

Tenancy Deposit Schemes

What is the tenancy deposit scheme?

The tenancy deposit scheme comes into force from 6 April 2007. Any deposit taken by a landlord who lets an assured shorthold tenancy after this date will have to safeguard the deposit using one of the government approved schemes.

What is the definition of a "deposit"?

"tenancy deposit", in relation to a shorthold tenancy, means any money intended to be held (by the landlord or otherwise) as security for-

- (a) the performance of any obligations of the tenant, or
 - (b) the discharge of any liability of his,
- arising under or in connection with the tenancy

Can I take something other than money for example a car, as a deposit?

No. No person may, in connection with a shorthold tenancy, require a deposit which consists of property other than money.

Does the tenancy deposit scheme apply to all tenancies?

No. It only applies to assured shorthold tenancies. Certain tenancies are excluded from being an assured shorthold tenancy for example if the rent is greater than £25,000 a year it cannot be an assured shorthold tenancy or if you are a resident landlord. It also does not apply to assured tenancies. This type of tenancy does not exist much these days but can be easily created, however the tenant will have security of tenure (i.e. you can never ask the tenant to leave except for one of the 17 grounds set out in the Housing Act 1988, for example rent arrears, breach of tenancy etc.)

Do the schemes apply to existing tenancies?

No. It only applies to new assured shorthold tenancies granted after the 6 April 2007.

If I renew my existing tenancy after 6 April 2007 will I have to comply with the scheme?

Yes. A renewal is regarded as a new tenancy and therefore you would have to comply with the scheme. You should never (in the opinion of the Guild) renew a tenancy; however it is probably now more important than ever not to. If you don't renew a tenancy, the tenancy will become a statutory periodic tenancy.

Can I put a clause in my tenancy to contract out of the scheme?

If I take a deposit what schemes are available?

- (1) A tenancy deposit scheme must be either—
 - (a) a custodial scheme, or
 - (b) an insurance scheme.

(2) A "custodial scheme" is a scheme under which-

- (a) tenancy deposits in connection with shorthold tenancies are paid to the landlords under the tenancies,
- (b) amounts representing the deposits are then paid by the landlords into a designated account held by the scheme administrator, and
- (c) those amounts are kept by the scheme administrator in that account until such time as, in accordance with the scheme, they fall to be paid (wholly or in part) to the landlords or tenants under the tenancies.

(3) An "insurance scheme" is a scheme under which-

- (a) tenancy deposits in connection with shorthold tenancies are paid to the landlords under the tenancies,
- (b) such deposits are retained by the landlords on the basis that, at the end of the tenancies-
 - (i) such amounts in respect of the deposits as are agreed between the tenants and the landlords will be repaid to the tenants, and
 - (ii) such amounts as the tenants request to be repaid to them and which are not so repaid will, in accordance with directions given by the scheme administrator, be paid into a designated account held by the scheme administrator,
- (c) amounts paid into that account are kept by the scheme administrator in the account until such time as, in accordance with the scheme; they fall to be paid (wholly or in part) to the landlords or tenants under the tenancies.
- (d) landlords undertake to reimburse the scheme administrator, in accordance with directions given by him, in respect of any amounts in respect of the deposits paid to the tenants by the scheme administrator (other than amounts paid to the tenants as mentioned in paragraph (c)), and insurance is maintained by the scheme administrator in respect of failures by landlords to comply with such directions.

Both schemes operate an alternative resolution service. Will it be compulsory to use the schemes ADR?

No, you may use the courts instead. The Guild suggests using the courts maybe a preferred method because the courts will be able to settle any dispute where amounts in question are greater than the deposit amount and also there is a good appeals procedure in the courts, whereas the schemes ADR has no appeal and their decision is "final and binding". It will probably be the best suggestion that if the amount in dispute is less than or equal to the deposit, use the schemes ADR, but if the amount owed to you is greater than the deposit, to use the courts instead.

If I get somebody else to pay the deposit for example the parents of the tenant, will it still fall under the schemes?

Yes. References to tenants under shorthold tenancies include references to persons who, in accordance with arrangements made with such tenants, have paid tenancy deposits on behalf of the tenants.

If I take a deposit and use one of the schemes, what procedures must I follow?

(3) Where a landlord receives a tenancy deposit in connection with a shorthold tenancy, the initial requirements of an authorised scheme must be complied with by the landlord in relation to the deposit within the period of 14 days beginning with the date on which it is *received*.

(4) For the purposes of this section "the initial requirements" of an authorised scheme are such requirements imposed by the scheme as fall to be complied with by a landlord on receiving such a tenancy deposit.

