

LAWPACK

THE COMPLETE GUIDE TO

Residential Letting

The smart landlord's guide to renting out property

'This book amounts to a management tool that no landlord should be without'

National Federation of Residential Landlords

Tessa Shepperson

This is an excerpt from Lawpack's book *Residential Lettings: The Complete Guide*.

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The Complete Guide to Residential Letting

by Tessa Shepperson

1st edition 2000

2nd edition 2002

3rd edition 2003

4th edition 2004

5th edition 2005

6th edition 2006

7th edition 2008

Reprinted 2008

© 2008 Lawpack Publishing

Lawpack Publishing Limited

76–89 Alscot Road

London SE1 3AW

www.lawpack.co.uk

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Printed in Great Britain

ISBN: 978-1-905261-80-2

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CHAPTER 7

Tenancy deposits

A tenancy deposit is a sum of money taken by the landlord (or his agent) from the tenant at the start of the tenancy to provide a fund of money for the landlord to use after the tenant has vacated, should the property need repair work or should any of the items in the property need to be repaired or replaced. If the property is left in good condition, the damage deposit is returned to the tenant without deduction. Most landlords and letting agents like to take a damage deposit, as it is felt that this gives tenants an incentive to look after the property, as they will not recover their deposit unless they do so.

However, there have in the past been complaints from tenants' organisations that many landlords are not dealing responsibly with deposits. In 1998 the Citizens' Advice Bureaux published a report called 'Unsafe Deposits' claiming that thousands of tenants were being cheated out of their deposit money by unscrupulous landlords, and calling for a statutory tenancy deposit scheme similar to one which had been running very successfully in Australia. This was followed by a pilot tenancy deposit scheme which was run by the Independent Housing Ombudsman. Finally, provisions for a statutory tenancy deposit scheme were included in the Housing Act 2004, and these provisions came into force (in both England and Wales) on 6 April 2007.

Tenancy deposit schemes are not in force in Scotland. The Housing (Scotland) Act 2006 makes provision for them to be brought in, but there is no word yet when this will be – the latest is that it will be sometime in 2008 after a consultation process.

However, the tenancy deposit protection rules do not apply to all tenancies.

The scheme will apply to:

- all new assured shorthold tenancies where a deposit is taken after 6 April 2007; and
- all tenancies where a deposit was taken prior to 6 April 2007 but a new tenancy agreement is given to the tenant after that date.

The scheme does not apply to:

- tenancies where a deposit is taken before 6 April 2007 and there has been no renewal of the tenancy since (i.e. if it has been running on as a periodic tenancy);
- tenancies which are not assured shorthold tenancies. These will mostly be 'common law' tenancies; for example, where there is a resident landlord, tenancies where the tenant is a limited company, and tenancies where the rent is over £25,000 per annum or under £250 per annum (£1,000 in Greater London). The scheme will also not apply to tenancies which are assured rather than assured shorthold tenancies;
- deposits taken for other types of occupation which are not tenancies, for example from lodgers

In this chapter we will first consider deposits where the schemes do not apply and the underlying law, and then look at the schemes in some detail.

Deposits where the schemes do not apply

The tenancy agreement

In this situation you (or your agent) will be holding the deposit, and your tenancy agreement will need to set out how this will be dealt with. It is normal for the agreement to cover the following points:

- The amount of the deposit. It is usual for this to be the equivalent of one month's rent. It should not be for more than two months' rent, otherwise it will be held to be a premium, which is inadvisable.
- What the landlord can use the deposit for (e.g. damage to the premises or furniture, unpaid rent and services) and also any sum repayable to the local authority when Housing Benefit has been paid directly to the landlord.
- A requirement that a tenant should make up the deposit if the landlord has to use part of it during the tenancy (e.g. for repairs).
- Whether the tenant shall be entitled to interest on the deposit (normally the agreement provides that interest will not be paid).
- When the deposit is to be returned to the tenant – normally this is when the tenant gives up possession of the property; however, it is a good idea for the agreement to provide that if the tenant's Housing Benefit has been paid directly to the landlord, the landlord is entitled to hold the deposit until he is sure that there will be no clawback. He can, however, only retain the deposit for a reasonable period of time.
- The agreement should also state that the tenant is not entitled to withhold rent on the grounds that the landlord is holding a deposit. However, be warned that this will not always stop a tenant from leaving without paying his last month's rent!

Note that most new tenancy agreements nowadays will be drafted on the basis that the tenancy is an assured shorthold tenancy and that the tenancy deposit scheme will apply. If you have a common law tenancy you will need to find an agreement drafted for common law tenancies. There is a wide selection of different tenancy agreements available for members of the author's website service at www.landlordlaw.co.uk.

