

Where you want to be.



**Coronavirus:
Insights for commercial
property owners**

6 April 2020

bentleys.com.au | advice@adel.bentleys.com.au

➤ Advisors

➤ Accountants

➤ Auditors

Covid-19 restrictions have had a devastating impact on both commercial and residential tenants. Many businesses are being forced to shut or substantially wind-back their operations. Tenants are finding themselves without an immediate source of income to fund their obligations.

The Government has not yet put in place a firm framework for negotiation. However, it is working to achieve this outcome.

We have seen tenants demanding immediate rent relief over periods well into the future.

We have seen landlords demanding rent or threatening eviction.

None of these actions are helpful in such a stressful situation for everyone.

Where does this leave you, as the property owner?

- Do you accept tenant demands?
- Do you push back on your suppliers (e.g. banks)?
- What concessions can you access?
- How can you help your tenants access funding?

This is where we as your financial advisors, working with your legal advisors, can help you negotiate a mutual arrangement for both parties.

The underlying principle here is “everyone shares the pain”. Things aren’t going to be normal for some time, but hopefully we can help you ease the cashflow pain.

Sustainability of your business during the down-turn

You need to bear in mind that this situation will end. Decisions that you make now may have a permanent impact on your property value. You need to be careful to maintain relationships and cashflow during the period to ensure your property can maximise cashflows following the resumption of trade.

How do you sustain your commercial property business during the down-turn?

Step 1: Make an assessment of which tenancies are going to be impacted, how much and over what period. Assess your relationships here and the importance of the tenant to the sustainable value of your property and/or portfolio. Understand which tenancies may be subject to the mandatory code of conduct and the flow-on impacts this will have on your rental cashflows;

Step 2: Understand the impact of a tenancy hibernation and rent reduction arrangement on your net cashflows. What variable costs reduce? What fixed costs remain? Where you engage a property manager, how will their costs be impacted? What recoverable outgoings will reduce? what may not be recovered?

Step 3: What are your fixed costs? For many, staffing, finance, state taxes and office overhead costs may not reduce relative to rent and may not be passed onto tenants.

Step 4: Consider strategies to reduce, offset or defer costs during the hibernation period:

- What staffing decisions can you make? You need to have regard to employment laws in managing your workforce¹. How will you look after your employees;
- Will you be eligible for the JobKeeper concession for a 30% reduction in turnover. How do you manage your entitlement and what cashflow impact will this have on your staffing costs;
- Will you be eligible for the 'cashflow boost' payment relating to your employee withholdings and BAS lodgements to 30 June;
- Will your bank reduce or defer funding costs. We note banks will generally allow a six-month period for deferring repayments²;
- Can your energy costs be reduced or deferred during the period? We note the energy regulator and many states have announced relief for these costs³;
- Can you defer your tax payments during the period. The ATO has announced very concessional arrangements to defer tax and access income tax payments you may already have advanced during the year. Your accountant should be able to assist with this negotiation⁴;
- State governments have announced payroll tax and other government charge waivers or deferrals⁵;
- What other funding is available? Various State governments have announced emergency funding for businesses. For example, the SA government has set aside funding⁶. Can you access concessional bank funding with low interest and deferred payments?

Step 5: Set the parameters of your negotiation. Understand your own cashflow impact. Understand your tenant and the concessions they are likely to be entitled to. Does the tenant need assistance to help them understand what they are entitled to and the impact on their cashflows? Consider the information you require from them to prove a business case for rent relief⁷ (see example below for an impacted tenant).

Step 6: Consider how you will structure the rent relief package. There will be a tension between offering permanent and deferred rent relief. You need to be prepared to 'take a

¹ <https://coronavirus.fairwork.gov.au/>

² **ABA COVID details**

³ **Energy issues**

⁴ **ATO concessions**

⁵ Refer to separate concession listing.

