



The ramifications of COVID-19 on commercial landlords and tenants is large scale and unprecedented both in SA and nationally.

There is much uncertainty in the commercial leasing space at this time concerning the legal rights and obligations of landlords and tenants, which is further challenged by the announcements made by Governments at both Federal and State levels, the delay in obtaining clear understanding of how new Government measures will work, and the difficulty in having one solution applied to all tenancies.

**Commercial & Legal** have been engaged by REISA to assist our members to gain an understanding of the new Code and how our Agents, Property Managers, Landlords, Tenants and other Members should respond when dealing with their commercial tenancies.

### Part 1 – Code of Conduct

The National Cabinet recently agreed on a mandatory Code of Conduct which is to be implemented by each State and Territory nationally (“**Code**”). A full copy of the Code can be obtained from: <https://www.pm.gov.au/sites/default/files/files/national-cabinet-mandatory-code-ofconduct-sme-commercial-leasing-principles.pdf>

Members engaging in commercial leasing activity are encouraged to download and read the Code. A summary of the key points within the Code is also provided below.

- 1) **The Purpose of the Code** - To “impose a set of good faith leasing principles for application to commercial tenancies (including retail, office and industrial)”.
- 2) **Who does it apply to?** - The Code applies to circumstances where the tenant, having been affected by the COVID-19 pandemic, is a small-medium sized business (annual turnover of up to \$50 million) and is an eligible business for the purpose of the Commonwealth Government’s “JobKeeper” program.
- 3) **How will the Code be implemented?** - The Code will be given effect in South Australia via amendments to SA legislation and regulations (more details on this Bill below).
- 4) **How long will the changes apply?** - The Code as implemented through SA legislation is intended to be temporary. It will come into effect from a date following 3 April 2020 (to be determined by each jurisdiction) and shall continue for the period during which a tenant’s business is affected by the COVID-19 pandemic, which more than likely will be the period that the Commonwealth JobKeeper program remains operational.

5) **Leasing Principles** – The Code sets out key leasing principles (for example):

- *Moratorium on Termination* - Landlords must not terminate leases due to non-payment of rent during the COVID-19 pandemic period (or reasonable subsequent recovery period).
- *Tenant remains contractually bound* - Tenants must remain committed to the terms of their lease, subject to any amendments to their rental agreement negotiated under the Code.
- *Rent waivers and deferrals* – Rent relief given to tenants must be proportionate to their loss in trading and landlords must offer tenants proportionate reductions in rent payable in the form of:
  - Rental waivers, to be not less than 50% of the total reduction of rent payable, unless otherwise agreed by the tenant by agreement; and
  - Rental deferrals, to be based on the balance of the rent relief afforded which is not granted in the form of a rental waiver.
- *Repayment of deferred rent* - Payment of rental deferrals by the tenant must be amortised over the balance of the lease term and for a period of not less than 24 months, whichever is the greater (unless otherwise agreed) and no repayment should commence until the earlier of the COVID-19 pandemic ending (taking into account a subsequent reasonable recover period) or the existing lease expiring.
- *Landlord's Security* – Landlords must not draw on a tenant's security (e.g. a security bond, bank guarantee or personal guarantee) during the period which the Code applies.
- *Freeze on rent increases* – There shall be 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.
- *Reductions in Outgoings* – Any reduction of landlord outgoings (e.g. land tax, council rates) or insurance is to be passed on to tenants. Where appropriate, landlords should seek to waive recovery of other expenses or outgoings during the period the tenant is unable to trade (noting that the landlord may be entitled to reduce services offered).
- *Late Payment Charges* – Landlords shall not apply fees, punitive interest or other charges towards any deferred rent.
- *Lease Extensions* – Landlords should offer tenants an opportunity to extend the lease term by a period equal to the rent waiver/deferral period.
- *Trading Hours* -Landlords may not prevent tenants from reducing trading hours or closing doors (related to COVID-19) nor apply any penalties for doing so.
- *Mediation* - Where landlords and tenants cannot reach agreement on leasing arrangements (as a direct result of the COVID-19 pandemic), the matter should be referred to applicable State or Territory dispute resolution processes for binding mediation.

All interested participants await legislative action in their respective State and Territory for further guidance and detail. The South Australian State Parliament has now passed the *COVID-19 Emergency Response Bill 2020*, being a Bill for an Act to make various temporary modifications to existing SA legislation. We note that the Bill is awaiting assent and is therefore yet to become law.

## Part 2 – Practical Implications and Issues to Consider

Agents and Property Managers are being required to work harder than ever, in an environment that is or may be demanding a reduction in remuneration for those services, and where they find themselves on the frontline of tense negotiations between landlord and tenant.

Landlords will now more than ever be relying upon the quality of their relationship with their tenants (where applicable) and the relationship as between the Agent / Property Manager and the tenant.

