in brief...

Successful caps on fees disprove the idea that it's unwise to meddle with free markets

Jan David Bakker and **Nikhil Datta** show how the success of a reform of letting agents' fees was partly due to their hidden nature.

Five years ago, the UK government enacted the first legislation regulating prices in the English rental market since the 1960s. The Tenant Fees Act 2019 didn't interfere with what landlords can charge tenants in rent, but targeted lettings agents instead.

Lettings agents are ubiquitous on British high streets. They provide services such as finding tenants for landlords and managing properties – especially important in a country where most rentals belong to small-time investors who are not professional landlords.

But there had long been concerns that agents were charging beyond what was considered a reasonable price. They had been frequently charging tenants in excess of £1,000 to secure a deal – or even higher by charging a month's rent upfront. Under the 2019 act, the maximum they could charge tenants for a rental deal became £50.

Around the world, people who set housing policy have been watching closely. Tampering with a rental market can have adverse consequences, and no one has attempted to target agents in this way before. Our research reveals for the first time how it has played out.

Rising rents have been one of the main reasons for the cost-of-living crisis, both in the UK and elsewhere, but intervening isn't as simple as you might think. Rental caps, for example, can lead to renters moving less often, because they lose their protection if they sign a lease elsewhere (Diamond et al, 2019; Mense et al, 2023). It can see more rental properties getting converted into owner-occupier homes and developers building fewer new rentals, which in turn can make it harder for prospective tenants to find a rental property.

The quality of rental properties can also fall because landlords have less money to spend on them, while the rents on any properties not covered by the cap tend to rise. This helps to explain why the Conservatives shied away from rental caps in the UK, and also why Labour is not introducing them in its current Renters' Rights Bill.

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UK governments have instead sought to make it easier for tenants to become homeowners, such as with right to buy, help to buy and stamp duty exemptions for first-time buyers. Yet these have also produced mixed results.

Help to Buy, for example, which ran during most of the recent Conservative era, increased prices by more than the value of the subsidy and did not increase the amount of housing in supply-constrained areas (House of Lords, 2022). Time will tell whether Labour's plans to build 1.5 million more houses will be any more successful.

So how has targeting lettings agents worked out? Economics 101 suggests that in markets with a lot of competition, governments don't need to intervene as prices should be low and quality high. There are certainly lots of letting agents in the UK, so one might have thought that agency fees simply reflected the costs they incurred for their service.

Before the 2019 act came into force, this prompted some commentators to worry that agents would instead charge landlords more, who would then pass on the cost to their tenants with higher rents. For example, Capital Economics predicted that either rents would increase by an average £103 per year, or up to 16,000 agency jobs would be at risk in the sector to cover the cost.

In fact, our five years of research show that the policy did not lead to higher rents. Some letting agents increased the fees they charged to landlords, passing on some 25% of their reduction in revenues. This led to some landlords switching letting agent, but far less than you would expect in a competitive market.

We also found no evidence of landlords leaving the market, or of agencies closing down. The main effect of capping agent fees has been to save renters an average of £400 per tenancy. In other words, the reform has been a success.

So why were there no adverse consequences? The key lies in three features of the rental market. Tenants don't seem to pay attention to fees when selecting a property, possibly because they're often hidden in the depths of agents' websites and not easy to understand. In many cases, tenants only learn about how much they have to pay after having chosen a property and when signing the contract.

On the other hand, tenants are heavily influenced by rental prices, making it harder for landlords to pass increased fees on to them. And competition among letting agents is such that it only allowed them to pass on a fraction of their losses.

This all has important implications for other jurisdictions. Notably, New York City Council has passed similar legislation, in a city where brokers' fees can be as high as 20% of the annual rent.

These types of "dripped" fees that consumers only discover after making their purchase are also common across many industries, including air travel, concert tickets and Airbnb rentals. The UK recently passed a Digital Markets, Competition and Consumers Act, which will require vendors and agents to make all fees clear upfront, while the Biden-Harris administration has introduced something similar in the United States, where these have been dubbed "junk fees" by Joe Biden.

Our findings in the UK tenants' market suggest that these generate bumper profits for companies. Banning them elsewhere or in other sectors is likely to have a comparably beneficial effect. The lesson for those in government is that a market's structure, and situations where information is initially hidden from customers, can sometimes give policymakers more headroom to intervene than basic free-market assumptions might suggest.

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Further reading

Rebecca Diamond, Tim McQuade and Franklin Qian (2019) 'The Effects of Rent Control Expansion on Tenants, Landlords, and Inequality: Evidence from San Francisco', *American Economic Review* 109 (9): 3365–94.

House of Lords Built Environment Committee (2022) 'Meeting Housing Demand'.

Andreas Mense, Claus Michelsen and Konstantin Kholodilin (2023) 'Rent Control, Market Segmentation, and Misallocation: Causal Evidence from a Large-Scale Policy Intervention', *Journal of Urban Economics* 134: 103513.