

# Specific features of gross lease contracts and possibilities for their rearrangement

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## Preamble

In Germany the most common rent structure for apartments is those of the net cold rent. In addition, there exists a row of other rent structures. Furthermore, there is a distinction between gross warm rent, gross cold rent, partly -inclusive rent and the all -inclusive rent; however, in addition later more.

In Germany, the procedure for increasing the rent of gross lease contracts is complicated and it is hardly enforceable. Hence, in times of permanently rising energy prices the rent structure of the gross lease contracts for the renter is the conceivably most unfavorable variant. If the part of the operating expenses rises, the interest, which is available to the renter as a compensation of the surrender of the lease item, automatically sinks. The goal should be to reach a re-arrangement of the gross lease contracts in net cold contracts. This text tries to examine, how this can work. In the Akelius region east, the re-arrangement of approx. 80 gross hire contracts is a goal for 2009.

## Different kinds of lease contracts

As already mentioned in the introduction, there are different rent structures existing for renting living space in Germany. One variant is the gross warm rent, it contains all costs including the heating costs. With the gross cold rent all operating expenses are included, but the heating costs must be paid separately. Within the partly-inclusive rent, there is a part of the operating expenses included already. The costs dependent on consumption and the heating costs must be added. With the variant of the all -inclusive rent, all operating expenses resulting at the moment of completion of the contract are included as a uniform amount in the rent and cost rises can be put down in each case. Also with this rent structure, the heating costs have to be paid separately. The contract form of the net cold rent is the economically most meaningful variant for the renter. On this occasion, the tenant pays a pure remuneration for the surrender of the living space, and an operating expenses advance or an operating expenses -all inclusive. The operating expenses can therefore be put down

directly on the tenant and adaptations can be carried out. The renter thereby receives at all times the same amount for the living space surrender and is not dependent on the partly very fluctuating operating expense prices.

## **Advantages and disadvantages of gross lease contracts**

In Germany, it is generally not possible to value the different rent structures as good or bad. By the assessment of the advantages and disadvantages of rent structures, all parameters must be considered.

The most important point in case of the consideration is probably the present owner's structure. Under the circumstances, the structure of the gross warm rent can be the ideal contract form for a small private investor with ten rent units. These small private investors often do not have any specific economic real estate knowledge. However, they administer these units for cost reasons themselves. Hence, for this type of private investor, it is extremely unfavorable to use another variant of the rent structure, because with the first operating expense account, they could get big problems in relation to the permanently changing legal regulations. The situation for big investors like Akelius is a different one. These bigger enterprises have no problems with the annual operating expenses account and the matching of legal regulations, since they normally have an internal or external accounting department. Hence, the rent structure of the net cold rent should be the right decision. With this rent structure, the development of the operating expenses is not from a big meaning for the owner. During times where somebody speaks of the "second rent", the tenants and especially the future tenants surely pay attention to the operating expenses and select their living space also after the height of the operating expenses. Thus, too high operating expenses can promote, for instance, the empty state or press the net cold rent, because the tenant wants to spend a certain total sum on their apartment. So, the optimization of the operating expenses should also be a constant goal of the owner.

On account of the technological developments in the area of the building technology, it can become interesting in the future, however, absolutely again to conclude gross warm hire contracts. An example is the heating of buildings by bedrock heating. The high costs amortize within less years, on account of the relatively low power costs for this variant of the building heating; the dependence on the energy prices is not so serious. Besides, there exists a row of other alternative heating variations on the traditional oil heating or gas heating, which still stand at the very beginning of the development. In this way, real estate

enterprises can unhook themselves more and more from the strong variations in the energy markets.

## Possibilities of increasing the rent on gross lease contracts

In Germany, the regulations for rent increases are very complicated and regulated by the Civil Code. Rent increases up to the local-usual comparable rent assume a formally correct approval demand. If the approval demand rests on a rent mirror, it also must be founded with this. If a certified rent mirror exists in the respective town, this must be pulled up, in any case, for establishment - even if the rent rise demand rests on another establishment.

equipment living space	without central heating and bathroom, toilett inside	with central heating or bathroom, toilett inside	with central heating, bathroom and toilett inside
under 40 sqm			5,26 * 3,84 - 6,90
40 sqm till under 60 sqm	2,78 ** 2,44 - 3,30	3,10 ** 2,76 - 3,62	5,57 4,95 - 6,49
60 sqm till under 90 sqm	2,79 * 2,31 - 3,08	3,11 * 2,63 - 3,40	5,52 4,32 - 6,65
90 sqm and more	2,68 * 2,49 - 2,77	3,00 * 2,81 - 3,09	5,28 3,67 - 6,89

