

# RETHINKING TENANCY DEPOSITS

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**GENERATION RENT**  
The national voice of private renters

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# Executive summary

As the government moves to ban letting agent fees to private tenants, it has taken the opportunity to revisit issues surrounding the treatment of damage deposits, with a current proposal of capping these at six weeks' rent. With licences for insurance-based deposit protection schemes set to expire in the next couple of years, this is an excellent opportunity for the government to consider phasing them out and replace them with a more balanced and equitable system.

**This report examines the current state of the deposit protection system more broadly to identify any other changes that may be beneficial for both tenants and landlords. We identify several challenges with the current system that operates in England and Wales:**

- 1 Over £4bn of private tenants' money is currently held in damage deposits, serving no productive value to its owners over the duration of tenancies
- 2 Most of these funds are held by landlords and letting agents while being protected by insurance policies, effectively providing themselves a low-cost loan from tenants
- 3 Very few tenants receive any of the interest that accrues on their deposits, despite recent government efforts to promote this
- 4 The need to find a new deposit before getting the old one back in order to move home creates a large and often overwhelming upfront cost for tenants

The evidence in this paper shows that, as the pool of deposit funds grows (353% over the last nine years), the vast majority of tenants in Britain continue receive no interest on this large pool of capital which, for them is, effectively, a frozen zero-interest deposit. This lack of productivity of tenants' assets has prompted the development of schemes to replace the refundable deposit (which are net wealth-neutral for most responsible tenants) with non-refundable insurance policies

(which reduce the net wealth of most tenants). These 'zero-deposit' schemes create additional cost to tenants, with excessively high fees in return for only moderate coverage.

This paper proposes a different future for deposits: a modified version of the existing custodial deposit system where funds are held on the tenants' behalf, and actively managed by an accredited third party, with any net returns from those funds paid back to tenants at the conclusion of the tenancy, on top of the security deposit. This system would treat tenants' deposits as tenants' assets and give them a return, while reducing the administrative burden on letting agents and landlords that comes with holding and managing these funds. At the end of the tenancy the landlord would maintain the opportunity to make a claim for damage or unpaid rent and the tenant would have the chance to challenge such a claim.

A crucial element of the modified system would be to allow a portion of the deposit to be released by the landlord upon payment of the final month's rent, to allow the tenant to transfer it to a new tenancy. Alongside the ban on letting agent fees, this would further reduce the upfront costs of moving home and save tenants who lack savings from paying interest on loans or insurance premiums.

These proposals offer not only win-win opportunity for the government to improve the position of private renters, but would also make new funds available to invest in new homes, benefiting wider society.

# Background

At the outset of a traditional private tenancy, tenants will typically pay a sum of cash to landlords or letting agents as a security deposit to cover the cost of replacing or repairing items damaged by the tenant during the course of the tenancy, or to cover any rent arrears at the end of the tenancy. According to the 2014/15 English Housing Survey (EHS), 74% of private tenants paid such a deposit (also known as a damage deposit, or bond).<sup>1</sup>

In 2004, the UK government passed a Housing Act which mandated the creation of tenancy deposit protection schemes in order to provide an independent third party responsible for overseeing deposits. Under this Act, landlords in England and Wales would be required to protect deposits (for tenancies with an annual rent of up to £100,000) in government-authorised schemes. The legislation came into force in April 2007 and was a big step forward for the growing population of renters, creating a framework for tenants and landlords to ensure an impartial process with full reimbursement of any funds due to their rightful recipients at the end of a tenancy.

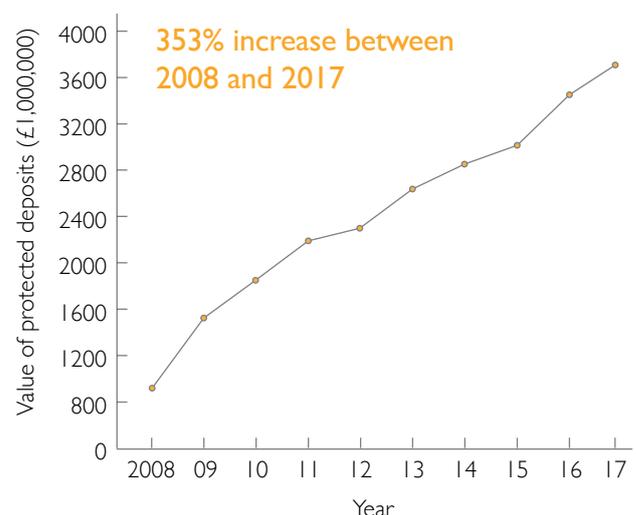
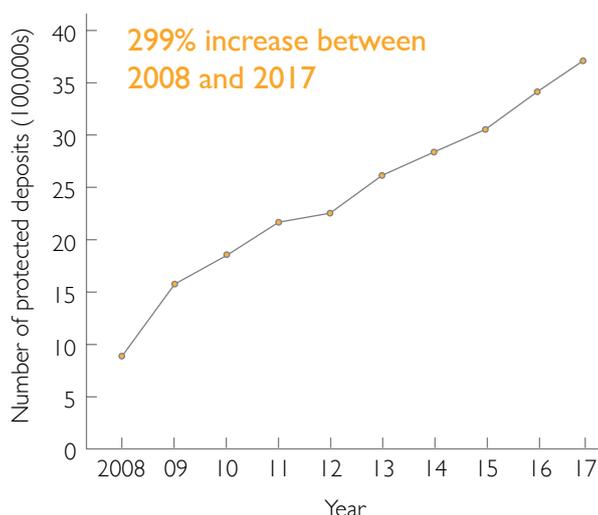
Over the past nine years (2008-2017) the size of deposit protection funds in England and Wales has increased dramatically by over 350% with the number of protected households increasing by around 300%. This is the result of new renters entering the market, and existing renters starting new tenancies that fell under the new regime. The extent of this growth can be seen below with deposit protection funds totalling around £4 billion as of March of 2017.

