

Hon Andrew Little, Minister of Justice

Advice on commercial lease issues and the Property Law Act

Date	3 April 2020	File reference	
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Action Sought

Timeframe/Deadline

Discuss with your colleagues on 5 April 2020, and direct officials as to your preferred next steps

At your earliest convenience

Contacts for telephone discussion (if required)

Name	Position	Telephone (work) (a/h)		1 st contact
Caroline Greaney	General Manager, Civil and Constitutional		s9(2)(a)	✓
Anna Johnson	Principal Advisor, Electoral and Constitutional		s9(2)(a)	
Julia Rendell	Senior Advisor, Civil Law and Human Rights		s9(2)(a)	

Minister's office to complete

☐ Noted ☐ Approved ☐ Overtaken by events

☐ Referred to: _____

☐ Seen ☐ Withdrawn ☐ Not seen by Minister

Minister's office comments

Purpose

1. This paper provides advice on work happening across government relating to commercial leases and mortgages, and provides advice on recommended changes to the Property Law Act 2007 that could be made. The changes address issues relating to commercial leases and mortgages.

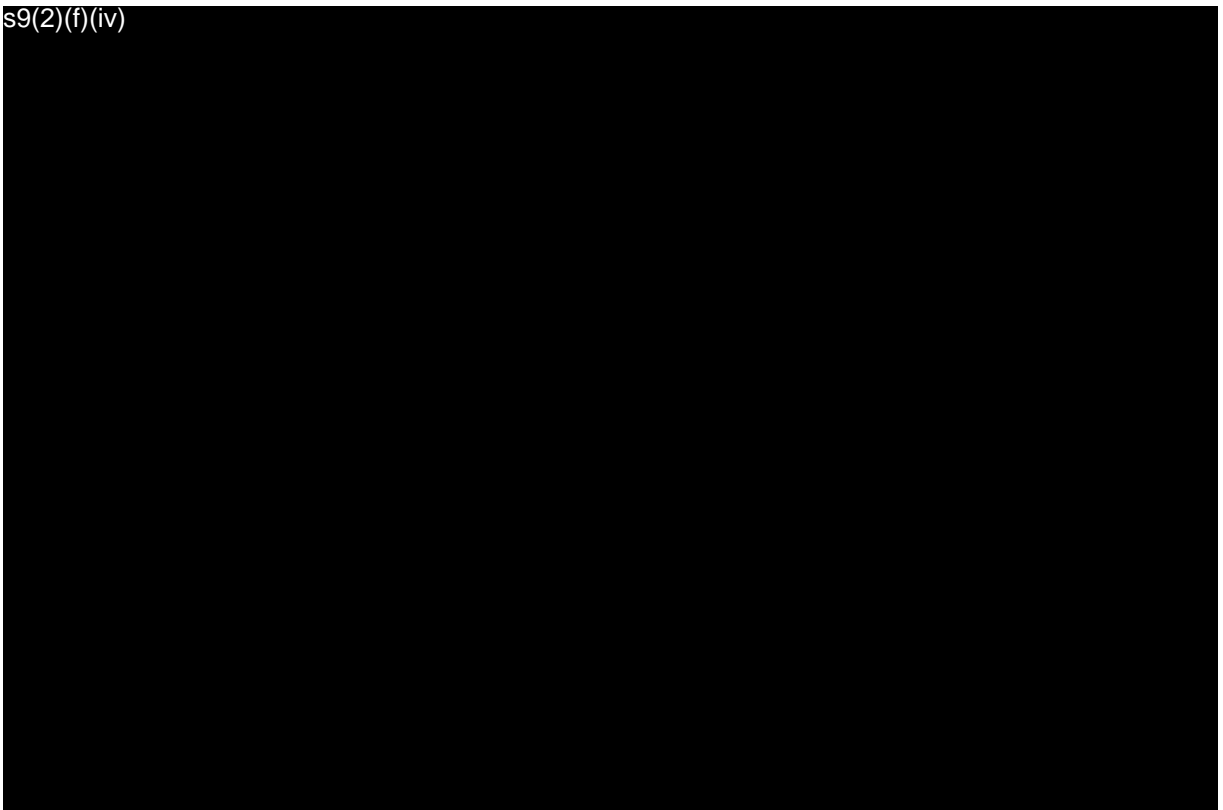
Background

2. You have indicated a preference to progress change to the circumstances in which commercial landlords may cancel leases for non-payment of rent, as a result of the epidemic. You have also directed us to provide advice on extending the period for which a mortgagor must be in default before a mortgagee can take action against them, and a possible freeze of commercial rents.