We invite Agents and Property Managers to turn their minds to the following matters:

### When to Negotiate

- Should I be advising my landlord to commence negotiations with tenants now or:
  - Wait for clarifying SA legislation and regulations to come into effect (likely to be 1-2 weeks)?
  - Wait for the tenant to establish that they are eligible for JobKeeper program (likely to be 2<sup>nd</sup> week of May)?
- What minimum documentation are you entitled to demand from a tenant to permit informed negotiations (e.g. latest turnover figures and/or certain financials or business activity statements) and how long tenants may need to compile this information.
- Any negotiated outcomes should be agreed subject to pending legislation.

### How to Negotiate

- Should I be negotiating rent relief for the next 1 month, 3 months, 6 months, or indefinitely whilst the COVID-19 pandemic continues?
- What if a tenant's circumstances change?
- Should I be assessing and negotiating rent relief on a monthly basis?
- Can a formula be negotiated, and how will this be reviewed/monitored?

### Assessing Tenant Turnover

- Consider how will you be assessing the Tenant's loss in turnover?
- Eligibility for JobKeeper payments will not, on its own, determine the rent relief for you. It is merely the first step in determining if a tenant is entitled to relief.
- Take note that turnover decline can be difficult to determine, in particular where the tenant's business has not remained 'static' the past 12 months.
- Take note that certain tenants could have decline in business without decline in turnover (e.g. if they had sought to expand their business 6 months ago, the decline may simply relate to the prior growth).
- Consider the reliability of turnover information, in particular where not provided by a tenant's accountant, or where turnover decline cannot be verified.
- If the existing lease does not oblige disclosure of turnover, consider the benefits of asking tenants to disclose their prior 2 years financials and committing to ongoing disclosure, say for the next 2 years. Alternatively consider negotiating the simple inclusion of a turnover provision in the lease to apply throughout.

### Rent reviews

- The Code includes a rental freeze, but does not forbid rent review calculations.
- Consider continuing to undertake annual rent reviews as per the lease terms (but not actually applying the increase during any restricted period). Otherwise landlords will miss the opportunity.
- For Market rent reviews – consider (where appropriate) undertaking any current market rent reviews sooner than later to take advantage of the state of the market immediately prior to the effects of COVID-19. Deferring market reviews may sound appealing, however it is likely that the market values will drop as comparable evidence gathers due

to increased tenant leverage. Alternatively consider (where appropriate) changing to a fixed increase or CPI agreement with agreement between the parties, or simply not instigating a market rent review altogether.

### **Extending Lease Terms**

- The Code asks parties to consider extending the lease expiry to match the duration of the rent relief period.
- Consider how to apply this lease extension where tenants already have existing rights of renewal?
- Consider what leverage landlords may have to request an extension term if tenants do not wish to extend, and vice a versa.

### **Payment for PM Services**

- Is your fee fixed, or based on percentage of rents?
- Be sure to review your entitlement to be remunerated for ongoing property management under your current Agency Agreement.
- If based on percentage of rent, are you at risk of being paid less due to rent relief measures and/or reduced outgoings (particularly when you have substantially more work to undertake)? Thankfully the REISA commercial property management agreement excludes rent incentives and rent reductions from the calculation of PM fees, so be sure to follow this wording, as opposed to negotiating a “varied” rent (which is different to a rent reduction). However unfortunately it is likely that PM fees will be reduced on account of reduced outgoings payable by tenants.
- How will you deal with tenancies that receive no rent? How will property outgoings be paid? Will you invoice landlords for your PM fee (and how will they react)?
- Consider how you will respond to landlord requests for reduced PM fees, or Tenant requests for reduced PM outgoings.

### **Agency Agreements**

- Consider the current term of your Agency Agreement and whether this need or should be extended now in order to capture current workload and recovery periods (including any increased lease terms).

### **Documenting agreed variations to lease**

- Agents and Property Managers to consider putting obligation on landlord to decide whether to outsource or seek assistance with negotiations (e.g. landlord’s accountant or solicitor) and whether documentation ought to be by the landlord’s solicitor (where the variations justify).
- Documentation may take the form of a side letter through to proper form Deed of Variation of Lease (depending upon the nature of the variations to the lease).
- Consider sharing documentation costs equally as between the parties.

No doubt there are many more considerations for all parties to take into account.

### Part 3 – Deeds of Lease Variation

**Commercial & Legal** will be working with REISA to consider the development of a short-form agreement that may be used by REISA members for documenting agreed rent relief measures.

In many circumstances there will be no alternative but to have a proper drafted Deed of Lease Variation prepared by a party's solicitor. In such cases, we acknowledge that Agents / Property Managers will want to streamline their processes and costs.

**Commercial & Legal** will be offering Deeds of Lease Variations prepared specifically for COVID-19 negotiations, which will be affordable and fixed in cost, and which afford Agents / Managers a simple and streamlined process.

# Commercial & Legal

For more information or to seek assistance, please contact **Graham Hall, Andrew Dunccliff** or **Elias Farah**; or alternatively, call our office on (08) 8206 8444 to find out more information.



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