

## The missing link in Polish real estate

For nearly 10 years investment funds operating as REITs have experienced dynamic growth in Europe, but have not been implemented into the Polish market. This should change.



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Economic growth entails – and sometimes forces – change to existing methods of financing investment. During globalisation, classic forms of investment are used with modern methods of financing. However, real estate financing in Poland is still primarily based on mortgage and construction loans, granted by banks. A lack of variety in the methods of financing is characteristic of a financial market that has yet to fully develop.

Even though the Polish investment fund market is growing and the funds operating on the market are stoking the interest of both institutional and individual investors, funds investing in real estate have been unable to achieve a share of the market even comparable to funds in other European countries. One reason for this is the state of Polish legal regulations for creating and operating investment funds for real estate. There is a lack of a legal framework necessary to create a type of investment fund called Real Estate Investment Trust (REITs), which is widely used in countries across the world and is dedicated to real estate investment.

REITs are a kind of a closed-end investment fund created for the purpose of investing in real estate, bonds secured with mortgage or both. They developed in 1960s America to allow individual investors to access the very profitable commercial real estate market, previously reserved for institutional investors, by using join-financing to eliminate the high entry threshold acting as a barrier to the market. They have certain tax privileges: they have the right to deduct their dividend payments out from their income because they are required to regularly pay their investors the vast majority of their profits – almost 90% in the United States. In order to maintain this privileged status, REITs must meet the requirements of periodic tests designed to verify that all legal statutory requirements are met regarding sources of income, the state of possessed assets and the ownership structure. Most REITs in the US are commercial law companies that sell their shares on the regulated market, with IPOs providing one of the main sources of capital for the funds. Types of REIT can vary: capital funds directly invest into real estate and manage pur-

### REITs developed in 1960s America to allow individual investors to access the market

chased assets while mortgage funds purchase indirectly or debts secured by mortgage. In the American market, hybrid funds deal with both types of investment. There has also been an emergence of so-called specialised funds which focus their investments on a select area of the market; for example, offices or warehouses. This has lowered management costs, because there is less need to use a wide array of consulting services, but has been criticised for increasing susceptibility to market fluctuations.

While REITs were created to serve individual investors, they are currently also used by institutional investors and are a major source of real estate financing in the US. Although first introduced to Europe in Holland in 1969, the legal framework brought in by Germany and the UK in 2007 encouraged a boom in this type of real estate investment. Although regulations in the European investment fund market have been harmonised through the EU, REITs have not been included in the changes and national regulations in European countries vary widely as a result. Despite their continued growth worldwide, Poland currently has no legal structure available for creation of REITs, with the closest alternative being closed-end investment funds. These can directly invest in real estate and purchase real estate ownership, while open-end funds can only invest in real estate indirectly, by buying bonds of companies in the real estate market.

Despite the growth of the Polish investment fund market, funds buying into real estate are a small portion of the market. Currently, the number of closed-end investment funds investing in real estate is less than 10. Given the rapidly developing market of commercial real estate in Poland, this has

created a niche that foreign REITs are trying to utilise by investing in numerous sectors of the market: offices, commercial premises or warehouses.

Introducing the necessary regulation in order to construct the legal framework allowing the creation of REITs in Poland would help to improve the current state of affairs. REITs are an attractive investment opportunity because of their regular provision of income, provided by their periodically paid dividend. They also have substantial asset liquidity, lower transaction and management costs and better public supervision compared to closed-end investment funds.

In light of growing capital needs of the Polish market, legislation to allow REITs would be in the best interests of the real estate market and the Polish economy as a whole. Their simple structure, allowing for real estate purchase and management, provides for regular profits meaning REITs would be interesting to individual clients, allowing them to invest in commercial real estate, which would normally require an amount of capital well beyond the reach of an individual investor. Because international financial institutions are accustomed to this form of investment, they would also be more willing to invest the Polish market. The future of REITs in Poland looks bright as representatives of the Polish real estate market and the government have recognised the need to change the existing Polish law. Reviews are being prepared and seminars and conferences debating the future presence of REITs in Poland are becoming increasingly more common. The drive to raise awareness has made progress: information has recently surfaced focusing on preparations for the expected bill creating the legal framework for Polish REITs. • by **Piotr Rusin**

#### A LIQUID INVESTMENT

**REIT (real estate investment trust)** uses the pooled capital of many investors to purchase and manage real estate through income property or mortgage loans and often trades on major exchanges, like a stock. REITs provide investors with an extremely liquid stake in real estate. They receive special tax considerations and typically offer high dividend yields.



photos: Grazyna Myslińska (Forum)

**Will the new government** introduce legislation enabling REITs to be formed and traded on the Warsaw Stock Exchange? This is the question the Polish real estate industry hopes to get a positive answer to soon, bringing a highly liquid form of investment structure into the commercial property market.