

Landlords in the Lurch: Tips for Discouraging Tenant Default

By Mark S. Litner

In these difficult economic times, it's no secret that lots of businesses are struggling to make ends meet. Many of those affected are tenants facing significant financial challenges, including difficulty paying the rent due under their leases. If you are a landlord who is concerned about a tenant's ability to meet its obligations on time, there are certain steps you can take to discourage your tenant from remitting rental payments late or failing to perform other responsibilities as required under its lease.

Virtually all leases contain what are commonly known as default provisions, which entitle the landlord to exercise various remedies if the tenant fails to pay the rent on time or neglects to perform any other lease obligation. However, by imposing more stringent penalties that take effect in the event of repeated late payments, nonpayment or any other default, you might be able to motivate your tenant to take the necessary steps to avoid such unwanted consequences. Accordingly, the next time you are ready to sign a new lease or amend an existing one, consider including one or more of the following provisions, each of which would become effective after a default by the tenant:

- **Reserve the Right to Increase the Security Deposit.** If the landlord has the right to require the tenant to increase its security deposit following an event of default, the tenant will likely be motivated to avoid triggering such an occurrence. You might also require the tenant to submit the security deposit in the form of a letter of credit (instead of cash) to reduce your risk in the event the tenant files for bankruptcy protection.
- **Impose a Late Fee.** Charge a late fee beginning the second time the tenant fails to make a payment on time or commits a breach of the lease, and increase the amount of the late fee by a certain percentage or dollar amount upon each subsequent violation.
- **Forfeit Rent Abatement.** If the terms of an existing lease entitle the tenant to any free rent (commonly known as rent abatement), state that the right to enjoy these benefits is conditioned upon the tenant's ability to perform its lease obligations and will be forfeited if the tenant fails to meet that condition.

- **Limit or Terminate the Tenant's Options and Rights.** Allow the tenant to exercise any options and rights granted under the lease, but only if the tenant is not in default under the lease at the time of exercise. These might include (1) options to renew, terminate early, expand or contract, and (2) rights of first refusal and rights of first offer. You may also want to state that any such options and rights will no longer be available if the tenant defaults more than once during the lease term.
- **Switch to Quarterly Rent Payments.** If the tenant fails to perform any obligation involving the payment of money, no longer allow the rent to be paid in monthly installments. Instead, require the tenant to pay in advance on a quarterly basis on the first day of the first month of each calendar quarter during the lease term.
- **Require Automatic Debits or Transfers.** If the tenant fails to pay any amount of money owed under the lease, require that all future payments of rent and other amounts due under the lease be made by automatic debit or electronic transfer pursuant to rules and procedures adopted by the landlord.
- **Eliminate Any Further Cure Rights of the Tenant.** Reserve the right to take away any further rights that the tenant may have to cure a default and authorize the landlord to pursue any or all of its legal rights and remedies.

Note that the timing and applicability of any of these provisions can be modified and tailored to reflect the specific relationship and the relative negotiating leverage between the landlord and tenant. However, keep these in mind as effective tools to enhance the enforcement of your rights and your tenant's obligations under its lease.

If you have any questions about the topics covered in this article or any other leasing issues, please feel free to contact me at 312-372-0414 or mlitner@jaffeberlin.com.