The 2004 Housing Act was less clear on the system of deposit protection and the allocation of interest accrued on the damage deposit over the tenancy. Generation Rent has identified three areas in which the current deposit protection scheme could be improved in terms of equity and efficiency for both tenants and landlords:

- The popularity of riskier insurance-backed schemes
- The unproductive nature of deposits from the tenant's perspective
- The upfront cost of deposits when moving home

Figure 1: Size and Value of Protected Deposits in England and Wales

Data source: The Dispute Service (TDS) and DCLG



# Shortcomings of the Current Deposit Protection System

There are currently two types of protection schemes in England, Wales and Northern Ireland: i) custodial, where deposit funds are held by an independent third party for the duration of the tenancy, and ii) insured, where the landlord, or letting agent, maintains control over deposit funds in return for an insurance premium or fee to protect it.<sup>2</sup>

While giving tenants protection, and access to a process of dispute resolution, the system does not yet operate in the tenant's interests, largely due to the popularity of insurance-based schemes and the treatment of accrued interest on deposits. Under the current system, deposit funds are unproductive to the tenant over the duration of the tenancy. Instead, tenants are, from their perspective, effectively providing their landlord or letting agent with a zero-interest loan.

The evidence in the following sections will show that the majority of deposits in England and Wales are protected in insurance-backed schemes, and the vast majority (~98%) of tenants continue to receive no interest on their deposits. From this, we can look at the cost to tenants under the existing system and alternative options for making this increasingly large pool of funds more productive for tenants.



## I. Insurance-based Deposit Schemes

As noted above, insurance-based schemes provide landlords and letting agents the opportunity to pay an upfront fee in exchange for a guarantee that the deposit is paid out to its rightful recipient at the end of the tenancy, following dispute resolution if necessary. For landlords and letting agents, the cost of this loan is a modest insurance premium needed to protect the deposit – as low as a fixed rate of £9.50 per tenancy (table 1).

As a result of these relatively modest fees, the majority of landlords and letting agents choose to insure damage deposits, maintaining access to the funds over the period of the tenancy. To illustrate the popularity of insurance schemes, we can look at a breakdown of deposits, and their value, protected through each scheme in Table 2 below. These numbers were provided in response to a Freedom of Information request to the then Department for Communities and Local Government.<sup>4</sup>

Although the number of deposits protected is split 59:41 between insured and custodial, the difference in total and average value is notably wider. As of March 2017, approximately 68% (£2.7 billion) of total deposit protection funds were being insured by landlords and letting agents with the remaining 32% (£1.3 billion) in custodial schemes. From Table 2, we can see that insurance-backed schemes are also skewed towards higher-value deposits: the average deposit held through insurance schemes is £1240, compared with £867 for custodial schemes, a 43% difference. Effectively, this suggests that landlords and letting agents are more likely to opt for insurance schemes when the deposits are large (i.e. they can borrow at a lower effective rate).

Relative to custodial schemes, insured schemes also come with an additional level of risk for tenants. There have been cases where agents have been expelled from a scheme while continuing to possess the tenants' deposit funds. These tenants have subsequently struggled to recover their deposit

2. Scotland moved to a purely custodial system in 2012.

3. <https://www.tenancydepositscheme.com/landlord-membership-fees.html>

4. Available here [https://d3n8a8pro7vhmx.cloudfront.net/npto/pages/6440/attachments/original/1521467977/2017\\_figures.pdf?1521467977](https://d3n8a8pro7vhmx.cloudfront.net/npto/pages/6440/attachments/original/1521467977/2017_figures.pdf?1521467977)

5. <https://www.channel4.com/news/daniel-burton-landlord-deposits-mydeposit-unida-tenancy-protection>

6. Tenants do have legal rights in this regard. Even where a deposit is unprotected, the tenant can be eligible for compensation worth up to three times the value of the deposit. However, being prepared to take the necessary legal action involves being able to pay an up-front cost of several hundred pounds in legal fees.

7. English Housing Survey 2014-15, Private Rented Accommodation Report, AT3.11

at their own expense. The most infamous case was that of 'rent-to-rent' operator Daniel Burton whose expulsion from My Deposits in 2013 resulted in £145,000 of tenants' money losing protection.<sup>5</sup>

The most concerning cases are those where tenant deposits are not protected from the outset.<sup>6</sup> The 2014-15 English Housing Survey asked tenants on assured shorthold tenancies who had paid a deposit if it was protected: 11% of tenants said that it was not; a further 25% did not know.<sup>7</sup> In the case of protected deposits, insured schemes must

notify tenants if their landlord or letting agent has their membership terminated to prompt them to take legal action. TDS will continue to protect the deposit in such a situation.

Even with these safeguards, the use of insured schemes creates an unnecessary additional risk to tenant deposits with no real benefits accruing to them over the period of the tenancy. It was for these reasons that the Scottish government approved only custodial schemes when it introduced protection requirements in 2012.

