

Dear Valued Clients

The Government has announced a range of measures to help renters. This includes a temporary hold on evictions and a mandatory code of conduct for commercial tenancies to support small and medium sized enterprises (SMEs) affected by coronavirus. A Mandatory Code of Conduct for Commercial Leases has been created.

The purpose of the mandatory Code of Conduct For Commercial Leases (**Code**) is to introduce mandatory principles that facilitate landlords and tenants negotiating in good faith to temporarily change existing leasing arrangements – to aid the management of cashflow for tenants and landlords on a proportionate basis.

Who does the Code apply to?

The Code applies to all commercial tenancies – retail, office and industrial - where the tenant's business has a turnover of less than \$50 million, and is eligible for the Government's JobKeeper subsidy. Eligibility criteria for the JobKeeper subsidy are that the business:

- has a turnover of less than \$1 billion, and turnover has fallen by more than 30% (of at least a month); and
- the business is not subject to the Major Bank Levy.

About the Code

The objective of the Code is “to share, in a proportionate, measured manner, the financial risk and cashflow impact during the COVID-19 period, whilst seeking to appropriately balance the interests of tenants and landlords.” In other words, landlord and tenants must play nice and share the financial burden of the pandemic.

The Code does not mandate how leases are to be varied during the pandemic, rather it imposes a set of good faith principles which are expected to be followed by all parties to a lease. The reference to the Code being mandatory gives a good indication that the States and Territories will ensure the Code must be applied in good faith negotiations.

The variations to leasing arrangements will be up to the parties – individual leases and circumstances are so varied no legislation can effectively deal with them all.

Landlords and Tenants will need to negotiate bespoke temporary arrangements taking into account their specific circumstances, and the requirements of the Code.

Some Overarching Principles

- Landlords and tenants are to negotiate temporary leasing arrangements in good faith acting in an open, honest and transparent manner.
- Any agreed arrangements will take into account the impact of the COVID-19 pandemic on the tenant, with specific regard to its revenue, expenses, and profitability.

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- The Parties will take into account the fact that the risk of default on commercial leases is ultimately (and already) borne by the landlord. The landlord must not seek to permanently mitigate this risk in negotiating temporary arrangements envisaged under this Code.

So we all must co-operate. But what about the important stuff? Will rents be reduced? Can tenants be evicted? Can security deposits be claimed?

Leasing Principles

- Landlords must not terminate leases due to non-payment of rent.
- Tenants must remain committed to the terms of their lease, subject to any amendments to their rental agreement negotiated under the Code. Material failure to abide by substantive terms of their lease will forfeit any protections provided to the tenant under the Code.
- 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 based on the reduction in the tenant's trade.
- Rental waivers must constitute no less than 50% of the total reduction in rent payable. Tenants may waive the requirement for a 50% minimum waiver by agreement.
- Payment of rental deferrals by the tenant must be amortised over the balance of the lease term and for a period of no less than 24 months, whichever is the greater, unless otherwise agreed by the parties.

Example: a business suffers a 50% loss in turnover = a rent reduction of 50%. The rent reduction must be comprised of (at least) 25% waived, and the remainder may be deferred and be recouped over (at least) 24 months.

- Any reduction in statutory charges (e.g. land tax, council rates) or insurance will be passed on to the tenant in the appropriate proportion applicable under the terms of the lease.
- A landlord should seek to share any benefit it receives due to deferral of loan payments, with the tenant in a proportionate manner.
- Landlords should, where appropriate, seek to waive recovery of any other expense (or outgoing payable) by a tenant during the period the tenant is not able to trade. Landlords reserve the right to reduce services as required in such circumstances.
- If negotiated arrangements under the Code necessitate repayment, this should occur over an extended period in order to avoid placing an undue financial burden on the tenant.
- No fees, interest or other charges should be applied with respect to rent waived or deferred.
- Landlords must not draw on a tenant's security for the non-payment of rent.
- The tenant should be provided with an opportunity to extend its lease for an equivalent period of the rent waiver and/or deferral period.
- Landlords agree to a freeze on rent increases (except for retail leases based on turnover rent).
- 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.

These principles apply during the pandemic period and for a reasonable subsequent recovery period.

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What if we can't agree?

If parties can't agree, the matter can be referred by either party to a binding mediation. In Victoria, this will likely be through the Victorian Small Business Commission. It is very hard to say now how the process would work if the Commission was dealing with a high volume of cases.

There are many dangers in these arrangements for Landlords. There really is a loss of control over outcomes – and a form of role reversal - which for some Landlords will be very difficult. For those landlords who want and/or need to retain their tenants, then the best outcome is a negotiated resolution – by which by the landlord and tenant both suffer some pain. Even then, there will be fingers crossed because none of us know where this will end up. Will our tenant survive irrespective? Are we headed for a post virus boom, or a bust?

For any further information, please get in touch with your Lombardi Partners contact on 9328 5300.



[Contact Us...](#) to discuss how these changes may affect you.

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