

Article Information

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Leases and the impact of COVID-19 for landlords and tenants

Piper Aderman discusses the impacts of covid-19 on leasing for tenants and landlords.

NATIONAL CABINET STATEMENT ON RENT RELIEF

What is the process for implementing the principles set out in the National Cabinet?

On 29 March 2020, the National Cabinet issued a statement of principles 'to underpin and govern intervention to aid commercial tenancies' (**National Principles**). This is part of the Federal Government's 'hibernation plan'. The hibernation plan is intended to allow parties to freeze obligations to each other without enforcement while measures are in place to slow the spread of COVID-19.

The Prime Minister announced on 20 March 2020 that the NSW and WA State Governments will lead the development of 'model rules' designed to bring relief to tenants experiencing hardship.

The National Principles are not yet law, but are designed to 'encourage tenants and landlords to agree on rent relief or temporary amendments to the lease.'

How are the principles legislated?

Leasing is a state matter and implementation of the National Principles or any 'model rules' will need to be through state legislation.

NSW has already enacted the *COVID-19 (Emergency Measures) Act 2020* (NSW). It amends the *Retail Leases Act 1994* (NSW) and the *Residential Tenancies Act 2019* (NSW) to allow regulations to be made under those Acts and any other 'relevant Act'.

We expect that other states may take a similar approach.

At this stage, no regulations have been made to implement these measures.

We anticipate a regulation will be made to prevent termination of a lease or recovery of possession as a result of default for a period of 6 months.

Is it safe to rely on the principles?

The National Principles are not law and we do not recommend a tenant terminate a lease on the grounds of "financial stress". We cover this issue below in the section titled "Termination for Financial Stress."

Affected parties are encouraged to negotiate on a case by case basis using the National Principles as a guide.

MORATORIUM ON TERMINATION

What does it mean?

The National Principles include “a short term, temporary moratorium on eviction for non-payment of rent to be applied across commercial tenancies impacted by severe rental distress due to coronavirus” (**Principle 1**).

The extent to which Principle 1 will be enacted by the states is unknown at this stage but we suspect that states will legislate to prohibit the recovery of possession of premises, or the termination of a lease, by a landlord during the moratorium period if there is a breach of the covenant to pay rent.

It is not clear whether other relief available to landlords will also be restricted, for example:

- the recovery of default interest;
- calling up bank guarantees;
- prohibiting enforcement action against guarantors.

Will rent still need to be paid during the moratorium period?

Principle 1 does not suggest the obligation to pay rent is waived.

If landlords and tenants are not able to agree to arrangements for a waiver (whether partial or absolute) and/or deferral of the rent then the moratorium on termination will be of little or no utility to address the heightened strain between landlords and tenants. In such circumstances, there will be nothing precluding landlords from terminating leases post-moratorium if rent remains outstanding.

For this reason, we suggest landlords and tenants negotiate and depending on the circumstances:

- provide an extended period after the moratorium to repay rental arrears;
- waive the payment of rent which has accrued during the moratorium period.

The symbiotic relationship between landlords and tenants reinforces the importance of communication where a tenant is in financial distress and we suggest the parties consider:

- a realistic time for recovery following a period of “business hibernation”;
- a waiver of rent payable during the moratorium if the tenant is otherwise viable;
- a right to terminate any rental waiver arrangement which is subsequently covered by any statutory moratorium.

Will a landlord be able to appropriate bank guarantees during the moratorium period?

Principle 1 does not include any details which are specific to this issue, and unless legislation prevents a landlord from calling up a bank guarantee, the landlord will be able to call up a bank guarantee and apply it to unpaid rent.

RENT REDUCTION AND RENT WAIVERS

Proving severe rental stress

As stated above, the National Principles do not address what amounts to ‘severe financial hardship’ or ‘rental stress’.

Industry experts suggest tenants provide evidence showing a significant decrease in turnover by comparing a trading period post COVID-19 with the same trading period in 2019.

The requirement for turnover information has long being a requirement of retail leases and is consistent with the concept that existing systems be used .

The Western Australian Government has indicated that landlords should not be asking tenants to provide evidence of existing savings to prove financial hardship. This may be an indication that the test will relate to changes to a tenant’s financial situation resulting from COVID-19.

The position of each State is expected to become clearer as emergency legislation is introduced.

Lease Outgoings

The Federal government has been silent on whether rent moratoriums will apply to other expenses under leases, such as outgoings.

It does not seem fair that a Landlord should also be required to bear the expenses relating to the premises, when the tenant is in occupation.

The National Principles suggest savings in outgoings offered by a government should be “passed through” to the tenant. It follows that tenants should otherwise continue to meet their obligations to pay outgoings.

Outgoings should be dealt with by landlords and tenants on a case-by-case basis in rent relief negotiations.