Table 1: Deposit Insurance Fee Structure (as of February 2018)

Deposit value	Up to £500	Over £500
TDS for Landlords	£16	£23
Deposit Protection Service	£15	£22.50 (£9.50 for agents)
My Deposits	£20	£26

Source: TDS; DPS<sup>3</sup>

Table 2: Tenancy Deposit Protection Schemes 2017

Scheme	Number of deposits protected at 31 March	Value of deposits protected at 31 March	Average deposit value
<b>INSURED</b>			
TDS	1,220,946	£1,661,186,264	£1360.57
DPS	41,597	£42,933,952	£1032.14
My Deposits	924,654	£1,009,011,715	£1091.23
Total insured	2,187,197	£2,713,131,913	£1240.46
<b>CUSTODIAL</b>			
TDS	16,278	£16,266,574	£999.30
DPS	1,473,671	£1,274,209,374	£864.65
My Deposits	14,096	£13,438,019	£953.32
Total custodial	1,504,045	£1,303,913,967	£866.94

Source: Freedom of Information release by DCLG



## 2. Accrued Interest on Deposits

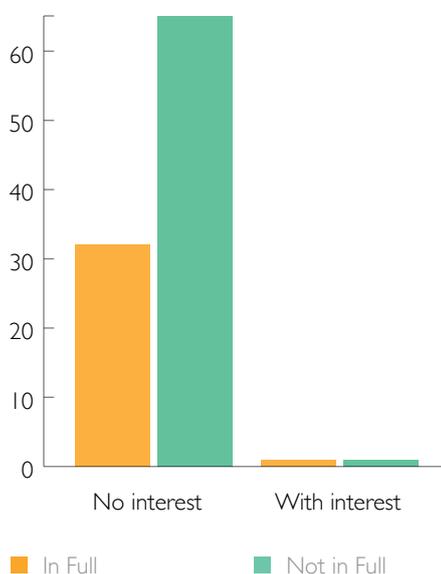
From the above evidence, the majority of damage deposits currently paid by tenants tend to be controlled and managed either by letting agents or landlords. In this case, deposit funds, which have productive value over time in the sense that they could be invested over the course of the tenancy, generate zero profit to the owner of those funds. Noting that the owner of the funds remains the tenant, it would be reasonable to assume that any accrued profits or interest should go to the tenant at the end of the tenancy (minus any administrative costs).

The popularity of insurance-based schemes – and the higher average value of deposits protected through them (see Table 2) – can likely be explained by the benefit to the landlord or agent of access to cheap liquid capital. This however relies on the assumption that no interest is paid out to the tenant at the end of the tenancy. Letting agents and landlords are currently free to collect interest on their tenants' deposit funds, but TDS advises its members that it is good practice to obtain tenants' consent for this first.<sup>8</sup>

The scheme adds, 'If there is no mention of the interest in the tenancy agreement then an argument could be made that the interest belongs to the tenant, as it is technically the tenant's money.' Tenancy agreements might therefore include clauses allocating the accrued interest on damage deposit funds to the landlord or agent. For many renters, especially those who are new to the rental market or just learning English, these clauses can be confusing and difficult to amend.

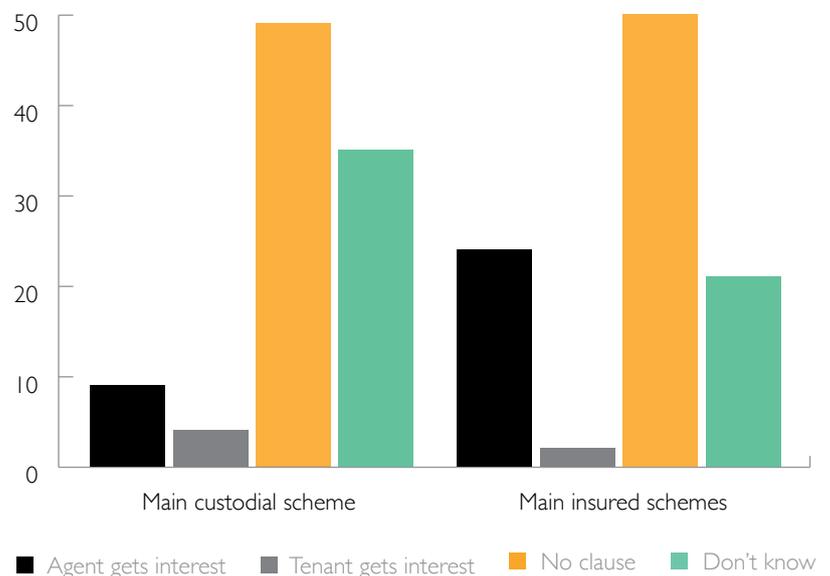
In order to get a better idea of current practices relating to insured deposits, a recent Generation Rent survey asked a sample of private renters whether their current tenancy agreement included a clause which allocated any accrued interest on their damage deposits to either themselves or the landlord or letting agent. The survey, which was carried out between October 2017 and January 2018, received responses from a sample of 1170 private renters in the UK.<sup>9</sup> Two of the questions asked respondents about their previous experience (where applicable) with damage deposits, including what funds they received back at the end of their previous tenancy, and to whom the accrued interest was allocated in the current tenancy agreement. Figures 2 and 3 below provide a summary of the findings.

