

The Challenge of the Initial Rent in Switzerland: An Empirical Study

In an unexpected decision issued in 2020, the Swiss Federal Supreme Court significantly increased the allowed return for most rental properties. This decision does not seem to have had any effect on the level of new rents, which suggests that the rules regarding the challenge of the initial rent have little effect on the level of new rents.

I. Introduction	90
II. The Federal Supreme Court decision	90
III. Empirical Strategy	91
IV. Results	91
V. Discussion	92
1. The Evolution of the Average Mortgage Rate	92
2. The Evolution of the Consumer Price Index	92
3. The Tightness of the Housing Market	93
4. The COVID-19 Crisis	93
5. The Lack of Knowledge of the Regulation	93
6. The Lack of Binding Effect of the Regulation	93
7. The Low Probability of a Challenge	94
VI. Conclusion	94

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I. Introduction

- 1 According to article 270 of the Swiss Code of Obligations¹, tenants of residential and commercial premises can, in principle, challenge the initial rent within thirty days of taking possession of the property.
- 2 It is difficult to determine the effect of this regulation on the level of new rents, and it is obviously not possible to observe new rents without this regulation. As for the number of challenges, it is not decisive: a regulation can have a significant effect even if there are few cases handled by the courts. In fact, the low number of challenges could be explained precisely by the fact that the regulation is very effective.
- 3 This paper exploits a fundamental and unexpected decision of the Swiss Federal Supreme Court issued in 2020, which changed the allowed return on rental properties. It aims to examine the impact of this ruling on new residential rents in Switzerland.
- 4 While some studies have examined the effect of the Swiss regulation protecting tenants against unfair rents on the evolution of existing rents², this is the first study I am aware of that examines the impact of the rules for challenging the initial rent on the level of new rents in Switzerland.
- 5 This paper shows that the level of new rents in Switzerland does not seem to have increased after the Federal Supreme Court decision, which suggests that the rules regarding the challenge of the initial rent have little effect on the level of new rents. This result seems to confirm the assertions of several practitioners³, including experts close to the real estate world⁴, who had claimed before the Federal Supreme Court decision that many rents exceeded what was allowed at the time.
- 6 The rest of the paper is organized as follows. Section II (N 7 ff.) provides additional details about the Federal Supreme Court decision. Section III (N 14 ff.) describes the empirical strategy. Section IV (N 17 ff.) presents the results. Section V (N 20 ff.) discusses the results, and section VI

1 Federal Act of 30 March 1911 on the Amendment of the Swiss Civil Code (Part Five: The Code of Obligations) (CO; SR 220).

2 See, for example, DANIEL SAGER / MARIA GROB / TIMON SCHMIDT, *Auswirkungen des Schweizer Mietrechts im Umfeld stark steigender Angebotsmieten – eine empirische Untersuchung*, Berne 2018.

3 See, for example, DAVID LACHAT, *Le rendement des immeubles subventionnés*, in: *Ordre des avocats de Genève (Ed.), Regards de marathoniens sur le droit suisse*, Genève 2015, p. 167 f.

4 See, for example, MARK MULLER, *La fixation du taux de rendement net admissible des fonds propres: pour un changement de jurisprudence*, *Cahiers du bail* 2016, p. 3; BEAT ROHRER, *Revisionspostulate im Mietrecht*, in: Rohrer (Ed.), *Aktuelle Fragen zum Mietrecht*, Zurich 2012, p. 173.

(N 31) concludes. An online Appendix provides the data and code used to create the figures in the paper⁵.

II. The Federal Supreme Court decision

According to article 270 CO, within thirty days of taking possession of the property, the tenant of residential and commercial premises may challenge the initial rent as unfair before the authority and request said authority to order a reduction of the rent (a) if the tenant felt compelled to conclude the lease agreement on account of personal or family hardship or because of the conditions prevailing on the local market for residential and commercial premises; or (b) if the initial rent required by the landlord is significantly higher than the previous rent for the same property⁶.

This provision applies to all residential premises in Switzerland, except for vacation premises, luxury premises with six or more bedrooms, residential premises benefiting from public subsidies, and premises falling under specific cantonal regulations⁷.

