

07/08/2008

Subject: Tenancy Deposit Schemes (TDS)

Article title: Understanding Tenancy Deposits

Quotation:

"Every revolution evaporates and leaves behind only the slime of a new bureaucracy."

Franz Kafka

Introduction:

This article will provide the reader with an overview of the tenancy deposit protection schemes which came into force on the 6th of April 2007 in England & Wales. It is designed to explain the schemes and critique their relevance, however, it is not designed to provide prescribed, one solution fits all advice. Readers must consult the terms and conditions of each scheme prior to becoming a member to satisfy themselves of the appropriateness of the scheme.

Key points about the Tenancy Deposit Schemes

- The Tenancy Deposit Schemes cover all Assured Shorthold Tenancies where a deposit is taken from 6th April 07.
- It is enforceable by law, with fines of up to three times the deposit, and a bar on using the s21 possession procedure
- There are two types of scheme: custodial and insurance based.
- You do not have to take a deposit from a new tenant, and there are other alternatives.
- Disputes over deposits are resolved via a tribunal or the County Court.
- It is important to use an inventory as evidence to support a claim.

Article

The tenancy deposit scheme (TDS) was introduced in England and Wales on the 6th of April 2007 to protect the deposits of all tenants renting a property on an Assured Shorthold Tenancy¹ (AST). The scheme was designed to provide a fairer way of settling disputes about the return of tenancy deposits. ASTs started before this date and non shorthold tenancies are not subject to the tenancy deposit schemes, only new tenancies created from the 6th of April 2007 are covered.

What is a deposit?

When explaining the TDS it is essential that landlords understand what the legislation defines as a deposit. The Section 213 (8) of the 2004 Housing Act defines a deposit as “a transfer of property 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”. Deposits can only be taken in the form of money, no goods equivalent can be taken, for example, you can not take a tenant’s car or watch as a deposit. The deposit can be provided by anyone on the tenant’s behalf and all are subject to the TDS.

Which types of tenancies are affected?

The TDS only covers ASTs which commenced on or after the 6th of April 2007.

Tenancies which are not covered by this new legislation include:

- Lets to companies
- An owner occupier letting part of their house having served a Ground 1 Notice. A ground one notice applies to properties previously occupied by the landlord or

¹ Link to landlordzone article on ASTs

their spouse as their only, or principle home at some point. The ground one notice signals their intention to return to the property.

- Assured tenancies.
- If the rent charged is in excess of £25,000 per annum.
- Holiday lets
- If a holiday property is let for a holiday and subsequently an out of season holiday let is agreed, provided a Ground 3 Notice is given. A ground three notice applies to premises that have been used as a holiday let within the last 12 months and have subsequently been let on a fixed term for up to 8 months. Notice must be served that the property will be returned to holiday let use.
- If the tenant (or at least one in the case of a joint tenancy) do not occupy the property as their only or main home.

What are the penalties for not protecting a deposit?

The new deposits schemes are supported by legislation². Landlords and agents who have taken a deposit and not protected it within one of the schemes or who have not provided the prescribed information are vulnerable to fines of up to three times the amount of the deposit via the County Court.

The County Court has the power to rule the landlord must protect the deposit via one of the Tenancy deposit schemes. If the landlord does not protect the deposit within 14 days of this ruling, or, provide the prescribed information, the court can order the landlord to pay the tenant three times the amount of the deposit.

One of the greatest penalties for not protecting a tenant's deposit is relinquishing the automatic right to regain possession of the property using the section 21 procedure.

Types of Tenancy Deposit scheme and their providers

² Housing Act 2004: Chapter 4 Tenancy Deposit Schemes

There are 2 types of deposit protection scheme, the custodial scheme and the insurance-based scheme. These schemes replace any voluntary schemes that were in force prior to the 6th of April 2007. The landlord or agent is allowed to choose which of the schemes to use. The next part of this section will outline each type of deposit schemes.

