

**CPRF Newsletter September 2008**  
**Commercial Real Estate Market**

**Table of content**

Title	Page
Market Value in Relation to Assumed Use	2
Justified v. Groundless Charge of the Zoning Fee	5
A Practitioner's Glimpse on the Assessment of the Compensation Amount for the Easement of Access	8
CPRF Achievements in 2008	10

## Market Value in Relation to Assumed Use

The National Valuation Standard KSWP1 of the Polish Federation of Valuers' Associations (PFVA) entitled "Market Value and Replacement Value" requires the valuer to identify the most probable use of the property in order to establish the Market Value. Such use may be a continuation of a current use or other potential (alternative) use. Please note that National Valuation Standards of PFVA suggest that the analysis of the highest and best use may be treated as a separate study. However, if agreed with the client, such analysis can be included in the valuation report. Therefore it is worth noting that the National Valuation Standard of PFVA raise the importance of the highest and best use.

### **National Valuation Standards**

The motion No. 26/07 of 12 December of the National Council of PFVA defines the type and scope of application of professional valuation standards in the transition period. Since 1 March 2008 the following standards constitute enforceable rules to be applied in performing the profession of a property valuer:

#### **Basic Standards (BNVS)**

BNVS 1: Market Value and Replacement Value,

BNVS 3: Valuation Reporting.

#### **Special Purpose Standards (SNVS)**

SNVS 1: Valuations for Public Purposes

SNVS 1.1. Valuation of Properties Left Behind the Current Borders of Poland for the Purpose of Indemnity Payment

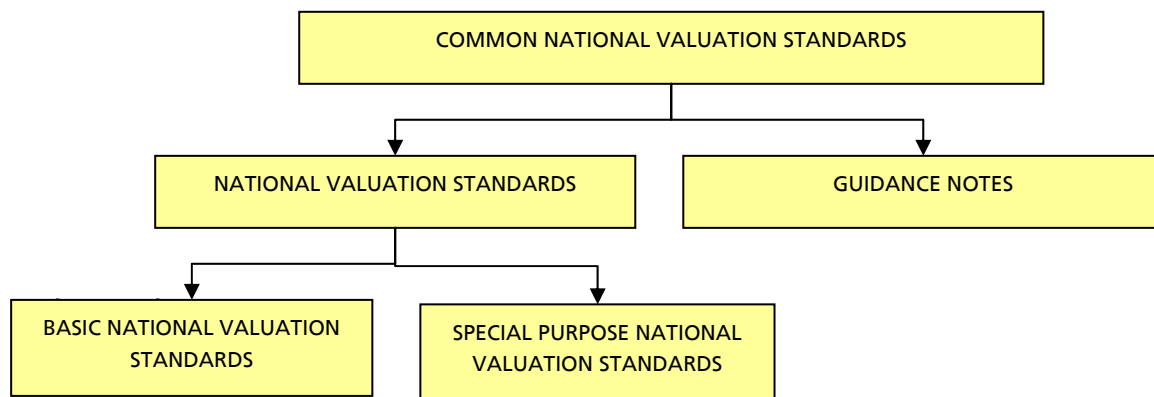
SNVS 2 Valuation for Financial Reporting in the Context of Polish Accounting Act

SNVS 3: Valuation for Debt Security

PFVA standards binding since 1995 (marked with symbols, e.g. III.6, V.4) have a status of temporary Guidance Notes, while binding standards are only those mentioned in the motion. Please note that some standards were repealed because they were replaced by new ones or because of negative assessment of their contents.

The following documents are currently under development: a National Valuation Standard marked BNVS 2: Values Other than Market Value, and three Guidance Notes: GN 1: Comparison Approach in Property Valuation, GN 2: Income approach in Property Valuation, GI 3: Cost Approach in Property Valuation.

***Chart No 1: Structure of National Valuation Standards***



In the BNVS 1 Standard “Market Value and Replacement Value” a considerable part is dedicated to the definition of the Highest and Best Use. The necessity to provide the definition ensues from general economic and social reasons. Developed and undeveloped properties, being a rare commodity, require that their uses are optimized. Furthermore, the highest and best use reflects the market pattern of behavior where a rationally thinking and acting investor is pursuing the most effective use of his/her property.

