

February 2020

## *Market update: Berlin Rent Act passed – What are the practical consequences?*

### 1. Background

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At its meeting held on 18 June 2019, the Berlin Senate approved the key elements of a new Berlin law on residential rents, including the so-called "rent freeze" as its main feature. On this basis, the Senate Department for Urban Development and Housing presented a draft bill entitled the "Act on Limiting Rents on Berlin's Residential Market" (*Gesetz zur Mietenbegrenzung im Wohnungswesen in Berlin*) on 30 August 2019. The cornerstones of the draft bill were the "rent freeze" (i.e. freezing the rents at their current rate for a period of five years) and the prescription of a rent cap. In light of the in some cases harsh criticism which the draft bill attracted, the Berlin Senate agreed a compromise in respect of the

"rent freeze" in October 2019 and resolved to submit the corresponding draft legislation (Act for Redrafting Statutory Requirements on Rent Limits - the **Rent Act**) to Berlin's House of Representatives.

At its plenary meeting on 30 January 2020, Berlin's House of Representatives passed the Rent Act by 85 votes to 64 (printed record 18/2437). It will take effect on the day following its publication in the Journal of Laws and Ordinances for the State of Berlin. Publication is expected to take place in late February/early March 2020, with retroactive effect 2019.as of 18 June

### 2. Key elements of the Rent Act

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The Rent Act provides in particular for the following key elements which will apply for a term of five years:

- Application of a **rent freeze** on all existing leases: Subject to the following exceptions, it will not be permitted to charge rents in excess of the rent effectively agreed on or before 18 June 2019 (the **effective date**). Staggered and index rents are also subject to this rent freeze, i.e. any rent increases due as a result of indexation or staggering clauses between the effective date and the date on which the Rent Act takes effect are prohibited. Insofar as a rent

increase imposed after 18 June 2019 is deemed unlawful, a tenant could demand that the landlord pay back any excess rent on the grounds of unjustified enrichment (sections 812 ff. of the German Civil Code (*Bürgerliches Gesetzbuch*; **BGB**).

- If residential space that had never been let out as residential space up to the effective date is or was let for the first time between the effective date and the date on which the Rent Act takes effect, the first agreed rent is relevant in respect of the above

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- prohibition. Thus, in such cases a market rent may be agreed before the Rent Act takes effect without the risk of the agreement being retroactively deemed invalid and the landlord being required to return any excess rent. At the same time, the tenant may, within nine months of the law taking effect, demand that the rent be reduced to the permitted cap (see below).
- If residential space is or was re-let after the effective date and the lease continues to apply upon the Rent Act taking effect, the newly agreed rent will be relevant for the rent freeze. Thus, in such cases too, a market rent may be agreed before the Rent Act takes effect without the risk of the agreement being retroactively deemed invalid and the landlord being required to return any excess rent. At the same time, the tenant may, within nine months of the law taking effect, demand that the rent be reduced to the permitted cap (see below).
  - If the permitted monthly rent under the aforementioned criteria is less than EUR 5.02 per m<sup>2</sup> of residential space and if the property possesses two "modern furnishings" (see below), the permitted monthly rent will be raised by EUR 1/m<sup>2</sup> in the case of re-letting, but must not exceed EUR 5.02 per m<sup>2</sup> of residential space.
  - As of 1 January 2022, these defined rent caps will be subject to an annual increase equal to the percentage inflation determined by the Federal Statistics Office as of 31 December of the previous year compared with the effective date, but this must not exceed 1.3%. The Senate department responsible for housing must define the relevant percentage by way of a legal order.
  - Definition of **rent caps** for residential space that is let for the first time or re-let after the Rent Act takes effect: The caps are based on the 2013 rent index and apply to re-lettings and renewals as well as to existing rental agreements. In order to account for the increase in incomes in Berlin since 2013, the rent caps were adjusted to reflect real wage developments and were 13.4% higher than 2013 levels. A corresponding rent table was published for the first time together with the draft legislation on 22 October 2019.
  - In the case of housing with "modern furnishings", the rent cap is raised by EUR 1/m<sup>2</sup>. "Modern furnishings" are deemed to exist if the property has at least three of the following five features:
    - barrier-free access to a lift from the apartment door and the building entrance;
    - fitted kitchen;
    - "high-end" sanitary appliances;
    - "high-end" flooring in the greater part of the living space ; and/or
    - energy consumption value of less than 120 kWh/(m<sup>2</sup>a).
  - Increasing the rent cap by an additional 10% for residential properties containing no more than two apartments.
  - **Rent reduction** to permitted level in the case of "exorbitant" rents: If the rent exceeds the relevant rent cap set out in the rent table by more than 20%, the tenant is not responsible (in contrast to the provisions of the initial draft bill) for applying to the Senate authorities for a reduction of the rent. The landlord is now obliged to reduce the rent to the permitted level. This duty of the landlord to reduce the rent only applies, however, once nine months have elapsed since the Rent Act took effect, thus not before November 2020. This amendment, which was only included in the legislation shortly before it was passed by the House of Representatives, means that excessive rents can no longer be reduced by the Senate authorities by way of an administrative order, but that tenants may be forced to take their case for rent reduction to the permitted level before the civil courts.
  - The **property location** also plays a role when determining the maximum permitted rent. The legislation provides for surcharges and discounts for a "simple" location (-28ct/m<sup>2</sup>), "average" location (-9ct/m<sup>2</sup>) and "good" location (+74ct/m<sup>2</sup>).
  - It will be possible to perform **modernisation work** in future and to increase the rent to cover the corresponding costs, provided the rent is not increased by more than EUR 1/m<sup>2</sup> in this context and
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the respective rent cap is not exceeded by more than EUR 1/m<sup>2</sup>. The *Investitionsbank Berlin* must be notified of such rent increases. Any additional modernisation costs incurred cannot be passed on to tenants; however, they may under certain circumstances be covered by applying for funding under appropriate incentive schemes.

