

In Confidence

Office of the Minister of Justice
Chair, COVID-19 Ministerial Group

Amendments to the Property Law Act 2007 relating to commercial leases and mortgages

Proposal

- 1 This paper seeks your agreement to amend the Property Law Act 2007 to support businesses and commercial landlords to manage situations where, because of the impact of the COVID-19 epidemic, businesses are unable to pay their rent and landlords are unable to meet their mortgage payments. I propose extending the timeframes required before landlords can cancel leases and mortgagees can exercise their rights to sale or repossession, under the Property Law Act.
- 2 This will form part of a wider package of business support that is being developed across portfolios. A paper setting out the additional choices for the business support package will be brought by Hon Grant Robertson, Minister of Finance shortly. I anticipate that the public announcement of the package, including these proposed law changes, will be made following those decisions.
- 3 An amendment Bill will need to be enacted to implement the law changes proposed in this paper. I propose these changes be included in the next COVID-19 Omnibus Bill, planned for enactment after the House resumes on 28 April. I seek a decision on the timing of when the law changes would take effect, and those choices are set out in this paper.

Context

- 4 Many businesses are experiencing an unprecedented loss of income due to the COVID-19 epidemic. The impact of the 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. I know most businesses including commercial landlords and tenants are working together to find a way through the pressures caused by COVID-19.
- 5 The loss of income will mean that businesses which would otherwise be viable are at a higher risk of insolvency due to COVID-19, and the likely subsequent economic downturn. 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 New Zealand economy.

- 6 The Ministers of Finance, Small Business, Economic Development, Housing and Justice are working together to consider options to provide relief for businesses, with the aim of supporting businesses to stay solvent through the epidemic, which will aid New Zealand's economic recovery.
- 7 The proposals in this paper to support commercial tenants and landlords form the base of a wider package of business support that is being developed across portfolios. A paper setting out the additional proposals for the business support package will be brought by Hon Grant Robertson, Minister of Finance. This builds on Government support already announced, such as the Business Finance Guarantee and the Mortgage Holiday Scheme, which will also support people to manage their business finances over this time.

Due to the impact of COVID-19, more commercial tenants will be unable to pay rent, and more commercial landlords will default on their mortgages

- 8 The COVID-19 epidemic is having, and will continue to have, an impact on both landlords and tenants in respect of their obligations under commercial leases. Tenants may find it difficult or impossible to pay rent if they are no longer able to operate their business. If landlords are not receiving rent, they may not be able to meet their mortgage obligations and / or may seek to exercise their rights to cancel the lease. If landlords default on their mortgages, mortgagees may seek to exercise their rights, for example to sell the property.

Commercial leases

- 9 Whether it is lawful for a lessee to stop paying rent, or to reduce the amount of rent paid, will depend on the terms of the lease agreement. The number or percentage of commercial leases which contain provisions allowing the tenant to not pay rent, or pay a reduced amount of rent, when they cannot access the building is unknown.
- 10 The standard 2013 commercial lease agreement contains a clause that provides for a fair proportion of payment of rent to stop temporarily if a property is unable to be accessed in an emergency (including an epidemic). However, there will be leases that have been in place prior to the 2013 template, and others that have been amended or use a different template and do not contain clauses for tenants to pay reduced rent.
- 11 Under the Property Law Act, a landlord may issue a notice 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 issue a notice to cancel a lease for a failure to pay rent, if:
 - 11.1 the rent is unpaid for no less than 10 working days, and
 - 11.2 the landlord has served a notice of the breach that specifies a period of not less than 10 working days to remedy the breach (these periods can be concurrent), and
 - 11.3 the lessee does not remedy the breach by the end of the specified period.

- 12 It may be difficult for a landlord to evict a commercial tenant at this time because the landlord is required to either peaceably enter the property or make an application to the court. Courts are unlikely to have capacity to hear such cases in the immediate future. However, a landlord could take action once the Alert Level 4 is altered and before a tenant has time to resume operating its business and make up the rent arrears. A tenant could apply to court for relief once 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.
- 13 This could mean that leases may be cancelled during the period of the COVID-19 epidemic, in situations where it would be difficult or impossible for the tenant to prevent the cancellation.

