



CONSTRUCTION & REAL ESTATE REVIEW 2022

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

The burgeoning inflationary tendencies in the USA and the Eurozone remind us that the era of very low interest rates will end one day. However, this is not yet the case in Switzerland. Although capital market yields trended upwards at the beginning of 2022 and the 10-year Swiss government bond exceeded the zero per cent mark for the first time in about three years, in view of an average net cash flow yield of 3.3% for residential and mixed investment properties, the yield premium for real estate investors remained high in 2021 in a long-term comparison and demand for real estate remains high. This is also reflected in the numerous capital market transactions by real estate funds and real estate stock corporations last year or the high growth in outstanding mortgage loans to companies of up to 6% year-on-year at times (Credit Suisse, Swiss real estate market, March 2022, p. 48 et seq.).

In February 2022, the KOF Economic Barometer of the KOF Swiss Economic Institute fell slightly and now stands at 105 points. This is still to some extent higher than the long-term average. The normalisation since the most recent peak in May 2021 is thus proceeding. The economic situation should therefore continue to develop positively.

The UBS Swiss Real Estate Bubble Index relating to owner-occupied homes stood at 1.49 in Q4/2021 (compared to 1.23 in Q4/2020 (as adjusted)); please note that the index methodology has been updated and the numbers published are not anymore directly comparable). The market for owner-occupied homes is thus overvalued compared with its own history (see chart on one of the following pages).

The demand for office space experienced a significant recovery during 2021 but the pre-crisis level hasn't been achieved yet. The usually close correlation between growth in office employment and demand for office space has been partially decoupled in the pandemic. Despite the robust growth in office

employment, many demanders held back on leasing new space due to the pandemic and the trend towards home offices.

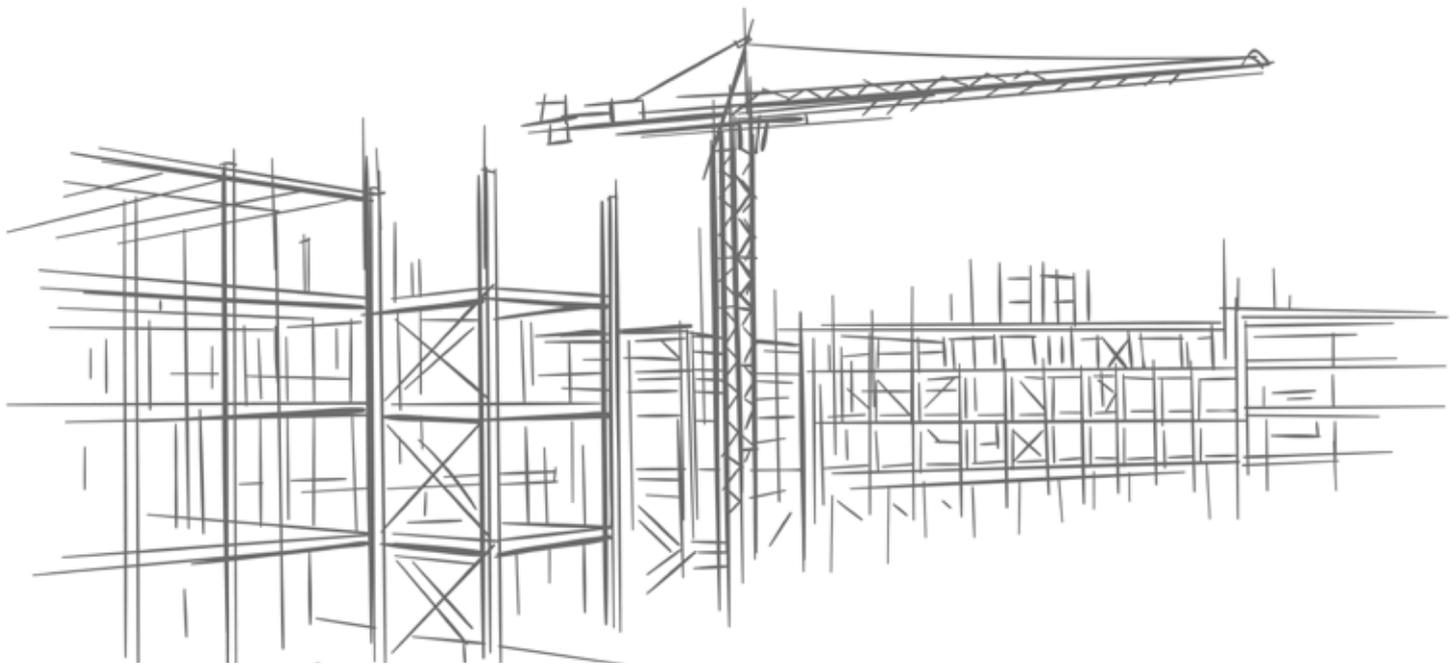
The construction index prepared by Credit Suisse together with the Swiss Contractors' Association (SCA) rose from 141 points in the fourth quarter of 2020 to 150 points in the fourth quarter 2021 corresponding to an increase of 6.8% and reflecting the increased demand for construction services. In Q1/2022, the index fell slightly to 148 points (see chart on one of the following pages).

