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Holding Deposit Agreements: Pre-tenancy Obligations and Rights

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☞ Deposits; Landlords' duties; Leases; Residential tenancies; Tenants' rights

There is confusion in the rental market over the legal significance of holding deposits, which are routinely paid by prospective tenants prior to signing a lease document. The purpose of this article is to clarify the legal position of holding deposit agreements (HDAs) entered into in the pre-tenancy period. In particular, to emphasise that, in the usual course:

- *The agreement to, and payment of, a holding deposit creates a binding contract between the prospective tenant and the landlord.*
- *A HDA is a conditional contract, which grants the applicant both the right and obligation to enter into the proposed lease provided conditions, such as passing reference checks, are met.*
- *Neither party may insist on the terms of the lease being “renegotiated” contrary to an agreed HDA. An attempt to do so would ordinarily amount to repudiation of the contract, entitling the innocent party to remedies under contract law.*

Agreement for lease

Holding deposits serve as a practical solution to the problem of a rapid rental market, where decisions to rent are swift but lease formalities can take days or weeks to complete. A holding deposit is a payment by a prospective tenant to a landlord (or their agent) prior to the signing of the lease document. Its purpose is to assure the landlord that the applicant is serious about leasing the property and to assure the prospective tenant that the property is “locked in”, provided the necessary reference checks and conditions to lease are satisfied. Whilst amounts vary considerably, in London a holding deposit will typically be the value of at least one week’s rent (often much more).

A holding deposit will correspond to a HDA between the landlord and prospective tenant. The HDA is a brief written document or oral agreement (often both) that records the basic terms of the agreement for which the deposit is being paid. It should stipulate the key terms upon which the lease will be entered: the parties and the tenancy address, the amount of rent, the type and/or duration of the lease and the start date for the tenancy. Ideally, it will record the amount of the security bond and any fees that will be due. It might also include specially negotiated terms, such as a lease break clause or a provision for the applicant to add another tenant to the lease at a later date (common in shared flatting situations). In agreeing the HDA, the expectation is that the applicant will enter into the tenancy if the applicant passes a reference checking

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process (to verify the applicant's income position and tenancy history) and any other agreed conditions.

A holding deposit is not a tenancy deposit. It is not subject to the statutory tenancy deposit protection scheme, although after the lease is signed it will typically be credited toward the tenancy deposit due: see, S. Bright, *Landlord and Tenant Law in Context*, (Oxford: Hart Publishing, 2007), para.16.4.3; D. Cowan, *Housing Law and Policy*, (Cambridge: Cambridge University Press, 2011) pp.224–228. Nor is a HDA a lease. Rather, in the usual course a HDA is an agreement for lease—a conditional contract, which grants the applicant the right to enter into the proposed lease provided the conditions are met. It satisfies the requirements of offer, acceptance and valuable consideration in the form of the holding deposit payment. HDAs are thus governed by contract law, not by residential tenancies legislation: S. Garner and A. Frith, *Landlord and Tenant*, 7th edn (Oxford: Oxford University Press, 2013), paras 3.10–3.12; Clark, *Hill and Redman's Law of Landlord and Tenant*, (Release 97, 2015), paras 444–445, 450–460. (See also, the discussion of holding deposits (including an example HDA) in M. Stewart, R. Warner and J. Portman, *Every Landlord's Legal Guide*, 12th edn (NOLO, 2014), pp.28–31).

In theory, HDAs should be more significant to the parties' interests than the final lease document. They record the essential terms and are the basis for entering into the tenancy. HDAs protect landlords from bad tenants, by giving landlords an "out" in respect of tenants whose references come back negative. They also give tenants peace of mind that the property they have paid a deposit on will not be let out to another party during the pre-tenancy period. Once it comes time to sign the lease, the key terms reflected in the HDA will be of most importance to the parties, particularly in comparison to detailed standard form lease terms which are subject to statutory restrictions and regulatory oversight. The ultimate lease document should not deviate from the agreed HDA terms.

In practice, however, this is often not the case. In the frantic rental market, applicants compete to be first in time to negotiate with the landlord or agent and, if agreement is reached, to pay the holding deposit immediately to secure their position. Once paid, applicants invariably shift their position in reliance on the HDA. They decline other rental proposals and cease searching; they cannot feasibly arrange a "back up" place without the payment of a second holding deposit, which would be liable to be forfeited.

