

CPRF Newsletter February 2007

Commercial Real Estate Market

Table of content

Title	Page
New Image of www.cprf.com.pl	2
Property Valuers Professional Standards – Past, Present and Future	3
Property Valuation Standards – International Market	4
New Property Valuation Technique?	5
Restaurants in Office Buildings: What is the Best Type of Lease Agreement?	8
The Warehouse / Light Industrial Market Heart of Poland	11

New Image of www.cprf.com.pl

CPRF has been operating since the beginning of 2004. Gaining the expertise, improving our image and creating new development perspectives we have decided to change the hitherto appearance of our website, www.cprf.com.pl

In the opinion of its users, the current version of CPRF website is more clear and user-friendly. It contains a profile of our company, a detailed description of services provided, interesting links and list of references we have received.

Property Valuers Professional Standards – Past, Present and Future

The idea behind the development of the Polish Professional Standards for Property Valuers (PSPV) by the Polish Federation of Valuers' Associations (PFVA) was making the professional practice in a property valuation more consistent, as well as harmonize activities and rules used in conducting valuation business by professional valuers. The objective of the professional standards is to promote consistent rules in terms of approaches applied in a property valuation and secure interests of the client.

With regard to Poland's accession to the European Union, expansion to European real estate markets and the necessity to extend the binding standards in order to accommodate new concepts, a need and necessity arose to amend hitherto enforceable PSPV, adjust them to international valuation standards and directions of changes on international real estate markets and new areas of valuation.

Currently, due to numerous changes, new directions and areas of property valuers' professional activity it is planned to depart from PSPV approved by the National Council of PFVA and use them as a thread to develop new standards, matching the international ones. The New National Valuation Standards (NNVS) are to contain two groups of standards: Basic Valuation Standards (BNVS) and Special Valuation Standards (SNVS). Both group would be subject to reconciliation with the Ministry of Construction, as stipulated in the Real Estate Act.

At present, the most important task of the Standard Committee is to decide on the status of currently binding standards through the development of a new Standard 1.1 "Application of PSPV in the transition period with a general rule of departure". That standard will regulate the use of PSPV in the transition period before NNVS are agreed and approved by the Ministry of Construction. In the transition period the property valuer will have the opportunity to depart from provisions contained in the standards and if he/she chooses do so, will have to provide a justification of such departure. A portion of PSPV will be changed to Guidance Notes to the newly developed standards and as such will not be treated as standards but merely as recommendation or advice for valuers and hence will not be subject to reconciliation with the Ministry of Construction.

In 2007 three basic standards are going to be developed and reconciled by PFVA Standards Committee:

BNVS 1: Market Value and Replacement Value,
BNVS 2: Non-Market Values,
BNVS 3: Valuation Reporting.

and two special purpose standards:

SNVS 1: Valuations for Public Purposes
 KSWS 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 the Accounting Act

Property Valuation Standards – International Market

Although the real estate market is always local, global trends, mechanisms and standards start to play more and more important role in many areas of its operations. Poland, after gaining its membership in the European Union on 1 May 2005, started to be more exposed to those processes. That is why increasingly often a need arises or is even imposed to apply and rely upon international valuation standards. Two major global and European sets of international standards in valuation are:

- 1/ the International Valuation Standards (**IVS**) published by the International Valuation Standards Committee; and
- 2/ the Valuation Standards of the Royal Institution of Chartered Surveyors in London, (**RICS**), also known as the Red Book.

By the end of 2006, the above-mentioned standards could be obtained only by purchase of a printed publication. However, as a result of the market globalization, the need to provide an easy access and make them more widely used, the standards were made free of charge available to the general public for their familiarization and use. Their complete electronic copies can be found at the following websites:

IVSC

<http://www.ivsc.org/standards/index.html>

A Polish translation in a hard copy is available in the office of the Polish Federation of Valuers' Associations, www.pfva.com.pl.

RICS

http://www.rics.org/Property/Propertyappraisalandvaluation/red_book_050706.htm

If you are need a property or fixed assets valuation you can take the opportunity and acquaint yourself with the scope and structure of the standards. The real estate market is becoming more and more complicated. Definitely, the above Standards are very helpful in providing guidance and many answers to questions that arise in everyday business.

New Property Valuation Technique?

