Fprop plc

The Investment Case for **Polish Commercial Real Estate**

IPD Funds Measured Gold Level

The performance of funds managed by First Property Group ranked No.1 vs IPD CEE universe over the three, four, five & six years to 31 Dec 2008, 2009, 2010 & 2011

Fprop plc

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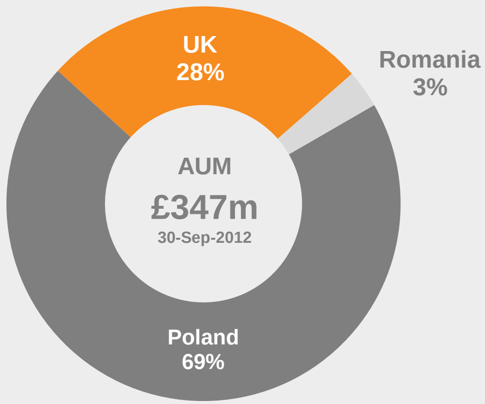
First Property Group plc is a commercial property fund manager with operations in the United Kingdom & Central Europe.

First Property Group plc is listed on the AIM segment of the London Stock Exchange (AIM: FPO) and was founded in 2000 by its Chief Executive, Ben Habib. At 30 September 2012 the Group had some £347 million of direct property assets under management, invested across six funds in the United Kingdom and Central Europe, managed by its wholly owned subsidiary First Property Asset Management Ltd (FPAM).

➢ **The business model of First Property Group is to:**

- Raise third party funds to invest in income producing commercial property;
- Co-invest in these funds;
- Earn fees for the management of these funds. Fees earned are a function of the value of AUM as well as the performance of the funds;
- Earn a return on its own capital invested in these funds.

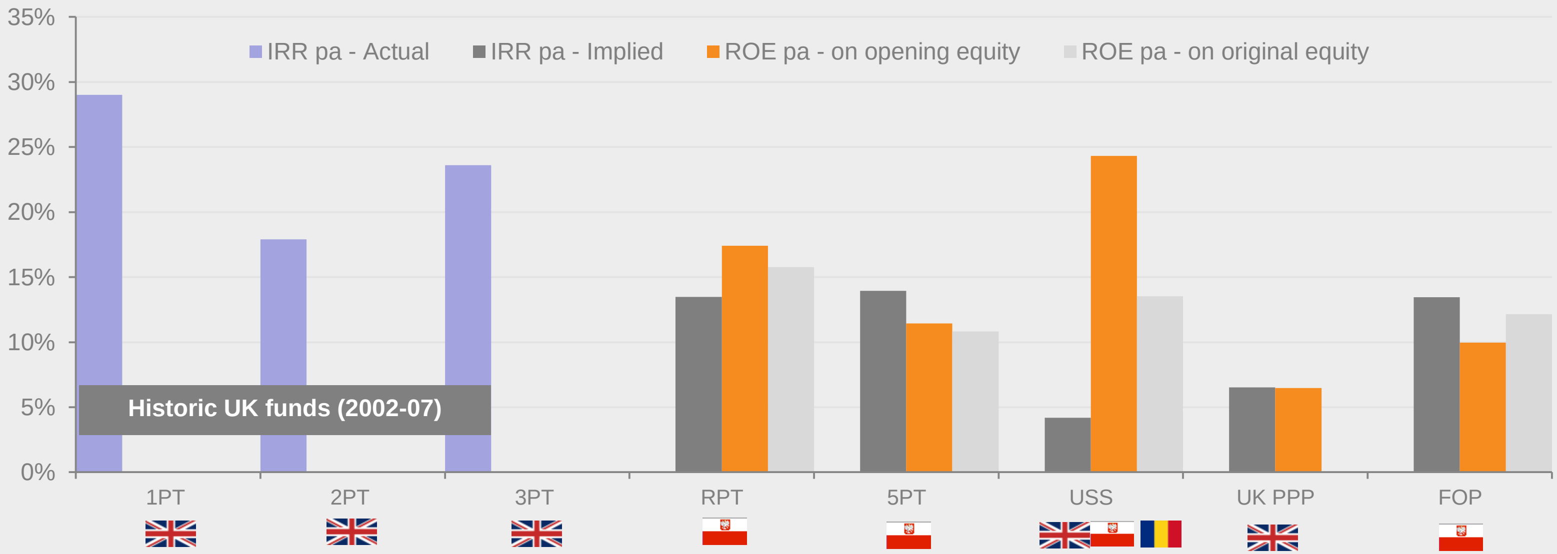


IPD Funds Measured Gold Level

The performance of funds managed by First Property Group ranked No.1 vs IPD CEE universe over the three, four, five & six years to 31 Dec 2008, 2009, 2010 & 2011

Fund performance at 30 September 2012:

- FPAM's three historic funds (all of which were invested in UK commercial property) generated a weighted average IRR of 23.0% p.a. net of fees.
- FPAM's five discretionary active funds (with inception dates ranging from 2004-10) are generating ROEs on original equity invested of between 6.5% p.a. (unleveraged) and 15.8% p.a. (leveraged) net of fees, as at 30-Sep-12.



- All implied IRR calculations use NAVs at 30-Sep-2012.
- Annualised ROE's on original equity are calculated using the annualised H1 2012/3 pre-tax income ÷ original shareholders' equity employed.
- Annualised current ROE's are calculated using the annualised H1 2012/3 pre-tax income ÷ by opening equity (NAV at 31-Mar-2012).