Mortgagee powers

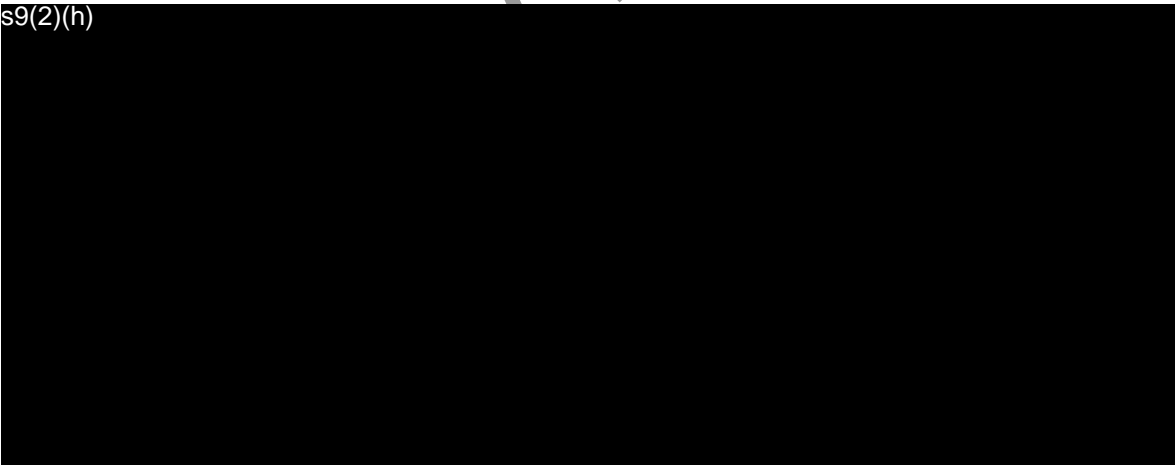

- 14 For reasons relating to the non-payment of rent or income lost due to COVID-19, it is also likely that more businesses and individuals than usual will be unable to make mortgage payments leading them to default. This relates to both commercial mortgages and personal mortgages (e.g. homes).
- 15 The Property Law Act sets out the process for mortgagees to exercise powers under the mortgage when the mortgagor is in default, such as the power of sale. Sections 120 and 129 cover notice requirements before a mortgagee can exercise powers of possession or sale under a mortgage. These provisions apply to any mortgage – whether residential or commercial.
- 16 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.

Proposed amendments to the Property Law Act seek to mitigate these issues

- 17 I am sure that in the first instance most commercial landlords and tenants are working constructively together to agree a way through the pressures caused by COVID-19. Finding a mutually acceptable agreement is the best approach to avoid legal disputes and court proceedings which can be time consuming, stressful, and expensive. Parties should consider that the impacts of COVID-19 are neither party's fault. However, in some situations commercial landlords and tenants will not be able to reach agreement. I consider it necessary to provide additional time for a tenant to remedy a breach of the covenant to pay rent before a lease can be cancelled.
- 18 I seek to make the following changes to the Property Law Act:
 - 18.1 extend time frames for the cancellation of commercial leases from 10 to 30 working 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. As now, these periods can overlap, and

- 18.2 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.
- 19 These changes would be temporary, and the law would return to the current timeframes six months after the end of the Epidemic Preparedness (COVID-19) Notice 2020. This timeframe reflects the likely ongoing economic effects of COVID-19 and gives businesses sufficient time to recover.
- 20 These changes would still allow landlords to cancel leases and mortgagees to exercise their powers during the period that an epidemic notice is in force but would allow for more time than is currently provided for breaches or defaults to be remedied.
- 21 These changes would not apply to residential leases under the Residential Tenancies Act. Although the proposed changes regarding mortgages are designed to assist commercial landlords, the change will apply to all mortgages, as the relevant provisions do not make a distinction between commercial and residential mortgages. The government has previously announced a major financial support package for home owners affected by the economic impacts of COVID-19. The package will include a six-month principal and interest payment holiday for mortgage holders, and this is likely to be the first port of call for residential borrowers.

