CONSTRUCTION & REAL ESTATE REVIEW 2021

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OVERVIEW OF MAJOR RECENT ACTIVITY IN SWITZERLAND IN THE REAL ESTATE MARKET OVER THE LAST YEAR

The Swiss real estate investment market did not suffer any harm during the Covid-19 pandemic in 2020: the transaction volume 2020 was overall slightly above the 2019 level. Due to the domination of the Swiss transaction market by Swiss institutional investors (which traditionally are responsible for close to 90% of the transaction volume) no decline, as in other markets (e.g. United Kingdom), could be seen in Switzerland. Although some delays arose on certain transactions, most investors maintained their original acquisition targets. Interest rates and price levels remained stable. 99% of the market participants consider the Swiss real estate markets as attractive or very attractive, according to the Ernst & Young Trendbarometer Real Estate Investment Market, Switzerland 2021.

In February 2021, the KOF Economic Barometer of the KOF Swiss Economic Institute rose to 102.7 points, which is slightly above its long-term average of 100 (see chart on page 103). As a result, the downward trend since the interim high during the pandemic in September 2020 has come to an end and the barometer now signals somewhat more lively economic activity for the next few months.

The UBS Swiss Real Estate Bubble Index relating to owner-occupied homes stood at 1.75 in Q4/2020 due to the strong economic recovery in the second half of 2020, which, however, is a decrease from 2.05 in Q3/2020 (see chart on page 105). Owner-occupied home prices continued to develop upwards in Q4/2020 and, adjusted for inflation, gained almost 5% compared to the previous year. By contrast, real rents fell by around 1%. The demand for buy-to-let and mortgage lending continued to be unimpressed by the economic volatility and remained at the level of the previous quarter. In summary: residential properties remained solid as a rock.

The Swiss office market has seen different developments in 2020. In Zurich, vacancies have increased for the first time since 2017. While the inner-city market was stable, vacancies outside the city-centre increased due to continued supply. In Geneva, office space in the city-centre was in good demand while there was ample vacant office space outside the central locations (JLL Switzerland, Swiss office market 2021).

Due to Covid-19, home office has become a trend. Big Swiss companies like ABB, Nestle or Swisscom were considering continuing the working-from-home trend into the future, which will reduce the need for office space. While Germany's Bain & Company Managing Partner stated in June 2020 that the future demand for office space will decline by 20% to 30% in Germany, Credit Suisse expects in its Real Estate Monitor Q2/2020 that service companies will reduce their office space by 7% and industrial companies by 3.6%. It is therefore possible that Covid-19 will bring about big changes for office-related real estate, including the reduction of rents and pressure on office

building prices. However, it is also possible that the demand for office space will not decline if the post Covid-19 future leads to greater demand for increased office-space requirements per person. JLL Switzerland concluded in its Swiss office market 2021 study that the breakeven for a space reduction of 20% is reached if net rents at least CHF 360/m2 per year. Besides this static approach companies should also take into account other factors like future growth and mental health of their employees in deciding whether space reduction could be an option.

A decrease in turnover relating to construction activities by 5.8% in 2020 compared to the previous year is reflected in the construction index prepared by Credit Suisse together with the Swiss Contractors' Association (SCA): the index is set at 141 points in the fourth quarter of 2020, compared to 151 points in the fourth quarter 2019 (see chart on page 107).

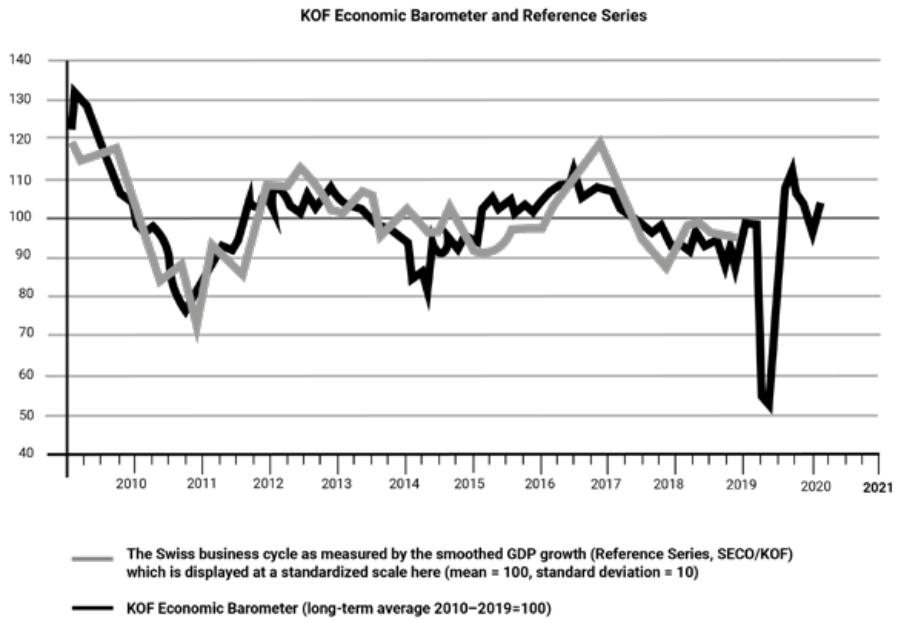
Switzerland is and will continue to be an attractive real estate market for investors in 2021. While the negative trend in certain asset classes (in particular retail spaces) and regions will continue, there will be opportunities in other markets such as logistics properties or along the increasing digitalisation trend (see also the section on future developments at the end of this article).