Scheme Name	<i>The Deposit Protection Service</i>	<i>Tenancy Deposit Solutions Ltd now known as MyDeposits</i>	<i>The Tenancy Deposit Scheme</i>
Scheme Type	Custodial	Insurance based	Insurance based
Scheme Provider	The Deposit Protection Service	Tenancy Deposit Solutions Ltd	The Tenancy Deposit Scheme
Website	www.depositprotection.com/	http://www.mydeposits.co.uk/	http://www.thedisputeservice.co.uk/
Telephone Number	0870 707 1 707	0871 703 0552	0845 226 7837
Cost to join	Free	£58.75 or £20.00 National Landlords Association (NLA)members (inc VAT)	N/A as focused on agents rather than landlords.
Annual Fee	Free	£14.70	N/A as focused on agents rather than landlords.
Charge to hold a tenant's deposit	Free	£30 or £20 NLA members	N/A as focused on agents rather than landlords.
Can the landlord retain the deposit?	No – paid to the DPS within 14 days of taking the deposit	Yes	Yes
Open to everyone?	See Scheme eligibility criteria in Terms and Conditions.	See Scheme eligibility criteria in Terms and Conditions.	Open to landlords but focused on agents. See Scheme eligibility criteria in Terms and Conditions.
Administered online?	Yes	Yes	Yes
Paper forms available?	Yes	Yes	Yes - £5 (exc VAT) if data submitted on paper
Call Centre Support?	Yes	Yes	Yes
Methods of returning the deposit	Cheque or electronically (BACS)	At the discretion of the landlord	At the discretion of the landlord

Table 1: Comparisons of Tenancy Deposit Scheme providers

The custodial scheme has only one provider; The Deposit Protection Service³ (The DPS). The DPS is free to use and open to all. It is funded entirely from the interest earned from the deposits held. The scheme is administered and run online, with paper documents available should they be required.

The Insurance based schemes are run by two providers, Tenancy Deposit Solutions Ltd (TDSL) (now known as MyDeposits) and The Tenancy Deposit Scheme (The TDS). Landlords or agents can hold the deposit on the purchase of an insurance premium from one of the two schemes. Both schemes are funded through this premium. TDSL is a partnership between the National Landlords Association and Hamilton Fraser Insurance. The TDS is run by The Dispute Service and builds on a scheme established in 2003 to provide dispute resolution and complaints handling for the lettings industry and is aimed at letting agents rather than landlords. Table one provides a quick reference comparison of the three schemes.

How the Tenancy Deposit Schemes work

This section aims to outline the process of receiving a deposit from a tenant and paying it into one of the schemes. It gives a general overview of the way the schemes operate. Figure 1 illustrates a simplified process of using a tenancy deposit scheme, more detailed information can be obtained from each scheme.

Disputes over the deposit

As a landlord or agent you are only allowed to withhold the deposit if you can show you have incurred a financial loss as a result of the tenant's actions, for example, if the tenant has damaged the property or not paid part of the rent. If you and the tenant can not agree on the amount to be withheld the dispute will move to the Alternative Dispute Resolution (ADR) service of the TDS provider. If you, or the tenant does not agree to use the ADR

³ The Deposit Protection Service www.depositprotection.com

07/08/2008

or have missed the deadline for submission of information to the ADR service, the dispute will usually go to the County Court. Pursuing a claim through the County Courts is likely to take longer and be more expensive when compared to each scheme's ADR.

