

## **Explanatory Memorandum to the Assured Tenancies (Amendment of Rental Threshold) (Wales) Order 2011**

This Explanatory Memorandum has been prepared by Housing and Communities Policy Team of the Housing Directorate and is laid before the National Assembly for Wales in conjunction with the above subordinate legislation and in accordance with Standing Order 27.1.

### **Minister's Declaration**

In my view, this Explanatory Memorandum gives a fair and reasonable view of the expected impact of the Assured Tenancies (Amendment of Rental Threshold) (Wales) Order 2011.

**Huw Lewis AM – Minister for Housing, Regeneration and Heritage**

**2 June 2011**

## **1. Description**

- 1.1 This order raises the annual rental threshold for assured tenancies (including assured shorthold tenancies) from £25,000 to £100,000. Tenancies above the threshold cannot be assured.

## **2. Matters of special interest to the Constitutional Affairs Committee**

- 2.1 None.

## **3. Legislative background**

- 3.1 The Housing Act 1988 (“The 1988 Act”) introduced assured tenancies, a new type of tenancy to be used for both private sector and housing association residential tenancies in England and Wales from 15 January 1989. The Act provides that all tenancies take the form of assured tenancies or assured shorthold tenancies unless they come within one of the exceptions set out in Schedule 1 to the Act. As originally enacted tenanted dwellings with high rateable values (£1,500 in Greater London and £750 elsewhere) could not be let under assured tenancies.
- 3.2 Following the abolition of domestic rates, the References to Rating (Housing) Regulations 1990 (S.I. 1990/434) replaced the rateable values with a single annual rental threshold of £25,000. Tenancies entered into on or after 1<sup>st</sup> April 1990 with annual rents above the threshold could not be assured or shorthold tenancies. The regulations also inserted section 1(2A) into the 1988 Act, which permitted the Secretary of State to replace the threshold amount by order. The order is to be made using the negative procedure. The functions of the Secretary of State have been transferred to Welsh Ministers so far as exercisable in relation to Wales. This threshold was increased to £100,000 in England on 1<sup>st</sup> October 2010.
- 3.3 The Housing Act 2004 made provision for a tenancy deposit scheme for the purposes of safeguarding tenancy deposits. Landlords of assured shorthold tenancies entered into on or after 6<sup>th</sup> April 2007 must protect their tenants’ deposits in a recognised tenancy deposit scheme.

## **4. Purpose and intended effect of the legislation**

- 4.1 The annual rental threshold is being raised because tenancies that would benefit from the protection of the legislation, such as letting of shared houses to students, run the risk of being excluded from being assured tenancies because, although their rent is not exceptionally high by today’s standards, it is above the threshold.
- 4.2 The rental threshold was originally introduced because, historically, tenancies with very high or very low rents have been excluded from the legislation. It was considered that tenants paying very high rents did not need statutory protection. An annual rent of £25,000 equates to a

calendar monthly rent of about £2,083 or a weekly rent of about £480. In 1990, a rent of £25,000 per year would have been considered very high and would only have been achievable by a very small number of properties at the very top end of the market.

4.3 The effect of the rental limit is that tenancies for which the rent is above the threshold are not assured tenancies and therefore not governed by the provisions of the 1988 Act. Such a tenancy continues to be a tenancy, but is outside the scope of the Act. Therefore, it would be regarded as a common-law tenancy and would be governed by the terms of the contract (if one was agreed) and any relevant common law requirements.

4.4 One effect of this is that the tenancy can be ended by a notice to quit without the landlord giving any reason. Long-term security of tenure is not such a significant issue for shorthold tenancies, as a landlord can normally seek possession after the initial six months of the tenancy or at the end of any longer fixed term agreed with the tenant without having to provide a specific reason for possession (known as 'notice-only' possession). However, the landlord must still give the tenant two months notice. If the rent level breaches the threshold, the tenant loses this protection.

