

# NATIONAL CABINET MANDATORY CODE OF CONDUCT

## SME COMMERCIAL LEASING PRINCIPLES DURING COVID-19

*The NSW Parliament has recently passed the National Cabinet Mandatory Code of Conduct SME Commercial Leasing Principles During COVID-19 (“the Code”).*

*This document provides a general overview of the Code with particular differentiation between Landlords and Tenants, a step by step guide as to the negotiation process between a Landlord and Tenant and some possible shortfalls of the Code.*

*While this document is intended to be provided as a general guide, Landlords and Tenants alike should be encouraged to take separate legal and accounting advice to assess their particular circumstances on a case-by-case basis.*

*Nevertheless, we trust this document will assist you with beginning the negotiation process. If Braye Cragg Solicitors can be of assistance to you specifically, please do not hesitate to contact our Commercial Law team by the details at the foot of this page.*

***[Important: This document is intended to provide general information only. No person should rely upon the information contained in this document without first taking legal advice. Braye Cragg Solicitors accept no liability in regard to any action taken, or not taken, in reliance of any information contained in this document.]***

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***OVERARCHING PRINCIPLE:*** *Impose a set of good faith leasing principles for commercial tenancies (i.e. retail, office and industrial) in order to preserve the commercial relationship between the parties beyond the COVID-19 pandemic period.*

***DURATION OF THE CODE:*** *Whilstever the Commonwealth JobKeeper programme remains operational in NSW, and where applicable, for a “subsequent reasonable recovery period” thereafter.*

***DISCLAIMER:*** *Throughout this document, some prohibitions or actions will be prefaced with either “should” or “must”. It is important to note the distinction between the two: where a Landlord “should” do something, the Code is encouraging the Landlord to do that act in the interests of good faith. Similarly, where a Landlord “must” do something, the Code obliges the Landlord to perform this act and, where breached, may be seen as a breach of the Code.*

## PART 1: General Overview of the Code

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In negotiating and implementing temporary arrangements to the Lease between a Landlord and Tenant, the following leasing principles should be applied as soon as practicable on a case-by-case basis.

### **General principles for Landlords:**

1. Landlords must not terminate leases due to non-payment of rent.
2. Landlords must offer tenants proportionate reductions in rent payable in the form of waivers and deferrals of up to 100% of the amount ordinarily payable under the terms of the lease, based on the reduction in the tenant’s trade during the COVID-19 pandemic period and a subsequent reasonable recovery period.
3. Landlords should share any benefit received due to any deferral of loan payments provided by a financial institution (as part of the Australian Bankers Association’s COVID-19 response)
4. Landlords must share any benefit received due to a reduction in statutory charges (eg. Land tax or council rates) or insurance in proportion to the benefit the Landlord has received.
5. Landlords should, where appropriate, waive recovery of any other expense (eg. outgoings payable) under the terms of the lease during the period the tenant is not able to trade (landlords reserve the right to reduce services).
6. Landlords should not force the tenant into undue influence when negotiating repayment of any deferred rent.
7. Landlords must not draw on a tenant’s security for the non-payment of rent.

8. Landlords must not charge interest, fees or other charges in respect of waived or deferred rent amounts.
9. Landlords agree to a freeze on rent increases (except for retail leases based on turnover rent).
10. Landlords may not apply any prohibition on levy any penalties if tenants reduce opening hours or cease to trade due to the pandemic.

### **General principles for Tenants:**

1. Tenants must remain committed to the terms of the lease, subject to amendments negotiated under the Code (failure to abide by substantive terms of the lease forfeits protections provided under the Code eg. Keeping the premises in a good state of repair and condition).
2. Tenants may waive the requirement for a 50% minimum waiver by agreement (NB: this may be necessary to come to a commercial solution for the parties).
3. Tenants must have an opportunity to extend its lease for an equivalent period of the rent waiver or deferral period.

## **PART 2: Process of Negotiation**

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### **STEP 1 (ELIGIBILITY): Is the Tenant eligible for the Commonwealth Government's JobKeeper programme, AND have an annual turnover of less than \$50 million?**

- The tenant will liaise with their Accountant as to their eligibility for the programme. As a side, the Accountant should (as much as they can) estimate the reduction in trade caused by COVID-19 and provide written confirmation for the Tenant to provide to the Landlord.

#### ***Example:***

***M&M lease commercial office premises to XYZ. The annual rent figure is \$120,000.00 per year (or \$10,000.00/mth). XYZ have seen a reduction in their trading of 60% and therefore are eligible for the JobKeeper Programme.***

### **STEP 2 (REDUCTION): If yes to step 1, the Landlord must offer the Tenant a proportionate reduction in rent payable either by way of waiver or deferral.**

- Proportionality is based on the reduction of the Tenant's trade during the COVID-19 pandemic and a subsequent 'reasonable recovery period'.
- Proportionality must be consistent with assessments undertaken for eligibility for the Commonwealth Government's JobKeeper programme.

**Example:**

*M&M must offer to XYZ a waiver/deferral (reduction) of \$6,000.00/mth, resulting in XYZ being required to only pay \$4,000.00/mth for the duration of the COVID-19 pandemic.*

**STEP 2(a) (WAIVER):** The Landlord **must** waive **at least 50%** of the proportionate reduction. The Landlord may elect to waive **more than 50%**.