OVERVIEW OF THE LEGAL AND REGULATORY FRAMEWORK IN THE REAL ESTATE PRACTICE AREA AND ANY RECENT OR PROPOSED CHANGES

The Swiss regulatory framework

The Swiss real estate regulatory framework is based on transaction law, rental law, planning and zoning law and construction law. Political discussions will continue to result in amendments to the regulatory framework. For example, the political decisions to be taken with respect to the Energy Strategy 2050 will continue to have a significant impact on the construction industry; the CO2 Act, which sets out targets for emission reductions and contains measures for buildings, transport and industry, will be further revised in order to comply with the obligations of the Paris climate agreement. On January 1, 2021, the revised CO2 Ordinance came into force as of in order to extend key climate protection instruments until the end of 2021 and to prevent a regulatory gap until the totally revised CO2 Act comes into force.

As publicly accessible establishments and businesses as shops, restaurants, museums etc. were shut down by the authorities for almost two months in 2020, the question whether the tenant is obliged to pay rent during the lockdown was heavily debated in 2020. However, a possible solution for tenants which were directly affected by the lockdown was eventually dismissed by the Swiss Parliament at the end of December 2020. Since Switzerland went into a lockdown again at the beginning of 2021, the topic will certainly be further discussed (see also the below section regarding open issues after the 'no' vote on the Covid-19 law on commercial rental agreements). Furthermore, the debate regarding the abolition of the imputed rental income (Eigenmietwert) is expected to continue in 2021 in Switzerland.



As the last year was strongly characterized by Covid-19 related issues, we will in the following address some open questions in relation to Covid-19 and commercial leases. However, there have been other trends and developments especially relating to rental law, such as the challenging of the initial rent, costs of energy performance contracting and accessory charges, error regarding the surface area and to tax law which we discuss in the following.

OPEN ISSUES AFTER THE 'NO' VOTE ON THE COVID-19 LAW ON COMMERCIAL RENTAL AGREEMENTS

During the first corona wave at the beginning of last year, the Federal Council ordered, among other things, the closure of facilities accessible to the public, which for many companies from the most diverse of business sectors meant the de facto termination of business operations. The question that arose for the affected tenants and their landlords was whether this closure ordered by the authorities had any effect on existing rental agreements. Parliament finally decided at the end of December 2020 against adopting a legal basis for a corona rent waiver, which leaves a number of questions unanswered.

Let us look back and describe the background: The measures ordered by the Federal Council on 13 March 2020 to combat the coronavirus pandemic included, among others, the obligation to close facilities accessible to the public, subject to some exceptions. As a result, many companies from the most diverse of business sectors had to de facto terminate their business operations. These included shops (with some exceptions), restaurants and hairdressers. These lockdown regulations were subsequently lifted step by step. Hairdressers, for example, were allowed to reopen on 27 April 2020 and all shops and restaurants reopened on 11 May 2020. They were mostly able to operate without restrictions throughout the summer, but with the rise in infection rates at the beginning of autumn 2020, restaurants in some cantons had to close again. The government initially refrained from once again ordering the country-wide closure of restaurants, but according to the provisions on the special situation pursuant to Art. 6 of the Epidemics Act, the individual cantons had the power to adopt stricter measures, which the French-speaking cantons in particular invoked from the end of October 2020.

Does the rent have to be paid for the duration of the lockdown ordered by the authorities?

The debate about whether tenants have to pay rent for the time during which they had to close their business operations has been raging since the Federal Council ordered lockdown in spring 2020. There are no precedents that can provide a clear answer to this question. Under the applicable law the question arises in particular whether

the closing of business operations ordered by the government constitutes a defect that would give the tenant special rights (cf. Art. 259a et seq. Code of Obligations, CO). The question remains unanswered, at least by the Supreme Court. The current legal uncertainty for tenants and landlords therefore persists. If a defect would be deemed to exist, tenants would basically have the right under Art. 259d CO to request a reduction in rent (up to 100% in some cases).

The situation as described above also gave rise to the question whether tenants can invoke another lawful basis to avoid paying rent, at least in part. This refers in particular to a (judicial) contract amendment in application of the rebus sic stantibus principle. This is subject to the conditions that (i) the circumstances after the conclusion of the contract changed enough to cause an exorbitant disproportion in services, and (ii) this disproportion could not have been foreseen or avoided when the contract was concluded.