⁶ **BusinessandJobsSupportFund@sa.gov.au**. NSW & Vic have also providing emergency \$10k funding for affected businesses

⁷ This could be evidence they are eligible for the JobKeeper concession and the impact on their turnover. In many cases this will be obvious, such as where the business has been forced to shutdown.

share of the pain'. Many of your's and your tenant cost savings will be timing only. A rent deferral is a preferred arrangement for you but may be damaging to them. Do you agree to an extension to the back-end of the lease? Do you recover the rent with higher payments in future? How will the tenant be able to afford future increases given many of their costs will also be deferrals? This is a time for mutual discussions. Have regard to the tax consequences of the relief package. We have outlined below tax issues you will need to address.

Step 7: Legally document the rent relief package. The Property Council has published a useful article on some of these issues⁸. We recommend you obtain legal advice to properly structure and document an arrangement which would involve an extension of the lease.

What is the government doing to support negotiations?

The Federal government has so far announced, working with the States, the following principles for negotiation⁹:

- a short term (6 month) temporary moratorium on eviction for non-payment of rent to be applied across commercial tenancies impacted by severe rental distress due to Coronavirus;
- tenants and landlords are encouraged to agree on rent relief or temporary amendments to the lease;
- the reduction or waiver of rental payment for a defined period for impacted tenants;
- the ability for tenants to terminate leases and/or seek mediation or conciliation on the grounds of financial distress¹⁰;
- commercial property owners should ensure that any benefits received in respect of their properties should also benefit their tenants in proportion to the economic impact caused by Coronavirus;
- landlords and tenants not significantly affected by Coronavirus are expected to honour their lease and rental agreements; and
- cost-sharing or deferral of losses between landlords and tenants, with Commonwealth, state and territory governments, local government and financial institutions to consider mechanisms to provide assistance.

The Federal Government on 3 April¹¹ also announced the following calls for a mandatory commercial tenancy code for tenancies with a turnover less than \$50m who are participating

⁸Property Council article

⁹ <https://www.business.gov.au/risk-management/emergency-management/coronavirus-information-and-support-for-business/a-hold-on-evictions-for-renters>

¹⁰ This is proposed to be removed for tenants who sign-up to the mandatory code of conduct.

¹¹ <https://www.pm.gov.au/media/press-conference-australian-parliament-house-act-030420>

in the 'JobKeeper' scheme¹². We expect that most retail tenancies (except where part of a major chain or not an essential service) will be in this category. This includes:

- A proportionality approach to the rent discussion, where a rent reduction is proportional to a turnover reduction for the tenant;
- Rent should continue to be paid where possible;
- A freeze on rent increases (except where based on turnover);
- A prohibition on penalties for non-trading or reduced trading;
- A prohibition for passing land tax on to tenants;
- A prohibition from charging interest on unpaid rent;
- A prohibition from making a claim against a rent guarantee or security deposit; and
- Administrative relief to allow renegotiation of the lease.

The government has announced that the State governments will consider arrangements to allow at least a three-month waiver and three-month deferral of land tax for eligible landlords and tenants who sign up to the scheme.

This scheme will be discussed further on Tuesday 7th April 2020.

It's important to note that these principles are not law. Negotiation is still the best relief for affected parties.

None of the States has formally announced a response to the proposed plan. However, we expect responses over the coming weeks. We will keep you updated.

The States have also offered various concessions relevant to tenancies including land tax and rent relief. However, the current land tax reliefs offered by the States may need to be extended under the proposed code.

The different concessions are set out further in our stimulus measures listing. Your local council may also be offering concessions during this period¹³. You should contact them for more details where relevant.

¹² This will require the tenant to have experienced at least a 30% reduction in turnover.

¹³ E.g. the City of Adelaide & City of Melbourne have announced rent concessions.

What tax issues do you need to consider associated with your rent relief package?