The definition of the Market Value of the property contained in the National Valuation Standards reads it is the most likely price for which the property would exchange on the market on the date of valuation with the two following assumptions:

- parties to the transaction are independent of each other, do not act under compulsion and are determined to close the deal; and
- sufficient time has elapsed for the property to be exposed on the market and to allow for negotiations of the deal.

According to the BNVS 1 Standard, the Highest and Best Use means the most probable use which is physically possible, appropriately justified, legally permissible, financially feasible and which results in the highest value of the property being valued.

The term “physically possible” denotes a requirement to verify whether such factors like: shape, size, topography, access to utilities, load capacity of ground, technical and functional condition of the improvements make the property under valuation unfit for the highest and best use considered.

The term “legally permissible” means that the property valuer must decide whether the contemplated use is legal. Some uses may be restricted or excluded by operation of provisions regarding town and country planning, zoning, environmental protection, nature protection, national heritage and monument protection, protection of arable and forest land and the building code.

A use that is not physically possible and legally permissible cannot be considered a highest and best use.

The term “financially feasible” means that the adopted use may generate income equal or higher than the amount needed to cover expenses and return initial equity.

### **Summary**

Market Value is a fundamental concept in the property valuation. It is perceived and interpreted differently depending on economic, political, social and legal environment. The practice of valuation in Poland evidences that in most case property valuers establish Market Value for the

current use. However, opinions were expressed in the valuers' community that valuation should be preceded by the analysis of a highest and best use of the property. It is associated with utilizing potential hidden in development sites, developed properties and the need to optimize their use. Reasoning behind such opinions was strong enough to be included in BNVS 1.

## **Justified v. Groundless Charge of the Zoning Fee**

Acceptance of a new local master plan or amending an existing plan is most often interpreted as enhancement of the property value. Therefore, owner or perpetual usufructer is obliged upon sale to pay a zoning fee to the local municipality.

The legislation in this area is clear and evident, however in practice it brings about many misunderstandings and problems. Their main reason are incorrect calculations and groundless collection of the fee, which result in the town/municipality baseless claim against the property owner.

### **Bases for Calculation of the Zoning Fee**

If acceptance of a new local master plan or changes made to an existing plan resulted in increased value of the property, then upon sale of the property its owner or the perpetual usufructer pays a one-off fee expressed as a percentage of the property value enhancement. The amount of such fee, called the zoning fee, must not be higher than 30% of the property value enhancement.

In order for the fee to be charged, all the following conditions must be met:

1. the value of the property increased as a result of acceptance of a new plan or changes to an existing local master plan;
2. the local master plan includes a percentage of the property value enhancement which serves as base for calculating the fee;
3. the owner or the perpetual usufructer sells the property or part thereof;
4. the claim for the zoning fee is filed within five years from the date when the plan or its changes came into life.

### **Procedure of Establishing the Market Value of the Property Needed for Calculation of the Zoning Fee**

When establishing the Market Value of the property for the purpose of setting the fee for value enhancement resulting from acceptance of a new local development plan or changes to an existing plan, the following should be taken into consideration:

1. zoning of the property before acceptance of the plan or before its changes;
2. zoning of the property after acceptance of the plan or after its changes;
3. state of the property as of the date of acceptance of the new plan or its changes;
4. prices from the date of sale.

Components of the property (buildings, improvements fixed to the ground, plants) are not taken into account when setting the amount of the zoning fee.

The value enhancement is the difference between the value of the property established for a zoning binding after acceptance of the plan or after its changes and the value of the property established for a zoning binding before its alterations or actual use of the property before acceptance of the plan.

### **Example of Changes in the Local Plan**

The zoning fee may be levied and subsequently collected if the zoning of the property in the new plan or after changes of the existing plan brought about increase in the value of the property

through permitting a more attractive use from a development point of view terms than before. Let us consider a case when changes to the local plan bring a potential for the property to increase in value.

Changes in local master plans may have diverse effects on the Market Value of different properties, even if they are located in an area with homogenous zoning both before and after alterations to the plan. Viable uses of different properties change in a different degree and it is possible for planning changes not to have any effect on the value of the property.

