DREW & NAPIER

The Fair Tenancy Code of Conduct: Key terms for new leases

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LEGAL UPDATE

In this Update

The Ministry of Trade and Industry has called for public feedback on legislation to mandate compliance with the Code of Conduct for Leasing of Retail Premises in Singapore ("**Code**"). The Code was introduced by the Fair Tenancy Industry Committee ("**FTIC**") in 2021. It has so far been voluntarily adopted by all Government landlords, and 8 private landlords.

This article highlights the key revisions that all landlords would have to make to their tenancy agreements in order to comply with the Code if and when it becomes law.

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INTRODUCTION

KEYPOINT

The key objectives of the Code are in essence, to bring about increased fairness to the realm of commercial leases, to balance the bargaining positions of landlords and tenants, and to provide a framework to foster a long-term partnership between the parties.

With the Government's proposal to legislate compliance with the Code, it may no longer be voluntary for landlords to adopt the Code in their practices. That means that tenancy agreements would need to be revised and leasing practices would need to be reviewed.

The Code applies to Qualifying Retail Premises ("**QRP**") defined as premises held under a lease entered on or after 1 June 2021 with a tenure of at least one year, and approved by the Urban Development Authority for use as restaurants, bar/pub, restaurant and bar, nightclub, shop, medical or dental clinic, pet shop or pet boarding, commercial school, childcare centre, sports and recreation, and place of entertainment. QRP would thus include, for instance, all food and beverage outlets, nightlife outlets, retail shops, services shops such as hairdressers and money changers, schools as well as tuition and enrichment centres, gyms, gaming centres, and cinemas.

The Code further provides that it applies, without limitation, to all QRP in shopping centres, office buildings, industrial and business parks, mixed-use developments, shop house and shop flats, hotels, community centres, recreation and social clubs, museums, schools, hospitals, petrol kiosks, MRT stations, bus interchanges and airports.

If the proposed legislation is passed, therefore, most commercial landlords would need to ensure compliance with the Code. This article highlights the key revisions that would need to be made to tenancy agreements in order to comply with the Code.

KEY MANDATORY TERMS

No exclusivity

Tenancy agreements frequently contain a clause preventing or restricting the tenant from opening a branch or franchise within a defined radius of the tenanted premises. Such "exclusivity clause" is prohibited under the Code and must be removed from all tenancy agreements. Any exclusivity clause

that prevents or restricts the landlord from leasing premises to competing businesses in the same building must also be removed.

Costs

The Code mandates certain requirements as to cost for specific areas, namely:

- in relation to the integration of a tenant's point-of-sales ("**POS**") system with the landlord's POS system (usually for the purposes of the landlord gaining access to the tenant's sales reports to calculate rent based on gross turn over ("**GTO Rent**")), the costs must be split equally between tenant and landlord in most circumstances;

- in relation to the legal costs of preparing the lease agreement, the landlord must provide a tenancy agreement that is compliant with the Code at its own costs and cannot impose such costs on the tenant, who shall pay the legal or admin costs of the landlord (but not both) only if amendments, to which compliance with the Code is not relevant, are requested by the tenant;

- in relation to third-party costs in general, the tenancy agreement must not include a "catch-all" clause requiring the tenant to pay unspecified and generic costs and instead, all third-party costs must be clearly set out in the tenancy agreement;

- in relation to sales audits, the landlord shall only be permitted to request for an audit if the tenancy agreement provides for (a) GTO Rent, and (b) the landlord's right to request for audit, and costs of such an audit must be split equally between the parties;

- in relation to public liability insurance, the landlord must not require the tenant's insurance coverage to exceed S$3 million or the landlord's own coverage, whichever is lower; and

- in relation to electricity, if the landlord purchases bulk electricity pursuant to the en-bloc contestability scheme, the landlord must charge tenants electricity costs calculated by usage on the same rates payable by the landlord without any mark-ups, price discrimination between tenants, and infrastructure or other extra fees besides reasonable administration costs.