The 'no' vote to the COVID-19 law on commercial rental agreements has pulled the plug on a political solution for Switzerland as a whole

Given the legal uncertainties highlighted above, voices demanding a political solution were soon raised in response to the official lockdown. Shortly after the lockdown measures were ordered in spring 2020, the Federal Council took the position that it did not want to settle this issue by way of ordinance as this would constitute interference in the relationship governed by private law between tenants and landlords. Solutions should rather be found in the context of a constructive and pragmatic dialogue. However, during the 2020 summer session Parliament ordered the government to submit a draft law (COVID-19 law on commercial rental agreements) regarding the division of rent between landlords and tenants for the relevant period. The Federal Council therefore started the consultation process for a preliminary draft on 1 July 2020, and issued its Dispatch to the COVID-19 law on commercial rental agreements on 18 December 2020. Although Parliament was still in favour of a partial rent waiver for commercial tenants during the first corona wave in summer 2020, the COVID-19 law on commercial rental agreements was definitively rejected by both Chambers at the beginning of the winter session. This has pulled the plug on a political solution for Switzerland as a whole.

The main argument that was raised against a statutory solution was that the law would retroactively interfere in private contractual relationships. It was also argued that the law does not take account of the differences in the way that individual businesses were affected and that the solution clearly came too late for many businesses - in particular because the probability of a referendum means that the law is unlikely to take legal effect any time soon. The Federal Council, which from the outset disapproved of a partial reduction in commercial rents, referred to a recently published article stating that there are few indications that commercial tenants cannot pay their rent. The article referred to "a surprising number of agreements regarding rent reductions between the parties to rental agreements".

Opponents of the COVID-19 law on commercial rental agreements refer to the hardship fund

Following the rejection of the COVID-19 law on commercial rental agreements, it was pointed out many times that affected tenants should now obtain help from the hardship fund. It should also be possible at least in part to process rents for the period of the first corona wave as hardship cases. However, time will tell if this is actually possible. It will in any case be a difficult process involving a lot of red tape for tenants as implementation will differ from canton to canton (some cantons will pay contributions with no hope of return, while others will grant loans) and the cantons will have to asses each individual application. Due to these cantonal differences, tenants who operate in several cantons will also have to incur additional expenses. In many cantons it will likely take a long time for money to actually be paid out.

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Some cantons adopted individual solutions

At least, the situation is a little better for tenants in some cantons. For example, the Geneva landlord organisations (USPI Genève and Chambre genevoise immobilière) already concluded an agreement on 6 April 2020 (called "Vesta") with the Canton of Geneva and ASLOCA (the tenants' association of French-speaking Switzerland) regarding a voluntary support programme for landlords who wish to help their commercial tenants. Under certain conditions, the Canton of Geneva agreed to compensate landlords who were willing to waive rents in whole or in part (and to defer the accessory charges) for April 2020 (and later also for May and June 2020). The agreement was renewed at the beginning of November for rents for November and December 2020. The cantons of Vaud and Fribourg developed similar solutions for SMEs. In German-speaking Switzerland, the two Basel cantons found solutions for tenants during the first wave. In part, the parties to rental agreements who wanted to benefit from a cantonal solution had to submit an application before a specific deadline (e.g. in the Canton Basel-City, before the end of September 2020 for the "three-thirds rescue package"). It is unclear whether additional cantons will offer similar solutions, including cantons who ordered a cantonal closure of restaurants in autumn 2020. It is advisable in any case to keep an eye on developments to avoid missing any deadlines.

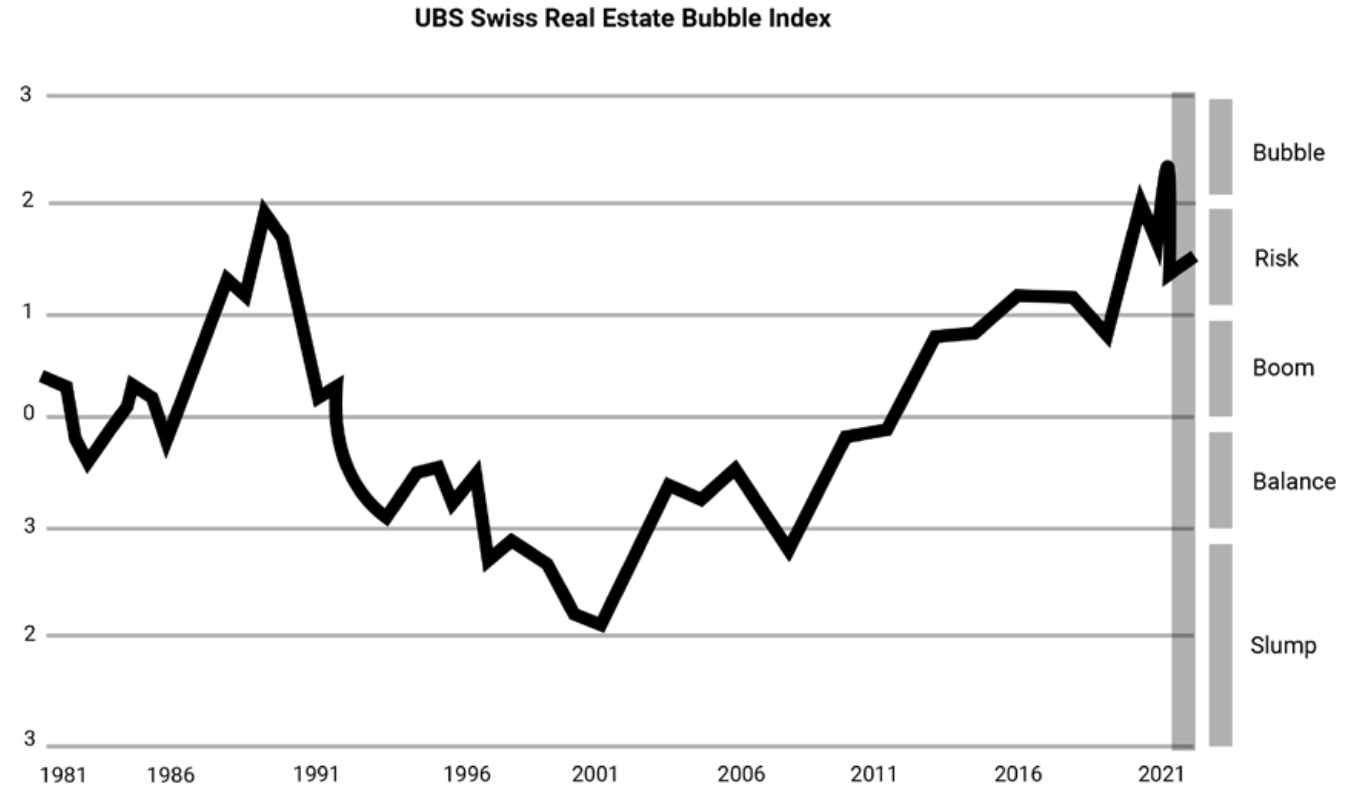
Where the affected parties have not yet come to an agreement, discussions between the parties remain a good idea

