

WHEN IS A BANK GUARANTEE EFFECTIVE?

While the pandemic has wreaked havoc with the Australian economy over the last six months, in the past few weeks we have seen a resurrection of leasing transactions, be it retail, commercial, or industrial.



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Whether you're a retail shop landlord trying to recover rent owing under a lease, a small retail business forced to close due to the pandemic, or a commercial office tower landlord looking at the sudden influx of demand for commercial office space in the CBD, you will find this article useful when your attention turns to the one piece of paper provided by a tenant: the bank guarantee.

Tenants providing a bank guarantee to secure their obligations under a lease is a well-established practice and preferred by landlords over receiving cash bonds for a variety of reasons. However, for a bank guarantee to be effective in securing a tenant's obligations, it must satisfy several criteria.

Here, senior associate Helen Wu shares a few tips to help minimise the risk the bank guarantee may be ineffective, which the landlord may only discover years later.

Favouree

The most obvious detail to make sure is correct, but sometimes overlooked, is the name of the favouree (ie the entity in whose favour the bank guarantee is made). It is important to

ensure the spelling and ACN (if the favouree landlord is a company) are correct. When it comes to claiming on a bank guarantee, some banks require the letter of demand is on the favouree company's letterhead so it is important the details are consistent.

Ensuring the favouree's details are correct does not stop at checking the spelling and ACN. It extends to checking the details of any trust are included. If the property is held by a trustee, the name of the trust should also be included. Trustees sometimes change so noting the name of the trust will assist the new trustee in proving it is entitled to claim on the bank guarantee on behalf of the true owner of the property.

Purpose

It is obviously important to confirm the description of the premises which is the subject of the lease being guaranteed. It is also important to make sure the purpose of the bank guarantee is not described as security for a lease of the premises only, or even worse, described as guaranteeing rent for the premises.

Leases often contain more than just leased areas. They may contain licensed areas or other rights to occupy or use. These rights may not be contained in the lease, but instead in a separate document. Tenants' obligations under leases are also not restricted to paying rent.

So, while you will want the purpose of the bank guarantee to be broad enough to allow you to claim on the bank guarantee, not just on the tenant's failure to pay rent, you don't want the purpose to be so broad you cannot pinpoint your right to claim on the bank guarantee. Although, in the latter scenario, your tenant or their bank will unlikely agree to issuing a broad form bank guarantee in the first place.

Payment without reference to the tenant

Another important term to be included in a bank guarantee is permitting, or even better, demanding, the bank pay out the favouree's claim from the bank guarantee without any reference to permission from the tenant or customer noted on the bank guarantee.



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This is an important term as any reference to permission from the tenant prior to paying out the claim defeats the purpose of the unconditional undertaking the bank guarantee purports to be.

Right to claim on the bank guarantee

The faveuree must also ensure it has the right to claim on the bank guarantee.

Although ideally the bank cannot make any reference to obtaining permission from the tenant prior to paying out the claim, this does not give the faveuree an unfettered right to make a claim.

This is an especially important factor to consider in the current climate. The National Cabinet Mandatory Code of Conduct for commercial leasing may prevent a landlord from calling on a bank guarantee even if the tenant has clearly breached their obligations under the lease. Visit our website for a recent article by partner Kristy Dorney about assessing whether you can claim on a bank guarantee during these extraordinary times.

Should a bank guarantee be from a 'bank'?

We have recently received several enquiries about what happens if a tenant can suddenly no longer provide a bank guarantee due to current market conditions.

The landlord can ask for cash bonds from their tenants, but what if the sum guaranteed is so large their tenants cannot front the cash in the first place? One tenant offered to provide an insurance bond.

The practice of accepting bonds issued by insurance companies is widely accepted in construction transactions, but in leasing it is rare, if not unheard of.

When we rejected the tenant's offer on the landlord's behalf, our rejection was not well received. The tenant argued the bond was clearly titled as an unconditional undertaking (same wording as a bank guarantee), the bond had no expiry date (unlike some bank guarantees), and the bond insurer is part of a large international underwriting group with offices all around the world. So why wouldn't we accept the 'better option'?

Our concern with the insurance bond was not with the title of the document or even the content of the document. We preferred that the bond had no expiry date.

Our concern was with the 'large international underwriting group with offices all around the world' because the office in Australia is, quite simply, not of the same calibre as a bank. What if the overseas head office decides to close all offices in Australia? What then? How will the landlord make a claim?

You might say the same risk lies with an Australian bank, but shutting down an Australian bank will undoubtedly be plastered across the newspapers. Shutting down an insurance company's outlet in Australia probably won't garner the same attention and the landlord might not find out

about the closure until it has to make a claim on the bank guarantee, which may be years down the track.

We believe our concern is especially valid in today's uncertain market, but this is not to say we are ruling out insurance bonds entirely; it might just become 'the new norm'. For now, we prefer bank guarantees from banks.

For further advice and practical assistance understanding what criteria need to be met for a bank guarantee to be effective, please contact our Real Estate team.