What is in this for the Landlord?

The National Principles are likely to result in a statutory moratorium of 6 months on a landlord’s right to terminate a lease because of a tenant’s default resulting from COVID-19.

The National Principles do not dictate how the lease will continue in 6 months time.

In our view the National Principles are designed to encourage negotiation between landlords and tenants regarding rent deferral or rent relief. The Prime Minister has been consistent in his message that parties should seek a commercial way to “share the pain.”

Landlords may be more comfortable to offer rent relief in the short term in exchange for:

- the tenant agreeing to extend the lease term; or
- the tenant amortizing the rent relief over the remaining term of the lease.

The economic uncertainty caused by COVID-19 is likely to make sitting tenants with a proven track record a more attractive option than a start up.

Landlords should focus on retaining their current tenants and negotiating with them early to prevent a tenant abandoning its premises.

Any negotiations agreed between landlords and tenants should be documented by a deed.

What should be included in rent relief deeds?

Important items for consideration in deeds reflecting the negotiations between landlords and tenants are:

- the duration of any rent relief period;
- whether the tenant’s requirement to pay rent is waived, or merely deferred;
- any other amendments to the lease agreed by the parties (eg. to reflect the repayment methods for the amortised rent or an extension of the term); and
- the impact of any yet-to-be-determined emergency legislation.

Another important consideration is confidentiality. Landlords and tenants are being encouraged by the government to negotiate and any information exchanged between them and the resultant agreement should be confidential.

If the deed purports to amend an existing registered lease the amendment also should be registered with the Titles Office.

PASSING ON RELIEF

The National Principles suggest that commercial property owners should pass on any benefit to their tenants in proportion to the economic impact caused by the virus.

This includes relief on land tax which has already been introduced in South Australia, Tasmania, Victoria and Western Australia.

Landlords are expected to pass on the benefit of any land tax deferral.

Relief for Landlords on loans

It is anticipated that without rental income, landlords will not be able to meet interest payments under property loans. It is important that relief is also available to landlords.

Many banks have announced relief packages to help borrowers manage the impact of the COVID-19 crisis such as a

repayment holiday for up to six months.

The Australian Banking Association (**ABA**) has indicated it will be a condition of relief to commercial landlords that they provide an undertaking not to terminate a lease or evict a current tenant for rent arrears resulting from the impact of COVID-19 (see the [ABA's comments](#)).

TERMINATION FOR FINANCIAL DISTRESS

What has the Government said so far?

The National Principles include the ability for tenants to terminate leases on the grounds of financial distress.

Can a tenant rely on the National Principles as a ground to terminate its lease?

Until legislation has been enacted, it would be very risky to terminate.

The finality of lease termination is inconsistent with the government's stated aim of putting businesses into hibernation.

Further, there is no guidance as to what constitutes financial distress.

Until there is more certainty, the best strategy is to use the National Principles as a negotiating tool and as the National Principles suggest, "seek mediation or conciliation on the grounds of financial distress."

Legal rights to terminate

Force Majeure: A typical Force Majeure clause relieves a party from obligations under a contract if circumstances outside the party's control prevent it from complying with the contract. Leases do not usually contain force majeure clauses.

Doctrine of Frustration: The legal doctrine of frustration is available irrespective of contract terms, however it is unlikely that a tenant could argue that the lease has been frustrated if the event is transient and temporary, as is likely the case with the pandemic.

This position was tested and confirmed by the Hong Kong courts in *Li Ching Wing v Xuan Yi Xiong* [2004], where the tenant argued frustration of a lease on the basis of a 10-day isolation order caused by SARS, and the court rejected the argument on the basis that:

- the isolation period was not significant in terms of the overall use of the premises; and
- the supervening event was not one which meant that the tenant was incapable of performing its contractual obligations because the circumstances were 'radically different' to those circumstances contemplated by the contract.

What happens if I terminate now?

A tenant terminating a lease now risks being in fundamental breach of the lease for unlawful termination.

The landlord would be entitled to call on any bank guarantee and to sue for damages resulting from the breach.

COMPLEX LEASING ARRANGEMENTS

The National Principles do not consider complex leasing arrangements involving headlease/sublease concurrent leases or licence arrangements.

We expect the definitions of landlord and tenant to be given a wide meaning.

Problems may arise where a sub-landlord does not receive rent for 6 months but has an obligation to pay the head-landlord.

To mitigate this risk, we encourage early negotiations between all parties involved in the complex leasing arrangement, to ensure that the specific circumstances of arrangement are addressed.

KEY TAKEAWAYS

- The National Principles should be used as a guide to assist the parties to negotiate rent relief, based on the circumstances of each case.
- Any agreements should be documented by a deed.

If you would like to discuss any of the issues raised, please contact the Real Estate Partner in your state.