Especially in cantons that have not yet presented any cantonal solutions, the legal uncertainty described above as well as the global and national dimensions of the problem mean that it remains a good idea for the parties to a rental agreement to discuss the matter and try and find a compromise. It should be kept in mind that any legal disputes can go on for months and years. To avoid affected tenants from going bankrupt, solutions have to be found earlier.

The last option is the courts

If an amicable agreement cannot be found, the parties (e.g. the tenant who wants to apply for a rent reduction or if the tenant is in arrears with rent payments, the landlord who wants to collect the rent) only have recourse to the courts to assert their claims.

The judge will have to assess the issues that arise in each individual case, based on the rental agreement. When it comes to the question whether the rent was in fact payable during the lockdown, it plays a role, among other things, whether the rental agreement contains a clause that regulates the current situation (e.g. a force



Source: UBS

majeure clause). This is seldom the case in practice, but cannot be excluded. Rental agreements that contain an obligation on the part of the tenant to operate – which is regularly the case in shopping centres, for example – make the situation even more complicated. It is therefore advisable for both parties to obtain prior advice from an expert in tenancy law.

CHALLENGING THE INITIAL RENT – CHANGE IN PRACTICE FOR CALCULATING THE NET YIELD

In its judgement 4A_554/2019 of 26 October 2020, the Federal Supreme Court changed its case law regarding the calculation of the net yield in cases where the initial rent is challenged.

Under certain conditions, the tenant has the option to challenge the initial rent for residential and commercial premises as unfair and request its reduction. In order to assess whether the rent is unfair, it has to be established whether an excessive income is derived from the rental property (net yield; Art. 269 CO) or whether the rent is within the range of rents customary in the locality or district. If the property does not qualify as an old building, i.e. the property is younger than 30 years, the calculation is based on the net yield; the rent has to cover the costs and the permissible yield on rent may not be exceeded.

Until now, the Federal Supreme Court's case law recognised two things in particular as relevant to the calculation of the net yield and the decision whether the net yield that is earned is permissible:

To date, the permissible yield equalled the landlord's yield on their own capital invested in the property at the time of acquisition, plus any subsequent value-enhancing investments, whereby the own capital invested by the landlord could be adjusted to inflation for up to 40% of the total investment.

The permissible net yield under Art. 269 CO could not exceed the current interest rate for mortgages or (since 2008) the reference interest rate by more than 0.5%. The maximum permissible net yield was therefore calculated by adding 0.5% to the current reference interest rate.

In its judgement of 26 October 2020, the Federal Supreme Court changed these parameters dating from 1994 and 1986 as follows:

- Now, the own capital that was invested can be adjusted to inflation for up to 100% rather than only 40% as before.
- The yield may exceed the reference interest rate by 2% rather than 0.5% as before if the reference interest rate is 2% or less.

The change in practice is explained by the changes that have occurred since the original case law was established, in particular the long-standing decline in mortgage interest rates and the applicable reference interest rate. These developments have meant that rent yields based on the previous calculation method are very low and no longer match the usage of the apartments in question.