Considering the combined impact of options

3. Treasury and MBIE have also been considering options to provide relief for commercial tenants and landlords. These are summarised at a high level below. We understand Treasury's advice to the Minister of Finance will canvass the combined effect of options.
4. Treasury's advice notes that many firms are experiencing an unprecedented loss of income. The impact of a loss of income will be shared at varying rates between landlords, businesses, banks and the Government. The share will depend on contractual terms, negotiations and government interventions.

s9(2)(f)(iv)



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7. We consider the proposed change to extend the period for which a mortgagor must be in default before a mortgagee can take action against them will assist landlords. On the other hand, a freeze on rent increases alone could exacerbate it.
8. MBIE is also working on insolvency law proposals which would provide a means for businesses which may be viable in the long-term to put themselves (with the agreement of 50% of creditors) into a Covid Business Standstill (CBS). MBIE has indicated that our proposed changes align with MBIE's advice to Cabinet on reduce the risk of business insolvency through legislative change.
9. This work follows from the announcement last week that businesses can start applying to their banks for loans under the Business Finance Guarantee Scheme set up to support the New Zealand economy during the COVID-19 pandemic. Under the scheme, businesses with annual revenue between \$250,000 and \$80 million can apply to their banks for loans up to \$500,000, for up to three years. The scheme will offer a total of \$6.25 billion in loans to New Zealand businesses. The Government is guaranteeing 80% of the risk, while the banks are covering the remaining 20%. A normal lending process will be followed by the banks, which will make the lending decisions.

Proposed changes to the Property Law Act

10. The Property Law Act sets out legal mechanisms for enforcing obligations under mortgages and leases. Where a mortgagor or a tenant is in breach of these obligations, the mortgagee or lessor must give them a specified time to remedy the breach before they can take action under the mortgage or the lease.
11. We consider that extensions to the timeframes given to remedy any breach (as set out below) could assist mortgagors and lessees who are in financial difficulty. A change to the enforcement mechanisms would operate alongside the support for businesses proposed by Treasury and MBIE.
12. The changes would operate as a backstop to delay the use of enforcement powers where other approaches have failed, for example, the parties have not been able to reach an agreement, or other support is not available. This recognises that the courts are unlikely to have capacity to hear such cases in the immediate future.

Temporary eviction protection for commercial leases

13. The Alert Level 4 restrictions raise issues for both landlords and tenants in respect of their obligations under commercial leases. Tenants may find it hard to pay rent if they are no longer able to operate their business. If landlords are not receiving the full amount of rent, they may not be able to meet any mortgage obligations or may seek to exercise their rights under their lease. This could mean that businesses which would usually be viable are at a higher risk of insolvency during the COVID-19 lockdown. Given the size and value of the commercial property sector, worth approximately \$224 billion in 2018, this also risks a significant reduction in cashflow in the sector and NZ economy.
14. It is lawful for a lessee to stop paying, or reduce, rent in accordance with the terms of the lease agreement. The standard commercial lease agreement contains a clause that provides for a fair proportion of payment of rent stop temporarily if a property is unable to be accessed in an emergency (including an epidemic). However, some leases will not contain this provision or an equivalent and tenants will not be entitled to a reduction in

rent. Generally, we would expect landlords and tenants in these situations to reach an agreement. Landlords do not generally want to lose their tenants, especially when market conditions favour tenants (such as may occur after the epidemic notice is lifted). But some landlords may take a hard line and insist that rent be paid in full, particularly if they had another reason for wanting to end the tenancy. A landlord could then seek to cancel a lease if rent is not paid. This would be unusual in the current circumstances.

