

COVID-19 and commercial tenancies – questions raised by the mandatory code and what’s next for landlords and tenants

Source: [Prime Minister of Australia](#)

Date: 22 April 2020

As noted in our [legal update](#) on 9 April 2020, the mandatory code of conduct approved by the National Cabinet for commercial tenancies affected by the COVID-19 pandemic (**Code of Conduct**) is expected to be implemented shortly in each jurisdiction through the relevant state or territory legislation or regulation.

Under the Code of Conduct, landlords and eligible tenants suffering financial stress or hardship as a direct result of the COVID-19 pandemic are required to negotiate, in good faith, temporary amendments to their existing leasing arrangements, subject to certain leasing principles.

While the Code of Conduct provides helpful guiding principles to landlords and tenants, it has also raised many questions which need answering:

- **When will the Code of Conduct take effect and for how long will it be in place?**

At the moment, all we know is that it will come into effect from a date after 3 April 2020 (to be decided by each jurisdiction) and will remain in effect while the [JobKeeper program](#) remains operational, which is expected to be until the end of September 2020.

- **Will pre-Code of Conduct arrangements be affected?**

Some landlords and tenants have presumably already negotiated and agreed temporary arrangements, i.e. on or before 3 April 2020. It is not clear if those arrangements (which will now come under the Code of Conduct) must be revised to comply with the Code of Conduct.

- **When will the “COVID-19 pandemic period” come to an end?**

Many of the leasing principles under the Code of Conduct protect tenants “during the COVID-19 pandemic period”; however, there is no indication given as to when or under what circumstances the COVID-19 period will come to an end, other than a statement in one of the principles that the ending of the COVID-19 pandemic will be “defined by the Australian Government”. As noted above, the Code of Conduct is to remain in effect while the [JobKeeper program](#) remains operational.

- **What is the “reasonable subsequent recovery period”?**

Many of the principles under the Code of Conduct also protect tenants during the “reasonable subsequent recovery period”, which was presumably included

to allow businesses some recovery time and to ensure that lease terms are not immediately enforceable as if the pandemic never happened. But it's not clear at this stage what will constitute a "reasonable subsequent recovery period", i.e. if it will be a standard period of time for all tenants or if it will be determined on a case-by-case basis, according to a tenant's individual circumstances. Some businesses will inevitably take longer than others to recover. Others may not even recover at all. If it is to be determined on a case-by-case basis, then landlords will probably be entitled to require further "sufficient and accurate information" from tenants (see below) so that they can assess their financial situation at the end of the COVID-19 pandemic period.

- **What are "existing leasing arrangements"?**

The Code of Conduct applies to "*existing leasing arrangements*". It is assumed that this means leases which were entered into before the Code of Conduct comes into effect, e.g. on or before 3 April 2020. But it is not clear if it also applies to leases to be granted by landlords pursuant to agreements entered into before that date, e.g. agreements for lease, or under options in existing leases.

- **How do tenants prove a reduction in trade?**

Tenants who are eligible for the federal government's [JobSeeker program](#) are automatically protected by the Code of Conduct provided they have an annual turnover of less than \$50 million; however, they have to show a reduction of at least 30% in turnover to be eligible for the [JobSeeker program](#) and any rent reduction permitted under the Code of Conduct must also be proportionate to the reduction in the tenant's trade during the COVID-19 pandemic period and a reasonable subsequent recovery period. But the Code of Conduct does not expressly state how tenants are required to substantiate this reduction in trade. One of the overarching principles of the Code of Conduct is that parties should act in an open, honest and transparent manner in negotiating appropriate amendments and provide "*sufficient and accurate information to achieve outcomes*". While "*sufficient and accurate information*" is defined "*to include information generated from an accounting system, and information provided to and/or received from a financial institution*", it is not really clear what specific information is required or appropriate or how it should be provided. Landlords will no doubt seek detailed financial and accounting information, showing tenants' current and past turnover figures, to verify that tenants are entitled to the protection of the Code of Conduct. This requirement could cause tension between the parties as many tenants may not want to share confidential or "commercially sensitive" information with their landlords. It is hoped that the implementing legislation will detail the specific information required and how it is to be provided. It may possibly require an independent auditor to verify and provide the relevant information.