If the challenge is admissible, the authority will, in principle, calculate the net return on equity from the leased property to determine whether the rent is excessive⁸. However, special rules apply to buildings acquired more than 30 years before the beginning of the lease and to buildings constructed less than 10 years before the start of the lease⁹.

In a decision dated October 26, 2020, the Federal Supreme Court changed its precedent regarding the allowed net return on equity¹⁰. While it previously admitted that this return should not exceed the reference mortgage rate by more than half a percentage point, it stated that it should

5 See: *The Challenge of the Initial Rent in Switzerland: Data and Code*.

6 For more details, see, for example, PETER HIGI / ANTON BÜHLMANN / CHRISTOPH WILDISEN, in: Schmid (Ed.), *Zürcher Kommentar, Die Miete – Art. 269 – 273c OR*, 5th ed., Zurich 2022, Art. 269 ff.; DAVID LACHAT / PIERRE STASTNY, *Le bail à loyer*, Lausanne 2019, p. 473 ff., and BEAT ROHRER, in: *Das schweizerische Mietrecht – Kommentar*, 4th ed., Zurich 2018, Art. 269 ff.

7 For more details, see LACHAT/STASTNY (n. 6), p. 451 ff., and references cited.

8 LACHAT/STASTNY (n. 6), p. 484, and references cited.

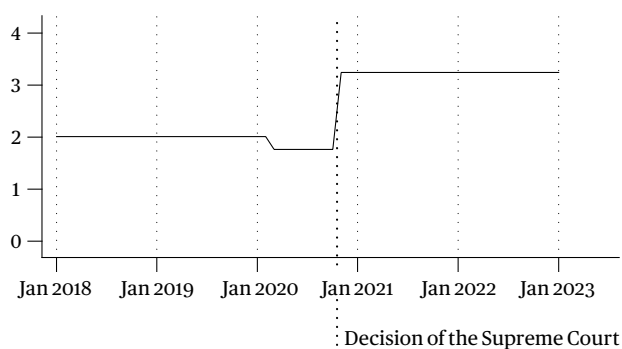
9 For more details, see LACHAT/STASTNY (n. 6), p. 692 ff., and references cited.

10 BGE 147 III 14 consid. 8.4. On this decision, see PHILIPPE CONOD, *Rendement net art. 269 CO; réévaluation des fonds propres; taux de rendement des fonds propres* (arrêt TF 4A_554/2019), *Newsletter Bail.ch*, Decembre 2020; THOMAS KOLLER, *Die mietrechtliche Rechtsprechung des Bundesgerichts im Jahr 2020*, *Zeitschrift des Bernischen Juristenvereins/Revue de la société des juristes bernois* 2021, p. 480 ff.; DAVID

now not exceed the reference mortgage rate by more than two percentage points¹¹. The Federal Supreme Court also noted that this change only applies when the reference mortgage rate does not exceed 2%¹².

- 11 Since the reference mortgage rate amounted to 1.25% in October 2020, the Federal Supreme Court decision had the effect of suddenly increasing the net allowed return from 1.75% to 3.25%, as shown in Figure 1¹³.

Figure 1: Allowed Return (%)



- 12 The effect of this change on the allowed initial rents is substantial. For example, for a property purchased for 1 million Swiss francs, financed by 40% equity and by 60% debt at the reference mortgage rate (1.25%), and for which the operating and maintenance costs represent 30% of the rent, the allowed monthly rent increases from 1726 Swiss francs to 2226 Swiss francs¹⁴, an increase of 29%¹⁵.

LACHAT, La fixation du loyer contesté : une jurisprudence à bout de souffle?, *sui generis* 2021, p. 29 ff.; BEAT ROHRER, Urteil des Bundesgerichts vom 26. Oktober 2020 (zur Publikation vorgesehen), *MietRecht Aktuell* 2020, p. 163 ff.; PIERRE STASTNY, Rechtsprechung des Bundesgerichts zur Nettorendite: quo vadis?, *mietrechtspraxis* 2021, p. 7 ff.

11 BGE 147 III 14 consid. 8.4.

12 BGE 147 III 14 consid. 8.4.

13 The reference rate is available on the website of the Federal Office for Housing, *Evolution du taux de référence et du taux d'intérêt moyen*.