(5) A landlord who has received such a tenancy deposit must give the tenant and any relevant person such information relating to-

- (a) the authorised scheme applying to the deposit,
- (b) compliance by the landlord with the initial requirements of the scheme in relation to the deposit, and
- (c) the operation of provisions of this Chapter in relation to the deposit, as may be prescribed.

(6) The information required by subsection (5) must be given to the tenant and any relevant person-

- (a) in the prescribed form or in a form substantially to the same effect, and
- (b) within the period of 14 days beginning with the date on which the deposit is received by the landlord. [s213(3)-(6) HA 2004].

In addition to the above taken from the Housing Act 2004, a landlord will have to follow the rules and procedures of the scheme operators including prescribed information to be provided to tenants.

Above it states I can not ask for a deposit to be any property other than money. What is the definition of property?

"property" means moveable property; [s213(10) HA 2004]. In theory therefore you could ask for property that is not moveable for example a house, but that is unlikely to happen!

If I take a deposit but I fail to either notify the tenant of the necessary scheme details, or fail to place the deposit under one of the schemes, what are the penalties?

(1) Where a tenancy deposit has been paid in connection with a shorthold tenancy, the tenant or any relevant person (as defined by section 213(10)) may make an application to a county court on the grounds—

- (a) that the initial requirements of an authorised scheme (see section 213(4)) have not, or section 213(6)(a) has not, been complied with in relation to the deposit; or
- (b) that he has been notified by the landlord that a particular authorised scheme applies to the deposit but has been unable to obtain confirmation from the scheme administrator that the deposit is being held in accordance with the scheme.

(2) Subsections (3) and (4) apply if on such an application the court-

- (a) is satisfied that those requirements have not, or section 213(6)(a) has not, been complied with in relation to the deposit

OR

- (b) is not satisfied that the deposit is being held in accordance with an authorised scheme, as the case may be.

- (3) The court *must*, as it thinks fit, either-
 - (a) order the person who appears to the court to be holding the deposit to repay it to the applicant, or
 - (b) order that person to pay the deposit into the designated account held by the scheme administrator under an authorised custodial scheme, within the period of 14 days beginning with the date of the making of the order.

(4) *The court **must** also* order the landlord to pay to the applicant a sum of money equal to **three times** the amount of the deposit within the period of 14 days beginning with the date of the making of the order.

(5) Where any deposit given in connection with a shorthold tenancy could not be lawfully required as a result of section 213 the property in question is recoverable from the person holding it by the person by whom it was given as a deposit.

(6) (1) If a tenancy deposit has been paid in connection with a short hold tenancy, *no section 21 notice may be given in relation to the tenancy* at a time when-

- (a) the deposit is not being held in accordance with an authorised, scheme, or
- (b) the initial requirements of such a scheme have not been complied with in relation to the deposit.

Who runs the schemes?

The Government has awarded contracts to three companies to run tenancy deposit protection schemes from 6 April 2007. Computershare Investor Services PLC will run the single custodial deposit scheme, with the Chartered Institute of Arbitration providing the Alternative Dispute Resolution (ADR) service. The Dispute Service Limited will run an insurance-based scheme directed primarily at letting agents. It will also run the scheme ADR.

The National Landlords Association, in consortium with Hamilton Fraser Insurance, will also run an insurance-based scheme directed primarily at landlords. The Chartered Institute of Arbitrators will be the principal provider of ADR to the scheme.

Will inventories be mandatory?

No. However how else can the dispute resolution make a decision without one? (Including courts). It will now be much easier for a tenant to dispute a deposit and so is more likely to occur. The money is always the tenants, so the assumption is going to be that the tenant gets all the money back, unless the landlord can show different. In addition under the rules of one tenancy deposit scheme, it states that they may automatically return the deposit to the tenant if "There is either no check-in or no check out inventory" [rule 9.3.4 The dispute service].

Can I avoid the scheme?

Only by not taking a deposit or by granting an assured tenancy (*not an assured shorthold tenancy*). However there are also options available and this list seems to be growing as people come up with new ideas. The following suggestions are detailed below.