Yet, once the pre-tenancy administration is completed and the lease is ready to be signed, it is not uncommon for landlords to change tack. It may be that many are simply more unwitting than unscrupulous: in the interim period, a landlord might receive "a better offer" and so wish to renegotiate the key terms of the proposed lease, perhaps by increasing the rent or amending other agreed terms. In law, this is breach of contract and is impermissible. It takes advantage of incoming tenants who, by that stage, have committed to the lease on the basis of the HDA, who will usually have no realistic alternative arrangements and who are at a substantial negotiating disadvantage. Unfortunately, this is all too common in the rental market.

Prospective tenants' obligations and rights

Prospective tenants bear two main obligations when agreeing a HDA with a landlord. The first is to provide honest representations as to their income, tenancy history and other queries the landlord makes during negotiations over the lease. Applicants who mislead landlords as to their background can expect to have their agreement cancelled before the right to enter the lease accrues. Tenants should also endeavour to comply with reasonable requests from any reference verification agency engaged by the landlord (Clark, *Hill and Redman's Law of Landlord and Tenant* (2015), para.469.3). If a tenant fails the verification process and the HDA is cancelled,

the tenant may not insist on performance of the lease. They will, however, ordinarily still be entitled to a full or partial refund of the holding deposit.

Upon satisfying the landlord of their reference background and any other conditions, the second obligation on tenants is to enter the lease as agreed. If a tenant fails to enter into the lease, the landlord is entitled to deduct from the deposit compensation for the reasonable costs incurred: see, The Property Ombudsman, *Code of Practice for Residential Letting Agents* (August 2014), para.9k. Accordingly, at any one time a tenant should only pay one holding deposit in respect of one property, and should decline other proposals to let in the interim.

The primary benefit for tenants of entering into a HDA is the assurance that, subject to specified conditions, they have secured a home in which to live. The HDA gives the tenant a conditional right to sign the lease. (Note: a right will not arise where it is explicitly excluded by the terms of the HDA. However, such one-sided drafting would neither be in the applicant's interests to sign, nor necessary from the landlord's perspective.) A subsequent attempt by the landlord to vary the terms agreed in the HDA or to decline to enter into the lease arrangement would be a repudiation of contract. An incoming tenant in that position would be entitled to a remedy for the breach. As a matter of law, the tenant could elect either to insist on specific performance of the HDA by entering into the lease as envisaged; or to accept the landlord's repudiation and to recover—in addition to a refund of the holding deposit—compensatory damages (Clark, *Hill and Redman's Law of Landlord and Tenant* (2015), para.601). Potentially, such damages could extend to the reasonable additional cost of temporary accommodation as well as the difference in value between the lost rental arrangement and the tenant's subsequent alternative lease arrangement. As a matter of common practice, however, with no practical avenue to enforce their rights promptly in the courts, such tenants often simply find themselves either acquiescing to the landlord's demands or back house-hunting, poorer and frustrated.

Landlords' obligations and rights

The primary advantage to landlords of HDAs is the right of cancellation where applicants fail to meet the pre-tenancy conditions. Landlords who insist on payment of a holding deposit are, though, subject to a number of obligations. First, prior to any payment, the landlord should provide the prospective tenant with a draft copy of the full lease document (The Property Ombudsman, *Code of Practice for Residential Letting Agents* (2014), para.9e). Both parties should know precisely the conditional arrangement to which they are agreeing. Doing so should also serve to highlight to the parties the legal significance of the HDA.

Secondly, landlords must accept only one holding deposit for one property. A landlord who accepts multiple applications, with a view to a competitive tenant "vetting process", is in breach of contract with each applicant. Landlords should also ordinarily direct their agent(s) to remove all advertisements of the property upon acceptance of a holding deposit.

