

Tenancy Deposit Schemes

Introduction

The Housing Act 2004 ("the Act") contains provisions which for the first time will restrict the ability of landlords to hold deposits as security against breaches by tenants of the terms of their tenancy agreements.

Under Sections 212–215 of the Act, any tenancy deposit paid to a person in connection with an assured shorthold tenancy ("AST") must, as from the time when it is received, be dealt with in accordance with an authorised scheme set up for the purpose of safeguarding such deposits. The new provisions apply in relation to renewals of existing ASTs or grants of new ASTs from 6 April 2007.

The general sanctions for non-compliance with the requirements of the schemes are that the landlord may be prevented from recovering possession of its property from the tenant and may be ordered to pay a financial penalty.

Registered Social Landlords are not exempt from the new provisions and must comply in the same way as other landlords. However, it is important to note that only ASTs are covered and not assured or other types of tenancies.

Basics of the Proposed Scheme

Under the Act, a "tenancy deposit scheme" is a scheme which:-

- Is made to safeguard deposits paid in connection with ASTs
- To facilitate the resolution of disputes arising in connection with such deposits; and
- Is either:-
 - A custodial scheme; or
 - An insurance scheme

The scheme will come into force on 6th April 2007. From that date, it will be illegal to require the payment of a tenancy deposit in connection with an AST which is not protected by one of the two schemes. Where an AST was entered into before 6 April 2007 and has been continuing on a periodic basis with no new agreement, then membership of an authorised scheme will not be required. If an AST was entered into before 6 April 2007 and after the initial 6 month period has expired a new tenancy is agreed or renewed on substantially the same basis after 6 April 2007, then membership of an authorised scheme will be required.

A landlord will have to:-

- Deal with a deposit in accordance with an authorised scheme
- Comply with the initial requirements of a scheme within 14 days and

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- Give the tenant the prescribed information relating to the deposit within 14 days of receiving the deposit.

It is for the Landlord to decide what type of scheme to use.

Inventories of fixtures and fittings are not included in the list of prescribed information but Scheme Administrators may make them a compulsory requirement for their schemes. In any case, as well as being good practice for landlords, an inventory may be useful for resolving disputes.

Custodial Schemes

Under the first type of scheme, which is free for landlords to use, the landlord must within 14 days of receipt of the deposit pay the whole of it into a designated scheme account in the name of the Scheme Administrator. The deposit will not be paid out to either the tenant or landlord after the tenancy has ended, unless they agree how the sum should be split or a court has decided on the split.

Any interest on the designated account can be retained by the Scheme Administrator to fund the administration of the scheme. Otherwise, it is split between the landlord and the tenant on the same basis as the deposit is paid out.

Insurance-Based Schemes

Under the second type of scheme, the landlord retains the deposit but secures it by paying a fee and an insurance premium to the Scheme Administrator. The premiums are then used to pay the tenant if the landlord misappropriates the deposit.

Scheme Administrators

There are a limited number of Scheme Administrators: one for custodial schemes, one for insurance-based schemes aimed at landlords and one for insurance-based schemes aimed at letting agents.

The administrators are:-

- Custodial Schemes - The Deposit Protection Service Ltd (owned and administered by Computershare Investor Services).
- Insurance Schemes for Landlords - Tenancy Deposit Solutions Ltd (sponsored by The National Landlords Association and administered by Hamilton Fraser Insurance).
- Insurance Schemes for Letting Agents - Dispute Service Ltd.

Their contact details can be found via the Department for Communities and Local Government (DCLG) website.

Sanctions

If a landlord does not comply with the requirements of the Act, the landlord will be unable to regain possession of the property at the end of the term of the AST even though it is after the first six months of the tenancy and the landlord has served the usual two months written notice under Section 21 of the Housing Act 1988 requiring possession. Essentially, the notice will not be valid in the following situations:-

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- If a landlord has not arranged for a deposit to be held in accordance with an authorised scheme or the initial requirements imposed on the landlord under an authorised scheme have not been complied with.
- If the landlord has not provided the tenant or other relevant persons with the prescribed information within 14 days of receiving the deposit.
- If the deposit given by the tenant comprises property other than money.

In addition, the tenant can apply for a court order for the landlord to repay the deposit to that person or pay it into a custodial scheme. The court must also order the landlord to pay the applicant an amount equivalent to three times the deposit within 14 days.

If the deposit given by the tenant was property other than cash, then the property is recoverable from the person holding it by the person who gave it.

If a landlord has been unable to serve a valid Section 21 notice for any of the above reasons, if it remedies the position by complying with the relevant provisions of the Act, it will then be able to serve a valid notice.

There are additional sanctions which affect insurance-based schemes only. The Scheme Administrator can:-

- Require the landlord to pay the deposit as the Scheme Administrator directs.
- Pay the tenant the deposit that is properly due to be returned to the tenant and sue the landlord for that amount.
- Direct that the deposit will no longer be held under the insurance scheme.
- Direct that the landlord can no longer be a member of the insurance scheme.

In the last two cases, the landlord will, as a result, almost inevitably have to join the custodial scheme.

Dispute Resolution

The justification put forward by the former Office of the Deputy Prime Minister (now the DCLG) for these new rules was at least, in part, to provide the tenant with much greater “security of tenure.” Nevertheless, the regulations do recognise that there can be genuine disputes between landlords and tenants. A key feature of both types of scheme therefore is dispute resolution.

Both the custodial scheme and the insurance schemes are required to offer dispute resolution to tenants and landlords as an alternative to issuing court proceedings, but both the landlord and the tenant retain the right to go to court.

The DCLG has indicated that the dispute resolution service provided will be free of charge but it does not seem to be clear whether this service will be paid for out of the administration costs of the scheme or from Government funding. It is also unclear how broad the service will be so that, for example, a tenant wanting advice on the recoverability of a deposit may still have to pay for legal advice.

Alternatives

Landlords may seek alternatives to deposits to avoid these provisions. For example, a letter of guarantee where no money passes to the landlord is not covered.

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At least one company is offering landlords and letting agents such a service whereby it acts as guarantor for 2 months rent which pays out if the tenant fails to pay the rent or causes damage to the property. A fee is charged for this service which the landlord or letting agent may then be able to pass on to the tenant.

The future

At the time it sponsored the original legislation, the former ODPM promised to revisit provision for tenancy deposit protection in the context of the Law Commission's report '*Renting Homes*' and their draft Bill. Further radical change can therefore be expected.

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This briefing note is not intended to be an exhaustive statement of the law and should not be relied on as legal advice to be applied to any particular set of circumstances. Instead, it is intended to act as a brief introductory view of some of the legal considerations relevant to the subject in question.