COVID-19 RENT RELIEF LEGISLATION – VICTORIA'S RESPONSE ... IS HERE.

The second step in the Victorian legislature's response to the National Cabinet's Code of Conduct (**Code**) was published on 1 May 2020 – The *COVID-19 Omnibus (Emergency Measures) (Commercial Leases and Licences) Regulations 2020* (Vic) (**Regulations**). The Regulations were made pursuant to the *COVID-19 Omnibus (Emergency Measures) Act 2020* (**Act**).

Brief Overview

The Regulations were worth the wait. They:

- apply only to "Eligible Leases" (unlike the NSW Regulations);
- do not refer back to the principles in the Code (again, unlike the NSW Regulations);
- resolve many (but not all) of the shortfalls in the Code identified by the property industry; and
- set out a clear process for the negotiation of rent relief agreements.

The Regulations override the terms of leases, so landlords and tenants cannot 'contract out' of them (except where specified).[1] This implies that agreements that landlords and tenants have entered into in anticipation of these Regulations can be re-negotiated - although this is unclear.

There is also an overriding obligation on landlords and tenants to work cooperatively, reasonably and in good faith in their dealings under the Regulations.[2] Failure to do so constitutes a breach of the lease.

As expected, the Regulations are deemed to have been in operation since 29 March 2020, and will remain in operation until 29 September 2020 (**Relevant Period**).[3] This is unlike the NSW Regulations, which apply from 24 April 2020 to 24 October 2020.

"Eligible Lease"

The Regulations apply **only** to "Eligible Leases".

"Eligible Leases" is defined in the Act, and is largely consistent with the Code.[4] The 4 criteria that must be satisfied are:

1. the lease must be either:
    a. a retail lease under the *Retail Leases Act 2003*; or
    b. a commercial lease or licence for the sole or predominant purpose of carrying on a business at the premises;
2. the lease must have been '*in effect*' as at 29 March 2020 (but there is no guidance as to what '*in effect*' means);

[1] section 17 (Act)
[2] regulation 8(2)
[3] regulations 3 and 4
[4] section 13 (Act)

3. the tenant must be an '*SME entity*'. This is defined by reference to the *Guarantee of Lending to Small and Medium Enterprises (Coronavirus Economic Response Package) Rules 2020* (**Guarantee Rules**) – essentially, an entity with an annual turnover of less than $50m.[5] See below for further commentary on this; **and**

4. the tenant must be an employer who **both** qualifies for and participates in the Jobkeeper scheme.

SME Entity – Turnover

To determine whether an entity is an SME Entity, turnover is defined:

- by reference to the aggregate turnover of:
    - the tenant itself, and any entities '*connected*' to the tenant (as defined in section 328-125 of the Income Tax Assessment Act 1997 (Cth) (ITA Act)); or
    - the tenant itself, and any '*affiliates*' of the tenant (as defined in section 328-130 of the ITA Act).

  If the aggregate turnover of turnover in (a) **or** (b) exceeds $50m, the lease will not be an Eligible Lease; [6]
- by reference to either:
    - the actual turnover for the financial year ending 30 June 2019; or
    - the likely turnover for the financial year ending 30 June 2020.[7]

  Only one of these needs to apply for a tenant to be an SME Entity; and
- by reference to section 5(2)(a)-(g) of the Guarantee Rules,[8] - which includes:
    - the proceeds of sales of goods and/or services;
    - commission income;
    - repair and service income;
    - rent, leasing and hiring income;
    - government bounties and subsidies;
    - interest, royalties and dividends; and
    - other operating income.

This is interesting because it differs from the Jobkeeper Rules, which refer to GST Turnover. The Guarantee Rules would appear to be broader in capturing income – making it easier to reach the $50m threshold. Also, it will be more difficult for tenants to give evidence that they qualify as an SME Entity, as the provision of BAS statements will not necessarily provide this evidence.

[5] section 12 (Act)
[6] regulation 7
[7] section 5(1)(b) Guarantee Rules
[8] regulation 5

Excluded Leases – Agricultural

Leases and licences under which the premises ***may*** be used wholly or predominately for the following purposes are not Eligible Leases:

- agricultural, pastoral, horticultural or apicultural activities;
- poultry farming dairy farming, and other types of farming;
- grazing, including agistment; or
- other farming operations, as per the definition in section 3 of the *Farm Debt Mediation Act 2011*. [9]

The Operative Part

Rent relief procedure

Tenant's request

A tenant under an Eligible Lease may request rent relief by providing to its landlord:

- a statement that the lease is an Eligible Lease; and
- evidence that the tenant:
    - is an SME entity; and
    - qualifies for and is a participant in the Jobkeeper scheme. [10]

The Regulations do not prescribe the extent of the evidence required to be submitted by tenants. The Regulations refer landlords and tenants to the Small Business Commissioner for clarity on this.

Landlord's obligation to make an offer – 14 days

A landlord must make a rent relief offer within 14 days after the tenant gives the landlord a complying request (or such other period agreed by the landlord and tenant in writing). [11]

What must the landlord offer?

