

Mandatory Code of Conduct – COVID-19 and the way forward for commercial leasing

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On 7 April 2020, the Federal Government announced a mandatory code of conduct for commercial tenancies which have been impacted by COVID-19 (**Code**). The Code is a set of good faith leasing principles that will apply when owners/operators/other landlords and tenants are negotiating amendments to existing leasing arrangements as a result of the commercial impact of COVID-19 and the subsequent Government restrictions.

Who does the Code apply to?

Before proceeding with any negotiations amending existing leasing arrangements in accordance with the Code, landlords and tenants need to determine whether the Code applies to their lease.

Commercial Tenancies

The Code applies to commercial tenancies, including retail, office and industrial, that are suffering financial hardship as a result of COVID-19 and:

1. are eligible for the Federal Government's Jobkeeper programme; and
2. have an turnover of up to \$50 million.

It is important to note that despite this specific criteria, the Code is intended to apply "in spirit" to all leasing arrangements for businesses affected by COVID-19, and landlords and tenants who are not bound by the Code, are still encouraged to use the principles set out in the Code as a framework for negotiating any relief which may be necessary and appropriate for those leases during the COVID-19 pandemic.

Jobkeeper programme

Under the Jobkeeper programme, businesses and not-for-profits are able to access a wage subsidy from the Federal Government to continue paying their employees for the next 6 months. To be eligible for the Jobkeeper programme, at the time of applying, a business needs to comply with the following:

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1. if their annual turnover is less than \$1 billion, their turnover must have fallen or is likely to fall by 30% or more;
2. if their annual turnover is \$1 billion or more (or the business is part of a consolidated group for income tax purposes with turnover of \$1 billion or more), their turnover must have fallen or is likely to fall by 50% or more; and
3. they are not subject to the Major Bank Levy (this applies to banks with over \$100 billion in total liabilities).

Self-employed individuals are eligible for the Jobkeeper programme if they meet the above criteria. Registered charities are also eligible for the Jobkeeper programme if their turnover has or is likely to fall by 15% or more.

The turnover threshold will be applied to franchises at the franchisee level and in respect of retail corporate groups at the group level (rather than the retail outlet level).

What are the requirements under the Code?

The objective of the Code is to proportionally share the financial hardship being suffered between the interests of the tenant and the landlord.

Landlords

Under the Code, it is intended that landlords will agree to temporarily adjust the leasing arrangements for each of their tenants that are suffering financial hardship due to COVID-19, taking into account their individual circumstances.

When making the temporary leasing arrangements, the Landlord should take into account factors such as:

1. the impact of COVID-19 and the resulting Government restrictions on the tenant's revenue, expenses and profitability;
2. whether the tenant's lease has expired or is about to expire;
3. whether the tenant is in administration or receivership; and
4. whether the tenant is already in arrears.

This list is not exhaustive and any factors should be considered by landlords on a case-by-case basis.

Landlords' obligations under the Code

Under the Code, a landlord:

1. must not terminate a lease due to non-payment of rent during the COVID-19 pandemic and a reasonable subsequent recovery period;
2. must offer tenants a proportionate reduction in rent payable in the form of a waiver and/or deferral of up to 100% of the amount ordinarily payable under the lease. This is to be based on the reduction in the tenant's trade during the COVID-19 pandemic and a reasonable subsequent recovery period;
3. must pass on any reduction in statutory charges or insurance in the appropriate proportion applicable under the lease;
4. should proportionally share with the tenant any benefits it receives due to the deferral of loan repayments provided by a financial institution;
5. should, where appropriate, waive recovery of any other expenses (or outgoings payable) from the tenant during the period the tenant is unable to trade. Importantly, the landlord retains the right to reduce services as required in such circumstances;
6. must not apply any fees, interest or other charges in respect of rent waived;
7. must not apply any fees, punitive interest or other charges in respect of rent deferred;

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8. must not draw on the tenant's security (including cash bond, bank guarantee or personal guarantee) for non-payment of rent during the COVID-19 pandemic and a reasonable subsequent recovery period;
9. should provide the tenant an opportunity to extend its lease for an equivalent period of the rent waiver and/or deferral period on existing lease terms during the subsequent recovery period after the COVID-19 pandemic;
10. must agree to freeze any rent increases (except for retail leases based on turnover rent) for the duration of the COVID-19 pandemic and a reasonable subsequent recovery period, regardless of any arrangement between the landlord and tenant; and
11. may not apply any prohibition or levy any penalties if the tenant reduces opening hours or ceases to trade during the COVID-19 pandemic.