- The waiver must constitute no less than 50% of the total reduction in rent payable over the course of the COVID-19 pandemic period and it is encouraged, where appropriate, that Landlords provide a greater than 50% waiver so that Tenants are not prejudiced from trading post-COVID.
- Regard must be had for the Landlord's ability to offer such allowances in accordance with allowances the Landlord receives from its Creditors (eg. Mortgagee, Loan Provider etc.).
- The Tenant may waive the requirement for a 50% minimum waiver by agreement.

**Example:**

*The proportion of XYZ's waiver/deferral would be a matter for agreement between the parties. However, M&M are obliged to offer at least a \$3,000.00 (30%) waiver (being half of the Tenant's proportionate reduction of trade) and the remainder will be a deferred.*

**STEP 2(b):** The Landlord must defer the balance of the Tenant's proportionate percentage of reduction of trade

- The deferral must be paid off:
  - over the balance of the lease term; or
  - for a period of no less than 24 monthswhichever is the greater.
- Care should be taken to ensure that any repayment of the deferred rent does not compromise the ability of the Tenant to recover from the crisis (i.e. not place the tenant in undue financial burden).
- The Code encourages repayment to be made "over a reasonable subsequent recovery period" (NB: Given the lack of certainty in the wording of the Code around key terms such as what may or may not constitute "a reasonable subsequent recovery period", this leaves that issue undefined. Be mindful to specifically define, as far as practicable, an agreed repayment arrangement between the parties).
- NB: Post COVID-19, there will be no restriction on the Landlord calling on the security (bank guarantee, bond, or deposit) to recover unpaid rent. Again, given the lack of certainty around the definition of "a reasonable subsequent recovery period," it is unclear as to when the Landlord will have the right to do so.

**Examples:**

*XYZ have 2.5 years remaining on their Lease. M&M have agreed, by way of written agreement, that XYZ will repay the \$3,000/mth in deferred rent in equal repayments over the remaining 30 months on top of the agreed monthly lease figure of \$10,000/mth.*

*XYZ have 1.5 years remaining on their Lease. As the remaining term of the Lease is less than 24 months, M&M must allow the repayment of the deferred \$3,000.00 to be paid over the course of the following 24 months. XYZ may pay the balance sooner.*

**STEP 3: Where the parties cannot meet a commercial resolution**

- The parties should apply for mediation/arbitration through the NSW Small Business Commissioner or private mediation.
- NB: Mediation should not be used as a 'tactic' to delay the negotiation process – may be seen as a breach of the lease.

## PART 3: Shortfalls of the Code

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- In our view, there is a lack of certainty as to the extent and application of the Code. Further, There is a lack of certainty around key terms such as the "COVID-19 pandemic period" and "a reasonable subsequent recovery period."
- There is a lack of certainty regarding how mediation processes and/or penalties for non-compliance might operate.
- There are no mandated timeframes for which disputes between landlords and tenants must be resolved.
- Whilst the Code is clear as to the percentages and ratios that the landlord should afford the tenant, the Code does not speak with specificity to the allowances the landlords must pass on where the landlord has been afforded allowances from any Mortgagee.
- There is no scope for addressing issues in relation to Agreements for Lease and existing incentives for tenants (for example, rent incentives and fitout contributions). Further, whether the requirements under the Code will be in addition to any existing and operational incentive arrangements or whether such arrangements can be temporarily deferred.
- Whether the Code will prohibit landlord actions (eg termination or claim against security) in respect of historic arrears incurred prior to the COVID-19 pandemic period (or whether this Code only relates to rent unpaid during the "COVID-19 pandemic period" or "subsequent reasonable recovery period").

- If the Lease expires prior to when the 24 month period ends, and the tenant does not have the ability to repay any deferred rent before the cessation of the Lease, how will the tenant's repayment covenant and how the landlord's security position be protected (bearing in mind Tenant's security may have an expiry date, for example, bank guarantees or limitation periods for claims on the Retail Lease Bond)?
- It is not clear whether interest can be charged on the payment of late deferred rent. For example, where a payment for deferred rent is paid 10 days late.

## **PART 4: General Advice**

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### **General Advice to Landlords**

1. Be proactive and talk with the tenant – a leased property is more advantageous to you than a vacant property;
2. Ask your tenant for written evidence of their eligibility for the JobKeeper programme (in particular, BAS statements, profit and loss statements etc.). Do not simply take the tenant at their word.
3. Discuss and disclose any allowances that have been afforded to you. Factor this in to any negotiations.
4. Have a signed Agreement (eg. Deed of Variation of Lease), rather than a 'handshake agreement' or an agreement by email.

### **General Advice to Tenants**

1. Register for the JobKeeper Programme if you are eligible.
2. Be proactive and contact your landlord to discuss – you need a premises to trade after COVID-19 is over.
3. Keep accurate and correct (and truthful) records of your reduced turnover (if any).
4. Be prepared to share any relevant information with the landlord and ask that it be kept confidential as part of your negotiations.
5. Have a signed Agreement (eg. Deed of Variation of Lease), rather than a 'handshake agreement' or an agreement by email.

We trust this document will assist you in beginning the negotiation process. If Braye Cragg Solicitors can be of assistance to you specifically, whether that be in providing advice or the drafting and implementation of documentation, please do not hesitate to contact our Commercial Law team.

Our office is still open and trading. If you have any questions in relation to your Lease and COVID-19, or if we can assist with any of your legal matters, please contact us by telephone on (02) 4926 6000 or by email at [reception@brayecragg.com.au](mailto:reception@brayecragg.com.au).

**Yes, we can help.**