We have seen various examples of rent relief packages being offered which might be a basis for a negotiated commercial deal. For example:

- The City of Adelaide is offering 100% rent-free for 3 months for small and community businesses;
- The City of Melbourne is offering a 50% rent reduction for April to June 2020 for smaller impacted tenants.

The type of package which is offered will depend on the unique circumstance and cashflow timing issues with each affected business. For example, tenants may have short-term cashflow issues now which may be picked up with deferred government funding later¹⁴.

Rent-free or reduced rent period

A permanent rent-free or reduced rent period is likely to have the following tax consequences:

- The taxable income for the property should be reduced during the period;
- GST should not apply to the rent relief given.

Where the lease-term is extended to compensate for the period this should have no adverse tax consequences for the landlord or the tenant.

Where the rent is increased in future, this will need to be carefully documented as relating to the future use of the property, such that this is not just a deferred payment relating to the prior period. Landlords accounting on an accruals basis¹⁵ may have a risk of the income coming home earlier (see below).

Deferred rental arrangement

Where the rent still accrues but is merely a deferred payment it is likely to have the following tax consequences:

- Where the landlord is accounting on an accruals basis it may still come home as assessable income if and when accrued. However, the landlord may be able to account for the rent on a cash basis where if the future recovery is doubtful or is contingent on some event future happening (such as the premises still being made available to the tenant in future);¹⁶
- The landlord may need to account for GST where they raise a tax invoice. The tenant may be entitled to an input tax credit in this situation. This may raise a tax cashflow risk for the landlord unless they can negotiate a payment extension with the ATO. It may be preferable not to raise a tax invoice until the cash is payable in future;

¹⁴ E.g. under the JobKeeper payment.

¹⁵ Taxation Ruling TR 98/1, 'Income Tax: determination of income: receipts v earnings' (14 January 1998) at para 48

¹⁶ Taxation Ruling TR 94/32, 'Income Tax: Non-Accrual Loans' (22 December 1994)

- The deferred payment may still be ‘turnover’ for the purposes of the JobKeeper test¹⁷ which may impact entitlements of the property owner.

Cash payment - permanent

The landlord could provide a direct cash lease incentive to the tenant provided this is consistent with the Code of Conduct. This is likely to have the following tax consequences:

- The payment is likely deductible to the landlord. The timing will depend on conditions attached to the payment¹⁸. However, rents would still be assessable;
- The payment is likely assessable to the tenant. The timing will depend on conditions attached to the payment;
- The payment may be subject to GST;
- The rent will likely still accrue and may be ‘turnover’ of the landlord under the JobKeeper payment;
- The lease incentive payment may be ‘turnover’ of the tenant under the JobKeeper payment and may impact their entitlement.

Given these consequences, this is likely to be a less preferred option.

Cash payment – timing

The landlord could advance the tenant a loan provided this is consistent with the Code of Conduct¹⁹. This is likely to have the following tax consequences:

- The loan would generally not be deductible to the landlord or assessable to the tenant;
- Interest on the loan may be deductible to the tenant when accrued;
- Interest on the loan may not be assessable to the landlord until paid²⁰;
- Rent would still accrue (and be paid) and would have the impacts previously explained;
- The loan should not be subject to GST.

Other arrangements

There are likely many other incentive arrangements which may be considered. You should ensure you consider the tax impacts such that the arrangement is mutually beneficial for both parties (e.g. arrangement involving capex may be eligible for accelerated tax write-offs).

We can assist you with structuring these arrangements.

¹⁷ We have not yet seen legislation on this measure, so we cannot confirm this position.

¹⁸ E.g. it may be a ‘prepayment’ and spread over a period of service.

¹⁹ In particular, a principal is that interest will not accrue on unpaid rent. Loan interest accrued could be seen as a substitute for interest on unpaid rent.

²⁰ Unless they were in the Taxation of Financial Arrangement measures or the funding was provided in the ordinary course of business.

Accounting impacts

You should also consider the accounting impact of the arrangements.

