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Rentals in Belgium and inflation: the end of a link?

Rentals in Belgium are almost always linked to the consumer price index. Economic policy arguments are now being raised to end this practice.

Key Issues

- Powerful voices demand a change to the current indexation system
- History shows that governments can tamper with the system
- The Belgian practice is unusual compared to the rest of Europe
- What to expect is not yet clear

If even the National Bank of Belgium and Angela Merkel say so...

It used to be an obvious truth: incomes rise in line with inflation. This was, and still is, Belgium's view of the laws of economics. Salaries are linked to inflation and are adjusted automatically in line with the consumer price index. So are pensions and other social allowances. And so are rentals: lease agreements consistently provide for an annual adjustment of the rentals, through a so-called "indexation". The practice is the same for all types of properties: residential, office, commercial, etc.

This paradigm is now under attack. It started softly enough when the national collective bargaining over wage increases for 2011-2012 ended mid-January with a vague agreement between employers and trade unions to "conduct further study on how to reduce the volatility of the indexation system". Then at the European summit of 4 February 2011, German Chancellor Merkel and French President Sarkozy demanded the establishment of a European "competitiveness pact" that would include a prohibition of automatic linkage between wages and inflation. And on 16 February, the National Bank of Belgium itself published its annual report saying that the indexation system must be reconsidered.

There is no political consensus at the moment to change the system, but the genie is out of the bottle. We look below at the current law and practice, and at a history of past governments having repeatedly tampered with the indexation mechanics already.

Current law and practice

Belgian law provides that leases may provide for indexation of rentals, subject to certain conditions: indexation cannot take place more than once a year, and the indexation cannot exceed the increase in a so-called "health index" – that is an adjusted consumer price index, which excludes the prices of car fuel, tobacco and alcohol. These rules apply to most types of leases, with some exceptions for leases that take the form of rights *in rem*, such as long leases (*emphytéoses / erfpachten*), building rights or usufruct agreements. Other arrangements for variable rents, like turnover rents, are not in themselves indexation mechanisms and escape these rules; they are common for specific forms of leases such as retail leases.

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Most commercial and retail leases in Belgium apply indexation clauses in line with the law, and add a ratchet feature which provides for "upward only" indexation. The market practice has been moving somewhat since the beginning of the financial crisis in 2008. Parties will now occasionally agree on indexation caps, for instance, on pre-set indexation percentages, or on "upward and downward" indexation.

A history of tampering with the indexation system

The laws on rental indexation have changed several times already.

Before 1984: contractual freedom and specific temporary laws. Until 1984, lessors and lessees were generally free to determine (or not) indexation mechanisms in their lease agreements without particular restrictions. The authorities sometimes interfered with these mechanisms, during times of economic crises (*eg* in the 1975-1983 period) or during times of war, by freezing or capping rent rates.

Between 1984 and 1994. The first true regulation of rent indexations entered into force in 1984 after fierce political negotiations. The 1984 law provided for three essential principles: indexation is allowed but is not automatic, it can only be applied once a year, and the maximum reference index is set by law.

Since 1994. A new maximum reference index became compulsory: the "health index", based on the consumer price index excluding the evolution of the prices of tobacco, alcohol and car fuel. The evolution of this index has since then consistently lagged below the full consumer price index. Two aspects of the 1994 law are worth remembering: firstly, the arguments used to justify the choice of a "health index" were exactly the same as those put forward today (*ie* protection of the competitiveness of the country, reduction of the volatility of the indexation, etc) and, second, the change in law applied immediately to current contracts.

Belgium is the odd one out

The Belgian indexation law and practice is somewhat unusual when compared to the rest of Europe. With the exception of Germany, Belgium's neighbouring countries do not generally apply the same indexation principles to commercial leases. For example, France generally applies a "National Cost of Construction Index" to commercial leases (subject to certain recent evolutions), the Netherlands allow for full contractual freedom, and in the United Kingdom parties generally do not apply rental indexation.

What to expect?

The current caretaking government will not be able to do much on the subject, but wage and rental indexation is likely to be a topic in the formation of the next government. A full repeal of the indexation system is not on the agenda for now and would be politically unattractive. On the other hand there is growing pressure not to leave things as they are. If legal history is any guide, we should not be surprised to see something like this:

All leases are caught: even if the political rationale will relate to residential leases only – wage earners who lose indexation of their income should not have to pay inflation-linked rentals to their landowners – the new regime will apply indiscriminately to all leases, including commercial and retail leases.

Current leases are caught immediately: the new regime will overrule contractually agreed clauses and will apply immediately to all current contracts.

Compromise: a political compromise is much more likely than a clear cut departure from present practice. For instance, the "health index" could be made even healthier by excluding from its calculation inflation-prone components such as domestic gas, fuel oil or electricity, or could be tweaked by some formula linked to the evolution of the country's productivity.

A European summit convened for 11 March 2011 will look again at this issue. More to come in the next few weeks and months, no doubt ...