

Commercial Property - Switzerland

Falling Reference Mortgage Interest Rate May Trigger Requests for Rent Reduction

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Introduction

As in many other countries, in Switzerland the measures taken to mitigate the consequences of the financial crisis have led to falling credit interest rates. Since 2008 a Switzerland-wide reference mortgage interest rate has been published quarterly by the Federal Housing Office. This rate forms the basis for requests by landlords or tenants for rent increases or reductions. The reference rate is calculated based on the weighted average interest rate of all variable, fixed interest rate, London interbank offered rate or other Swiss franc mortgages granted by Swiss banks for properties in Switzerland. According to a Federal Housing Office communication dated June 1 2009, the relevant average mortgage interest rate fell from 3.43% in September 2008 to 3.07% as of March 31 2009. Pursuant to the Ordinance on the Lease and Usufructuary Lease of Residential and Business Premises, the reference mortgage interest rate is adjusted if the average mortgage interest rate varies by 0.25%. Accordingly, this leads to a reduction of the applicable reference mortgage interest rate from 3.5% to 3.25%. This reduction became effective on June 3 2009.

Rules on Rent Reduction

The rules of the Code of Obligations and the Ordinance on the Lease and Usufructuary Lease of Residential and Business Premises on rent adjustments in lease agreements for residential and commercial leases provide that tenants may request a rent reduction if there is a significant change in the basis of the calculation of the rent, in particular because of a decrease in the landlord's costs, including mortgage interest costs. In such situations the law entitles the tenant to challenge the rent as abusive as per the next possible date of termination of the lease.

Since a reduction may be requested only as per the next termination date, only lease agreements of indefinite duration are affected. Customarily, this is the case for lease agreements for residential premises; lease agreements for business premises are often concluded for a minimum duration of five years. In such cases the rent is usually linked to the Consumer Price Index and, therefore, no rent reduction may be requested as a consequence of a falling reference mortgage interest rate.

Under the existing circumstances, a reduction in the reference mortgage interest rate by 0.25% may entitle a tenant to a rent reduction of approximately 3%. However, to the extent that rent has not been increased in the past, the landlord may offset a rent reduction with:

- any increase in other costs;
- 40% of the increase in the Consumer Price Index; and
- any rent increase in case of investments for value-enhancing improvements to the building.

Furthermore, the landlord may claim that it does not receive excessive return from the rental property. While tenants' associations claim that rents must now be reduced, landlords' associations believe that rent reductions will be justified only in a limited number of cases, since in the past many landlords have not increased rent as they could have done. Such landlords will be permitted to offset the current grounds for reduction against past grounds for a rent increase.

Formally, the tenant must file a written request for a rent reduction to the landlord which must respond within 30 days. If the landlord does not comply with the request or does

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not reply within the time limit, the tenant may appeal to the Conciliation Authority within a further 30 days. The landlord must receive the written request before lapse of the notice period for termination – usually three months for residential premises and six months for business premises. Many lease agreements have only two possible termination dates – the end of September and the end of March. In those cases tenants would have to make their requests before the end of June 2009 in order for the rent reductions to become effective at the earliest possible date.

Outlook

In 2008 it seemed that the existing, rather complex rent adjustment system could be overcome after the landlords' and tenants' associations had agreed in principle to uncouple rents from mortgage interest rates and to switch to a system of index-linked rents on the basis of the Consumer Price Index (For further information please see "[Rules on Rent Adjustments to Residential and Commercial Leases Reviewed](#)").

However, in May 2009 the National Council viewed the proposed changes unfavourably because it considered that a switch from a cost rent system to an index rent system would be unrealistic from a political perspective. After the landlords' and tenants' associations had come to a compromise and agreed, in principle, a system change, the Federal Council proposed an amendment of the proposal to the disadvantage of landlords by excluding rental and energy costs from the calculation of the Consumer Price Index. Following this proposal the landlords' associations no longer felt bound by the compromise and there was also criticism from the tenants' association.

It seems unlikely that the second chamber of the Swiss Parliament, the Council of States, will succeed in convincing the tenants' and landlords' associations to reach agreement in this regard.

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