4.5 In addition, a number of important tenant or landlord benefits have been tied to the use of shorthold tenancies and these are at risk of not applying as intended where rents breach the threshold:

- *Tenancy deposit protection* – this applies only to assured shorthold tenancies. The legislation was applied specifically to assured shorthold tenancies as these are used by the vast majority of private landlords and enable effective penalties to apply (failure to protect a deposit results in loss of ability to use 'notice-only' possession).
- *HMO and selective licensing* – similarly, where a landlord fails to comply with a requirement to obtain a licence, they cannot seek 'notice-only' possession.
- *Accelerated possession* – for shorthold tenancies where 'notice-only' possession is sought landlords may use an accelerated possession procedure as opposed to the ordinary possession route. This can significantly speed up the time taken to obtain an order for possession as the case may be dealt with without the need for a court hearing.

4.6 Now that an annual rent of £25,000 is not so unusual, particularly where groups of sharers such as students sign up to a joint tenancy, many tenancies that would have traditionally benefitted from the protection of the legislation now fall outside its scope. There has been no concerted campaign in Wales to raise the threshold to date. However, the vast majority of persons calling for the threshold to be raised, and for parity with England to be introduced, have been from Student groups, particularly NUS Wales.

- 4.7 The review of the private rented sector in England, carried out by Julie Rugg and David Rhodes of the Centre for Housing Policy at the University of York in 2008 (the Rugg Review) reported that there was strong support from the stakeholders they consulted, for a change to the threshold and quoted the figure of £52,000 as a more appropriate one. The Welsh Government consulted on a package of measures relating to the private rented sector including this proposal in February 2010 and the majority of respondents to the consultation exercise supported the idea of raising the threshold.
- 4.8 Raising the threshold to £100,000 brings all tenancies, except those with the very highest rents, under the protection of the 1988 Act and restores the position intended in the original legislation, to exclude only the tenancies at the very top end of the market. It also means that the threshold will not need to be reviewed again for several years.
- 4.9 The new rental threshold will affect the existing rights of those landlords and tenants with existing tenancy agreements. We consider the proposed increase in rental threshold is prospective rather than retrospective because it will not affect the rights of tenants and landlords prior to its commencement. The new threshold comes into force on 1<sup>st</sup> December 2011 giving existing landlords an opportunity to prepare for the change.
- 4.10 The new threshold may have an effect on a few tenancies entered into between the commencement of the Housing Act 1988 on 15 January 1989 and the commencement of the Housing Act 1996 on 27 February 1997, which were not then assured because the rent was above £25,000 p.a. In the case of assured tenancies entered into before 28 February 1997, if landlords wished to grant an assured shorthold tenancy, they had to serve notice on the prospective tenants before the start of the tenancy. The notice procedure was contained in section 20 of the 1988 Act and thus only applied to assured tenancies. The s.20 notice informed the tenant, prior to commencement of his or her tenancy, that they were being granted an assured shorthold tenancy rather than a fully assured one.
- 4.11 If the tenancy was not assured because the rent exceeded the statutory threshold (then £25,000 p.a.) the procedure under s.20 would not have been applicable. However, when the threshold is raised those tenancies may become assured if the annual rent is less than £100,000. Because the tenants would not have been served notice under s.20 and entered into their tenancy agreements before the law changed on 28 February 1997, they will automatically become assured tenants rather than shorthold tenants. This means that a landlord will not be able to recover possession by giving two months notice, which is possible for landlords of assured shorthold tenants. It is anticipated that this will affect a very small number of tenancies, because the rent threshold applicable at the time was relatively high. In addition, the bulk of tenancies will be entered into after February 1997 and will automatically be assured shorthold tenancies (if they are not otherwise exempt).