Let us take a real life example of two properties located in an area with a homogenous zoning, denoted in the local plan by a letter U. The U zone includes only the two subject properties. One property is developed and practically its whole area is improved with buildings and hardstands, the other one is undeveloped and unimproved. The size of the developed property accounts for 50% of the total U zone. The amended local master plan required that in the U zone all properties have a certain percentage of biologically active area. Below is a brief reasoning how the subject properties can be improved depending on the provisions in the plan before and after alterations.

#### Requirements for the U zone before changes to the local master plan

Before changes the local master plan required that at least 60% of the area of **planned project** must be biologically active.

#### Requirements for the U zone after changes to the local plan

After changes, the local plan required that on average at least 40% of the **whole U zone** must be biologically active.

#### **Impact of Changes of the Local Plan on Values of the Properties**

The change in the local master plan decreasing by 20% the necessary biologically active area to be maintained in the U zone at first sight may allow to improve a larger area. However, the results for the two properties are quite different. Below is an analysis of the impact of changes to the plan on the two properties: the developed one, whose whole area is practically improved and the other property, which is undeveloped and unimproved.

#### Developed property

The local master plan after changes reduces its requirements regarding the minimum biologically active area, which provides a base for a conclusion that it gives a potential to put up new developments. However, the subject property was fully developed when the plan was amended and it is physically infeasible to increase the size of the developed area. It is impossible to make use of new opportunities offered by the plan and increase the size of developed land. Therefore the modification of the plan changing the required percentage of biologically active area does not affect the value of the land of the fully improved property. The Market Value of the developed property as zoned before, after changes to the plan is exactly the same. Hence, there are no grounds to levy the zoning fee, as the criterion of value enhancement is not met.

#### Undeveloped property

Changes in the local master plan have a very different effect on the value of the undeveloped and unimproved property. Decrease in the percentage of the minimum required biologically active area allows to improve 20% more of the property area. As a result, the change in the local plan may be translated into the growth of land value of the subject property. Hence, there is a base to levy a one-off fee due in case when changes in the plan result in a higher value of the property. But not in this particular case, since the developed property, whose area make up 50% of the U zone is improved and thus only 20% of the undeveloped property is available for development (i.e. 10% of the whole U zone). It is 20% less than before the plan was changed. The final conclusion is that there are no premises justifying the zoning fee, as the criterion of property value enhancement was

not met. The result of the changes are adverse to the owner/ perpetual usufruct, so he/she may claim indemnity from the municipality for a reduction of the Market Value of the property.

### **Summary**

Acceptance or change of the local master plans may cause increase or decrease of values of land under the plan or may have no such effect on land values. Zoning provisions allowing specific type of development in a particular area have different impact on values of particular properties. Based on the example using the required percentage of minimum biologically active area two extreme cases were discussed, where changes to the plan did not affect the value of the land and did not contribute to its enhancement. It is likely there are more similar cases on the market and sometimes in cases incorrect assessment of the situation and mistaken interpretation of regulation the zoning fee is charged without sufficient justification. To cure such situation, local government officials should gain better understanding of the matter.

