

EXECUTIVE NOTE

THE TENANCY DEPOSIT SCHEMES (SCOTLAND) REGULATIONS 2011

SSI 2011/176

1. The above instrument is being made in exercise of the powers conferred by sections 121(1) and 191 (5) of the Housing (Scotland) Act 2006. The instrument is subject to the affirmative resolution procedure.

2. Part 4 of the Housing (Scotland) Act 2006 gives the Scottish Ministers powers to bring forward regulations to establish the regulatory framework for tenancy deposit schemes in Scotland, including conditions for the approval of schemes by Ministers (“tenancy deposit regulations”).

Policy Objectives

3. It is common practice in the private rented sector for landlords and agents to require a tenant to pay a returnable deposit at the start of a new tenancy. All or part of the deposit may be legitimately withheld at the end of the tenancy if the tenant has failed to meet their obligations under the tenancy agreement. For example, where damage has been caused to the property.

4. However, evidence from the Review of the Private Rented Sector, published in March 2009, indicates that a significant minority of tenants in Scotland may have had their deposits unfairly withheld. Concerns over poor tenancy deposit practice led to the Scottish Ministers being granted powers in the Housing (Scotland) Act 2006 to bring forward tenancy deposit regulations.

5. The available evidence indicates that between 8,000 and 11,000 tenants per year may have part or all of their tenancy deposits unfairly withheld. This equates to between £2.2 million and £3.6 million.

6. The main objectives in bringing forward tenancy deposit regulations are:

- To reduce the number of unfairly withheld tenancy deposits;
- Ensure that deposits are safeguarded throughout the duration of the tenancy;
- Ensure that deposits are returned quickly and fairly, particularly where there is a dispute over the return of the deposit, or proportion of it, to tenant or landlord.

7. The policy is consistent with the broader objective of supporting the growth of a professional, high quality private rented sector that can be considered as a desirable and sustainable housing solution.

8. Unlike the national authorities in England and Wales, the Scottish Ministers have no statutory duty to secure a tenancy deposit scheme. Part 4 of the 2006 Act allows the Scottish Ministers to approve tenancy deposit schemes, in accordance with regulations made by them. Therefore, tenancy deposit regulations will provide a framework for the approval and subsequent operation of tenancy deposit schemes in Scotland, providing a basis for potential

scheme providers to develop the detail of how a proposed scheme would operate. To be approved, a scheme will have to operate across all of Scotland.

9. The regulations will require that proposals to operate a tenancy deposit scheme must include a robust financial strategy that demonstrates that the proposed scheme is sustainable without the need to rely on financial support by the Scottish Government. A scheme will require to have procedures to safeguard tenancy deposits held by it in the event that it ceases to operate.

10. The regulations will impose a duty on a landlord who receives a deposit in connection with a relevant tenancy to participate in an approved tenancy deposit scheme, and to abide by the rules of that scheme. Deposits must be submitted to the administrator of an approved scheme within 30 working days of the beginning of the tenancy. In most cases the date on which the tenancy begins will be specified in a tenancy agreement.

11. In order to safeguard as many tenancies as possible, and at the same time provide consistency with existing legislation, the types of tenancy to which these regulations will apply mirror those to which the landlord registration provisions in the Antisocial Behaviour etc. (Scotland) Act 2004 apply.

12. The regulations will set out the sanctions for failure to comply with the regulations. A sheriff, on application by the tenant, must consider whether the landlord has failed to comply with the duties to pay a deposit to an approved scheme and to provide the tenant with the required information. If the landlord has failed to comply, the sheriff must order the landlord to pay the tenant up to three times the amount of the deposit and may order the landlord to submit the deposit to an approved scheme or provide the tenant with the information.

13. In order for the sanctions to be effective and to actively encourage landlords to comply with the legislation, it is intended that they should apply even if the failure to comply is rectified by the time the application is considered by the sheriff. The sheriff will have discretion to take the individual circumstances of each application into account when deciding what amount of financial penalty should apply.

14. The regulations will permit custodial tenancy deposit schemes. This means that landlords must submit deposits to the administrator of the scheme. The deposit will then be safeguarded in a designated account until it falls to be repaid under the rules of the scheme.

15. Every approved scheme will be required to provide access to a free and independent dispute resolution service, as an alternative to seeking redress through the court system, where there is a dispute over the return of the deposit. Tenants and landlords will be able to request a review of a decision where there is evidence that the adjudicator has erred in fact or law (or both). Once started, the adjudication process may be abandoned or suspended at any time as long as both parties consent e.g. where tenant and landlord reach agreement about the amount of deposit to be returned. Use of the service will not be compulsory.

16. The tenancy deposit scheme must also include processes for ensuring that deposits will be returned fairly where either the tenant or landlord does not cooperate or is not contactable. Where it is the landlord who fails to cooperate, the deposit will be repaid to the tenant. Similarly, the scheme must have procedures to permit repayment of the deposit to the landlord where the tenant does not agree to use the dispute resolution service or otherwise

agree with the landlord the amount to be repaid within a specified timescale, for example because the tenant has decided to raise court proceedings for recovery of the deposit. The regulations envisage that where a dispute is taken to court by either party, there is no longer any role for the scheme. The deposit should therefore be repaid promptly by the scheme administrator rather than awaiting the outcome of the court proceedings.