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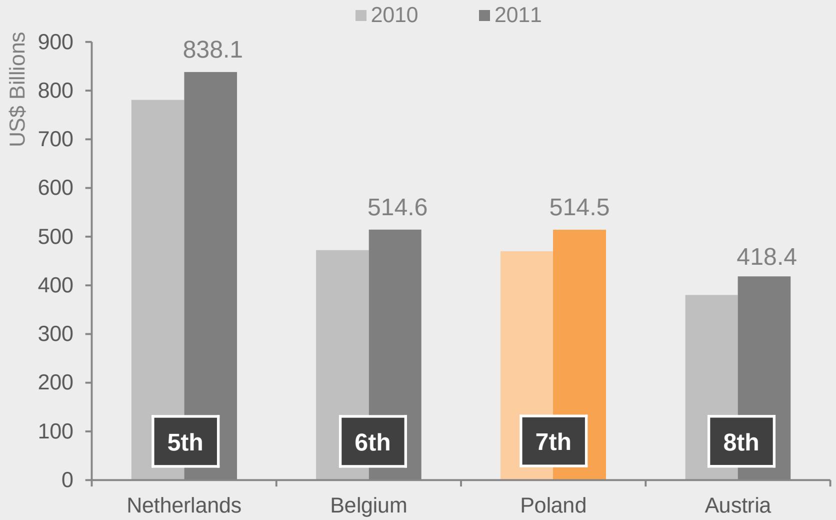
Macroeconomics - Poland

Poland is the 7th largest economy in the EU with a nominal GDP in 2011 of $515bn:

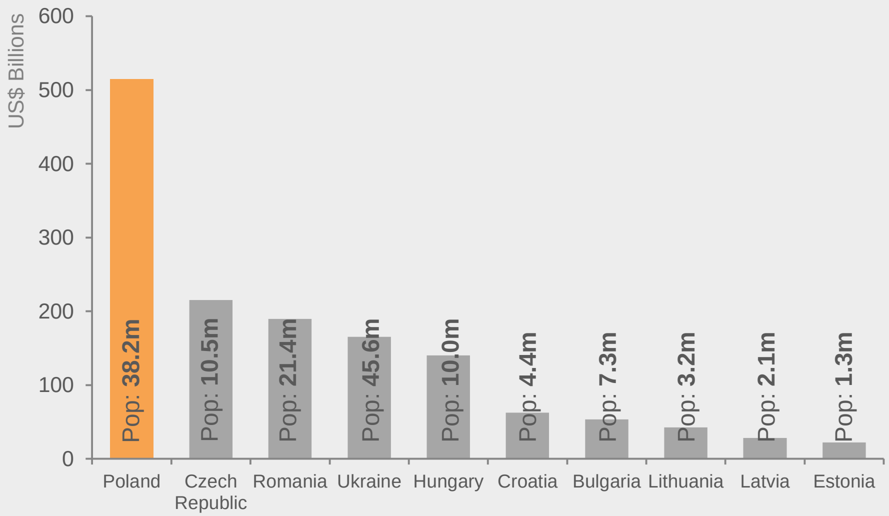
GDP of EU-27
current prices in US$ Billions (2010-2012)



Source: IMF, World Economic Outlook Database, Oct-12.

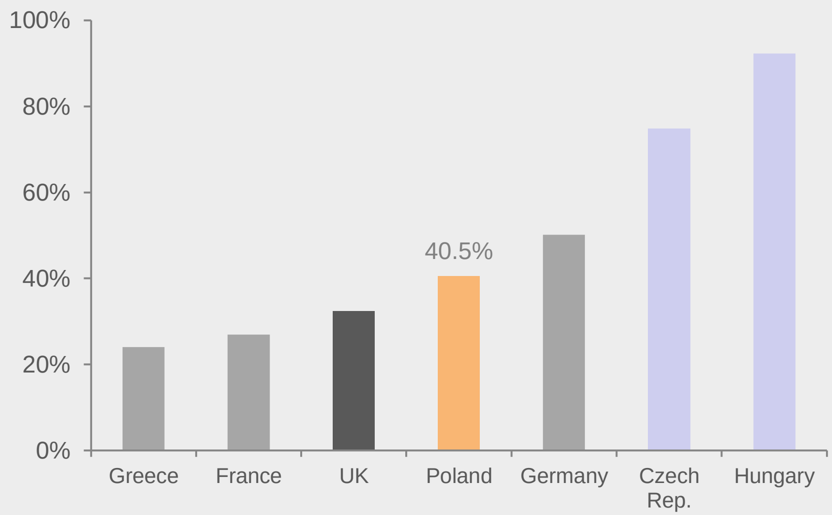
Poland is the largest economy in emerging Europe with the second largest population size after Ukraine:

GDP and Pop. Size of Emerging European countries
current prices in US$ Billions (2011)



