



1 May 2020

The Hon Steven Marshall MP
Premier of South Australia
via email: premier@sa.gov.au

Dear Premier

Implementation of National Cabinet Mandatory Code of Conduct for SME Commercial Leasing Principles during COVID-19 crisis.

On behalf of the Real Estate Institute of South Australia (REISA), I am writing in respect of the implementation of the National Cabinet's *Mandatory Code of Conduct: SME Commercial Leasing Principles during COVID-19 (the Code)* in South Australia.

REISA welcomes the Federal Government's approach to working collaboratively with the real estate industry during the COVID-19 crisis and fundamentally supports the need for Government action to ensure the minimisation of disruption and financial disadvantage during this challenging time.

Furthermore, REISA is particularly supportive of the fact that the Code identifies the unique nature of commercial leasing and has as its core, the principle that commercial lease arrangements between landlords and tenants should be dealt with on a case-by-case basis.

While we understand that the Code has been agreed to and endorsed by the National Cabinet, we consider that there are some key aspects that need to be reconsidered and/or further refined to suit our unique leasing landscape and economy before it is legislated in South Australia.

Implementation of the Code in South Australia

To ensure the principles of the Code are appropriately achieved in any proposed legislative framework, REISA submits the following issues for your consideration:

1. Retrospective Application

Mandatory application of the Code should not be retrospectively applied prior to 7 April 2020, being the date the Code was endorsed by the National Cabinet. As financial pressures arose early in the COVID-19 crisis, many commercial leasing arrangements had already been negotiated and varied

appropriately between landlords and tenants prior to 7 April 2020. Retrospective application of the Code would have the effect of reopening these mutually acceptable arrangements to renegotiation, with further disruption to business.

2. Definition of Qualifying Tenants

a. The Code provides specific eligibility criteria for the establishment of a tenant as a 'Qualifying Tenant'. However, it qualifies that criteria by adding that the Code should also apply "in spirit" to tenants who do not meet that criteria. REISA believes that in order to avoid confusion as to the applicability of the Code as a mandatory imposition, that the definition of 'Qualifying Tenant' be clear with no exemptions.

b. The Code is designed to support small and medium enterprises (**SME**) that are suffering financial stress or hardship as a result of the COVID-19 crisis who meet the qualifying criteria:

- the tenant is eligible for the JobKeeper programme; and
- has an annual turnover of up to \$50M

REISA submits that the qualifying criteria are simplistic in nature and do not take into account other relevant factors pertaining to the tenant's overall financial position and ability to continue to meet their contractual obligations. For example, tenants may have substantial assets or significant other financial resources available to them. While the qualifying criteria are stipulated in the Code, it is important that additional evidentiary and assessment parameters are established in South Australia to appropriately guide and define negotiations in relation to rent between the parties. This is discussed further at paragraphs 2c, 11 and 12 of this submission.

c. In addition, eligibility as a 'Qualifying Tenant' during the COVID-19 crisis may change depending on the particular circumstances of the tenant and the impact of any Government directed restrictions. A lack of certainty of what would constitute circumstances leading to a Federal Government declaration that the COVID-19 crisis has 'ended' means that changes to lease arrangements negotiated under the Code may apply for an extended period notwithstanding that the financial circumstances of the tenant have recovered due to the staged easing of restrictions, resulting in the tenant no longer meeting the criteria of a 'Qualifying Tenant.' In view of this, REISA submits that measures to implement the Code include the requirement for periodic reassessment of the financial position of the tenant to ensure continued eligibility as a 'Qualifying Tenant.' These measures should include the requirement for tenants to provide relevant financial information and updates as to JobKeeper allowance entitlements to landlords on a regular basis, recommended monthly and an ongoing requirement for tenants to inform landlords of any changes to their financial position which could impact upon their eligibility as a 'Qualifying Tenant.'

d. REISA further submits that tenants whose ultimate ownership lies with a foreign parent company should be excluded from the application of the Code notwithstanding that a tenant subsidiary entity meets the criteria of a 'Qualifying Tenant.'