Figure 2: At the end of your last tenancy, did you receive your deposit back?



Source: Generation Rent Survey (2018)

Figure 3: Does your tenancy agreement specify who receives interest on the damage deposit?



Source: Generation Rent Survey (2018)

These numbers are supported by the English Housing Survey 2014-15, which found that 62% of tenants received their deposit in full.<sup>10</sup> A surprisingly small minority (2%) of survey respondents received any interest on their deposit when it was returned to them.

The ‘custodial scheme’ results from Figure 3 (left) comprise responses by tenants whose deposit is protected through DPS, which runs the largest custodial scheme and a much smaller-scale insured scheme, so we should expect fewer clauses relating to interest and more ‘don’t knows’.

For the main insured schemes (My Deposits and TDS), only one in four agents have tenants’ agreement for their claim over accrued interest. Only 2% explicitly say that the tenant receives what is rightfully theirs. Nearly half of landlords and letting agents do not appear to have their tenant’s permission to collect any accrued interest on their deposit. It might therefore be reasonable for the tenant to expect this at the end of the tenancy.

For its part, the government has recognised the tenant’s claim to the interest on their deposit and, when it allocated new licences for custodial schemes in 2014, its guidance said, ‘Schemes are expected to offer tenants interest although only after they have deducted costs and a relevant contribution.’<sup>11</sup> It is important to note that there is no evidence that the schemes are doing this – in fact, the evidence suggests the opposite in practice.

In June 2017, TDS noted ‘the deposit scheme is funded by the interest generated from all the deposits held by the scheme’.<sup>12</sup> MyDeposits states ‘The custodial scheme retains any interest earned on the deposit for that time.’<sup>13</sup> DPS appears to make no mention of interest on its website. There are restrictions on how custodial schemes can invest deposits, and therefore they do not accrue large sums of interest.

In 2015-2016 TDS had roughly £6m in operating costs (cost of sales plus administrative costs) to protect around 1.2m deposits.<sup>14</sup> Assuming equivalent costs per-deposit for custodial protection, and constant returns to scale, a back of the envelope calculation would suggest that the whole system might now cost around £18m to administer, which is about 0.45% of the total value of the deposits.

If tenants’ deposits were held in long-term accounts bearing annual interest rate of 2.5% – the rate they might get on a Help to Buy ISA – the £4bn that is currently protected could be accruing £100m this year. Subtracting the estimated £18m operating costs would leave a surplus of £82m, which could be paid out to tenants who supplied the principal into these funds. We note that TDS and DPS put some of their profits towards good causes, but this was approximately £180,000 in the year to 31 March 2017.<sup>15</sup>

From the evidence above, an extremely small minority of tenants (2%) can expect to see any interest at all. In the case of insurance-backed schemes, it appears, in the majority of cases, that letting agents are managing deposit funds and collecting any interest they generate over the life of the tenancy. Based on our simple calculation above, tenants are missing out on millions of pounds which rightfully belong to them.

In short, tenants are being asked to provide sizeable sums of otherwise productive liquidity, while earning 0% in nominal interest over the life of the tenancy agreement. The evidence in this section indicates that tenants have little knowledge or control over how their deposit funds are being treated, and the majority are receiving no returns in the form of accrued interest, despite government efforts promoting this.

8. <https://www.tenancydepositscheme.com/news/blog/ask-tds-who-gets-the-interest-on-the-tenancy-deposit/>

9. A summary of these questions is available here [https://d3n8a8pro7vnmx.cloudfront.net/nptto/pages/6440/attachments/original/1521555576/GR\\_Survey\\_2017\\_deposits.pdf?1521555576](https://d3n8a8pro7vnmx.cloudfront.net/nptto/pages/6440/attachments/original/1521555576/GR_Survey_2017_deposits.pdf?1521555576)

10. English Housing Survey 2014-15, Private Rented Accommodation Report, AT3.12

11. DCLG, Custodial Tenancy Deposit Scheme: Statement of Requirements, Section 3.2

12. <https://www.tenancydepositscheme.com/news/blog/ask-tds-who-gets-the-interest-on-the-tenancy-deposit/>

13. [https://www.mydeposits.co.uk/tenants/faqs/Answer 2, “What are the different types of tenancy deposit protection schemes?”](https://www.mydeposits.co.uk/tenants/faqs/Answer%202)

14. <https://www.tenancydepositscheme.com/resources/files/Interactive%20annual%20report%202015-16.pdf>

15. <https://www.depositprotection.com/the-dps-charity-donations-fund/>; <http://tdsfoundation.org.uk/wp-content/uploads/2014/03/TDS-Annual-Report-Web.pdf>



### 3. The Cost to Tenants

A challenge for many tenants is the need to provide a large sum of cash to secure a tenancy, often before receiving a deposit back from a previous tenancy. For tenants who have little savings and may be forced to move for reasons outside of their control – the tenancy might have been ended by the landlord, or prompted by the end of a relationship – taking out an interest-bearing short-term loan may be the only option.

This hardship can be compounded if the former landlord makes a spurious claim on the deposit. The tenant may wish to challenge the claim, but this could result in weeks or months of waiting for the scheme to adjudicate (the adjudication process is generally meant to take no more than 28 days). Many tenants might prefer to settle and get a smaller share of their deposit back sooner than having to wait through an expensive and time-consuming process.