Fair wear and tear

When making deductions from the damage deposit, landlords are not allowed to claim for damage caused by 'fair wear and tear', i.e. damage due to the normal consequence of the tenant living in and using the property. Many landlords do not realise that they are not entitled to receive the property back in the same pristine condition at the end of the tenancy as

it was at the start. The landlord is entitled to receive the property back in the condition you would reasonably expect it to be in after having been lived in for the period of the tenancy. If it was left in a clean and tidy condition the landlord is entitled to expect to receive it back in a clean and tidy condition, but he is not entitled to demand professional cleaning and redecoration. Note also that if a property has been let to a family with young children, the landlord cannot expect the property to be in the same condition it would be in if it had been let to, say, an elderly spinster. It is reasonable to expect that the property will have suffered more wear and tear with children in occupation.

Dealing with deposits during and at the end of the tenancy

There are often misunderstandings about the way deposits should be dealt with, particularly when proceedings are being brought for possession on the basis of rent arrears. While the tenant is in the property, the deposit is held by the landlord as security and should not be credited to the tenant against unpaid rent. When the tenant leaves, the landlord will inspect the property, and assess its condition. The damage deposit should then be used as follows:

- If there are any repairs that need to be done or items to be replaced, the cost of this will be deducted from the deposit. It may also be necessary to clean the property and again the costs of this will normally be deducted. It should be emphasised that costs must be reasonable and landlords should keep all receipts. There may be other deductions that are appropriate (e.g. if there has been a local authority clawback). However, all deductions from the deposit must be authorised by the relevant clause in the tenancy agreement.
- After these costs have been deducted, and only after this, the remaining money is credited to any rent arrears due.
- The balance (if any) is then paid to the tenant.

While the tenancy is continuing, strictly speaking the deposit should not be used until the tenants have left. However, many tenancy agreement clauses provide for the deposit to be used for any repair or similar work which falls due to be done (and which is not the landlords responsibility)

during the tenancy, with the tenant then being asked to replace this money to bring the deposit up to the full amount.

At the end of the tenancy, the landlord should, ideally, inspect the property with the tenant (who will not be in arrears) the day the tenant leaves (the 'handover' meeting), the property will be in perfect condition, and the landlord will hand the deposit back there and then. If there are deductions that need to be made, the landlord should deal with any work quickly so as not to delay returning any remaining balance to the tenant. Often tenants will need this for the deposit on their next property and will suffer hardship if it is not returned promptly.

Tip

If you are using a letting agent, make sure that he has a client's money protection scheme, as damage deposits held by him will be at risk if he goes out of business. If this happens, you will still be responsible for paying the money back to the tenant.

Tip

Many local authorities have damage deposit guarantee schemes to help people obtain housing in the private sector, who otherwise could not raise the initial payments.

Taking a deposit subject to the statutory schemes

If you are going to take deposits which will be subject to the statutory schemes, you need to have decided in advance which scheme you will be using, and to have made any necessary arrangements to join if required.

There are two types of scheme:

- 1 **Custodial scheme:** Here the landlord or agent has to pay the money over to the scheme administrators. This scheme is free of charge to landlords and agents, as the running cost is covered by the interest on the deposit money. There is only one custodial scheme which is called

The Deposit Protection Service – this is run by Computershare Investment Services PLC. They are a large international company and have been running a similar scheme in Australia for over 8 years. They have a website at www.depositprotection.com.

- 2 **Insurance schemes:** Here the landlord or agent keeps the deposit money, but informs the scheme administrators of the new tenancy. If the landlord fails unreasonably to return the money to the tenant at the end of the tenancy, money will be paid to the tenant by the scheme administrators. Landlords and agents have to pay to be a member of this type of scheme. There are two insurance-based scheme:
 - **The Tenancy Deposit Scheme:** this is run by The Dispute Service Ltd which previously ran a similar voluntary scheme for regulated letting agents. This scheme is aimed mainly at letting agents, although it is open to landlords. It is the only one of the three companies which will be using its own in-house arbitrators. They have a website at www.thedisputeservice.co.uk.
 - **Tenancy Deposit Solutions:** this scheme is run in partnership between the National Landlords Association (the largest landlords' association) and Hamilton Fraser Insurance. The scheme is aimed mainly at private landlords but is open to agents. They have a website at www.mydeposits.co.uk.

The Deposit Protection Service and Tenancy Deposit Solutions will be using members of the Chartered Institute of Arbitrators to provide the arbitration service.

Which scheme should you use?

This really depends on how many deposits you will be taking and what is important to you.

If you are a large landlord with many properties and will be taking many deposits – probably the most suitable will be The Tenancy Deposit scheme run by the Dispute Service. For this scheme you pay an annual payment (which varies depending on whether you belong to any regulatory body or accreditation scheme). However, this scheme is really aimed mostly at letting agents and is geared to their needs rather than the needs of individual landlords with smaller portfolios.