3. Definition of Turnover and Application of \$50M Turnover Ceiling

a. The Code does not provide a definition of turnover. This is problematic. REISA submits that any legislation introduced to effect the introduction of the Code include a comprehensive definition of turnover. Where the definition relates to current (or impacted) turnover, it should specifically include any and all government support and stimulus measures provided to the tenant (for example, the PAYG credits that can provide up to \$100,000 for some businesses) as well as any financial relief measures such as state taxes, fees and charges. Where the definition relates to comparative former turnover, it should provide for an averaging mechanism to address circumstances where the

tenant's previous annual turnover was unusually or artificially high when compared to prior financial years.

b. REISA also submits that the application of a \$50M turnover ceiling is not representative of the majority of SMEs in South Australia. Business turnovers in South Australia are generally lower than those in New South Wales and Victoria which are reflected in comparatively lower lease costs which commonly apply in this State. Tenants whose turnover is in the upper end of this ceiling would not commonly be considered an SME in South Australia and would most likely have a greater financial capacity to meet the challenges faced during the COVID-19 crisis. For these reasons, REISA submits that the \$50M turnover ceiling be considerably reduced in South Australia. We recommend a reduced \$25M turnover ceiling be adopted in South Australia. It is REISA's view that such a reduction would better address the objectives of the Code by applying it more accurately to those tenants that are truly small to medium enterprises.

4. Expansion of Corporate Groupings to Include Industrial and Office Corporate Groupings

REISA submits that the principle under the Code that retail corporate groups should *not* be treated as individual outlets for the purposes of eligibility and that the entire corporate group as a whole be the relevant measure, should be expanded to include other corporate groupings occupying individual industrial and office tenancies across the group. Similarly, consideration should also be given to tenants operating under service trust arrangements which are commonly used by larger corporate groups for the purposes of quarantining commercial tenancy obligations.

5. Exemption for Small Commercial Properties

The Code is designed to benefit and protect SMEs not large and highly resourced tenants. In the same way, the Code should not be imposed on small commercial landlords who do not possess appropriate financial resources to meet its onerous requirements. To limit the impact of the Code on landlords of small commercial premises, REISA submits that the Code should be restricted to tenancies where the value of the commercial property exceeds \$50M. The purpose of this restriction is to limit the cash flow impact on owners of smaller commercial properties where the application of Code provisions would disproportionately impact the financial wellbeing of the landlord. REISA is concerned that in the absence of an appropriate value threshold, small retail shops, single offices and industrial sheds may be expected to meet the same obligations as large shopping centre and multi-storey office building landlords. It is imperative that there is clear distinction between small and large commercial landlords and the obligations for each differ according to their size and ability to manage the Code's requirements.

6. Clarity for Sub-Tenant/Head-Tenant Arrangements

The Code currently only applies to landlord/tenant arrangements and is unclear as to how the principles of the Code would apply to sub-tenancy arrangements that make up a significant proportion of commercial tenancy arrangements in South Australia. Legislative implementation of the Code would need to provide clear guidance on the scope and application of provisions in respect of sub-tenancy/head-tenancy relationships, with sufficient lead time on any proposed implementation to ensure appropriate industry engagement and consultation.

Overarching Principles

7. Legislative Principles

REISA generally supports the overarching principles from which the Code is derived and submits that those principles be specifically enshrined in any legislation to implement the Code. Any exceptions to this are outlined in this submission.

Leasing Principles

8. Principle 1 – Landlords must not terminate leases due to non-payment of rent during the COVID-19 crisis (or reasonable subsequent recovery period).

a. REISA submits that this principle should not apply where a termination of lease process was underway for non-payment of rent or any other breach arising during the period prior to COVID-19. REISA submits that the appropriate date for quarantining such action from the restrictions on termination imposed by the Code be 7 April 2020.

b. REISA submits that termination rights arising from the insolvency of a tenant also be excluded, given that in such circumstances the tenant would be unable to trade post-crisis or otherwise meet their obligations in relation to reimbursement of deferred rent et al.

c. REISA submits that implementing legislation should clarify that restrictions on the termination of a commercial lease does not extend to circumstances where a current lease expires within the COVID-19 period, and that the Code does not apply whatsoever to commercial leases entered into *after* the commencement of the COVID-19 period.

d. REISA submits that the term ‘reasonable subsequent recovery period’ be properly defined as a specific period. REISA recommends a maximum of three (3) months as an appropriate recovery period.

9. Principle 2 – Tenants must remain committed to the terms of their lease, subject to any amendments to their rental agreement negotiated under this Code. Material failure to abide by substantive terms of their lease will forfeit any protections provided to the tenant under this Code.

a. While REISA fundamentally supports this principle, to ensure its effectiveness, implementing legislation and/or regulations should include appropriate guidance as to what constitutes ‘material failure’ and ‘substantial terms.’

b. REISA seeks clarity as to the meaning of ‘forfeit’ protections in circumstances of a tenant breach and whether that includes a requirement to reimburse a landlord for rent waived and the cessation and repayment of a rent deferral applied to the tenancy arrangement as a result of the Code.