This has prompted the recent emergence of ‘zero deposit’ schemes. Over the past few years, at least four new firms have entered the British market to offer insurance policies or warranties aimed at allowing tenants to avoid a large up-front deposit. These new schemes are advertised as being

emancipating, or even enriching, for tenants, allowing them to purchase new furnishings, rent a bigger flat<sup>16</sup>, purchase hundreds of cups of coffee, or take several holidays to Barcelona.<sup>17</sup>

These may appear to be attractive to cash-strapped tenants. In a 2016 Generation Rent survey, we asked tenants if they would benefit from a scheme where they paid a non-refundable £100 a year instead of a deposit: 29% said they would benefit a lot, 31% said they would benefit a little and 40% said they would not benefit at all.<sup>18</sup>

However, the survey question did not include one crucial detail. In some of the schemes that have emerged, the tenant remains liable for at least some of the costs if their landlord makes a claim at the end of the tenancy, even after having paid fairly generous fees. In the model used by Reposit and Zero Deposit, the insurance company pays the landlord, and then pursues the tenant to recover their costs.<sup>19</sup>

The downside of these new schemes are heavy costs with moderate coverage, at best. Three of these deposit-free schemes will diminish a tenant’s net wealth, rather than enhance it (as would be the case if a traditional deposit bore interest to the tenant). To demonstrate this, we can look at the average cost to tenants to enter these schemes and compare this with the cost of simply borrowing the money for a new deposit.

Table 3: Costs of ‘zero-deposit’ schemes

Scheme	Who pays	Initial cost*	Annual renewal*	Additional cost to tenant
Canopy	Tenant	£213 (10% of deposit)	£21 (10% of premium)	10% excess
Delighted	Letting agent	£129	£129	Cost of unsuccessful dispute
Reposit	Tenant	£356 (1 week’s rent)	None	Landlord’s costs; cost of unsuccessful dispute
Zero deposit	Tenant	£356	£25	Landlord’s costs

\*Rents based on £1542 per month used as Canopy benchmark<sup>20</sup>

16. <http://delighted.apps-landl.net/tenant/>

17. <https://getreposit.uk/tenants/>

18. This might look positive, but other products were more popular – for example, insurance that helped fund legal action against a negligent landlord would benefit 42% of respondents; only 16% saw no benefit at all. Survey results available at <https://bit.ly/210LH90>

19. <https://www.theguardian.com/money/2017/jun/10/deposit-free-renting-will-tenants-lose-out>

20. <https://findyourcanopy.com/faq/>

Suppose a tenant were to take out a personal loan of £2135 at 1% per month to cover the cost of a six-week deposit at the same rent, while waiting for their old landlord to release a previous deposit.<sup>21</sup>

From signing the new tenancy agreement, to receiving the deposit back after dispute resolution, they should not expect to wait more than three months. In this case, and if the refunded deposit was used to pay off the loan immediately, the tenant would pay only £65 in interest. Even if it took nine months to have their deposit returned, the interest would still be less than the equivalent cost of Canopy's service.

From Figure 2 above, about 66% of tenants receive their deposit back in full at the end of the tenancy. Similarly, the 2016 Generation Rent survey found that 65% had received their deposits in full. That survey found that a further 21% received "most" of it while another 9% had "some" of it returned. Just 5% of tenants saw the landlord receive the full amount.<sup>22</sup> If 86% of renters can expect to have their deposit returned in full and borrowing money in the interim is cheaper than buying insurance, these new schemes appear to be unnecessary for existing tenants.

If we want to reduce the up-front cost of moving home, then we should instead allow deposits to be transferred between tenancies. As the Ministry of Housing itself notes, the deposit is designed to cover the final month's rent at the very least.<sup>23</sup> Once this rent is paid, it should be possible to make an equivalent portion of the deposit available for the tenant to apply to a new tenancy. This would reduce the cash the tenant needs to find, making an 'insurance premium' even less attractive.

For tenants on low-incomes who are new to the private rental market or otherwise don't have the money for a damage deposit or the credit file to borrow one, there are already local Help to Rent schemes, of which Crisis has a database.<sup>24</sup> They need additional government support for sure, but any lack of coverage is no reason to introduce a new Poverty Premium to the housing market.

Given that these high fees do not offer good value (even compared with borrowing one's next deposit), and that these 'insurers' do not offer full insurance services, tenants would benefit from greater regulatory oversight of these new firms, especially if such schemes are to be adopted widely. This is especially important where tenants are explicitly misled into believing that their services will make them richer when in fact they do the opposite.

The 'zero deposit' schemes are correct to identify the poor deal tenants get from the existing deposit protection system. But this is not solved by imposing a new cost on them. The solution lies in reshaping the existing system.

Based on the above discussion and evidence, tenant deposits have the potential to play a productive role for their owner (the tenant), rather than effectively acting as a low-interest loan to landlords or letting agents. This is especially true for tenants who meet their obligations set out in the tenancy agreement, who should expect to have their deposit returned at the end of the tenancy. In this sense, it is important to re-emphasise that deposit fund ownership remains with the tenant over the course of the tenancy.

21. Interest rates range widely – we have selected a typical rate. Some high street lenders offer loans for this purpose, though not all do.