In relation to waivers, it is important to note that:

- a waiver must constitute at least 50% of the total reduction in rent payable, and should constitute a greater proportion if failure to do so will result in the tenant being unable to fulfil their ongoing obligations under the lease; and
- any amount of reduction provided by a waiver may not be recouped by the landlord over the term of the lease or recovered at a later date;
- the tenant may waive the requirement for a minimum 50% waiver by agreement; and
- regard may be had to the landlord's financial ability to provide additional waivers.

In relation to deferrals, it is important to note that:

- rental deferrals must be repaid over the balance of the lease term or over a period of no less than 24 months, whichever is greater, unless otherwise agreed by the parties;
- repayment of any other negotiated deferrals should occur over an extended period; and
- no repayment should commence until either the COVID-19 pandemic ends (as defined by the Federal Government) or the existing lease expires, taking into account a reasonable subsequent recovery period, whichever is earlier.

Tenants

Although the aim of the Code is to mitigate the financial impact of COVID-19 on tenants, there are certain requirements that tenants must satisfy to receive these protections.

Pursuant to the Code, tenants are required to comply with the terms of their lease, subject to any amendments under the Code. Material failure to abide by the substantive terms of their lease would forfeit any protections provided under the Code.

How do the parties negotiate temporary leasing arrangements under the Code?

Under the Code, the temporary leasing arrangements must be proportionate to the financial impact of COVID-19, and appropriate based on a reasonable recovery period. To achieve this, negotiations between the landlord and the tenant must be conducted in good faith and must work towards achieving a temporary leasing arrangement that is mutually satisfactory.

Both parties must be prepared to provide sufficient and accurate information. As such, tenants and landlords will need to evidence the financial impact of COVID-19 on their respective businesses.

The tenant will need to provide the landlord information such as:

1. a statement of financial position, outlining income, expenses, assets and liabilities, currently and before 1 March 2020, which evidences a decline in income, sales and/or loss of clients;
2. a recent financial year financial statement;

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3. a report from an accountant or financial adviser with evidence that the business has experienced a substantial reduction in revenue due to the impact of COVID-19; and
4. evidence of the current operation of the business, for example whether there have been any work from home arrangements (if possible) or whether staff have been terminated.

The landlord will need to provide to the tenant information such as:

1. a summary of major debt obligations and whether any repayment deferrals have been offered by the financial institution, insurance companies, government departments and/or utility companies; and
2. evidence of any loss of rent insurance proceeds being paid.

The focus is on the landlord and tenant working together to ensure that the tenant's business continues and the landlord retains the tenant for when the COVID-19 pandemic ends and normal trading conditions return.

What if the parties are unable to reach an agreement?

The code provides that in the circumstances where the landlord and tenant are unable to agree on a temporary leasing arrangement, the matter is to be referred to the appropriate retail/commercial leasing dispute resolution process in that State or Territory for binding mediation.

In Western Australia (subject to any changes, by regulation or otherwise, being made in the *Commercial Tenancy (Retail Shops) Agreements Act 1985*), the appropriate body to conduct the binding mediation in respect of retail leases, would be the State Administrative Tribunal (**SAT**). Under the Code, either party may refer the matter to the SAT. In relation to other commercial leases, such as industrial or office leases, it is unclear what the governing legislation would be and which body would conduct the binding mediation.

It is important to note that neither party may use the mediation process to prolong or frustrate any attempts to reach an amicable resolution to the negotiations.

When will the Code come into effect in WA?

The Code comes into effect from a date after 3 April 2020, to be defined by each jurisdiction through legislation or regulation, as appropriate. The Code will be in effect for as long as the Jobkeeper programme is operational, which at this stage is six months (subject to any appropriate extension or reduction). To date, the West Australian Government has not announced how or when they will implement the Code.

What happens now?

Until the State based legislation is enacted, the Code is an important starting point for landlords and tenants seeking to negotiate rent relief in their existing lease arrangements due to COVID-19. We will need to wait and see how the State Government enacts the Code, and once enacted, how it will work in practice.