Consultation

17. Since August 2006, the Scottish Government has been consulting with a stakeholder group to consider the nature and scale of the problem of withheld tenancy deposits, and the options for improving tenancy deposit practice. Consensus amongst group members was reached on a number of key provisions. The group consists of the following members:

- Association of Residential Letting Agents
- Chartered Institute of Housing
- Citizens Advice Scotland
- Consumer Focus Scotland
- Convention of Scottish Local Authorities
- Crisis
- National Association of Estate Agents
- National Union of Students
- Royal Institution of Chartered Surveyors
- Scottish Association of Landlords
- Scottish Rural Property and Business Association
- Shelter

18. Informal consultation has taken place with a number of other organisations as the policy has developed, including:

- The Deposit Protection Service
- MyDeposits
- The Dispute Service
- The Private Rented Housing Panel
- Private Residential Tenancies Board
- Local Authorities (Landlord Registration contacts)
- Edinburgh Community Mediation Services
- The Property Ombudsman
- IDRS
- Letwise
- St Andrews University Students Association
- Robert Gordon University
- UK Government Department for Communities and Local Government
- Government of Ireland
- Private Rented Tenancies Board, Republic of Ireland
- States of Jersey

There has also been discussion with the Scottish Court Services.

19. A public consultation on a set of the draft regulations took place between 2 August and 3 October 2010. A report on the findings of the consultation and responses to the consultation were published on 22 November 2010. The report contains a list of those who were consulted, and those who responded, including local authorities, universities, tenancy deposit scheme administrators in England and Wales, landlords, agents and individuals with experience of tenancy deposit practice. The report is available at the following address:

<http://www.scotland.gov.uk/Publications/Recent>

Impact Assessments

20. A partial Equality Impact Assessment was included in the consultation on the draft regulations. No comments were received on issues relating to any equality groups. An Equality Impact Assessment was completed on 9 December. There are no identified equality impact issues. The report is available at the following address:

<http://vq73eda/systems/EqualityUnit/Assessment/view.asp?ID=630>

21. A Strategic Environmental Assessment pre-screening report was submitted to the Consultation Authorities (CA) for their information. The report advised that our judgement was that the instrument would have no or minimal environmental effects. The CA has not expressed any concern over our assessment.

Financial Effects

22. The main financial impact on landlords and agents will arise as a result of submitting deposits to a custodial tenancy deposit scheme. Currently, any interest accrued on deposits held by landlord and agents is retained by them, unless there is agreement that it is returned to the tenant. Under the proposed regulations this income may be lost. Other costs may be incurred from additional administration, although this is likely to be minimal.

23. Scottish Government will incur costs in developing a communications strategy to inform the public and businesses about the introduction of tenancy deposit regulations and approved tenancy deposit schemes. The regulations will permit financial assistance to be given in respect of all or part of the activities of a scheme, but there will be no obligation to do so.

24. The instrument has minimal financial implications for tenants.

25. A full Business and Regulatory Impact Assessment, which includes a compliance cost assessment of the effect that these Regulations will have on the costs of business and the voluntary sector, has been prepared and placed in the Scottish Parliament Information Centre. A copy of the BRIA is attached.

Scottish Government
Housing and Regeneration
20 January 2011

BUSINESS AND REGULATORY IMPACT ASSESSMENT

Title of Proposal

The Tenancy Deposit Schemes (Scotland) Regulations 2011

Purpose and intended effect

1. This Business and Regulatory Impact Assessment (BRIA) provides assessment of the impact of making regulations to provide for tenancy deposit schemes, including setting out the criteria that schemes must meet. The powers to make such regulations are contained in Part 4 of the Housing (Scotland) Act 2006.

Objectives

2. The main objectives in bringing forward regulations for the approval of tenancy deposit schemes are to:

- tackle the problem of unfairly withheld deposits;
- ensure that deposits are safeguarded throughout the duration of the tenancy;
- ensure that deposits are returned fairly, particularly where there is a dispute over the return of the deposit, or a proportion of it, to tenant or landlord;
- encourage continued improvement in standards of property management in the private rented sector.

3. The Scottish Government wants to support the growth of a professional, high quality Private Rented Sector equipped to provide sustainable housing solutions for Scotland. A subsidiary objective is to help the private rented sector to function more effectively and to improve its professionalism and attractiveness to tenants.

Background

4. A landlord can legally require a tenant to pay a returnable deposit (of no more than two months' rent for an assured or short assured tenancy). The landlord is entitled to withhold all or part of the deposit at the end of the tenancy if the tenant has failed to meet his or her obligations under the tenancy agreement. However, there have long been concerns about tenancy deposits being unreasonably withheld by landlords, in whole or in part.

