

DEPOSIT AGREEMENT

Guidance Notes



Introduction

As an alternative to seeking guarantees to bolster the covenant of a tenant which is regarded by a landlord as inadequate, landlords sometimes seek deposit agreements, in terms of which money is placed on deposit at commencement of the lease as a financial pot into which the landlord can dip in the event of tenant default. Such arrangements may apply in relation to the grant of a lease or on an assignation. Typically, such an agreement will cover rent but it may also cover other sums under the lease. For that reason, the PSG document is called a “Deposit Agreement” rather than a “Rent Deposit Agreement”.

1 Parties and Definitions

The amount of the deposit requires to be specified, and it will be noted that there is provision elsewhere in the document for that sum to be supplemented as required.

In particular, if any of the sums payable by the Tenant will attract VAT, the amount of the Deposit taken should include an amount equal to VAT on the Deposit, so that if the landlord has to make withdrawals from the Deposit, such as in respect of rent, to which VAT has to be applied, then the funds held will include sufficient for the VAT element, without having to draw funds to meet VAT from the principal deposit amount. It should be noted that the taking of the Deposit, along with a sum equivalent to VAT on it, is not intended to create a tax point, and therefore it would be inappropriate for any VAT invoice to be issued at that stage.

Other defined terms specify the nature of the account in which the money is to be held, and also recognise that the actual balance in the account will of course fluctuate from time to time.

2 Deposit Account and Deposit Fund

It is assumed that the money will be held on deposit for the duration of the lease, but if that is not the case then suitable amendment will require to be made. Such deposit arrangements might, for example, subsist only for an initial one year period or perhaps for five years until the first rent review.

The clause makes it clear that the money is held in trust, on the basis that the landlord has the right to apply the monies to compensate for tenant default, while the tenant retains its right to interest on the monies, as also the ultimate right to the fund itself insofar as not exhausted in accordance with the provisions of the deposit agreement.

There is provision for the fund to be topped up by the tenant as required, either to reflect depletion of funds owing to the funds being utilised or to take account of rent reviews under the lease or changes in the VAT rate.

3 Interest Earned on Deposit Account

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It is assumed that the interest belongs to the tenant, who will require to account for tax. Subject to the caveats in clauses 3.3.1 and 3.3.2, there is an entitlement to have the interest paid over on a periodic basis.

4 **Provision of Account Details**

This simply provides for an accounting upon request, as is clearly reasonable in the circumstances.

5 **Withdrawals by the Landlord**

This clause sets out the circumstances in which the landlord can dip into the fund, essentially relating to breach, insolvency or irritancy.

6 **Return of Deposit Fund**

Conversely, this clause sets out the basis upon which the arrangement will come to an end and monies be released to the tenant. These circumstances comprise a permitted assignation – there may of course be a requirement for a new deposit with the assignee depending on covenant strength; at expiry of the lease; on renunciation of the lease; if thought appropriate, at a date by which some other financial test has been met by the tenant; and otherwise as agreed by the landlord.

7 **Landlords' Remedies**

This allows the landlords to treat a breach of the agreement as equivalent to a breach of the lease but otherwise to recognise that the arrangements are separate and no set-off applies.

8 **Alienation**

It is thought reasonable that the landlord should accept an absolute obligation to transfer the deposit fund in the event of a transfer of its interest.

9 **Costs**

It is assumed that the tenant will be responsible for all bank costs etc in relation to operation of the arrangement, but it will be a matter for negotiation in each case as to liability for legal costs in connection with setting up the arrangement.

10 **Certificate**

This is the customary provision that a certificate on behalf of the landlord will be conclusive unless manifestly in error.

11 **Consent to Registration**

It is assumed that the parties will want the document to be registered for preservation and execution.