Overall, Switzerland is and will continue to be an attractive real estate market for investors in 2022 (see also the section on future developments at the end of this article).

– Economic Barometer



Source: KOF Swiss Economic Institute



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.

In the current spring session in Bern, three initiatives are scheduled for debate that have an impact on the real estate market: the Glacier Initiative, which wants to make CO2 targets binding, the Landscape Initiative, which is directed against the excessive building up of the landscape, and the Biodiversity Initiative, which demands, among other things, stricter protection of the village appearance.

As examples of the developments that took place in 2021 we would like to discuss hereafter three court decisions on rental law, Lex Koller and construction outside the building zone.

the rent.

In this context, part of the doctrine was of the opinion that these closures ordered by the federal and/or cantonal authorities due to the pandemic constituted a defect in the rented property.

The first court decisions in this regard concerned debt enforcement and bankruptcy law, more specifically the legal opening procedure. In two decisions of the District Court of Zurich of 23 April 2021, the judge found that the lease agreement did not constitute a sufficient title to initiate legal proceedings to obtain payment of the outstanding rent, as it was "beyond question that [the] performance did not reach the [tenant] in the manner that could have been expected on the basis of the concluded lease agreement [...]". On the other hand, and although this point did not fall within the jurisdiction of the relevant judge, the judge decided that the measures taken by the federal and/or cantonal authorities did not lead to a defect in the rented property or to an impossibility for the landlord to fulfil its contractual obligations. The only question that remained open was thus the applicability of the *clausula rebus sic stantibus* (i.e. a significant and unforeseeable change in circumstances that leads to such an imbalance that the risk allocation provided for in the agreement is no longer acceptable for one party and the other party, by insisting on its fulfilment, takes advantage of the imbalance that has arisen and therefore obviously abuses its right).

While this first decision already pointed the way in favour of the landlords, the core of the question was dealt with in the course of the year in the cantonal decisions of the courts of the Cantons of Geneva and Zurich,

One of the questions that arose was whether tenants whose shops/businesses were temporarily closed as a result of the measures ordered by the Federal Council and/or the cantonal authorities to combat the coronavirus must continue to pay their rent

RENT REDUCTION AND COVID-19 (DECISION JTBL/565/2021 OF THE TRIBUNAL DES BAUX ET LOYERS OF THE CANTON OF GENEVA OF 28 JUNE 2021, DECISION MJ210008-L OF THE RENT COURT OF THE CANTON OF ZURICH OF 2 AUGUST 2021 AND DECISION MG.2021.20 OF THE CIVIL COURT OF THE CANTON OF BASEL-CITY OF 28 JANUARY 2022)

The current pandemic has led to legal uncertainties in many respects, at least initially. In the absence of case law on the subject, one of the questions that arose was whether tenants whose shops/businesses were temporarily closed as a result of the measures ordered by the Federal Council and/or the cantonal authorities to combat the coronavirus must continue to pay their rent until the business can be resumed, or whether they are entitled to a reduction – or even an exemption – of

respectively, which specialise in rental agreements and which are mentioned in the title above. After detailed analysis, both found that the closures of businesses ordered by the federal or cantonal authorities in connection with the covid-19 crisis did not constitute a defect in the rented property entitling to a reduction (or even complete exemption) of the rent payment based on article 259d CO. In particular, it was stated that the rented property remained in a suitable condition for use within the meaning of article 256 CO for which it had been rented. The measures ordered by the authorities were not aimed at the use of the rented property, but only at the activities carried out there that could favour the transmission of the virus. However, it was pointed out that the tenants would indeed not have been able to carry out their activities in other premises either.