This part gets interesting. The Regulations do not strictly follow the Code, mainly because there is no set formula to determine the amount of relief. Simply because a tenant suffers a 30% loss in revenue does not entitle the tenant to 30% relief.

Instead, the landlord's offer of rent relief must be based on all the circumstances of the Eligible Lease, and must "*take into account*":

- the reduction in the tenant's turnover *associated with the premises* during the Relevant Period. The reference to turnover associated with the premises is interesting;
- any waiver of outgoings given by the landlord (see below);
- the tenant's ability to fulfil the ongoing lease obligations without sufficient rent relief (this will help landlords take into account any increased turnover from internet sales that are not 'associated with the premises');

[9] regulation 6
[10] regulation 10(2)
[11] regulation 10(3)

- the landlord's financial ability to offer rent relief (including any relief provided to a landlord by any of its lenders as a response to COVID-19); and
- any reduction to any outgoings charged, imposed or levied in relation to the premises (this is particularly relevant for leases with gross rents). [12]

In a legal sense, 'taking into account' requires a party to have consideration to such matters in making a decision. On this basis, landlords have fairly broad discretion in determining the amount of rent relief they offer. However, as per the overriding principle of the legislation, landlords must take into account those matters in good faith and acting reasonably (or be in breach of the lease).

Offers must apply to the Relevant Period, and, as per the Code, provide that at least 50% of the rent relief be in the form of a complete waiver (unless otherwise agreed by the tenant).[13] Note that if a landlord wants to *offer* the tenant less than 50% of the rent relief by way of a waiver, it must obtain the tenant's consent to this in writing within the 14-day offer period – or alternately the landlord could provide two offers (so long as one is fully compliant with the 50% rule).

Negotiations

The parties must negotiate the landlord's offer in good faith (or be in breach of the lease). [14] If the parties do not agree on the rent relief to be provided, either party can refer the matter to the Small Business Commissioner (see the Dispute section below).[15] There is no time frame that needs to pass before a dispute can be referred to the Small Business Commissioner. Therefore, landlords or tenants can refer disputes for resolution at any time after the landlord's offer is rejected by the tenant.

Waived Rent

The Regulations include a note stating that any amount of rent that is waived under an agreement cannot be claimed back by the landlord. [16] This precludes 'clawback provisions' in agreements (eg where the tenant breaches the rent relief agreement or the lease ends due to a default by the tenant).

Tenants can have a second go

While the Regulations are somewhat kinder to landlords than the Code and the NSW Regulations, tenants are given a significant benefit here.

If the financial circumstances of a tenant materially change after a rent relief agreement has been reached under the Regulations, the tenant can commence the above process again – the only difference being that the landlord need not provide a minimum 50% rent waiver in any new agreement. [17]

Landlords are not given the same right if a tenant's financial circumstances improve.

[12] regulation 10(4)
[13] regulation 10(4)(b)-(c)
[14] regulation 10(5)
[15] regulation 20
[16] regulation 10 - note 2
[17] regulation 11

Breaches of leases and rent relief agreements

A tenant is not in breach of an Eligible Lease for non-payment of rent during the Relevant Period if it:

- has requested rent relief and complied with the above rent relief procedures; or
- after a rent relief agreement is reached under the Regulations, complies with that agreement. [18]

A landlord may not evict, attempt to evict, re-enter or attempt to re-enter the premises, or call on any security, where either of the above apply. [19] In addition to a potential claim by the tenant, any such action by the landlord carries a penalty of $3,304.40 per offence (based on 20 penalty units, as at 1 May 2020).

Therefore:

- eligible tenants are encouraged to submit complying rent relief requests, and negotiate rent relief agreements in good faith, to enable them to cease paying rent until a rent relief agreement is reached; and
- landlords are encouraged to resolve rent relief agreements as soon as possible to minimise the period during which a tenant is not required to pay rent.

The being said, the Regulations do not prohibit a landlord taking action for:

- non-payment of rent for periods outside the Relevant Period, non-payment of outgoings or other breaches of a lease; and
- breaches of rent relief agreements under the Regulations.

Extensions to Lease Terms

If a rent relief agreement includes a deferral of rent, the landlord must offer the tenant an extension to the term of their Eligible Lease. [20]

The extension must:

- be equivalent to the period for which the rent is deferred – unless the parties agree otherwise in writing; and
- be on the same terms as the existing lease (this could create interesting results if, for example, the lease provides for rent to be reviewed on set dates, but not on each anniversary of the lease commencement date). [21]

Given the time for payment of deferred rent set out in the Regulations (see the next section), landlords may be required to offer lease extensions for up to 24 months.

Interestingly, the Regulations do not require any lease extension to be resolved at the same time as the rent relief. While it may make sense for these negotiations to occur at the same time, landlords may choose to defer these negotiations to ensure that rent relief agreements are reached at the earliest possible time.

[18] regulation 9(1)
[19] regulation 9(2)-(4)
[20] regulation 13(2)
[21] regulation 13(2)-(3)

Payment of deferred rent

The following applies in respect of deferred rent – *unless the parties agree otherwise in writing*.