- It is not possible to pass on to tenants the costs of "luxury refurbishments", i.e. modernisation work

that is not designed to achieve barrier-free access or energy savings.

- The Rent Act provides for cases of **economic hardship**, whereby landlords can apply for approval of higher rents if the net basic rent (without utilities) under the rent cap would cause the landlord to suffer losses or place the substance of the leased space at risk; such applications must be submitted to the *Investitionsbank Berlin*.

## 3. Scope of application and legal consequences of non-compliance

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### TERM AND REGIONAL SCOPE

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The Rent Act still provides for retroactive application as of the effective date (18 June 2019), i.e. as of the date on which the Senate resolved the first key elements of the "rent freeze".

As a piece of legislation at state level, the Rent Act would only apply to leases in Berlin. Advocates of a rent

freeze can be found in other parts of Germany, too. Bavaria is currently witnessing a "rent stop" campaign inspired by Berlin's "rent freeze". We do not anticipate other German states to introduce similar legislation before the Rent Act has entered into force and its constitutional compliance (see below) has been clarified.

### PROPERTIES COVERED

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The legislation will apply to all existing rental properties located within the City of Berlin comprising more than one apartment that are not price-linked (approx. 1.5 million apartments in total).

Exemptions are to be granted for government-sponsored residential building ("social housing"), housing provided by social welfare organisations for persons with urgent needs ("welfare organisation housing"), housing in respect of which public funds were granted for modernisation and refurbishment work and apartments in residences (such as student halls or retirement homes) and new builds.

"New builds" applies to all residential properties that were ready for occupancy on or after 1 January 2014. In deviation from the original draft legislation, the Rent Act will also apply to former residential space that is initially permanently uninhabitable or uninhabited and which is then restored for residential purposes, using efforts equivalent to those required for new builds.

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## LEGAL CONSEQUENCES

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Breaches of the planned regulations under the Rent Act will be subject to administrative fines of anything up to EUR 500,000 in the individual case.

# 4. Assessment – Constitutionality of the Rent Act and political reception

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The Senate Chancellery and the Senate Department for the Interior and Sport (both *SPD*) have each raised legal concerns relating to the Rent Act in letters addressed to the Senator for Urban Development Katrin Lompscher (*Linke*). The opposition parties in Berlin's House of Representatives regard the Rent Act in its resolved form as anti-constitutional.

The Rent Act thus raises numerous unanswered questions, some of which have not yet been the subject of judicial clarification, and countless strong arguments are being introduced which may lead to the Rent Act being ruled unconstitutional on both formal grounds (of competence) and on its merits (i.e. content).

The legal debate focuses primarily on the questions of (a) the extent to which the State of Berlin has legislative competence to pass the provisions, (b) the extent to which the Rent Act represents an unreasonable infringement of fundamental rights, (c) whether the basis for assessment of the planned rent cap is to be considered

legally permissible and (d) whether the backdating of the law is constitutional.

Not least the constitutional concerns have given rise to substantial political resistance to the planned legislation. The *FDP* and *CDU* factions of the Berlin Senate have already announced their intention to file an abstract avoidance petition (under state law) with Berlin's Regional Constitutional Court to have the Rent Act scrutinised. They wish to launch the proceedings before the summer recess.<sup>1</sup> At the federal level, the *CDU* and *FDP* factions also wish to file an abstract avoidance petition with the Federal Constitutional Court.<sup>2</sup>

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<sup>1</sup> Source: <https://www.sueddeutsche.de/wirtschaft/wohnen-berlin-cdu-und-fdp-wollen-klage-gegen-mietendeckel-dpa.urn-newsml-dpa-com-20090101-200131-99-718423> (downloaded on 31 January 2020).