14 Allowed rent = allowed return on equity x 400,000 francs + mortgage interest rate x 600,000 francs + operating and maintenance costs. Assuming that operating and maintenance costs = 0.3 x allowed rent, we obtain: allowed rent = (allowed return on equity x 400,000 francs + mortgage interest rate x 600,000 francs)/0.7. Therefore, with an allowed return of 1.75%, the allowed rent amounts to (1.75% x 400,000 francs + 1.25% x 600,000 francs)/0.7 = 20,714 francs, which means a monthly rent of approximately 1726 francs. With an allowed return of 3.25%, and assuming that the value of the property and the operating and maintenance costs remain constant, the allowed rent amounts to 3.25% x 400,000 francs + 1.25% x 600,000 francs + 0.3 x 20,714 = 26,714 francs, which means a monthly rent of approximately 2226 francs. This example is based on the standard model of the Federal Office for Housing. On this model, see LACHAT/STASTNY (n. 6), p. 586, and references cited.

15 $(2226 - 1726)/1726 = 0.29$. In the case decided by the Federal Supreme Court on October 26, 2020, the admissible rent amounted to 900 francs under the old precedent, whereas it amounted to 1390 francs under the new precedent (including the change regarding the indexation of equity, see text accompanying note 16), a 54% increase $(1390 - 900)/900 = 0.54$. See Federal Supreme Court of Switzerland, October 26, 2020, BGE 147 III 14 consid. A, B, C, and 8.5.

In its decision of October 26, 2020, the Federal Supreme Court also modified the rules on equity indexation when determining the net return¹⁶. This change is negligible for this study because of the very low inflation rate in Switzerland in the years preceding the Federal Supreme Court decision (if this change were taken into account, it would increase the allowed initial rents only slightly).

III. Empirical Strategy

The Federal Supreme Court decision was totally unexpected. In a decision issued only a few years earlier, the Federal Supreme Court had stated that it was up to the legislature to modify the allowed net return¹⁷.

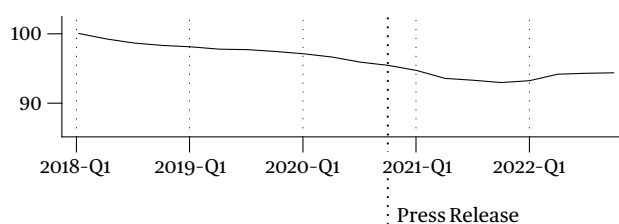
The Federal Supreme Court decision was widely reported in the media¹⁸. It was the subject of a press release by the Federal Supreme Court on November 16, 2020, and was discussed in the main Swiss newspapers.

Under these circumstances, given that the change took effect immediately, a substantial increase in the level of new rents could be expected in the weeks following the press release of the Federal Supreme Court.

IV. Results

Figure 2 shows that the asking price for rental housing in Switzerland did not increase after the decision¹⁹.

