

# NEWSLETTER

## May 2008

# SCHELLENBERG WITTMER

Attorneys-at-Law

## Revision of the Ordinance on the Lease and Usufructuary Lease of Residential and Business Premises (OLRB)

The Swiss Federal Council revised on 28 November 2007 the Ordinance on the Lease and the Usufructuary Lease of Residential and Business Premises dated 9 May 1990 (OLRB). The revision came into effect on 1 January 2008. This Newsletter sets out the situation until 1 January 2008 and the three modifications made by the Swiss Federal Council, namely: 1. introduction of a single reference mortgage rate for the whole of Switzerland; 2. the possibility for the landlord to increase the rent in case of energy improvements works carried out at the building; and 3. clarifications regarding the possibilities to index the rent of residential premises to the development of the Swiss Consumer Price Index (SCPI).

### 1 Introduction

The OLRB dated 9 May 1990 was issued by the Swiss Federal Council on the basis of the Swiss Code of Obligations (CO) and came into effect on 1 July 1990. This Ordinance contains the implementing provisions of the CO chapter relating to the lease. The provisions of this Ordinance also apply to the usufructuary lease.

The OLRB especially includes regulations regarding ancillary costs (in particular costs to be included in the heating expenses), the elements to determine the rent in line with the usual rent of the neighborhood or the municipality and the requirements to the form for the notification of rent increases to tenants.

### 2 Reference Mortgage Rate

#### 2.1 Situation before 1 January 2008

Until 1 January 2008, the relevant interest rate for the adjustment of the rent was the interest rate of the cantonal bank at the place of the property for 1st ranking mortgages with variable interest rates (i.e. mortgages whose interest rate can be changed at any time upwards or downwards).

As a consequence, 26 reference mortgage interest rates coexisted. The changes of the rates were published by each cantonal bank at different times.

According to the development of the applicable mortgage rate at the place of the property, the parties were authorized to request the adjustment of the rent pursuant to the following method: an increase of the mortgage rate by 0.25 percent entitles, in general, to a maximum rent increase of:

- I 2%, if the mortgage rate exceeds 6%;
- I 2.5%, if the mortgage rate ranges between 5 and 6%; and
- I 3%, if the mortgage rate is lower than 5%.

The rent had to be reduced according to the reduction of the mortgage rate, unless the mortgage rate reduction was set off by an increase of other costs relating to the property.

On the one hand, if the mortgage rate amounted to 3% at the time of the conclusion of the lease agreement and to 5% at the time of the rent increase notification to a tenant, the landlord would have been entitled to a rent increase by 24%.

On the other hand, if the mortgage rate amounted to 5% at the time of the conclusion of the lease agreement and to 3% at the time of the tenant's request for a rent reduction, the tenant would have been entitled to a rent reduction of 19.35%. This could have been set off fully or partly by the development of the Swiss Consumer Price Index and an increase of the annual expenses relating to the property.

#### 2.2 Revision of the OLRB

The revision of the Ordinance introduced a single reference mortgage rate for the whole of Switzerland and to the abolishment of the 26 rates published by each cantonal bank.

Contrary to the system prior to 1 January 2008, the reference mortgage rate is no longer calculated on the basis of the variable rate for mortgages. Mortgages with variable interest rates have become less common and represent as of today only approximately 15 to 20 % of the total volume of the mortgages granted in Switzerland. The reference mortgage rate is based on the weighted average interest rate of Swiss Francs mortgages granted by Swiss



banks for properties in Switzerland. This new calculation method takes into account other existing forms of financing (mortgages with fixed interest rate, LIBOR mortgages etc) and reflects more accurately the current mortgage market trends.

The Ordinance provides that the rate is published on a quarterly basis by the Federal Department of Economy (DFE). However, although the Ordinance came into effect on 1 January 2008, taking into account the time the Swiss National Bank requires to gather the data enabling it to calculate the reference mortgage rate, said rate is expected to be published for the first time at the earliest on 1 September 2008. Pursuant to information of the Federal Office of Housing, these data will be gathered for the first time by the Swiss banks by 30 June 2008 and then communicated to the DFE.

The Department issued an ordinance dated 22 January 2008 regarding the determination of the reference mortgage rate (Ordinance on the Mortgage Rate). This ordinance came into force on 1 February 2008. It provides for a definition of the reference mortgage rate, specifies the method to gather the data and regulates the publication of the reference mortgage rate.

The calculation of the rent increases and decreases pursuant to the development of the reference mortgage rate will remain unchanged.

As the reference mortgage rate will be published only approximately eight months after the entry into force of the revised OLRB, the Ordinance provides for transitory regulations. Thus, in case of changes of the mortgage rate by the cantonal banks between 1 January 2008 and 1 September 2008, the law into force until 1 January 2008 continues to be applicable to the rent adjustments claimed by landlords or tenants. This year, in the following cantons the cantonal banks have already published an increase of the mortgage rate: Aargau, Appenzell AR, Basel-Town, Basel-Land, Fribourg, Glarus, Graubünden, Jura, Luzern, Nidwalden, Obwalden, Schwyz, Solothurn, St. Gallen, Ticino, Thurgau, Uri, Wallis, Vaud, Zug and Zurich. If a rent adjustment is granted to a tenant or to a landlord on the basis of the law into force until 1 January 2008 based on a change of the cantonal mortgage rate prior to the first publication of the reference mortgage rate, a further rent adjustment can be requested after the first publication of the reference mortgage rate. This obviously only applies if the reference mortgage rate will be different from the previously used cantonal mortgage rate.

