
- are responsive and accessible in the management of their properties, providing a good service to tenants that goes beyond their statutory obligations.

This would not necessarily require the creation of a single, centrally administrated accreditation scheme, which would most likely not be as cost effective as making use of the resources of the many organisations that already have an interest in this area. Instead a number of different accrediting bodies could continue to operate but use an agreed set of common standards. National policy makers would then have the option to offer conditional incentives to greatly increase the take-up of these schemes, with individual landlords retaining the ability to join any recognised scheme of their choosing.

We have identified a number of options for policy makers to link conditional incentives to a new national framework for accreditation. These include the following, each of which is discussed in more detail below:

- changes to the 'allowable expenses' that private landlords can claim for income tax purposes
- eligibility for capital gains tax rollover relief
- incentives delivered through the welfare system, particularly to encourage landlords to house tenants in receipt of housing benefit.

Allowable expenses

Allowable expenses are costs incurred by landlords that can be deducted from any profit they make from letting their homes before their tax liability is calculated. They include things like mortgage interest, letting agent fees, building and contents insurance and the cost of making repairs to their properties. At present allowable expenses are offered unconditionally and do not reward those landlords who maintain and manage their properties to a higher standard.

Furthermore while the costs of repairs can be deducted as allowable expenses, improvements are treated as a capital investment and are instead deducted from the landlord's capital gains tax liability at the point where they sell the property. This means that there is a much less immediate benefit for the landlord, in terms of their tax liability, from this kind of investment. There can also be some confusion about whether a particular piece of work should be categorised as a 'repair' or as an 'improvement'.

We recommend that government should consider adding an element of conditionality to the way in which allowable expenses for repairs and maintenance are calculated. This could be achieved in any of a number of ways:

- by allowing accredited landlords to deduct an amount in excess of their actual costs, at a cost to the Treasury
- by allowing unaccredited landlords to only deduct a proportion of their costs, perhaps a more punitive approach but one which would increase the revenue collected by the Treasury
- through a combination of the two, so that at least some of the tax revenue lost from accredited landlords is off-set by increased returns from those who are unaccredited.

For clarity and to allow landlords to benefit more immediately from a commitment to improve their properties, we also recommend that the government specify that the cost of any improvements that are needed to bring a home up to accreditation standard should be treated as an allowable expense. This change would benefit both small and large scale landlords.

Capital gains tax rollover relief

At present private landlords are required to pay capital gains tax on any profit made on their original investment when they sell one of their properties. In similar circumstances businesses which are 'trading' are allowed to 'rollover' this capital gain on the sale of a property used in the trade. This means that if the proceeds from the sale are immediately reinvested in another area of their business they defer the payment of capital gains tax. Individual landlords also do not benefit from indexation allowance on their gains, in contrast to corporate landlords.

We recommend that private landlords who commit to higher standards are allowed to benefit from rollover relief as part of a 'something for something' deal to boost the take up of accreditation services. Although this would result in a deferral of revenue for the Treasury, it would also help to establish a valuable principle that landlords who commit to high property standards and a professional approach to housing management should be treated in the same way as other businesses by the tax system.

We suggest adopting a system whereby the proportion of the gain which benefits from rollover relief is linked to the length of time for which the property has been rented out and the length of time for which the landlord has been accredited. Clearly it would not be beneficial to tenants if a landlord improved a property and secured accreditation just prior to selling it, and so this approach would encourage landlords to make improvements and seek accreditation early on.

We consider that this would be an attractive offer for many buy-to-let investors, who often generate most of the return on their investment through capital gains at the point of sale, rather than from the rental income from their properties. Rollover relief would support these landlords to more actively manage their assets over time, by selling individual properties and reinvesting the proceeds to release more regular capital gains. This could lead to higher levels of property 'churn' in the sector, potentially displacing tenants more frequently. However we consider that this can partly be mitigated by adopting the approach described above, which should encourage responsible management of assets over the long term rather than short term 'flipping' of properties.

However it should also be acknowledged that this offer may do less to encourage single property landlords, and particularly accidental landlords, to commit to higher standards as they are less likely to churn their portfolios in this way, and would therefore be less likely to benefit from this particular incentive.

Incentives delivered through the welfare system

Another option would be to build incentives into the welfare system. This could improve access to the PRS where landlords are otherwise unwilling to let homes to households in receipt of housing benefit.

