

It's not their money:

Reforming tenancy deposit protection

Since April 2007, it has been a legal requirement for landlords to place tenants' deposits in a deposit protection scheme. This has led to major improvements in ensuring tenants do not forfeit their deposits unfairly. Indeed, the fact that less than 1% of deposits go to adjudication does not mean that regulation was not needed, but shows that it has been successful in protecting the majority of deposits.

However, it is clear that, seven years into tenancy deposit protection, problems remain with how the schemes work. Centrally, it is not the case that deposits are always fully protected. Within the insurance-based schemes, where a landlord still holds the money, it is quite possible for an unscrupulous landlord to leave or be removed from a scheme, leaving deposits uninsured and therefore open to theft and misuse. It is thought that 30% of "insured" deposits in England have actually been used for cash flow purposes by the landlord or agent holding them, despite deposit protection audits, broadly in line with what was brought to light in Scotland when they moved to a custodial-only system.

There is also a major difficulty with dispute resolution through the current schemes. Most typically a tenant will need their current deposit at the end of a tenancy in order to put it down on a new home. As a result, there is an imperative to retrieve this money quickly from the tenant's perspective, which is not the case for the landlord or letting agent.

When disputes take a long time to conclude – several months in some cases – then it can lead to tenants getting into debt or suffering financial difficulties through no fault of their own. Indeed, the worst landlords can put in spurious claims in the knowledge that a tenant may just settle for some of their money, even if rightly they should receive it all back. It is not uncommon to hear of landlords holding renters to ransom in this way and a fairer and speedier dispute resolution process would prevent this. When tenants "agree" to a groundless landlord claim against a deposit simply to access their own money quickly, this does not show up on deposit scheme statistics as a failure.

The high upfront cost of deposits is also problematic, particularly for low-income tenants. There is no cap on how much a deposit can be, yet there is no mechanism to both ensure they are affordable for tenants and reflective of the kinds of costs a landlord might incur through property damage or wear and tear. You would expect deposits to go up in line with market rents and the deposit schemes suggest they are increasing faster than this. But this is far in excess of any inflation in the costs of any likely damage.

Ultimately, deposit protection should reflect the fact that the money involved belongs to the tenant, not the landlord. To this end, schemes should be designed to be low-cost and convenient for renters, and should not allow landlords or agents to benefit from money that is not their own. Renters put away substantial amounts of money for longer periods of time in the form of deposits, but receive no interest, and get no benefit from these savings. As tenants are putting down large sums of money to secure somewhere to live, deposit schemes should work for them, not for landlords.

Below we set out a number of issues with tenancy deposit protection and set out potential reforms to the schemes. We would like to hear your views on the ideas in this paper as well as other suggestions for ways to improve this area of private renting. After taking your responses on board, we will publish a proposal

paper to submit to Government and Parliament. Please send your comments, thoughts and ideas to sebklier@generationrent.org by **Monday 18 August 2014**.

1. It's not the landlord's money

According to the debt charity [Step Change](#), private sector renters are far more likely than others to fall into problem debt. Exacerbating this is the almost complete absence of a savings culture among renters, meaning a small shock of a few hundred pounds, perhaps a car breakdown or the loss of a tenancy deposit, has the ability to turn someone who's coping with their financial stresses into someone who is not.

And yet, for many renters, their tenancy deposit is the most money they have ever saved and it should be treated as an illiquid form of savings. If we consider the £3 billion that is protected by the three schemes, covering 3 million households, add the 1 million private rented households that are estimated to be illegally unprotected, and the hidden deposits of people occupying spare rooms, boats and park homes (caravans), we estimate that about £5 billion of tenants' money is held on deposit, meaning tenants are missing out on up to £95 million a year in interest¹.