- **Can a landlord terminate a lease for pre-pandemic rent arrears?**

The Code of Conduct provides that a landlord cannot terminate a lease due to non-payment of rent during the COVID-19 pandemic period or a reasonable subsequent recovery period. But it does not deal with a termination for the non-payment of rent before the COVID-19 pandemic period. It appears that

the Code of Conduct will not prevent a landlord from being able to terminate for a breach other than non-payment of rent or outgoings (if applicable) or reducing/ceasing trading.

- **How is a new tenant's trade reduction calculated?**

Under the Code of Conduct, a landlord must offer to a tenant a rent reduction proportionate to the reduction in the tenant's trade during the COVID-19 pandemic period and a subsequent reasonable recovery period. But it does not specify how this reduction is to be calculated for a new tenant who has had little or no pre-COVID-19 pandemic trade.

- **How long should rent reductions last?**

The Code of Conduct only provides that a rent reduction must be proportionate to the reduction in the tenant's trade during the COVID-19 pandemic period and a subsequent reasonable recovery period (which said periods have not been defined). It also not clear if the rent reduction should be a one-off reduction or if it can be changed given that a tenant's level of trade is likely to change during these periods.

- **Is a tenant entitled to a rent reduction if it ceases trading?**

The Code of Conduct provides that a landlord cannot take any action if a tenant reduces its opening hours or ceases to trade because of the COVID-19 pandemic. But it is not clear if a tenant will be entitled to a proportionate rent reduction if it does decide to cease trading or reduce its opening hours (whether forced to do so by law or otherwise) and its turnover is consequently reduced.

- **What about deferred rent if the remainder of the term is less than 24 months?**

Under the Code of Conduct, the payment of a rent deferral by a tenant must be amortised over the balance of the lease term and a period of at least 24 months (whichever is the greater), unless otherwise agreed by the parties. But it is not clear how this will work if the balance of the lease term is less than 24 months, i.e. the term has ended and the deferred rent is still payable. Presumably, the intention is that the agreement reached between the parties will be enforceable, even if the term of the lease has already ended.

- **Is a landlord's financial situation only to be considered in the context of rent waivers?**

The Code of Conduct provides that a rent waiver must constitute at least 50% of the total rent reduction offered by a landlord over the COVID-19 pandemic period and that "*regard must be had to the landlord's financial ability to provide*" for a rent waiver constituting more than 50%. Accordingly, it would appear that a landlord's financial situation is only relevant in the context of a rent waiver constituting more than 50% of the total rent reduction and not in relation to any other relief.

- **How must landlords pass on the benefit of loan payment deferrals or a reduction in statutory charges or insurance costs?**

The Code of Conduct provides that a landlord must pass on to a tenant the proportionate amount of any such benefit received by a landlord. But it does not make it clear how this “proportionate amount” is to be calculated.

- **How can a landlord reduce services?**

The Code of Conduct provides that a landlord reserves the right to reduce services in circumstances where a landlord does not seek to recover other expenses or outgoings payable by a tenant under a lease during the period that the tenant is unable to trade. The extent to which the landlord will be able to reduce services in these circumstances is not clear. It is also assumed that, if the tenant resumes trading, the landlord will be required to resume providing those services and will be entitled to seek recovery of the expenses or outgoings again.

- **What about those tenants not protected by the Code of Conduct?**

There are likely to be many tenants suffering financial stress or hardship as a direct result of the COVID-19 pandemic who do not qualify as “eligible” tenants under the Code of Conduct. To qualify, a tenant must be eligible for the [JobKeeper program](#) and have an annual turnover of less than \$50 million. It is likely that many of the national retail outlets will not qualify given that the \$50 million turnover threshold is to apply at the retail corporate group level for retail tenants rather than at the individual retail outlet level. The Code of Conduct is therefore clearly designed to protect the small and medium sized enterprises. But while landlords and tenants not covered by the Code of Conduct can still adopt the same principles in negotiating their own temporary arrangements, the landlords will not be bound by the Code of Conduct and the tenants will not be protected by it. The landlords will therefore be entitled to charge interest on unpaid rent, draw on tenants’ securities or even terminate leases for non-payment of rent.