How is the cashflow incentive reflected in your accounts and how does this impact your financial metrics and other obligations derived from those metrics (e.g. employee incentive plans, management fees, banking arrangements, reporting and distribution to investors, asset/ unit valuation etc.)?

Example

Sally's gym is a tenant in your property. Her gym is forced to shut down due to COVID-19 restrictions. Sally's turnover has reduced by 90% due to the shutdown. The only income Sally continues to earn is from her online exercise business. Sally stood down her two personal trainers and an administration employee. Sally's rent currently accounts for 10% of the income on your commercial property.

Sally has assessed her short-term three-month cashflow projection situation and her impact on cashflows as:

	Pre-shutdown	Post-shutdown	(Shortfall) / Benefit
Cash inflows:			
Trading Income	150,000	15,000	(135,000)
COVID funding:			
- Govt grant		10,000	10,000
- Cashflow Boost		10,000	15,000
- JobKeeper		27,000	27,000
Total inflows	150,000	67,000	(88,000)
Cash outflows:			
Wages	50,000	27,000 ²¹	23,000
Rent	20,000	20,000	-
Outgoings	1,000	500	500
Utilities	2,000	1,000	1,000
Finance costs - Plant	5,000	²²	5,000
Other operating costs	30,000	20,000	10,000
Income tax	10,000	-	10,000
Owner personal expenses	12,000	10,000	2,000
Total outflows	130,000	73,500	51,500
Net inflows/ (outflows)	\$20,000	(\$16,500)	(\$36,500)

Sally proposes that you waive her rent for the next three months to cover her shortfall. However, based on your cashflow projections this would cause you issues with funding your overhead. Therefore, you propose to reduce the rent by 90% based on her turnover reduction²³ in line with the proposed 'code'.

²¹ JobKeeper payments to employees

²² The finance company has deferred payments for 6 months

²³ Not taking into account government COVID compensation she has received.

Sally is only deferring many of her costs which will come home in future and some of the short-term government funding may not be available in future. She will struggle to pay the rent back after the shut-down period. You negotiate to recover 30% of the rent reduction through increased rent over the term of the lease starting in 6 months.

Sally is comfortable with this arrangement as she also thinks she can reduce some of her other operating costs further. You agree to review again in 3 months to assess the continuing COVID impact on the business

Next Steps

This is a stressful time for everyone involved and requires a high degree of cooperation to ensure mutually beneficial outcomes for all. It is not a time for either landlords or tenants to make unreasonable demands of each other.

Your Bentleys advisors are available to help you through this process. The right advice is a win-win for both parties.

Please call us for a no-obligation initial discussion if you would like assistance with your arrangements. During this time of uncertainty, don't go it alone. Talk to your trusted Bentleys SA advisor.

Contact us today.

08 8372 7900

advice@adel.bentleys.com.au

Prepared by:

Simon How

Partner, Taxation Consulting

0424 039 088

show@adel.bentleys.com.au

Where you want to be

Bentleys SA

Let us help you

Your Bentleys SA advisor can help you tailor a cashflow support package which will help you, your business and your employees survive during this time.

Initial consultations are complimentary.

Contact us now

advice@adel.bentleys.com.au

08 8372 7900

Disclaimer

The comments in this paper are general in nature only. The material and opinions in the paper should not be used or treated as professional advice and readers should rely on their own enquiries in making any decisions concerning their own interests.

Bentleys is a network of independent advisory and accounting firms located throughout Australia, New Zealand and Asia. All members of the Bentleys Network are affiliated only, are separate legal entities and not in partnership. Limited liability by a scheme approved under Professional Standards Legislation. Bentleys is a member of Allinial Global – an association of independent accounting and consulting firms.

Member of
Allinial
GLOBAL[®]
An association of legally independent firms



bentleys.com.au | advice@adel.bentleys.com.au
Level 5, 63 Pirie St, Adelaide, SA 5000
08 372 7900

 Advisors  Accountants  Auditors