

The new mandatory COVID-19 rent relief code – ANSWERS TO YOUR QUESTIONS

After weeks of scrambling amongst commercial landlords and tenants about options for rent relief during the COVID-19 crisis, the Morrison Government last week released the **National Cabinet Mandatory Code of Conduct** (Code).

The Code secures rental waivers for tenants and immediate cash flow relief together with benefits for landlords to assist in offsetting the loss to their turnover. You can read the Prime Minister's media statement [here](#).



KRISTY DORNEY

Partner
Real Estate and Commercial Disputes
61 7 3239 2947
kristy.dorney@mcmahonclarke.com

Although the Code will not become law until it is implemented through legislation by each of the states and territories in the coming weeks, there are steps landlords can take now to ensure current and new agreements will comply with the intention of the Code.

To help you navigate these significant changes, partner Kristy Dorney answers your key questions about how the Code applies and provides some tips for landlords on documenting rent relief agreements and what steps they can be taking now.

IS THE CODE LIMITED TO RETAIL TENANCIES?

The Code captures all commercial tenants and is not limited to retail.

WHEN IS THE CODE TRIGGERED?

The Code applies to any tenant who is an eligible business under the Federal Government JobKeeper program and has a turnover of \$50 million or less. While the rules for JobKeeper eligibility are still in draft you can [click here](#) for the latest Government factsheets.

Eligibility under JobKeeper requires a business to estimate and demonstrate a decline in projected GST turnover of at least 30 percent for any month in

the period March to September 2020 or in either the June or September 2020 quarter.

Even if the Code is not triggered, landlords may think about complying with it. Both the Queensland and New South Wales Governments have announced they are offering a three-month rebate of land tax for 2019-20, followed by a three-month deferral of land tax for 2020-21. However, to be eligible for this relief, landlords must agree to adopt the Code for all tenancies at the property, whether the Code applies or not. It is expected any relief packages announced moving forward will be tied to compliance with the Code. You can view the Palaszczuk Government's media statement [here](#).

DOES THE CODE APPLY TO INDIVIDUAL TENANCIES OR CORPORATE GROUPS?

For a lease to fall under the Code, the tenant's annual turnover must be \$50 million or less.

For retail corporate groups, the \$50 million threshold will apply at the group level rather than the individual retail outlet level. The Code is silent on whether non-retail corporate groups are tested at the group level. However, we see no reason why they would be treated any differently from retail.

Where a franchise is operated from the tenancy, the \$50 million annual turnover threshold is to be applied 'at the franchisee level', even if the lease is in the name of the franchisor and not the franchisee.

WHAT RELIEF AM I REQUIRED TO GIVE UNDER THE CODE?

While the Code sets out several 'leasing principles', one of the more important is the principle of 'proportionality' which is described as:

Landlords must offer tenants proportionate reductions in rent payable in the form of waivers and deferrals of up to 100 percent of the amount ordinarily payable, on a case-by-case basis, based on the reduction in the tenant's trade during the COVID-19 pandemic period and a subsequent reasonable recovery period.

Proportionate means the amount of rent relief proportionate to the reduction in trade as a result of the COVID-19 pandemic...

The Code includes a basic example - where the tenant suffers a 60 percent loss in turnover as a result of the COVID-19 pandemic the rent payable during the period of the COVID-19 pandemic, and for a reasonable recovery period, is reduced to 40 percent of



THE CODE'S 'GOOD FAITH' PRINCIPLES ARE EXPECTED TO BE APPLIED BY THE LANDLORD AND TENANT TO REACH AGREEMENT ABOUT THE PERCENTAGE FALL IN TURNOVER DUE TO THE COVID-19 PANDEMIC.

the usual rent. The 60 percent rent relief is dealt with by a combination of waiver and deferred payment agreement.

Therefore, parties will need to agree by what percent the tenant has suffered a reduction in trade as a result of the COVID-19 pandemic.

HOW DO I WORK OUT THE REDUCTION IN TRADE CAUSED BY THE COVID-19 PANDEMIC?

