

Commercial Leases



A practical guide for handling the impact of COVID-19

The purpose of this guide is to support New Zealand businesses with understanding how their leases work in the COVID-19 pandemic and Alert Level 4 lockdown environment and help them avoid a legal dispute by coming to an agreed position. **We expect that in most cases a negotiated position, formalised into a Deed of Variation of Lease, is likely to create the best outcome for all parties.**

The majority of landlords will want to do the right thing contractually and ensure they have a good tenant/landlord relationship that survives the lockdown period. The majority of tenants will be looking for some sort of rent relief to assist with cash flow management through the depths of the disruption period and until their businesses return to some level of normality.

As at 3 April, the economic response package has not yet been extended to commercial landlords and tenants, apart from the reintroduction of depreciation on industrial and commercial buildings (including accommodation assets) which applies from the start of the 2020-21 tax year. Support more specific to commercial leases (rent revenue to landlord/rent cost to tenant) may be coming. If it does, the level and manner of support is going to impact your decision making. We will keep you updated.

Landlords and tenants should look closely at their leases. We recommend you follow the steps in this plan and take advice:

STEP 1: Check Insurance

Ascertaining cover for business interruption and loss of rent insurance policies will be the first step, but we understand most policies will have an infectious disease exclusion.

STEP 2: Check the Form of the Lease

ADLS (Auckland District Law Society) Lease:

The ADLS Lease is the most common form of lease for commercial premises (office, retail and industry). It is often amended and there are different versions of this lease form.

The ADLS Lease Sixth Edition 2012 allows for a “fair proportion” of rent and outgoings to cease to be payable during an emergency while the tenant is unable to access the property to fully conduct their business. If, however, you trigger that reduction, and if the tenant does not regain access during the specified “no access period”, the lease could be cancelled by either party post the no access period. Landlords and tenants that wish to preserve their rights under their lease and avoid a potential termination are advised to agree to a Deed of Variation of Lease.

Fair proportion factors to consider:

Determining the “fair proportion” discount is not simple. Your best case scenario is to create a fair and defensible position. Record how you reached and calculated the reduction and get a desktop assessment if you are unsure or cannot agree. PwC can help with “fair proportion” assessments.

Any agreement between the parties should be recorded in a deed and signed by all parties (including any guarantors). It’s a “proportion” so it shouldn’t be NIL or 100%.

Factors to consider:

- Does either party have applicable insurance cover?
- Does the tenant have full, partial or no access to the premises?
- Has the use of the premises by the tenant changed to simply storage of business assets?
- Are there important business assets (servers, signage, IT systems, stock, equipment, chattels etc) at the premises that are still providing the tenant with benefits?
- Does the landlord have finance repayment obligations? Have these changed?
- Does the tenant still have business revenue? If so, what proportion compared to normal?
- Has the tenant taken advantage of the government subsidies and cash flow incentives?
- What are the essential outgoings that are still being paid by the landlord?

Other leases:

The earlier ADLS Lease versions do not have the “no access” provisions. There are also many other forms of lease used in the market and many are bespoke. For example, shopping malls have bespoke retail leases, banks will have their own preferred form and central government agencies have developed their own for office accommodation.

Check for any “no access” provisions similar to those in the ADLS Sixth Edition Lease. There may be force majeure clauses which have specific triggers and specific outcomes. Check the wording carefully to see if it covers events like the COVID-19 pandemic. The outcomes might, for example, be suspension or termination. That might not be desirable for either party.

If the lease does not include specific clauses for COVID-19 type events, it is possible that the Doctrine of Frustration could apply; this doctrine has high legal hurdles and if not managed carefully, it could lead to cancellation of your lease.

No matter the form of the lease, it will not have been specifically drafted to deal with COVID-19. Having reviewed many leases and analysed the provisions, it is our opinion that in most cases a negotiated position formalised into a Deed of Variation of Lease is likely to create the best outcome for all parties.

STEP 3: Negotiating a Deed of Variation of Lease – Options to Consider:

- **Future certainty.** Working out the trigger point for when and how lease obligations return to normal. This could be linked to the Epidemic Notice and Alert Levels and likely triggered by an assumption of when an acceptable level of 'normality' is likely to return for the tenant's business.
- **Staged return to business as usual.** A staged return to normal rent and outgoings might be considered and linked to the COVID-19 Alert Levels.
- **Rent reduction.** Even where an ADLS Sixth Edition lease is not in place, parties might consider reducing the rent and outgoings.
- **Create a hiatus.** Reset the lease time frames to extend the term by the period of time during which performance has been suspended.
- **Rent freeze.** Deferring rent reviews (the Government's current restrictions on rent increases don't apply to commercial property). For market rent reviews, it may, in any case, be difficult for some time to determine market rent.
- **Finance options.** Financing current rent and outgoings for future repayment. This might take the form of the lessor's ability to recoup the foregone rent once occupation recommences over a longer period of time.
- **Guarantees and bonds.** Creating instruments to de-risk the tenant's ability to pay rent in the future by structuring, for example, guarantees or bonds.
- **Negotiating terms.** Parties could consider increasing the term of the lease, adding renewals or adding future rent reviews in exchange for rent relief now.
- **Changing permitted use.** Allow for alternative uses during this period (storage for example).
- **Lease accounting.** Before finalising any variations, check with your accounting advisors as to the impact of the contractual changes on your current and future lease accounting.

We are here to support you with these challenges. For advisory and legal advice contact:



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