Case Study

The commercial real estate market is becoming increasingly complicated and sophisticated. Developers and investors try to use innovative legal, tax and investment solutions to optimize their investment performance. Therefore, based on completed investment transactions on the commercial real estate market and legal regulations concerning the ownership of land and improvements in Poland, it is possible to have an open market transaction in which land owned by Company A is sold separately from improvements on that land, which include a commercial building developed for a lease by Company B, independent from Company A. As a result, despite a number of restrictions, it is possible under such circumstances to establish Market Value of the land.

What is the Market Value of the right to such land?

In this case the owner of the land under valuation is not in a forced position and on the free market may reasonably dispose of the right to the land. Buyers of the land, in this particular legal and financial condition, i.e. improved with a leased up commercial building, are solely investors/investment funds, who buy income generating properties from developers. Their interest in such purchase results from their will to own rights to a whole property, including both the land and the improvements. Based on several hundred market transactions involving investment properties, developers sell them at a price that includes the so called developer's profit. It is a sort of developer's compensation for a risk, entrepreneurship, incurred costs and organizational efforts. The profit is expressed as a percentage of total project costs, including price/cost of purchasing the land and is treated like a gross profit before tax. A percentage is the same on land acquiring costs, costs of construction and financing. In other words, referring to the Market Value definition contained in the *Real Estate Act*, the most likely price for which such land would exchange on the market is the price that includes the developer's profit on land acquisition costs.

Valuation methodology

Since the commercial real estate market in Poland is only at the development stage, the number of land transactions that involve developer's profit is limited. Also, very often the access to detailed information on such transactions is restricted. Therefore, it is practically infeasible to find comparable land transactions with the profit component and to apply the comparison method of valuation to the subject land. Another reason that makes it more difficult to assess a market developer's profit from such transaction is lack of its transparency. Therefore, referring to and based on §16 of the *Ordinance of the Council of Ministers of 21 September 2004 on property valuation and development of the Valuation Report*, particular clauses 3 and 4 of the § 16, as well as taking into consideration a considerable number of already closed investment transactions of income generating properties and information thereof, it is acceptable to establish the Market Value (W_{kg}) of the above-mentioned land in the following procedure:

- 1/ establish the Market Value of the land in the market approach with the assumption the land is undeveloped and can be developed with the existing commercial facility and leased at the date of valuation (C_{zg}).

The commercial development sites market brings a sufficient number of transactions and information, so the value of the title to undeveloped land can be established with a high accuracy. No other approach than the comparison method of valuation is justified in order to assess the Market Value of such land.

- 2/ determine the market developer's profit as a percentage based on relevant investment transactions involving whole developed according to the principles and bases of the residual method of property valuation. This method is widely used to determine the developer's profit. In investment transactions, the profit expressed in percentage is equal for the whole property and for each component of a developed property, among other components, land acquisition costs (Z_d).

The sum of C_{zg} and Z_d gives the market value of the land described above.

Residual method

It may seem that the valuation procedure described above is equivalent with the procedure used to establish the land value under the residual method. However, valuation of land or the developer's profit using the residual method leads to determination of a non-market value and boils down to the following formula:

$$W_{kn} - C_{kp} - Z_d = C_{zg}$$

or

$$W_{kn} - C_{kp} - C_{zg} = Z_d$$

Where:

(W_{kn}) Capital Value of the Property

- it is the value of the developer's project after its completion, calculated as capitalized forecasted annual rental income the project is going to generate. It is equal to W_{kg} (capital value of the land) plus W_{kz} (capital value of improvements/ buildings);

(C_{kp}) Total Project Costs

- includes total costs of construction and other works needed to prepare the site and its infrastructure for the project, professional fees, brokers' commissions, costs of financing;

(Z_d) Developer's Profit

- calculated as a percentage of total project costs, usually set by developers on an individual basis;

(C_{zg}) Land Purchase Price

- it is the maximum price (value) the developer can pay for the land.

The above formula can be transformed as follows:

$$W_{kg} = C_{zg} - W_{kz} + C_{kp} + Z_d$$

Bearing in mind the condition of the subject of valuation, C_{kp} and W_{kz} are equal zero, so formula can be shown as:

$$W_{kg} = C_{zg} - 0 + 0 + Z_d$$

$$W_{kg} = C_{zg} + Z_d$$

and thus, from the viewpoint of the principles of the residual method, confirms the appropriateness of the suggest approach to a market valuation of the subject land and the adjustment for selling the land as a part of an investment project.