Any deferred rent may not be recovered by the landlord until the earlier of:

- the expiry of the Relevant Period; and
- the expiry of the term of the Eligible Lease (disregarding any extension to the lease term referred to above). [22]

The deferred rent payable by the tenant must be amortised over the greater of:

- the balance of the term (including any extension to the lease term referred to above); and
- a period of at least 24 months. [23]

Note that the landlord may not require the tenant to pay interest or any other fee or charge in relation to any payment of deferred rent. [24]

Interestingly:

- the parties are free to negotiate on the method of amortisation.[25] eg. front-end loaded, back-end loaded, etc; and
- the repayment time frame could result in tenants paying deferred rent after the term of their lease ends.

When negotiating payments of deferred rent for periods after lease terms, tenants and landlords alike should consider the impact of the deferral on the return of lease security, bank guarantee expiry dates, the release of guarantors and the tenant's ability to wind-up.

No rent increases

A landlord under an Eligible Lease must not increase the rent payable during the Relevant Period, unless the parties agree otherwise (in writing). [26]

It appears this this is only a 'postponement' of any rent increase due during the Relevant Period until the end of the Relevant Period, rather than a total loss of the ability to increase the rent. However, as this is a little uncertain, landlords should ensure that rent relief agreements confirm that the rent will increase after the Relevant Period to take into account any reviews during the Relevant Period.

Turnover Rent

The prohibition on rent increases does not apply to turnover rent for *retail leases* only. [27] Interestingly, this does not apply to other leases or licences. Accordingly, where turnover rent is payable under an Eligible Lease that is not a retail lease, it appears that turnover rent under those leases cannot increase during the Relevant Period.

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[22] regulation 16(2)(a)
[23] regulation 16(b)
[24] regulation 17(2)
[25] regulation 16(3)
[26] regulation 12(2)
[27] regulation 12(3)

Outgoings – tenant not able to trade

The main outgoings relief offered to tenants is where the tenant is **not able** to operate its business from the premises for any part of the Relevant Period.

If a tenant is **not able** to operate its business from the premises, landlords must '*consider*' waiving payment by the tenant of any outgoing or other expense payable during that period. [28] This only requires landlords to '*consider*' waivers, however landlords are required to do this acting reasonably and in good faith (or otherwise be in breach of the lease).[29]

Interestingly, this does not appear to apply to leases where the tenant can operate its business, albeit in a significantly diminished capacity (eg a restaurant with takeaway service only).

To further assist in reducing outgoings if a tenant is not able to operate its business at the premises, the landlord may cease or reduce services at the premises as is reasonable in the circumstances, and in accordance with the any reasonable request of the tenant. [30]

Outgoings – landlords must pass on savings

Similar to the NSW Regulations, if any outgoing is reduced, the tenant is only liable to pay the tenant's proportionate share of the reduced outgoing. [31]

For example, if the landlord's land tax assessment reduces and outgoings are payable in monthly instalments based on annual estimates, the monthly instalments should be adjusted immediately (and not after the end of the outgoings year) to take into account the reduction in land tax.

In addition, if the tenant has already paid an instalment in excess of the reduced amount, the landlord must reimburse the excess as soon as possible. [32]

Trading hours

A tenant under an Eligible Lease may reduce its trading hours, or not trade at all, during the Relevant Period. [33]

Landlords may not evict, attempt to evict, re-enter or attempt to re-enter the premises, or call on any security, where a tenant takes such action. [34] In addition to a potential claim by the tenant, any such action by the landlord carries a penalty of $3,304.40 per offence (based on 20 penalty units, as at 1 May 2020).

Confidentiality

Landlords and tenants must keep confidential the following information obtained pursuant to the operation of the Regulations:

- personal information of any person other than the landlord or the tenant; and
- information relating to business processes and financial information. [35]

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[28] regulation 14(2)
[29] regulation 8(2)
[30] regulation 14(3)
[31] regulation 15(2)(a)
[32] regulation 15(2)(b)
[33] regulation 18(1)
[34] regulation 18(2)-(4)
[35] regulation 19(2)

This is subject to the usual confidentiality exclusions (eg. disclosure with consent, to advisers or financiers on a confidential basis, as required by law or in connection with any court or tribunal proceedings).

Note that this will not apply to keeping confidential the nature of the deals. Accordingly, confidentiality deeds could prove useful to protect confidence in the deals as you are negotiating them, and at a minimum, rent relief agreements should contain a confidentiality clause requiring the nature of the rent relief to be kept confidential.

Disputes

Any dispute under the Regulations is subject to the dispute resolution procedures under the *Retail Leases Act 2003*, including mediation.[36] This applies even if the Eligible Lease is not subject to that Act.

Disputes must be referred to the Small Business Commissioner in the first instance, and will almost certainly be subject to mediation before VCAT or court determinations. It is therefore likely that the dispute resolution process could take time. Accordingly, landlords (in particular) are encouraged to refer to disputes for resolution at the earliest possible time.

Contacts

This publication was drafted by the Mills Oakley's Melbourne Property team and is current as at 5:30pm, 3 May 2020.

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[36] regulation 20