Good question! Unfortunately, the Code does not include a prescriptive formula. Instead, the Code's 'good faith' principles are expected to be applied by the landlord and tenant to reach agreement about the percentage fall in turnover due to the COVID-19 pandemic.

Tenants seeking the benefits of the Code need to disclose sufficient information about their turnover to show what their turnover was for the last few years to set a fair base, what the turnover is now, and the turnover moving forward. This will be easier for landlords who regularly collect turnover data from their tenants. However, this information is not commonly shared outside of the retail tenant space.

Tenants not comfortable with disclosing their financials may look to strike a deal with their landlord outside of the Code. This should be done in writing and reflect the tenant's election to waive their rights under the Code in exchange for the alternative arrangement.

The Code does not limit the turnover assessment to turnover generated from the premises. The turnover of all businesses operated by the tenant or franchisee is relevant to assessing the extent of the financial hardship suffered by the tenant and the rent relief the tenant genuinely requires. Turnover from telephone or online sales and through third party platforms which may have no connection to the premises will be particularly relevant.

Once a fall in turnover is identified, an assessment should be made about whether the cause of the fall is entirely 'as a result of the COVID-19 pandemic'. Each tenant's circumstances will be different and there may be other reasons at play for a downturn. It is unclear how the Code will deal with a situation where a tenant is not subject to a direction to cease trading but has voluntarily decided to close its doors.

WHAT IF I CAN'T REACH AGREEMENT WITH MY TENANT?

If agreement cannot be reached between the landlord and tenant about the percentage reduction in trade, the Code foreshadows a 'binding mediation' service will be made available.

It is unclear whether this is intended to be a mediation in the traditional sense, where an independent third party assists the parties to reach an agreement (if they can), which is then documented and becomes binding, or whether the mediator will hold power to make binding determinations. It is also unclear what recourse a tenant will have where they believe the landlord is not adhering to the Code.

Steps we think will aid in reaching an agreement and avoid the need for mediation include:

- having an accountant review the tenant's financials to provide an opinion on the fall in turnover and the likely causes
- ensuring communications with the tenant acknowledge the principles of the Code and demonstrate the landlord has taken them into account in reaching its decision or making its proposal.

Tenants should be given sufficient time to consider any proposal and to seek their own advice.

IS THE AGREED RENT RELIEF WAIVED OR DEFERRED?

The starting point is the Code requires 50 percent of any relief agreed must be waived (ie forgiven entirely). However, the Code states waivers should constitute a greater proportion of the total reduction in rent payable in cases where failure to do so would compromise the tenant's capacity to fulfil their ongoing obligations under the lease agreement. This is another acknowledgement that some businesses will be more affected than others and even when social distancing restrictions are lifted, it is simply not possible for some tenants to recover revenue lost during this period. In those cases, it may be appropriate to waive a greater proportion of the rent.

The balance of the rent relief amount is the 'deferred component'.

However, the above is simply the starting point. The Code allows a tenant to waive the requirement for a 50 percent minimum waiver if they reach alternative commercial arrangements with their landlord. There is a whole range of other agreements landlords and tenants might agree on which fall outside the

If you agree something as an alternative to the minimum thresholds in the Code, you should confirm the tenant is aware of the Code and is agreeing to waive the relevant entitlement.

Code or provide the tenant with other benefits that can be secured in lieu of the 50 percent minimum waiver.

HOW DO I RECOVER THE DEFERRED COMPONENT?

Repayment of the deferred component must be amortised over the balance of the lease term or for a period of no less than 24 months, whichever is the greater, unless otherwise agreed by the parties. Practically speaking, this means if the tenant's lease ends within 24 months of the end of the COVID-19 pandemic, then the landlord will need to negotiate an early repayment or negotiate security for repayment of any outstanding amount. Payment of the deferred rent is not to commence until the earlier of the end of the lease or the date the COVID-19 pandemic is declared to have ended.