Legislative Implications

- 22 s9(2)(h) 
- 23 s9(2)(h)  a bill would be necessary to amend the Property Law Act. If you agree with the proposals, I will instruct my officials to issue drafting instructions to PCO, so that the bill can be introduced as soon as practicable. I propose that an amendment bill be enacted at the earliest opportunity, and after the House resumes on 28 April 2020 at the latest.

Some options would have retrospective effect

24 I seek a decision on whether the proposals should have a retrospective effect, and, if so, the timing of retrospectivity. There are three options regarding the date from which the proposals would take effect.

24.1 **Option A:** the extended timeframes only apply to any notices issued after the law receives Royal assent. This would have no retrospective effect and would only apply to a notice of a breach issued after the law comes into effect.

24.2 **Option B:** the extended timeframes apply to any notices issued after the date the law change is announced.

24.3 **Option C:** the extended timeframes apply to notices that were issued from 10 days after the promulgation of the Epidemic Notice on 25 March 2020.

Options A has no retrospective effect

25 Option A does not have retrospective effect because it changes the timeframes for new notices only.

26 However, it might not effectively protect people who are unable to meet rent obligations due to the impacts of Covid-19 because many notices issued during the Alert Level 4 period would not have the extended notice periods. This is particularly the case with arrears in rent. Notices regarding the payment of rent are likely to go out at the beginning of the month. By the time legislation is passed, the notice period of 10 working days may have expired.

27 In addition, if tenants are already in arrears, the announcement may incentivise some landlords to issue a notice about arrears, before the law is changed. This is likely to only be in situations where landlords and tenants were not likely to be able to reach agreement easily and the landlords wants to preserve bargaining power.

Options B and C apply more widely but have a significant retrospective effect

28 Options B and C would apply to all lessees and mortgagors affected by the impacts of Covid-19. They would have a significantly greater retrospective effect because they would apply to notices that were issued prior to the date the Bill is given Royal assent.

29 Option B would only apply to notices issued after the law changes are announced. It involves a clear message from government about what law changes are intended and would provide a degree of comfort to businesses and individuals.

30 Option C may capture some notices about rent arrears issued in early April, provided they are issued from 10 days after the promulgation of the Epidemic Notice on 25 March 2020. For this reason, Option C would provide greater protection to lessees and mortgagors affected by the impacts of Covid-19 who