Once accepted, the landlord is bound by the terms of the HDA. At this point, landlords will often engage an external agency to check the incoming tenant's employment and tenancy background. In addition to verifying the tenant's veracity, agency reports will usually recommend to landlords whether to accept a prospective tenant based on an income/expense and credit rating calculation. The relevance of this agency recommendation is frequently misunderstood. Provided that at the outset the applicant has made honest representations to the landlord about their income and ability to pay rent, a landlord may not cancel the agreement on the basis that a third party agency considers that the tenancy would not be prudent (unless this condition has been agreed beforehand). An agency recommendation can only validly be relied upon to cancel

the agreement where the report reveals that the applicant has misled the landlord in a material manner.

Once the landlord is satisfied of the incoming tenant's reference background, the landlord is obliged to enter into the lease. The contractually binding nature of HDAs is confirmed in guidance on holding deposits from the Citizens Advice Bureau's online service AdviserNet at para.85, which states that:

“Acceptance of a holding deposit by the prospective landlord is also a binding contract on her/his part, subject to conditions, for example, taking up of the prospective tenant's references.”

The landlord may not subsequently purport to revoke the offer of tenancy or to change the terms that were agreed. Attempts to do so will be repudiation of the HDA, entitling the tenant to contractual remedies.

Market failures

In practice, HDAs are not operating as they should. Landlords frequently treat HDAs as a one-sided protection of their interests—a valid justification for retaining the holding deposits of unreliable tenancy applicants. The obligations that HDAs impose on landlords—namely, to enter into the lease on the agreed terms—are often ignored. Frequently, HDAs are treated as a mere starting point for “negotiating” the final terms of the lease. Landlords may believe that their liability for repudiating a HDA extends only to returning the deposit. This belief is mistaken.

The agreement of a HDA signifies the conclusion of negotiations over the tenancy key terms. In law, an incoming tenant faced with a landlord repudiating their agreement is entitled to the full remedies contract law provides, including compensatory damages and injunctive relief. Even if a tenant accepts and signs the landlord's variations to the lease, the new terms contrary to the HDA may not be enforceable for lack of consideration. A tenant gains nothing from agreeing to a less favourable lease in circumstances approaching duress.

The problem is that tenants in this situation are between Scylla and Charybdis: forced to choose between a lease on less-favourable terms (for example, higher rent) or walking away and reinitiating their house search from scratch. Running to the courts when time is constrained is not practicable, even if the tenant has the wherewithal to navigate that complex avenue. A judgment many months or years later is of no practical use to a tenant who needs a home within a week. Landlords are thus able to run roughshod over HDAs because of their significant practical advantage—that they hold the keys. Some tenants may even try to mitigate this situation by placing multiple holding deposits and accepting the likelihood of their forfeiture as a necessary risk. This is both wasteful and impractical.

Remedial steps

How, then, can this situation be rebalanced? Several points are worth considering:

- The legal significance of a HDA needs to be emphasised to landlords and tenants. Rental agents should be informing both parties at the outset that payment of a holding deposit creates a legally binding contract. Tenancy applicants should be provided a draft copy of the lease document before any HDA is agreed or holding deposit is paid. Agents should advise landlords that, if the referencing process and conditions are satisfied, they cannot “renegotiate” the key terms of the lease after a HDA has been agreed, and agents should not assist landlords to do so. They

should also advise that, once a holding deposit is accepted, advertisements for the property should be removed and other applications to let should be declined.

- Formal complaint to a registered letting agents association or to the Property Ombudsman could be made if an agent facilitates the repudiation of a HDA. It is appropriate that agents who assist landlords to breach contract are held to account.
- Local councils who provide complaints procedures and dispute resolution services, and other advice providers, ought to be advising landlords and prospective tenants of the legal and practical options available in the face of a repudiated HDA. Clear and published guidance can be a useful tool for correcting aberrant market behaviour; in this case, rectifying confusion over HDAs.

Ultimately, if either party to a HDA persists in disregarding their obligations under the pre-tenancy agreement, it remains open to the other to pursue their lawful remedies in the courts.

Conclusion

Whilst aggrieved tenants are not without legal remedies when presented with a lease document that disregards the HDA terms, practical vindication of their rights will invariably be a difficult road. In a demand-driven rental market, prospective tenants can too easily be taken advantage of and forced into unreasonable compromises. It is hoped that clarity over the legal position of the pre-tenancy period will help also to improve the position in practice.

The law is stated as at June 20, 2015.