22. <https://bit.ly/210LH90>

23. Oral evidence to the Commons Housing Select Committee by Housing Minister Heather Wheeler MP and MHCLG official Becky Perks, 26th February 2018, Questions 344 and 345 <http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/housing-communities-and-local-government-committee/private-rented-sector/oral/79158.pdf>

# An Improved System of Deposit Protection



## Personal Tenant Accounts and the Tenant Deposit Fund

### To better serve the interests of both landlords and tenants, an improved deposit system should:

- Eliminate the ability of landlords and letting agents to use tenant deposit funds as low-cost loan, and the risk of the funds being misused over the course of the tenancy
- Provide a reasonable return to the tenant on their deposit
- Facilitate the passporting of funds between tenancies in order to reduce the upfront costs of moving
- Prevent tenants feeling pressured to use alternative schemes that entail a non-refundable cost

The government could achieve this while reducing the bureaucratic burden on landlords and letting agents, and creating wider social benefits by using tenants' funds more productively. This could be achieved through the creation of Personal Tenant Accounts which would function in a similar way to existing custodial schemes, and contribute to a Tenant Deposit Fund.



## Personal Tenant Accounts

Under the new system, tenants would be provided with an individual account with an accredited deposit protection scheme. Tenants would have access to information about their account, including accrued interest and fees, much like a commercial bank account. Once tenants have a direct relationship with the organisation that holds their deposits, then it becomes easier to provide them with a transparent account of how their deposits are being invested and their rates of return.

It also permits the tenant to transfer, or 'passport', funds seamlessly from one tenancy to the next. At the end of a tenancy, as long as the tenant gives adequate notice to their landlord and pays the final month's rent, an equivalent portion of the protected deposit could be released so that the tenant can transfer these funds towards the deposit on a new tenancy.<sup>25</sup>

### Achieving this with the existing system would be complicated, with a number of steps:

- 1 Tenant asks landlord to release agreed portion of deposit
- 2 Landlord asks scheme to release deposit
- 3 Tenant is paid the deposit (either from the landlord or letting agent if insured or the scheme if custodial)
- 4 Tenant pays deposit to new landlord or letting agent
- 5 New landlord or letting agent pays deposit into custodial scheme or insures it

There would then be a second step of the process that would see the remainder of the deposit released at the end of the tenancy, subject to claims and the dispute resolution process.

If the tenant has the relationship with the deposit protection scheme, rather than the landlord, then it becomes possible to switch cash between tenancies with ease.

24. <https://www.crisis.org.uk/ending-homelessness/housing-resource-centre/prs-database/>

25. There is support for passporting within the existing deposit protection system and the Residential Landlords Association has suggested a low-cost insurance policy to allow 'bridging' of the deposit between tenancies.

### A deposit protection system of Personal Tenant Accounts could shorten the steps involved to the following:

- 1 Tenant asks landlord to release agreed portion of deposit
- 2 Landlord asks scheme to release deposit; tenant notified but cash stays in personal account
- 3 Tenant tops up their scheme account to the agreed deposit for the new tenancy and gives account details to new landlord or letting agent
- 4 New landlord registers interest in deposit

No money changes hands so there is minimal administration involved. There would be a second stage of the process to give the landlord an opportunity to make a claim on the remaining deposit, resolve it, and distribute the funds accordingly.

If the average deposit is £1088 and represents 6 weeks' rent, and a month's rent is available for transfer, then £786 would be available to assist with the move. For the 86% of tenants who get most or all of their deposit back, this means they must raise less money in order to move home. Their deposit would also attract a better rate of return.

The deposit would be held in the account for as long as the holder was a private tenant, with a higher balance during periods when the holder had started a new tenancy and was waiting for the old one to end. Its near-perpetual nature makes it similar to a Help to Buy ISA (but without the expectation that the tenant continues to pay money in). We might therefore expect the funds to attract a better rate of interest than an instant access cash ISA.

For example, Barclays currently offers the most generous interest rate on Help to Buy ISAs, at 2.5%.<sup>26</sup> If we took this rate as a starting point and deducted 0.45% as the contribution to the schemes' administration costs (see Section 2), then renters might receive a rate of 2.05% on their assets.

Given the EHS 2015-16 finding that 66% of private renters have no savings or investments, a Personal Tenant Account with a deposit protection scheme would, for many, be the sole long-term savings account which earns the tenant a financial return.<sup>27</sup>



## Tenant Deposit Fund

As of March 2017, £4.02bn of deposits were protected, for approximately 3.69 million private renter households. As we have shown, these funds are currently unproductive. If they became part of a Tenant Deposit Fund, they could instead be actively invested, working for the tenant and making a contribution to the economy and wider society. A portion of the funds would always need to be held in highly liquid assets to finance rollover costs of reimbursing tenants moving home, or landlords making claims. But this portion is relatively small.

In 2016-17, 1.46 million deposits were released by protection schemes – to be returned to the tenant or to reimburse the landlord (around 40% of the total). In the same period, 1.72 million deposits were submitted to protection schemes.<sup>28</sup>

If we assume, based on the constant growth of the deposit system (see Figure 1), that departing tenants are replaced by new tenants on at least a one-to-one basis, and that it takes a month, on average, from paying a deposit on a new home and getting back your deposit on the old home, the deposit protection system would require sufficient liquidity to pay out one twelfth of the 1.46 million deposits at any point in time. Under these conservative assumptions, our simple calculations suggest that the system requires £133 million available in cash (122,000 deposits worth an average £1088). Given current trends, these funds are replenished on at least a one-to-one basis by households starting new tenancies.