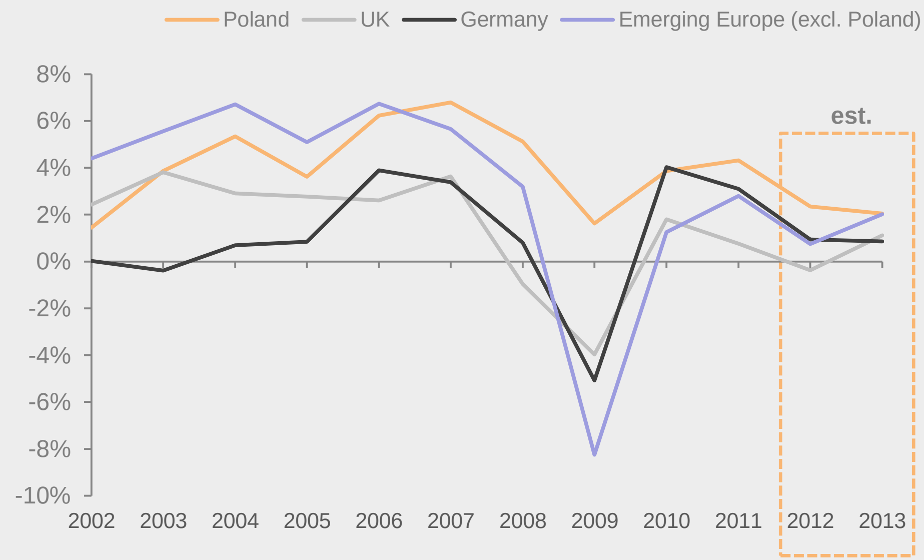
Source: IMF, World Economic Outlook Database, Oct-12.
Note: Emerging Europe (as defined by Capital Economics) comprises Bulgaria , Croatia, Czech Republic, Hungary, Poland, Latvia, Romania & Ukraine.

Poland has a strong balanced economy with around 60% of GDP generated internally



Source: World Bank dataBank, accessed Nov-12
Note: Data for Poland's exports as % of GDP for 2011 is not yet available so the mean % of the past four years is used instead.

Poland is the only EU member state not to enter recession since the onset of the credit crunch



Source: IMF, World Economic Outlook Database, Oct-12
Note: Emerging Europe = weighted average GDP % change of Bulgaria, Croatia, Czech Republic, Hungary, Latvia, Romania & Ukraine EXCLUDING Poland.

Poland is a large recipient of FDI and is the largest beneficiary from the EU Cohesion Policy budget 2007-2013[1]
It is expected to receive a similar amount in the 2014-2020 EU budget[2]

EU Subsidies:

- €67.3 billion has been committed to Poland for the period 2007–13 as part of EU Cohesion Policy, of which some 40% had been drawn down at 27 July 2012[1].
- Donald Tusk, the Polish Prime Minister, is reported to expect Poland to receive PLN 300bn (€73bn) in the 2014-20 EU Cohesion Policy budget[2], scheduled to be announced in Nov-2012.

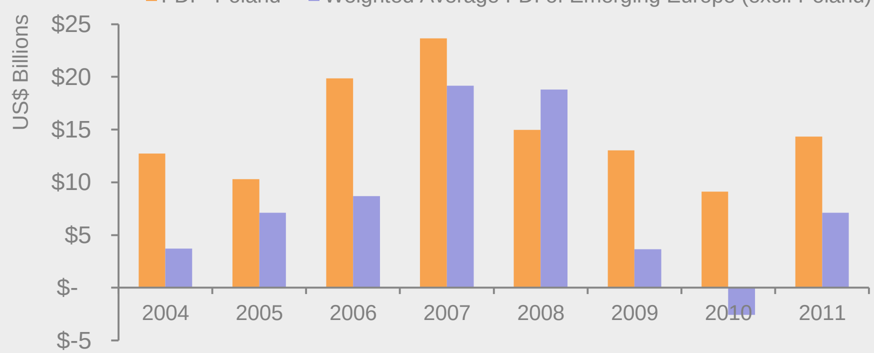
Foreign Direct Investment (FDI): (see graph top right)

- Poland has seen significant corporate investment from large multi-nationals such as Dell, IBM, Cadbury, IKEA & Fujitsu.

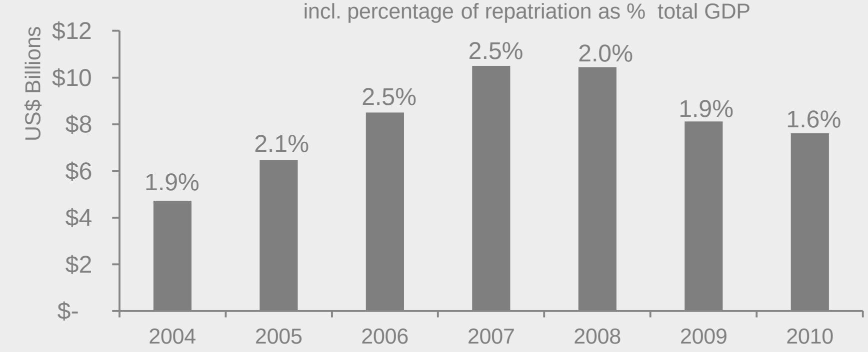
Source for text:
[1] European Commission
[2] Business News Europe (Jan Cienski) - 22-Oct-2012

Source for Graphs: World Bank dataBank , accessed Nov-12
Notes:
- FDI = net inflows. FDI for each Emerging Europe constituent country has been weighted by GDP (current, US$).
- Emerging Europe = weighted average data of Bulgaria, Croatia, Czech Republic, Hungary, Latvia, Romania & Ukraine EXCLUDING Poland.