If it is important to you that you hold the damage deposit perhaps the best scheme for you will be Tenancy Deposit Solutions. This scheme is run by a landlords' organisation for landlords and is geared to their needs. Instead of an annual fee, you pay a modest fee to join the scheme and then an additional fee per property. There is a slight discount if you are a member of the National Landlords Association.

If cost is an important consideration the best scheme is probably the custodial scheme. Although you will have to pay the deposit money over to the scheme administrators, the scheme is completely free of charge. However, if your tenants are good tenants who will leave the property in good condition, this should not be a problem. You will no longer earn interest on the deposit money of course, but if you do not hold many deposits, this is unlikely to be a significant amount.

However, before making up your mind you should visit each of the three websites and read all the online information. The sites also publish the schemes terms and conditions and many of the forms.

Note that for all of the schemes it will be a great help if you have internet access as you will be able to deal with the scheme administrators online. Indeed the schemes encourage this, the Tenancy Deposit Scheme going so far as to charge £5 per document if information is not provided electronically (payable in advance!).

The tenancy agreement

All new tenancy agreements for assured shorthold tenancies in the shops will (or should) now be suitable for use with the The Deposit Protection Service custodial scheme, and Tenancy Deposit Solutions insurance based scheme. However if you use the insurance based Tenancy Deposit Scheme, the administrators, the Dispute Service Ltd, will require you to insert additional clauses into your tenancy agreement. This is another reason why this scheme is only really suitable for the larger landlords and for letting agents.

Note that as all disputes will be referred to arbitration it is particularly important that a detailed inventory is prepared and checked over with the tenant at the start of the tenancy. Indeed some of the scheme administrators have indicated that landlords will have little chance of

successfully claiming damages from the deposit at arbitration if they are unable to prove the condition of the property at the start of the tenancy by way of an agreed inventory. Inventories are discussed in more detail in the previous chapter.

How the schemes will work

- Make sure, if you are using one of the insurance-based schemes, that you are aware of its charges, and that you have joined as a member. Note that it may take several weeks for applications to join the insurance-based Tenancy Deposit Scheme to be processed.
- Immediately, or as soon as possible after taking the deposit, you must provide the scheme administrators of the tenancy deposit scheme you are using, with such information about the tenancy as they may require. If you are using the custodial scheme you will also need to pay the deposit money over to the scheme administrators. The easiest way to do this is via the scheme website, which is totally secure.
- Within 14 days of taking the deposit from the tenant, you must give them details of the tenancy deposit scheme being used, together with certain other prescribed information. The administrators of the scheme you are using will tell you what information you need to provide and may also give you a form to use and leaflets to give to your tenants. Otherwise, a suitable form is available from Lawpack or a similar form is available for members of the author's website at www.landlordlaw.co.uk.
- During the tenancy you must comply with the terms and conditions of the scheme you are using. Make sure you have a copy of these and have read them carefully.
- At the end of the tenancy, you should check the property, preferably during a 'handover' meeting with the tenants. If possible you should try to agree any deductions to be made. If agreement can be reached, you should then, if you are using an insurance-based scheme, pay all or part of the deposit (as agreed between you) to the tenant, and inform the scheme administrators. If you are using the custodial scheme, the scheme administrators will need to be informed and they will then pay the money as agreed, within 10 days of receiving notification.

- If agreement is not possible, then you should inform the scheme administrators so the dispute can be referred to arbitration. If you are part of an insurance-based scheme you will be required to pay the money in dispute to the scheme administrators, and pay any undisputed part of the deposit to the tenant or keep it depending on what has been agreed with the tenants. If the money is held in a custodial scheme, the undisputed part of the deposit will be paid out as agreed between you and the tenant
- You and the tenant will both have to confirm that you agree to the dispute being dealt with by arbitration. It is possible to have any dispute resolved by the County court instead of by arbitration, but the arbitration procedure is so much quicker and simpler that most people will prefer it, particularly as it is free with no court fees.
- You and your tenant will need to provide details to the arbitrator to enable them to reach a decision. This will normally be done on the paperwork alone, without a hearing.
- The scheme administrators will pay out the deposit money as ordered by the court or by the arbitrator within 10 days of being notified on the decision.

Dealing with arbitrations

The arbitrator will almost always deal with the case on the paperwork without any meeting, hearing or visit to the property. It is very important therefore that the paperwork you provide should be as full and helpful as possible. If possible the arbitrator should have:

- A copy of the current tenancy agreement.
- A copy of the inventory.
- Photographs to prove the condition of the property and its contents. Photographs must be very clear, not out of focus, preferably date stamped, and include a ruler to show the scale. Sometimes a video can be used, but again this must be clear and relevant.
- Any evidence you may have to prove that the sums claimed by the you are reasonable, such as estimates for work, and details of prices for contents such as printouts of details of similar items sold on the

internet or the relevant pages of Argos or similar catalogues.

