



## Late Fees: The Lease, the Law and Lessons

This article discusses the late fees provision in the TAA Lease, the new amendment to the late fees statute in Texas, and possible factors and questions to consider in evaluating your late fee practice, as well as tips for avoiding late fee clauses that might be considered illegal by a court.

Texas law allows rental property owners to charge late fees if the rent is not paid on time—but the law historically has not spelled out exactly what can be charged, or for how long. Owners have been challenged in court over their late fees—and with a statutory penalty of three times the amount of the fee charged in violation of the statute, \$100 and attorneys’ fees, that can quickly add up, especially in a class action lawsuit. With new clarity provided by S.B. 1414 during the 2019 Legislative Session, owners are in a much stronger position to set their late fees in accordance with the law and avoid litigation.

### LATE FEE PROVISIONS IN THE TAA LEASE

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The 2019 TAA Lease has been modified to reflect statutory changes approved by the 2019 legislature and to help provide members some protection and reduce liability exposure. Paragraph 6 of the TAA Lease entitled “Rent and Charges” allows you to charge residents late fees if rent is not paid on time. If you charge late fees, you must fill in the amount of the initial charge and a daily charge (if any) as Texas law requires you to notify the resident of the fees in the lease. The recent changes to Paragraph 6 made available through the Click & Lease Program as of August 28, 2019 include: (1) clarification that late fees are due immediately and without demand (2) revision to the grace period provision so that no late fees may be imposed until the 4th day of the month, (3) options to charge a percentage or dollar amount for the initial fee and daily fees, and (4) option for members to limit the number of days daily fees may be imposed beyond the 15 day maximum.

Under the TAA Lease, daily late charges still cannot exceed 15 days per month. However, be mindful if you are using one of the safe harbors created in the new legislation and further discussed below. The total of your initial and any daily late fees collected in any one month cannot exceed the appropriate safe harbor percentage for the type of dwelling. If you violate the statute, you can be held liable for up to three times the amount of the fee charged in violation of the statute, a \$100 penalty and the resident’s reasonable attorney’s fees.

The new law effective September 1, 2019 states that late fees cannot be charged until “any portion of the tenant’s rent has remained unpaid two full days after the date the rent was originally due.” If you are using the TAA Lease, rent is due on or before the first of the month. This means that, under the revised TAA Lease and in accordance with the new law, the earliest date that a late fee may be charged is the fourth of the month.

However, Paragraph 6 of the TAA Lease gives an owner the flexibility to wait longer before charging a late fee, as follows:

***New paragraph 6 language:***

“If you don’t pay rent in full on or before the \_\_\_\_ day of the month at 11:59 p.m., you will pay us the following initial late charges immediately and without demand in addition to rent: \_\_\_\_ percent of one month’s rent as stated in this paragraph OR \$\_\_\_\_\_.”

Therefore, if you fill in the “4th” in the first blank above, you cannot charge the initial late fee until the 5th day of the month. Under this scenario, if the resident pays rent on or before the 4th, you are contractually prohibited from charging a late fee. Likewise, if you fill in the 3rd in the first blank above, then you may charge a late fee on the 4th if rent has not been paid. Filling in the 3rd allows you to charge a late fee on the 4th, which is the earliest you may charge a late fee under the statute.

Remember, the grace period on late fees for unpaid rent does not limit any other rights or remedies an owner may seek for non-payment of rent under the lease or by law, such as issuing a Notice to Vacate.

## **LATE FEES UNDER TEXAS LAW**

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Section 92.019 of the Texas Property Code provides that a late fee may not be charged unless it is part of a written lease. In addition, the amount of the fee must be reasonable. Also, late fees cannot be charged until at least the fourth day of the month, if rent is due on the 1st. For example, if rent is due on March 1st, a late fee cannot be charged until March 4th. While owners must wait to impose the late fee, there is nothing that prevents them from taking another action, such as pursuing eviction, as soon as the rent is late.

The law does not mandate dollar limits or a percentage of rent that may be charged as a late fee. However, it does provide two different safe harbors depending on the configuration of your property.

For structures that contain 4 units or less, a late fee of 12 percent or less of one month’s rent is automatically considered reasonable under the statute. For structures that contain 5 units or more, a late fee of 10 percent or less of one month’s rent is automatically considered reasonable under the statute.

The law also clearly allows the late fee to include an initial fee and a subsequent daily fee for each day the rent continues to remain unpaid. Note that the total amount charged by any initial and daily fees combined must be less than or equal to the applicable percentage of one month’s rent to qualify for the safe harbor.

An owner has the option to charge more than the safe harbor percentages. However, owners must be prepared to demonstrate that the fee collected is still reasonable. How? By making sure the late fee is not more than the damages to the property owner related to the late payment of rent, as is discussed further in the next section.

Penalties for violating the late fee provisions make a property owner liable to a resident for \$100, three times the amount of the late fee collected in violation of this section and the resident’s reasonable attorney’s fees. As noted above, there is no statutory limit on the amount of late fees, except that late fees must be reasonable.

The limits on late fees cannot be waived. Collection of the fee, charge or other sum of money by a property owner does not waive a resident’s rights or remedies. Therefore, just because a resident has paid a late fee does not mean that he or she has given up the right to sue an owner if such fee was unreasonable, unconscionable, or otherwise violated the law. Lastly, a property owner’s right to terminate the lease or take other action permitted by the lease or other law is not affected by the late fee statute.

In addition, the new law adds a provision that an owner must provide, upon the resident’s request, a written statement of any late fees owed and the amount of the late fees.