<sup>2</sup> Source: <https://www.tagesspiegel.de/berlin/mietendeckel-in-berlin-cdu-und-fdp-bereiten-klage-vor/25495374.html> (downloaded on 31 January 2020).

## 5. Reserve clauses in case the Rent Act should be ruled unconstitutional

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Given that the Rent Act will enter into force in the near future regardless of whether it stands up to constitutional scrutiny, it may appear conceivable to landlords to include a reserve or alternative clause in lease agreements to be newly concluded for residential properties. Such a clause could stipulate that the parties are to be obliged, in case the Rent Act is held to be unconstitutional, to agree on a higher rent (in compliance with the applicable provisions of civil law governing the amount of the rent).

However, concerns have been expressed by some with regard to the validity of such a reserve clause should the provisions dealing with the "rent freeze" in fact be ruled unconstitutional and the Act is consequently found to be null and void.

To begin with, it is in principle legitimate for contracting parties to contractually provide for a remedy in case the (Federal) Constitutional Court declares a provision which was of decisive importance in the transaction to be unconstitutional. Although the nullity of a transaction concluded in breach of a prohibitory act (as, in this case, the Rent Act) remains unaffected if the act is subsequently repealed (section 134 BGB), the clause concerned in the present case would be intended to become effective only if the Rent Act is held to be unconstitutional, and therefore no violation of section 134 BGB would have been committed.

In detail, however, it is necessary to distinguish between (1) an adjustment clause, which has an effect only in the future, so that the increase in rent becomes effective only from the point in time at which the Rent Act is declared to be unconstitutional (so-called effect "ex nunc"), and

(2) a clause having a legal effect in that the increase in rent is to be effective retroactively from the moment of the conclusion of the lease agreement.

It is the entry into force at the time of the declaration of unconstitutionality which is consistent with the rationale of the law. Where continuing obligations are concerned, the nullity of the law constitutes a frustration of contract in accordance with section 313 BGB. There is therefore a right to demand an adjustment of contract, which has already been provided for by the inclusion of the reserve clause in the lease. This reservation can be included in the lease; it merely rules out the possibility of having to sue for the adjustment of the lease at a later date.

By contrast, the case of a retroactive increase in rent is problematic from the outset. Although the freedom of contract might also enable the parties here to make such a provision, it could be deemed to constitute a violation of section 558b I BGB, which allows a demand for increased rent only with effect in the future. Any deviation to the tenant's disadvantage is inadmissible according to section 558b IV BGB (although a limited exception exists in respect of the allocation of operating costs, section 560 II 2 BGB).

A safer provision therefore appears to be one that provides for an increase in rent effective only from the moment at which the Rent Act is declared unconstitutional; but here, too, it would be necessary in each case to bear in mind further requirements that could follow from the laws governing general terms and conditions.

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## 6. Conclusion

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Since the Rent Act was adopted by the House of Representatives in Berlin on 30 January 2020, landlords will have to accept for the time being (until the question of the constitutionality of the legislation has been decided by the courts) that they will have to swallow rent reductions for a period of nine months after the entry into force of the Act.

However, no obligation to repay rent need be feared under any lease agreement for which the most recent increase in rent (or, as the case may be, indexation or staggering) took place **before the effective date**. But the tenant has a claim to a reduction of the rent to the cap set under the Rent Act, which must be asserted within nine months after of the law entering into force. The same applies to residential space that is let for the first time (or re-let) **between the effective date and the date on which the Rent Act takes effect**.

However, as the rent freeze applies retroactively from the effective date, any rent increase (or, as the case may be, an indexation or staggering) made **after the effective date** is null and void. The excessive rent resulting from such a rent increase can be reclaimed by the tenant.

All lease agreements concluded **after the Rent Act enters into force** are subject to the Act without any

limitations and consequently the caps set for the amount of rent are mandatory and must be observed as such.

However, new building projects that are on-going or have been completed since 1 January 2014 are expressly exempt from the scope of application of the Rent Act.

For any new lease agreements, landlords should consider including a so-called "reserve clause" in the lease governing the permitted amount of rent. Should the Rent Act be held later by the courts to be unconstitutional and the Act consequently be declared null and void, a reserve clause could allow an adjustment of the rent (at least for the future) to the level that applied prior to the law entering into force.

Both landlords and tenants will have legal certainty only once a final decision has been taken by the constitutional courts. But it should be noted here that, even if the Regional Constitutional Court of Berlin passes a decision before the Federal Constitutional Court does, the issue of the existing legislative power can be adjudicated only by the Federal Constitutional Court. In our opinion, a decision - even in the form of a temporary injunction - is not to be expected this year.

# Your key contacts

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