

Real Estate - Switzerland

Rules on Rent Adjustments to Residential and Commercial Leases Reviewed

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Introduction

The Swiss Code of Obligations and the Ordinance on the Lease and Usufructuary Lease of Residential and Business Premises contain restrictive provisions limiting contractual freedom to adjust the rent in lease agreements for residential and commercial leases. The parties must choose between the following three options:

- Under the basic system, the rent may be adjusted in case of a cost increase and, in particular, in case of an increase in the applicable mortgage interest rate. Thus, a 0.25% increase or reduction in the mortgage interest rate entitles a maximum corresponding rent increase or reduction of between 2% and 3%. Further, the rent may be increased in accordance with fluctuations in the Consumer Price Index and by 1% a year for increases in other costs.
- The parties may agree on an index-linked rent following fluctuations in the Consumer Price Index, but only if the landlord cannot terminate the lease for a minimum duration of five years. In such cases the rent is usually adjusted annually according to a formula following the index.
- The parties may agree on a staggered rent if the lease agreement is for a minimum duration of three years. In such cases the rent may be adjusted once a year by a specified amount which is determined in the lease agreement.

The first option is the only possible way to adjust the rent in lease agreements without a minimum duration and is customarily included in lease agreements for residential premises. The second option is customarily included in medium to long-term lease agreements for business premises.

Outside of these options, a landlord may increase the rent only if it makes improvements to the building or under certain other specific (and rare) circumstances.

Changes

With effect from January 1 2008 the Ordinance on the Lease and Usufructuary Lease of Residential and Business Premises was revised, in particular with respect to the reference mortgage interest rate and energy improvements to buildings.

Reference mortgage interest rate

Until December 31 2007 the relevant mortgage interest rate entitling to a rent adjustment under the system described under the first option above was the first ranked variable interest mortgage rate of the cantonal bank at the location of the property. Switzerland has 26 different cantons, each with a cantonal bank which publishes different reference mortgage interest rates at different times. In the last 25 years cantonal variable interest mortgage rates have fluctuated between around 3% and 7% (the latter in the early 1990s).

To simplify the procedure for obtaining the reference mortgage interest rate, the revised ordinance provides that a single reference mortgage interest rate for the whole of the country is published on a quarterly basis by the Federal Department of Economic Affairs. The mortgage rate is calculated by the Swiss National Bank based on the weighted average interest rate of Swiss franc mortgages granted by Swiss banks for properties in Switzerland, thereby also taking into account other types of mortgage such as fixed-rate mortgages and London interbank offered rate mortgages. The reference mortgage interest

rate is adjusted only if the average value of the relevant mortgages varies by at least 0.25%. The rate is published on a quarterly basis.

The new reference mortgage interest rate was published for the first time on September 10 2008 and was fixed at 3.5%, which corresponds to the previous reference mortgage interest rate in all cantons except Berne and Geneva. In these two cantons rents may therefore be increased by 3%, while the introduction of the new nationwide reference mortgage interest rate triggers no rent adjustments in the rest of the country.

Energy improvements to buildings

The new legislation provides that the following energy improvements are considered value-enhancing investments:

- measures for the reduction of energy losses through the building envelope;
- measures for more efficient energy use;
- measures for reducing emissions from technical installations;
- measures for the use of renewable energies; and
- replacement of high-consumption appliances with low-consumption appliances.

Only those costs which exceed the costs of repair or maintenance qualify as value-enhancing investments. Before the entry into force of the new provisions, it was often questionable whether energy improvements qualified as value-enhancing investments entitling the landlord to increase rent. The revision aims to encourage landlords to effect energy improvements to buildings which are also in the interests of tenants in view of likely savings on heating costs.

Outlook

After many years of calls for simplification of the system, in 2007 the landlords' and tenants' associations agreed in principle to uncouple rent from mortgage interest rates and switch to a system of index-linked rent based on the Consumer Price Index. Such a change would require the revision of the Swiss Code of Obligations, which would have to go through the legislative process in Parliament. On September 19 2008 the Federal Council instructed the Federal Department of Economic Affairs to draw up a draft for revision. However, the consultation process in drafting this revision has already revealed that opinions on certain details remain divergent. Therefore, if the revision passes the sessions in Parliament and a possible referendum occurs, any changes are unlikely to enter into force before 2011.

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