# A Practitioner’s Glimpse on the Assessment of the Compensation Amount for the Easement of Access

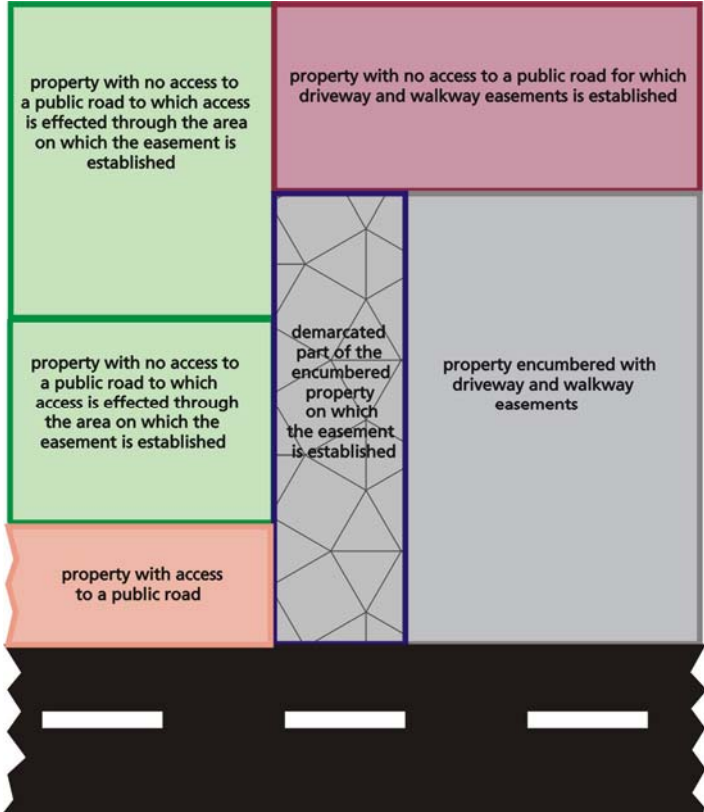
## Case study: Setting the Compensation for the Easement of Walkway and Driveway

In order to gain a better understanding of the issue it is worthwhile to consider a simple case of establishing the right-of-way. Let us assume the easement is not going to be limited in time. Vehicles will use a demarcated part of the property only, the traffic will not be burdensome and will not have a negative impact on the remaining part of the property.

When the right-of-way does not cause damage in the servient tenement like cutting down trees or demolition of buildings and needs only the use of a portion of land as a driveway to the dominant tenement, the compensation could be based on the Market Value of the portion of land used to exercise the right. When establishing the Market Value of the land, all factors impacting the value of the servient tenement, such as its location, zoning in the local development plan, existing technical infrastructure, condition of its improvements, etc. should be taken into consideration

Under such scenario it is fairly easy to establish the Market Value of the portion of land allocated for a walkway to a property that does not have access to a public road.

The next step is to consider existence of any important special considerations affecting the amount of compensation. What should be taken into account among other factors is that the land used for a driveway easement serves also as an access road to other properties deprived of access to a public road and that the owner of the servient tenement is also going to use the road. The amount of compensation should reflect the degree in which the owner of the property with no access to a public road uses the portion of land on which the easement is instituted in relation to the degree of use by other property owners. Below are three cases showing the diversity of factors affecting the amount of compensation for establishment of the right-of-way.



### Case 1

When properties to which access is effected through the area on which the easement is established are:

- of similar size,
- of the same type and their owners use the easement land with the same intensity,

the amount of compensation for the right-of-way may depend solely on the number of properties which are accessed through the land on which the easement is established.

### Case 2

When properties to which access is effected through the area on which the easement is established are:

- of different type and their owners use the easement land with different intensity,

in order to determine the amount of compensation for the driveway and walkway easements it is necessary to define a criterion for an assessment of intensity of use of the easement by owners of properties with no access to a public road, e.g. number of vehicles, number of dwelling units on such properties, size of buildings developed on the properties. The criterion should allow for a correct assessment of the degree of use of the easement land by owners of properties with no access to a public road.

### Case 3

When properties to which access is effected through the area on which the easement is established:

- cannot be compared in terms of their type and intensity of use of the easement by their owners,

the most appropriate comparison criterion for setting the amount of compensation for use of the driveway and walkway easement is the size of properties/plots accessed by the easement land. It reflects the intensity and the potential of using the easement land by individual owners of properties with no access to a public road.

### Owner of the encumbered property uses the land on which the easement is established

Please note that if there are premises that the owner of the encumbered property is using the easement right and will continue to do so in a degree similar to that of owners of properties with no access to a public road, such circumstance should be taken into account by setting an appropriate compensation for establishing the easement.

### **Summary**

The above thoughts on practical aspects of determining a compensation for the driveway and walkway easements spring out from real life situations faced by property owners in our country. The example given above of the driveway and walkway easement is a small fragment of a much wider practical issue. In every case, reasonable consideration of all aspects affecting the amount of compensation for the right-of-way requires that all situations are approached on an individual basis.

