

# HOLDOVER RENT CLAUSES: DON'T LET THIS TICKING BOMB EXPLODE!

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In lease negotiations, a holdover clause in a commercial lease often does not receive the attention it should as its ultimate impact is not as immediate as many other terms. However, this provision merits more attention, as the tenant could become liable for a landlord's actual damages caused by a holdover, including the landlord's loss of a new lease, or the new tenant's own holdover expenses.

Such clauses typically provide that if a tenant remains in possession of the leased premises after the expiration of the stated lease term, they must pay holdover rent to the landlord in an amount substantially in excess of the rent charged during the lease term – usually as high as 150 percent, and even 200 percent in some cases, especially if the tenants and counsel do not push back at the 200 percent rate.

Consider the impact of market conditions at time of lease negotiations. When conditions are soft, such as in the Great Recession, landlords smiled when tenants overstayed their lease term and

paid the increased holdover rent. Today, however, market conditions are vastly improved, with less available space for lease for both industrial and office tenants when their lease terms expire or when they seek additional space. The holdover clause, then, becomes critical as lease expiration approaches, especially in the circumstances described in the following examples.

## Scenario 1:

A holdover clause simply states that if a tenant remains after the lease expires, the tenancy becomes month-to-month at the increased rental rate. What happens if another long term tenant comes along and wants the occupied space? Can the landlord evict the holdover tenant? What if, prior to the lease expiration, the existing tenant had informed the landlord that it would hold-over past the expiration? When can the landlord evict that tenant? Or, does this holdover provision create a lease extension on a month to month basis, one that the landlord neither expected nor wanted?

## Scenario 2:

A holdover clause states that at the end of the lease term, the tenant may not hold over and that the tenancy will not become month-to-month, but if the tenant does remain after lease expiration, it must pay the increased rent amount. In this case, the landlord can initiate eviction proceedings immediately to evict the first tenant and install a new long-term tenant in place, all while still collecting the increased rent from the existing, but soon-to-be-vacating, tenant. A thornier issue is raised in a few states: if a tenant continues to pay rent after a lease expires and the landlord accepts the rent, the lease could be deemed automatically renewed depending on specific language in the lease.

As for the holdover clause itself, consider these tips to level the playing field between landlord and tenant:

1. Limit the holdover penalties and damages recoverable by landlords: Ensure that the tenant is not ultimately responsible for any loss of rent or

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future tenant damages as a result of the existing tenant's holdover.

2. Delay the assessment of holdover rent after lease expiration: Most owners seek holdover rents at 125 percent to 200 percent over the existing rate at expiration. Work to delay such increases with a sliding scale. For example, 125 percent of the first month of holdover, 150 percent of the second month, 200 percent thereafter, or some such combination or sliding scale.

3. Limit holdover to “base rent” only: Since many leases differentiate between “base (or net) rent” and “additional rent” (real estate taxes, operating expenses, insurance), make sure that the tenant is not paying for 150 percent of base rent AND 150 percent of additional rent during its holdover. Instead, negotiate for 150 percent of base rent and 100 percent of Additional Rent.

4. Avoid liability for consequential damages: Since holdover rent is designed to compensate an owner for damages sustained due to a tenant's holdover, the clause should state that

the holdover rent in excess of the normal rent represents liquidated damages for all damages for which the tenant is liable in a holdover situation. This way, the tenant limits its exposure for damages the landlord may sustain (lost rent from a new tenant) due to the holdover.

In most of the reported Illinois cases where a tenant was occupying leased premises after expiration of the lease term, it is the landlord which holds the power (and option) to either claim a holdover tenancy and collect increased rent as liquidated damages, to evict the tenant while holdover rent is accruing and due, or to declare the lease renewed if facts and circumstances support such a finding. The tenant, by comparison, is a mere tenant at sufferance, with no privity of contract with the landlord and none of the benefits of lease provisions in the original lease.

In the grand scheme of the lease negotiations, there are many provisions that have immediate impact. The parties' failure to give attention to the holdover

provision could allow the proverbial ticking time bomb to explode as the lease expires. The parties had intended to walk away from one another, but they are now faced with the consequences of their neglect of a critical provision. ▼