

COVID-19 and commercial leases - Victoria issues Regulations to implement the Code



Background

On 7 April 2020, the National Cabinet published a mandatory Code of Conduct (the **Code**) setting out the principles to guide negotiations around the structuring of rental relief to be granted to tenants under commercial leases impacted by COVID-19. The principles were to be implemented by legislation passed in each state and territory.

On 23 April the Victorian Government passed the [COVID-19 Omnibus \(Emergency Measures\) Act 2020](#) which, among other measures, created the power to make regulations to implement the principles of the Code in Victoria. On 1 May the government issued the [COVID-19 Omnibus \(Emergency Measures\) \(Commercial Leases and Licences\) Regulations 2020 \(Vic\)](#) (the **Regulations**).

Landlords and tenants in Victoria will now have a much clearer understanding of their rights and obligations, and of the roadmap for resolving and formalising rental relief terms. We have summarised below some of the key obligations and processes imposed by the Regulations, and some of the practical implications.

Eligibility

The Regulations apply where:

- the lease is a retail lease, or a commercial lease or licence, and the premises are used solely or predominantly for the purpose of carrying on a business. Subleases and sublicences are also covered;
- the tenant, or the group of which it is a member, had annual turnover in the previous financial year of less than \$50m **OR** its annual turnover in the current financial year is likely to be less than \$50m. This means that the impact of the pandemic up to 30 June this year can be taken into account in determining whether a tenant (or a group) who would normally have annual turnover in excess of \$50m, may nevertheless be covered by the Regulations; and
- the tenant is an employer who qualifies for the JobKeeper scheme and is participating in the scheme.

The following leases are excluded:

- leases or licences entered into on or after 29 March; and
- leases for farming, grazing and a broad range of other agricultural activities.

Unlike the NSW Regulations, which adopts the “related corporations” test under the *Corporations Act 2001*, the Victorian Regulations adopt definitions from the *Income Tax Assessment Act 1997*, which potentially create a wider membership group, for the purpose of applying the turnover threshold test. Under the Victorian approach:

- an ownership interest of 40% between two entities will be sufficient to make them part of the same group; and
- a person or company who is under the effective control of the tenant (in that the person or company acts or could reasonably be expected to act at the tenant’s direction) is an affiliate, and that affiliate’s turnover must be combined with the tenant’s turnover for the purpose of the turnover test under the Regulations.

As discussed below, it will be the responsibility of any tenant seeking rental relief to demonstrate to the landlord that it meets all the eligibility criteria.

Tenant must initiate negotiation process

The fundamental principle that underpins the Code is that the circumstances of each lease are different and a negotiated agreement must be reached on a case by case basis.

The Regulations now put the onus on the tenant, if it wants rent relief, to initiate the process by making a written request to the landlord for rental relief. The request must state that the tenant is eligible for relief (see discussion on eligibility above) and be accompanied by supporting information.

A tenant is not obliged to request relief, but if it does not do so, it will not be entitled to the protections under the Regulations (see discussion on protections below).

Relevant period

The Regulations apply for the period commencing on 29 March 2020 and ending 29 September 2020 (the **Relevant Period**). Eligible tenants are only entitled to seek rent relief for rent payable during that period (although the parties can agree otherwise), and the protections under the Regulations only apply during that period.

The Code contemplated that the protections would continue to apply for a “reasonable recovery period” after the end of the JobKeeper scheme. No mention is made of a recovery period in the Regulations, and the protections will end on 29 September 2020, regardless of the pandemic situation at that time, unless legislative changes are made before then.

Landlord must make offer within 14 days of receiving request

A landlord must make a written offer of rental relief within 14 days of receiving the written request from the tenant (or a longer time, if agreed). It will be important for a tenant to include with its request all the necessary information to verify its eligibility, because the 14 day period for the landlord to make an offer will not commence until that information is provided.

The landlord’s offer must relate to the whole of the Relevant Period, and must include a waiver by the landlord of at least

50% of any rental reduction, and the remaining portion must be dealt with by way of deferral as envisaged by the Code, or other means agreed between the parties. A range of other issues must be taken into account by the landlord, which are discussed below.

