

COVID-19 and the code

mandatory code of conduct

8 April 2020

The Federal Government yesterday released the National Cabinet Mandatory Code of Conduct for SME commercial leasing principles during the COVID-19 pandemic.

The Code is to apply for the life of the JobKeeper program. It is mandatory in relation to SME tenancies suffering COVID-19 financial distress (as defined by their eligibility for the JobKeeper program).

An SME is a business with a turnover of up to \$50 million, and applies at a group level in relation to retail corporate groups (and not an individual brand level).

In its announcement, the Government said that the Code should also be applied “in spirit” to all leasing arrangements for affected businesses.

The Code is intended to be rolled out on a state-level through legislation and regulations, yet to be announced.

In this report, we provide an annotated summary of the key principles applying to commercial leases.

key principles on rent relief

1. landlords must offer tenants proportionate reductions in rent payable in the form of waivers and deferrals of up to 100% of the amount ordinarily payable, on a case-by-case basis, based on the reduction in the tenant's trade during the COVID-19 pandemic period and a subsequent reasonable recovery period.

The “reduction in trade” refers to turnover. Treasury has provided guidance on this measure:

To establish that a business or not-for-profit has, or is likely to, face the relevant fall in their turnover, most would be expected to establish that their turnover has or will likely fall in the relevant month or quarter (depending on their Business Activity Statement reporting period) relative to their turnover in a corresponding period a year earlier. Turnover is calculated as it is for GST purposes, and is reported on Business Activity Statements. It includes all taxable supplies and all GST free supplies but not input taxed supplies.

If a tenant ceases trade due to the pandemic, then 100% rent relief must be provided.

If a tenant continues trade and the turnover drops 60%, then 60% rent relief must be provided. The remaining 40% of rent must continue to be paid as normal.

The tenant would bear the onus of proving the proportionate reduction in trade it has suffered, presumably by providing copies of turnover statements.

key principles on rent relief **cont.**

- 2. rental waivers must constitute no less than 50% of the total reduction in rent payable under the principle 1 above over the COVID-19 pandemic period and should constitute a greater proportion of the total reduction in rent payable in cases where failure to do so would compromise the tenant's capacity to fulfil their ongoing obligations under the lease agreement. Regard must also be had to the landlord's financial ability to provide such additional waivers.**

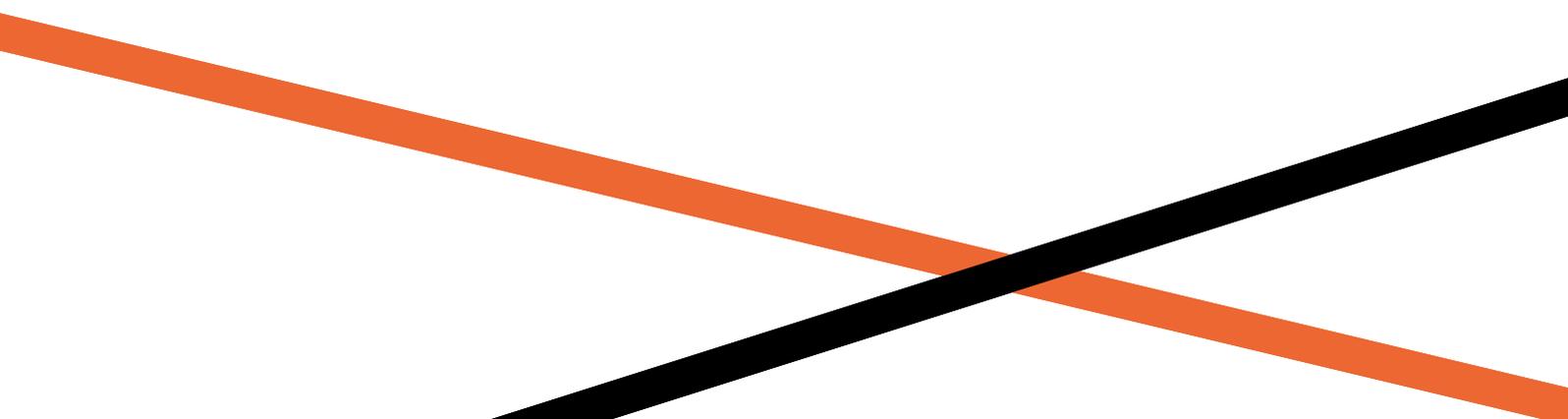
For a tenant entitled to 80% rent relief, at least half of that relief (being 40% of the usual rent) will be waived – rent that is never required to be repaid. The other half of the relief (40% of the usual rent) is dealt with as a rent deferral (expanded on in principle 3).

