

Mandatory Code of Conduct Retail and Commercial Leases

**DSA
LAW**

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On 7 April 2020, the National Cabinet released the Mandatory Code of Conduct (“Code”) for commercial tenancies during the COVID-19 pandemic period. While we are yet to see how the individual State jurisdictions will implement it and some fine tuning is expected, here is DSA Law’s summary of the key points

1. Purpose: What is the purpose of the Code?

The purpose of the Code is to:

- ensure that landlords and tenants share a common interest in:
 - working together,
 - the promotion of business continuity,
 - the negotiation of temporary arrangements, and
 - working towards achieving mutually satisfactory outcomes
- set good faith principles between landlords and tenants; and
- facilitate open, honest and transparent communication between landlords and tenants,

with, the objective that financial risk and cash flow impacts are shared proportionately between landlords and tenants.

The Code is closely connected with the national JobKeeper program.

2. Eligibility: Are you eligible?

The Code applies to commercial tenancies, which is broadly defined to include retail, office and industrial tenancies.

To be eligible, the tenant must:

- have an annual turnover of less than \$50 million AUD; and
- have suffered, or be suffering, financial stress or hardship as a result of COVID-19. If your business is deemed eligible for the JobKeeper programme, the Code applies automatically to you.

Furthermore, the annual turnover threshold test is only intended to be applied for franchises at the individual franchisee level, as opposed to retail corporate groups, for which it applies to the group as a whole.

3. Leasing Principles: What are they?

The key Leasing Principles, include:

Non-Termination

Landlords must not terminate leases due to non-payment of rent during the COVID-19 pandemic and the reasonable recovery period, which is yet to be determined (**Relief Period**). It is yet to be made clear whether this only applies to leases falling under the Code, or a wider mandate.

Commitment

Tenants must remain committed to their leasing arrangements, subject to negotiation in accordance with the Code. This would appear to be a warning to tenants not to try and use the Code unnecessarily or to their unfair advantage.

Proportionality

Landlords must offer tenants rent reductions proportionate to tenants’ reduced trade during the Relief Period. Any reductions in statutory charges and insurances must flow through to tenants proportionate to their obligations to pay those amounts as outgoings.

Rental Waivers & Deferral

Any agreed rental waiver and deferral should continue for entire Relief Period.

Waivers (that is, the landlord will never ask this amount to be paid) of rental must be at least 50% of the total reduction in rent negotiated.

Deferred rent (that is, rent the landlord still claims but will wait to be paid when the business is recovering after the Relief Period) must be spread out equally over the balance of a lease term or 24 months, whichever is the greater.

“...the objective that financial risk and cash flow impacts are shared proportionately between landlords and tenants...”

Security

Landlords are precluded from drawing on a tenant's security for non-payment of rent during the Relief Period.

Penalties

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.

Rent Freeze

Landlords are to freeze rent increases for the Relief Period.

Extension of Lease

Tenants should be provided an opportunity to extend their lease for a period equivalent to the Relief Period.

4. Sufficient Information: What Tenants should know?

If you intend to rely on the Code of Conduct, landlords may ask you for 'sufficient and accurate' information to support your reliance on the Code. As a tenant, you should be prepared to provide evidentiary support for any decline in business. This may include:

- evidence that your business' annual turnover is less than \$50 million AUD;
- evidence that your business is eligible for the JobKeeper programme (i.e ATO approval or evidence submitted for such approval showing your revenue has decreased by more than 30%);
- financial reports stating your income, expenditure, assets and liabilities. The financial statement should be certified by an accountant; and
- a financial report from an accountant showing your business' current cash flow trajectories, with any significant present or anticipated changes in revenue or income relating to your business.

The landlord may also request:

- any insurance policies that may cover your losses, expenses or liabilities during the Relief Period;
- statements generated from your accounting system; and
- statements provided to / received from financial institutions.

4. Negotiations: What may happen?

Landlords and tenants should openly communicate and attempt to negotiate the best mutual outcome possible based on the Leasing Principles.

Landlords should not attempt to adopt a 'one-size fits all' approach, as the circumstances of each individual tenant differ.

Moreover, the Code illustrates an example of how the application of proportionality may apply, in Appendix 1. For example, a qualifying tenant that experiences a 60% loss in turnover would be guaranteed a 60% cash flow (rent) relief. This relief may provide that:

- at a minimum, half of the rent reduction is to be waived during the cashflow relief period; and
- at most half can be deferred rent, which may be negotiated with the landlord to be paid over a minimum of 24 months, or the remainder of the lease term, whichever is the greater.

Please note that these are guidelines and therefore the landlord and tenant may negotiate and agree on an alternative arrangement.

If the parties are unable to arrive at a mutually agreeable arrangement then the dispute will be referred to a binding mediation. In Victoria, we would expect the Victorian Small Business Commissioner's office will be involved.

Key Takeaways

- landlords should be prepared to negotiate with qualifying tenants, in accordance with the Code.
- tenants should be regularly updating their financials to substantiate any decline in revenue / income from their business.
- the Code is intended to redistribute, fairly, the financial risk and cash flow impact between landlords and tenants.
- the application of the Code is subject to how it will be legislated in each State or Territory.

For more information regarding the Mandatory Code of Conduct, get in touch at www.ds.alaw.com.au, contact us on 1300 060 510, or visit our offices:

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