5. To develop the regulations, a stakeholder working group, representing tenants, agents and landlords, and other housing interests was established in August 2006, to examine the evidence on tenancy deposits and options for improving tenancy deposit practice. The group formally met on 9 occasions to consider a range of evidence including material from the *Review of the Private Rented Sector*, which was published in March 2009, and also evidence from the three tenancy deposit schemes currently operating in England and Wales.

6. The Review was the most extensive study of the sector carried out in Scotland and included comprehensive surveys of tenants and landlords, which asked a number of questions about experiences of tenancy deposits.

7. Part 4 of the 2006 Act allows Scottish Ministers to approve tenancy deposit schemes, in accordance with regulations made by them. Unlike the national

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authorities in England and Wales, Scottish Ministers have no statutory responsibility to secure a tenancy deposit scheme. Following a meeting of the working group on 24 September 2009, the decision was taken to work towards introducing regulations for tenancy deposit schemes in Scotland, as permitted by Part 4 of the 2006 Act.

8. Tenancy deposit regulations provide a framework for the approval of tenancy deposit schemes in Scotland. They also set out the range of sanctions for failure to comply with the regulations. Scottish Ministers may approve more than one scheme.

9. All private sector landlords letting property in Scotland, and receiving a tenancy deposit in connection with a tenancy type covered by the regulations, will be required to comply with tenancy deposit regulations. Once the regulations are in force, Ministers will consider any schemes proposed against the conditions as set out in this SSI.

Rationale for Government intervention

10. The Scottish Government recognises that most landlords operate to good standards and let their properties in a responsible way. However, the available evidence indicates that a significant minority of tenants experience difficulties in recovering their deposit.

11. Evidence from the *Review* indicates that a significant minority of tenants in Scotland may have had their deposits unfairly withheld. Based on data from the *Review*, it is estimated that about three quarters of the approximately 233,000 households in the private rented sector had paid a deposit. Estimates of the total amount of deposits held by landlords at any one time ranged from £63.6m to £74.2m, with the amount paid each year ranging from £27.4m to £31.9m.

12. Approximately one quarter to one third of households seeking return of their deposit had some or all of it withheld, i.e., 18,000 to 26,000 tenancies per year. In monetary terms, this ranged from £5.3m to £8.4m. Where deposits were withheld in whole or part, approximately three quarters of tenants considered that the landlord or agent behaved unfairly. This would suggest that £3.7m to £6m is considered by tenants to be unfairly withheld each year, affecting between 13,000 and 19,000 tenants.

13. It is not possible to tell how many deposits were actually unfairly withheld in objective terms. For example, a tenant's perception of whether a property needs to be cleaned may differ from a landlord's. However, we understand that between 50% and 60% of tenants disputing the withholding of deposits in two of the tenancy deposit schemes operating in England and Wales were successful. The disputes were resolved by means of a dispute resolution scheme as offered by the scheme as an alternative to taking legal action through the courts.

14. Assuming a similar situation in Scotland and applying the 60% figure to the numbers above suggested that the actual amount of wrongly withheld deposits in Scotland at that time may have been between £2.2 million and £3.6 million, due to be repaid to between 8,000 and 11,000 tenants in the private rented sector. These figures were based on an average deposit of between £364 and £403 in 2008.

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Market evidence obtained by one major letting agent indicates that the average monthly rental in Scotland in the third quarter of 2010 is now £649. This means that the amount of unfairly withheld deposits could exceed £3.6 million, and could continue to grow.

15. Based on evidence gathered in the *Review* and the experiences of the schemes operating in England and Wales, we estimate that approximately 2,500 disputes may be raised in Scotland per year. Taking into account the number of cases that may not be pursued (case rejected or resolved by other means) we estimate a potential caseload of around 1,925 disputes requiring formal adjudication each year.

16. Establishment of a scheme to safeguard tenancy deposits supports the wider policy objective of raising standards of property management in the private rented sector. It compliments other policies such as national landlord registration, voluntary landlord accreditation and the Repairing Standard, which also aim to raise standards in the sector. The policy also contributes to the overarching purposes of ensuring that the housing system is effective and meets the needs of the Scottish people.

Consultation

Within Government

17. The Scottish Government's Consumers in Private Rented Housing Team, which has responsibility for tenancy deposit regulations, has consulted with:

- Scottish Local Authorities & Development Division
- Legal Services Division
- Communities Analytical Services
- Family and Property Law
- Department for Communities and Local Government
- Government of the Republic of Ireland
- Private Rented Tenancies Board, Republic of Ireland
- States of Jersey
- Marketing Unit

There has also been discussion with the Scottish Court Services

- **Public Consultation**

18. The Scottish Government has been consulting with the stakeholder working group on the issue of tenancy deposit practice since August 2006. The working group considered a range of evidence and options for tackling the issue of poor tenancy deposit practice. Broad consensus was reached on a significant number of issues informing policy instructions for the regulations. Members consist of representatives of:

- Association of Residential Letting Agents
- Chartered Institute of Housing
- Citizens Advice Scotland