15. Under Section 245 of the Property Law Act, a landlord may take steps to cancel a lease where a lessee fails to pay rent (in breach of the lease), or otherwise breaches a covenant or condition of the lease. A landlord can cancel a lease for a breach of the covenant to pay rent, if:
 - the rent is unpaid for no less than 10 working days, and
 - the landlord has served a notice of the breach that specifies a period of not less than 10 working days to remedy the breach
 - the lessee does not remedy the breach by the end of the specified period.
16. The two 10-day periods can happen concurrently.
17. Practically, it may be difficult for a landlord to evict a tenant during the Alert Level 4 because it requires them to either make an application to the court or to peaceably enter the property. However, a landlord could take action once Alert level four was lifted and before a tenant had time to resume operating its business and make up the rent arrears. A tenant could apply to court for relief but that may not be a viable option for tenants in difficult financial circumstances, and a business may no longer be viable by the time the application is heard.
18. We recommend amending the Act to allow 30 working days after a tenant is in arrears before a landlord can give notice to cancel a lease, and 30 working days for a tenant to remedy the breach before a landlord can cancel a lease. These changes would only apply to commercial leases subject to the Property Law Act. It would not apply to residential leases under the Residential Tenancies Act (see s 142 of that Act).
19. The initial conversations we have had with the Property Law Section of the Law Society show a degree of support for this measure.
20. They agree that the current timeframes for remedying rent arrears could be an issue for tenants whose leases do not contain provisions allowing for rent adjustments or non-payment during emergencies. On the other hand, the Property Law Section noted that sometimes commercial tenants are in a more powerful position than landlords and they are already seeing some aggressive action by tenants refusing to pay rent. Any measure should not shift the balance of power between commercial landlords and tenants too far in favour of tenants.
21. We think the proposed measure reaches an appropriate balance. It will not reduce the tenants' obligation to pay rent but will provide more time for tenants to catch up if they can't pay due to COVID-19. We considered not taking any action to mitigate this issue and encourage landlords and tenants to negotiate appropriate amendments to their lease agreements. We think agreement will be reached in most cases and that this measure is to protect tenants in cases where it is not possible for the two parties to reach


agreement. We also considered taking action to completely prevent the cancelation of leases at this time, but we considered that there may be some cases where, for reasons unrelated to the epidemic, a lease cancelation would be appropriate.

22. These changes would apply to notices given before the change came into effect provided that the notice period had not already expired. For example, if 10 working days' notice was given on 1 April (and this period has not expired by the time change commences) this would be extended to 30 working days' notice.