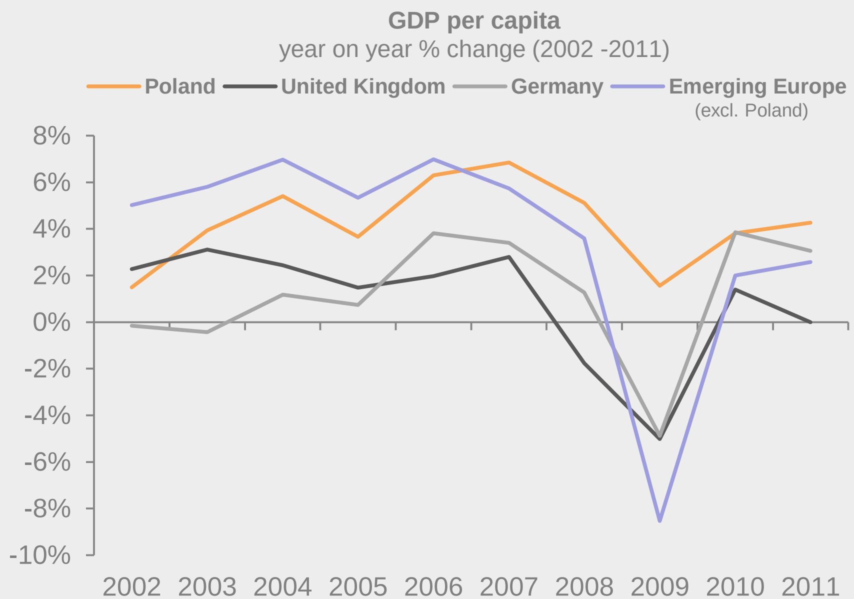
Foreign Direct Investment into Poland (2004-2011)



Money repatriated from Polish Nationals Abroad (2004-2010)
incl. percentage of repatriation as % total GDP



Poland's GDP per capita is forecast to grow twice as fast as the UK's over next 40 years[1]



Source: World Bank dataBank, accessed Nov-12
Note: Emerging Europe = weighted average GDP per capita of Bulgaria, Croatia, Czech Republic, Hungary, Latvia, Romania & Ukraine EXCLUDING Poland.

Polish retail sales have held up relatively well over the credit crunch

Sources: NBP (Poland); ONS (UK); Destatis (Germany).
Note: Graph shows percentage change of retail sales vs corresponding month in the previous year.

[1] HSBC, The World in 2050 (published Jan-11)

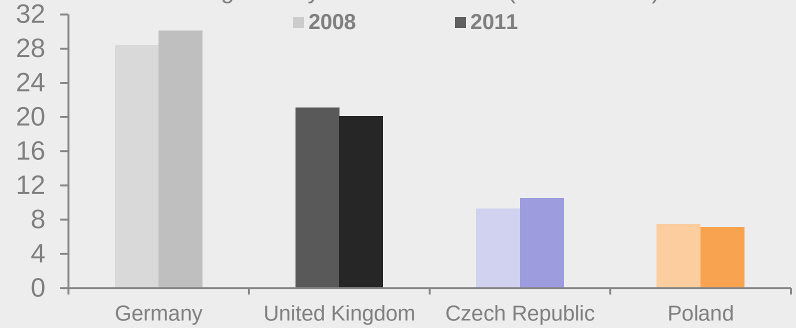
Additional Supporting Factors – Labour Market

Poland benefits from a young, low cost, and highly educated labour market

- **Youthful:**
  - 71% aged 15-64 years (UK = 66%)[1]
  - 14% aged 65+ (UK = 17%)
- **Low cost:**
  - Average labour cost of €7.1 per hour (UK = €20.1 per hour)[2]
- **Well Educated:**
  - High literacy rate of 99.7% (UK = 99.0%)[1]
  - c.95% of 25-34 year olds achieved at least upper secondary education (c.17% more than the UK)[3]
  - 71% of school leavers have A-Level (UK) equivalent English[3]
  - Polish secondary school students perform better than their UK and USA contemporaries in both reading and maths[4]
- **Unemployment:**
  - Fallen from 20% in 2002 but remains high (current estimates are >10%) meaning there is capacity in the labour market for growth

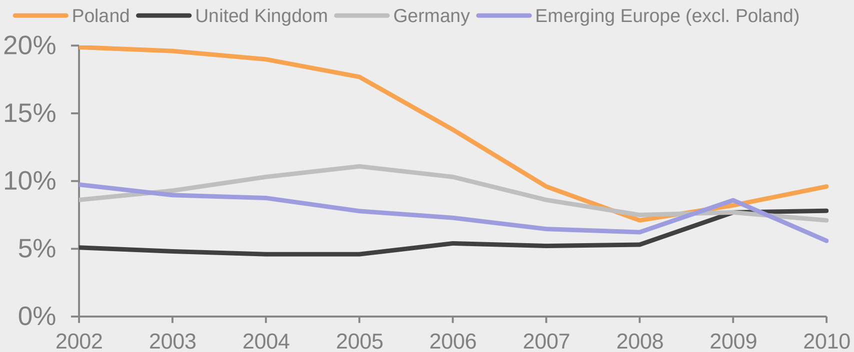
[1] World Bank dataBank, accessed Nov-12
[2] Eurostat: Labour costs in the EU27 Report; 24-Apr-12;
[3] OECD, Equity and Quality in Education Report, revised Feb 2012
[4] OECD, Programme for International Student Assessment 2009