Figure 2: Asking Price in Switzerland



16 BGE 147 III 14 consid. 8.3.

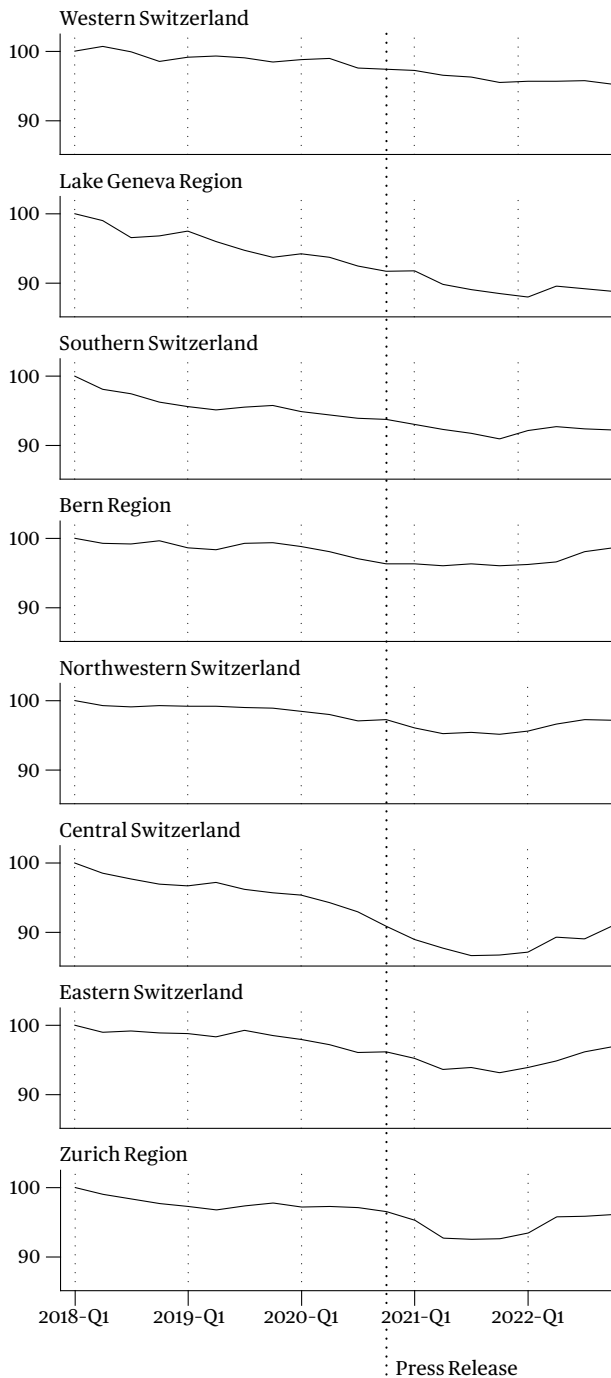
17 Decision of the Swiss Federal Supreme Court 4A_465/2015 of March 1, 2016, at 5.6.

18 See, for example, CONOD (n. 10), p. 5, who describes this change in case law as one of the most significant in the field of tenancy law ("un revirement de jurisprudence qui sans nul doute est l'un des plus marquants en matière de droit du bail").

19 The figure is based on data collected by the company Wüest Partner, and published on the website of the Swiss National Bank, *Real estate price indices – by market area – by quarter*.

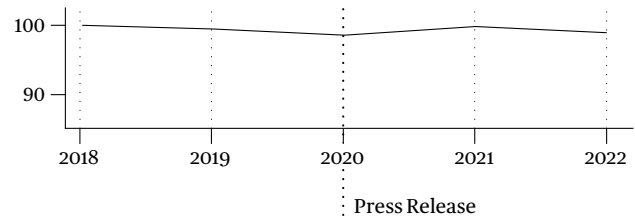
18 Figure 3 shows that similar results can be observed in the main regions of Switzerland²⁰.

Figure 3: Asking Price in Swiss Regions



19 The canton of Geneva provides data on new residential rents on its territory²¹. As Figure 4 shows, the level of these rents did not increase after the Federal Supreme Court decision either.

Figure 4: New Rents in the Canton of Geneva



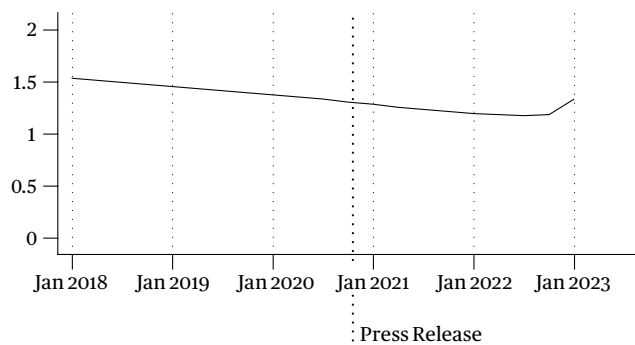
V. Discussion

The Federal Supreme Court decision does not seem to have had any effect on the level of new rents. To interpret this result, several points are worth discussing.

1. The Evolution of the Average Mortgage Rate

The evolution of the average mortgage rate paid by landlords during the period under consideration does not explain the lack of increase in the level of new rents. As Figure 4 shows, there was a slight decrease, but no substantial change, in the average mortgage rate paid in Switzerland after the Federal Supreme Court decision²².

