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Real Estate

**Schellenberg
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Rent Increases and Decreases

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Key Take-aways

- 1.** In a recent decision, the Swiss Federal Supreme Court has changed its previous practice: A surcharge of 2% to the reference interest rate is now permissible for the net return as long as the reference interest rate is equal to or below 2%.
- 2.** According to the Zurich District Court of First Instance, impairments to the tenant's business caused by the government measures to fight the COVID 19 pandemic do not constitute a defect in the leased property.
- 3.** Where the initial rent includes a surcharge of "significantly more than 10%", it is presumed abusive. Further, the standard of reasonable doubts to refute the presumption was lowered.

1 Introduction

In recent years, a number of court rulings have been issued on rent increases or reductions, particularly in connection with business closures due to Covid measures. In addition, political efforts are underway to reform this area of tenancy law. This newsletter provides an overview of the legal framework and recent developments.

2 Rent Increases

2.1 Legal Framework

In principle, a landlord is **free to increase the rent** in an ongoing tenancy. The landlord must notify the tenant of the rent increase at least ten days before the start of the notice period on a form approved by the canton, and provide reasons for such increase. The rent increase is **null and void** if the landlord fails to comply with these requirements. The same applies if the landlord threatens to give - or gives - a notice of termination at the same time as the notification.

In the case of residential and commercial premises (with the exception of holiday homes, luxury apartments, publicly subsidized apartments), the tenant may **challenge the rent increase if it is abusive**. A rent increase is abusive if it leads to an abusive rent. A rent is abusive if it results in a **excessive return of investment** from the rental property or if the **low return on investment** is based **on an obviously excessive purchase price**. As a rule, rents are not abusive if, in particular, (i) they are within the range of the usual rents in the locality or neighborhood; (ii) they are justified by cost increases or additional services provided by the landlord; (iii) in the case of newer buildings, they are within the range of the cost-covering gross yield; or (iv) they merely compensate for inflation on the risk-bearing capital. The **purchase price is excessive** if it is 10% or more above the income value of the property. The capitalized income value is determined by capitalizing rents of comparable properties (i.e., not the actual rents of the building) that are customary in the locality and neighborhood. If the landlord wants to justify the rent increase with reference to the higher rent customary in the locality or neighborhood, he/she must present at least **five properties of the same size, location, equipment, condition and age with a higher rent**. The properties must not belong to the landlord who wishes to increase the rent.

In case of a **fixed rental period or a minimum rental period**, the rent can only be increased before the expiry of the fixed rental period or the minimum rental period if this has been contractually agreed. The law provides for the indexation or staggered rent for increases during the fixed rental period or a minimum rental period. In the case of indexation, the lease agreement must be binding on the landlord for a period of at least five years and an adjustment is only permitted in accordance with the development of the national consumer price index. An **early termination by the tenant** is possible. A staggered rent is only permitted if (i) the lease is concluded for at least three years, (ii) the rent is increased no more than once a year and (iii) the amount of the increase is fixed in francs. A **combination of indexation and staggered rent is not permitted**.

In addition, the parties usually contractually agree that increases in the event of new charges incurred or additional

services provided by the landlord during the fixed rental period or the minimum rental period are **also possible without taking into account the termination dates**, which is permissible according to case law and doctrine.

2.2 Recent Case Law

Pursuant to previous case law, a rent was abusive if it resulted in a net return on investment of more than **0.5% above the reference interest rate** (see Section 3.1). The net return on investment is the ratio of the net income to the equity capital invested. The net income is equal to the net rental income (excluding compensation for ancillary costs) minus expenses. The expenses, in turn, include all actual mortgage interest, management costs, and maintenance and operating costs not covered by the tenants. In **decision 4A_554/2019 of 26 October 2020**, the Federal Supreme Court changed its previous practice: Now, a **surcharge of 2% to the reference interest rate is permissible** as long as the reference interest rate is equal to or below 2%.

**A rent is abusive
if it generates
an excessive income.**

3 Rent Reductions

3.1 Legal Framework

The tenant may challenge the **initial rent as abusive** with the conciliation authority within 30 days of taking possession of the property and request a reduction if (i) the tenant felt compelled to enter into the agreement because of personal or family hardship, or because of the conditions in the local market for residential and commercial premises; or (ii) the landlord substantially increased the initial rent from the previous rent for the same property.

A tenant may request a rent reduction at any time **during the term of the lease** with effect from the next possible termination date if he has reason to believe that the landlord is earning an excessive return on investment from the rented property. In other words, if the rent has become abusive due to a significant change in the basis for calculation, in particular due to a reduction in costs. In particular, a **reduction in the mortgage interest rate** is deemed to be a reduction in costs. For rent adjustments due to changes in the mortgage interest rate, the mortgage reference interest rate as determined by the Federal Government applies. A reduction in the reference interest rate of 0.25% generally entitles to a reduction of 2% if the mortgage interest rate is more than 6%, of 2.5% if the mortgage interest rate is between 5% and 6%, and of 3% if the mortgage interest rate is less than 5%. However, the landlord may offset the cost savings resulting from the reduction of the reference interest rate against cost increases that

have occurred (since the conclusion of the lease or the last adjustment). In this case, the rent reduction claim is reduced accordingly. If a rent reduction is granted in full, the landlord must expressly reserve the right to claim any other cost increases at a later date.