Cost of labour
Average hourly labour costs in € (2008 & 2011)



Source: Eurostat Labour costs in the EU27 Report; 24-Apr-12

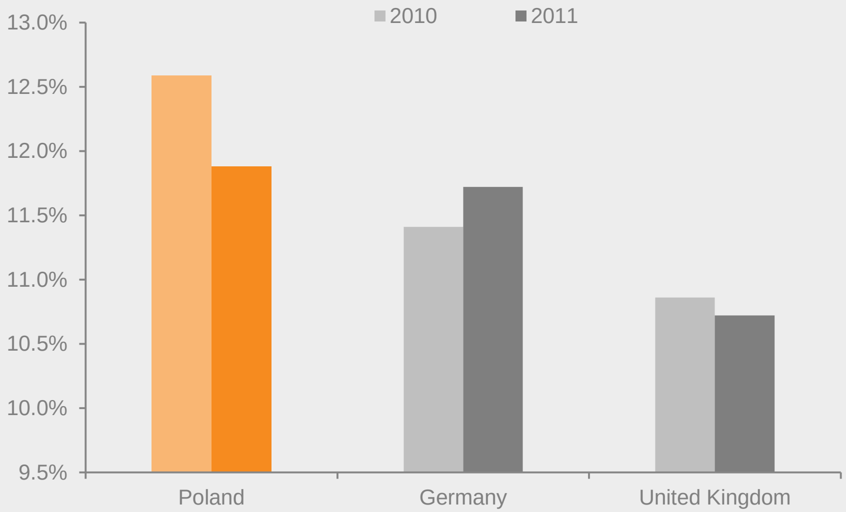
Unemployment
% of available workforce (2002 - 2010)



Source: World Bank dataBank, accessed Nov-12

Polish banks are better capitalised than those in Western Europe

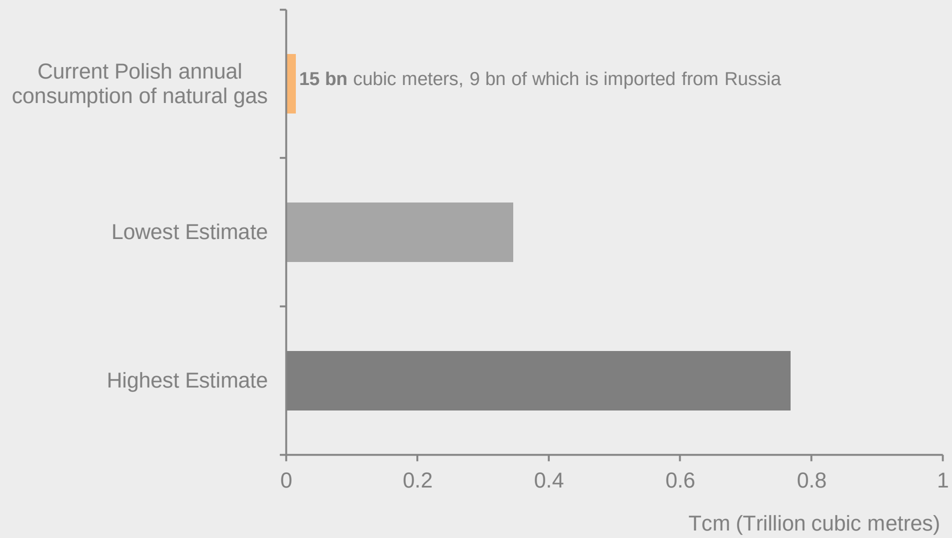
Tier 1 Capital Ratio of all Banks in Selected Countries
(2010 & 2011)



Source: ECB. Reference Period, end of 2011.
Note: Tier 1 Capital Ratio data = aggregate solvency of all banks in each country.

Poland has large shale gas reserves which will reduce dependence on Russian natural gas imports

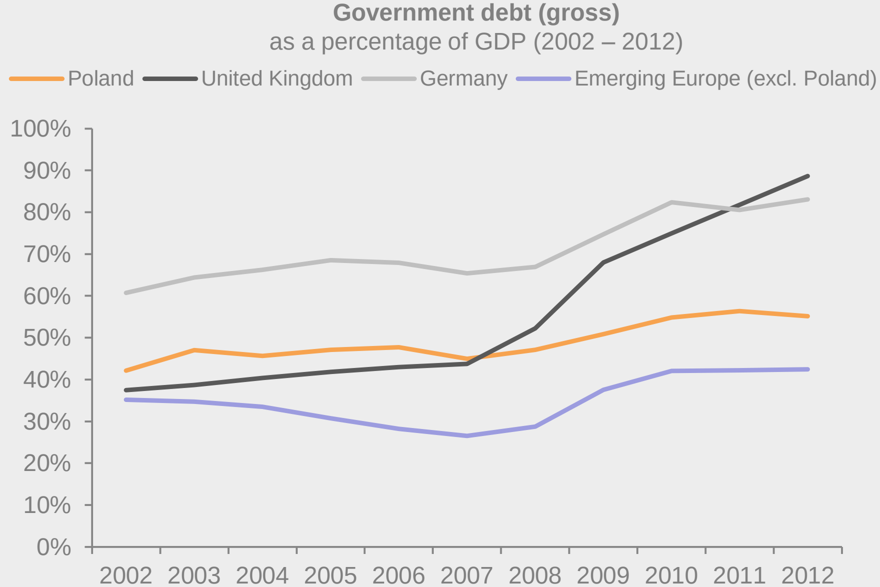
Current estimates of technically recoverable shale gas reserves
(est. in March 2011)



Source: Polish Geological Institute (March 2012 report); FT.