- ✓ **Grant an assured tenancy**
- ✓ **Take two months rent in advance**
- ✓ **Tenants discharge bonus**
- ✓ **Charge the tenant administration fees**
- ✓ **Guarantors**
- ✓ **Tenant vetting**
- ✓ **Credit cards**
- ✓ **Fake company let**
- ✓ **Insurance**

Grant an assured tenancy (may take a deposit)

The granting of an assured tenancy is relatively simple to do. A simple notice is required informing the tenant that the tenancy is to be an assured tenancy, not an assured shorthold. The guild provides an assured tenancy document and the appropriate notice (form no. 70 & 71). However, the landlord is unable to give the tenant the normal section 21 notice (two months notice) and therefore the tenant has security of tenure. A section 8 notice seeking possession may be served though on the 17 grounds provided within Schedule 2 of the Housing Act 1988. The most common of these are ground 12 (breach of tenancy) and 8,10 & 11 (rent arrears). If you are intending to let for a long period and are not worried about ever being able to get your property back by giving two months notice, this could easily be a viable option allowing you to take a deposit and not be governed by the tenancy deposit legislation. If you choose this method, it is essential to make the rent payable two calendar months in advance. See the "take two months rent in advance" and see the explanation for this under "advantages".

Take two months rent in advance (no deposit may be taken)

Again, another viable option, however there are a couple of downsides to this. Firstly, your agreement would have to specifically refer to the rent being payable two calendar months in advance and after receiving the first payment you would not then be able to claim the rent until the next two monthly payment was due (in two months time). It has been suggested that you could claim two months rent in advance then collect further rent monthly after one month into the tenancy. This would not be allowed and the months rent you would be holding in-hand would be regarded as a deposit. The second problem is when you want to issue a section 21 notice, the periods of the tenancy would be two monthly instead of monthly and therefore, you would effectively have only six opportunities in a year to expire a valid two months notice as opposed to twelve opportunities on a normal monthly tenancy.

Advantages

However, there is the advantage that if the tenant misses one payment by one day, you can immediately issue a section 8 notice on the basis of two months rent arrears, which is a mandatory possession case.

Also in law, where rent is payable in advance, the whole of the payment is due on the day that it becomes due. Therefore, if a tenant gave notice to vacate during a two month period, the landlord will in law be entitled to the full two months rent and therefore would not have to refund the tenant any rent if any were in hand. [Ellis v Rowbotham 1900 1 Q.B. 740].

Tenant discharge bonus (no deposit taken)

This is now fondly known as the '*kilvington*' clause due to the member of the guild who came up with the idea.

Included in the tenancy agreement could be a "tenant discharge bonus". Basically, the rent is increased by £20.00 per month, providing £240.00 per annum. There would then be a clause providing an incremental amount of bonus that would be paid to the tenant subject to of course, the property being left in a clean state, rent arrears etc. It could be at £10.00 per month the tenant is in occupation, with a cap on the amount of say £200 or £300 (or whatever).

Clearly it is crucial that the rent increase is in no way referred to as anything but rent and only you would know what the increase was. For example I have a property to let at £400.00 pcm but what was the rent two weeks ago?

The guild was slightly concerned about the rent increase element, as we believe you and I are getting the maximum amount of rent possible, however, as the tenant no longer has

to find a deposit on top of the last months rent, the initial layout of money is going to be considerably less, so we now think that a rent increase may be possible.

But is a "discharge bonus" legal? It is clear by the wording of the Housing Act 2004 that the definition of deposit means, "money intended to be held..." However it also includes the definition of "the discharge of any liabilities of (the tenant)". As the bonus is not intended to be held by a landlord then in theory, there is nothing wrong with this type of clause. But there is an incentive to "discharge" the tenant of his obligations and therefore we are very concerned that this would fall under the definition of deposit. The capped amount being the amount treated as the amount of deposit concerned.

The problem with this method is that one of the penalties for non compliance of the tenancy deposit scheme is that a landlord may not serve a section 21 notice, which will mean a notice could easily be defended as not being valid if the discharge bonus was shown to be a deposit under the Housing Act 2004, therefore the landlord would be unable to evict the tenants except for rent arrears, breach of tenancy etc. by using a notice seeking possession.

We are currently looking into the legal position of the discharge bonus (Kilvington clause) and will report on this soon with an absolute opinion.

Charge the tenant administration fees (no deposit taken)

This option is really only available if your deposits are quite low up to £300 - £400.00 and you have a number of properties, I would suggest 10 or more. Otherwise, other options like the custodial or insurance based schemes may be preferable.

This guidance is written on 7 February 2007, and at this stage, prices have not been fully announced for private landlords, however we are aware of the possible figure of £50 -£70 per property per annum for one of the insurance based schemes.