The Code states landlords are not permitted to charge 'punitive interest' on the deferred component, which suggests some interest can be charged. In our view, it would be appropriate for a landlord to charge interest based on its own cost of funds or an alternative reasonable commercial rate of interest.

WHAT IS A 'REASONABLE RECOVERY PERIOD'?

Another good question! No one knows, but it is clear it will not be acceptable for rents to immediately revert to the rent agreed in the lease as soon as the Federal

Government declares the COVID-19 pandemic is at an end. Therefore, depending on the nature of the business, landlords and tenants could be living with whatever rent relief they agree for some time in the future. So, it is important whatever arrangement you agree is properly documented and can be administered effectively, including if relevant, an opportunity for review and adjustment at appropriate intervals in the months to come.

WHAT OPTIONS ARE THERE FOR RENT RELIEF AGREEMENTS UNDER THE CODE?

The Code accepts that each tenancy is different and there cannot be a prescribed approach. Landlords are encouraged to agree 'tailored, bespoke and appropriate temporary arrangements for each SME tenant, taking into account their particular circumstances on a case-by-case basis'.

Looking back at the example given in the Code, 60 percent rent relief is given during the COVID-19 pandemic and for a reasonable recovery period. Of that 60 percent, 30 percent is required to be waived as unrecoverable (to meet the 50 percent minimum requirement) and the other 30 percent is deferred for later payment. This example assumes a rate of rent relief is agreed upfront and applies for the life of the rent relief period. Practically, there may be several reasons during the period of the COVID-19 pandemic, the rate of rent relief

could trigger a review, including a change in consumer trends or the Government's directives.

Subject to each tenant's circumstances, below are some examples of alternative arrangements that could be reached following the principles of the Code:

- Rather than agreeing a fixed rate of rent relief to apply for the entire rent relief period, based on an estimate of the reduction in turnover or the reduction at the time of the agreement, the rent relief could be assessed on the actual turnover achieved each month. This still requires an agreement as to the base 'pre-COVID-19' turnover against which the actual turnover is compared each month. The percentage reduction in turnover each month is applied to the base rent to determine the rent relief and the balance is the rent payable each month. Agreement is still required about the percentage of rent relief that will ultimately be waived or deferred.
- A variation on the above could be to agree for the tenant to pay a 'minimum base' each month in advance with an adjustment being made in arrears once trading figures are available three or six months down the track or a reconciliation made at the end of the rent relief period.
- We are aware some landlords have agreed a blanket waiver of all rent for a period of three to six months without reference to the tenant's fall in turnover and in circumstances where, under the Code, the tenant would only be entitled to have a portion of that rent waived as unrecoverable. This can be a significant benefit to the tenant providing much needed cash flow relief and certainty without the need for drawn out discussions and assessment of the tenant's financial documents and trading figures. It will be of benefit to both the landlord and tenant to confirm this agreement in writing and waive the right of either party to resort to the Code.

WHAT IF I HAVE ALREADY NEGOTIATED A RENT RELIEF PACKAGE WITH MY TENANT?

Where a landlord has already agreed a relief package with a tenant, then it should be assessed against the Code and the legislation (once available) to ensure it complies. If it does not comply there is a risk of it being unwound once the legislation is finalised.

WHAT SHOULD I KEEP IN MIND WHEN AGREEING TO GRANT RENT RELIEF?

Here is a list of things landlords should consider when negotiating the terms of any rent relief under the Code:

1. If you agree something as an alternative to the minimum thresholds in the Code, you should confirm the tenant is aware of the Code and is agreeing to waive the relevant entitlement. The Code permits the tenant to waive those entitlements.
2. Clearly identify any other concessions agreed in addition to rent waiver/deferment, such as reduced trading hours, maintenance obligations or agreements to extend the lease terms.
3. Where you agree a turnover rent relief arrangement as provided by the Code, the arrangement should be clearly detailed, including agreeing on a clear methodology for calculating it, ie what information the tenant must provide and how frequently and when, or if, it will be subject to review.
4. To the extent calculations are to be based on a review or audit by an accountant, consider whether an agreement can be reached now as to the nominated accountant to minimise disputes moving forward.
5. Payment terms for deferred rent need to be agreed, particularly where the balance of the lease term is already less than 24 months. Consider whether any security is required, including whether the landlord can retain bank guarantees or extend personal guarantees to support repayment of the deferred rent.