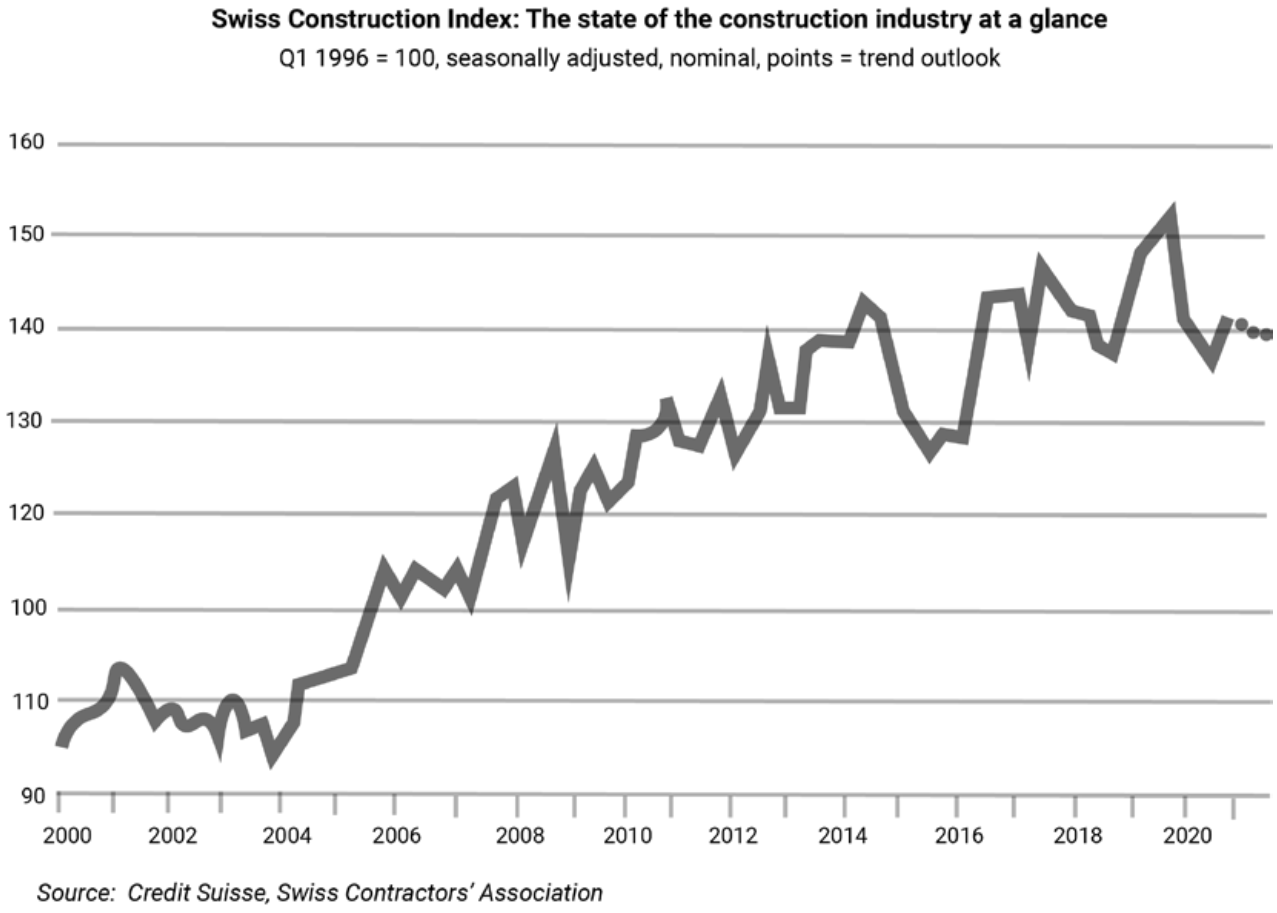
This is made very clear by the case on which the judgement of the Federal Supreme Court of 26 October 2020 is based. The initial rent for a 4.5-room apartment of CHF 2,190 net and for two parking spaces in the garage of CHF 130 each was reduced by the court of first instance to CHF 900 net and CHF 50 per parking space; this was confirmed by the second instance court. Applying the changed practice, the Federal Supreme Court finally determined these amounts at CHF 1,390 net and CHF 73 per parking space.

Landlords will be happy about this change in practice, as this makes rent yields more interesting and removes some of the injustices arising from the schematic application of the former criteria.

It may also be that the change in case law has contributed indirectly to the fact that the Federal Council's Motion No. 20.3922 regarding a balanced revision of the rules governing rent calculations for residential and commercial properties has now also been approved by the Council of States. The motion will be submitted to the National Council in 2021.

RENTAL AGREEMENT: RESTITUTION OF EXCESS RENT AFTER SUCCESSFUL CHALLENGE OF INITIAL RENT

In its judgement 4A_495/2019 of 28 February 2020, the Federal Supreme Court revised its judgement of 2014 (BGE



140 III 583) in which it decided that the statute of limitations under Art. 67 para. 1 CO applying to all restitution claims for unjust enrichment starts running from the date of contract conclusion. Based on this judgement, the Court argued in 2014 that after such a long time the tenant no longer had any legitimate interest in proceedings for the court to determine the rent.

The case concerned a rental agreement concluded at the end of 2003, which entered into force on 1 January 2004. The rental agreement was renewed every year until it was terminated by the tenant in 2016. During the dispute that arose between the parties following the termination of the rental agreement, the landlord applied to the court for an order to collect several months' rent. The tenant in return applied to the court to determine the initial rent and filed an action for restitution of excess rent, explaining that he only found out about the nullity of the initial rent in 2016 when the dispute arose. The courts in Vaud ruled in favour of the tenant.