## Imperfect Assessment of Market Values of Land Allocated to Roads

Property valuers preparing valuation reports should have a thorough understating of the contents and application of legal regulations binding in Poland and regarding assessment of value of properties taken over by the State Treasury or local governments for a construction of roads as they serve as a basis for determining a compensation for this take-over.



### Binding Provisions

The basic legal tools containing rules and principles that should be followed by property valuers in Poland when dealing with such properties are, among others, the following:

- the Real Estate Act of 21 August 1997 (REA),
- the Ordinance of the Council of Ministers of 21 September 2004 regarding property valuation and valuation reporting.

In the above legislation, special attention should be paid to Article 134 of REA, which reads as follows:

1. *The basis for a compensation, with reservation of Article 135, is the Market Value of the property.*
2. *In the assessment of the Market Value of the property, the following must be taken into consideration: its type, location, use and zoning, existing technical infrastructure, overall condition of the property and current market prices.*
3. *The Market Value of the property is assessed for its current use provided that its zoning, consistent with the purpose of expropriation, does not increase its value.*
4. *If zoning of the property, consistent with the purpose of expropriation, increases value of the property, the Market Value is assessed for an alternative use resulting from this zoning.*

In the above mentioned Ordinance of the Council of Ministers rules for assessment of value are contained, among others, in § 36 Clause 1:

*„Market Value of land allocated for or used as public roads is assessed based on the market approach the comparative method of valuation, using prices from transactions of selling land respectively allocated for or used as public roads.“*

The objective of the above provisions was that valuation reports providing market values, necessary for a determination of a compensation for properties.

### Price Data from Notary Deeds

In the current legal environment, instituted by many factors, one of them being the Act of 10 April 2003 on special rules of a preparation and implementation of projects in the area of public roads (special purpose act), transaction prices of such properties are no longer recorded in notary deeds. Properties are purchased by the State Treasury or local governments by the operation of the law. In practice, the Market Value of properties allocated for roads is assessed solely to determine the compensation amount for taken-over land, to which also provisions of the said REA are applicable.

## **Impact of Legal Regulations on Setting Transaction Prices**

Taking into account the above, §36 Clause 1 of the Ordinance of the Council of Ministers cannot be applied because its current wording seems to be in conflict with Article 134 of the REA. Even before this provision caused a lot of controversy. Its restrictive use could lead to extreme and remote values of similar plots of land located close to each other, as the reference was made to prices agreed in covenants/negotiations with owners or set in the expropriate process. Such prices were different, depending on the advancement of the road construction process.

The lowest prices were paid to property owners at the beginning of the road development process, at the stage of taking decisions where the road would be located. Sale transactions frequently were initiated by owners, who wanted to sell quickly. Then land prices grew in subsequent stages of the project. The highest prices per sqm were paid for small pieces of land necessary for the project to get started. They were much above market prices and more often were higher than prices of development sites in the neighborhood.

As a consequence, a possible scenario is that land values in valuation reports are either under or overestimated. Whereas the latter case is not directly harmful to the society, nevertheless the amount of compensation for land allocated for a construction of public road determined based on underestimated value was not adequate to the actual value of the asset.

## **Valuation of Land for Public Roads**

Under the binding legislation, value of land for public roads should be established based on value of properties from which such land was carved out, using provision of article 134 and 135 of the REA. Undoubtedly, §36 clause 1 of the Ordinance of the Council of Ministers should be amended, as it should not be applied in the current wording.

## CPRF Achievements in 2008

Services	Area	Price / Value (EURO)
Office, Warehouse Agency Services	30 000 m <sup>2</sup>	
Agency Services regarding Development Sites Sale and Acquisition	15,0 ha	10 000 000
Commercial Property Valuation		500 000 000

Since the beginning of 2008, CPRF has appraised existing and planned office buildings, warehouse parks, industrial properties, retail properties, residential complexes and development sites totaling in value to approximately **0.5 billion Euro**.

As far as agency services are concerned, CPRF has secured lease agreements for approximately **30,000 m<sup>2</sup>** of commercial space and sale agreements of about **15.0 ha** of development properties with a total value of approximately **10.0 million Euro**.