Ancillary Charges

Gross rent often includes an advertising and promotion charge and a service charge where the lease premises are located in malls or other building with common facilities. While the landlord is permitted to adjust these charges during the term of lease, the landlord must ensure that any such adjustment does not cause the gross rent to increase. The landlord

must also keep proper records and accounts in respect of the charges imposed on and collected from tenants.

Pre-termination by landlords

One of the hallmarks of the Code, is the regulation of circumstances in which a landlord has the right to pre-terminate the lease for redevelopment works ("**LL Pre-Termination Right**"). Prior to the Code, a lease could be pre-determined on the pretext of redevelopment without compensation or justification to the tenant. To correct this obvious imbalance, the Code requires that, for a landlord to acquire a LL Pre-Termination Right, the tenancy agreement must contain provisions granting the landlord such a right in accordance with the Code's conditions.

Under the Code, the LL Pre-Termination Right exists only in relation to "substantial redevelopment, asset enhancement or reconfiguration works" where vacant possession of the leased premises is necessary to carry out these redevelopment works. Landlords must give 6 months' notice when exercising the LL Pre-Termination Right.

Significantly, where the LL Pre-Termination Right is exercised, the tenant is entitled to compensation based on the value of capital expenditure less "salvageable items" ("**Capex**") expended by the tenant on fitting out the leased premises. Parties are required to agree on the Capex value for the purposes of compensation either during the initial term or any renewed term, if there is Capex incurred during the renewed term. Compensation must take into account depreciation of the Capex.

The Code sets out the process for parties to agree on the relevant Capex value.

No other circumstances give landlords a right to pre-terminate a lease. Specifically, the Code prohibits tenancy agreements to impose a clause that entitles the landlord to pre-terminate a lease due to poor sales performance by the tenant. The landlord has no right to make a tenancy agreement contingent on stipulated sales targets.

When a lease is terminated pursuant to the LL Pre-Termination Right, the tenant shall not be required to reinstate the leased premises, provided that the tenant removes all movable items and returns the premises in a clean state.

Pre-termination by tenants

Conversely, a tenant may acquire a right to pre-terminate the lease for loss of sales or brand viability ("**TT Pre-Termination Right**"). The tenancy agreement must contain provisions granting the tenant such a right in accordance with the Code's conditions.

Under the Code, the TT Pre-Termination Right is premised on the occurrence of either (a) the insolvency of the business principal from whom the tenant obtains the right to sell the goods or provide the services at the leased premises, or (b) the loss of tenant's distributorship or franchise to sell the goods or provide the services at the leased premises. In relation to the latter, such loss of distributorship or franchise cannot be due to the tenant's default. Tenants must give 6 months' notice when exercising the TT Pre-Termination Right.

A tenant exercising the TT Pre-Termination Right must compensate the landlord with a sum equivalent to the security deposit for the lease premised. The tenant must also reinstate the leased premises in accordance with the tenancy agreement.

Security deposit

The amount of security deposit that can be imposed is capped at the equivalent of 3 months gross rent where the leased premises is not more than 5,000 square feet with a lease term of no more than 3 years.

The landlord must accept half the security deposit provided in non-cash modes, if the tenant notifies the landlord prior to signing the lease, of the intention to not provide the security deposit fully in cash. An example of non-cash security deposit comes In the form of a bankers' guarantee.

The Code prohibits tenancy agreements from including a catch-all clause stating that the tenant's directors, shareholders, employees or any persons are personally liable for the tenant's default. Unless a personal guarantee is provided on the security deposit, the landlord is not entitled to impose personal liability on those related to the tenant by contract.

Surveyed area

A registered surveyor's certificate to confirm the surveyed area of the leased premises must be provided by the landlord prior to handover. For redeveloped buildings, a re-survey must be conducted to obtain such a certificate.

If the certificate shows that the floor area is larger than that specified in the tenancy agreement, there shall be an upward adjustment of rent based on the difference but capped at a 5% increment. If the floor area surveyed is smaller that that stated in the tenancy agreement, there shall be a downward adjustment of rent based on the difference if the difference is 10% or less. If there difference is more than 10%, each party has the right to terminate the tenancy agreement without liability, by giving a month's written notice to the other party. If neither party terminates the lease, the rent shall then be adjusted downwards based on the surveyed floor area.