Where tenants who already possess personal accounts are moving properties within the UK (leaving one tenancy for another), the passporting scheme described above would further reduce the necessary rollover capital required. If 86% of tenants get most or all of their deposit back, and two-thirds of their deposits' value could be transferred directly to the next tenancy, then £76 million would remain in Personal Tenant Accounts, and the scheme would only require around £57m in cash.

Therefore, in theory, the deposit protection system as it stood in March 2017 had up to £3.96bn that could be used for more productive purposes. If well-managed, the system could be designed to finance a well-diversified pool of low-risk social welfare-maximising projects which provide positive economic benefits to the UK – and a return to the tenants.

26. <https://www.barclays.co.uk/savings/isas/help-to-buy-isa/> Accessed 13 March

27. EHS 2015-16, Private Rented Sector Report, AT2.5

28. Freedom of Information disclosure by Department for Communities and Local Government

One asset class with potential to make up at least part of a Tenant Deposit Fund portfolio would be investment in building new homes. This would have the additional benefit of reducing rents and easing house price inflation in the medium-to-long term. In this case, renters could benefit both directly in the short term, and indirectly in the long term.

**Potential candidates for this proportion of the Fund's portfolio include:**

- Housing Association retail bonds, which would fund a range of new housing, including affordable housing. A seven-year Places for People retail bond yielded 3.55% in December 2017.<sup>29</sup>
- A National Savings & Investment bond which was earmarked for social housing. The experience of Pensioner Bonds and the NS&I Investment Bond suggest that a model for this already exists.
- A community land trust (CLT) fund. This could finance the building of affordable homes for sale, with regulated prices, which would attract a return as soon as the homes were sold. The government should provide assistance to community land trusts in acquiring public sector land at a reduced cost.
- Funding the development of Pocket-style homes. Similar to CLT homes, these are flats for sale with a perpetual discount.
- Homes for social rent. These projects provide a steady return over a long period and are increasingly popular for defined benefit pension funds. The suitability of this would depend on there being no major decline in the private rented sector which would lead to a net reduction in deposits held, and a need to realise the value of the homes.

To provide a sense of scale, we have made one estimate of the impact a housing-focused fund could have in providing a balance of returns, stability and homes. Suppose our £3.96bn were available for investment. Of that, £1bn could finance at least 2000 affordable CLT homes for sale per year, based on a unit cost of £200,000 in high-demand areas.<sup>30</sup> As homes are for sale, the initial investment would be recouped after around two and a half years and get reinvested in the same tenure.

The other £2.96bn could build more than 25,000 rented homes, if we assume a cost of £118,000 per unit.<sup>31</sup> These investments would take a generation to pay off with rents alone. Along with 10,000 homes for sale over five years, this would mean more than 35,000 new homes in total from an initial investment of £3.96bn. In comparison, the government announced funding to build 25,000 'affordable' homes in October 2017.<sup>32</sup>

If the private renter population continues to grow, the capital available for new housing would also grow – so another £2bn in those five years would build a further 17,000 rented homes.

Some may see investing tenant deposits in a potentially volatile housing market as risky. This could be mitigated by including housing as one element of an actively managed, diversified portfolio of assets.

In order to maintain landlords' confidence in the system the government should consider providing a guarantee so the landlord would continue to receive any deposit funds due to them in a scenario where the Tenant Deposit Fund portfolio experiences short-term negative returns.

29. [https://www.socialhousing.co.uk/AcuCustom/Sitename/DAM/089/Market\\_digest\\_-\\_January\\_2018.pdf](https://www.socialhousing.co.uk/AcuCustom/Sitename/DAM/089/Market_digest_-_January_2018.pdf)

30. Roughly based on prices in an existing CLT <http://www.londonclt.org/about-us/what-is-a-community-land-trust/>

31. Based on Capital Economics' estimates in 'Building New Social Rent Homes', 2016, Exhibit 23

32. <https://www.gov.uk/government/publications/autumn-budget-2017-documents/autumn-budget-2017#housing>

# Summary

## The Personal Tenant Account would operate as follows:

- 1 The tenant sets up an account directly with an accredited deposit protection scheme and pays in the contractually agreed damage deposit
- 2 The tenant provides the details/verification of the account to the agent or landlord who then registers their interest in the deposit
- 3 These funds are then frozen from both the tenant and landlord/letting agent over the duration of the tenancy and are managed by the protection scheme
- 4 When applying for a new tenancy, the tenant can apply for a portion of the deposit to be directly transferred to the new property. The landlord would approve this if certain conditions are satisfied, such as appropriate notice being served, and there being no rent arrears. This 'passporting' of the deposit would enable more responsible but cash-strapped tenants to move.
- 5 When the tenancy ends, the landlord will instruct the scheme to release the remainder of the deposit, or make a claim on it. The tenant will maintain an opportunity to dispute the claim.
- 6 Any investment returns (or accrued interest) on the deposit will be returned to the tenant net of a fee to cover the operating costs of the scheme. These returns could also be transferred into the new tenancy agreement with consent from the tenant.

With licences for insurance-based schemes to expire in the next couple of years, there is an opportunity to phase them out and replace them with a tenant-focused system. The government should therefore start exploring these options now.