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- Consumer Focus Scotland
- Convention of Scottish Local Authorities
- Crisis
- National Association of Estate Agents
- National Union of Students
- Royal Institution of Chartered Surveyors
- Scottish Association of Landlords
- Scottish Council for Single Homeless
- Scottish Rural Property and Business Association
- Shelter

19. Informal consultation has taken place with a number of other organisations as the policy has developed, including:

- The Deposit Protection Service
- MyDeposits
- The Dispute Service
- The Private Rented Housing Panel
- Private Residential Tenancies Board
- Local Authorities (Landlord Registration contacts)
- Edinburgh Community Mediation Services
- The Property Ombudsman
- IDRS
- Letwise
- St Andrews University Students Association
- Robert Gordon University

20. A public consultation on draft tenancy deposit regulations was carried out between 2 August and 3 October 2010. The consultation was circulated to approximately 350 external stakeholders with an interest in housing issues as well as relevant internal colleagues. 125 responses were received from a range of organisations as well as private individuals as follows:

- Local authorities – 12 -
- Private Landlords and letting agents – 35
- Representative and trade bodies – 16
- Voluntary organisations/lobby groups – 5
- Private individuals – 49
- Other – 8

21. The consultation included 27 questions relating to various aspects of the draft regulations. Respondents were able to provide either an open response or to complete the consultation questionnaire. Some responses were complex, making it difficult to categorise responses in terms of support or opposition. Some respondents supported some provisions, but not others.

22. In general, local authorities were supportive of the majority of the proposals. The majority of landlords and private letting agents were generally opposed to the

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principle of regulations for tenancy deposit schemes, although some were supportive of individual proposals within the draft legislation, such as provision of a free dispute resolution service, and no fees for joining a custodial tenancy deposit scheme. The other respondent groups were generally positive about the proposals, although opinions were divided on the proposals for appropriate sanctions and financial penalties that should apply for non-compliance.

Business

23. In addition to the various organisations represented on the working group, a number of individual businesses have been consulted. The profile included private landlords with a small number of lets and letting agents with much larger business interests:

One business, 2 offices, Edinburgh/Glasgow)), 12 employees, 700 properties;
One UK business, 2 offices in Scotland, one in England, 17 employees, 1000 lettings;

One business, Forfar, no employees, 2 lettings;

One business, St Andrews, 4 employees, 75 lettings;

One business, Dundee, 7 employees, 390 lettings;

One UK business, 6 offices across Scotland, 40 employees in Scotland (8750 across UK), 1600 lettings in Scotland;

One business, Edinburgh, 3 employees, 35 lettings.

24. Options

Option 1: Do nothing

Option 2: Establish a statutory dispute resolution service for tenancy deposit disputes as an alternative to the court.

Option 3: Introduce regulations for insurance and custodial tenancy deposit schemes including a dispute resolution service as an alternative to the court.

Option 4: Introduce regulations for custodial schemes including a dispute resolution service as an alternative to the court.

Sectors and groups affected

25. The main groups of people who would be affected can be categorised as:

- *Private tenants of relevant tenancy types:* would have their deposits paid in connection with a relevant tenancy safeguarded by an approved independent third party. Tenants can also take action through the court to apply sanctions against landlords who do not comply with the regulations. They will also have access to dispute resolution services offered by approved schemes as an alternative to taking legal action to resolve disputes.
- *Private landlords* who receive deposits in connection with a relevant tenancy would need to become familiar with the new legislative requirements, and any

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new processes arising from them. Landlords must ensure that any agent acting on their behalf undertakes the action necessary to ensure compliance with the regulations. Sanctions may apply to landlords who fail to comply.

- *Letting agents* who act on behalf of a landlord would need to become familiar with the new legislative requirements, and any new processes arising from them.
- *Local authorities* who would receive information from approved tenancy deposit schemes about landlords who apply to an approved scheme. Local authorities may use this information to confirm whether landlords are registered and consider whether enforcement action was required. In addition local authorities may be provided with information relating to tenancy deposit disputes by approved schemes, on request, to inform the fit and proper assessment of landlords.
- *Consumer organisation and advice agencies* would need to become acquainted with the tenancy deposit regulations in order to be able to provide support and guidance to service users.

Benefits

Option 1: Do nothing

26. The Scottish Government is committed to ensuring that the private rented sector operates effectively and is able to meet the needs of a wide range of client groups in Scotland.

27. Doing nothing would not help improve tenancy deposit practice. This would mean that there would still be potentially £3.6m in unfairly withheld deposits per year. The reputation of the private rented sector would continue to be blighted by the poor behaviour of some landlords and agents.

Option 2: Establish a statutory dispute resolution service for tenancy deposit disputes as an alternative to the court.

28. The intention would be to provide tenants and landlords with an effective and efficient means of resolving disputes over tenancy deposits, without the need to go through a potentially costly and time consuming court action. The dispute resolution service would not be compulsory, and both parties would still have the option of taking legal action through the courts.