*Example of Berlin rent mirror > our property Droyesenstraße 7*

In Berlin, we have the "problem" that the rent mirror display only net cold rents and it is not directly comparable with gross or partly-inclusive rent directly. Hence, the comparability must be produced by the owner. The owner must determine the concrete operating expenses of the respective apartment and deduct this from the gross rent. It is not enough to use an operating expense average from the rent mirror. The so preserved net rent can be compared to the rent mirror value and be adjusted. Afterwards, the operating expense interest is opened again and the new rent level can be informed to the tenant. The whole procedure also works in the other direction. Thus, it is likewise possible to open the operating expense interest specific for apartment on the rent mirror value and to compare the gross rents with each other. In addition, it is important, that the operating expense values must be current. The values are current when they were determined immediately before the delivery of the explanation for the increase. Another point which has to be followed with the described approach, is the legal cap. The renter may increase the rent within three years only by 20%. For a long time, it was controversial, whether with the gross lease contracts the ascertained net part must be brought in attempt or which counts agreed gross rent. The Federal Supreme Court decided that the legal cap has to be charged with the help of the agreed gross

rent. Another interesting point with the rent structure of the gross lease contracts is the adaptation of the operating expenses. Indeed, with the lease contracts, which were concluded before 9/1/2001, the possibility of the operating expenses adaptation consists; however, this procedure is similarly extensive as by the normal rent rise of gross lease contracts. Moreover, the renter is also obliged here to carry out an adaptation if the operating expenses sink. With the lease contracts, which were concluded after the 9/1/2001, the operating expenses cannot be increased separately. The only possibility for the rise of these contracts is the before described variant considering the waiting periods and the legal cap. For the renter this means under certain circumstances, that they cannot increase the rent to such an extent as the operating expenses rise. This again leads to the fact that with rising operating expenses, the original rent taking is curtailed.

## **Possibilities of re-arrangement of gross lease contracts**

The conclusion of the above mentioned disadvantages, for a bigger real estate enterprise in Germany, is to move its existing gross lease contracts as fast as possible. But, which possibilities exist? We can state, as already expected, that it is not simple to move the contracts. In Germany, it is not possible as a renter to move the contract simply. With a lease contract, according to law it concerns an arrangement between the parties. That is the fact, that after the first-time construction, every change has to be approved by both parties. Besides, the change arrangement must be concrete and unequivocal. The bare announcement of a rearrangement by a certain appointment is not sufficient. The tenant has to be informed about which operating expenses they must pay in future separately, and how high the advance will be. Nevertheless, there are exceptions:

One exception establishes the silent consent. So it suffices to inform the tenant about the wish for the re-arrangement of the rent structure and to request them, to bring forward objections within a certain time period. If the tenant does not comment and pays the altered rent, this is considered as an approval of the re-arrangement.

Another exception applies to the area of the costs dependent on cause and dependency on consumption. Should such dependency on consumption and apart to measurable costs be deducted in future, there exists the possibility to change the rent structure unilaterally. This means, that on the changed parts, adequate pre-payments can be required. However, it must concern a real change, it does not manage on changing the way of the registration. The explanation needs to be in written form and the tenants must be able to recognize, to what extent the

renter makes use of their one-sided regulation right. The respective cost categories, the re-allocation key, the beginning of the re-allocation change and the first accounting period are to be informed to the tenant. In addition, the current gross satisfied operating expenses from the gross rent must be calculated of course.

A not yet appealed variant is the possibility of the negotiations. Should the special rules not apply in the respective object, insists, as already mentioned, no other possibility on reaching as a gentle arrangement with the tenant. If the tenant refuses the approval, you can try to persuade them with small concessions. Thus for instance, one could offer to the tenant, to decline a rent rise or grant to them a small reduction on their rent during the next two years. Another interesting variant could be the installation of an attribute, which increase housing quality and which is also an investment in the object, and is still available to the renter also after the moving out of the tenant.

## **Result**

The elaboration has shown, that the subject of the gross lease contracts is a very complicated one, which brings a serial of difficulties by itself. Because of the multi-layered problems, for big real estate enterprises, it should always be the goal, to convert the existing gross hire contracts. Besides, every tenancy has to be considered separately and every decision must be made individually. So it is possible, that one tenant agrees without any problems, but another one refuses the approval and cannot even be persuaded by negotiation. Hence, the change of an existing rent structure will be always an isolated case decision.