4.12 The Housing Act 2004 made provision for a tenancy deposit scheme for the purposes of safeguarding tenants deposits. Landlords of assured shorthold tenancies entered into on or after 6<sup>th</sup> April 2007 must protect their tenants' deposits in a recognised tenancy deposit scheme. Landlords with existing common-law tenancies will become assured shorthold tenancies when the threshold is increased will not need to protect their tenants' deposits immediately, they will need to protect the deposit if the tenancy is renewed on or after the commencement date, or if a new deposit is taken on or after that date. Failure to comply with this requirement means a landlord will not be able to use notice-only possession to recover his or her property.

## **5. Application**

5.1 This instrument will apply in relation to Wales. The same change was made in England on 1<sup>st</sup> October 2010.

## **6. Consultation**

6.1 The proposal to raise the annual rental threshold for assured tenancies was consulted on in February 2010 as part of a wider consultation on proposed measures relating to the private rented sector. The majority of respondents supported the idea of raising the threshold and some suggested that the threshold should be abolished altogether.

## **7. Impact**

7.1 The impact on business, charities or voluntary bodies is likely to be very small. Landlords with tenancies that are affected by the change will benefit from being able to use standard forms under the 1988 Act rather than having to produce their own. It is acknowledged that there will be an impact on those landlords whose tenants will become assured or assured shorthold tenants. However, additional costs, such as those arising from the need to protect their tenants' deposits, will be administrative only as deposits can be protected at no cost.

7.2 The impact on the public sector is expected to be negligible as these tenancies are used by the private sector.

7.3 A Regulatory Impact Assessment has been prepared for this Instrument and is attached at Annex 1.

## **Regulatory Impact Assessment**

This Impact Assessment covers the proposal to increase the annual rental threshold for assured tenancies from £25,000 to £100,000.

### **1. Why is the legislation necessary ?**

1.1 Historically, tenancies with very high or very low rents have been excluded from the protection of the landlord and tenant legislation. The annual rental threshold for assured tenancies was set at £25,000 in 1990 and has not been revised since. While this, as intended, excluded only a very small number of tenancies at the very top end of the market in 1990, rents in interim have risen significantly. Tenancies that would benefit from the protection of the legislation may now be excluded. Thus the rationale is to address the issue of fairness in the private rented sector (PRS) to ensure that more tenants receive the protection of legislation.

### **2. What are the policy objectives and the intended effects?**

2.1 The main policy objective is to restore the position intended in the original legislation, to exclude only the tenancies at the very top end of the market. The effect would be to bring tenancies that would currently be excluded, under the protection of the Housing Act 1988 (as amended).

2.2 Rents above the current threshold of £25,000 are mainly found in London and the south east of England. It is estimated that less than a hundred properties will be affected in Wales. The majority of these will be joint tenancies between groups of students or house sharers. The proposed legislation is considered necessary to capture these few cases where they exist and prevent further properties being excluded as rents rise.

2.3 The threshold can only be raised through subordinate legislation. The proposed increase to the current threshold will ensure that further legislation will not be required for some time.

2.4 Raising the threshold to £100,000 will ensure consistency with the position in England where equivalent legislation was introduced in 2010.

### **3. What policy options have been considered?**

Option 1 - Do nothing.

Option 2 - Raise the threshold from £25,000 to £100,000

### Option 3 – Raising it higher than £100,000

- 3.1 The Review of the Private Rented Sector, carried out by Julie Rugg and David Rhodes in England (2008) was followed by a consultation by the Department of Communities and Local Government on a range of issues raised in the report. That consultation included a further option to increase the threshold to £52,000 as suggested in the Rugg report. Whilst some respondents supported this option over raising to £100,000, the Government opted to go for the higher figure as there was considered to be little difference in impact between the two figures.

Doing nothing is not considered a viable option, we have already been approached by several Student Union groups because their members in Wales are at a disadvantage to those in England. There is no justification for different treatment, especially when the same legislation applies to other elements of their tenure. So having decided that something needs to be done, the next question was how far to go.