The two aforementioned courts also examined whether the conditions of impossibility within the meaning of article 119 CO were fulfilled, which would have led to a release from the obligation to pay rent. In the cases at hand, however, the cantonal courts were of the opinion that the requirements for an exemption were not fulfilled, as the provision of the rental object by the landlord was still possible.

The question of the application of the *clausula rebus sic stantibus* was left open by the courts, as the tenants in the cases at hand had not proven that the requirements for a judicial adjustment of the contract had been met.

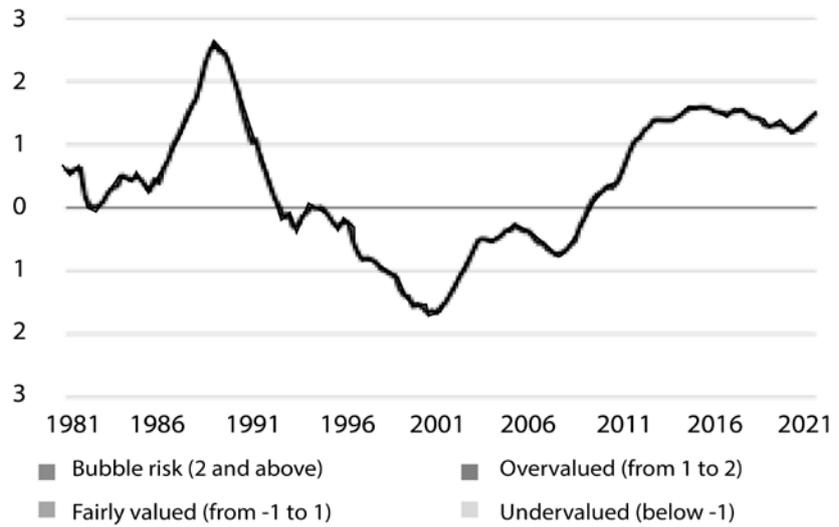
It should be noted that the mentioned decision in Geneva was not appealed. The decision in Zurich was appealed to the Higher Court of the Canton of Zurich; as the parties thereafter settled the case, the Higher Court of the Canton of Zurich did not have the opportunity to decide about the question of a possible defect either.

In the meantime, the first instance court of the Canton of Basel-City had a different opinion regarding the question of a defect and rendered an interesting decision, granting a commercial tenant a 30% rent reduction based on the government ordered closure of restaurants. The restaurant in question consisted of a conventional restaurant area, combined with a take-away service. While the restaurant had to be closed due to the government ordered lockdown, the take-away area was closed voluntarily (due to commercial considerations). However, the court qualified that situation as a deviation of the actual condition of the rented property from the contractually agreed condition during the period of the government ordered closure as a result of which the presumed use

UBS Swiss Real Estate Bubble Index

4 Quarter 2021

Standard deviation



Source: UBS

of the rented property was considered to be restricted and hence a defect in the meaning of article 259d CO.

The Federal Supreme Court has not yet had the opportunity to comment on that topic.

LEX KOLLER: CLARIFICATION OF THE CONCEPT OF A PERMANENT BUSINESS ESTABLISHMENT IN THE CASE OF A BUILDING CONSISTING OF COMMERCIAL AND RESIDENTIAL SPACE

On the occasion of two recent court decisions, namely the decision BGer 2C_639/2019 of 10 July 2020, which concerns a project to increase the height of a commercial building in order to create residential units, and the decision BGer 2C_589/2020 of 22 March 2021, which is intended for official publication and concerns a project to build flats for the staff of a hotel operated by the applicant on a neighbouring property, the Federal Supreme Court had the opportunity to rule on the application of the Federal Act on the Acquisition of Real Estate by Persons Abroad (FL) in the context of construction projects to create residential property. In doing so, it clarified its case law on the concept of a permanent business establishment within the meaning of article 2 paragraph 2 lit. a FL.

Under the FL, the acquisition of real estate by persons abroad is subject to authorisation by the competent authority, except in the cases exhaustively regulated in article 2, paragraph 2 and article 7 FL. The Federal Supreme Court is of the opinion that article 4 FL does not contain a *numerus clausus* of transactions that qualify as real estate

acquisitions. Furthermore, the absence of a transfer of ownership is not a decisive factor in determining whether or not the transaction is subject to authorisation. What is decisive, on the other hand, is the increase in the living space of the building through the addition of apartments, which is regulated by the FL. This is also the case even if the increase in gross floor area is less than 10% and the creation of additional apartments is therefore not likely to call into question the commercial use of the building. The judges in *Mon-Repos* consider that the provisions of the FL would remain a dead letter if it were possible, after the purchase, to proceed with works to increase the living area of a building subject to the permit regime without first applying for a new permit. This is the only solution that guarantees compliance with the main purpose of the FL, namely to prevent the over-exploitation of Swiss soil.

