Article Information

Authors: Greg Taylor, Warren Denny, Adam Rinaldi, Margot King, Mark Askin, Samantha Gou
Service: Corporate & Commercial, Leasing, Planning & Environment, Property & Development
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COVID-19 Code of Conduct for Commercial Leasing

The National Cabinet has released the 'Mandatory Code of Conduct: SME Commercial Leasing Principles during COVID-19' (Code) for small/medium enterprise "SME" tenants.

The Code sets out principles to negotiate amendments to leases to aide the management of cash flow for SME tenants and landlords on a proportionate basis. The Code will be implemented through state and territory legislation and regulation.

Commencement

Each state and territory will determine a date after 3 April 2020 for the Code to take effect in that state or territory.

How long will the Code apply?

The Code applies while the Commonwealth JobKeeper program operates.

Who does the Code apply to?

The Code applies to commercial leases, including retail, office and industrial.

The Code is designed to support small and medium enterprises and is mandatory for 'SME' tenants that are suffering financial stress or hardship as a result of the COVID-19 pandemic who meet the qualifying criteria set out below:-

- the tenant is eligible for the JobKeeper programme; and
- has an annual turnover of up to $50 million.

It is also stated that the principles of the Code 'should nevertheless apply in spirit to all leasing arrangements of affected businesses'.

What is financial stress or hardship?

Financial stress or hardship is where as a direct result of the COVID-19 pandemic a tenants business is not able to generate sufficient revenue to meet its financial and/or contractual commitments. SME tenants eligible for the JobKeeper payment automatically qualify, provided annual turnover is less than $50 million.

What information is required to determine financial hardship?

Evidence that an SME tenants is eligible for the JobKeeper payment is sufficient.

In other situations information generated from an accounting system or from a financial institution can be used to establish financial stress or hardship.

Objective of the Code

The objective of the Code is to share, in a proportionate and measured manner, the financial risk and cashflow impact during the COVID-19 pandemic period, whilst seeking to appropriately balance the interests of landlords and tenants .

Overarching principles

The Code sets out some overarching principles.

The principles require the landlord and tenant to work together to allow for business to recommence at the end of the COVID-19 pandemic. The key principles:

- require discussion between the landlord and tenant to achieve satisfactory temporary leasing outcomes;
- acknowledge each lease must be dealt with on a case-by-case basis;
- require good faith negotiation, transparency and honesty;
- require landlords and tenants to assist each other in dealing with other stakeholders, including utility companies and banks;
- require the commercial position of each party to be recognised.

This list is not exhaustive and we suggest the Code be considered in each case.

Leasing principles

The Code also includes specific leasing principles to be applied on a case-by-case basis. The key leasing principles are as follows.

1. Landlords must not terminate the lease due to non-payment of rent during the pandemic or a reasonable subsequent recovery period.
2. Tenants are not able to terminate a lease under the Code.
3. Tenants must remain committed to the terms of the lease as re-negotiated under the Code or risk forfeiting the protection of the Code.
4. Landlords must offer tenants a rent reduction through rent waiver (rent free period) or rent deferrals (rent paid at a later date) proportionate to the reduction in the tenant's trade.
5. Rent waivers must be at least 50% of the total reduction in rent payable and subject to the landlord's position a greater rent reduction can apply.
6. Any rental deferrals must be amortised over the balance of the lease term or for 24 months, whichever is the greater.
7. A landlord should pass on to the tenant any reduction in statutory charges or insurance in the appropriate proportion.
8. A landlord should share any benefit of deferred loan payments with the tenant in a proportionate manner.
9. Landlords should, where appropriate, waive other expenses or outgoings under leases if a tenant cannot trade. Landlords can also reduce services during this time.
10. Any repayment of rent or outgoings should occur over an extended period to avoid placing an undue financial burden on the tenant. Repayment should only commence after the COVID-19 pandemic ends (as defined by the Australian Government) including a reasonable subsequent recovery period.
11. No fees, interest or other charges should be applied with respect to rent which is waived and no fees, charges nor punitive interest may be charged on any deferred charges.
12. Landlords must not draw on a tenant's security for the non-payment of rent during this period.
13. Tenants should be provided with an opportunity to extend a lease for an equivalent period of the rent waiver and/or deferral period.
14. Landlords agree to a freeze on rent increases (except for retail leases based on turnover rent).
15. Tenants must not be penalised for reducing opening hours or ceasing to trade due to the COVID-19 pandemic.

What is meant by 'waiver and deferral'?

A rent waiver is a rent free period – the landlord 'waives' completely the tenant's obligation to pay rent for that period and the rent will not be paid. A rent deferral is when rent is required to be paid at a later date.

In the Code, 'waiver and deferral' includes other forms of agreed variations to existing leases, such as pausing or hibernating the lease.

What is the principle of proportionality?

'Proportionate' means the amount of rent relief proportionate to the reduction in trade as a result of the COVID-19 pandemic plus a subsequent reasonable recovery period. Reduction in trade is measured based on principles consistent with assessments for eligibility under the JobKeeper programme

Can the Parties agree commercial terms different to the Code?

The Code does not prevent the parties from agreeing to any other commercial outcome.

What happens if a landlord and a tenant cannot reach an agreement?

If landlords and tenants cannot reach an agreement on leasing arrangements, a binding mediation process is to be made available in each state or territory.

The purpose of the Code is so that leases are preserved and businesses can re-commence once the pandemic ends.

The Code gives rise to many potential issues including:

- what is a reasonable recovery period after the end of the pandemic?
- the period of time that the rent may be amortised will also cause issues;
- for landlords there are added complications if a tenant subsequently becomes insolvent as any deferred rent and outgoings may never be recovered;
- landlords cannot recover rent and whilst they can negotiate a deferral of loan payments, the Code does not prevent interest on loans from being capitalised;
- although the landlord might be entitled to a deferral of loan repayments on any Australian facility, the situation for any overseas sourced corporate finance is unclear;
- landlords will need to negotiate with banks and financiers to ensure they are not in default under loan facilities for breach of loan covenants;
- the 'proportionality' principle does not take into account the situation of new tenants who do not have pre-COVID-19 income to assess the reduction in income caused by the pandemic;
- rent waiver and deferrals are proportionate to the reduction in revenue for example, a 60% loss of turnover would result in a 60% cash flow relief, however even if the parties are honest and transparent this issue could give rise to disputes;
- for tenants, the waiver or deferral of rent may not be enough to allow the business to survive if no revenue is coming in.

These issues are complex and will need to be properly considered by the landlords and tenants and documented in a deed or as a lease variation.