On the basis that there is no case for treating Welsh tenants any differently from those in England, there is no evidence that we need to raise the threshold any higher than £100,000. Proportionately far fewer tenants will be affected in Wales anyway and there will not be many (if any) tenants paying above £100,000 in rental each year. Therefore, in Wales, only the £100,000 option is considered to be the only viable option. Raising the threshold to this level will maintain consistency with England, ensure tenants particularly students in Houses in Multiple Occupation, have the same level of protection and will give greater clarity to landlords who have properties on both sides of the border.

- 3.2 Abolishing the threshold would require primary legislation. Section 1(2A) of the Housing Act 1988 allows the Welsh Assembly Government to alter the threshold by Order. An enabling Statutory Instrument would be subject to negative resolution. Section 2A of the Act allows any 'amount' set out in Schedule 1 to be replaced by 'such amount as is specified in the order'. This means that a threshold must be retained but that the Government is free to propose any amount to replace the existing £25,000 annual threshold that it considers appropriate. To abolish the threshold was therefore not considered to be a practical option. For this reason it is proposed to revise the threshold as this would enable early implementation.

## **4. The case for review**

- 4.1 The rental threshold was originally introduced because, historically, tenancies with very high or very low rents have always been excluded from the legislation. It was considered that tenants paying very high rents did not need statutory protection. An annual rent of £25,000 equates to a calendar monthly rent of about £2,083 or a weekly rent of

about £480. In 1990, a rent of £25,000 per year would have been considered very high and would only have been achievable by a very small number of properties at the very top end of the market.

4.2 The effect of the rental limit is that tenancies for which the rent is above the threshold are no longer governed by the provisions of the Housing Act 1988. Such a tenancy continues to be a tenancy, but is outside the scope of the Act. Therefore, it would be regarded as a common law tenancy and would be governed by the terms of the contract (if one was agreed) and any relevant common law requirements. One effect of this is that the tenancy can be ended by notice to quit without regard to any of the grounds for possession in the Housing Act 1988.

4.3 While long term security of tenure is not such a significant issue for assured shorthold tenancies, as a landlord can normally seek possession after the initial six months of the tenancy or at the end of any longer fixed term agreed with the tenant without having to prove a specific grounds for possession (known as 'notice-only' possession), the landlord still has to give the tenant two months' notice. If the rent level breaches the threshold, the tenant loses this protection.

4.4 In addition, a number of important tenant/landlord benefits have been tied to use of assured shorthold tenancies and these are at risk of not applying as intended where rents breach the threshold and tenancies are no longer assured shortholds:

- *Tenancy deposit protection* - this applies only to assured shorthold tenancies. The legislation was applied specifically to assured shorthold tenancies as these are used by the vast majority of private landlords and enable effective penalties to apply (failure to protect a deposit results in loss of the ability to use 'notice-only' possession).
- *HMO and selective licensing* – similarly, where a landlord fails to comply with a requirement to obtain a licence, they cannot seek 'notice only' possessions
- *Accelerated possession* – for assured shorthold tenancies where 'notice-only' possession is sought landlords may use an accelerated possession procedure as opposed to the ordinary possession route. This can significantly speed up the time taken to obtain a possession notice as the case may be dealt without the need for a court hearing.

## 5. Pressure to change

5.1 The intention of the threshold was that only those tenancies at the very top end of the market should be affected and that the majority of private tenants should have the protection of the legislation. In the UK, an annual rent of £25,000 is not as unusual as it was in 1989, particularly where groups of sharers, particularly students, sign up to a



single tenancy, many tenancies that would have traditionally benefited from the protection of the legislation now fall outside its scope.

- 5.2 The Review of the Private Rented Sector, carried out by Julie Rugg and David Rhodes in England (2008) reported that there was strong support from the stakeholders they consulted for a change to this regulation.
- 5.3 In Wales there has been no campaign to date to raise the current threshold due to the small number of tenancies affected but students' groups, particularly NUS Wales, have supported the proposal for parity with England and the added protection for their members who will be affected.