In the aforementioned judgement, the Federal Supreme Court stated that the criticism of BGE 140 III 683 raised in the legal literature is justified and that the tenant still has a legitimate interest in filing proceedings for the court to determine the initial rent throughout the term of the rental agreement, regardless whether the claim for restitution of excess rent has expired or not, unless the action is abusive. With regard to the period of limitation, the Federal Supreme Court stated that the deadline starts running separately for each individual rent payment.

According to this judgement, a tenant whose rental agreement is still in force will thus always have a legitimate interest in filing proceedings for the court to determine the initial rent, and the limitation period for the claim for restitution of excess rent due to unjust enrichment (which equals the difference between the rent that was actually paid and the new rent determined by the court) starts running separately for each individual rent payment. This means that theoretically, a tenant can file proceedings for the determination of the rent nine years and eleven months after the end of the rental agreement by claiming that he has an (unexpired) claim to restitution of excess rent. The landlord's only defence against this would be to claim that the tenant is in abuse of the law.

Although such a solution may seem expedient from the legal point of view, it creates considerable legal uncertainty for the landlord. In fact, protection against legal abuse seems to be very weak in this case as it suffices for asserting such claims that the tenant alleges to not have known anything before about his claim for restitution. It should also be noted that the relative limitation period in Art. 67 para. 1 CO has been three years (instead of one year as before) since 1 January 2020. This means that tenants can draw out the case against the landlord even longer.

AMENDMENT OF THE ORDINANCE ON THE LEASE AND USUFRUCTUARY LEASE OF RESIDENTIAL AND BUSINESS PREMISES (VMWG)

The Federal Council adopted an amendment to the Ordinance on the Lease and Usufructuary Lease of Residential and Business Premises (VMWG) on 29 April 2020. It has contained a new Article 6c since 1 June 2020, pursuant to which the landlord under specific conditions may pass on the costs of Energy Performance Contracting (EPC) to his tenants as accessory charges. EPC is given when a service provider undertakes against payment vis-à-vis the owner to lower the energy consumption of a building by way of suitable technical or even structural energy savings measures (cf. Art. 6c para. 1 VMWG). Such energy savings measures include, among others, measures to optimise the operation of heating, ventilation and air-conditioning installations as well as buildings automation, the replacement of installations or the improvement of the building's shell. The cost of such measures can now under specific conditions and

for a period of 10 years at most be passed on to the tenant as accessory charges. However, the amount invoiced annually as accessory charges may not exceed the amount saved on energy costs (cf. Art. 6c para. 4 VMWG).

The objective of the new Art. 6c VMWG is to promote energy savings measures in rental properties without increasing the rent by adding the costs or part of the investment made to the rent. Until now, depending on which measures were taken, the costs associated with energy savings did not meet the legal definition of the term accessory charges pursuant to Art. 257b CO. According to this definition, accessory charges for residential and commercial premises are the actual outlays made by the landlord for services connected with the use of the property, such as heating, hot water and other operating costs, as well as public taxes arising from the use of the property. As this term does not cover the cost of EPC, payments made by the owner to the service provider could until now only be passed on to tenants by way of rent adjustments.

The new Art. 6c VMWG now makes it possible to pass these costs on as accessory charges. This is only possible, however, if the landlord does not make a direct investment, but mandates a third party (energy service provider) to initiate the energy savings measures. The energy service provider has to reduce energy consumption for a building over a specific period of time. As the landlord may only charge the savings in energy costs achieved through these measures to the tenant, the tenant's accessory charges will not increase. Tenants should therefore experience financial relief. The landlord is unlikely, however, to be able to pass on the total EPC costs.

The EPC model is hardly new, but many owners, particularly in German-speaking Switzerland, have until now decided against it, most probably in view of the costs. The new Art. 6c VMWG should set a new incentive for EPC. The landlord must take note that any amendments or changes to the rental agreement (in particular with regard to the accessory charges) must be notified to the tenant in advance by way of the approved cantonal form for unilateral contract amendments.

FUNDAMENTAL ERROR REGARDING THE SURFACE AREA AS STATED IN THE RENTAL AGREEMENT

In a decision (BGer 4A_108/2019 of 22 January 2020) about a rental agreement for an apartment, the Federal Supreme Court specified its case law about the (partial) nullity of a rental agreement owing to a fundamental error based on the fact that the actual surface area of the rental property differs from the surface area specified in the rental agreement.

In the present case, the tenants found out after taking receipt of the rental property that the surface area of the apartment – a first-time rental – was 4.15% smaller than stated in the rental agreement.

The Geneva Landlord and Tenant Court presiding over the action for determination of the rent and restitution of the excess rent paid since the entry into force of the rental agreement decided in favour of the tenants and stated that the error regarding the surface area is fundamental, both subjectively and objectively, and that the rent has to be reduced in proportion to the established difference. This decision was subsequently confirmed by the Cantonal High Court before being appealed to the Federal Supreme Court.