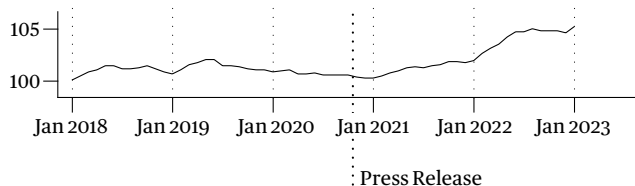
Figure 5: Average Mortgage Rate in Switzerland (%)



2. The Evolution of the Consumer Price Index

The evolution of the consumer price index does not explain the lack of increase in the level of new rents either. As Figure 6 shows, the consumer price index remained almost constant during the relevant period²³.

Figure 6: Consumer Price Index



²⁰ The figure is based on data collected by the company Wüest Partner, and published on the website of the Swiss National Bank, Real estate price indices – by market area – by quarter.

²¹ The data are published on the website of the Canton of Geneva, Statistiques cantonales: Loyers.

²² The figure is based on data published on the website of the Federal Office for Housing, Evolution du taux de référence et du taux d'intérêt moyen.

²³ The figure is based on data published on the website of the Federal Statistical Office, Consumer Price Index: Detailed results.

3. The Tightness of the Housing Market

23 The change in the vacancy rate does not explain the result either. Indeed, as Figure 7 shows, the vacancy rate in Switzerland decreased after the Federal Supreme Court decision, which should have led to an increase in the level of new rents²⁴.

4. The COVID-19 Crisis

24 The COVID-19 crisis is probably not an explanation either since the virus began spreading in Switzerland in February 2020, several months before the Federal Supreme Court decision.

5. The Lack of Knowledge of the Regulation

25 The fact that some landlords were unaware of the initial rent regulation probably explains part of the result, but it cannot explain the complete lack of effect of the Court's decision on the level of new rents.

6. The Lack of Binding Effect of the Regulation

26 It is likely that the regulation was not binding in the regions of Switzerland that were losing inhabitants and were experiencing a housing surplus. In these regions, market rents were probably equal to or lower than allowed rents.

27 And even in economically dynamic regions, the regulation was probably not binding for recently acquired properties. For these properties, the equity value is correctly assessed, and the allowed return is probably close to the return that could be earned in the absence of regulation.

28 However, for properties that have not been recently acquired, the value of the equity, which is based on the property's historical value, is often significantly underestimated, leading to an overestimation of the true return²⁵. For these properties, the regulation was clearly binding²⁶.

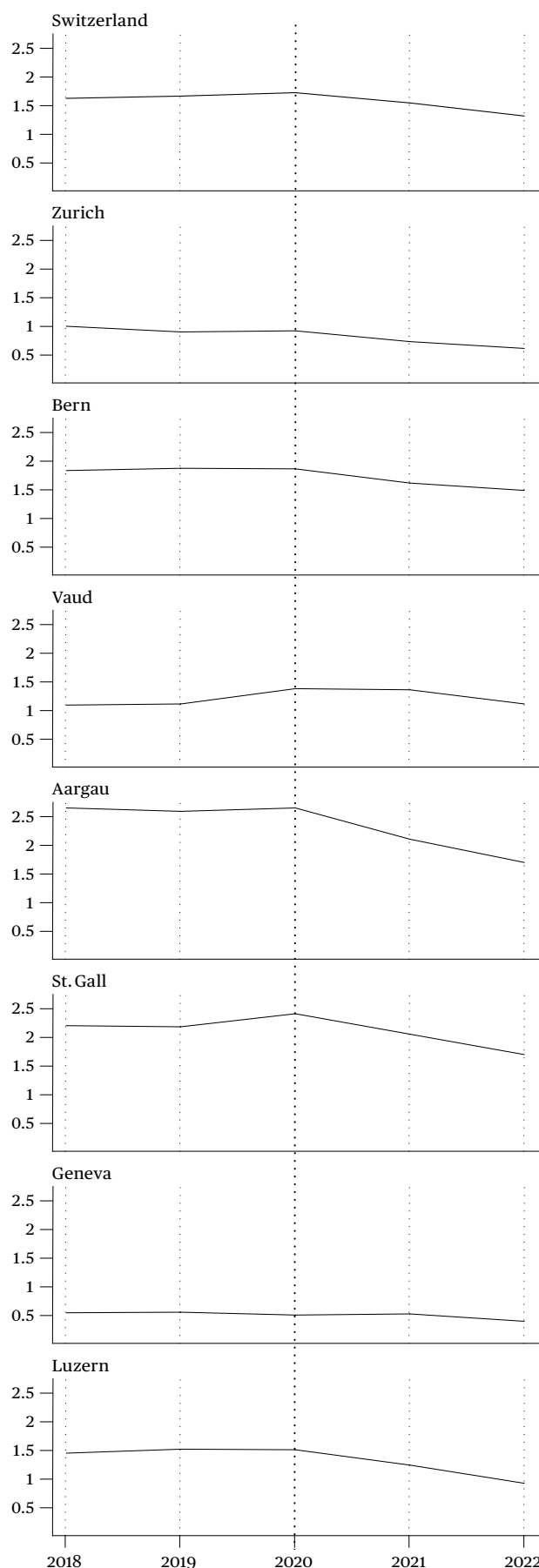
29 Therefore, the lack of binding effect of the regulation only partly explains the lack of impact of the Federal Supreme Court decision on the level of new rents.

