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Australia's property industry
Creating for Generations

12 October 2020

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By email: MCDInsolvency@TREASURY.GOV.AU

Corporations Amendment (Corporate Insolvency Reforms) Bill 2020

The Property Council welcomes the opportunity to opportunity to respond to the draft *Corporations Amendment (Corporate Insolvency Reforms) Bill 2020.*

As you would be aware the Property Council initially held some concerns that reforming insolvency laws in Australia during the pandemic could further harm landlords who have already been providing relief to tenants under the Code. Landlords, especially small, private landlords, are simply unable to wear any more debt while supporting tenants, as Deloitte has already noted, the extension of the Code of Conduct will have an estimated "*cost to commercial landlords (of)…. $14.9 billion over an 11-month period.*" [1]

However, we were pleased to see that the proposed reforms negate this issue by only allowing proponents to utilise the insolvency trigger once in seven years. We also believe that only allowing businesses with debt liabilities of up to $1 million strikes the right balance and allows institutional landlords to avoid a mass exodus of tenants from long-term leases.

The Property Council has consulted with its members, both the large institutional property owners and smaller, private landlords on the proposed changes. Our large members believe that the proposed reforms will be unlikely to impact them negatively, as long as the drafting has no unintended consequences.

Our smaller landlords likewise do not appear overly concerned that they will see a rush of insolvencies, as they believe small business owners only declare bankruptcy as an absolute last resort. That said, the Property Council will continue to monitor the impacts of the new insolvency regime on private landlords (many of them small business owners themselves) once the changes come into effect in January 2021.

Insolvency reforms – the current state of play

It is acknowledged that the current insolvency laws in Australia are due for a review. The current system does not lend itself to negotiated timeframes for small and medium sized businesses to work with creditors over a longer term, to negotiate repayments or to work with landlords to ensure that rents are paid and leases negotiated in a meaningful way when the business may be facing a downturn.

Commercial owners are motivated to support their small business tenants as their viability is essential to their own business survival. Retention of existing tenants will remain a priority for owners in the business conditions that are likely to prevail across Australia for some time.

The default position of involuntary administration does not benefit either the debtor or the unsecured creditors and the administration process is adversarial at best.

The ownership makeup of Australian landlords

The proposed changes have been accepted by and large by institutional investors because their assets tend to have business tenants larger than the proposed $1 million cap the Government has committed too. For this reason, the new insolvency regime is likely to impact smaller private landlords outside of shopping centres and premium commercial buildings, whose tenants are made up of small and family businesses.

The Productivity Commission noted in its 2008 review[2] of the market in retail tenancy that of the approximately 290 000 retail leases in Australia only one-fifth or 60 000 leases were accommodated in shopping centres, meaning that approximately 230 000 retail leases were held in regional neighbourhood centres, strip malls or street frontages - the majority of which are held by small investors. These are the landlords who are at risk of an exodus of tenants once government support measures during COVID-19 have come to an end.

Further, the Productivity Commission noted that only around 1 percent of all retail lettable space is owned by large enterprises, with the remainder held by smaller landlords.

Retail is only one of many sectors in property that accommodate the approximately 823,000[3] small businesses in Australia. Leases in industrial, office, logistics and hospitality will make up the remainder of the small business sector.

It is key that the drafting of the new insolvency regime does not leave small, private landlords and investors, who own the majority of Australia's strip malls, suburban retail shops and hospitality venues, at a disadvantage. Their rights as creditors who have already provided relief to tenants for the better half of a year must take priority in all insolvency negotiations.

It is also important that regulations ensure that corporate groups are identified correctly so that companies are not structured intentionally to fall within this regime (for example different tenant entities for each lease, which could see large retail groups able to claim insolvency for each individual lease).

[2] https://www.pc.gov.au/inquiries/completed/retail-tenancies/report/retail-tenancy-market.pdf

[3] https://www.asbfeo.gov.au/sites/default/files/documents/ASBFEO-small-business-counts2019.pdf

It is also critical that companies registered in Australia that are part of large international corporate groups should not be eligible for the insolvency exemptions.

Working with landlords to get the balance right
To ensure that the change of the insolvency laws for small business move from creditor led to debtor led without harming small, private landlords and investors, the Government should be consulting and working in concert with the property sector to ensure that there are no unintended consequences.