The following example shall illustrate the above situation. A landlord notifies a rent increase of 6% to the tenant based on the difference between an applicable cantonal mortgage rate of 3.5% at 1 March 2008 and a rate of 3% at the time of the conclusion of the contract. If the reference mortgage rate published on 1 September 2008 were 3,25%, the tenant would have the right to require from the landlord a rent reduction of 2.91% based on the calculation method described in Section 2.1 above. Therefore, the final rent increase would be only slightly more than 3%.

### 3 Energy Improvements made to the Building by the Landlord

#### 3.1 Situation before 1 January 2008

The law into force until 1 January 2008 and the new applicable law into force since this date provide that the landlord may increase the rent in case of value-enhancing investments. In case of a general renovation of the property, only 50 to 70% of the expenses can be considered as value-enhancing and, thus, entitle for an appropriate rent increase.

The provisions regarding value-enhancing investments did not expressly provide that investments improving the energy characteristics of a building entitled the landlord to a rent increase. A cantonal court decision of 2001 ruled that the costs for energy improvement works (*in casu* the installation of water heating solar panels) carried out by a landlord in the course of the building renovation are fully value-enhancing investments and, therefore, entitle to a rent increase in line with the entire costs of such investments (for more details, see the Decision of the Civil Court of the District of Neuchâtel of 28 September 2001 quoted *in* Cahiers du bail 2/02, p. 53).

#### 3.2 Revision of the OLRB

The revision of the OLRB incorporated the rule retained in the above court decision into the law. The Ordinance provides now that the following energy improvements qualify as value-enhancing investments (the list is conclusive):

- | measures reducing the energy losses through the building shell;
- | measures increasing the efficiency of the energy use;
- | measures reducing the emissions of technical installations;
- | measures to use of renewable energies;
- | the replacement of household appliances with high energy consumption with low energy consumption appliances.

Measures to reduce the energy losses through the building shell include heat insulation of the façade or the roof as well as the interior insulation of the top floor or the attic (in particular the elimination of thermal bridges in the roof, the basement, the balconies, the doors, the windows, etc; sufficient thickness of the insulation and the air tightness of constructions; the installation of windows with simple or double insulating glazing).

Measures increasing the efficiency of the energy use include the installation of thermostats, individual meters of heating or hot water, comfort ventilation systems (channeling the outside air through the living room and the bedroom and draining off the inside air through the kitchen and the bathroom), domotic systems in an apartment or a house which automatically switch on and off the lights and electrical household appliances.

Measures to use renewable energies include the installation of solar panels for domestic water heating or supplementary building heating, heat pumps, stoves or pellets wood installations for the central heating.

The Ordinance specifies that only the share of the costs which exceeds the costs of repair or maintenance fully qualifies as value-enhancing investments. For example, a landlord undertakes works on the building for a total amount of CHF 1,000,000. Thereof, CHF 200,000 are required to reduce the energy losses by improving the insulation and eliminating thermal bridges. The costs for the building repair are CHF 800,000. In such case, the amount of CHF 200,000 qualifies fully as value-enhancing investments. The repair costs in the amount of CHF 800,000 only qualify to 50 and 70% as value-enhancing investments.

This revision of the OLRB constitutes undoubtedly an improvement for the landlords and the tenants (insofar as the ancillary costs relating to the heating and hot water could decrease because of energy savings in connection with energy improvement works as described above). However, the distinction between energy improvements and important repairs will be difficult to make in certain cases and could give rise to litigation between landlords and tenants.

## 4 Indexing of a Lease for Residential Premises

### 4.1 Situation before 1 January 2008

According to the law into force until 1 January 2008, the parties had the choice to index the rent for residential or business premises to the development of the Swiss Consumer Price Index (SCPI). This was possible provided the lease was concluded for a minimum period of five years. The Ordinance in its previous and in its new version specifies for the lease of residential premises that the rent increase may not exceed the rise of the SCPI. In the event of a decrease of the SCPI, the rent must be adjusted proportionally to the reduction. The latter case never occurred since the entry into force of the CO chapter on the lease.

Prior to the revision of the OLRB, the law did not expressly specify the notification period to increase the rent because of a SCPI rise and did not define the five year lease.

### 4.2 Revision of the OLRB

In order to clarify the above-mentioned issues and to codify the rules developed by case law and scholars, the OLRB states that the rent increase based on the SCPI can be notified as of the end of each month with a prior 30 days notice period. The majority of the indexed lease agreements already provides for such a notice period. This notwithstanding, the parties are still free to agree on a longer notice period. However, a notice period of less than 30 days is not anymore permitted.

Although the majority of the lease contracts provides for an annual adjustment, the parties could also agree on a rent adjustment due to changes of the SPCI every six-months, every two or three years, or even at irregular intervals.

Moreover, the Ordinance provides now that a lease is concluded for five year period according to the CO if the landlord cannot terminate the lease for such a period. In other words, a residential lease can only be indexed to the SCPI, if the landlord undertakes not to terminate the lease for a minimum period of five years. The landlord remains entitled to terminate the lease prior to the expiry of the five year period, if the tenant does not pay, is bankrupt or violates its duty of care). It is possible to provide for the tenant's right to terminate the lease prior to the expiry of a five year period, e.g. annually or semi-annually.

## 5 Conclusion

Among the novelties introduced by this modification of the OLRB, the one concerning the energy improvements made by the landlord to its building constitutes certainly the most interesting. Since the 1 January 2008, in case of renovations or important works, the landlords are from now on clearly moved to take into account the technical means and measures which enable to offer the tenants an additional comfort by respecting at the same time the environment. Such new possibility to increase the rent in proportion of the costs of such works constitutes a progress benefiting to all the parties insofar as it is also beneficial for the tenants whose ancillary costs will be reduced thanks to the energy improvements



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The content of this Newsletter does not constitute legal or tax advice and may not be relied upon as such. Should you seek advice with regard to your specific circumstances, please contact your Schellenberg Wittmer liaison or any of the following persons:

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