There are already some examples of this approach working well at a local level. For example some individual authorities offer to 'fast track' housing benefit applications and/or to make payments directly to the landlord (with the tenant's consent) for those who sign up to their accreditation scheme. For example, Birmingham City Council pays housing benefit directly to landlords who house tenants through their Private Rented Access Service. To participate, landlords must also sign up to the Midland Landlord Accreditation Scheme.

Feedback suggests that these authorities are having some success in convincing more landlords to accept tenants who are in receipt of benefits. However as universal credit is rolled out, this approach will no longer be possible as responsibility for the administration of benefits will be centralised and will no longer be the responsibility of individual authorities. This will take some time, as the roll out of universal credit is not due to be completed until 2017 at the earliest, and so in the short/medium term authorities will be able to continue to offer incentives to landlords in this way.

Over the longer term, it would be possible to replicate this approach under universal credit if the Department for Works and Pensions (DWP) were to offer, with tenants' permission, to pay the housing element of universal credit directly to accredited landlords. Pragmatically, this option is quite attractive, given the success of locally administrated schemes based on the same approach and it would be likely to be popular with both tenants and landlords. However it would seem to undermine one of the fundamental principles of universal credit – that it is paid directly to the tenant as a single, monthly payment to encourage personal responsibility and financial independence – and as such may be unacceptable to policy makers. Of equal importance is the fact that it would also risk worsening the situation for vulnerable tenants of unaccredited landlords by excluding them from arrangements which are intended to promote tenancy sustainment.

Unconditional incentives

We have also identified a number of options for policy makers to offer incentives to all private landlords. These differ from the conditional incentives discussed above in that, rather than acting as 'carrots' to encourage landlords to enter into a 'something-for-something' deal by committing to higher standards, they are simply designed to encourage and reward particular behaviours among landlords. These include, specifically, making physical improvements to their properties and helping to address some of their common concerns around offering greater security to tenants and housing those in receipt of housing benefit.

The following measures are each discussed in more detail below:

- reviewing the options to revive the Green Deal
- allowing landlords to treat property improvements not funded by the Green Deal but that result in a higher standard assessment procedure (SAP) rating as an allowable expense
- supporting local authorities to offer increased provision of tenancy support services to PRS tenants and landlords.

Reviving the Green Deal

The Green Deal is an existing policy which sees the government cover the upfront cost of carrying out selected works to improve the energy efficiency of privately owned properties, including those which are owned and rented out by private landlords. The cost of the work is then repaid through a charge which is added to the property's energy bills.

Although the Green Deal is still supported by the government, there have been major problems in its implementation including many specifically relating to private landlords' ability to access it. The latest government figures show that to date only 3,000 homes have received, or are waiting to receive, work funded through the scheme. This is significantly short of the government's original target of 10,000 homes by the end of 2013.

Feedback from landlords suggests that the Green Deal is in principle an attractive offer which, if implemented successfully, could have a significant impact on property standards, including in the PRS. However at present it is failing to have a significant impact. Feedback from landlord organisations suggests that the delays and legal problems that their members have already experienced have affected their interest in the scheme and that, even if these were resolved, take-up is now likely to be much lower than they would originally have projected.

To address this, the government should now review the options to revive the Green Deal, including engaging with private landlords and landlord organisations to understand and address their concerns about the scheme.

Energy efficiency measures not covered by the Green Deal

Even under a revived Green Deal, not all energy efficiency measures would be eligible for funding through the scheme. It applies only to specific improvements and in circumstances where the savings delivered to utility bills would be greater than the charge that needs to be applied to them to repay the costs of the work (i.e. the occupant of the house must be better off as a result of the work, even once the cost of repayments are taken into account).

However we consider that landlords should also be encouraged to carry out other works to improve the energy efficiency of their properties. As such, we recommend that they should be allowed to treat any work not funded by the Green Deal, but which would result in an improved SAP rating (the standard method used for measuring the energy efficiency of properties, which is reported on Energy Performance Certificates) as an allowable expense for tax purposes. This means that landlords would be able to deduct the cost of the work from their income tax liability immediately, rather than deducting it from their capital gains tax liability at the point that they sell the property – essentially delivering a more immediate benefit to the landlord from their investment.