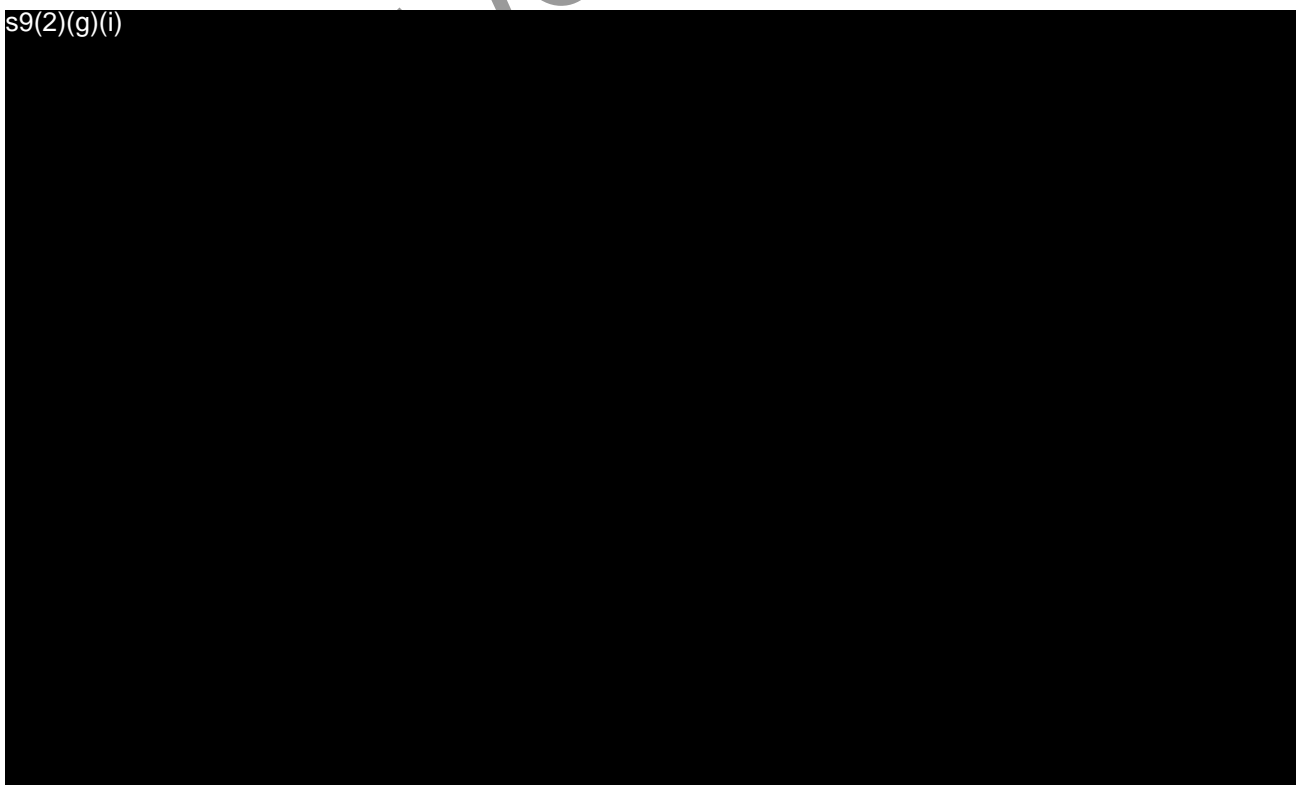
were issued with a notice but did not have an opportunity to remedy it because of the impacts of New Zealand moving to Alert level 4.

- 31 While Option C would provide greater coverage, it introduces increased complexity (because notices may have expired before commencement) and will be complex to draft and to interpret. The complexity of it may result in some uncertainty. The Courts may be likely to interpret it strictly in line with principle that the law should not be retrospective in its application, if there is uncertainty.
- 32 Under Option B and Option C, where notices are issued after, or have not expired at the time of the announcement of the law changes, people affected by the proposed law changes could evaluate their options in light of the proposed change. For example, a landlord could choose to include a longer notice period, or to defer enforcement action once the notice period has expired.
- 33 However, longer notice periods could not be enforced until the law has changed. In practice, this may not have much impact because the courts are unlikely to have capacity to hear such cases in the immediate future.

Presumption against retrospectivity

- 34 Section 7 of the Interpretation Act 1999 makes it a general principle of interpretation that legislation does not apply retrospectively. The Legislation Design and Advisory Committee Guidelines set out a starting point that legislation should not have retrospective effect. The guidelines provide limited exceptions when retrospective legislation might be appropriate (e.g. be entirely to the benefit of those affected or validate matters generally understood and intended to be lawful) but none appear to apply here.

s9(2)(g)(i)



It is unclear how the retrospective law could be enforced

- 39 The courts will be unable to enforce the proposed new law until the enactment of validating legislation. This is because the courts must apply the law as enacted by Parliament, not as proposed by the Executive. People would be entitled to issue eviction notices in line with the current law and have them enforced by the courts.
- 40 However, once the law is enacted, action taken under an expired notice would be in breach of the new law. Either the law could not be enforced, or the lessee would be entitled to seek relief against a landlord for exercising rights which they were entitled to exercise at the time. This creates a risk of inequitable outcomes for landlords and tenants depending on the point at which notices are issued and the legislation is enacted.

Compliance

- 41 The proposals described in this paper are not inconsistent with the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993. That is because there is no general protection for property under the Bill of Rights Act. While extending the notice periods for tenants to amend breaches and mortgagors to remedy defaults does restrict the exercise of property rights, these proposals do not remove any property rights. Landlord and mortgagee are still able to enforce their rights, within an extended time frame. The restrictions are moderate and will apply temporarily.
- 42 There are no financial implications for the Crown resulting from the proposals in this paper. Financial implications of wider package of business support will be set out in the paper being brought by Hon Grant Robertson, Minister of Finance.