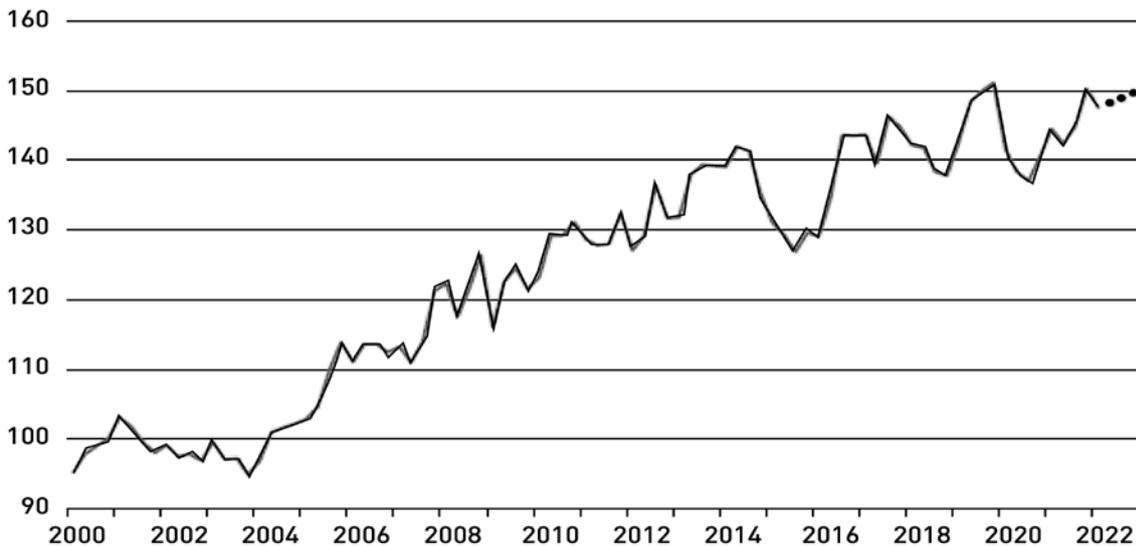
Thus, the FL is applicable in connection with the creation of residential space if the construction is planned on a plot of land on which a building is used for commercial purposes. It then applies to a plot of land adjacent to the one on which a building is erected for commercial purposes and acquired by a person abroad.

With regard to the authorisation requirement, the Federal Supreme Court recalled that the concept of a permanent establishment must be interpreted restrictively.

According to article 2 paragraph 2 lit. a FL, no authorisation is required if the real estate is used as a permanent business establishment. If a plot of land is acquired under the above provision, article 2, paragraph 3

Swiss Construction Index: The state of the construction industry at a glance

Q1 1996 = 100, seasonally adjusted, nominal, points = trend outlook



Source: Credit Suisse, Swiss Contractors' Association

FL allows the simultaneous acquisition of dwellings prescribed by residential share regulations and the land reserved for them. According to the case law of the Federal Supreme Court, the same applies to dwellings that are necessary for the operation of the business.

The construction of residential units, even on a plot of land on which a commercial building is located, is subject to approval under the FL. In fact, in the view of the judges in *Mon-Repos*, land used for residential purposes does not fall under the definition of a permanent business establishment within the meaning of article 2, paragraph 2, lit. a FL.

A foreign investor intending to acquire a commercial building that is to be increased in height to create residential units is therefore well advised to check, when formulating its purchase offer, whether or not it is likely to meet the requirements for obtaining the authorisation under the FL necessary for carrying out the increase project.

In its decision 2C_589/2020 of 22 March 2021, the Federal Supreme Court recalls that only the acquisition of real estate serving as a permanent business establishment for business purposes is not subject to authorisation. According to the Federal Supreme Court, the wording of article 2 paragraph 2 lit. a FL is unambiguous and only refers to buildings that directly serve commercial activity. In other words, the commercial activity must take place in the building concerned itself. In this context, the acquisition of residential property by a person abroad is exempt from authorisation only if there is a simultaneous acquisition of dwellings subject to the residential share regulations and of land reserved for this purpose within the meaning

of article 2, paragraph 3 FL. The Federal Supreme Court clarifies that simultaneous acquisition is also permissible for dwellings that are necessary for the operation of the business and for which separation from the business premises into a separate building would be practically impossible or would result in a disproportionate expense.