## **EVALUATING YOUR LATE FEE PRACTICE**

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Determining what might be considered a “reasonable” late fee if the amount is in excess of the safe harbor percentages under the law will depend on the facts of each case. Late fees cannot

be awarded in an eviction case, and with few owners choosing to file separate lawsuits for rent and damages beyond evictions, this means late fees are rarely adjudicated in Texas courts.

It also is important to note that “reasonableness” varies property to property. Each property is unique. Factors may be considered differently based on the situation, but the statute does give some limited guidance on what can be considered.

Specifically, you may include direct and indirect expenses, costs, or overhead associated with the collection of the late payment. Factors that could be considered are administrative expenses, time value of money, predictability of property income, and the effect on vendor relationships. You should consult the attorney of your choice for advice regarding your specific situation.

## **POSSIBLE QUESTIONS IN EVALUATING YOUR LATE FEE PRACTICE**

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Consider asking yourself questions like these:

- What is the safe harbor for the type of property I operate?
- What are my damages in collecting late rent?
- How often do my residents pay late?
- How is our community adversely affected when rent payments are late?
- What are our recurring monthly costs (e.g. payroll, debt service, vendors, scheduled improvements, insurance, prorated emergency expenses)?
- Are any of our amenities compromised if our income cannot be accurately predicted?
- If rent is not paid timely, is our ability to compete with other rental properties compromised?

## **OTHER ISSUES A COURT MAY CONSIDER**

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***Unconscionability.*** Texas courts have the power to strike down any clause in a contract that they believe is “unconscionable,” i.e., so onerous that it shocks the conscience of the court. If a judge believes a particular owner’s late fee is unconscionable, the judge can declare the late fee invalid. This would not be an issue with a late fee falling within the applicable safe harbor, but could be for a higher fee.

***Penalties.*** Texas courts can also strike down contractual clauses that are so unreasonable that they constitute a “penalty” (which Texas courts have the power to invalidate.) “Liquidated damages,” on the other hand, are lawful. There is a fine line between unlawful penalties and lawful liquidated damages. In order to be classified as a liquidated damage, a late fee must be reasonable and related to the damages that the owner will incur in trying to collect the rent if a resident is late in paying. This would not be an issue with a late fee falling within the applicable safe harbor, but could be for a higher fee.

Still, it is important that the lease and other written documents from the owner never characterize late fees as “penalties,” particularly for owners who wish to charge a fee that is greater than the applicable safe harbor limit. Labels and terminology can occasionally control the eventual outcome of a case in the courthouse.

***DTPA violation.*** If a late fee provision in a lease is alleged to be a violation of the statute, it is possible that a resident may try to file suit under the Texas Deceptive Trade Practices Act (DTPA), which is in Chapter 17 of the Texas Business and Commerce Code. Section 17.46(b)

(12) of the DTPA prohibits the inclusion of any “illegal” clause in a lease or contract. If the judge holds that the late fee clause is a violation of the DTPA, the resident could be entitled to recover three times the amount of late fees paid by the resident, plus attorney’s fees. That makes illegal late fees an enticing target for plaintiff attorneys, especially if a class action is filed on behalf of existing and former residents. This would not be an issue with a late fee falling within the applicable safe harbor, but could be for a higher fee.

**Usury.** Usury is another theory of late charge invalidity that has been alleged in other states, as well as Texas. So far, to TAA’s knowledge, the intermediate appellate courts in Texas have held that the word “money” in the usury statute’s limit of 18 percent interest on “payments for the forbearance of money” applies only to a loan and not to rent, and therefore late fees on rent are not subject to the Texas usury statute and TAA is unaware of any cases to the contrary. Nonetheless, this does not prevent a plaintiff attorney from arguing unconscionability by pointing out what the annual rate of interest for a particular late fee would be if it were to be analyzed in terms of usury. This would not be an issue with a late fee falling within the applicable safe harbor, but could be for a higher fee.

The law is ambiguous regarding late fees greater than the applicable safe harbor, and Texas courts have not issued concrete guidelines on late fees, due to the newness of the revised statute and the minimal amount of litigation that involves them. Some safeguards to reduce the risks of potential late fee lawsuits are the following:

- Make sure your lease clearly allows you to charge a late fee in writing (Paragraph 6 of the TAA Lease contains such a provision).
- Don’t begin assessing a late fee until at least the third day after the rent was due, i.e. if rent was due on March 1, don’t begin charging a late fee until at least March 4. If you want to be able to charge a late fee on the 4th, fill in the 3rd in the first blank of the late fee provisions in paragraph 6. Keep in mind that you may charge an initial late fee the first day you’re legally permitted to charge a fee and a daily late fee thereafter, but the total of all initial and daily late fees must be less than the applicable safe harbor percentage to utilize its protection.
- Make sure that your daily late fees do not continue indefinitely, i.e., make sure there is a cap on the total accumulated late fees if the resident never pays the rent. Courts dislike daily late fees that can go on forever without limit. (Paragraph 6 of the TAA Lease caps daily late fees at 15 days).
- Evaluate your late fee practice by asking the questions above and consider factors that should influence how you set your late fees. Remember the dollar amounts for the initial and daily late charges must be reasonable, considering all the factors discussed earlier in this article.

## CONCLUSION

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It is up to you as a rental housing owner to make sure that your initial and daily late fees are not excessive or unreasonable. Limiting the total late fees collected to fall within the safe harbor is one way to do that. Alternatively, you can charge a greater fee, but you should make sure you can demonstrate that the higher amount collected is reasonable. Ultimately, the question of what is excessive for fees greater than the safe harbor is one that only a judge or jury can answer on a case-by-case basis.