- a. Tenants should receive interest on their deposit. Effectively this would mean breaking the links deposit protection schemes currently have with insurance companies and replacing them with links to retail banks.
- b. Tenants should have the freedom to choose which deposit scheme holds their money so they can choose the best deal. It should not be the choice of the landlord.
- c. Treasury should apply ISA-style tax breaks to savings built around tenancy deposits to encourage tenants to top up their savings. This would help tenants to become more financially resilient in the event of a financial shock.
- d. Tenants should be free to secure their deposits against other illiquid assets, for example their pension fund. If a tenant lost part of their deposit to the landlord, you would expect a corresponding contribution to be made to HMRC as a reimbursement of past tax subsidies if that asset had in the past attracted such a subsidy.

2. A wholly landlord-captured system

At the moment, discussion by landlords and agents about deposit protection schemes centres around which ones are thought to be most "tenant friendly" in the event of arbitration. As tenants don't get to choose the scheme, this means there is real market pressure for the schemes to win customers (landlords) but no countervailing market force in favour of tenants. This is exemplified by the schemes' lack of enthusiasm for reforming the "Daniel Burton" loophole referred to in section 5 below.

- a. Each deposit protection scheme independently sets the terms of arbitration that it uses. The terms of arbitration should be standardised and set by DCLG so that deposit schemes can't compete on "landlord friendliness" in arbitration.
- b. In the event of a dispute, there should be a clear presumption in favour of the tenant, with the landlord having an absolute obligation to provide proof if they are planning to deduct all or part of a tenant's deposit.

¹ 1.95% interest is the best savings rate available on 120-day notice accounts listed on www.moneysupermarket.com

- c. The right for a tenant to receive proof that their withheld deposit has been spent on the work claimed and a right to repayment if it has not.
- d. Landlord representative bodies are profoundly influential in the deposit schemes. Landlord and letting agent representative bodies should be banned from owning, part owning or occupying board positions on deposit protection schemes. All board members of deposit protection schemes and those owning 5% or more of a scheme should be required to register publicly any interests they have in landlord or letting agency activity.
- e. There should be a taxi-rank rule for arbitrators so that schemes can't preferentially select those who are more landlord-friendly.

3. Tenant responsive efficiency in the system

The ability for a landlord to hold a deposit "to ransom" rests on the deposit scheme system allowing them to do so. The entire system should be regulated to make this impossible, while facilitating a fair challenge when damage has been done.

- a. Arbitration should be fair and speedy.
 - i) Deposit schemes should facilitate the uploading of photos and agreements at the start of a tenancy agreement to help resolution of disputes at the end of the tenancy and to inhibit spurious claims or defences.
 - ii) Tenants should have a right to inventory assessment on the handover of keys as part of the checking out process, without any subsequent delay. Failure to assess the inventory on the agreed day of key handover should void a landlord's right to claim against a deposit.
 - iii) Landlords should be barred from making a claim against a tenant's deposit later than three working days after checking out. Failure to assert a claim within this time should lead to the automatic release of the deposit to the tenant.
 - iv) In the event of an unchallenged deposit or at the completion of arbitration over a deposit, it should be returned to the tenant within 48 hours. Landlords should be penalised for making a tenant wait the full period if they do not make a claim against the deposit.
- b. There should be a penalty for instigating speculative arbitration without reasonable cause.
- c. Agents and landlords should not be able to charge tenants for inventory checking in and out.
- d. If tenants are to continue to be charged for inventory checking in and out, the tenant should be able to choose the inventory checking company. There is significant anecdotal evidence that some agencies and landlords are earning additional revenue from their selection of preferred inventory checking providers and therefore charging tenants an excessive fee for this.

4. Tenants' Insurance

Tenants are already able to take out contents insurance that covers damage to the landlord's property, furniture and appliances, but it is not regularly taken up and use of a deposit is still the norm in the private rented sector. However, a well-formulated tenants' insurance would do away with the need for tenancy deposits altogether, meaning renters would no longer face the huge up-front costs of finding the amount

for a deposit and would end disputes about money owed between landlord and tenant. In the event of damage, the landlord would claim on the tenant's insurance. This is a direct parallel to the insurance based deposit protection schemes that currently exist and are available to landlords.