## **6. Consultation**

- 6.1 In February 2010, the Housing Directorate issued a consultation entitled "The Private Sector in Wales". The consultation proposed a number of improvements for the sector including the proposal to increase the threshold for assured shorthold tenancies from £25,000 to £100,000. The consultation period closed on 14 May 2010.
- 6.2 A total of 42 responses were received to the consultation as a whole from the following sectors:
  - Local authorities and related organisations and groups – 12
  - Landlord/Letting Agent Organisations – 3
  - Tenant/Residents Organisations – 5
  - Other Representative Organisations – 16
  - Individuals – 6
- 6.3 The consultation included the specific question: *Do you agree that the threshold for Assured Shorthold Tenancies should be increased to £100,000?*

Twenty seven responses were received on this question. The majority (22) of respondents supported this proposal, although many pointed out that it had caused little problem in Wales as yet as very few properties exceeded the current threshold. However, most agreed that there was merit in mirroring the position in England.

- 6.4 Some respondents asked why there should be any upper limit at all, suggesting that the removal of such a limit would avoid the need for periodic reviews of any threshold. Alternatively, suggestions were made that any limit could be self adjusting and index linked to inflation to avoid keeping under review.

- 6.5 Another point highlighted was the need for a transitional period to allow landlords time to ensure that any of their tenancies affected would comply with Assured Shorthold Tenancies legislation.
- 6.6 Copies of the responses to the consultation can be found on the Welsh Assembly Government's web site at:  
<http://wales.gov.uk/consultations/housingcommunity/privaterentsector/?lang=en&status=closed>

## **7. Impact on Small Businesses**

The impact of introducing this legislation on business, charities or voluntary bodies is likely to be minimal. Most private landlords operate as individuals and do not employ staff.

## **8. Costs/Benefits**

- 8.1 The standard form of tenancy in the private rented sector is the assured shorthold tenancy which gives the landlord and tenant certain protections and obligations under the Housing Acts 1988, 1996 and 2004. If the tenancy is not an assured shorthold because it is above the rental threshold, a common law contractual tenancy will arise. While such a tenancy will not be covered by the Housing Acts, the tenant will still have statutory protection from eviction and the landlord will still have statutory repairing obligations etc under other legislation. In practice, therefore, there will be very little difference. The main significant difference is that tenancy deposit protection only applies to assured shorthold tenancies.

### **8.2 Costs**

- Protecting the deposit need not cost anything as the custodial version of the tenancy deposit protection scheme is free to use (and is, in any case, good practice).
- The landlords that have to protect the deposit will incur a cost in the form of the interest forgone on the deposit (if using the custodial scheme) or the fee to join the insurance based deposit protection scheme.
- They may also face administration costs of having to protect the deposit.
- Unaware landlords face a potential fine if they fail to protect the deposit, although the courts are likely to take a sympathetic view as the intention was not to catch landlords out.

### **8.3 Benefits**

- Bringing a tenancy within the threshold could reduce a landlord's costs. For example, the landlord would be able to use an off the shelf assured shorthold tenancy agreement, rather than having to devise their own contract.
- Also, with an assured shorthold tenancy, accelerated possession procedures can be used (without the need for a court hearing), while if a tenant fails to move out at the end of a contractual tenancy, this would normally need to be settled through the courts. Landlords would benefit from being able to use standard assured shorthold tenancy agreements and notices for possession etc and benefit from reduced void periods.
- Tenants would benefit in the knowledge that their deposit is protected by law. In addition they have the security of knowledge that they must receive a 2 month notice before eviction.
- The operators of the deposit protection schemes would see an increase in the volume of the deposits received as those landlords now encompassed by the threshold have to use their services.

### **9. Post Implementation Review**

The policy will be reviewed in 5 years.