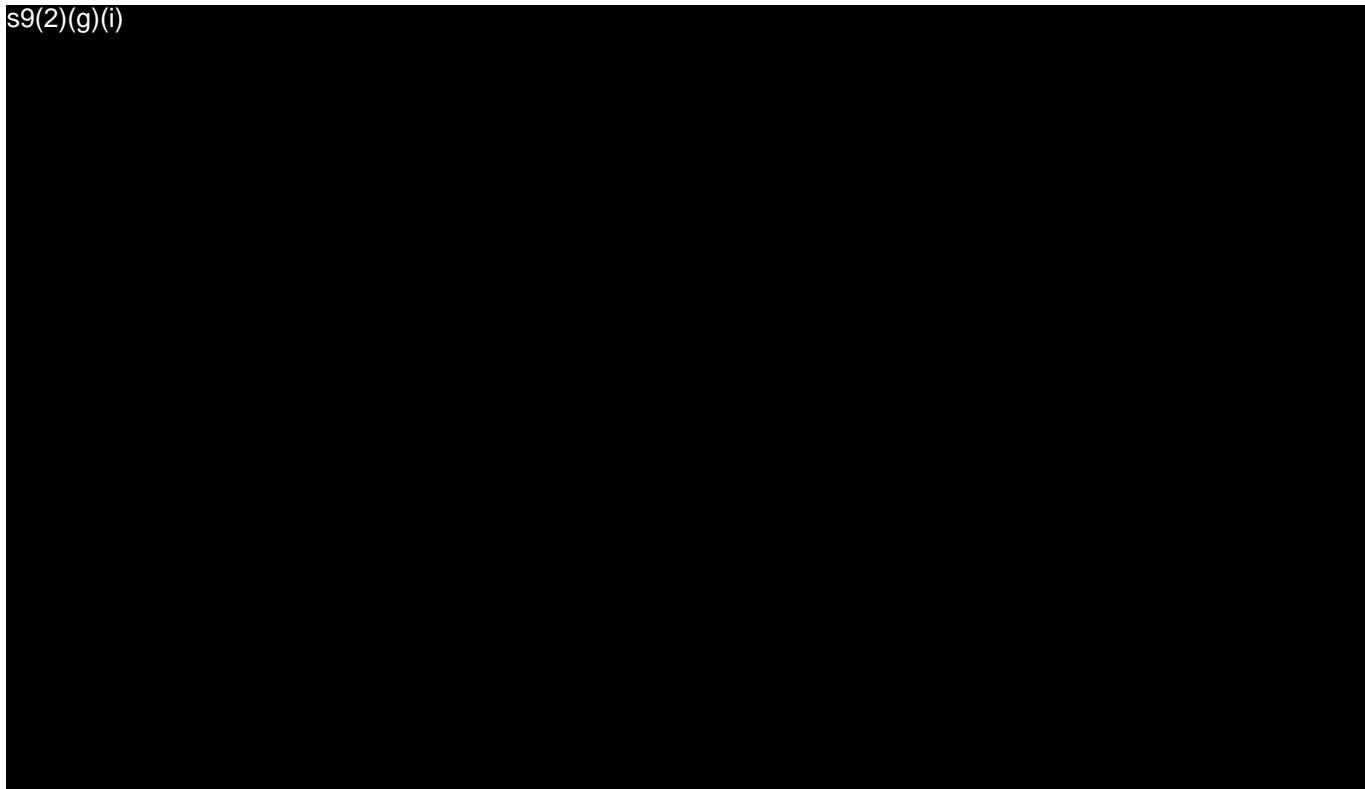
Mortgagee powers – residential and commercial

23. The Business Finance Guarantee and the Mortgage Holiday Scheme will support people to manage their business finances over this time, however there will still be some business that have difficulties with the payment of rent due to lost income. It is likely that more businesses than usual will be unable to make mortgage payments leading them to default.
24. Sections 120 and 129 of the Property Law Act address the exercise of mortgagees' powers. These provisions cover notice requirements before a mortgagee can exercise powers of possession or sale under a mortgage when the mortgagor is in default. These provisions apply to any mortgage - residential and commercial.
25. For mortgaged land, the mortgagee must give 20 working days' notice to the mortgagor to remedy default before the mortgagee exercises powers. A similar provision applies to mortgaged goods, but the notice period is 10 working days.
26. We propose restricting the exercise of mortgagees' powers by extending the period of notice in sections 120 and 129 from 20 to 40 working days for mortgaged land, and from 10 to 30 working days for mortgaged goods. This would apply to all mortgages whether they are commercial or residential.
27. We note that mortgage holidays and the Business Finance Guarantee scheme are likely to be the first port of call for borrowers, and mean that there is less risk for mortgagors. However, as noted above, we still think this is a useful backstop where other support arrangements have failed., and the Reserve Bank has indicated that it doesn't think the changes will have any effects on the prudential regulations.