6. Consider whether you want to agree an extension of the lease or exercise of an existing option term as part of the arrangement.
7. The Code requires rent reviews falling due during the COVID-19 pandemic be put on hold. Consider whether new timing for rent reviews needs to be agreed.

WHAT SHOULD LANDLORDS DO NEXT?

The impact of the COVID-19 pandemic is so profound and so sudden that there are many examples of tenants simply advising their landlord they are not paying rent, as though their lease does not exist or is no longer legally binding. This is not the case (the Code makes it clear leases continue to be binding) and is not something landlords can allow to persist.

The proper administration of this process will help to manage cashflows and preserve the value of assets throughout the COVID-19 pandemic and possibly into the future. It is important landlords give proper care and attention to the details surrounding these upcoming negotiations to preserve the value of assets.

We recommend landlords take the following steps:

1. Turn your mind now to the alternative ways rent relief can be provided under the Code, and generally, and determine the approach that best suits your needs. If turnover reviews are likely to be required, will you want an accountant's opinion? Do you want monthly reviews? One review at the end? Or, no reviews? Most of these alternatives will equally satisfy the Code requirements and will have limited impact on the tenant. So, it is open to you to agree now what suits and make that the starting point in negotiations.
2. Check your insurance policies to determine whether any coverage for non-payment of rent is available. Feedback

we have received from landlords to date is that it is unlikely. However, it should not be ruled out because if coverage is available then the insurer should be involved in any rent relief agreements made.

3. Check your finance documents to see whether you are required to obtain your financier's consent before amending lease terms to provide rent relief. Where consent is required, then we recommend preparing and agreeing a 'COVID-19 strategy' with your financier and, where possible, securing their agreement to negotiate lease amendments in accordance with that strategy without the need for specific approval.
 4. At the same time, we recommend securing waivers from any financial covenants during the COVID-19 period.
 5. A COVID-19 strategy document will also assist in ensuring you and your advisers and property managers are on the same page in terms of negotiating rent relief agreements with tenants. If you have multiple tenants, adopting a process which can be applied across your portfolio will significantly reduce the cost of administration. A strategy document should include a checklist of the minimum financial information a tenant seeking rent relief will be required to provide and details of any preferred outcomes or arrangements favoured by the landlord or financier which can form a base for negotiations.
 6. Communicate with tenants in a way which is compassionate, in accordance with the principles in the Code (whether it applies or not), but reinforce to tenants that their lease continues to apply unless and until an agreement is reached in accordance with the Code.
7. Prepare your own non-disclosure template agreement under which you agree to receive and use the tenant's financial information, including confirming the right to disclose information to your financier and advisers. We have seen several tenants present draft non-disclosure agreements to landlords which have inevitably required review and amendment first.
 8. Prepare a pro forma rent relief deed which sets out your preferred terms which will form the basis of discussions with your tenants.
 9. Ensure any agreements you are reaching are properly documented - this applies even if you are offering terms more generous than the Code and it will reduce the likelihood of the tenant seeking to revisit the agreement.
 10. Where tenants have stopped paying rent when at least some rent should be paid, you may need to be proactive to bring them to the negotiating table. A good way to start this is with a letter to the tenant, addressing the Code, noting its protections (such as relief from termination and recourse to security) are only available if the tenant complies with the substantive terms of its lease and the Code and requesting disclosure of relevant financial information.

WE CAN HELP YOU

If you have any questions or require assistance in preparing any of the documents or communications we have discussed above, please contact **Kristy Dorney** or a member of our **Real Estate team**. We are here to help you.