29. The provision of a statutory alternative dispute resolution (ADR) service could be achieved by adapting an existing body to deal with tenancy deposit disputes, such as the Private Rented Housing Panel (PRHP). This could be done by introducing secondary legislation if the scope of the Public Services Reform (Scotland) Bill allowed, or alternatively by Primary legislation.

30. Disputes would be dealt with by way of a paper based decision making process, to be undertaken by an independent adjudicator. Tenants and landlords would be

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required to submit evidence in support of their claim on the deposit, but would not be required to attend a formal hearing.

31. Benefits of this approach include:

- Provision of an alternative means of resolving disputes without taking legal action;
- A single decision making body would encourage consistency in terms of decision making and service delivery;
- Only tenants and landlords involved in a dispute would be affected.

Option 3: Introduce regulations for insurance and custodial tenancy deposit schemes including a dispute resolution service as an alternative to the court.

32. With this option, every approved tenancy deposit scheme would include optional access to a cost effective and independent dispute resolution service to deal with disputes over deposits. The benefits associated with this option are as follows:

- Provides an alternative means of resolving disputes without taking legal action, or the need for a hearing (as with the PRHP);
- The PRHP would require significant changes to its function to deal with tenancy deposit disputes. There are a number of established independent adjudication services. This would minimise costs and make the timescale for set up of an ADR service much quicker than under Option 2;
- Scheme administrators would have the freedom to choose the most appropriate delivery mechanism for the ADR service, thereby promoting competition in terms of cost and quality of service;
- Access to the ADR service would be free to tenants and landlords and there would be no cost to Scottish Government;
- Under custodial schemes, the deposit would be safeguarded throughout the tenancy by an independent scheme administrator;
- Landlords would have a choice of which model to participate in, if more than one scheme model was proposed and approved;
- Tenants would be able to apply to the courts for sanctions to be imposed on a landlord who did not comply with the regulations;
- Potential sanctions for non compliance likely to encourage improvements in practice;
- Local authorities would be notified by tenancy deposit scheme administrators of any unregistered landlords/properties that were identified as a result of an application to a tenancy deposit scheme.

Option 4: Introduce regulations for custodial schemes including a dispute resolution service as an alternative to the court.

33. There are a number of risks associated with the insurance scheme model which mean that this option provides more fundamental protection of tenancy deposits than Option 4. The benefits associated with Option 4 can be summarised as follows:

- Tenancy deposits would be safeguarded in a designated client account by an

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independent third party throughout the tenancy;

- All tenants would receive the same level of protection;
- There is no risk to the tenant if the landlord or agent goes bankrupt or misappropriates funds;
- There would be no cost to tenants or landlords to join a custodial scheme, as there would be to join an insurance scheme;
- Access to the ADR service would be free to tenants and landlords and there would be no cost to Scottish Government;
- Scheme administrators would have the freedom to choose the most appropriate delivery mechanism for the ADR service, thereby promoting competition in terms of cost and quality of service.
- Where there is a dispute, the deposit is already held by the scheme administrator. This allows for disputes to be resolved, and the deposit to be returned to either tenant or landlord in good time;
- Scheme administrators will be required to return deposits within a specified timescale, where there is no dispute over the amount;
- Tenants would be able to apply to the courts for sanctions to be imposed on a landlord who did not comply with the regulations;
- Potential sanctions for non compliance likely to encourage improvements in practice;
- Local authorities would be notified by tenancy deposit scheme administrators of any unregistered landlords/properties that were identified as a result of an application to a tenancy deposit scheme.

Costs

Option 1: Do nothing

34. This option presents no implementation costs. However, a significant minority of tenants would continue to lose part, or all of their deposit, or face the cost of taking legal action to recover their money.

Option 2: Establish a statutory dispute resolution service for tenancy deposit disputes as an alternative to the court.

35. The costs of establishing an ADR service would probably fall to the Scottish Government. Costs for the adaptation of the PRHP to deal with tenancy deposit disputes would need to take into account additional staff, IT, equipment, stationery, training, publicity and marketing, accommodation and other miscellaneous set up costs. Miscellaneous set up costs are estimated by the PRHP to be around £70,000, with an additional £15,000 for marketing.

36. The PRHP currently uses of a panel of members, including specialist trained mediators, solicitors and lawyers who are paid on a daily fee basis. It is not envisaged that this level of expertise would be required to resolve tenancy deposit disputes. A more cost effective and efficient approach would be to employ salaried staff to deal with tenancy deposit casework, with the option to refer to a specialist panel member if required.

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37. Based on information from the PRHP and the number of anticipated disputes, we estimate that the addition of two A3 members of staff @ £22,000 and 2.5 B1 staff @ £29,000 would be sufficient. This figure is based on adjudicators clearing an average of three cases per day. The total cost would be in the region of £116,500 pa. The responsibility for meeting the running costs of the service either fall to the Scottish Government or to the tenants and landlords that apply to the service. Based on the estimated case load of 1,925 this would equate roughly to a cost of £60 per adjudication. The cost could be more or less depending on actual number and complexity of cases referred for adjudication.

Option 3: Introduce regulations for insurance and custodial tenancy deposit schemes including a dispute resolution service as an alternative to the court.