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According to Art. 23 CO, a party labouring under a fundamental error when entering into a contract is not bound by that contract. According to Art. 24 para. 1 (4) CO, a fundamental error can specifically relate to facts which the party acting in error considered in good faith to be a necessary basis for the contract.

In its judgement, the Federal Supreme Court stated that an error is subjectively fundamental if it actually convinced the tenant to enter into the agreement, while it is objectively fundamental if the contracting partners can in good faith recognise that the error relates to a fact that is suitable for convincing the tenant to enter into the agreement.

In a rental agreement, whether for residential or commercial premises, the surface area to be rented is an important factor in the decision whether to enter into the agreement or not, at least for judging whether the rent demanded by the landlord is customary for the respective region. However, some leeway or even a difference arising from different methods of calculation is permissible.

With regard to the possible partial nullity of the rental agreement, the Federal Supreme Court has to date consistently ruled that a difference in surface area of more than 10% is always unreasonable. In one specific case, the court recognised that a difference of 8% can already justify nullity owing to a fundamental error.

In the present case, the Federal Supreme Court mitigated its position by stating that a difference in surface area of approx. 4% may not in absolute terms qualify as an objectively fundamental error, but that the specific circumstances can lead to different conclusions.

In the case before the court, the landlord offered the tenant two almost identical apartments located on the same floor; they differed only in size and price. The surface area given in the rental agreement was therefore not approximate. The judges decided that the tenants chose the apartment with the highest rent, specifically because they wanted to live in the biggest unit, and not because they wanted to pay more. The landlord understood the reason for the tenants' choice. He could not argue in good faith that the difference in surface area was not sufficient to convince the tenants to conclude an agreement for an apartment with the higher of the two rents.

It is also interesting that the Federal Supreme Court judges rejected the landlord's argument that the tenants, by refraining from invoking the difference in surface area in the rental agreement at the time of receipt of the apartment and in the following years, were satisfied with the apartment and therefore can no longer invoke a subjectively fundamental error. The Federal Supreme Court was of the opinion that it is not the responsibility of the tenants to check the accuracy of the surface area provided in the rental agreement, and that they asserted their rights by declaring themselves within one year of discovering the error (Art. 31 para. 2 CO).

With regard to the substantiation of the decision, it has to be noted that it is unclear whether the Federal Supreme Court would have come to the same conclusion if an approximate surface area had been provided in the rental agreement and/or if the landlord had verified the surface area in the presence of the tenants when handing over the rental property.

CONSEQUENCES OF UNEXCUSED FAILURE TO ATTEND A HEARING IN SIMPLIFIED PROCEEDINGS

In its judgement of 20 May 2020 (BGE 146 III 297 of 20 May 2020), the Federal Supreme Court used tenancy law to answer a question of prime importance, i.e. the

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consequences of unexcused failure by one of the parties to attend the oral hearing in simplified proceedings. This question has been at the heart of many controversies and has led to deviating court practices in a number of cantons. The above judgement of the Federal Supreme Court has now made it clear that a party who fails to attend a hearing in simplified proceedings without an excuse has no right to be invited to a second hearing. The court in question has the authority to pass judgement on the basis of the documents and the investigations concerning the evidence that have already been carried out.

Simplified proceedings are one of three types of proceedings recognised by the Swiss Civil Procedure Code (CPC) and are governed by Art. 243 et seq. CPC. They apply to cases with a small value in dispute (up to CHF 30,000 in financial disputes) and – regardless of the amount in dispute – to disputes concerning particularly sensitive matters of social private law. As the Federal Supreme Court emphasised in its judgement, simplified proceedings have to go quicker than ordinary proceedings, which in particular means that the judge must take all necessary measures to settle the case during the first hearing, if possible.

The present case before the Federal Supreme Court concerned an appeal by a landlord (defendant) who claimed that his right to be heard before the court was violated as he was not invited to a new hearing in simplified proceedings after he failed to attend the first hearing called by the court. The defendant himself applied for a first postponement of the hearing, which was accepted by the court. The defendant then failed to attend the postponed hearing without providing any reasons. The court therefore based its decision on the documents filed with the court and the statements of the plaintiff during the oral hearing.

The landlord's appeal against this decision was rejected by the Federal Supreme Court with the argument that it is not compatible with the principle of simple and quick proceedings for the judge to invite the defendant to a new hearing if he failed to attend a hearing without excuse. The Federal Supreme Court judges emphasised that non-attendance by the defendant not only leads to a delay in the proceedings, but also means that the court has to schedule and reserve the time for another hearing and that the plaintiff has to appear before the court again. To allow a party who is negligent to cause such trouble for the court and the other party is incompatible with the objective of simplified proceedings.

We fully support the arguments submitted in this judgement. We often find in practice that the courts do not grant sufficient consideration to the accelerated nature of simplified proceedings and do not manage the proceedings expeditiously enough. It can happen that simplified proceedings hardly differ from ordinary proceedings in the number and volume of legal briefs as well as the duration of the proceedings. Against this background, the Federal Supreme Court is to be lauded for highlighting the original intention of the legislator in introducing simplified proceedings in the CPC in this landmark judgement.