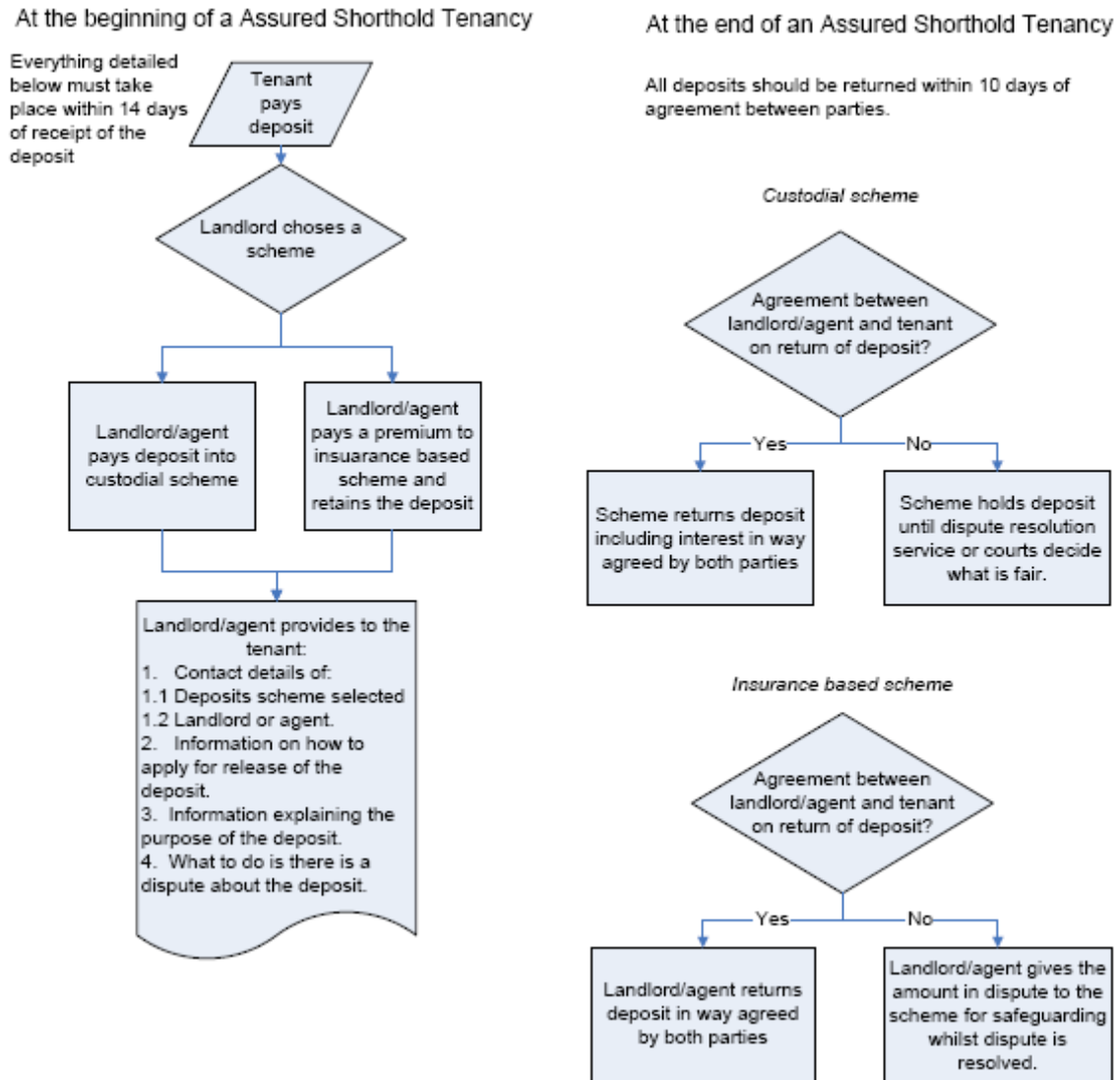


Figure 1: The simplified process of using a Tenancy Deposit Scheme

As the rent must be below £25,000 for it to qualify for an assured shorthold tenancy and the deposit is likely to be approximately six weeks rent, there is a high probability that the amounts will be small enough to be dealt with through the small claims court. If you

07/08/2008

use the ADR, you and the tenant both agree to accept its decision and will not be able to apply to the courts after the decision has been made.

In any dispute you will be required to submit evidence to support your claims of how the tenant has caused you financial loss, including any justification of the costs associated with that loss (repairs, cost of recovering rent). This makes the use of an inventory⁴ essential.

An inventory details the condition of any furniture or fittings within the property at the start and end of the tenancy. Ideally, an inventory should be supported by photographic or video evidence acknowledged and signed by the tenant(s). Such information will increase the likelihood of a landlord or agent winning their dispute. Always ensure the inventory is signed by you as the landlord or agent and the tenant, showing you both agree to what has been documented.

