

# SME COMMERCIAL RENTAL RELIEF DURING COVID-19



*The Federal Government announced on the 7<sup>th</sup> April a mandatory Code of Conduct ("Code") setting out the principles governing commercial and retail tenancies affected by Covid 19. These will be enforceable via state based legislation. The code of conduct strongly encourages negotiation between landlords and tenants, whilst providing some basic protections for both. However, there are a lot of practical difficulties in how these principles will actually operate. The code of conduct generally applies where the tenant is able to access the jobkeeper program.*

## WHO DOES THE CODE APPLY TO?

Landlords and tenants need to comply with the Code where

- The tenant has an annual turnover of less than \$50m
- The tenant is suffering financial hardship as a result of COVID-19 AND it has experienced at least a 30% drop in revenue
- The tenant is able to access the Jobkeeper program.

Note that it only applies from when the tenant can demonstrate the drop in turnover. For example, if a tenant only experiences a drop in turnover of at least 30% in June, then the code will only apply from June.

## WHAT PROTECTIONS ARE AVAILABLE TO LANDLORDS?

In order to provide some basic protection to landlords from potentially false claims from tenants, the code suggests that landlords ask for the following of tenants

- Evidence that the tenant is receiving jobkeeper
- A statement of the tenants financial position pre and post Covid-19
- Potentially, an accountant's report demonstrating evidence of the % drop in revenue.
- Details of the ongoing operations of the tenants business.

Practically, this evidence will be obvious in some industries eg dentists which are effectively not allowed to work. However, the impact of COVID 19 is not so clear in many other industries which is why this protection is included.

In addition, tenants must remain committed to the terms of their lease, subject to the amendments negotiated under the code. Failure to comply with the main terms of the lease will remove any protection offered under the code. For example, if the tenant still does not pay their remaining rent, then the Code protections are removed.

## PROTECTIONS OFFERED TO TENANTS

There are several levels of protections offered to tenants under the code including

- Landlords must not terminate leases due to non-payment of rent during the COVID-19 pandemic or a reasonable subsequent recovery period.
- Landlords must offer tenants **proportionate reductions** in rent in the form of waivers and deferrals of up to 100% of the rent (excluding variable outgoings as discussed below), based on the reduction in the tenant's trade during COVID-19. The waivers must constitute at least 50% of the total reduction. The deferral of rent must be amortised over the balance of the lease term and for a period no less than 24 months, whichever is the greater. Refer to the example below.
- Any reduction of variable outgoings by government agencies need to be passed onto the tenant.
- Any bank deferral received by the landlord (if any) should be passed onto the tenant. Note: many landlords will not receive any of this.
- No fees, interest or other charges should be applied to the waivers or deferrals.
- Landlords cannot draw on the tenant's security during the period.
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- The tenant should be provided with an opportunity to extend the lease for an equivalent period of the deferral period.
- There will be a freeze on rent increases for the duration of COVID 19
- Landlords cannot apply any prohibition or penalties for reduced opening hours. This mainly affects large shopping centres.

#### **WHAT ABOUT VARIABLE OUTGOINGS?**

There is a waiver of variable outgoings required for the period that the “tenant is not able to trade”. For example, if there is a complete lockdown and restaurants are not able to trade at all, including no takeaway, then this would be deemed not able to trade. However, if they can still trade, albeit in a reduced capacity, then this will not apply.

#### **EXAMPLE**

ABC Engineering Pty Ltd (“ABC”) is an office tenant paying \$20000 per month in rent. ABC has implemented work from home protocols for its staff but continues to operate with skeleton staff at the premises. Due to projects being postponed indefinitely as a result of COVID-19, ABC’s turnover reduces by 70%. The relevant lease has a term of three years of which two years have expired. In accordance with the code, ABC and its landlord agree:

- A 70% rent reduction (\$14000 per month) is to apply for the COVID-19 period

- 50% of the rent reduction (\$7000 per month) is permanently waived and not recoverable by the landlord.
- 50% of the rent reduction (\$7000 per month) is deferred and becomes repayable in equal instalments over 24 months starting from when the pandemic is over. They agree to extend the lease term for the agreed relief period.
- On the basis that ABC’s decision to work from home was not an inability to trade, the landlord did not agree to a waiver of outgoings.

#### **PRACTICAL CONSIDERATIONS**

Clearly the most difficult aspect of this code is determining exactly what % of revenue and from when the tenant’s income has reduced. The code does not provide for an automatic reduction of rent but does require some provision of proof of this. As this is linked to the Jobkeeper payments, it is envisaged that there will be some kind of reporting produced from the ATO to assist. However, it is clear that being able to provide evidence of any reduction and both parties negotiating and communicating in good faith is important.

#### **DOCUMENTATION**

Any agreements reached between landlords and tenants should be formally documented.

Parties should take care to ensure that there is no inadvertent waiver of rights and/or the creation of express or implied representations/warranties in their negotiations. The impacts of the changes on the whole lease need to be carefully considered.

If you would like more information, then feel free to contact either Gino Terriaca, Tony Cassetai or Silvia Caratti of Maxim Private Advisory on (08) 9489 2555.

*Please note that this is general information only and professional advice should be obtained before acting on any information contained herein.*