If termination by either party occurs prior to hand-over, no reinstatement by the tenant shall be required and the landlord shall refund all monies paid by

the tenant. If termination by the landlord occurs after the tenant has taken possession, no reinstatement may be required and the landlord must refund all monies paid by the tenant and compensate the tenant for Capex incurred. Conversely, if the tenant terminates the lease after taking over the premises, the tenant must reinstate the premises.

All rent adjustments in relation to surveyed area must be made within 2 months of the landlord furnishing the tenant with the certificate.

Building maintenance

The tenancy agreement must contain an obligation on the landlord to maintain the building or the part of the building (if the landlord only owns part of the building) where the leased premises are located. The landlord shall also be liable for any loss or damage suffered by the tenant due to gross negligence or wilful default in relation to the landlord's building maintenance.

It bears here to note that the costs of any building infrastructure necessary for the landlord to participate in the en-bloc contestability scheme for electricity, must be borne by the landlord and cannot be passed on to the tenant.

Rental structure

Importantly, the Code prohibits rental structures that use the "either/or, whichever is higher" formula with regards to base rent and GTO Rent. All rental structures must be calculated as a single computation, that is, base rent plus GTO Rent (if any). Landlords shall no longer be allowed to benefit from the upside of a tenant's business without subsidising its downside, by asking for rent to be either base rent or GTO Rent, whichever is higher.

GUIDING PRINCIPLES

Good faith

The principles of good faith shall apply to tenancy agreement negotiations. This includes acting honestly, transparently and fairly, observing acceptable and reasonable commercial standards of fair dealing. Unfair profiteering from or advantage over the other party does not accord with good faith.

Specifically, deliberately or negligently misleading the other party by misrepresenting facts or concealing facts is an example of acting in bad faith.

Costs

As general principles, both parties must be transparent as to any costs charged to the other party, and fees charged to the other party must be legitimate and justifiable as real costs of work incurred, without any profiteering, that is, without a mark-up. That means tenancy agreements must not contain ambiguous provisions relating to the recovery or bearing of costs.

Independent advice

Tenants must conduct their own due dilligence to review the tenancy agreement. Landlords may not dictate who a tenant appoints as legal counsel.

Contractual freedom

The Code upholds parties' freedom to contract by permitting certain clauses to be deviated from as long as a joint declaration by both parties in lodged with the FTIC in accordance with the Code.

Data transparency

Where a landlord collects sale data from its tenants as part of a GTO Rent structure, such sales data must be shared by trade category with potential tenants before the lease is signed, and bi-annually after the lease is entered into, unless there are less than 3 tenants in a particular trade category.

Confidentiality

Any confidentiality obligations contained in a tenancy agreement must be mutual and reciprocal between the parties.

Compliance

The Code requires landlords to provide tenants with tenancy agreements that comply with its requirements. These must be provided at the landlord's own costs. If a tenant requests revisions to a tenancy agreement in order for that agreement to be compliant with the Code, the landlord must bear the costs of these revisions. A checklist showing compliance with the Code, in the form of Appendix 1 of Part D of the Code, must be provided by the landlord at the same time as the first draft of the tenancy agreement is provided to the tenant.

At present, non-compliance with the Code by either party during negotiations may be referred to the FTIC who may "name and shame" the party in default. After the tenancy agreement is signed, any non-compliance with the Code may be referred to the Singapore Mediation Centre. It

remains to be seen if these provisions will be amended by legislation to better reflect the legal force of the Code when it passes into law.

NEXT STEPS

The public consultation period ended on 5 August 2022. As the leasing industry awaits the outcome of consultation and the recommendations that may follow, all QRP landlords should be prepared to revise standard tenancy agreements to comply with the Code, and tenants should familiarise themselves with their rights and obligations under the Code.

If you require any advice on the Code, please feel free to reach out to us.

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