Improved availability of tenancy support services

Concerns about the likelihood of tenancy breakdown dissuade many landlords from offering longer tenancies and from accommodating households in receipt of housing benefit.

For tenants in the social sector a range of advice and tenancy sustainment services are often available to help address these issues and to reduce the risk of tenancies breaking down. Similarly many existing accreditation schemes also offer access to advice and support services, for both landlords and tenants, as a conditional incentive to encourage take up. However we consider that access to these services should be more widespread in order to benefit a greater number of tenants and to provide reassurance to landlords.

We therefore recommend that government considers the options to support and encourage local authorities to expand the provision of advice and tenancy sustainment services in the PRS for those who need them. This could include, if necessary, providing some ring-fenced funding to help individual authorities to properly resource this work.

To ensure efficient use of these resources, advice and support could be provided at the beginning of a new tenancy in a tailored and highly targeted manner - to those who are most likely to be at risk of tenancy breakdown, following a process of risk assessment. This might include, for example, those with a history of tenancy breakdown and those who are being housed in the PRS by a local authority homelessness team. In addition to this, there may be scope for individual providers of accreditation to offer access to a greater level of ongoing support, perhaps including mediation between landlords and tenants, as a conditional incentive to encourage sign up to their schemes.

SECTION 4 Conclusions and summary of recommendations

The PRS is growing and, as it expands, it is housing an increasingly diverse group of tenants, including a higher proportion of people across every income decile and a growing number of families with children. However there are still a range of challenges associated with the sector which need to be addressed. These include variable standards of property condition and housing management, concerns regarding affordability and some households' ability to access the sector and a growing demand from some tenants for greater levels of security than are currently on offer.

Addressing these challenges will require some clarification of basic legal minimum standards. However there are limits to how far legislation can go and risks associated with relying entirely on legislative/regulatory options when dealing with an extremely diverse sector, which is made up of a number of distinct sub-markets. We, therefore, think that a combination of a clearer and better enforced set of minimum legal standards and a stronger role for accreditation and incentives is required.

To achieve this, we recommend:

- **a review of the statutory minimum standards to which landlords are subject and the arrangements for enforcing them.** This should be aimed at ensuring that there is a single, easily understood set of minimum standards (covering both property conditions and housing management) for landlords and that sufficient resources are made available for enforcement to effectively tackle unscrupulous landlords
- **regulation of letting agents and an end to the practice of charging tenants fees for their services.** Regulation could most easily be achieved by extending the arrangements already in place to regulate estate agents to the lettings industry
- **the development of a nationally agreed set of standards for accreditation** (covering both property conditions and housing management). Accreditation could still be awarded and administered by a range of different bodies, however a nationally agreed set of standards would ensure greater consistency between them
- **greatly increasing the number of landlords who sign up to a recognised accreditation scheme by adding an element of conditionality to the tax relief currently available to landlords – a 'something for something' deal. Enhanced tax relief should be available to accredited landlords compared to**

those who remain unaccredited. This could include:

- giving accredited landlords a more generous allowance for allowable expenses (where landlords deduct the cost of repairs from their profits for income tax purposes), compared to unaccredited landlords
- allowing landlords to treat any improvement that is necessary to bring a property up to accreditation standard as an allowable expense (instead of deducting it from the landlords' capital gains tax liability at the point that they sell the property). This would mean that there would be a more immediate tax benefit for the landlord from this kind of investment
- allowing accredited landlords to benefit from capital gains tax rollover relief (meaning that if a rented property is sold and the proceeds are immediately reinvested in another, the landlord can defer the payment of capital gains tax on any profit they had made). We suggest adopting a system whereby the proportion of the gain which benefits from rollover relief is linked to the length of time for which the property has been rented out and the length of time for which the landlord has been accredited.

- **considering the options to offer 'unconditional incentives' to all private landlords to encourage them to make physical improvements to their properties and to help address concerns about security and access to the sector.** These could include:
  - reviewing the options to reinvigorate the Green Deal
  - allowing landlords to treat property improvements not funded by the Green Deal but that result in a higher SAP rating as an allowable expense
  - supporting, potentially by providing funding for, local authorities to increase their provision of basic tenancy support services to PRS tenants and landlords. These could be targeted at those at high risk of tenancy failure and provided at the beginning of a tenancy. Providers of accreditation schemes may also wish to supplement this by offering a higher level of ongoing support, where needed, to their accredited landlords.