Since the aforementioned decision concerns a construction project, the exception is not applicable due to the simultaneity of the acquisition. Furthermore, the creation of staff apartments does not constitute an extension of the hotel as a place of business for a commercial activity. Such apartments are presumed to serve a residential function. However, the Federal Supreme Court recognises that a hotel's ability to employ staff is fundamentally dependent on the provision of staff housing, that it is difficult to find housing on the local rental market and that without the provision of staff housing, the hotel in question may have difficulty recruiting the necessary staff. However, this does not change the fact that under the FL, the residential part of the property in question cannot be acquired by a person abroad without authorisation, as there is no legal basis for this.

THE LAPSE OF TIME DOES NOT PROTECT BUILDINGS AND FACILITIES ILLEGALLY ERECTED OUTSIDE THE BUILDING ZONE

In a public hearing on a dispute concerning an illegal construction outside the building zone, the Federal Supreme Court has ruled that the duty to restore a state in conformity with the law does not expire after 30 years (decision of the Federal Supreme Court 1C_469/2019 and 1C_483/2019 of 28 April 2021).

With regard to unlawful construction in the construction zone, the Federal Supreme Court already stated in 1981 that the right of the authorities to restore a state in conformity with the law expires in principle after 30 years, unless the cantonal legislation provides for a shorter lapse of time (BGE 107 IA 121). However, the court has never ruled on the application of this time limit in the case of buildings erected illegally outside the building zone.

The present case concerns the construction of numerous buildings and facilities without authorisation on a plot of land located in the agricultural zone of a municipality in Lucerne. The authorities of Lucerne, referring to the above-mentioned case law on illegal construction in the building zone, ordered the demolition of only some of the unauthorised buildings, namely those erected after 1983.

In the opinion of the judges in *Mon-Repos*, the illegal constructions outside the building zone do not cause a problem for legal certainty and equal treatment, hence it is not necessary to introduce a time limit to protect illegal constructions outside the building zone. In contrast to buildings in the building zone, the legal situation is clear, as only federal law applies to building permits outside the building zone. In addition, both legal certainty and equal treatment are strengthened if it is stipulated that an unlawful use will not be tolerated even if it continues for more than 30 years.

The Federal Supreme Court thus opposes the unfair favouring of owners of buildings outside the building zone who have violated federal law for years, although the legal situation in this area is easy to determine.

INDUSTRIES OR TYPES OF CLIENT THAT ARE PARTICULARLY ACTIVE IN THE REAL ESTATE SECTOR

Also during the second year of covid-19, we had the chance to close a few nice transactions. As a highlight, we were part of the acquisition of a large plot directly on the lake of Zurich and the related plans for the development of the area. Another great deal we could close is also situated in the greater Zurich area and close to the lake – it involves different plots and the planning and building of five modern apartment buildings. Furthermore, we were, for example, advising in the sale of a portfolio containing three mainly commercial buildings in the city centre of three different cities in three different cantons.

Fuelled by an ongoing strong increase in online shopping activities, a booming asset class are logistics properties. We advised on several transactions relating to logistics property, one transaction involved a logistics centre in the Northern part of Switzerland.

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

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

to a significant decrease of attainable yields over the past few years.

According to Credit Suisse Real Estate Monitor Q1/2022, home ownership remains – as a result of covid 19 and the resulting increase in home office activity, which will likely continue at least in part after the pandemic – in high demand. The demand appears to be settling permanently at a much higher level than before the pandemic. At the same time, the demand is shifting toward less central locations and larger apartments. In

contrast to the quality of housing, an increase in serviced apartments and micro-living apartments is expected in the major cities. At the same time, on the supply side, there has been a noticeable decline in the construction of new residential property, except single-family homes. However, the trend towards home office is likely to continue to negatively influence the office market. In the long term, on the other hand, the change in working environments promises substantially higher demand for modern office properties. Retail properties are still avoided by investors.

The trend towards digitalisation in terms of using interlinked technologies for smart asset management remains unchanged. Starting with recording 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.

