

About Late Fees - The Tale Of Two Landlords

by Wojciech Kic

The landlording business of owning and managing single family houses is supported by the cash flow generated by the rents paid by the tenants. It is no wonder that the lease clause stipulating the rent due date is the foremost clause of the multi-page lease agreement. The lease agreement also stipulates tenant penalties for late rent payments. The so-called late fees vary in amount from landlord to landlord.

Some landlords may charge a flat late fee with additional daily penalties. Other landlords may express the late fee as a percentage of monthly rent. While tenants accept late fees in the residential lease agreement when signing the lease, the actual application of the late fees by the landlords often provokes later challenges from the tenants on the grounds of fairness and legality.

Which side of the late fee controversy are you on?

As an amplification of the issue, let's use two hypothetical landlords renting similar, single family houses in Katy, Texas for \$1,000 a month. Each landlord, Mr. Jones and Ms. Smith, uses a lease agreement with identical clauses. Both lease agreements define the late fee at \$75 for rent payments received after the third of the month with an additional late fee of \$10 a day until the rent is paid in full.

Mr. Jones has a full-time professional job and manages his time efficiently. He is concerned about tenants not paying the rent on time. To that effect, he views late fees as the most effective method of discouraging late rental payments. After all, he believes, if the tenants were not motivated to pay the rent on time, the rent would never be paid.

But Mr. Jones also expresses his belief in fairness. When tenants in his house do not pay the rent on time, Mr. Jones mails reminders and leaves voice mail messages at home and at work. He does not serve vacate notices unless the tenants are seriously past due.

Mr. Jones believes that his tenants are customers. Whenever possible, he educates the tenants about the importance of timely rent payments. Consequently, when tenants are late, Mr. Jones strictly enforces the late fee provisions in the lease agreement.

Ms. Smith's background is similar to Mr. Jones. She also has a professional job and she frequently travels. She is also concerned about the tenants not paying the rent on time. But she does not believe in educating tenants about the importance of timely rent payments. She does not extend the courtesy of sending past due rent reminders.

Ms. Smith believes that, pursuant to the lease agreement, the first day of rent delinquency creates the tenant's default. She does not call defaulting tenants. Instead, Ms. Smith drives to the house in full expectation of finding the house vacant. If the house is still occupied, she immediately serves an eviction notice.

Furthermore, she will continue to drive to the house daily to monitor the status of occupancy. If she finds the house vacant, she immediately completes the make-ready maintenance and places the house on the market for rent.

Which landlord is entitled to a late fee?

Mr. Jones extends the courtesy of late rent reminders and goes out of his way to educate the tenants about the importance of paying the rent on time. But clearly, his education efforts with the tenants are not working. The tenants continuously pay the rent late.

Yet, Mr. Jones does not file vacate notices unless the tenants are seriously past due. He does not drive by the house to ensure continued occupancy. His rent collection effort creates no out-of-pocket expense save interest on the delinquent rent.

But Mr. Jones charges a late fee in excess of his marginal cost. In his talks with the delinquent tenants, Mr. Jones, under the guise of concern about tenants' late fees, confirms continued occupancy without the expense of a visit to the house. His motives are transparent to the tenants; tenants' protests about excessive late fees are just.

On the other hand, Ms. Smith incurred many expenses in protecting her interests when dealing with delinquent rent. She physically confirmed that the house was still occupied and she ensured that the delinquency would be short lived. The late fee falls short of her additional expenses yet the tenants pay the late fee promptly and without protest. In addition, tenants continue to compensate landlord's excess expenses with an increased effort to pay the rent on time and ongoing lease renewals.

Ms. Smith is active in managing the rent delinquency. She is not misled into passive management by the tenants' late fee carrot. She does not talk to the tenants. Ms. Smith's tenants know that the rent is past due. Ms. Smith's preemptive management effort produces the desired outcome. (Read: profit)

Mr. Jones is passive in his management effort. A phone call to the delinquent tenants sets a new rent payment due date. But the tenants already failed on a signed lease agreement. A late fee becomes a smoke-screen for the landlord. The tenants' goal of rent-free occupancy is now assured. As for the timing of the free rent windfall? Strictly, at the tenants' option. The tenants' sense of fairness makes this landlord's impending loss all but predictable. The value of earlier late fee profits soon disappears.

The quality of the lease is determined by the landlord's awareness of his interests. The recognition of tenants' opportunities minimizes the landlord's mistakes. Understanding late fees, which are about making the landlord whole, is the key to successful landlording.

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