10. Principle 3 – Landlords must offer tenants proportionate reductions in rent payable in the form of waivers and deferrals (as outlined under ‘definitions’) of up to 100% 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.

a. The Code does not include specific information as to how or at what time, a reduction in a tenant’s trade is to be established. REISA submits that the appropriate measure on which an accurate assessment of a tenant’s capacity to pay rent is where the reduction is in profit, rather than turnover or other revenue measure.

b. REISA submits that standardised concession application forms should be developed and released in order that tenants are required to provide comprehensive and relevant information to support their application for relief under the Code. As submitted previously, tenants should be compelled to inform the landlord of any change to their financial or trading situation that may impact upon their eligibility as a ‘Qualifying Tenant.’

c. REISA submits again that a specific recovery period be legislated. REISA recommends a three (3) month subsequent recovery period is appropriate.

11. Principle 4 – Rental waivers must constitute no less than 50% of the total reduction in rent payable under Principle 3 over the COVID-19 pandemic period and 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. Regard must also be had to the landlord’s financial ability to provide such additional waivers. Tenants may waive the requirement for a 50% minimum waiver by agreement.

a. The fundamental principle of the Code is that each commercial lease arrangement should be treated on a case-by-case basis and that the parties are encouraged to reach “*tailored and bespoke arrangements.*” With this in mind, it is REISA’s view that Principle 4 has the potential to compromise that overarching objective through the application of specific and firm minimum rent reductions and waivers. It is REISA’s submission that to maintain the overarching objective of the Code, Principle 4 should be promulgated as a ‘best practice’ guide, and not legislated as specific criteria. Contractual freedom is of key importance to enable the parties to achieve “tailored” and “bespoke” outcomes suited to the individual circumstances of the parties.

b. To ensure proper application of the Principle, landlords confronted with a request for rent reduction should be empowered with the right to request from the tenant sufficient information to make an accurate assessment of the tenant’s financial position, including but not limited to information relating to the likelihood of continued solvency post-COVID-19. Landlords should also be given the right to reasonably enquire of the tenant what steps they have taken to secure Federal or State Government stimulus or support and what measures they have taken to reduce operating expenses and/or increase revenue through other means.

12. Principle 5 – 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.

a. REISA submits that rental deferrals be amortised for a capped period of 24 months irrespective of the lease term.

b. REISA submits that where a lease expires prior to the 24 month period and a rental deferral amount remains, that the landlord may retain any security provided by the tenant under the lease until such time as the amortisation period ends and all rent deferral amounts are paid.

13. Principle 6 – Any reduction in statutory charges or insurance will be passed on to the tenant in the appropriate proportion applicable under the terms of the lease.

REISA submits that any reduction in statutory charges or insurance provided to the landlord should be retained by the landlord to reduce the cashflow impact of providing the rent relief to the tenant mandated under the Code.

14. Principle 7 – A landlord should seek to share any benefit it receives due to deferral of loan payment, provided by a financial institution as part of the Australian Bankers Association’s COVID-19 response, or any other case-by-case deferral of loan repayment offered to other landlords, with the tenant in a proportionate manner.

REISA submits that any deferral of loan payments provided to a landlord by a financial institution offers no benefit to the landlord and as such is incapable of being shared with a tenant. It is REISA’s view that as deferral of loan payments come with an associated accrual and capitalisation of interest, landlords who receive such deferrals ultimately see themselves in a worse financial position than those who did not seek loan deferrals. Accordingly, it is REISA’s submission that to avoid unfounded expectations this principle should be removed from the Code entirely or at the very least, should not be legislatively implemented in South Australia.

15. Principle 8 – Landlords should, where appropriate, seek to waive recovery of any other expense (or outgoing payable) by a tenant, under lease terms, during the period the tenant is not able to trade. Landlords reserve the right to reduce services as required in such circumstances.

a. REISA submits that landlords should *not* be required to waive recovery of outgoings and other expenses as required under Principle 8. While landlords may be able to negotiate mortgage repayment deferrals with a single bank, it is not reasonable to expect landlords to seek to negotiate deferred payment arrangements and/or suspension of contractual arrangements with multiple suppliers that provide the products and services comprising the outgoings.

b. If Principle 8 is to be adopted in South Australia (which we do not support), REISA submits that where a landlord is required to pay an outgoing or expense to a third party, the tenant is required to reimburse or contribute to that outgoing in accordance with the terms of the lease.

16. Principle 9 – If negotiated arrangements under this Code necessitate repayment, this should occur over an extended period in order to avoid placing an undue financial burden on the tenant. No repayment should commence until the earlier of the COVID-19 pandemic ending (as defined by the Australian Government) or the existing lease expiring and taking into account a reasonable subsequent recovery period.

a. REISA submits that any repayment period be capped at 24 months to reflect the period specified for the repayment of rent deferrals amortised in accordance with Principle 4.

b. REISA again submits that the subsequent recovery period be specified as no more than three (3) months.