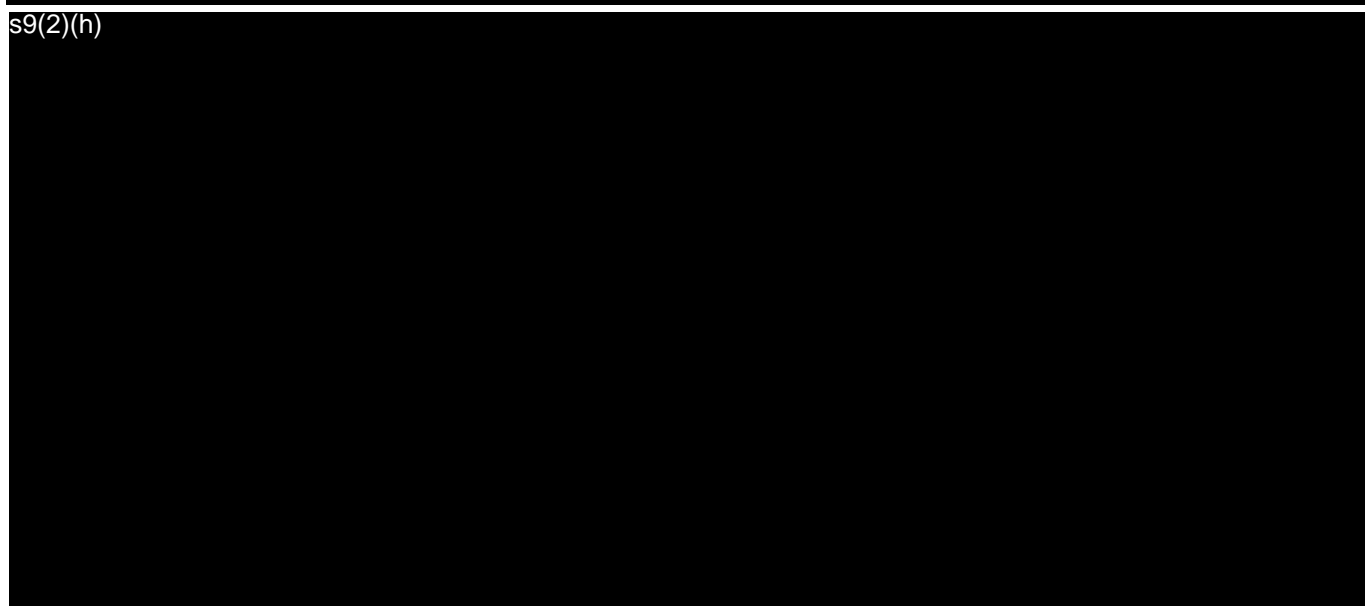
s9(2)(g)(i)



s9(2)(g)(i)



s9(2)(h)



These changes could be made through an Omnibus Bill

34. s9(2)(h) a Bill would be necessary to amend the Property Law Act. If you agree with the proposals in this briefing, they will be submitted for inclusion in the second COVID-19 omnibus bill and will be considered by the oversight group for inclusion in this Bill. The oversight group is reviewing all proposals for law reform.

Consultation

35. There has been informal discussion with representatives of the Property Law Section of the New Zealand Law Society. They helped to identify the advantages and disadvantages of the proposals in this paper, without formally expressing a view on behalf of the Society.


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36. We have also provided an opportunity for MBIE, HUD, Treasury, DPMC, and PCO to provide input on these proposals. As discussed above, Crown Law provided advice on whether the proposals meet the statutory test for modification orders as contained in section 15 of the Epidemic Preparedness Act.

Recommendations

37. I recommend that you:

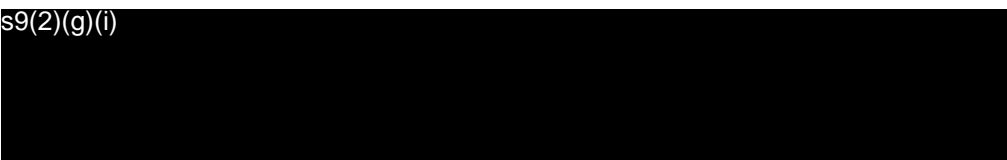
s9(2)(h)



2. **Indicate** whether you wish to pursue making the following changes to the Property Law Act 2007 through the proposed second COVID-19 omnibus bill:

- a. restrict the exercise of mortgagees' powers by extending the period of notice in sections 120 and 129 from 20 to 40 working days for mortgaged land, and from 10 to 30 working days for mortgaged goods **YES / NO**
- b. extend time frames for the cancellation of commercial leases in section 245, from 10 to 30 days for both the period the lessee must be in arrears before notice can be given, and for the period to remedy a breach of the covenant to pay rent. These periods would continue to be able to be concurrent **YES / NO**

s9(2)(g)(i)



YES / NO

Caroline Greaney
**General Manager, Civil and Constitutional
Policy**

APPROVED / SEEN / NOT AGREE

Hon Andrew Little, Minister of Justice

Date: / /