Summary

Please note that the procedure proposed in the Valuation Methodology section is based on market analysis and comparable analysis of market transactions. Therefore C_{zg} and Z_d are established in a procedure leading to an assessment of their market values, while in the residual method to assessment of their non-market values. The residual method is applied to establish non-market/

individual (worth)/ investment values associated with a particular, clearly defined planned concepts of land development. Hence the proposed Valuation Methodology, although in mathematical terms identical to the residual method, can not be perceived as such.

Restaurants in Office Buildings: What is the Best Type of Lease Agreement?



Naturally, when it comes to leasing space for a restaurant in an office building, both the building owner and the tenant signing the lease agreement would like to get real value for money. However, the real value for money lease agreement should secure smooth cooperation between the owner and the operator and satisfaction of other tenants in the building, who are also future customers of a restaurant.

Different types of lease agreements are used for space designed for a catering operation in office buildings. The selection of a particular type of lease agreement is based on many criteria, including the following:

- type of food/catering operator (employees' canteen, snack bar, restaurant);
- location of office building;
- type of building: for lease/ owner occupied;
- occupancy rate of the office building;
- specific features of tenants' business and operations (office hours, corporation structure, employees' habits).

After consideration of the above factors, an appropriate type of a lease agreement is selected to satisfy the needs and expectation of the building owner and the operator in the most comprehensive manner. The market uses lease agreements with a fixed total monthly rent for leased premises and lease agreements where the rent is based on the performance of the catering business and thus the rent is variable and based on a percentage of the operator's sales. Lease agreements of premises for catering services in office buildings can be split as follows:

- Lease Agreement with Rent Depending on Sales Volume of Catering Operator;
- Standard Lease Agreement;
- Hybrid Lease Agreement;
- Business Rental Agreement.

The above lease agreements treat differently rights and obligations of both the office building owner and the catering operator.

Lease Agreement with Rent Depending on Sales Volume of Catering Operator

Such lease agreements result mainly from the need to make available a canteen/restaurant to people working in the building and are mainly used in buildings where companies' headquarters are located, with controlled access not allowing people from outside to use the facility and in buildings which suffer from a shortage of canteens/restaurants in a neighborhood.

In such lease agreements the rent paid by a tenant is not calculated based on the total area of premises and market rent rates, this applies also to operating expenses. The rent is based on monthly or average annual sales of the operator (net of VAT). Usually the operator starts paying after an agreed monthly sales threshold is exceeded. The market amount of the threshold varies considerably. General idea is that the more the building owner cares about quality of food and services offered by the operator and the more owner demands from the operator, the higher is the threshold amount.

Standard and Hybrid Lease Agreements

Standard and hybrid lease agreements are used by owners/developers of office buildings when it is not absolutely necessary for them to provide catering services to people working in the building. Such lease agreements are frequently signed with restaurants and cafeterias which decided to lease space in the building.

Such lease agreements provides for a fixed or hybrid lease payments. Under the hybrid system, the tenants pays a base rent and operating expenses calculated based on a per square meter rate and on top of that a percentage rent depending on actual monthly net sales. In practice, the percentage rent is paid above a certain sales threshold.

Business Rental Agreements

They are signed in buildings where the owner creates conditions for conducting a catering business, provides necessary space, kitchen equipment, furniture and leases the whole unit to someone who runs the catering business.

Correct Structure of Each of the Above Lease Agreements Should Include Provisions Regarding:

1/ duration of lease agreement

In case of large chain companies from the catering sector, lease agreements are signed for a long-term, for several years. In case of smaller operators, the minimum duration of the lease is one year.

2/ catering equipment

In many cases, the landlord is responsible for providing standard catering equipment and appliances to the space, while the tenant is responsible for utensils and tableware.

3/ range of provided services

Opening hours and days of the week are to be specified. What is also often agreed is the menu in terms of the number of meals of a particular type and their prices.

4/ quality of food

The landlord, through a relevant provision in the lease agreement, may restrict the tenant to use preservatives in meals, other additives quickening preparation of meals and taste improvers.

5/ termination of agreement

In case of fixed lease term lease agreements, the tenant may require a provision regarding termination of the agreement when an office building vacancy rate drops down a certain percentage.