17. Principle 10 – No fees, interest or other charges should be applied with respect to rent waived in Principles #3 and #4 and no fees, charges nor punitive interest may be charged for deferrals in Principles #3, #4 and #5.

a. REISA acknowledges Principle 10 but submits that the landlord should be entitled to charge fees, interest or other charges (or draw on security) and take such other action as available to them under the lease in circumstances where the tenant fails to meet negotiated obligations in relation to the repayment of deferred rent or deferred outgoings et al.

18. Principle 11 – Landlords must not draw on a tenant’s security for the non-payment of rent (be this a cash bond, bank guarantee or personal guarantee) during the period of the COVID-19 pandemic and/or a reasonable subsequent recovery period.

a. REISA submits that any implementing legislation specifies that Principle 11 does not apply where the landlord is properly entitled to draw upon security for matters arising prior to the COVID-19 crisis. REISA submits that any matters attributable to the conduct of the tenant prior to 7 April 2020 be quarantined from the application of the Code.

b. REISA again submits that the subsequent recovery period be specified as three (3) months.

19. Principle 12 – The tenant should be provided with an opportunity to extend its lease for an equivalent period of the rent waiver and/or deferral period outlined in Principle #4. This is intended to provide the tenant additional time to trade, on existing lease terms, during the recovery period after the COVID-19 pandemic concludes.

REISA submits that where a landlord has an existing contractual obligation in relation to the property, the subject of the lease, the application of Principle 12 should not apply to that lease. Accordingly, the lease should expire in the normal course unless the parties mutually agree otherwise.

20. Principle 13 – Landlords agree to a freeze on rent increases (except for retail leases based on turnover rent) for the duration of the COVID-19 pandemic, and a reasonable subsequent recovery period, notwithstanding any arrangement between the landlord and the tenant.

a. REISA requests clarification as to scheduled annual rent reviews. REISA understands that rental reviews may occur at the appropriate time (in accordance with the specific term of the lease) but that increases may only be applied following the end of the of the COVID-19 pandemic period.

b. REISA again submits that the subsequent recovery period be specified as three (3) months.

21. Principle 14 – 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.

a. REISA submits that this principle should not apply where a business is not subject to COVID-19 related restrictions on trade and has voluntarily ceased to trade. It is important that tenants do not seek to exploit the protections under the Code. If this basic threshold test is too strict and inflexible in certain circumstances, an appropriate mechanism must be developed to ensure that only COVID-19 impacted tenancies are afforded the protection measures.

Other issues for consideration

22. Going concern sales and contracts of sale

REISA is concerned about the potential impact of the Code on contracts involving the sale of commercial properties and the sale of property as a ‘going concern’. It is important that consideration be given to this to ensure the preservation and protection of such contracts.

23. Definitions

As noted throughout this submission, REISA submits that significant consideration needs to be given to properly defining the various terms and concepts relevant to the operation of the Code.

24. Sunset Clause

As the Code is an urgent and immediate response to a unique crisis requiring unique solutions, it is REISA’s submission that implementing legislation includes appropriate expiration dates and/or review mechanisms along with clarification that existing legislative and regulatory provisions will be reinstated.

25. Support for commercial landlord

While REISA appreciates the need to support South Australia businesses and tenants during this crisis, it is concerned by the lack of support and assistance that has been offered to landlords in connection with the Code. In some instances, landlords may be receiving no rent or minimal rent. Although land tax relief has been offered by the State Government, landlords have a multitude of ongoing financial obligations in the form of mortgage repayments (which may be able to be deferred for a limited time only), rates and taxes, insurance payments and various other expenses arising in connection with ownership. Although larger commercial landlords may have the financial resources and wherewithal to withstand the cash flow impact of the Code, many smaller commercial landlords will not be in such a position. It is imperative that the State Government provides further financial incentives and support to commercial landlords to ensure that the Code does not result in their own financial demise. One suggestion is to tie the relief offered to landlords at 25% of the rent received for the property but capped at the Jobkeeper level and if the landlord has multiple properties, it applies only to one nominated property meaning that while minimal, the landlord does receive some assistance. The level of assistance cannot exceed the amount of relief the landlord is applying to the tenant.

I look forward to the opportunity to discuss this submission in further detail.

If you wish to discuss any aspect of this submission, please do not hesitate to contact me by email at: andrew.shields@reisa.com.au or by telephone on 0475101022 at any time.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Shields', with a horizontal line underneath the name.

Andrew Shields
Interim General Manager

cc: Treasurer of South Australia
Leader of the Opposition