38. Scottish Government may need to undertake a strategic campaign to raise awareness of both the new legislation and any subsequently approved tenancy deposit schemes. Marketing Unit colleagues advise that a suitable publicity campaign might cost in the region of £300,000.

39. Costs for assessing and approving scheme proposals, monitoring performance and reviewing schemes would fall to the Scottish Government. It is difficult to estimate how much staff resource would be given over to this process, until we know how many schemes come forward. However, based on one B2 staff member this could be in the region of £28,000 in the first year. This cost would reduce significantly once the approval process was completed and the role became more one of monitoring performance.

40. There would be a charge for landlords to join an insurance scheme. Fees may be set at levels that reflect the insurance risk posed by individual landlords and the cost of providing ADR. Some agents who have been consulted have indicated that if they pay to join an insurance scheme, the cost would be passed on to the landlord. The cost for landlords and agents to join one of the two insurance schemes in England and Wales depends on a number of factors including the number of tenancies protected and whether the landlord or agent is affiliated to particular organisations such as the National Association of Landlords. Fees range from a flat rate of £750 for under 50 properties; £15 per tenancy for 50 or more properties; £1,150 plus £18 per tenancy; annual fee of £57.50 plus between £17 and £29 per tenancy. One business (75 lettings) estimated that membership fees for participating in an insurance scheme could amount to around 15% of the net profits of the business.

41. The costs for landlords to join an insurance scheme in Scotland would not be known until proposals to run a scheme were submitted. The regulations would not include provisions relating to the setting of fee amounts. To do so could have a negative impact on the ability of any scheme to adapt to market conditions, and be sustainable.

42. Landlords would pay nothing to participate in a custodial scheme. However, there would be an indirect cost associated with the submission of tenancy deposits to a custodial scheme, by way of lost interest that would otherwise have been accrued by the landlord. The tenant may lose this income if the landlord would

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normally return interest to them. For illustrative purposes, a £500 deposit generating interest at 2% would achieve around £1.60 gross interest over a six month period. The loss of interest to letting agents with larger portfolios would be more significant.

43. Financial penalties may be imposed on those landlords that fail to comply with the regulations. The amount would be at the courts discretion and would not exceed three times the original tenancy deposit.

Option 4: Introduce regulations for custodial schemes including a dispute resolution service as an alternative to the court.

44. The costs associated with this option would be similar to those shown under Option 4, except that there would be no costs relating to participation in an insurance scheme.

Scottish Firms Impact Test

45. The landlord survey undertaken as part of the *Review* indicates that the average size of portfolio of all landlords in Scotland is 12 dwellings, although most landlords owned between 1 and 4 properties. Very few portfolios were in excess of 20 properties. Agents are reported to be involved in management of 50% of all dwellings. It is impossible to say how many landlords and letting agents would be affected by the proposed legislation, although we know that as at 31 October, 167,943 landlord registration applications had been received, covering 236,616 properties.

46. The proposed tenancy deposit regulations do not make any distinction between businesses of different sizes, in terms of the requirement to comply. The same duties in relation to approved tenancy deposit schemes would apply to all landlords who received a deposit in connection with a relevant tenancy would be required to comply, regardless of the number of properties they let, or the number of employees they have.

47. Feedback from those consulted suggested that additional administration in respect of participating in a tenancy deposit scheme, and also in the dispute resolution process, would be more time consuming and would result in additional costs to the business. The potential costs were difficult to quantify until the precise details of any approved scheme was known. There was nothing to suggest that this would prevent any of the businesses from complying with the regulations. One business did suggest that the additional layer of regulation, rather than cost, may act as a barrier to new landlords entering the market.

48. Some provisions within the regulations would include a timescale for compliance. Feedback from two of the businesses indicated that the specific timescale relating to the submission and application for repayment of deposits may be difficult to achieve. This would be a particular problem if large numbers of tenancies were due to end at around the same time e.g. student accommodation. The proposed timescale has since been removed from the proposed regulations. One business indicated that compliance would be straightforward if the requirements were similar to those already adhered to with tenancy deposit schemes in England

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and Wales. No other issues with compliance were highlighted.

49. The relative cost impact to the businesses consulted related directly to the number of properties let, with by far the largest costs associated with membership fees for joining an insurance-backed tenancy deposit scheme and loss of income generated from deposits if submitted to a custodial scheme. It should be noted that not all landlords retain interest on deposits, although most agents appear to do so. One letting agent consulted with as part of this assessment estimated that the potential loss of income on a deposit pool of around £500,000 would be in the region of £15,000, or between 1.5% and 2% of business turnover. Another letting agent estimated the impact between 3 – 5% of turnover. It was not clear whether this loss would be absorbed by the business, or passed on to individual landlords.

50. One business, estimated that lost interest based on current low interest rates was negligible at around £120 per annum, but that if rates increased to 5% would be around 3.75% of turnover. It was not clear whether the cost would be passed on to individual tenants in some form, but there was a possibility that increased costs could affect profitability. A number of businesses indicated that the cost may well be passed on to tenants by way of higher deposits and rent.