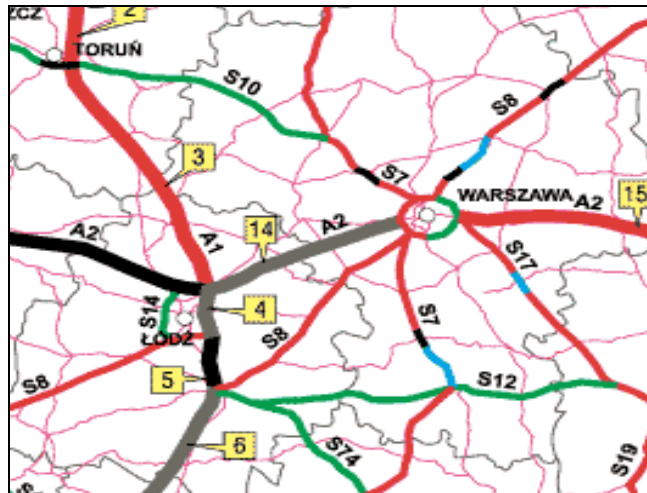
6/ exclusivity

The landlord may grant the tenant exclusivity right for rendering catering services in the building and a ban of door-to-door selling of food products in the building.

When the landlord and the building owner take a decision on starting mutual cooperation, both parties have limited information data concerning the number of potential customers of the catering service and future sales. Therefore choosing the most appropriate and beneficial to both parties contract, despite a wide range of available choices and flexibility of the above described agreements, may prove to be an extremely difficult task.

The Warehouse / Light Industrial Market Heart of Poland

Until recently, the answer to the question where in Poland distribution parks are concentrated was simple and unambiguous – it was the Warsaw region. Nowadays, the situation is substantially changing. Although Warsaw and its vicinity is still considered by many developers and end-users as good location for their development projects, their interest also shifted to attractive areas close to the future intersection of A1 and A2 motorways, i.e. in the region of Łódź and Piotrków Trybunalski.



Source: GDDKiA

Piotrków Trybunalski

Piotrków Trybunalski has a perfect location with regards to the road network, it lies at the intersection of five major transportation routes in Poland. It is where route E67 leading to Warsaw and Wrocław connect with A1 motorway, which in a future will link the Tri-City with Upper Silesia. Advantages of Piotrków Trybunalski's location were recognized by such investors like Ikea. The Swedish furniture corporation built here its main warehouse. FM Logistic has it's the largest logistic park in Mszczonów and the second largest in Piotrków Trybunalski. Prologis, a leading warehouse/light industrial parks developer in Poland, purchased a land and constructed first buildings and leased to large tenants from the food industry - Unilever and Ahold. Also Auchan, the hypermarket chain constructed its distribution center in Wolborz close to Piotrków Trybunalski. Following 2004, next companies who purchased land near Piotrków Trybunalski were major developers active on Polish market, like Parkridge and Europolis. Another project in the pipeline, for which land has already been purchased is Logistic City – Piotrków Distribution Centre. As far as end-users, the chain of Kaufland supermarkets bought land for construction of its central warehouse in Poland. After 2001, the most active years in terms of purchasing investment land for warehouse facilities/ light manufacturing where 2005 and 2006.

Stryków

In Stryków, 50 km north of Piotrków Trybunalski, where A1 and A2 motorways will interchange, the first investors were Raben, a logistic company, and a hyper and supermarket chain Geant, which completed their projects before 2001. Currently there is Tulipan Park warehouse center under construction, developed on land initially purchased by Dutch developer Grontmij Real Estate and currently owned by British Slough Estate. Also other developers, AIG/Lincoln and Panattoni, bought land in the municipality of Stryków planning to construct there large warehouse and light industrial buildings for a lease. End-users are also interested in this location, too, like Lidl supermarket chain, which in 2005 built in Stryków one of its two central warehouses in Poland. The highest number of land transfers was recorded in 2004 and 2006.

Zgierz and Nowosolna

Onninen, a European leader in deliveries of all kinds of technical materials has built its central warehouse in the municipality of Nowosolna, south of Stryków, and Masterlink, a parcel service, located their warehouse in the vicinity of Zgierz.

The strength of demand for land located in that region is shown by the overall area of land purchased so far. In the environs of Piotrków Trybunalski in total 380.0 hectares were transferred and in the Stryków municipality approximately 150.0 hectares. Taking into account the number of investors and developers who have already bought land in that region, it may be presumed that the demand in quantitative terms has been satisfied. However, taking into account large investors' interest and their activity, evidenced by the number of transactions in 2006, it may be also presumed that in the years to come demand will be maintained at the current level.

Bearing the above consideration in mind, because of the location near the geographical center of the country and the intersection of planned main transportation routes, regions of Stryków, Piotrków Trybunalski and Zgierz have a chance to become the second, after Warsaw, or – in a perspective of a few years – perhaps even the first warehousing heart of the country.