The Explanatory Memorandum states that much of the reforms to insolvency will be contained within subsequent regulations, however this results in areas of ambiguity within the current legislation.

To that end our members are seeking clarity on the following points:

- Is the $1m cap a figure as at the day that the debtor lodges with the small business practitioner or will it include debts such as future rents and future liabilities as is the current practice?
- Related parties do not have voting rights as creditors. Do the debts owed to them count towards the $1million?
- What are the implications for director liability?
- The practitioner can determine that the company should not be eligible and stop the process. Will there be an ability for creditors to challenge the eligibility as well and stop the process if it is not appropriate? Under the current structure the only other protection is to vote against the plan which may not be successful.
- The current proposal has a twenty (20) day period for the applicant to submit a restructuring plan, however there is no provision for application for an extension by the applicant for more time to compile their restructuring plan. Will there be provisions for the applicant to apply for an extension of time? If so, will there be provisions for creditors to appeal any application for an extension?
- What will happen to suppliers who continue to supply goods during the 20+15 day period? Are payments guaranteed? If not, they will just refuse to supply and then we will have tenants with stocking problems
- Will there be provisions that tenants are required to pay commercial rent rated during the period?
- Who bears liability for the management of the plan, the SBRP? If so, are they acting in the interest of the company or creditors?
- Bonds and performance guarantees are considered a secured creditor provision even though they are issued by an unsecured creditor – i.e. pay the landlord to help pay for refit of premises should the tenant vacate the space. Will those debts be made good to the unsecured creditor during the pre-administration phase?
- Will landlords be compelled to offer further rent relief during the restructuring plan?
- What are the implications for termination of leases during the restructuring plan?
- Will there be provisions for leases to be modified to reflect the new operating structure and will those provisions provide flexibility for landlords to terminate leases if the debtor breaches their lease covenants?

Case Study

Gary and Beth own a two- storey terrace in Ftizroy which they purchased as an investment property for their retirement portfolio with the aim of selling the investment property when they reach retirement in age.

The top floor is a two- bedroom flat which is leased out as residential and the ground floor is leased out to a small business owner who operates a gym. The gym owner signed a lease in 2018 for three years with an expiration date in May 2021.

Between the two rents Gary and Beth receive they have been able to cover the majority of their mortgage, effectively making their investment cash neutral, meaning they can concentrate their incomes into paying off the mortgage on their home.

During the Covid-19 pandemic the gym was shut down due to the enforced lock-down and as such the gym owner, with falling revenue of over 30%, applied for rental relief under the National Commerical Code of Conduct.

Gary and Beth applied for some relief from their lender in relation to interest on their loan, however the lender still requires regular monthly payments on the mortgage on the investment property as well as Gary and Beth's home.

In January, the gym owner applies for insolvency protection and has a restructuring professional appointed to form a plan for the gym to trade its way out of financial stress.

The gym's major secured lenders are their bank and the ATO who between them cover the majority of debt by value of the business and hence, under the new Act, have the final decision on the viability of the restructuring plan. After being approached by the restructuring professional a restructuring plan is approved by the majority of creditors by value that the gym can continue to operate for a period of eighteen months to attempt to trade itself out of financial stress.

Gary and Beth meanwhile have been approached by another gym owner, this time a franchisee of a major gym network who are looking to expand their business and are seeking a three-year lease and provide Gary and Beth with increased rent.

Can Gary and Beth terminate their lease with their current tenant and enter into a new lease with a new tenant as the current lease is due to expire, or are Beth and Gary bound to the agreed eighteen month restructuring agreement?

The above questions require clarification so that landlords can begin to ready themselves for the new regime, which is rapidly approaching.

The Property Council would like to offer the assistance of our expert industry members to Treasury, to assist in the drafting of these important laws. We would be happy and able to pull together a panel of experts, which includes overseas practitioners with specific experience with Chapter 11, to ensure that the new regime strikes the right balance.

We would welcome the opportunity to discuss these matters with Treasury in more detail.

Should you wish to arrange a time to meet with us please contact myself or Collin Jennings – Policy Manager Capital Markets on 0413 472 189 or at cjennings@propertycouncil.com.au

Yours sincerely

Torie Brown
(Acting) Executive Director
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