Where a tenant is unable to meet its deferred rent repayment obligations, there will likely be a tension between its inability to pay the deferred rent and the landlord's financial inability to provide an increased waiver.

- 3. payment of rental deferrals by the tenant must be amortised over the balance of the lease term and for a period of no less than 24 months, whichever is the greater, unless otherwise agreed by the parties.**

A rent deferral, unlike a waiver of rent, requires a tenant to repay the deferred sum at a later date. The deferred sum will be amortised over the balance of the term or a minimum of 24 months, whichever is greater, unless otherwise agreed.

Repayments are not to commence until the pandemic period has ended or the existing lease expires, and taking into account a subsequent recovery period.



example of application

background facts

- The tenant has experienced a 60% loss in trade due to the pandemic.
- It has 32 months left on its lease.
- The pandemic and associated recovery period is 6 months.

application

The Code applies to the tenant as follows:

1. The monthly rental instalments for the next 6 months is reduced by 60%.
2. The tenant must continue to pay the 40% balance of the rent as it falls due, or risk losing the benefit of the Code.
3. Half of the rent relief is waived and not payable by the tenant, ever.
4. The other half of the rent relief will be treated as deferred rent.
5. After 6 months, when business returns to normal and the lease has 26 months left to run, the total amount of the deferred rent will be divided equally over each of the 26 months and added to each monthly invoice.

other key principles

4. the tenant should be provided with an opportunity to extend its lease for an equivalent period of the rent waiver and/or deferral period. This is intended to provide the tenant additional time to trade, on existing lease terms, during the recovery period after the COVID-19 pandemic concludes.
5. tenants must remain committed to the terms of their lease, subject to any amendments to their rental agreement negotiated under the Code. Material failure to abide by substantive terms of their lease will forfeit any protections provided to the tenant under the Code.

Tenants should continue to comply with their leases, or risk losing the benefit of the Code. This includes the payment of the balance of any rent which remains payable and is not subject to relief.

6. landlords may not apply any prohibition or levy any penalties if tenants reduce opening hours or cease to trade due to the COVID-19 pandemic.

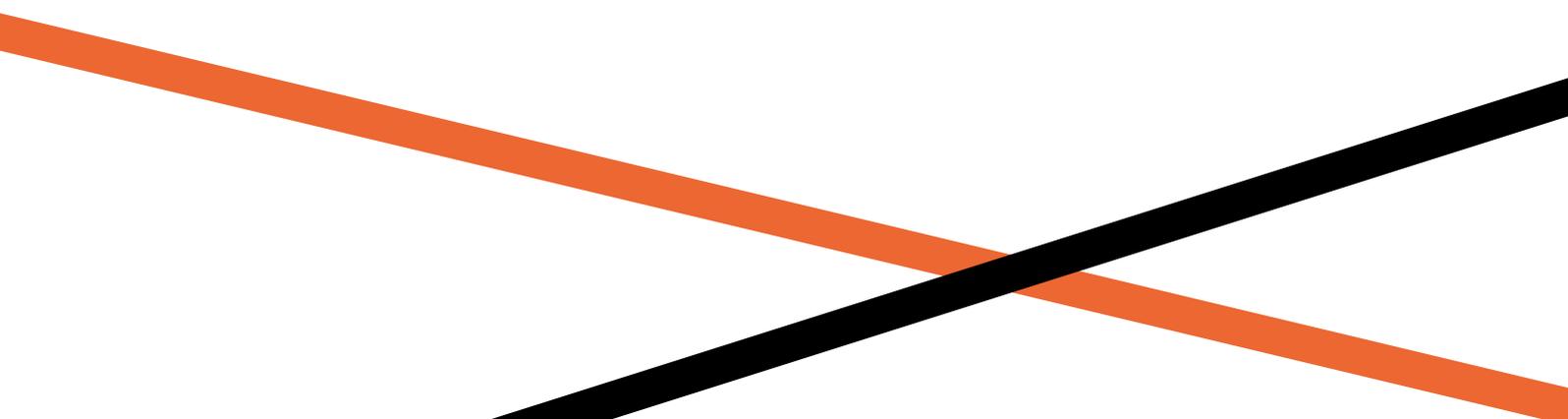
This is relevant in to the application of the principle at point 5 above – the Code will continue to apply in the event a tenant fails to trade due to the pandemic in breach of must trade obligation.