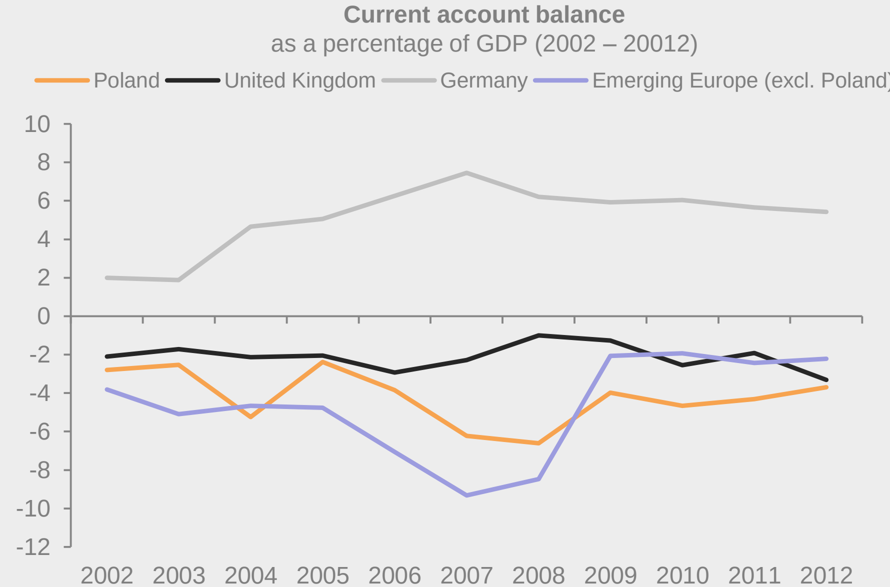
Government Debt & Current Account Balance

Poland has a low debt-to-GDP ratio compared to Western Economies.



Source: IMF, World Economic Outlook Database, Oct-12
Note: Emerging Europe = weighted average government debt of Bulgaria, Croatia, Czech Republic, Hungary, Latvia, Romania & Ukraine EXCLUDING Poland.

Poland's current account deficit trend.



Source: IMF, World Economic Outlook Database, Oct-12
Note: Emerging Europe= weighted average current account balance of Bulgaria, Croatia, Czech Republic, Hungary, Latvia, Romania & Ukraine EXCLUDING Poland.

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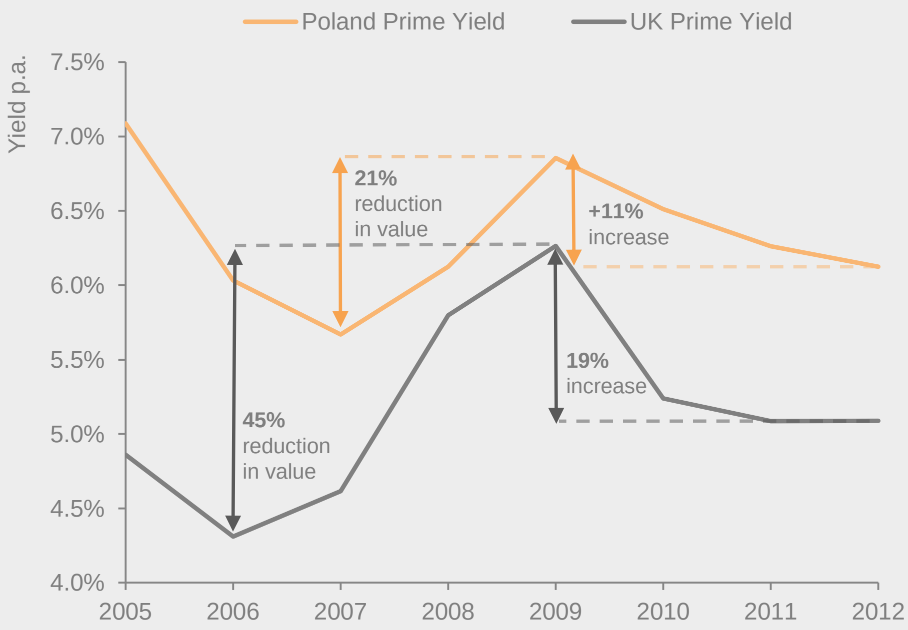
Polish Commercial Property Market

Change in yields during credit crunch
Poland vs UK (2002 – 2012)



Source: CBRE
Notes:
- UK = average yield of all UK prime offices (incl London) & all UK prime retail.
- Poland = average yield of Warsaw prime offices and all Polish prime shopping centres.