In the same way drivers show their credentials when hiring a car, renters could show details of their current insurance when taking on a new tenancy. Following the car hire model, renters could receive 'no claims' bonuses after several rental contracts without damage or claims against them. Tenants' insurance would be a fair way to protect against damage in a rented property, as it does not assume guilt before proof, and would remove a financial obstacle for those entering the private rented sector.

5. The Daniel Burton loophole

The exposure of rent-to-rent landlord Daniel Burton highlighted a major issue with the deposit protection schemes as they stand, which is that insurance-based products only protect the deposits for the life of the landlord's membership of the scheme.

Daniel Burton was ejected from the MyDeposits scheme, meaning about 160 of his tenants no longer had their deposits protected. Almost a year later, few of those tenants got their money back. All three deposit schemes in England have been approached regarding this issue but have so far refused to support any measures that would protect tenants from such actions. We propose the following simple measures that would protect tenants:

- a. Oblige insurance-based schemes to protect deposits for the life of the tenancy, not for the life of the landlord's membership of the scheme. This would notionally raise the cost of insurance-based schemes due to the increased risk. The two effects of this would be to encourage landlords to use a lower-cost custodial scheme, an absolute protection for tenants, or for deposit schemes to undertake better due diligence of landlords, effectively barring from landlordship any landlord the insurance scheme felt was too risky to insure. "Risky" landlords would effectively have custodial schemes as their only option.
- b. Move to a wholly custodial scheme, as has been implemented in Scotland.

6. 'Help to Rent' – a bond scheme to support renters with tenancy deposits

As set out in our [Renters' Manifesto](#), a tenancy deposit protection bond scheme which allows renters to pay one week's deposit up-front, with a further week paid per month for 3-5 months, and underwritten by government or by the deposit schemes themselves (effectively through the charges to landlords), would support economic and social mobility as those without the necessary immediate capital could move into the private rented sector for work or education purposes.

The tenant would pay a week of their deposit each month in addition to their rent and they would pay the tenancy deposit protection fee, representing a saving to the landlord. The gap between the deposit paid and the deposit owed would have to be underwritten; however, every deposit would be fully paid by the time a tenant was at 6 months unless they were in default. The underwriting costs for this would be minor.

This scheme would also identify those tenants in need of a little more support and could act as means to channel new information about work, the rights and responsibilities of renting, financial information and saving to tenants.

The charity Crisis has done extensive work with bond schemes for vulnerable tenants and we feel this has proven their success to the extent that it could be expanded to help many more renters.

7. Protecting tenants without deposits

There is evidence that some landlords are legally bypassing deposit protection schemes altogether in order to force money out of tenants at the end of their tenancies. Some landlords have decided that the use of tenancy deposit protection and its subsequent arbitration process may delay or inhibit the ease with which they make financial claims on their tenants.

Instead, these landlords don't ask for tenancy deposits of any kind at the start of the tenancy, but threaten tenants with legal action through the small claims court for supposed damage when the tenancy ends. Often this is done without any supporting evidence, like the use of an inventory, but is a blatant attempt to intimidate naïve or vulnerable tenants into paying up for 'damage', to avoid the threat of legal action.

Furthermore, other landlords have written about the financial benefits of charging a higher rent instead of a deposit, yet never returning this additional revenue to the tenant at the end of their tenancy. In both cases this reflects an ability for landlords and agents to take advantage of the most vulnerable tenants.

We propose that landlords who do not ask their tenants for deposits should forfeit the right to take them to small claims courts for damages at the end of the tenancy. This would encourage the use of deposit protection and bond schemes as we have envisaged.

Conclusion

The implementation of tenancy deposit protection was a huge advance for tenants. But moving from no protection to sub-standard protection is not ideal. Now that the deposit protection schemes have bedded in, it is time to review how well £5 billion of tenants' money is protected.

Generation Rent welcomes any comments on the proposals set out above as well as new reforms of schemes or wholly-new models of deposit protection. Please send your comments to our Policy & Campaigns Manager Seb Klier at sebklier@generationrent.org