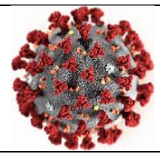
National COVID-19 Science Task Force (NCS-TF)	

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Contact person: marius.brulhart@unil.ch	
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Title: Public matching payments for commercial rent abatements during the Covid crisis

Summary of request/problem

Executive summary: In order (a) to further strengthen the resilience of the Swiss economy during the pandemic, and (b) to unblock the current deadlock between tenant and landlord lobbies, public matching payments on rent abatements for commercial tenants offer an economically attractive solution. Matching payments "grease" landlord-tenant negotiations and would serve as a relatively low-cost policy intervention to internalize a potentially important externality.

Main text

The Covid pandemic and its associated restrictions threaten to trigger a wave of bankruptcies and a private debt overhang that could depress the economy well beyond the end of the lockdown.

The Federal Council has taken swift action to compensate firms' wage costs in crisis-hit sectors. Economists have called early on for comparable intervention in the area of capital costs (Alós-Ferrer *et al*., 2020; Bonardi *et al*., 2020; Gersbach and Sturm, 2020).

The current policy of government-backed loans alleviates liquidity shortfalls, but it cannot stave off the threats to solvency that are building up the longer demand remains depressed (be it *de jure* or *de facto*). Fully 40% of the fixed costs of Swiss small and medium-sized enterprises are estimated to consist of capital costs (Siegenthaler and Stucki, 2015).

It is no surprise, therefore, that a debate is underway on how to deal with those capital costs – a significant part of which are rent payments for commercial real estate. The question boils down to how the Covid bill should be split between renters, landlords and the state.

Landlords and tenants are currently left to negotiate individual settlements without intervention by the federal government. However, evictions and bankruptcies generate costs to the economic system as a whole that are bigger than the costs to the negotiating parties themselves. While landlords have an incentive to avoid driving their tenants out and/or into bankruptcy, that incentive is not as strong as it should be, because individual landlords do not internalize the follow-on costs on other business triggered by the distress of their individual tenant. Similarly, business owners will close down too easily from a societal point of view, as they too do not internalize the follow-on costs of their actions. Moreover, there could be a free-rider problem in the case of tenants with multiple premises and multiple landlords: every landlord has an incentive to wait for other landlords to grant concessions so that they themselves do not have to (because thanks to the other landlords' concessions, the tenant's solvency may be assured). A laissez-faire approach thus risks triggering a socially undesirable number of closures and bankruptcies.

One solution would be for the state to shoulder a substantial part of rental costs of commercial renters whose turnover has been hit by the pandemic. This would shift the debt burden to the government, whose borrowing terms are cheaper than the private sector's and who could distribute the burden of debt repayment in transparent and democratically legitimized fashion. This approach, however, appears to have limited political support because of its perceived favoring of landlords (even though this could be corrected by taxation after the crisis – including through taxes on real estate wealth).

A second approach therefore merits to be considered: **public matching payments on rent abatements for commercial tenants**. Such a solution is in force for small businesses and restaurants in the cantons of Fribourg and Vaud, and variants are being evaluated by the economic committees of the federal parliament, as well as by cantonal covernments (e.g. Basel-Stadt, see Regierungsrat Basel-Stadt, 2020).

With that approach, the state offers to match rent reductions granted by landlords by a proportional amount (e.g. 50% or 100%). If the subsidy rate were set at 100%, for example, a landlord granting a 25% abatement would receive 25% of the original rent from the public purse and the remaining 50% from the tenant.

Such matching payments could helpfully "grease" negotiations between landlords and tenants, and they would have a coherent rationale as a public subsidy for internalizing the positive externality implied by keeping commercial renters afloat.

This approach would leave room for individually negotiated solutions fitting the financial circumstances of each tenant-landlord pair. Hence, once the proportional rate is fixed, landlords and tenants could be left free to negotiate (subject to legal safeguards to avoid collusion by related renters and landlords). Public matching payments could be linked to a statement that future recourse to courts is excluded, which would reduce legal and planning uncertainty for the negotiating parties and alleviate the subsequent burden on the legal system. From a legal standpoint, matching payments would have the additional advantage of avoiding regulatory interference in the sanctity of ongoing contracts.

In order to be acceptable to landlords, such subsidized contracts would need to be time-limited. But given the uncertain duration of the crisis, they ought also be extendable by mutual agreement, with the public matching payment ex ante guaranteed for the duration of the crisis (as defined by the government, possibly differentiating between sectors and regions).

The fiscal cost of such an intervention could be quite limited. With an estimated volume of crisis-affected commercial rental payments of some CHF 350 million per month (Valda, 2020), and assuming a matching payment of 30% on average, the monthly budget cost would amount to some CHF 105 million. Commercial tenants, in that scenario, would benefit from an average abatement of 60%, safeguarding their solvency. The discounted effective budgetary cost would therefore be smaller still, to the extent that future tax revenues will increase faster after the crisis thanks to renter businesses having been kept in operation.
Unresolved issues Budgetary attribution (federal budget and/or cantonal/municipal budgets)

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