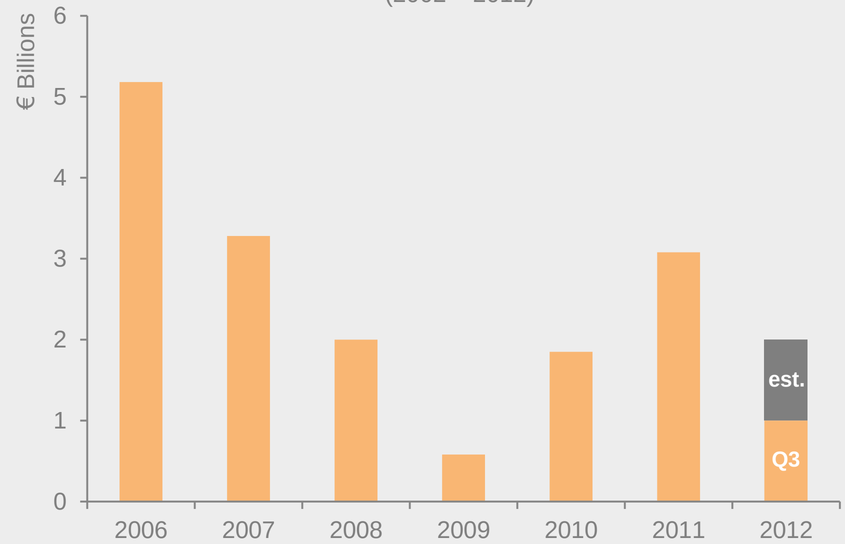
Change in prime rents during credit crunch
Poland vs UK (2002 – 2012)

Source: CBRE
Notes:
- London prime office rent s = average of London West End and City office rents.
- Polish rents are traditionally denominated in € per m² per month. Conversion rate to GBP = £1/€1.256.

Investor Demand & Liquidity:

- **Current legislation prohibits domestic institutional investors from investing in non-listed assets**
  - WSE listed property company's tend to be focused on property development, not property investment.
  - Like in the rest of the world, the majority of property investment in Poland is carried out via non-listed vehicles, meaning that foreigners dominate the market.
- **Resulting dependence on foreign investors**
  - Foreigners turned sellers at the onset of the credit crunch.
  - In general only the larger foreign investors have returned.
- **Leading to asset price falls in the wake of the credit crunch**
  - Even though occupational demand has remained strong.
  - Further magnifying the capital value differential between Poland and Western Europe.

Total Investment Deals in Poland
(2002 – 2012)



Source: CBRE
Note: 2012 uses actual figures for the first 9 months (orange) and predicted figures for remaining 3 months (grey)

Transaction Costs:

- **Standard costs:**

	Poland	UK
Agent Fees	1%	1%
Legal & Valuation Fees	1%	0.8%
Stamp Duty	0-2%	4%
TOTAL	**2-4%**	**5.8%**

- **Additional benefits:**
  - Flat corporation tax of 19% (as opposed to 26% in the UK)
  - Depreciation permitted up to 2.5% per annum on building value
  - EU related tax concessions for foreign investors

Polish Lease Structure:

- **Lease lengths**
  - Typically 3 - 10 years.
  - Longer leases with major tenants becoming more common following law change in January 2009 permitting new leases up to 30 years (from 10 years previously).
  - Retail leases are generally longer than office leases.
- **Lease Renewals**
  - No statutory rights of renewal for tenants.
- **Indexation**
  - Increase in rent every year in accordance with Euro-zone CPI is standard.
- **Repairing Obligations**
  - Generally tenants are responsible for internal repairs and landlords are responsible for structure.
  - Triple net leases to major tenants are becoming more common.
- **Enforcement of covenants**
  - Landlords have stronger and simpler rights to remedy tenant covenant breaches.

Fund Manager

Our investment philosophy:

- **Sustainable income is a priority.**
- **Property is illiquid:**
  - This illiquidity can be mitigated by rental income – liquidity through income.
  - Over the long term it is income and not capital value movements which largely determine total returns (IPD: income contributed 87% of total returns over the 10 years to 31-Dec-2011 and 71% over the 30 years to 31-Dec-2011).
- **Capital preservation:**
  - Capital is better protected if investments yield a high income. Income cushions possible capital value reductions.
- **A fundamental approach to investing:**
  - Consensus may chase a particular investment theme but that does not justify the theme.
- **Flexibility in the light of market changes:**
  - Exited the UK commercial property market in 2005, re-entered in 2009. We act dynamically.
- **An active approach to asset management (where possible):**
  - Drive income and in turn capital values by hands-on property management, relying as much as is possible on internal resources.
- **Thinking from first principles.**

We credit our recognition of the importance of high sustainable income returns as the key reason for our market leading track record.