7. landlords must not terminate leases due to non-payment of rent during the COVID-19 pandemic period (or reasonable subsequent recovery period).

This moratorium has been in place for the past week, however has been extended to cover the reasonable subsequent recovery period.

8. landlords must not draw on a tenant's security for the non-payment of rent (be this a cash bond, bank guarantee or personal guarantee) during the period of the COVID-19 pandemic and/or a reasonable subsequent recovery period.

other key principles **cont.**

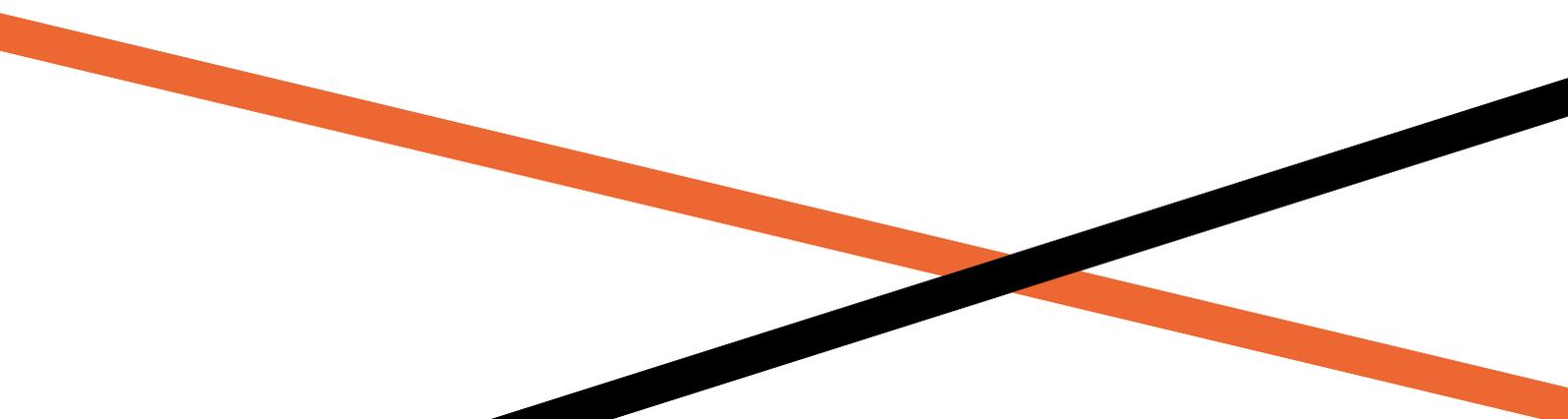
9. landlords agree to a freeze on rent increases (except for retail leases based on turnover rent) for the duration of the COVID-19 pandemic and a reasonable subsequent recovery period, notwithstanding any arrangements between the landlord and the tenant.
 10. no fees, interest or other charges should be applied with respect to rent waived and no fees, charges nor punitive interest may be charged on deferrals.
 11. any reduction in statutory charges (e.g. land tax, council rates) or insurance will be passed on to the tenant in the appropriate proportion applicable under the terms of the lease.
 12. a landlord should seek to share any benefit it receives due to deferral of loan payments, provided by a financial institution as part of the Australian Bankers Association's COVID-19 response, or any other case-by-case deferral of loan repayments offered to other Landlords, with the tenant in a proportionate manner.
 13. landlords should, where appropriate, seek to waive recovery of any other expense (or outgoing payable) by a tenant, under lease terms, during the period the tenant is not able to trade. Landlords reserve the right to reduce services as required in such circumstances.
 14. if negotiated arrangements under this Code necessitate repayment, this should occur over an extended period in order to avoid placing an undue financial burden on the tenant. No repayment should commence until the earlier of the COVID-19 pandemic ending (as defined by the Australian Government) or the existing lease expiring, and taking into account a reasonable subsequent recovery period.
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mediation

where landlords and tenants cannot reach agreement on leasing arrangements (as a direct result of the COVID-19 pandemic), the matter should be referred and subjected (by either party) to applicable state or territory retail/commercial leasing dispute resolution processes for binding mediation, including Small Business Commissioners/Champions/Ombudsmen where applicable.

landlords and tenants must not use mediation processes to prolong or frustrate the facilitation of amicable resolution outcomes.

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