If you have 10 properties, with an average deposit of £300.00, you would have to pay £700.00 per annum to insure those deposits. Therefore, if a tenant stays just over 4 years, there was no point in taking a deposit because it has all gone in insurance premiums! It was never the landlord's money in the first place and even though after 4 years you have virtually no money left, you still have to pay out the £300.00 back to the tenant (Subject to rent and damages etc.) This amount is also similar to the amount you pay in buildings insurance to insure almost £1m worth of rebuilding costs! So why can't the landlord make his own insurance scheme? It is perfectly normal for landlords and agents to charge administration costs. The costs these would cover are production of the tenancy agreement; tenant vetting checks, guarantor checks, criminal record declarations, employer references, bank references etc. A little check on the Internet showed that a reasonable amount is around £180.

The same 10 properties based on an average of one tenant per year will produce the landlord with £1800.00 per annum, if you charged each tenant £180.00 when they take the tenancy. This money is non refundable as they are fees. The tenant is going to be willing and able to pay, because they won't have a deposit to fund, so their initial outlay has been reduced from £600-£700 down to around £480.

In addition to the fees, on a £300-£400 property, the landlord might well get an extra £20.00 per month additional rent, again this increase will be possible because the initial outlay the tenant needs to find has been greatly reduced by the lack of need for a deposit.

Let's now add that into the pot. £20.00 x 12 = £240.00 x 10 properties = £2400.00.

Guarantors

If you decide not to take a deposit, it is going to be crucial that a suitable guarantor is requested. There should be more tenants available which should make this job easier. You can see Guidance note 3 for full details on taking a guarantor.

Tenant Vetting

Again, like the requirement of a guarantor if you decide to no longer take deposits, it is going to be crucial to ensure you check the tenants more vigorously than ever before. The guild offers the tenant vetting service which is available at www.all4land-lords.com/tvs. This covers CCJ, bankruptcy and credit score amongst other things. Guidance note 1 explains more.

This gives a total in the pot of an approximate £4200.00 additional income to the landlord. The question now is, do you **Summary** lose £4200.00 in a year as a result of disputed deposits over 10 properties? Very rarely is a deposit not returned to a tenant, let alone disputed. Remember when considering this option you can't include any amounts over the deposit the tenant owes you because you should only compare like for like. For example I am sure out of those 10 properties, one tenant may well owe you £600-£700.00 in rent loss and damage, however for this calculation you can only consider the £300.00 deposit because the other you would have to claim for separately in any event.

Credit Cards

I recently had to hire a car and there, they didn't ask for a deposit but required my credit card details with a declaration that any costs incurred e.g. damage etc. could be taken from the credit card. There appears to be no reason why, instead of taking a deposit the landlord can't take the tenants credit card details and at the end of the tenancy deduct the damages and unpaid rent from the card. Obviously not all tenants will have a credit card but it may be worth asking the question. The advantages of this system are:

- Being able to rely on the credit checks undertaken by the credit card company
- Being an open ended payment rather than an amount of the deposit
- The amount is paid by the card company by them from the tenant.

Fake company lets

This suggestion is not a recommendation, but it will be interesting to see if "fake company lets" start appearing after the tenancy deposit legislation comes into force.

As only assured shorthold tenancies are covered by the legislation, in theory, the tenant could become a company, and then let the property as a company let. However, there is much case law on "sham" tenancies which I don't propose to go into now. Sufficient to say though that if it were proved to be a 'Sham' despite what the tenancy agreement said it was, it would be regarded as an assured shorthold tenancy.

Insurance

There are several companies available offering rent guarantee insurance, however at the moment they all require a deposit, so the legislation would still need to be followed. On a £695.00 per month property for six months insurance it can cost around £130.00 but remember this only insures effectively three months rent because the deposit and the first months rent is not covered.

Though the custodial scheme is free to use, our research shows that landlords are unlikely to want to hand over the cash to a government approved body, who will then decide whom gets the money back at the end of the tenancy if there is a dispute. Like all the schemes a good quality inventory with photographs and or video approved by all parties at the beginning of the tenancy will be crucial.

Which leaves the insurance method? The advantage of course being that the landlord retains the deposit and has control of negotiating with the tenant and therefore avoiding disputes more than is perhaps possible than with the custodial scheme. However there are what looks like relatively high cost implications for this method.

There is nothing in the regulations preventing landlords from re-claiming the costs of the premiums from the tenant, however, the fees are now looking likely to be annual recurring fees rather than a per deposit basis and therefore, it is more than likely that the tenant will simply say "please deduct those fees from my deposit". Therefore rendering the deposit useless and soaked up in fees. Clearly though, not all fees have been announced and they might not be as much as is being anticipated.