In the insurance backed schemes the landlord or agent must hand over the disputed amount to the scheme until the dispute is resolved. Once a decision has been made by the ADR or the County Court the scheme will distribute the amounts in accordance with this ruling. If the landlord or agent fails to pay the disputed money to the scheme, the scheme will pay the money to the tenant in accordance to the ruling of the ADR or the County Court. The scheme will then look to recover the amount from the landlord or agent.

Unlike the insurance backed schemes, the custodial scheme will continue to hold the whole of the deposit until the ADR or County Court has made a judgement. More details on this process can be found in the landlordzone article, “The Tenancy Deposit Scheme 12 months on....”.

⁴ example inventories can be found here <http://www.landlordzone.co.uk/agreements.htm>

07/08/2008

Returning the tenant's deposit

If there are no disputes over the deposit, the deposit should be returned in a maximum of 10 working days. In the case of the custodial scheme, the scheme will return the funds to the tenant electronically or by cheque. This means money can only be returned to tenants who have bank accounts. However, under the insurance backed schemes the form in which the deposit is returned will be at the discretion of the landlord.

Which scheme is better for the landlord?

This section aims to provide guidance on ways to determine which scheme to use. Due to the diverse ways in which landlords and lettings agencies run their businesses only general guidance can be provided here.

Factors to consider when choosing a scheme:

1. Do the majority of your tenants have bank accounts?
2. Do you feel the premium paid will afford you greater advantages than paying the whole deposit to the custodial scheme?

If you are a letting agent or landlord taking a large amount of deposits then it is probable the insurance scheme would be the most appropriate, however, there are alternatives which will be discussed in the next section.

07/08/2008

Alternatives to taking a deposit?

There are five alternatives to the insurance based tenancy deposit scheme, these are:

1. The custodial scheme.
2. Not taking a deposit.
3. Not taking a deposit and increasing the rent.
4. Not taking a deposit but charging 2 months' rent in advance.
5. Using an insurance policy such as tenant guarantee⁵.

An analysis of the advantages and disadvantages of the alternatives to the insurance based scheme are shown in table 2.

Alternatives 1 to 3 have either been explained or are relatively self explanatory, so this next section will briefly outline the idea of the tenant guarantee and the requirement for the tenant to pay two months rent in advance.

Two months rent in advance

A method of taking two months rent in advance is designed to give added security in the event of a tenant defaulting on their rent payment without the need to take a deposit. However, the two months advance rent must be used for rent, not for security for rent.

⁵ Tenant Guarantee web page <http://www.tenantguarantee.com/>

Scheme	Cost	Risk	Advantages	Disadvantages
<i>Custodial scheme.</i>	0	low	<ul style="list-style-type: none"> • Backed by the government • Protected against damage to property and loss of rent. • Free. 	<ul style="list-style-type: none"> • Bureaucracy. • Time consuming. • Complicated.
<i>Not taking a deposit.</i>	0	high	<ul style="list-style-type: none"> • No bureaucracy. • Simple. • Free. • Increase attractiveness to tenants 	<ul style="list-style-type: none"> • No protection against lost rent and damage to the property.
<i>Not taking a deposit and increasing the rent.</i>	0	medium	<ul style="list-style-type: none"> • No bureaucracy. • Simple. • Free. • Increase activeness to tenants 	<ul style="list-style-type: none"> • No protection against lost rent and damage to the property. • Debt may deter tenants
<i>Not taking a deposit but charging 2 months rent in advance.</i>	0	medium	<ul style="list-style-type: none"> • Relatively simple. • Free. • Increase activeness to tenants 	<ul style="list-style-type: none"> • Complicated – need an appropriate tenancy agreement. • Risk of breaking the law if not done correctly. • No protection against lost rent and damage to the property.
<i>Insurance policy e.g. Tenant guarantee⁶.</i>	Insurance premium	low	<ul style="list-style-type: none"> • Relatively simple. • Protected against damage to property and loss of rent. • Increase activeness to tenants 	<ul style="list-style-type: none"> • Cost – although this could be passed to the tenant. • Complicated.