Impact Analysis

- 43 The Treasury has determined that this paper and its proposals are a direct COVID-19 response and that the Regulatory Impact Analysis requirements have been suspended. An impact analysis for these proposals has not been done.
- 44 The Treasury has been consulted by the Ministry of Justice to ensure that adequate analysis has been included in this paper to help inform Ministers' decisions.
- 45 When determining the necessity of law changes, options considered included:
- 45.1 doing nothing and relying on landlords and tenants to negotiate their leases; and
 - 45.2 banning the cancellation of commercial leases, or the initiation of the process to cancel commercial leases, during the COVID-19 epidemic.
- 46 These proposals will have an impact on individuals, businesses, not-for-profits, landlords, and mortgagees. There are some risks or possible unintended consequences relating to the proposed law changes:

IN CONFIDENCE

- 46.1 Commercial tenants may take it as a sign that they do not have to pay rent during the COVID-19 epidemic
- 46.2 Landlords may take it as a sign that they do not have to accept a reduced rent during the COVID-19 epidemic, even if there is a clause in their agreement that allows for reduced rent.
- 47 These risks can be mitigated through clear guidance provided to businesses and commercial landlords about the proposed law changes.
- 48 The main benefit of these proposals is that they support businesses and commercial landlords to manage situations where they are unable to reach agreement on how to manage businesses being unable to pay their rent. Supporting businesses to stay solvent through the epidemic is key to New Zealand's economic recovery.

Publicity

- 49 I anticipate public announcements of the wider package of business support including of proposed law changes will be made in the coming weeks.
- 50 I propose to proactively release this briefing paper as part of those announcement so that businesses and commercial landlords are clear about the decisions that have been made, and timing of when it will take effect. Proactive release will be subject to any redactions that may be warranted under the Official Information Act 1982.

Consultation

- 51 Consultation has been necessarily limited by the urgency of this proposal and the short time to progress it. The Department of the Prime Minister and Cabinet (Policy Advisory Group), Crown Law, MBIE, HUD, the Parliamentary Counsel Office, the Treasury and the Reserve Bank have been consulted on these proposals.
- 52 My officials have discussed the proposals and their implementation with representatives of the New Zealand Law Society's Property Law Section.

Recommendations

The Minister of Justice recommends that the COVID-19 Ministerial Group:

- 1 **note** that the Property Law Act 2007 states that a landlord may cancel a lease 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, and the lessee does not remedy the breach by the end of the specified period;
- 2 **note** that the Property Law Act 2007 cover the requirements before a mortgagee can exercise powers of possession or sale when the mortgagor is default, and that they require the mortgagee to give 20 working days' notice to the mortgagor to remedy a default before the mortgagee can exercise their

IN C O N F I D E N C E

powers, when the mortgage is for land. For goods the notice period is 10 working days;

- 3 **agree** that the Property Law Act 2007 be amended to extend timeframes for the cancellation of commercial leases, 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;
- 4 **agree** that the Property Law Act 2007 be amended to 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;
- 5 **agree** that the amendments will come into effect in line with the following option:

EITHER

5.1 Option A: the extended timeframes only apply to any notices issued after the law receives Royal assent. This would have no retrospective effect and would only apply to a notice of a breach issued after the law comes into effect;

OR

5.2 Option B: the extended timeframes apply to any notices issued after the date the law change is announced;

OR

5.3 **Option C:** the extended timeframes apply to notices that were issued from 10 days after the promulgation of the Epidemic Notice;
- 6 **invite** the Minister of Justice to issue drafting instructions to give effect to the above proposals;
- 7 **agree** that the Minister of Justice be authorised to make additional minor policy decisions to assist with drafting, in discussion with the Minister of Finance as appropriate;
- 8 **note** that decisions on this paper will be part of public announcements on the wider package of business support from government.

Authorised for submission to the COVID-19 Ministerial Group

Hon Andrew Little

Minister of Justice