Polish Capital for Polish Property

By **Ben Habib**, chief executive officer, First Property Group plc

One of the principal reasons Poland has so far been able to navigate the credit crunch without going into recession has been its largely balanced economy, with a strong export and consumer economy. But its economy remains unbalanced in at least one material way. There is a very limited domestic capital market for investing in income producing commercial property – offices, shops, leisure and industrial. There are a number of first class property developers but Poland has not established a significant local market for investing in commercial property itself. Commercial property is part of the life blood of all economies housing, as it literally does, all businesses.

Poland's stock and debt markets have taken big steps forward in the last decade. The same is not true about commercial property. Long term investment in commercial property has thus far been a field dominated by international investors. This leaves Poland prone to the withdrawal of capital by such investors as has recently happened, with most international investors retreating to their home economies. A dearth of end investors for commercial property inevitably leads to a fall in values and a reduction in supply of new space and/ or an increase in the level of rent payable by occupiers. This is self evidently bad for Poland's growth prospects.

One of the reasons that Poland has failed to develop a vibrant internal property market has been the legal restrictions foisted on Polish institutions. Pension funds in particular are highly restricted in what they can invest in. Bizarrely, section 141 of the law on the organisation and operation of pension funds 1997, which stipulates the list of acceptable asset classes in which pension funds may invest, does not once mention property. It makes much mention of deposits, bonds, publicly quoted shares etc but it fails to address property. It would appear that the powers behind that legislation did not recognise property as a suitable asset class!

Poland's economy and legal structures have come a long way since 1997 and the regulatory environment for Polish institutions must now be reformed.

My own company, First Property Group plc, which owns, on behalf of funds managed by it (ironically, mostly for a UK pension scheme), some EUR 300 million of commercial property in Poland, is currently raising a new fund to invest in commercial property, mainly in Poland. As a result of value reductions, yields on commercial property have risen by some 20% since 2008 and we believe we are at or close to the bottom of the commercial property investment cycle. Rents, which have also fallen, would appear to be bottoming out and both rents and values are forecast to rise this year. This is therefore a very good time to invest in Polish commercial property. The number of UK and international institutions interested in investing in such a fund is much fewer than in 2005 to 2007. They are now much more risk averse and not ready to venture outside their own comfort zones.

BUT WHERE ARE THE POLISH INSTITUTIONS? They should be using this tremendous buying opportunity to capitalise on the market for the benefit of their pensioners and policy holders. Investing in property is a cyclical business and this is the right point in the cycle for them to be entering the market.

An adverse consequence of the recent weakness in Poland's economy has been the increase in the country's budget deficit. The deficit is still much healthier than many neighbouring and Western European countries but it is due to rise to some 7% of GDP, more than twice the rate prescribed by the EU.

One of the means by which the Polish government intends to lower this deficit and avoid breaching the statutory ceiling of total Government debt to GDP, of 55%, is by the privatization of state industries. Many commentators have caste doubt on this as being a viable solution because of the sheer scale of privatisations that would be required to make it workable.

There is an additional way they can reduce the budget deficit – by the sale (and possibly lease back) of government property. Many Western European governments have been using this well tested fund raising mechanism since time immemorial. The Polish government should be doing the same. In order to avoid selling all its crown jewels to foreigners and to create the market in which to sell these assets, it should liberalise the restrictions on Polish pension schemes and provide incentives for local investors to buy these assets. [My own company would be delighted to assist the Polish government with such an endeavour.]

The deregulation of property ownership to allow foreign investors to directly own Polish property was a very sensible statutory change introduced by the Polish authorities some years ago. But they left the local market at a distinct disadvantage when they failed to also deregulate and incentive local institutional property ownership – it is high time that this changed. ■