After the landlord provides its offer, the parties must negotiate in good faith and endeavour to reach agreement. A term is implied in all eligible leases that the parties must cooperate and act reasonably in all discussions concerning anything under the Regulations. It will assist the process of negotiation and in reaching agreement if the offer includes all the issues that the landlord wishes to address in any rent relief package. In some cases this might extend to a broader lease restructure proposal. Open discussions during that 14 day period will help to expedite the process of narrowing the issues and reaching an agreement.

What is relevant for a landlord in structuring its offer?

The Code suggested that any rental relief would be in proportion to the tenant’s reduction in turnover. The Regulations take a broader approach and suggest that the tenant’s reduction in turnover during the relevant period is only one of a number of specific things a landlord must consider.

The Regulations state that the landlord’s offer must be based on “... all the circumstances of the eligible lease...” and the landlord must “... take into account...” a number of other specified matters.

One of those specified matters is the reduction in the tenant’s turnover “associated with the premises” during the relevant period. Where a tenant has more than one business premises, or operates other business activities that are not directly related to the premises, the turnover from these other premises or activities must be quantified and excluded. Turnover from on-line sales will also be included provided it is sufficiently “associated” with the premises.

Another matter to be considered by the landlord is whether the rent relief package is sufficient to enable the tenant to be able to continue to perform its obligations under the lease, including payment of rent. This seems to suggest the landlord must give some consideration to how the proposed rent relief package will impact on the tenant’s financial viability.

The Regulations do not specify what information the tenant must give the landlord in relation to these issues (for example, there is no specific obligation for a tenant to provide trading and other financial information), nor do they give any guidance as to how a landlord is to consider these issues, or what weight is to be given to them. .

A landlord can only consider the issues that it is aware of. Therefore it would be prudent for a tenant requesting rent relief to put before the landlord all the information it says is relevant and should be considered by the landlord, including its current and anticipated turnover through to 29 September, and other financial details which it says will affect its ability to continue to pay rent and comply with the lease for the remainder of the lease term.

Is the landlord's financial situation relevant?

The Regulations also require the landlord to take into account its own financial ability to offer rental relief, including any relief provided by its lenders, in response to the pandemic.

While this is to be welcomed by landlords, the Regulations give no guidance as to how to resolve an impasse between a tenant who maintains it cannot survive financially without a certain level of rent relief, and a landlord who is not in a financial position to grant it.

Rental deferrals

Deferred rent is to be amortised over the remainder of the term of the lease (after the Relevant Period ends), but not less than 24 months. No costs or interest can be charged for the deferred rent. In effect the landlord is financing this deferral for the benefit of the tenant. It is presumed this Regulation does not prevent the parties agreeing on default interest to apply for late payments under the amortisation plan.

Outgoings

Consistent with the Code, the Regulations require a landlord to pass on to its tenant the benefit of any reduction or saving in outgoings (which includes operating expenses or authority charges), according to the tenant's proportional share.

The Regulations also deal with the question of recovery of outgoings in circumstances where the tenant does not trade. The relevant provision suggests this is not obligatory as it only requires a landlord to "consider waiving" outgoings for any period the tenant is not able to operate their business at the premises. However, it is noted that in preparing its offer of rent relief, a landlord must take into account any waiver of outgoings that is granted under this particular regulation.

Can a negotiated rent relief agreement be varied if things change?

If a tenant has negotiated and agreed on a rental relief package, and subsequently its financial circumstances change materially, it can make another request for rent relief from the landlord, and the same process will apply except that the landlord will not be obliged to waive any part of any further agreed rent relief. However, a threshold requirement is that there must have been a material change to the tenant's financial circumstances, and if the tenant cannot demonstrate that its financial circumstances are materially different to what they were at the time the original rent relief agreement was entered into, it may not be entitled to request further relief.

A landlord is not entitled to seek any adjustment if the tenant's circumstances change materially for the better – for example, if recovery in turnover is much greater or faster than envisaged when the rent relief package was agreed. Nor is it entitled to seek an adjustment if its financial circumstances were to change adversely.

Given the limited scope for making any changes to any rent relief package agreed at the outset, it will be important to ensure that the risk of these possible changes over the remainder of the Relevant Period is understood and accepted by each party, or that the agreement is structured to adapt to these changes in an appropriate manner.