51. One business was concerned about the potential impact on the running of the business where deposit funds may be used as a form of working capital. It was felt this particular impact would be felt more keenly by smaller businesses where deposits were used to assist with cash flow.

52. In terms of the impact of the regulations if existing tenancies were to be covered, two micro businesses indicated that having to find the deposit funds to put into a deposit scheme could pose a significant financial burden, with one of the businesses expressing concerns about being able to sustain the business. Larger businesses may also be affected, particularly if the funds are not readily available. The draft regulations were subsequently amended to allow an extended compliance period for existing tenancies of 9 months from the date that the first scheme becomes operational.

53. There was potential for the provision of access to an ADR service to impact on micro and small businesses. It was felt that tenants would abuse the service by raising unrealistic disputes. This could have the effect of delaying the return of the deposit to the landlord where they had a legitimate claim on it undertake repairs, cleaning etc. ultimately this could impact how quickly a new tenancy could begin, and hence continuity of rental income. For example, if a property normally rented at £650 pcm was empty for 2 weeks pending resolution of a dispute, this could result in lost income of up to £325. One of the micro businesses felt that access to a free ADR would be helpful.

Competition Assessment

54. Tenancy deposit regulations would apply to all landlords who take a deposit in connection with a relevant tenancy type. The main markets affected include landlords and letting agents. The same requirements will be placed upon all landlords to whom the regulations will apply and so it is not expected that any of the

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Options would limit the ability of landlords and letting agents to compete in the market. The businesses that were consulted as part of the Small Firms Impact Test supported this view.

55. None of the Options would place any direct restrictions upon the number of landlords or letting agents that are allowed to operate in the market. Nor would the proposed regulations award exclusive rights to any one scheme provider. The regulations would allow for more than one suitable scheme to be considered for approval as long as Scottish Ministers were satisfied that all the conditions in the proposed legislation were met.

56. None of the Options indirectly limit the number or type of landlords or letting agents. Under Option 3 the charges are likely to reflect the number of qualifying deposits a particular business receives. Therefore, the costs would be relative to the size of the business. The costs in relation to loss of interest under Option 4 would similarly be directly linked to the number of deposits received. This approach would not disadvantage smaller businesses any more or less than larger businesses. The proposals are not likely to significantly raise the costs of new landlords or letting agents seeking to enter the market relative to existing businesses, as both new tenancies and existing relevant tenancies will be covered by the regulations.

57. The proposed regulations include a number of provisions that would help to address the issue of poor landlord practice. By notifying unregistered landlords and properties to local authorities, and by permitting tenants to apply for sanctions against non-compliant landlords, tenancy deposit regulations would help to ensure that landlords did not gain a competitive advantage by failing to meet their legal obligations.

Test run of business forms

58. No new forms will be introduced as a direct result of this legislation.

Legal Aid Impact Test

59. The Legal Aid System Division and the Scottish legal Aid Board (SLAB) have been consulted in respect of this assessment. It is not considered that there will be any effect on individual's right of access to justice through availability of legal aid and SLAB have confirmed that they do not consider that there will be any impact of any significance on the Legal Aid Fund.

Enforcement and monitoring

Option 1: Do nothing

60. There are no implications for enforcement and monitoring with Option 1.

Option 2: Establish a statutory dispute resolution service for tenancy deposit disputes as an alternative to the court.

61. The tenant would be required to go to court recover the allocated deposit.

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Further consultation would be needed to identify whether any alternative enforcement measures were warranted.

62. It is envisaged that performance monitoring would be by means of annual report. A detailed evaluation of this option would be undertaken from time to time.

63. Local authorities would continue to have the power to take account of bad practice in assessing whether landlords are fit and proper to let property. This may include evidence of poor tenancy deposit practice.

Option 3: Introduce regulations for insurance and custodial tenancy deposit schemes including a dispute resolution service as an alternative to the court.

64. Approved tenancy deposit schemes would be required to submit quarterly and annual reports that would provide key information and also advise performance against a specified set of Key Performance Indicators (KPIs).

65. In respect of enforcement, a tenant will be able to take legal action through the Sherriff court for specified sanctions to be applied, where a landlord has failed to protect deposits in accordance with an approved scheme.

66. The key sanctions that would apply to a landlord are set out below and would depend on which type of scheme a landlord participated in:

Breach	Sanction
Failure of a landlord to submit a deposit to a custodial scheme within 30 working days of the beginning of the tenancy	<p>Where a landlord fails to comply with requirements noted opposite, the tenant can apply to the court. The court may decide to order the landlord to;</p> <ul style="list-style-type: none"> • Safeguard the deposit in accordance with an approved tenancy deposit scheme; or • Pay a disputed amount of deposit into an insurance scheme, of which the landlord is a member; or • Provide the tenant with prescribed information.
Failure of a landlord to provide the tenant with prescribed information.	
Failure of a landlord to ensure that the deposit is safeguarded by a tenancy deposit scheme throughout the period of the tenancy	
Failure of a landlord to notify a tenancy to an insurance scheme within 30 working days of the beginning of the tenancy or paying fees to become a member of the scheme	
Failure of a landlord to submit a disputed deposit to an insurance scheme with 10 working days of being requested to do so by the scheme administrator	

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67. If the court is satisfied that a landlord has not met the duties to comply, it may also order the landlord to pay the tenant an amount no more than three times the deposit. It is intended that the court has discretionary powers to consider the circumstances of each case in deciding the penalty that should apply. This means that legitimate reasons for non-compliance can be taken into account.