What’s next for landlords and tenants?

Unfortunately, the Code of Conduct comprises more a set of guiding principles than a clear set of rules for commercial landlords and tenants; however, as noted above, the Code of Conduct should be given effect shortly in each jurisdiction through state and territory legislation and it is hoped that the above questions will be answered in the implementing legislation. Once implemented, those landlords and tenants covered by the Code of Conduct will be required to negotiate temporary arrangements to their existing leases, subject to the leasing principles in the Code of Conduct, to take into account the financial stress or hardship being suffered by the tenants as a result of the COVID-19 pandemic.

Accordingly, once the Code of Conduct has been implemented:

- landlords and tenants should carefully review the relevant legislation to determine if the legislation applies to their existing leases;
- tenants should verify their eligibility for the [JobKeeper program](#) and provide the appropriate financial and accounting information to landlords (on a

confidential basis) detailing their past and current turnover figures so that their landlords can quickly assess the financial stress or hardship being suffered by them as a result of the COVID-19 pandemic and confirm that they are protected by the relevant legislation;

- landlords should carefully review any other legislation which is introduced giving them relief on land tax or other statutory charges (as the Code of Conduct requires landlords to pass on the proportionate benefit of any reductions in statutory charges); and
- landlords should determine if their financial institutions have allowed them any loan payment deferrals, e.g. as part of the [Australian Bankers Associations' COVID-19 response](#) (as the Code of Conduct requires landlords to pass on the proportionate benefit of any such deferrals).

If the legislation applies to an existing lease:

- the landlord and tenant should be open and honest with each other and immediately seek to negotiate, in good faith, temporary arrangements which are consistent with the leasing principles under the Code of Conduct/relevant legislation. The Code of Conduct provides that the leasing principles “*should be applied as soon as practicable on a case-by-case basis*” (group arrangements are not permitted);
- once negotiated, parties should formally document their agreed temporary arrangements in a deed of variation (varying the terms of the existing lease) so that they are binding on both parties and can be referenced at a later date, avoiding any risk of dispute. The deed of variation should confirm the terms of the lease in all other respects; and
- if the parties cannot come to a mutually agreeable arrangement, then the matter must be referred for binding mediation; however, in the interest of saving time and money, it is probably preferable for the parties to try and come to a resolution themselves, especially given the delays that are likely to occur from the number of disputes that will come before the relevant dispute resolution bodies. Under the current social distancing measures in place, it is also likely that any such mediations will have to be carried out remotely.

In the meantime, if a tenant is suffering financial stress or hardship as a result of the COVID-19 pandemic:

- the landlord and tenant should immediately review their existing leasing arrangements and insurance cover and, as soon as possible, open communication and endeavour to engage in negotiations, in good faith, to try and achieve a mutually beneficial outcome; and
- the tenant should prepare the relevant financial information to provide to the landlord so that the landlord can quickly verify the tenant’s eligibility for [the JobKeeper program](#) (if applicable) and the tenant’s financial stress or hardship,

even if it turns out that the tenant is not protected by the Code of Conduct/relevant legislation.

If tenants are not eligible for protection under the Code of Conduct, the parties are still free to adopt the same principles in negotiating their own temporary arrangements but the tenants will not be protected by the Code of Conduct. Equally, the landlords will not be required to grant any relief and will still be entitled to enforce their rights.

The parties should also watch out for other anticipated legislation granting relief to landlords regarding the payment of land tax or other statutory charges. The state or territory governments may grant this relief to all landlords and not just to landlords bound by the Code of Conduct.