Disputes

As contemplated by the Code, a mediation process will be available where the parties are unable to reach agreement. The Regulations give either party the right to refer any "dispute" to the Small Business Commissioner for mediation. The mediation provisions of the *Retail Leases Act 2003* will apply, and the mediator will have wide powers.

The parties must undergo a mediation before either can resort to proceedings at VCAT or in court. Time is likely to be critical in these matters, particularly for landlords who wish to reach agreement quickly so that rent payments re-commence. It will be important for the parties to actively plan and drive the negotiation process, so that they can initiate mediation quickly if they consider the other party is not acting in good faith or dragging out the process.

There is likely to be high demand for mediation and parties who are already in dispute should be applying for mediation as soon as possible.

Tenant protections during the Relevant Period

A landlord is prevented from taking or attempting to take action to evict a tenant, recover possession of the premises or access or pursue any security bond, guarantee or indemnity given under a lease, as a result of a tenant not making any rent payment which is due in the Relevant Period. However, there are some important qualifications:

- the restriction only applies if the tenant has made a written request for rental relief under the Regulations, provided the information required, and pursued good faith negotiations with the landlord after receiving the landlord's offer. The Regulations do not specify how quickly a tenant must make the application, or exactly what information is to be supplied to the landlord. To minimise the risk of losing these protections, tenants should make written requests as soon as practical, and include as much information as possible to substantiate its eligibility and the extent and duration of the relief it is seeking;
- if a tenant has reached an agreement with the landlord on a rent relief package, and does not pay the rent in accordance with that agreement, the tenant will lose the benefit of the protections with regard to those breaches, and be at risk of enforcement action by the landlord;
- in relation to timing of rental payments, the relevant date is the date the payment is due, not the period to which it relates. For example, in the case of rent for

March, if payment was due in advance (on 1 March) a failure to make that payment it is not protected, whereas if payment was due in arrears (on 31 March) a failure to make that payment is protected;

- other outstanding payments, which fell due before 29 March, are not protected.

Other rights and benefits for tenants are in effect treated as terms of the lease during the Relevant Period:

- a tenant has discretion to choose its own trading hours, and if these differ from the requirements of the lease, the tenant will not be in breach;
- a landlord cannot increase the rent. In effect rent increases that would otherwise apply during the Relevant Period are postponed until the period ends;
- any reductions in outgoings (including rates and taxes) must be passed on proportionally to the tenant;
- both the landlord and the tenant are bound by confidentiality obligations in relation to personal information and business and financial information.

Apart from the specific rights and protection granted under the Regulations, each lease continues to apply according to its terms, and each party continues to have the normal rights and remedies in relation to breach of those terms by the other.

Renewal options

Renewal options are not dealt with in the Code or in the Regulations. Accordingly tenants who have renewal options falling due during the Relevant Period must decide whether or not to exercise the option, and give the necessary notice, in accordance with their lease.

However, as rental increases are not permitted during the Relevant Period, any rent review scheduled to coincide with commencement of the renewal term, if it occurs during the Relevant Period, must be postponed.

Steve Aitchison

Principal
Melbourne

T +61 3 8602 9217

F +61 3 8602 9299

E saitchison@huntvic.com.au

Emily Clapp

Graduate-at-Law
Melbourne

Summary

While the Regulations have clarified many issues raised in the Code, and set out a workable process to guide the parties in their negotiations, fundamentally the scheme relies on the parties reaching agreement. Doing so involves human interaction and compromise which cannot be prescribed in a legal rule book. Each case will be different and questions of what circumstances are relevant, what weight is to be given to specified issues to be taken into account, and what will be sufficient to meet the requirement of "good faith" in the negotiations, will need to be determined on a case by case basis.

Our Property Group can provide advice and assistance on how to plan and manage the process in accordance with the Regulations, and in a way that best protects your rights and entitlements, whether as a landlord or tenant.

Disclaimer

This article is intended to provide general information only. It is not an exhaustive or accurate summary of the law, nor is it intended as legal advice and cannot be relied upon as such. Please seek legal advice specific to your circumstances should you require assistance.