68. Approved schemes must notify local authorities about any unregistered landlords and properties that are identified as a result of an application to participate in the scheme. The relevant licensing authority can then decide on any appropriate enforcement action. As with Option 2, licensing authorities can also take evidence of poor tenancy deposit practice into account.

Option 4: Introduce regulations for custodial schemes including a dispute resolution service as an alternative to the court.

69. Monitoring and enforcement processes would be as described under Option 3, with the exception that sanctions associated with insurance schemes would not apply.

Implementation and delivery plan

70. We anticipate that the tenancy deposit regulations would come into force in March 2011.

71. The Scottish Government will develop the process and related guidance for potential providers to be able to submit proposals to run a tenancy deposit scheme.

72. Officials would develop a strategy for publicising both the new legislation and the details of tenancy deposit schemes, once they are approved. Guidance and information on the changes would be developed for landlords, agents, tenants, local authorities and other interested parties such as advice agencies and consumer groups. We would work to co-ordinate dissemination of information with key stakeholders to ensure maximum coverage and quality of information. We will engage with local authorities specifically to maximise our ability to reach landlords through the landlord registration network.

- **Post-implementation review**

73. In accordance with the 2006 Act, Scottish Ministers must review approved tenancy deposit schemes from time to time. This would be in addition to the quarterly and annual reporting regime. To allow flexibility, the timescale for review would not be specified in the regulations.

74. Summary and recommendation

- **Summary costs and benefits table**

Option	Benefits	Costs
1	None	None

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<p>2</p>	<p>Possible financial benefits for tenants who pursue recovery of a withheld deposit. Dependent on value of deposit and any cost for ADR.</p> <p>Possible on-going savings as a result of disputes being taken to an ADR service rather than the court.</p>	<ul style="list-style-type: none"> • Initial set up costs - £85,000 (SG) • Annual cost of ADR/running costs - £116,500 pa (would fall SG/tenants/landlords)
<p>3</p>	<p>Significant financial benefits for tenants who pursue recovery of a withheld deposit through a free ADR service.</p> <p>Greater potential for on-going savings as a result of disputes being taken to an ADR service rather than the court.</p>	<p>SG costs:</p> <ul style="list-style-type: none"> • Assessing and approving schemes; • Performance management and review. <p>Total £28,000 pa</p> <ul style="list-style-type: none"> • Marketing £300,000 <p>Potential costs to landlords or agents:</p> <ul style="list-style-type: none"> • Charges for if apply to participate in an insurance scheme. • Lost interest if use custodial scheme. • Cost of compliance, providing information etc. • Cost of sanctions for non compliance. <p>Costs would vary depending on the type of scheme used, and the number of deposits held. Potential cost 1.5% - 5% of business turnover.</p> <p>Potential cost to courts:</p> <ul style="list-style-type: none"> • Cost of claim by tenant against landlord for non compliance
<p>4</p>	<p>Significant financial benefits for tenants who pursue recovery of a withheld deposit through a free ADR service.</p>	<p>SG cost as Option 4</p> <p>Potential costs to landlords or agents:</p> <ul style="list-style-type: none"> • Lost interest if use custodial

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	Greater potential for on-going savings as a result of disputes being taken to an ADR service rather than the court.	scheme. <ul style="list-style-type: none">• Cost of compliance, providing information etc.• Cost of sanctions for non compliance. Costs would vary depending on the type of scheme used, and the number of deposits held. Potential cost 1.5% - 5% of business turnover.
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75. The Scottish Government has a presumption against the creation of new tribunals for limited purposes. The general aim is to simplify and consolidate public bodies. If there is a problem with costs and delay in the ordinary courts, consideration of how those issues might best be resolved should be conducted in the context of the wide-ranging review of Civil Justice by Lord Gill. The Scottish Government will bring forward proposals in relation to the Gill review in the next Parliament.

76. On the basis of the analysis of all the options, Option 4 is recommended as it best meets our objectives in relation to improving tenancy deposit practice, and minimises the impact on businesses in Scotland. Option 4 also best satisfies the requirements for safeguarding tenancy deposits as intended by Part 4 of the Housing (Scotland) Act 2006. Provisions within the Tenancy Deposit Schemes (Scotland) Regulations 2010 have been drafted on this basis.

Declaration and publication

DECLARATION:

I have read the impact assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs. I am satisfied that business impact has been assessed with the support of businesses in Scotland.

Signed by the accountable Minister:

ALEX NEIL
Minister for Housing and Communities

Date: