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In comparison with European residential property markets, the Polish residential property market has a transparent structure. As regards supply, the highest market share is held by private owner developments (natural persons that build a house for their own needs) and property developers that build properties for sale or to rent, active mainly within the multi-family housing sector. Together the two groups represent more than 90% of the primary market. Demand is generated mainly by those that purchase a property in order to meet their own residential needs and investors that purchase an apartment in order to rent it out or for speculative purposes. The share of the latter group is steadily increasing and it is estimated that in 2016 it represented approximately 10-13% of demand on the primary market. The private rented sector (PRS) is growing dynamically, while investor demand for purchase of new apartments is driven by both macroeconomic factors and a belief in the long-term value of properties. Similarly as in other countries within the CEE region, there is an ingrained need in Poland to own property which is still extremely strong and grounded in historical context.

The increased investment activity on the residential property market and interest in renting apartments has been on the rise since Poland’s accession to the EU and shows that acceptance for other forms of use of property is increasing. Greater mobility of the Polish population and flexible labour market conditions have led to changing investment priorities and consumption styles of Polish families. In our opinion, we are currently witnessing a generation handover, a result of which is the way in which assets are utilised and it is not just their ownership itself that takes priority. This change is also evident in the approach to how a property is occupied and different investment priorities. The generation of today’s 40-50 year olds, who during the time of the political system transformation were focused mainly on establishing their professional position and providing material stability for their families, is now giving way to the spirited generation of the “citizens of Europe”. For the younger generation, attachment to a particular place in the form of a property represents an obstacle to growth and mobility, while a mortgage, unless used as a measure of providing comfort for the family or a tool for financial leverage, constitutes a form of restriction of freedom.

The evolution of the Polish residential property market is still ongoing. The phase of dynamic growth in 2006-2007 revealed that in addition to individual clients, the presence of institutional investors also plays an important role in increasing production of housing and growth of the market. Their expectations as regards rates of return, forms of providing security for capital and quality standards help improve security of trade and set new trends. Furthermore, the institutional investor market applies the most profitable forms of use of properties. Today, in the era of market stabilization, institutional capital is not looking exclusively for increases in property value; it is also looking for opportunities for mid- and long-term generation of income from renting a property.

The Polish residential property sale and rental market finds itself on the threshold of qualitative and organizational changes. The scope of services actively pursued by CBRE Polska includes services addressed to capital investors and property developers planning to enter and already operating on the Polish residential market. This publication is designed to better acquaint our readers with the challenges, restrictions and main directions of growth thereof. We mainly focus on an analysis of the processes taking place within the private rented sector (PRS). We are noticing clear signals that are indicative of a trend change as well as an increasing presence on the market of institutional investors in the form of investment funds and banking institutions. Moreover, we can also see that the rental market represents an attractive alternative for residential developers as regards increasing the scale and diversification of their current operations.
RENTAL MARKET

Summary

1. Growth of the private rented sector (PRS) in Poland is stimulated by the traditional perception of investments in property as a simple, safe and liquid financial instrument as well as a way of providing long-term security for one’s capital.

2. Rates of return on rental of apartments in new stock of residential housing that have been on the rise since 2014 encourage investors to withdraw funds from low-interest bank deposits, bonds and units of participation in investment funds and to move them towards more profitable rentals. The average return on rental on the residential property market oscillates around 4.7-5.0% per annum (source: CBRE 2017). This is also a level acceptable for institutional investors that see the residential property market as an alternative for the competitive office and retail property markets.

3. Stable purchase prices of new apartments and the opportunity to enter the private rented sector when investing an amount lower than EUR 100,000 encourage private investors that have free funds at their disposal to establish small portfolios of rental apartments.

4. Low-interest and easily available mortgages (interest for March 2017: 3.54-4.03% + one-off commission at 1.8-2.9%) (data published by the Polish Bank Association) sway those with positive credit ratings and cash resources that make it possible for them to make their own contribution to invest in rental property. Income from renting an attractively located property on one of the main residential property markets in Poland allows investors not only to safely cover the monthly mortgage payment, but also generates a surplus of available cash.

5. A large part of income from private rented apartments goes directly to the budget of owners bypassing the official channels and tax settlements. The estimates as to the size of the rental market are 50% higher than the official data of tax authorities on the number of people that declare in their tax returns that they derive income from concluded rental contracts. The changing legal and tax background and policy of tax authorities drive a sizable group of market participants to remain within the “grey market”.

6. The regulations on the so-called “temporary rental” currently applicable in Poland are seen as only moderately favourable for property owners despite the tax incentive in the form of the 8.5% flat-rate income tax. Alternatively, it is possible to tax your rental income on general terms, i.e. applying the 18% or 32% rate for rental by natural persons. Taxation on general terms allows investors to deduct depreciation costs, financial costs and current expenditure.

7. The experience from operating the BGK Rental Housing Fund and the first purchase transactions in respect of portfolios of apartments concluded by institutional investors are proof that institutional rental of apartments could represent a new competitive scope for investment on the Polish residential property market.

8. Property developers are displaying a readiness to provide a housing product of a standard expected by institutional purchasers as well as interest in expanding the target group by this particular segment of the market. The property developer circles have for several years observed the growing importance of the rental market and are now looking for partners ready to purchase and co-finance projects dedicated to this segment.
1. Size of the rental market

When using official statistics, it is difficult to unambiguously determine the size of the rental market which is above all shaped by individual owners. Depending on the source, it is estimated at between 570,000 apartments (research by the Central Statistical Office of Poland carried out based on the number of tax returns declaring income from property rental) and 900,000 apartments (data provided by the rental property management company Mzuri). According to the above data, there are approximately 2,000,000 people on the market living in rented properties, with the prospect of a 10% increase in 2017. Rental apartments constitute therefore 3-6% of Poland’s total housing stock held by natural persons. Various tax issues and the advantageous legal position of tenants against landlords mean that the size of the private rented sector (PRS) and the actual flows of money on this market slip from the official statistics of the state. The discrepancies between the official data and the estimates provided by industry experts show that a significant group of private landlords function within the grey market, while at the same time they secure themselves against the legal risks arising from disputes with tenants remaining in arrears with payment of rent and other charges (e.g. operating costs).

In parallel to the commercial rental market, there operates a property market that forms a part of the social housing stock owned by housing co-operatives. The share of the State Treasury is relatively low and according to data obtained during the National Census of 2011, it stands at 10.7% of the total volume of the rental offer. Social housing affects the commercial rental market by shaping the so-called index of property replacement value used as tenant’s protection against unjustified rent increases in the case of commercial rental subject to the regulations arising from the act on tenants’ rights (legal act register Dz.U. of 2001, no. 71, item 733).

At the same time, the Polish market displays some significant differences as to the age distribution of tenants (there is a dominance of tenants above 40 years of age on the Polish market) and the length of the rental relationship (approximately 2.5 years).
2. Available rental offer

The geographic distribution of the market is reflective of the scale of activities of property developers and the size of the labour and education markets as well as the prospects for their growth. As a natural consequence, Warsaw is the largest market, followed closely by the university hubs displaying signs of strong economic growth, i.e. Kraków, Wrocław, the Tricity, Poznań and Łódź. The dynamic growth of the rental offer is additionally noticeable in other university towns including Lublin, Toruń, Białystok and Rzeszów.

With regards typical residential properties, the structure of the rental offer reflects the structure of the offer presented by property developers. It is dominated by one bedroom residential units with an area of up to 45 sqm and small two bedroom apartments with an area of up to 60 sqm. Purchasing rental properties in a natural way focus on issues such as the purchase price, purchase incentives related to the transaction and future costs of maintaining the property. Future costs of maintaining common areas, the scope of additional services such as security and the issue of property tax and perpetual usufruct fees are of particular importance here.

The disproportion between the needs of the rental market and the offer presented by property developers is visible within regional markets and the university town markets, where the tenant’s budget plays a greater role than the property’s functional standard and quality of the fit-out. Therefore, the most sought-after properties on these markets are studios and small one bedroom units with an area of up to 45 sqm that can accommodate at least 2 people (desirable separate kitchen as opposed to a kitchen annex).

Parking Ratio

Depending on the transport policy for the city and different locations within it, the ratio for new schemes stands at between 0.5 and 1.5 parking spaces per unit. The average purchase price for a parking space in an underground car park falls between PLN 28,000 and PLN 40,000 gross. Admittedly, in accordance with the law, purchasing a parking space is not obligatory, however in many instances the opportunity to purchase a residential unit is connected with the purchase of such a space, as promoted by the appropriately managed sales policy of the developer. The costs of a parking space not only significantly increase the cost of the purchase, but also result in lower return on rental, as the return on rental of a parking space is distinctly lower than the return on rental of an apartment itself.

For example, the residential market in Kraków is experiencing a noticeable problem with sales of rental premises within buildings located on land covered by the right of perpetual usufruct as opposed to full ownership. Kraków city authorities for a few years now have had an efficient cadastral system in place and are on an ongoing basis updating the value of land within the stock owned by the city as well as levying the fees chargeable on account of the right of perpetual usufruct. In attractive central locations, the annual fees for a one bedroom apartment can amount to twice the amount of the expected monthly rent.

„The disproportion between the needs of the rental market and the offer presented by property developers is visible on the regional markets and the university town markets, where the tenant’s budget plays a greater role than the property’s functional standard and quality of the fit-out.”
3. Rental profitability, rental rates

A distinct increase in rental rates and higher return on this form of investment has meant a visible since 2014. The rate of return oscillating around 5%, given a minimum inflation rate, corresponds to the returns achievable on Europe’s mature residential markets. The highest returns have been generated by units within stock completed by developers after 2004, where modern building technologies have been applied to ensure long-term technical standard and value of the units. Additionally, as regards demand, there is a visible shift in tenants’ preferences towards new and almost new properties that are a guarantee of high functional parameters. Quality translates into acceptance of higher rental rates in respect of older units. This difference is partially compensated for by lower operating costs to be covered by the tenant.

The steady growth in respect of offers of new rental properties should not result in the diminishing of tenant activity. In our opinion, on a 5-year perspective, rental rates should remain at an unchanged level. On the one hand, there are the millennials (generation Y) that are now active within the property market and the increasingly active representatives from generation Z (i.e. those born after 2000, also referred to as the 3F’s – friends, fun, feedback). In opposition to their parents’ generation and in accordance with the philosophy of a sharing economy, representatives of these groups do not wish to be bound by long-term mortgage liabilities. They are flexible as regards the choice of place of residence and at the same time, expect a high standard.

As demonstrated by experience from other European markets, a shift in demand towards the rental market is a natural consequence of social processes and changing life attitudes, but above all, it is primarily related to the high barrier to availability of housing. From this perspective, the Polish residential market is still under-valued, thus stimulating the purchase of properties to be owned privately. A catalyst for change here will be the introduction of a long-term savings programme for purchase of an apartment (modelled after the German Bausparkassen) and the government-run “Mieszkanie+” programme. Even if the impact of these programmes is difficult to evaluate today, a mid-term shift in some of the demand from the primary market towards the rental market is expected. This may change when the effects of functioning of the government-run programmes become visible and are possible to predict.

“A catalyst for change here will be the introduction to the Polish legal system of the institution of a long-term savings programme for purchase of an apartment (modelled after the German Bausparkassen) and the government-run “Mieszkanie+” programme.”
4. **Rental market segmentation, short- and long-term rental**

One of the factors indicating towards the progressive professionalization of the rental market is the ongoing segmentation of the market.

When considering the length of the rental relationship, the **short-term rental market** has clearly distinguished itself, characteristic for large urban centres and holiday destinations. The short-term rental supply is enriched by apartments in aparthotels and condohotels, as well as offers for workers’ apartments created for blue-collar workers. In this market, there are many professional operators and services specialized in short-term rental such as Sun&Snow and AirBnB.

The supply of apartments in aparthotels and condohotels has an additional aspect, as it is aimed mainly at people looking for a tax shield and a guarantee of regular income. Operators sell their properties as self-contained units bearing a 23% VAT rate, offer rental management services and provide a limited (3-5 years) guarantee of profit (average 6-7% per year on expected net income). The aparthotel product is also a good formula to legally circumvent the restrictions of building standards that have to be met by residential premises (minimum room size of 16 sqm, obligation to meet the daylight standard and the parking ratio requirement).

The **long-term rental supply** is the domain of private owners. This market is heavily dispersed. The main channel of communication between owners and potential tenants are numerous real estate agents and the presentation of offers on websites such as otodom.pl, domgratka.pl, gumtree.pl, and others. The basic rental terms are subject to negotiations between the parties, however the standard rental terms in Poland provide that:

1. The minimum term of rental is 12 months; the contract may be renewed for a further 12 months by the tenant submitting an appropriate declaration at least one month before the end of the rental period;
2. rent is paid in advance, usually by the tenth day of each month;
3. the tenant is obliged, depending on the market, to pay for utilities in advance based on meter readings and/or for property management on the basis of utility consumption forecasts or invoices from service providers presented by the owner;
4. the tenant submits appropriate declarations to the owner and establishes collaterals in accordance with the provisions of the act on tenants’ rights, allowing the owner to simplify the eviction procedure;
5. the tenant, as a guarantee of proper performance of the contract, pays a deposit to the account named by the owner equal to a minimum of 1 month’s rent;
6. parties agree on the terms of termination prior to expiration of the rental term, the equipment and fit-out to be provided and liability for its proper use;

The **long-term rental market** benefits from legal instruments available to the parties to the rental contract and flexibly responds to changes in the environment. In the main markets, due to high levels of activity of property developers, apartment owners are subject to strong competitive pressure resulting from the concentration of new housing supply, which is in particular visible during the first 12 months following completion of the property and delivery of an apartment to its owner. The prospect of rent-free periods (in particular when purchasing an investment property with a mortgage) prompts owners to rationally consider even less attractive rental offers.
5. Rental Housing Fund

This structure of ownership experienced an increase in institutional ownership after 2014 when the state-run Bank Gospodarstwa Krajowego established the BGK Rental Housing Fund. Its free-market nature translates into the opportunity for the flexible selection of partners and assets, and the lack of burden on the state budget beyond the means provided to it and at its disposal upon launch. An amount of PLN 5 billion has been allocated to be invested in development of institutional stock to be spent in a period of five years on key residential markets in Poland with the prospect of obtaining 20,000 properties to be rented on a free-market basis. The purpose stated for the fund was to broaden the supply of quality rental apartments in the largest agglomerations in the country. The Rental Housing Fund is designed to support professional mobility of Poles and provide an alternative for people looking for apartments who cannot or do not want to take long-term loans to purchase their own property. By definition, the rental supply of the fund is addressed to individuals and families interested in taking advantage of the complex and unique rental service available on the Polish market. It includes the rental of good quality apartments situated in new buildings and in good locations, finished to a “turnkey” standard, along with tenant support provided by the customer service centre and the building manager. At the same time, conclusion of a rental contract with an entity from the banking industry guarantees security and stability of its terms in the long term. The fund now owns investments in the Warsaw agglomeration (Warsaw and Piaseczno), Kraków, Wrocław, Katowice, Łódź and Poznań. In its first year of operation, it has secured the purchase of 2,400 apartments which are currently being taken over from developers and offered on the rental market. The pioneering nature of the fund’s activities should be highlighted. However, from today’s point of view, one should notice the discrepancies in the assumptions and their enforcement. The fund’s offer is not significantly cheaper than the rental offer presented by natural persons, but it has created an efficient rental system and security guarantees. It is important that the fund applies “temporary rental” provisions as the basis for concluding contracts, which pertain only to natural persons. Moving the manner of shaping the rental relationship to a commercial context (where one can define it freely within the law) is, on the one hand, a way to recognize the tenant and respect their rights, and on the other hand, a rational and professional action that secures the fund against possible disputes with unruly tenants remaining in arrears with payments. It seems that the experience of this fund will support the knowledge necessary for other institutional investors. The activities of the fund have also reinforced the willingness of developers to sell all or part of their housing projects to capital market institutions at a discounted price.

6. Stimulators and restrictions to growth of the institutional rental market

Experiences from mature European markets, such as the UK and Germany, show that the growth of the rental market requires not only social and economic acceptance, but above all a stable legal environment and professional owner services in terms of rental contracts and property management. The dispersed and diversified in terms of quality private rented sector (PRS) in Poland has not yet developed uniform standards in respect of the rental offer, rental management, contract templates and methods of reconciliation between the owner and the tenant when it comes to the costs of operating the property and related services. An element that introduces a certain level of order to the market are the standards developed by real estate agents active in the sector. The current state policy is focused on protecting the tenant, both in the case of rental of social housing as well as on commercial terms. We believe that the barriers to expansion of the institutional supply should be looked for in the cooperation between property developers and target recipients. On the part of property developers, there is a readiness to implement projects designated for the rental market and very frequently the necessary knowledge to perfectly tailor the product to meet the needs of the market. Property developers also have an understanding of the specific requirements that have to be met by buildings intended for rental, for example in terms of common space and the finishing standard, the need to obtain additional permits (e.g. for conducting activities relating to provision of food and drinks in the building) and the appropriate standard of technical equipment. They additionally display a readiness to design and fit out the interior space. The primary developers’ concerns that we are aware of are related primarily to the shaping of contractual relationships and the risk transfer between the developer and the end investor. The developer’s priority will be to ensure stable cash flows and to have confidence that the building designed in the “build to suit” system will be accepted by the end user. Short-term investors will be reluctant to accept several years of price retentions on account of quality assurance or will have to transfer them towards the general contractor. Furthermore, the expected level of discount on the standard price possible to achieve in retail sales also raises concerns. For a residential property developer, a transaction with a financial institution will always be comparable to a typical development process aimed at winning individual clients and the costs of managing such a sales process. A significant group of developers already have a
When viewing the rental property market, we should distinguish property management activities from rental property portfolio management, which may include the above scope of services or concern only standard rental management services such as:

- presentation of the rental offer, tenant acquisition;
- verification of the tenant, preparation and signing of the relevant rental contracts on behalf of the owner;
- handover of the premises, inspections;
- carrying out reconciliations with tenants, debt collection;
- acceptance of the premises after conclusion of the rental relationship;
- care for the quality of equipment, minor renovations and repairs;
- additional services for tenants, such as cleaning, maintenance, repairs, concierge services in selected buildings;
- tax settlements in respect of the rented property.

The market of such services is heavily fragmented and at an early stage of development. This service is not yet in the offer of leading Polish residential property agencies or international entities operating on the Polish property market. A potential investor must take into account the need to create his own rental management system (e.g. modelled after the BGK fund system) or purchase a structure with appropriate back office and know-how. It must be assumed that the growing scale of purchasing rental property portfolios will result in an increase in the number of professional entities supporting this market segment.

The commercial rental market is at an important stage of development where it needs to be unified and standardized as regards rental contracts, rental management and introduction of balance between the owner’s rights and tenant protection. The growing share of institutional investors for whom the issues of maintaining the quality of the stock, fiscal stability, continuity of the rental relationship and sustainable profit are of key importance, will help develop uniform contract templates, description and presentation standards in respect of the offer, methods of reconciliation with tenants as well as procedures for acceptance and handover of premises. The target owners of rental housing portfolios (e.g. international pension funds and REITs) will expect clear business rules and fiscal policy rules.

sufficient capital base and access to bank financing, allowing them to execute independent investments, which means that access to money is not a critical factor. Since 2016, the level of risk associated with the changes in the legal environment and progressive fiscalization of selected areas of the economy has been increasing. Even today, there are interpretation problems at the level of transactions on the property market concerning the levying of VAT and the speed at which the charged and paid tax is refunded. The property market, be it the sales or rental market, seems to be an attractive source of revenue for the state budget, and the size of the “grey market” previously mentioned raises legitimate concerns for financial institutions. We assume that institutional rental will be subject to clear tax rules and will be distinctly separated from individual rental in the provisions of law.

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8. Investment exit scenarios

For opportunistic investors, the ability to exit an investment in a portfolio of rental apartments is of high importance. The first transactions made in 2016 were by Catella Real Estate A.G., which acquired a portfolio of 72 luxury suites in the building at Złota 44 Street in Warsaw, and by Bouwfonds Investment Management, which acquired a building with 193 apartments at Peręca Street in Warsaw from the property developer Matexi. The entry of these opportunistic investment funds illustrates that the investment exit prospect is visible at the stage of selection of a property and market liquidity remains strong. This liquidity is conditional on both location and the level of fit out within the development. An annual influx of 60,000 apartments onto the market illustrates the scale and strength of the Polish residential market. It remains unrivalled within the CEE region and for that reason attracts the largest share of institutional investors.

For the moment, there are no known examples of “sale&leaseback” transactions or sales transactions by a company (M&A) having this type of assets (with the exception of outside-market transactions relating to the so-called employer-owned apartments).

Selling single apartments or portfolios of apartments to investment purchasers, along with ensuring comprehensive rental management services and the so-called guaranteed rent (model typical for aparthotels). This constitutes an extension of the available offer of selected developers (e.g. Dantex, J.W. Construction), in which apartments in selected buildings are sold together with a rental management packet usually provided by an entity independent of the developer that would at the same time for a fixed period (3-5 years) guarantee an agreed level of return on investment to the owner regardless of the occupancy rate. The contract usually includes a 6-8% rate of return. This offer is associated with the risks related to the quality of the service, solvency of the managing entity and a short guarantee period.

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One of the key expectations of the institutional investor is to have apartments finished to a “turnkey” standard, which departs from the standards of a typical property development offer on the Polish residential market. And although the group of property development companies ready to present such an offer is growing, the obstacle here for the rental market is the lack of clearly defined finishing standards and clear criteria as to the necessary equipment needed for the property to be considered to be finished to a “turnkey” standard. On the one hand, there is the need to optimize the budget, while on the other hand, there is the need to equip an apartment with a dishwasher, washing machine, microwave or a specific type of furniture (e.g. bed of a given size). In the private rental market, these issues are often negotiated between the owner and the tenant, and are reflected in the proposed amount of rent. In the case of institutional rental, it is hard to imagine a situation in which each apartment is finished to meet the individual needs of the tenant, and in the case of improvements, that the institutional owner refunds part of the expenses incurred. When considering the equipment in an apartment, we should pay attention to the issue of sustaining the quality and standard of the equipment in the long term. Even though technical wear and tear of a building is relatively slow and corresponds to the typical periods of depreciation, the wear and tear of an apartment itself and, in particular, its technical equipment, for which the owner is responsible, is much faster and dissimilar for the individual apartments in the building. The issue of scope and quality of the equipment now represents a significant cost item and should be the subject of careful negotiations between the institutional purchaser and the property developer. It is also necessary to have an appropriate reserve which would allow the owner to carry out efficient maintenance or replacement of the equipment in order to sustain an adequate level of rental income in the future.
6. In its growth phase, there is strong competition on the market as regards access to land that is attractive due to location and price. As a result of changes in the legal environment, suspension of privatisation processes and restricted reprivatisation, the supply of land is noticeably decreasing. The proportion of the value of land in the price of 1 sqm of an apartment in Poland’s 6 largest cities: Warsaw, Kraków, Wrocław, the Tricity, Poznań and Łódź rose from 10-12% in 2014 to an average 20-23%. Therefore, property developers favourably view land that requires greater effort and preparation (such as brownfield land), but which provides a guarantee of a lower purchase price and a better chance of acquiring a central location.

Property developers are aware of the risks arising from the change in the economic cycle and are now actively looking for alternative areas of activity that would ensure that they achieve the same level of returns on their operations and are able to retain the necessary workforce.

Residential property developers are open to having their operations financed directly by investment funds or indirectly by means of purchasing corporate bonds, sale of units of participation as well as financing by stock exchange investors. There is an understanding of the fact that increasing the scale of one’s operations requires cooperation and delegation of authority in respect of management.
1. New apartment market in Poland

2016 ended with a record increase in sales on the Polish residential property market. As evident from our transactional experience, over the past 15 months, residential property developers made substantial acquisitions of land for future projects that will ensure they have enough investment pipeline for the next 2-5 years. It should be pointed out that prices of investment land are rising noticeably with as supply contracts. Frequently, the land purchased enables implementation of multi-phase projects located in urbanized areas or those parts of cities that are undergoing dynamic transformation from brownfield land into residential areas. This represents a significant qualitative change in the structure of purchases made by residential property developers who due to the scale and cost of funding avoided the risk of tying their capital in large land acreage for extended periods of time. The considerable increase in revenues from operations between 2014 and 2016 enabled large players to move from a typical level of land acquisition at net 20-40 million PLN per plot of land to net 80-100 million PLN. A record land purchase transaction was completed in 2016 by Dom Development S.A., where a plot of land with an area of 9.4 ha located between the street of Żwirki i Wigury and the Marina Mokotów residential estate in Warsaw was purchased from Qualia Development for the price of net 133.5 million PLN. The sales dynamics in respect of land in urban areas was boosted by the changes introduced in May 2016 to the provisions on disposal of land effectively and potentially used for purposes of agricultural production (as per the entries in the land registry). In effect they have halted land development processes in urban areas and around large agglomerations and private sales and purchases of agricultural land, while in the future they will curb suburbanization processes and provision of new investment land. As a consequence of the amendments to the regulations relating to sales and purchases of land, property developers are left with land covered by local zoning plans and plots for which a valid decision on the conditions for land development has been issued as a minimum. Additionally, supply of land made available as a result of its restoration to lawful owners in reprivatisation proceedings dropped due to the attention from the media and the political background. The political changes that followed the 2015 election led to a change of privatization policy towards large state-owned organizations and the halting of supply of land from this sector. The dynamic trend in respect of apartment sales that came with the growth cycle in evidence since 2014, brought about increased demand for land and proved favourable to emerging market players. It was companies that went public (through an IPO) in 2015 and 2016, thus distinctly increasing their purchasing power and potential, e.g. Lokum Developer S.A., Archicom S.A. and Atal S.A., that have been particularly active on the land market. This high level of activity was also recorded for entities which between 2012 and 2013 completed and delivered an average of 150-200 apartments and planned to intensify their operations and consequently organically increased the scale of their investments.
As far as market growth is concerned, statistics for newly issued building permits are optimistic, confirming that property developers are easily able to adjust the scale of residential property production to meet the increasing scale of demand. According to data collated by the Central Statistical Office of Poland, a total of 106,600 building permits were issued in 2016. Residential property developers have at their disposal a substantial reserve of ready-to-launch projects tailored to the current requirements of clients. The decision as to commencement of construction is closely linked to an analysis of market conditions and the prevailing loan policy of banks willing to finance property development projects with presales at a minimum level of 20%. Obstacles to growth of the primary market over the coming 2-3 years will be as follows:

1. Levels of optimism in potential purchasers translating into an inclination to purchase capital-intensive goods and enter into long-term financial commitments. The negative assessment of the political environment as shown by the consumer confidence indicators in Q4 2016 and in January and February 2017 could be the first signs of a slowdown.

2. Limited supply of bank funding for private residential investments resulting from a shift of interest of the largest state-run banks towards future government housing programmes.

3. Tightening of fiscal policy leading to a weaker position of residential developers in potential disputes with tax authorities and negative changes within the legal environment.

4. Increased risks and costs resulting from dispersed production by property developers and expansion into new markets.

"Additionally, the considerable financial independence of property development companies resulting from the amount of own capital accumulated, moderate level of leverage and flexibility in terms of adjusting the level of supply to the true scale of demand is also of importance here."

Despite the challenges referred to above, as long as the current pace of growth in the Polish economy is sustained, it can be expected that in 2017 and H1 2018 the housing market will remain robust. And though the players active on this market are expecting yet another correction resulting from the demand cycle, there is a general feeling that its scale will be limited due to a transfer of activities into new market areas as identified later in the report. Additionally, the considerable financial independence of property development companies resulting from the amount of own capital accumulated, moderate level of leverage and flexibility in terms of adjusting the level of supply to the true scale of demand is also of importance here. It should be highlighted that a significant part of residential schemes in the most active segments, i.e. popular and mid-to-lower, is commercialized at a very early stage of the project execution process. Information as to the scale of demand is provided as early as at the stage of active presales, shortly before or immediately after obtaining the building permit decision. In the event that there is negative feedback, property developers have the time to adjust their pricing policy or change their investment plans, which could go as far as suspending execution of the project.
AVGAPARTMENT PRICES IN MAIN POLISH CITIES

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Source: AMRON, Department of Communities and Local Government / Council of Mortgage Lenders

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Source: Eurostat
2. Property developer market structure

The dynamic growth of Poland’s property developer market within the residential sector started c. 1993-1995. A distinct shift took place as part of the political and economic system transformation with regard to the centre of gravity of residential developments from the dominant role played by housing co-operatives towards private property developers implementing housing projects with the aim of making a profit. Initially, the scale of operations of property developers was rather insignificant. According to data collated by the Central Statistical Office of Poland, 485 properties were completed in 1993, which when compared to more than 65,000 properties completed in 2016, clearly shows the scale and pace of growth of the industry. Up until the year 2000, the fledgling property development sector relied mainly on own capital accumulated by business owners and on the model for financing construction from the prepayments regularly made by clients. Importantly, when choosing to use the products offered by property developers, purchasers of new properties had to take into consideration and accept the high level of risk, while the potential failure of the project meant a virtual loss capital. Prior to the introduction of changes in 2012, a purchaser’s legal position against the property developer was extremely weak. In the event of bankruptcy of a property development company, the claims of purchasers were settled as last from the bankruptcy estate, where priority was given to public and legal liabilities, liabilities towards contractors and third parties. An important role as regards improving legal and transaction security standards was played by the banking sector which, following signs of economic recovery after 2003, became more willing to finance property developers. At the same time, it built a considerable portfolio of mortgages, where there was a visible disproportion in terms of financing the demand side at the cost of the supply side. Indeed, it was the banks that introduced the high standards for assessment of risk related to property development ventures, the procedures for banking supervision over property developments as well as the so-called project-dedicated bank accounts. The risks related to the project would be carefully analysed as early as the stage of provision of financing, while depositing clients’ payments in the project-dedicated bank account used exclusively for reconciliations with the bank reduced the risk of mistakes being made in money management. Additionally, this signalled the introduction of more advanced security measures such as escrow accounts which became a norm for property developers after 2012 (as an open or closed escrow account). In turn, the property developers’ response to the inadequacies of the legal system and the growing need for transaction security took the form of proactive steps undertaken by the companies associated with the Polish Association of Developers. They developed a Code of Good Practice, a set of rules for establishing the legal relationship with clients purchasing residential properties and a service delivery model. The code became an important milestone in building market confidence between participants of investment projects. The activities of the Office of Competition and Consumer Protection were also of importance from the viewpoint of developing a market transaction practice and standards. Even though property developers viewed these particular activities as too casuistic, the Office’s introduction of a register of abusive clauses considerably improved clients’ security. It should be highlighted that despite the frequently changing market conditions, in particular in the years 2009-2010, the scale of bankruptcies amongst property developers has been minimal over the years. The conclusions drawn from the spectacularly dramatic bankruptcies of companies such as Salvador and Leopard in Kraków and the stock exchange-listed Gant Development S.A. in 2015 were used by both their competition and the banking sector to improve investment standards and to better quantify the potential risk. Particular attention is given to risks related to excessive debt incurred by property developers that are increasingly willing to obtain capital from the issue of corporate bonds and mezzanine funds. The excellent market conditions and the dynamic pace of sales of residential housing between 2014-2016 proved favourable to property developers building considerable reserves of own capital, efficient debt servicing and establishment of land banks. It is the number of companies associated within the largest industry body, the Polish Association of Developers, with its 143 members as at March 2017, that illustrates the scale of the market today. It is the number of companies associated within the largest industry body, the Polish Association of Developers, with its 143 members as at March 2017, that illustrates the scale of the market today. “It is the number of companies associated within the largest industry body, the Polish Association of Developers, with its 143 members as at March 2017, that illustrates the scale of the market today.”
Historically, the following groups of property development companies can be identified on the Polish market:

1. Those formed as a result of the natural evolution and expansion of contractor firm operations that searched for new investment opportunities during the economic system transformation and later on the dynamically developing residential market. Using their contractor experience and own technical and human resources, they were able to become effective administrators, suppliers and sellers of new residential properties within a very short time and at limited expense. Some of them, simultaneously whilst forming their construction entities, established separate entities responsible for preparation and commercialization of their residential projects. Examples of this include the Skanska group and Skanska Residential Poland, Budimex S.A. and Budimex Nieruchomości, as well as Mota-Engil Central Europe and Mota-Engil Real Estate Management.

2. Companies that at a dynamic growth stage utilised foreign capital for their formation and over the past 10-15 years have organically grown together with Poland’s residential market. Many have Israeli or American origins. They use the know-how of their parent companies and successfully manage the funds invested by international investors. Some, such as the Asbud Group and Ronson Development, have been present on the market for over 20 years and the scale of their sales is in excess of 1,500 – 2,000 apartments per annum.

3. Property development companies formed around large banking and finance institutions, e.g. mLocum S.A., an entity from the BRE Bank S.A. group, LC Corp S.A., a property development company from Leszek Czarnecki’s banking group and Qualia Development S.A., an entity from the PKO Bank Polski S.A. group. They used the advantage of having access to finance from their parent banking structures, particularly between the years 2003-2005 and later during the 2009-2011 crisis. In some instances they additionally played an auxiliary role for the banks in taking over failed and poorly managed developments and would complete the development process and minimize the banks’ losses at the banks’ instruction.

4. Large property development companies, primarily Polish-owned and formed mostly between 2000-2004 prior to Poland’s accession to the EU, which achieved their significant market position riding the waves of market growth between 2006-2008, e.g. SGI Baltis S.A., Atal S.A., Archicom.

5. A dispersed, but nevertheless sizeable, group of domestic operators that organically expanded their property development activities by reinvesting the funds obtained from previous projects. They are frequently family-run and base their operations on efficient management and owner’s expertise. As per careful estimates, this group totals more than 3,000 entities. They function extremely well on the local markets and the so-called micro-markets (cities with a population of up to 50,000 residents) due to the alignment of the necessary competencies and knowledge with the needs of local residents. With their consistently growing capital reserves and expertise, they are now attempting to enter the property development mainstream on the markets in Poland’s large cities.

S.A., Marvipol S.A., Wawel Service S.A., Eko-Park S.A. and Vantage Development S.A. It should be highlighted that a sizeable group of these companies commenced their operations on markets other than Warsaw and have retained leading positions on their original markets.
The above list does not identify all the forms of activities of property developers. However, the main characteristic of the residential property development sector manifesting itself in Poland is the high flexibility needed and the ability to adjust the offer and the organizational framework of the operator to fit the current market situation and the available financing models. The continuous strive to increase profitability and the scale of operations is favourable to establishing complex structures with elements of equal importance including: the financial structure, e.g. a closed-end non-public asset investment fund with links to the entity providing the funding, an independent management company, an external structure for process management (sales, asset management), or a contractor structure in the form of a construction company. Examples of this modern approach include companies from the Echo Investment S.A. and Skanska Polska groups.

In our opinion, the synergies with can be achieved within a group and the ease with which the investment process risk can be transferred to a different entity within the group while retaining full control is growing in importance. The model for risk management dominant in Poland is based on experiences on the German market, where potential risks have to be monitored on an ongoing basis and reactions have to be swift when they occur. In contrast to the American market, Poland rejected the model for transfer of property development risks through insurance with the objective of reducing the premiums to a minimum. Furthermore, the synergies within a group enables the proper use of human resources and the knowledge to which the organization has access thanks to well-educated engineering and management staff. We should also mention the increasingly important role played by market consultants having the requisite knowledge as to the market’s growth, databases with information as to available land as well as information as to the pace and terms on which residential housing is transacted. The management processes in respect of a residential property development company have become distinctly similar to the processes characteristic for the commercial property sector. The pioneering era of residential property developers’ activities where decisions would frequently be intuitive or based on the owner’s limited knowledge are now in the past. Today’s property developers apply complex analytical tools, use the services of professional market, legal and tax consultants, and are able to meet the demanding reporting standards as set by the Polish Financial Supervision Authority for companies listed on the Stock Exchange.

„The model for risk management dominant in Poland is based on experiences on the German market, where potential risks have to be monitored on an ongoing basis and reactions have to be swift when they occur.”

3. Market consolidation, mergers and acquisitions

The continuous strive to increase the scale of sales and the margin is leading to a growth in the mergers and acquisitions market within the property developer sector. Acquisition by industry leaders of smaller players could prove to be the right business strategy even when the prices of the acquired companies are at a historic high, for an M&A transaction on the residential property development market makes it possible to:

1. easily enter a new residential market on which the given developer was not present at all, or – due to the lack of in-depth knowledge of the particular market – failed to succeed on it previously, while at the same time limiting the costs of establishing a brand new business structure from scratch;

2. take over a “land bank”, significantly shortening the time and reducing the costs of the acquisition of individual plots, thus accelerating the commercialization process and reducing the risk of settling on unprofitable locations;

3. reduce fixed costs due to the optimization of management processes, personnel costs and standardization of budgets for e.g. marketing and sales, as well as centralization of management in respect of these budgets;

4. transfer vital know-how relating to the project preparation process, contracting terms and cost management solutions;

5. include the financial result of the entity being acquired in the financial result of the acquiring entity, and thus demonstrating long-term growth prospects, which is of particular importance when financing is obtained by means of issuing shares and corporate bonds;

6. use the brand of the entity being acquired and its high recognition on the local market without having to engage in the costly activities aimed at establishing and promoting one’s own market position;

7. strengthen the financial position of the entire group, spread investment risks and boost the negotiating power for obtaining debt financing from banks.

A noteworthy signal here that demonstrates the importance of such transactions is the information that on 5 January 2017, Dom Development S.A., one of the market leaders in Warsaw and an entity active on Wrocław’s market, was granted exclusivity to conduct negotiations in respect of the acquisition of part of the Euro Styl S.A. group of companies, one of the largest firms active on the Tricity, Bydgoszcz and Olsztyn markets. It should be assumed that the successful completion of this transaction will open the path for further acquisitions and reveal the current difficulties in assessing areas of risks.
4. Alternative areas of activity for residential property developers

At the same time residential property developers will be searching for alternatives to their core area of operations relating to development and sales of B2C housing. The expected directions for expansion are:

1. Diversification of operations by shifting interest towards projects implemented concurrently on the office, retail and hotel markets. Importantly, residential property developers are willing to accept the greater business risks related to these types of projects through comparison to risks inherent in implementation of residential projects and the costs of positioning them on the market. They often have sufficient knowledge and experience from local and micro-markets that enables them to correctly assess the potential of locations traditionally rejected by large players from the commercial sector. Examples of such diversification include:
   a. involvement of the Murapol S.A. group with Cavatina sp. z o.o., a company traditionally active on the commercial market;
   b. expansion of the “Alfa” convenience store chain by owners of the Kraków based KG Group;
   c. completion by Eurostyl S.A. of the mixed-use scheme in Olsztyn with a substantial hotel component under the Hampton by Hilton brand;
   d. completion by Apricot of a local “Siódemka” shopping centre in Mława.

2. Investments in development of subsidized rental apartments as part of the BGK Rental Housing Fund and the government-run “Mieszkanie+” programme. Given the continuing vague announcements made by the government, it can be expected that in the absence of appropriate organizational structures, the governmental entities and agencies responsible for the disbursements of funds under the “Mieszkanie+” programme will consider inclusion of the private sector in the process.

3. Cooperation with opportunistic investors and pension funds in terms of development of build-to-suit rental apartment portfolios and sales of entire buildings and estates to the portfolios. Adequate rates of return on residential rental investments should be conducive to growth of the sector. Engagement of external partners at the initial stage of implementation of a project, e.g. in the form of foreign investment banks and pension funds, reduction of the cost of obtaining the necessary capital, reduction of the costs of managing the project implementation process due to the careful tailoring of the product to the needs of the future client and reduction of the marketing and sales costs mean that residential property developers are able to demonstrate high sales figures and margins, while at the same time reducing the investment risk.

4. Development of own rental apartment portfolios using subsidiaries of the parent property development company. This solution will enable the curbing of negative consequences for cash flows in an investment in the event of a decreasing pace in sales, it will ensure that there is a steady flow of funds from rental and rental management activities and it will enable preservation of the high value of assets which will make it possible to sell them to funds at a later date along with concluded rental contracts, while additionally in the event that the market conditions improve, it will still enable an attractive valuation of the portfolio.

5. Investments in the “second home” and “condohotel” sector resulting from the dynamic growth of Poland’s long-stay tourism market and the changing preferences in respect of holiday destinations due to the deterioration of safety in the holiday resorts around the Mediterranean basin.

6. Investments in the “senior housing” sector in the form of long-stay homes and apartments dedicated to the elderly providing at least minimal essential medical facilities and services for the residents. These investments will be supported by the process of professionalization of the “senior housing” sector and arrival in Poland of international operators active in this particular market segment.

7. Investments in the “health & care” sector as a response to the growing demands of the medical services market, in particular private recovery and rehabilitation services, the beauty treatments and enhancements market and the health resort market. The deficiencies as regards the base financed by the National Health Fund along with elevated social awareness and support from private medical chains will stimulate growth of the investment market in this sector.

8. Investments in the “student housing” sector in the form of modern student accommodation with an extensive range of additional services offered.

9. Investments in alternative building technologies enabling reduction of costs of the investment process, e.g. prefabrication and unification as regards the design work and manufacture of selected elements of the buildings’ structure and fit-out. Residential property developers are in this instance able to take on the role of the so-called “business angel” and run the testing process for these solutions as part of their own operations, which reduces the costs of establishing a distribution channel.
5. Stimulators and restrictions to growth of the property developer market

When attempting to characterize the Polish housing market against the background of other CEE countries, the following features have to be identified:

1. The largest scale and the highest potential for growth resulting from:
   a. A continuously high availability of land within urban areas;
   b. Stability of the Polish banking sector which is of key importance from the point of view of financing property developers’ activities and a stable mortgage market;
   c. Favourable demographic and macroeconomic indicators which stimulate demand;
   d. Strong social pressure as regards replacement of stock and continuous striving to improve the quality of living conditions construed as equalizing with those prevailing on EU’s largest markets.
   e. A continuously high level of profitability of residential investments, where risks are possible to forecast and labour costs are at a competitive level.

2. High level of professionalization of the property development market, which enables free transfer of capital and know-how, as well as well-educated and qualified managers and teams responsible for completion of development projects.

3. Uniformity and stability of the legal framework under which property development operations are run, in particular uniformity of contractual terms for all market participants as imposed by the so-called property developments act.

4. Scope of information available as to the market, pricing, zoning conditions and activities of competitors conducive to the security of transactions concluded.

5. Increasing awareness and expectations of consumers encouraging property developers to pay attention to the quality of their projects, aesthetics and compliance with the extensive building standards.

6. Competitiveness of the market encouraging property developers to seek an advantage through creating visually and functionally attractive spaces and high quality common areas as well implementing solutions designed to improve social integration (e.g. development of recreational areas within an estate).

7. The insufficient attention to date as regards adjustment of residential housing to family life cycles and its needs evolving over time. The current offer presented by residential property developers is designed to bring immediate sales results.

8. Attention to environmentally friendly solutions merely limited to the requirements imposed by the provisions of building law and failure to think in terms of care for the quality of life of future generations. Resistance as regards introducing environmentally friendly solutions, unless they are directly linked to a tangible boost in sales figures.

9. Strong individualization of projects designed to achieve a temporary visual effect and acceleration of the sales process, and the current inadequate responsibility adopted with respect to space and urban planning.

10. Tendency displayed amongst property developers to optimize their costs at the final stage of implementation of their projects at the expense of lowering the quality of small but visible elements of the buildings’ finish and fit-out.

A serious threat to the development of the residential investment sector is the tax policy of the state. VAT tax refunds in the process of land acquisition and investment are crucial for financial flows of property development companies. For developers, the policy of tightened control in respect of VAT income means, in practice, increased control of tax authorities and extended tax refund process. The amended of the criminal code have been in effect since 3 March 2017, providing for a punishment of up to 25 years in prison for VAT fraud based on fictitious invoices for more than 10 million PLN. Interpretative freedom of tax authorities in terms of assessing the merits of charging and paying VAT tax presents a real risk for management boards of property development companies. It should be noted that inadequate supervision of the investment process is punishable by imprisonment of up to 2 years, as stated in the so-called property developments act of 2012. This has caused a significant, albeit temporary, deceleration of property developers’ activities, changes in the policy of banks in terms of risk transfer, as well as an increase in the costs of supervision. It is expected that fiscal risks will lead to implementation of additional investment security required by financing banks and further increase in costs associated with additional financial audits and thus ultimately an attempt to transfer them to the end customer. We expect that in the next 5 years, there will be another important qualitative change in the Polish market of residential investments, namely an increase in terms of the market share held by entities having the capacity to prepare and deliver to the market 4,000-5,000 apartments per year. At the same time, natural...
decreases sales volumes will restrict the activities of small entities whose goal is to quickly invest in the stimulated housing market, and who cannot afford to build a sustainable back-office and land bank. In our view, the policy of increasing the presence of the state in the banking sector and its involvement in the housing market within the “Mieszkanie+” programme implemented consistently since 2015 will not be conducive to increasing the volume of available funding for the private residential development sector. Therefore, the leaders of this market, in addition to traditional bank financing sources, will be happy to use the support of large investment funds for which the residential sector will become an alternative to investments in the commercial sector. An example that we can name today is the Griffin Real Estate fund already active on the Polish residential market which implements its shareholders’ business goals through the subsidiary Echo Investment S.A. group. The group is exploring new market niches, such as “student housing” projects (Student Depot in Poznań) and the construction of a portfolio of rental apartments as part of the investment in the old Warsaw Breweries at Grzybowska Street. At the same time, it is trying to systematically increase the scale of funds invested in the residential sector, mainly by means of opportunistic investments. At the moment, it is not known how the housing market will affect the activity of REIT entities being created in Poland. Currently, there is an ongoing discussion about investment areas available for this form of organizations. Experts indicate currency risks associated with activity on the housing market. Although rental income related to commercial buildings is usually denominated in EUR, sales and rental of residential premises are denominated in PLN, which gives rise to additional currency risks. As shown by experiences from other markets, opening the housing market to domestic operators carrying out their activities with the use of the REIT formula may lead to inflow of additional streams of money to the real estate market. Due to very conservative house price growth forecasts in the coming months, rising share of land price in the overall cost of the project and the expected increase in legal and tax fees, it should be highlighted that access to non-bank sources of financing and the ability to negotiate favourable terms with banks, as a consequence of the scale of operations, will gain in importance.

By the Polish Financial Supervision which introduced further recommendations (treated as a type of a safety fuse for the financial system) and imposed an obligation on the banks to gradually increase the minimum amount required as own contribution. In 2017, the loan-to-value ratio cannot be higher than 80%. In the case of universal banks however, there are still instances where own contribution is as low as 10% and the missing 10% is financed against additional security for the so-called low contribution, but this is now a limited offer. Loans denominated in CHF have become a serious issue for the mortgage lending system and the source of systemic problems for the banking sector and its customers. The rapid increase in the exchange rate of CHF has resulted in the trapping of some of the clients in excessive debts. Furthermore, the value of the security provided against the mortgage has fallen, and the banks were forced to create higher reserves for portfolios of bad debt, while politicians were hurriedly
seeking a solution to the problem naming the intervention model known from the Hungarian market. In the case of several banks, a large portfolio of foreign currency loans seriously affected their security and damaged their reputation. Therefore, it is a principle now that loans are granted in the currency of the borrower’s income, which, in practice, has limited the offer of loans granted in currencies other than PLN.

As things stand in 2017 the situation in the mortgage market remains stable. The lessons learnt during the severe market downturn have resulted in changes being made to the way in which loans are handed out. However, record low interest rates and the absence of inflation have resulted in record high sales figures recorded by property developers. According to data collated the Polish Bank Association, 178,000 new mortgages were granted in 2016 with a total value of approx. 39 billion PLN, and the forecast for 2017 indicates the growing advantage of cash purchases and a further decline in the value of loans to approx. 37 billion PLN. The number of loans was significantly influenced by the “Housing for Young Adults” programme granting support by financing the necessary own contribution for first-time buyers no older than 35 and for large families (additional payment of up to 30% of own contribution in the case of 3 children + 5% when another child is born within 5 years from the purchase). It should be noted that the majority of mortgages is granted for amounts between 250,000 and 350,000 PLN, which shows that the main beneficiaries are primarily families purchasing 2-3 bedroom apartments, regardless of their location.

Change of course and its possible consequences

Greater involvement of the state in the housing policy is associated with political changes that took place in the autumn of 2015, as well as the specific climate related to family-friendly and social projects. The “National Housing Programme” announced in the fall of 2016 defines significant areas of state activity in the residential sector, such as:

1. Increased access to housing for people with income preventing them from purchasing or renting a property at market prices, by means of:
   - Increasing the supply of low-rent apartments;
   - Decreasing the costs of residential construction, in particular by using public lands, optimal technologies and architectural projects;
   - Popularization of regular saving for housing purposes;
   - Enabling investments in the housing market for institutional entities.

The goal is to reduce the so-called housing deficit by increasing the number of apartments per 1,000 inhabitants – by 2030 the number of apartments per 1,000 residents should be the EU average, which means an increase from 363 to 435 apartments per 1,000 people.

2. Increasing the capacity to meet the housing needs of people at risk of social exclusion (due to low income or particularly difficult life circumstances). The goal is to reduce the number of people waiting for social housing – by 2030 local authorities should be able to meet the housing needs of all people waiting for rental of social housing.

3. Improving housing conditions, technical standard of housing stock and increasing energy efficiency. The goal is to reduce the number of people living in substandard conditions – by 2030 the number of people living in substandard conditions (poor technical standard of the building, lack of basic technical installations and overpopulation) should fall from approx. 5.3 million to 3.3 million people, i.e. by 2 million people.
The program is based on 4 pillars defined as:

1. Development of available housing stock
   - Construction of rental apartments with the option to achieve ownership. The properties will be built on, among others, land owned by the State Treasury (“Mieszkanie+” programme);
   - Increasing support for social housing. Increase in the number of options with reduced rent and the activity of housing co-operatives, social housing associations and other entities (including property developers) interested in this type of activities due to the availability of preferential BGK loans;
   - Regular – creating a long-term programme for savings in Individual Residential Accounts.

2. Effective and stable financing of projects within the National Housing Fund.

3. Favouring the creation of better housing conditions – modern, efficient and safe.

4. Improving the regulatory environment in the housing sector, including, for example, urban and spatial policy, procedures in respect of the investment process and changes in the operation of housing co-operatives and municipalities, as well as efficient resource management.

Leaving the evaluation of the objectives and methods of their implementation to economists and sociologists, the far-reaching effects of the proposed policy should be emphasized. These changes indicate that the state is moving from liberal housing policies, calculated to shape mechanisms of market development and concern for the development of the necessary legal environment, towards a more interventionist policy, in which it is an active player equal with other market participants. On the one hand, the state enters the areas where it is difficult to generate profit at the level expected by property developers. On the other hand, it has a completely different access to land, it does not bear the costs of their commercial acquisition, and it does not bear the market costs of financing. The BGK Rental Housing Fund implemented in 2014 aimed at reversing the negative trend by popularizing institutional rental and increasing the mobility of citizens could be considered to be an important impulse to the creation of a new market sector, however the current activities may significantly affect the attitudes of market participants and the profitability of a business sector financed by property developers and institutional investors on the basis of market risk. First of all, there is the risk of postponing the purchasing and/or relocation decision until the effects of the aforementioned policy are materialized in the form of completed, delivered and inhabited buildings. Today’s stock of land prepared for the implementation of the “Mieszkanie+” programme and the policy of cheap apartments amounts to approx. 450 hectares, with the potential to construct up to 60,000 new apartments. Geographically, the activity of the state is not limited to the largest housing markets. Significant land resources are located on the local markets and the so-called “micro-markets”, and the rationale for their use is the development of local labour markets and an attempt to activate smaller hubs.

The declared political search in terms of construction technologies aimed at increasing the production output (prefabrication technologies) and pursuance of energy efficiency is positive. Unfortunately, introduction of the policy of subsidised rental with the option to achieve ownership competitive in terms of costs with the mortgage market raises doubts and questions as to certain privileges being extended towards some social groups at the expense of resourceful citizens ready to bear the market risks of purchase. The activities of the state noticing the benefits of growth of the rental market (regardless of the target group) are also positive. The activity of the state in this area will aid the formation of performance standards and the shaping of the necessary provisions of law regulating the relationship between owners and tenants.
The institution of rental in Poland

Under Polish law, the institution of rental is regulated mainly by the provisions of the civil code and, as regards rental of residential properties, by the provisions of the act of 21 June 2001 on lessee’s rights and municipal housing stock. A lease agreement is an agreement aimed at setting out the rules for using a property owned by another person. The parties to a lease agreement are the lessee and the lessor. The fundamental idea behind establishing a rental relationship is for the lessor to assume the obligation to release a given thing to the lessee for use for definite or indefinite period of time, and for the lessee to assume the obligation to pay to the lessor the rent agreed upon. The lease agreement shall identify the subject of the lease that it relates to. Both movables and immovable properties and parts thereof can constitute the subject of lease, which is particularly important in view of this report. The key issues relating to the institution of lease in Poland arising under the provisions of the civil code and the act of 21 June 2001 on lessee’s rights and municipal housing stock are presented below. It should be highlighted here that lease of residential premises in Poland takes the form of lease as regulated by the provisions of the civil code as well as the form of temporary lease as introduced to Polish law in 2009, where the subject thereof are exclusively premises intended to meet residential needs.

Moreover, it should be remembered that a lease agreement concluded for a term longer than 10 years is deemed, after expiration of that term, to have been concluded for an indefinite period of time. For lease agreements concluded between entrepreneurs this term is equal to 30 years. In view of the above, it has to be concluded that the statutory regime sets out a number of obligations on the side of both the lessee and the lessor. Despite the fact that the provisions of the civil code regulate the lease on many levels and it would seem that the catalogue of issues relating to lease has been fully regulated by Polish law, it should be highlighted that the legislator awarded the parties certain freedom in respect of defining various key rules governing lease agreements, e.g. provisions regarding rent.

Main lease rules

The provisions of the civil code set out the general rules that regulate the lease as well as the specific rules that apply to lease of properties. The basic rules to be taken into consideration are identified below:

- the lessor is to release the subject of lease to the tenant in a condition suitable for the use agreed upon and maintain this condition throughout the lease term,
- the lessor is obliged to carry out necessary repairs without which the subject of the lease would not be fit for the use agreed upon, however the lessee is obliged to cover minor expenses relating to carrying out minor repairs of doors, floors and technical installations and equipment,
- if the subject of the lease has defects that limit its suitability for the use agreed upon, the lessee has the right to demand appropriate reduction of the rent for the period of duration of such defects,
- during the lease term the lessee is obliged to use the subject of lease in the manner specified in the agreement, and if the agreement does not specify the manner of use, the lessee is obliged to use the subject of lease in a manner corresponding to the nature and designation of the subject of lease; additionally, without the consent of the lessor, the lessee cannot introduce in the thing being the subject of lease changes at variance with the contract or with the designation of the thing,
- the lessee may install in the premises being the subject of lease electric lighting, gas, telephone, radio sets and other similar equipment unless the manner of installing them would be contradictory to the applicable provisions of law or threatens the security of the premises; if the equipment requires the co-operation of the lessor, the lessee may demand such co-operation against the reimbursement of the resulting costs,
- the lessee of the premises is to observe the rules of maintaining order in the building if these are not contradictory to his rights resulting from the contract; he shall also take into consideration the needs of other residents and neighbours.
Rent and other charges

As a rule, the provisions of Polish law do not regulate the manner in which the amount of rent is agreed upon at the moment of conclusion of the lease agreement. The legislator has not provided for any limits (amount or percentage wise) applicable when agreeing upon the amount of rent. The parties have full freedom to negotiate the amount of rent and it is in the investor’s interest to agree upon such an amount as to ensure sufficient return and profit on the investment. Nevertheless, it should be pointed out that the regulations set out the rules for increasing rent. It is provided that the lessor has the right to increase rent by terminating the currently applicable agreement with respect to the amount of rent giving a three months’ notice (or a longer one in the event that the parties provided for such a longer notice period in the lease agreement). The act on lessee’s rights and municipal housing stock provides that in warranted circumstances it is possible to effect an increase in rent exceeding 3% of the replacement value of the property.

Essentially, the owner has the right to increase rent if the owner for permanent improvements introduced to an existing property that increase its use value. The lessee has the right to refuse acceptance of the increase in rent in writing with the effect of termination of the lease. Alternatively, the lessee has the right to challenge the increase in rent by filing a suit with a court challenging the legitimacy of the increase in rent or the amount of the increase. The burden of proof relating to the legitimacy of the increase lies with the lessor. In addition to the rent agreed upon, it is a standard practice that the lessee is obliged to cover the service charges directly related to his use of the subject of lease and other charges related to the building in which the property is located. Service charges include utilities connected to the property covered by the rental contract, i.e. electricity, water, internet and heating. The issue of service charges is not regulated by the provisions of law, therefore it is necessary to include the appropriate provisions in the rental contract in order to systematize the relation between the lessee and the lessor.

Temporary lease

The institution of temporary lease was introduced to Polish law by the act of 17 December 2009 on amending the act on lessee’s rights and municipal housing stock and on amending the civil code and certain other acts (Journal of Laws from 2010, no. 3, item 12). The subject of a temporary lease agreement may only be a residential property. This type of an agreement may only be concluded for a definite period of time, not longer than 10 years. The temporary lease agreement has to be concluded in writing, otherwise it is null and void.

The legislator’s objective behind introduction of the regulations relating to temporary lease was to increase the security of the lessor’s position. Therefore, the following are in particular to be attached to a temporary lease agreement:

- declaration of the lessee in the form of a notarial deed under which the lessee submits to enforcement and undertakes to vacate and release the premises used under the temporary lease agreement within the time limit identified in the demand to vacate the premises, which demand is to be made in writing with an officially certified signature of the owner and delivered to the lessee by the owner upon expiration or termination of the temporary lease agreement in the event that the lessee fails to voluntarily vacate the premises;
- identification by the lessee of a different property which he will be able to move into in the event that the enforcement as regards his obligation to vacate the premises is executed;
- declaration of the owner of the premises or a person holding a legal title to the premises granting consent for the lessee and the persons living with him to move into the property identified in the declaration; a declaration with a signature certified by a notary public is to be attached to the lessor’s request.

The above-mentioned documents which constitute an indispensable element of a temporary lease agreement, enable the lessor to carry out an eviction procedure in respect of a burdensome lessee in a less complicated manner than is the case with regular lease agreements. A frequent issue when concluding regular lease agreements is the inability to evict a lessee refusing to vacate the premises due to the unavailability of social housing, which leads to the ineffectiveness of eviction judgments. As regards temporary lease, upon expiration or termination of a temporary lease agreement, in the event that the lessee fails to voluntarily vacate the premises, the owner of the premise delivers to the lessee a demand to vacate the premises made in writing with an officially certified signature of the owner. The demand has to state the time limit in which the premises are to be vacated by the lessee and the people living with him, which time limit is to be not shorter than 7 days from the date of delivery of the demand to the lessee. Upon ineffective expiration of the time limit referred to...
above, the owner has the right to apply to court for the notarial deed under which the lessee submitted himself to enforcement and undertook to vacate and release the premises used under the temporary rental contract to be endorsed with an enforceability clause. It should be highlighted that the provisions on the unenforceability of eviction judgements between 1 November and 31 March and in respect of pregnant women and minors do not apply to temporary lease agreements. Under a temporary lease agreements, unless the agreement provides otherwise, in addition to rent, the owner collects only such charges as are independent of him. The owner has the right to increase rent as per the terms set out in the contract. An owner that is a natural person not conducting business activities in respect of property rental is obliged to notify the head of the tax office having jurisdiction over his place of residence of conclusion of a temporary lease agreement within 14 days from commencement of the lease term.

The lessee has the right to terminate a lease agreement concluded for an indefinite period of time without providing a specific reason giving a three months’ notice, unless the agreement concluded between the parties provides for a different notice period. In the event that the lease agreement is concluded for a definite period of time, it

Termination of lease

In the event that the lease term is not defined, both the lessor and the lessee have the right to terminate the agreement subject to the time limits set out in the agreement, and where no such time limits are set out, then subject to statutory time limits. The statutory time limits for termination of a lease are as follows:

- when rent is payable at intervals longer than one month, then the lease may be terminated three months in advance at the latest, at the end of a calendar quarter;
- when rent is payable monthly, then the lease may be terminated one month in advance at the latest at the end of a calendar month; when rent is payable at shorter intervals, then three days in advance;
- when rent is payable per day, then one day in advance.

The lessor of a residential property has the right to terminate a lease concluded for both a definite and indefinite period of time exclusively for the reasons set out in the act on lessee’s’ rights and municipal housing stock and on amending the civil code. The reason most commonly encountered in practice that gives the lessor the right to terminate the lease agreement is a delay in payment of rent and other charges for use of the premises by the lessee for at least three full payment periods despite a warning being issued to the lessee in writing as to the lessor’s intention to terminate the lease and the setting of an additional time limit of one month to pay the outstanding and current liabilities.

The lessee has the right to terminate a lease agreement concluded for an indefinite period of time without providing a specific reason giving a three months’ notice, unless the agreement concluded between the parties provides for a different notice period. In the event that the lease agreement is concluded for a definite period of time, it
may only be terminated by the lessee for the reasons identified in the lease agreement.

As regards a temporary lease agreement, than as it is an agreement concluded for a definite period of time, the lessor has the right to terminate it only when the lessee:

- despite a warning in writing continues to use the premises in a manner inconsistent with the agreement or with the nature and designation of the premises, thus giving rise to occurrence of damage, he devastates the fittings and installations intended for the common use of residents or grossly and persistently violates the property’s rules and regulations, thus making it difficult to use the other premises in the building,

- is in arrears with payment of rent or other charges for use of the premises for at least three full payment periods despite a warning being issued to him in writing as to the lessee’s intention to terminate the rental relationship and the setting of an additional time limit of one month to pay the outstanding and current liabilities, or

- leases, subleases or makes the premises or a part thereof available for gratuitous use without the required written consent of the owner.

As far as the right of the lessee to terminate the temporary lease agreement is concerned, then as per the arguments provided above, the contract may only be terminated by the lessee for the reasons identified in the temporary lease agreement.

Summary

The above deliberations lead to the conclusion that even though the institution or lease is clearly regulated within the applicable provisions of Polish law, the legislator has provided room for negotiations between the parties. The advantage of a temporary lease agreement over a regular lease agreement is particularly important from the point of view of the lessor when the relationship between the lessor and the lessee fails to work in the expected manner. Despite the fact that the institution of temporary lease is a relative novelty, the regulations governing it provide a response to a number of issues frequently encountered and faced by lessors.

General information

As per the principle of freedom to take up and pursue business activities, entities from within the European Economic Area have the right to pursue business activities in Poland under the same conditions as those laid regarding establishment for legal persons registered in Poland and natural persons that are Polish nationals.

The above freedom is somewhat restricted as regards entities from outside the EEA, however they are not substantial enough to preclude the taking up of business activities in Poland.

The rules of taxation for business activities consisting in investment in properties in Poland do not differ significantly from the rules of taxation for other types of activities. There are no particular restrictions or incentives in this regard.

Investment in properties (residential and others) may be effected through branches or subsidiaries, which is usually a limited liability company (spółka z ograniczoną odpowiedzialnością). Companies from outside the EEA have the right to establish branches in Poland on the basis of reciprocity, i.e. when the state where the company is registered allows establishment of branches by entities registered in Poland. Additionally, it is also possible to pursue business activities without establishing a branch, i.e. through a direct foreign holding company.

This requires that certain conditions are met, e.g. no employees employed in Poland, no own infrastructure except for properties in Poland. This particular solution is mainly adopted by foreign investment funds preferring direct investment in the given asset.
Income tax

The basic corporate income tax rate in Poland is 19%. Companies with a registered office or management board in Poland are subject to tax on all income. In turn, all other companies are subject to tax on the income earned in Poland only. The 19% applies to income earned from both renting and selling a property. As regards business activities consisting in investment in rental properties, natural persons are subject to an 8.5% flat-rate income tax.

Polish investment funds that invest in properties directly, i.e. without establishing a company, and their counterparties from EU member states and the EEA are eligible for income tax exemption. In such a case, the fund’s income becomes subject to taxation at the moment of distribution thereof to the investor on the terms applicable to the investor concerned (in certain cases it is possible to be exempted from the obligation to pay tax in Poland).

VAT

The basic VAT rate is 23%, however the purchase of residential properties (not intended for business activities) on the primary market is subject to lower VAT at 8%. In turn, the purchase of residential properties on the secondary market may be subject to either VAT at 8% or be exempted from it. This depends on whether the seller pursues business activities and is therefore a VAT payer, as well as on the manner in which the properties are used. In the event that the seller is exempt from VAT, the transaction is subject to a 2% tax on civil law transactions (which is a type of stamp duty) to be paid by the purchaser on the market value of the property. As far as estimation of the costs of the investment is concerned, the key issue is to analyse and correctly evaluate the rules of VAT taxation in respect of property purchases.

Property rental for exclusively residential purposes is fully exempt from VAT, where the disadvantage here is the inability to obtain a refund of the VAT paid when purchasing the property. Therefore, when purchasing residential rental properties from a property developer, the investor should take into account the additional cost arising under the 8% VAT paid on the purchase price.

Depreciation

Property depreciation, according to the act on corporate income tax, is carried out using the straight-line method over a period of 40 years (at a rate of 2.5% per annum). The basis for depreciation write-offs is the purchase cost, while the write-offs themselves constitute tax deductible expenses for the taxpayer. However, land is not subject to depreciation. In certain cases, e.g. old properties, properties used under challenging conditions, the rate of depreciation can be increased to a maximum of 10%.
CBRE

CBRE is the world’s largest commercial real estate services and investment firm, serving real estate owners, investors and occupiers through approx. 450 offices (excluding affiliates) worldwide. In Poland the company is present since 2000 and currently employs almost 1,000 staff in 9 offices located in Warsaw, Gdansk, Krakow, Poznan, Wroclaw and Lodz. CBRE offers strategic advice and execution for property sales and leasing; corporate services; property, facilities and project management; mortgage banking; appraisal and valuation; development services; investment management; as well as research and consulting.

To meet clients’ needs, CBRE became the first real estate services and investment company to take business to the next level, integrating all of our services for occupiers into one specialized division - Advisory & Transaction Services. The division does not just offer services directly related with lease management but also delivers the complete spectrum of strategic advisory and transaction services, including portfolio optimization and benchmarking, industrial and logistics services and tailor-made workplace, development and HR strategy. Regardless of place, CBRE provides a broad range of the highest quality integrated real estate services. Our unparalleled knowledge and preeminent experience supported by the global network, enables CBRE to build real advantage on the real estate. Please visit our website at www.cbre.com

Baker McKenzie

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The firm’s Real Estate and Construction team has been repeatedly ranked as the best in Poland by prestigious publications Chambers Europe and Legal 500. The team has substantial experience in advising on complex sale and acquisition transactions and on major real estate development. They advise investors, developers and general contractors at all stages of the construction process for business and infrastructure projects.
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