If the suitability of the property for the intended use is impaired or lowered during the rental period due to defects, the tenant may demand a rent reduction from the moment the landlord became aware of the defect until the **defect** is remedied, and this regardless of the fault of the landlord.

Finally, a tenant may demand a rent reduction if this has been **contractually agreed**, so in particular if the parties have agreed on **indexation** and the index falls. Lease agreements usually provide that the landlord may, but is not obliged to, adjust the rent in the event of a change in the index. This means that in the event of index reduction, the landlord is not obliged to grant a reduction.

Based on general contract law, the lease agreement and thus the obligation to pay rent ends if the performance of the service becomes permanently **impossible**. A final adjustment is possible if the **circumstances** have **unexpectedly changed to such an extent** that the originally agreed exchange ratio is no longer appropriate (*clausula rebus sic stantibus*).

The question was whether a closure due to Covid constituted a defect of the leased premises.

3.2 Recent Case Law

3.2.1 Reduction of Initial Rent

Based on the previous practice of the Federal Supreme Court, there was a presumption of abusiveness in the event of a **substantial increase of the rent**. In such case, the tenant could demand a rent reduction. It was up to the landlord to prove that the rent increase was not abusive. If the increase was not substantial, the tenant had to prove the abusiveness. However, it was unclear which increase qualified as substantial. In its decision 4A_183/2020 of 6 May 2021, the Federal Supreme Court indicated that abusiveness is now only presumed in case of an increase of "significantly more than 10%". Further, the standard of reasonable doubts to refute the presumption was lowered. Consequently, non-official statistics, three to four comparable properties (instead of four to five comparable properties), or a long rental period of the previous tenant may be sufficient.

3.2.2 Reduction Due to Covid Measures

In the context of Covid with the mandatory closures of shops and restaurants, the question arose whether such closures constitute a **defect of the rental property** which renders the

rental property completely unusable, and therefore justifies a rent reduction of 100%. It was further discussed that the Covid restrictions do not constitute a defect but are a fundamental change in the circumstances which could not have been foreseen by the parties at the time they entered into the lease agreement (*clausula rebus sic stantibus*). Finally, it was considered whether this was a case of impossibility because the landlord was not able to fulfil its obligation to provide usable premises, and therefore no rent was owed.

In a decision of **30 March 2020**, an **arbitration court** in Lucerne found that closures due to Covid qualify as a defect of the property, that there was a disproportion between the rent and the right to use the property, and that a rent reduction of 60% was appropriate. In a first-instance **ruling of the Zurich District Court of 23 April 2021**, the court did not exclude a rent reduction based on the *clausula rebus sic stantibus*.

However, in **decision MJ210008-L of 2 August 2021**, the **Zurich District Court** of First Instance ruled that in a lease agreement "as a general rule, the agreed quality of the leased property only relates to property-related conditions and not also business-related conditions." Furthermore, the Zurich District Court held that the landlord only undertook to "provide, for a consideration, premises in which the tenant can carry on his business - this business, however, unless otherwise agreed, is not part of the lease, but exists independently of it and is part of the legal sphere of the tenant." Pursuant to the Zurich District Court, the impact of the governmental measures to fight the pandemic on the tenant's business does **not** constitute **a defect in the leased property**.

The court also held that, in the absence of continuity, there was **no case of impossibility**. Finally, the court considered whether there was a case of *clausula rebus sic stantibus*. The court did not rule this out. In particular, it left open the question whether the official closures were sufficiently unexpected. **However**, this **argumentation was also rejected by the court in the case concerned**, as the tenant did not sufficiently prove the extent to which the relatively short-term closure of the business had affected him (for example, by disclosing the business books). Overall, at least in the case concerned, the Zurich District Court rejected a reduction of the rent due to the Covid measures. The decisions taken by the courts in other cases will depend on the specific contractual clauses as well as the effective - or at least possible - use of the premises during the official closure in the cases in question.

4 Conclusion

The latest decisions of the Federal Supreme Court and the District Court of Zurich regarding rent increases and rent reductions are rather landlord-friendly. At least in the question of rent reductions in the case of closures due to Covid, the question arises as to how the higher instances will decide. Political efforts regarding rents tend to be tenant-friendly. These include the (Carlo) Sommaruga and Badran parliamentary initiatives, which call for a periodic review of yields, and the Töngi parliamentary initiative, which proposes that the proportion of value-enhancing investments (which entitle to rent increases) be reduced in the case of renovations. It remains to be seen which trend will prevail.



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