Table 2: Advantages and disadvantages of the alternatives to the insurance based scheme

⁶ Tenant Guarantee web page <http://www.tenantguarantee.com/>

07/08/2008

How this works

This method takes two months rent in advance instead of one. This technique means the landlord takes two months' rent payment in the first month and then subsequently takes the next month in advance, as usual. However, you will not receive the last months' rent, as you have effectively received it in advance.

The AST which supports this must be created carefully to ensure the advanced rent is not considered as security for rent (a deposit). The AST used must state clearly, dates and amounts payable and that the advanced rent payments are made in respect of rent, not the security of rent.

Tenant guarantee

The tenant guarantee service is an insurance backed scheme that allows the landlord to pay an insurance premium (around £100) to get up to £2,500 in cover against a tenant breaching the terms of an AST, for example not paying rent or damaging the property or its contents.

The tenant must be checked using TenantVERIFY©⁷ as a condition of being granted the premium. The benefit of the tenant guarantee scheme is that landlord can offer it as an alternative to taking a deposit and can pass on the entire cost of the premium to the tenant or joint tenant.

Not taking a deposit and charging a relatively small fee for the insurance premium may make the property more attractive to tenants, as they do not have to have a large deposit. The disadvantage of using the scheme is the limit to the amount paid out by the scheme, as of the 24/04/08 this stood at £2,500 to cover breaches of the AST and £5,000 in legal cover. The insurance company will pursue the tenant separately to recover the costs of any claims. For more details on the scheme visit – www.tenantguarantee.com

⁷ TenantVERIFY© web page <http://www.tenantverify.co.uk/index.htm>

07/08/2008

Summary

The introduction of the tenancy deposit legislation has undoubtedly increased the bureaucratic and financial burden on the landlord. Whether this added bureaucracy and cost has increased the confidence of tenants that deposits will be returned is yet to be determined. In addition, whether the added costs to the landlord will ultimately be passed to the tenant is one that is to the discretion of the landlord and perversely, something that was identified to protect the tenant may actually cost them financially.

The custodial scheme is the only TDS that does not incur any financial costs, however, it does cost you in terms of opportunity costs, i.e. the opportunities that could be afforded by having an amount of money equivalent to the tenants deposit. This is why it is sensible for each landlord to use the scheme that suits their individual circumstances.

As ever, there are alternatives to taking a deposit, through the use of insurance policies and modifications to the way rent is paid. The choice of using or not using a scheme is dependent on individual circumstances but, is often complex and one that can not be considered inconsequential.

Author: Gary Wainman has been involved in property and letting for the past 4 years managing property lets and project managing refurbishments and complete renovations. Please do not hesitate to get in contact with Gary Wainman by visiting his website www.kandglettings.co.uk .

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07/08/2008

Related Links

Housing Act 2004:

http://www.opsi.gov.uk/ACTS/acts2004/ukpga_20040034_en_1

Housing Act 2004: Chapter 4 Tenancy Deposit Schemes

(http://www.opsi.gov.uk/ACTS/acts2004/ukpga_20040034_en_19#pt6-ch4)

The Deposit Protection Service <http://www.depositprotection.com>

Tenancy Deposit Solutions Ltd <http://www.mydeposits.co.uk>

The Tenancy Deposit Scheme <http://www.thedisputeservice.co.uk>

Inventory forms and other agreements <http://www.landlordzone.co.uk/agreements.htm>

TenantVERIFY® <http://www.tenantverify.co.uk/index.htm>

Tenant Guarantee web page <http://www.tenantguarantee.com/>

Residential Landlords Association: Tenancy Deposit scheme information

http://www.rla.org.uk/landlord/tenancy_deposits/

Directgov: Information on Tenancy Deposit Schemes

<http://www.direct.gov.uk/en/TenancyDeposit/index.htm>

“The Tenancy Deposit Schemes 12 months on ...” Dovar, B. & Walsh, M. (April 2008)

www.landlordzone.co.uk/pdf/TDS_12months_on.pdf

Grounds for Possession – AST

http://www.landlordzone.co.uk/grounds_for_possession.htm