- A written statement setting out your reasons for making the claim and giving any other information you may think relevant.
- Any statements from others (preferably professional, independent people such as an inventory clerk, builder or surveyor) supporting your claim, and also from any (preferably) independent witness who can confirm the condition of the property. Statements should have the full name and professional qualifications (if any) of the person giving the statement, and be signed and dated at the end. Ideally they should also have at the end before the signature and date, the words 'I believe that the facts stated in this witness statement are true'.

Avoiding the tenancy deposit schemes

Many landlords are annoyed about the tenancy deposit scheme, which they consider to be an unnecessary bureaucratic burden upon them. Quite a few would like to avoid the scheme if they can. However, this is difficult and many of the so called solutions are not really satisfactory. Here are some of the ideas I have heard:

- Taking a deposit which is not money. This is specifically prohibited under the legislation.
- Letting property as an assured rather than an assured shorthold tenancy. This is not advisable. If a property is let as an assured rather than an assured shorthold tenancy, then the landlord will not have recourse to the 'notice only' no-fault repossession procedure under section 21 of the Housing Act 1988. Although you may think at the time of letting that you will not need to evict the tenant, this view may change; for example, you may need to realise your capital to pay off debts or for an emergency, or the tenant may prove problematic, but not so problematic that eviction will be easy under the other grounds for possession. In both of these situations recovery of the property by using section 21 would have been relatively straightforward, but may be impossible if section 21 is not available.
- Taking a guarantee rather than a deposit. If the guarantee is under one of the local authority guarantee schemes, this is an excellent option. However, taking a guarantee from a relative or friend of the tenant is not really as satisfactory as a deposit; for example, if the tenant defaults

on payment they may refuse to pay. You may be able to obtain a County court judgment against the guarantor but this will take time and if they have no assets, will be of little value. Even if they do have assets the County court enforcement procedure is very slow. Taking a guarantee is often a good idea if you are worried about the tenants' ability to pay rent, but this should be in addition to and not instead of a deposit.

- Putting up the rent instead. This might get around the problem, but it will also make your property more expensive and possibly less attractive to tenants (although of course they will not have to find a deposit). Plus if this brings the rent to above the market rent, the tenants have the right to challenge the rent this by referring to the Rent Assessment Panel, who may decide to reduce it. If this happens the landlord will not be allowed to increase the rent until after the end of the fixed term. Note that putting up the rent with a 'cash back promise' to the tenants if they leave the property in a good condition is not advisable as it would probably be deemed to be a deposit.
- Insurance-based solutions. A number of insurance companies are developing various options; for example, one company has a policy which will allow the landlord to claim for all damage done to the property (including malicious damage) under the insurance policy with just £100 deduction. Another solution provides for the tenants to be insured, with the benefit assigned to the landlord, for more than a the deposit would have been. However, this option is only available where tenants have a good credit history and these tenants are unlikely to be the ones which cause the problems.
- Taking two months' rent, instead of one month's rent and a deposit. There is nothing to stop landlords doing this. However, the money can only be used as rent and cannot be used to pay for damage and replacements at the end of the tenancy. So the tenants would be quite entitled to pay nothing for the last two months of the tenancy leaving you with nothing to use to pay for breakages.
- No deposit. If you have a good tenant and believe that they will not cause any damage, you may decide to take no deposit at all. This will be popular with the tenants and no doubt they will be pleased to learn that you are trusting them! However, you may get caught out if the property is left in poor condition when they leave.

Penalties for non-compliance

If you fail to protect a deposit which is supposed to be protected under the legislation the following penalties will apply:

- The tenant can apply to the County court for:
- repayment of the money, or
- an order that you pay the deposit money to the custodial scheme within 14 days, and
- an award of three times the deposit money, to be paid to the tenant within 14 days
- any Section 21 notice served will be invalid if a deposit has been taken and the requirements of the scheme have not been complied with. This means that you will not be able to use this procedure to evict the tenants until either the deposit has been protected in compliance with the rules or it has been paid back to the tenants.

Note that the requirement to make an award of three times the deposit money is a mandatory requirement so the judge is not allowed to refuse the tenant the order once your default has been proved. This will therefore be very expensive for the landlord, and will effectively allow his tenants to live in the property rent free for (in most cases) three months.

Conclusion

At the time of writing the tenancy deposit scheme has been in force for several months and appears to be operating satisfactorily. Feedback from Australia, where a similar scheme has been in operation for some eight years, showed that after some initial resistance their scheme was accepted by landlords and now causes few problems.

Officials from the National Landlords Association have made the point to the author that although the scheme is unwelcome for many landlords, it will serve to remove the alleged non-return of deposits as an issue, and will enable landlords and tenants organisations to concentrate on other matters.