## How does this benefit landlords and letting agents?

The administration and management of sizeable numbers of damage deposits with varying maturities and contractual conditions requires resources. The proposed Personal Tenant Accounts would effectively bypass the landlord or letting agent allowing for a decrease in the administrative burden which comes with managing these funds. This would also allow for a saving in insurance premiums for those who currently make use of insurance schemes and will be bound by restrictions on the use of interest-bearing accounts when Client Money Protection becomes mandatory.<sup>33</sup>

With protection of the deposit no longer the landlord's responsibility, they would no longer bear liability for compensation if they failed to protect the deposit, through their own, or their agent's, negligence.

A new system will still need to be paid for. In order to compete with existing custodial schemes, the cost to landlords and letting agents would need to be minimal. One option therefore would be for the deposit scheme to collect a share of the interest on the deposit. As we explored above, using TDS figures to estimate systemwide operating costs of £18m, a new scheme would need a rate of return of 0.45% to cover operating expenses. Any additional returns could then be paid to the tenant at the conclusion of the tenancy.

33. Propertymark permits its members to keep client money in interest-bearing accounts as long as they have tenants' agreement on how the interest is treated. However, these accounts must be instant-access – which limits the rates available. Another scheme, Client Money Protect, prohibits its members from placing client money in an interest-bearing account.

### How does this benefit the tenant?

This scheme would reduce the upfront cost of moving between tenancies by around £786 for the typical tenant. They would no longer run the risk of their landlord misusing their deposit and having to take legal action to recover it. The scheme would also provide a decent return on what for many is their only savings. We have compared the likely benefit of this scheme over two years with those of the existing alternatives, using a six-week deposit of £1000 for simplicity's sake.

In the first scenario, the tenant has enough for the full deposit. They receive it back but with no interest – either their letting agent has laid claim to it in the tenancy agreement or the custodial scheme has kept it.

In the second scenario, the tenant doesn't have enough savings so borrows the money. Because they are leaving a tenancy with a spotless record they can expect the money back within three months so pay only an extra £30.30 on top of the principle, and they have £1000 waiting for them at the end of the tenancy.

In the third scenario, the tenant 'insures' the deposit with a premium of one sixth of the principle. Come the end of the

tenancy they get nothing back so are worse off than in the other two scenarios. This remains the case if the landlord makes deductions because the 'insurance' company pursues them for the debt.

In our proposed system, the tenant's deposit accrues net interest at our baseline of 2.05% and emerges at the end of the two years £41.42 better off. This also makes any deductions easier to bear.

For a tenant with no other savings, passporting would mean they already had the month's rent of £722, plus £41 in interest, to put towards their next tenancy. Assuming another £1000 deposit, their borrowing requirement would be £237, which would incur only £7 in interest over three months.

After ten years of renting under the proposed system, moving home every two years, the tenant would be £225 better off at today's prices, before any borrowing costs and deductions. In the same circumstances, a tenant using 'zero deposit' schemes would be worse off by £833.

Table 4: Effect of different deposit schemes on tenants' wealth

Scheme		Current deposit scheme	Deposit scheme using 3-month loan (at 1% per month)	Zero-deposit scheme (Reposit)	Reformed custodial scheme (2.05% net interest over 2-year tenancy)
Up-front cash required		£1000	£1030.30	£166.67	£1000
If no deductions	Amount returned	£1000	£1000	£0	£1041.42
	Interest	£0	£0	£0	£41.42
	<b>Net benefit</b>	£0	£ -30.30	£ -166.67	£41.42
With £200 deduction	Amount returned	£800	£800	£ -200	£841.42
	Interest	£0	£0	£0	£41.42
	<b>Net benefit</b>	£ -200	£ -230.30	£ -366.67	£ -158.58

# Practicalities

To put this system into place will require work with the Ministry of Housing, the protection schemes, landlord and agent groups, and, if the Fund invests in new homes, the house building industry. We hope this report will promote discussion, and lead to more in-depth research into the regulatory structure and implementation of – and likely returns on – Personal Tenant Accounts.

**We have identified some issues that would need to be considered as part of this:**

- There would need to be primary legislation – as part of the Tenants' Fees Bill perhaps – to put the new system of deposit protection on a statutory footing, followed by new regulations.
- The government could regulate what assets the fund can invest in, in order to assure landlords that any valid claim would be honoured. There should be appropriate governance arrangements to give renters the confidence that the funds and homes they had a stake in were managed ethically.
- A balance would need to be struck between securing decent returns for the tenant, and facilitating socially beneficial projects such as social housing. A rate of 2.5% might be the benchmark, but the higher rate on housing association bonds indicates what is achievable.
- To secure government support, tenants may need to bear some of the risk of the value of their deposit falling. In such a case, tenants should be offered an opt-out of the fund – and get a basic interest rate instead.
- Tenants would need assurance that their inaccessible deposits would not be treated as savings for the purposes of social security or Legal Aid means-testing.

The new and old systems would likely operate in tandem during an initial transition period. In the first year, assuming that all moving tenants used the more favourable new system, we might expect 1.71m new deposits protected in new personal accounts – 1.46m moving households and 250,000 new private renter households.<sup>34</sup> 2.35m would remain in the old system.

In the second year, perhaps 1.1m households will move from the old system to the new one, and already the new system would hold the majority of deposits, with 90% by the end of the fifth year.

34. These numbers are based on those provided in the FOI release for deposits submitted and returned in the year to March 2017.

Generation Rent campaigns for professionally managed, secure, decent and affordable private rented homes in sustainable communities.

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