24 The figure is based on data published on the website of the Federal Statistical Office, Logements vacants.

25 See LAURENT BIERI, Rendement net de la chose louée et réévaluation des fonds propres, *sui generis* 2022, p. 72 ff., and references cited.

26 In the case decided by the Federal Supreme Court on October 26, 2020, the rent agreed by the parties amounted to 2190 francs. It was reduced to 900 francs by the lower courts (in application of the former precedent), and to 1390 francs by the Federal Supreme Court (in application of the new precedent, including the change regarding the equity indexation, see text accompanying note 16). See BGE 147 III 14 consid. A, B, C and 8.5.

Figure 7: Vacancy rates



Press Release

7. The Low Probability of a Challenge

30 Even when an initial rent is excessive, the probability of a challenge is very low²⁷. Under these circumstances, it is likely that many landlords take the risk of setting new rents at levels relatively close to what would exist in a free market. The low probability of a challenge, therefore, also likely contributes to the lack of effect of the Federal Supreme Court decision.

²⁷ Every year, hundreds of thousands of new leases are concluded in Switzerland (see, for example, URS HAUSMANN, *Vertragsfreiheit im Schweizer Mietrecht von 1804 bis 2014 unter besonderer Berücksichtigung des Mietzinses*, Zurich et al. 2016, p. 2). There were approximately 1000 initial rent challenges in Switzerland in 2020 (see website of the Federal Office for Housing, *Statistiques des procédures de conciliation*). Therefore, the challenge rate is well below 1%, with strong cantonal disparities. If the initial rent is excessive, however, the challenge rate is probably higher (and probably lower if the initial rent is not excessive), but it is difficult to give a precise number.

VI. Conclusion

In an unexpected decision issued in 2020, the Swiss Federal Supreme Court significantly increased the allowed return for most rental properties. This decision does not seem to have had any effect on the level of new rents, which suggests that the rules regarding the challenge of the initial rent have little effect on the level of new rents. This is probably due to landlords' lack of knowledge of the regulation, the fact that the regulation is not binding in certain circumstances, and the fact that an excessive initial rent is unlikely to be challenged.

Résumé

Dans un arrêt inattendu rendu en 2020, le Tribunal fédéral a considérablement augmenté le rendement admissible de la plupart des immeubles locatifs. Cet arrêt ne semble pas avoir eu d'effet sur le niveau des nouveaux loyers, ce qui suggère que les règles sur la contestation du loyer initial n'ont que peu d'effet sur le niveau des nouveaux loyers.

Abstract

In einem unerwarteten Entscheid aus dem Jahr 2020 hat das Schweizerische Bundesgericht die zulässige Rendite für die meisten Mietobjekte deutlich erhöht. Dieser Entscheid scheint keine Auswirkungen auf die Höhe der Neumieten gehabt zu haben, was darauf hindeutet, dass die Regeln zur Anfechtung des Anfangsmietzinses kaum Auswirkungen auf die Höhe der Neumieten haben.