EARLY TERMINATION OF A MORTGAGE: ARE EARLY-TERMINATION FEES TAX-DEDUCTIBLE?

Historically low interest rates have convinced many real estate owners in the past few years to take out mortgages with a long term. The lender may only agree to early termination of the mortgage (e.g. owing to the sale of the property) if the loss in interest is compensated by the borrower in the form of an early-termination fee.

The question is whether such an

early-termination fee is tax-deductible, and if yes, if this deduction can be claimed for the calculation of income tax in the relevant tax period, or rather for the calculation of property gains tax when the property is sold.

The tax-deductibility of early-termination fees for the termination of a mortgage was controversial in the past and the cantons applied different practices. The Federal Supreme Court for the first time formulated binding principles regarding the application of the law in its landmark decisions of 3 April 2017 (cf. BGer 2C_1165/2014, 2C_1166/2014 and BGer 2C_1148/2015). The Federal Supreme Court has now further specified the current practice regarding the tax-deductibility of early-termination fees in its latest judgement of 16 December 2019 (cf. BGer 2C_1009/2019). The following practice applies now:

Early-termination fees can only be deducted as debt interest for income tax purposes if the cancelled mortgage is replaced by another mortgage with the same lender (if the cancelled mortgage is replaced by another mortgage granted by another lender, any early-termination fees cannot be deducted for tax purposes).

Early-termination fees levied in connection with the sale of a property encumbered by a lien (cancellation of a mortgage for an unencumbered sale) cannot be deducted as debt interest but have to be declared as investment costs for the purpose of property gains tax.

Important: these principles only apply to properties held as private assets.

These tax principles do not apply to the early termination of mortgages on properties held as business assets since such payment of damages qualifies as a business-related expense and thus reduces the taxable profit.

Industries or types of client that are particularly active in the real estate sector

The real estate transaction market was on a high level again in Switzerland in 2020 despite Covid-19. This allowed us to close a few nice transactions, the highlight being an acquisition of a real estate portfolio comprising 26 real properties in 4 cantons for a purchase price exceeding three hundred fifty million Swiss francs which was conducted by way of a so-called transfer of assets and liabilities based on the Swiss federal act on mergers, demergers, conversions and transfer of assets and liabilities.

Fuelled by a strong increase in online shopping activities a booming asset class are logistics properties. We advised on several transactions relating to logistics property. One transaction involving a portfolio of three logistics centres in the Western and Eastern part of Switzerland could be notarized just before Christmas 2020. Also, we could advise on an increasing number of sale-and-lease-back transactions.

Due to the Covid-19 pandemic many landlords and lessees of commercial properties contacted us for advice in relation to questions around the rent or early termination, in particular concerning retail stores.

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We were also active in different real estate area development projects – this shows that activities in the real estate sector in Switzerland have not stopped even in an overall rather difficult 2020.

DEVELOPMENTS IN THE SWISS REAL ESTATE MARKET IN THE NEXT YEAR OR SO

Despite the Covid-19 pandemic, real estate markets remain attractive due to continued negative interest rates enforcing the trend to a significant decrease of attainable yields over the past few years. There are still opportunities for investments, for example for investments which involve greater risks or involve special real estate.

According to Credit Suisse Real Estate Monitor Q3/2020 Covid-19 even strengthened existing market trends. While high construction activity in the rental apartment segment at the cost of owner-occupied housing construction is expected to continue and the demand for quality housing is about to increase, investors are still avoiding retail properties and hotels. However, Covid-19 will have an influence on the market for office space as many companies are considering carrying the home office trend into the future which could reduce the need for office space. Nonetheless, it is still open what this will mean in the longer run with respect to space needed for office work and, in particular, what office space will look like in the future. It is thus possible that the Covid-19 pandemic will develop into a game changer for office-related real estate, including the reduction of rents and pressure on office building prices. However, it is also possible that demand for office space will not decline because Covid-19 will also have the effect that more office space per person will be needed in the future.

Also other real estate trends that investors are or were focusing on such as student accommodation, retirement homes, short-term tourist rentals or co-working, were tested during the pandemic. For instance, less student accommodations are needed at the moment as fewer international students are coming to Switzerland and/or some of the teaching is done online. Limited travels also affect short-term tourist rentals.

The trend towards digitalisation in terms of using interlinked technologies for smart asset management has further strengthened its importance compared to last year. Starting with recoding all financial, market and technical data of the properties owned, a more efficient, faster and cost-effective management of the properties can be attained. The digitalisation is seen as an opportunity for the real estate industry to increase (process) efficiency. This is illustrated, as an example, by the increasing influence of proptech companies in the Swiss real estate industry (see also www.swissproptech.ch). Furthermore, the mass adoption of remote-working technology during the pandemic has clearly demonstrated the importance of technology in general.

Finally, companies in the real estate sector are increasingly focusing on sustainability and reducing their ecological footprint. For example, Swiss Finance & Property Group has published its first ESG report in 2020 emphasizing the importance of Environmental, Social and Governance (ESG) criteria for its business activities.