

National Cabinet Mandatory Code of Conduct – SME commercial leasing principles during COVID-19

The Prime Minister Scott Morrison announced on 7 April 2020 the mandatory commercial tenancies code (the Code) that will apply to commercial and retail tenancies Australia-wide. This Code will be separately legislated and administered by each State and Territory.

We have summarised the key issues below, along with general information detailing how the Code is intended to operate based on the commentary provided today. Please note that each situation is different and specific advice must be sought with regard to the particular facts at hand.

Commencement of the Code

It is not yet clear when the States will legislate to apply the Code and what date they will nominate for the Code to commence, however it is expected that each State will backdate the relevant legislation to 3 April 2020.

Application of the Code

The Code will apply to businesses that:

- have a commercial, retail or industrial tenancy
- qualify for the JobKeeper program – which includes a requirement that the business must have had a reduction in revenue of at least 30% for a period of at least a month comparable with the same period last year, and
- have a turnover of not more than \$50 million.

We also consider there is an argument that the Code applies to individuals, companies or businesses that cannot generate sufficient revenue as a direct result of the COVID-19 pandemic, causing it to be unable to meet financial and/or contractual (including retail leasing) obligations, even if they are not otherwise eligible for the JobKeeper program—see definition of “Financial stress or hardship”.

The \$50m threshold applies to Retail Corporate Groups and, although these groups have not been defined, the reference to “group level” indicates that subsidiary companies that turnover less than \$50m may not be eligible if the group as a whole turns over more than \$50million. It’s clear that franchisees are treated separately to the franchise group, which makes sense given they are separate businesses licensing a franchise name.

The Code sets out various overarching principles that should be reviewed and considered by Landlords and Tenants in negotiating agreements pursuant to the Code. We won’t summarise those principles here.

Here is our analysis of the “Leasing Principles” in the Code and the implications of those principles for Landlords and Tenants:

LEASING PRINCIPLES		
Principle	Consideration for Landlords	Considerations for Tenants
<p>1. Landlords can't terminate leases due to non-payment of rent during the pandemic or reasonable subsequent recovery period.</p>	<ul style="list-style-type: none"> Landlords are only restricted from terminating for non-payment of rent. It's unclear what constitutes a reasonable recovery period and what level of trade the Tenant needs to achieve to bring an end to that period. Depending on the terms of the lease, it can be terminated if the Tenant has committed another breach. 	
<p>2. Tenants must remain committed to the terms of their lease, subject to any amendments to their rental agreement negotiated under this Code. Material failure to abide by substantive terms of their lease will forfeit any protections provided to the tenant under this Code.</p>		<ul style="list-style-type: none"> It's clear from Principle 1 and this Principle 2 that not only can leases be terminated for breaches other than non-payment of rent, but also that the Tenant may forfeit protections under the Code. Tenants should consider how to comply with their lease obligations if they have temporarily vacated the Premises (e.g. repair obligations) and keep in mind the standard of “a material failure to comply”.
<p>3. Landlords must offer tenants proportionate reductions in rent payable in the form of waivers and deferrals of</p>	<ul style="list-style-type: none"> This principle only requires that rent reductions be offered. There is no mention of any reductions in payments of 	<ul style="list-style-type: none"> Tenants should gather their turnover data now to substantiate the reduction in rent they are seeking by waiver of deferral.

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<p>up to 100% of the amount ordinarily payable, based on the reduction in the tenant's trade during the COVID-19 pandemic period and a subsequent reasonable recovery period.</p> <p>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, consistent with assessments undertaken for eligibility for the Commonwealth's JobKeeper program.</p> <p>Waiver and deferral: may also include other forms of agreed variations to existing leases (such as deferral, pausing and/or hibernating the lease) or other commercial agreements between parties</p> <p>Any amount of reduction provided by a waiver may not be recouped by the Landlord over the term of the lease.</p>	<p>other amounts in this section. Principle 6 deals with payment of statutory charges.</p> <ul style="list-style-type: none"> • Rent relief must be proportionate to the reduction in the tenant's trade as a result of COVID-19. It's unclear how the parties will determine the reduction in trade due to COVID-19 due to the uncertainty of the length of the period. No clarification has been given as to the start of the period and no one knows at this point when the period will end OR the criteria for the end of the period (and subsequent recovery period). While the parties can reach a commercial agreement, hopefully this will be clarified when the States legislate. 	<ul style="list-style-type: none"> • The term "amount ordinarily payable" is not defined, making it unclear what rent amount the Tenant can obtain relief for. The Tenant should include anything that may constitute rent. • If a Tenant chooses to sublease the premises for a lower rent than payable under the headlease, it should consider whether the rent it receives will be taken into account in considering what the Tenant's turnover is from the Premises.
<p>4. Rental waivers must constitute no less than 50% of the total reduction in rent payable under principle 3 (above) over the COVID-19 pandemic period and should constitute a greater proportion of the total reduction in rent payable in</p>	<ul style="list-style-type: none"> • For example, if the qualifying Tenant's revenue has fallen by 30%, then at least 15% of total cash flow relief is rent free/rent waiver and the remainder is rent deferral. 	<ul style="list-style-type: none"> • Rent that is waived doesn't have to be paid back. • There is no clarity as to how does the Tenant establish that it cannot comply with the lease to receive a greater than 50% waiver amount. Tenants will need to

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<p>cases where failure to do so would compromise the Tenant's capacity to fulfil their ongoing obligations under the lease agreement.</p> <p>Regard must also be had to the Landlord's financial ability to provide such additional waivers.</p> <p>Tenants may waive the requirement for a 50% minimum waiver by agreement.</p>	<ul style="list-style-type: none"> There is recognition that the Landlord's financial capacity must be taken into account when considering waivers in excess of 50%. Landlords should raise this during negotiations, although it's unclear how this will apply in practice. 	<p>gather supporting information beyond drop in turnover to argue for greater waiver amounts.</p>
<p>5. 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</p>	<ul style="list-style-type: none"> This contemplates re-payment of rent after the lease has ended, i.e. if the lease has 6 months left, then the 24 months is the greater period and rent will be re-payable during that greater period. Although hopefully an unlikely scenario, if the COVID-19 period extends beyond 24 months then presumably a new agreement will need to be reached with the Tenant for waiver and deferral. We recommend that the rental agreements for waiver and deferral be drafted as variations to the lease that make it clear that the payment obligation survives expiry of the lease if necessary. Landlords who do not have personal guarantees from Tenants in their leases 	<ul style="list-style-type: none"> The reference to the rent being amortised over the relevant period implies periodic payments over that period as opposed to one lump sum payment at the end.

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	<p>should draft these into these waiver and deferral agreements so that, subject to any restrictions imposed by the Code, the Landlord can enforce these payment plans against guarantors if the Tenant does not comply.</p> <ul style="list-style-type: none"> Principle 12 (below) gives the Tenant the option to extend the rent for the deferral period / waiver period. The Landlord should press for this in its negotiation of this repayment plan, so it receives a greater lease period in return for the rent deferral (and waiver) granted. 	
<p>6. 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.</p>	<ul style="list-style-type: none"> It's unclear whether this only applies to statutory charges that are passed on to the Tenant in a net lease as opposed to a gross lease. Does the Tenant still share the benefit of the reduction of statutory charges for a gross lease? 	<ul style="list-style-type: none"> If the Tenant pays 26% of the share of the statutory charges for the building and the Landlord has council rates reduced by Council from \$100,000 to \$50,000, then the tenant should receive a reduction equal to 26% of the \$50,000 saving the Landlord receives.
<p>7. 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</p>	<ul style="list-style-type: none"> How will this apply in practice? Banks are deferring loan payments for up to 3 months rather than forgiving payments. The Landlord must ultimately repay the money deferred and the banks are still charging interest on those deferred amounts. 	<ul style="list-style-type: none"> How does a Tenant determine whether a Landlord has received a benefit from deferral of loan payments? An appropriate obligation should be inserted in any agreement between the Landlord and Tenant pursuant to the Code.

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other Landlords), with the Tenant in a proportionate manner.		
8. 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.	<ul style="list-style-type: none"> Consider when is it “appropriate”. For example, what if Tenant is partly trading such as restaurants offering take away. 	<ul style="list-style-type: none"> Tenants that are still trading in a reduced capacity will want Landlords to continue to offer services but must acknowledge they will have to pay for them if they do.
9. 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.	<ul style="list-style-type: none"> It’s unclear how this correlates with Principle 5, which provides for a minimum 24-month repayment period. Who determines the “extended period” if the parties can’t reach agreement? We await more detail as to what constitutes the end of the COVID-19 pandemic period. 	<ul style="list-style-type: none"> Note that Principle 12 gives the Tenant the option to extend the rent for the deferral period / waiver period (although Principle 12 only refers to Principle 12, not Principle 9).
10. No fees, interest or other charges should be applied with respect to rent waived in Principles 3 and 4 above and no fees, charges nor punitive interest may be charged on deferrals in Principles 3, 4 and 5 above.	<ul style="list-style-type: none"> Each party will have to pay their own costs e.g. legal costs. 	<ul style="list-style-type: none"> Each party will have to pay their own costs e.g. legal costs.

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11. 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.	<ul style="list-style-type: none"> See our comment in Principle 5 regarding personal guarantees to secure performance by the Tenant of any repayment plan. 	<ul style="list-style-type: none"> Remember the Landlord is still entitled to draw against security it holds for other breaches, including non-payment of amounts other than rent.
12. The Tenant should be provided with an opportunity to extend its lease for an equivalent period of the rent waiver and/or deferral period outlined in item 2 above. 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.		<ul style="list-style-type: none"> See Principles 2 and 9. The Tenant does not have to extend its lease—it's a right not an obligation. It's not clear what commercial terms apply during that extended period. Presumably it will be a matter for negotiation.
13. 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.	<ul style="list-style-type: none"> It's not clear whether the freeze on rent reviews applies during the extended period mentioned in Principle 12. How does the extended period correlate with the "reasonable subsequent recovery period"? We assume the reference to "notwithstanding any arrangements between the Landlord and the Tenant" refer to existing lease terms rather than commercial arrangements made during this pandemic period. 	<ul style="list-style-type: none"> What about restrictions on market reviews that have no ratchet? Such market reviews could cause the rent to be reduced substantially for the benefit of the Tenant (and to the detriment of the Landlord).

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14. 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		<ul style="list-style-type: none"> Tenants are not bound by “must trade” clauses in their leases.
<p>Binding mediation</p> <p>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.</p> <p>Landlords and Tenants must not use mediation processes to prolong or frustrate the facilitation of amicable resolution outcomes</p>		

Further information

If you need further information, please contact one of our senior Property team members.



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