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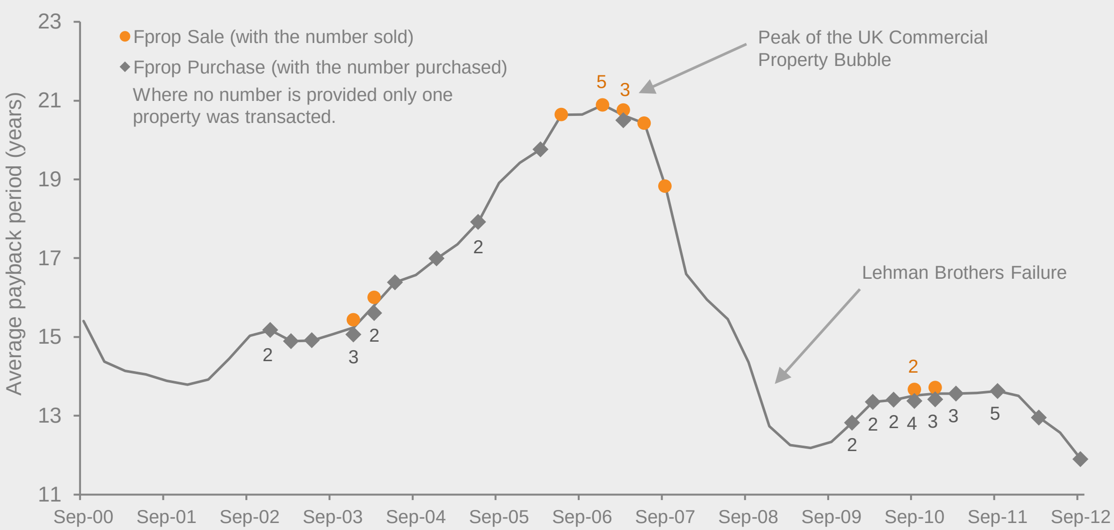
FPAM's UK Purchase & Sale History (2002-12)

Highlighting strategic decision to exit UK commercial property at peak of the bubble.

"…the commercial property investment market in the UK has risen sharply over the last few years and a large proportion of properties for sale are, in our view, overvalued..." **Ben Habib** Fprop plc Annual Report 2005



Graph notes: Payback period (the curve) is the number of years before the purchase is repaid from average rental income, where average rental income is calculated with reference to UK prime & secondary office & retail yields (inverse of net initial yields) - source = CBRE.

2012	**Re-opening FOP to subscriptions** and launch FSIF (FPAM's 6th UK fund).	Investing in Poland & UK
2011	**Decision to temporarily cease buying property in Poland** when phase 2 of the credit crunch began and the financing market, upon which the property market relies, deteriorated.	
2010	**Launch of FOP** (4th Polish fund) and **UK PPP LP** (5th UK fund) .	
2009	**Return to investing in UK** following the widespread fall in commercial property prices. Investment limited to core properties let to recessionary resilient tenants on long leases	
2007	Majority of UK sales executed by end of 2007	Primarily investing in Poland
2006	**Strategic decision to focus investment activities in Poland**, the only EU member state not to enter recession since the onset of the credit crunch, and whose commercial property market is now one of the best performing in Europe	
2005	**Strategic decision to exit UK property market** as a result of the virtual disappearance of the gap between property yields and the cost of debt – see graph left	Solely investing in the UK
2002	FPAM established	

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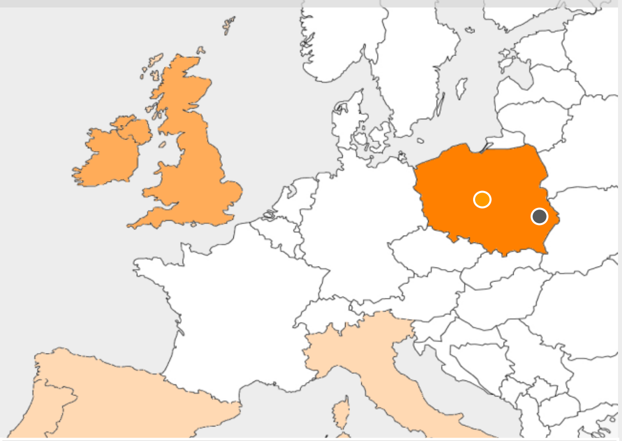
First Property Asset Management
Investment Opportunity – Poland

Fprop plc

Fprop Opportunities plc (FOP) was established in Oct-2010 with £8.28 million of equity, comprising £7 million from First Property Group plc and a further £1.28 million from staff, their families and friends. Currently open to subscriptions.

Pan-European Fund **focused on Poland**



Carrefour Hypermarket, Łódź   Shopping Centre, Krasnystaw

- **Mandate to invest in higher yielding commercial property targeting:**
  - Minimum rate of Return on Equity (ROE) of 15% p.a.
  - Minimum Internal Rate of Return (IRR) of 15% p.a.
- Pan European geographic remit focused on Poland;
- 99% capitalised at launch by way of non-interest bearing subordinated shareholder loans;
- Periodically open for subscriptions.

Please click here to download FOP's H1 2012 Investment Report

Fund Status as at 30-Sep-2012		
AUM	€25.1m (2x properties – see map)	**N.B.** For the year to 30-Sep-12 FOP's 2x investments were generating ROEs of 28.7% & 7.1% p.a. The figures to the left are at fund level and include c.£4.8m of cash.
ROE (actual)	13.3% p.a. (since inception)	
ROE (forecast)	11.0% p.a. (FY to 30-Sep-13)	

KEY INFO

- Target ROE and IRR of 15%+ p.a.
- Raising capital of £100-200m
- Core/ core plus risk
- Lot sizes of €3m - €100m
- Team of 24 based in Warsaw and 10 based in London carry out **all** fund and asset management activities

Group Chief Executive & FPAM Chief Investment Officer — Ben Habib, MA (Cantab)

Ben founded First Property Group plc in 2000. He is responsible for all aspects of the operations of Fprop and its fund management business. Subject to the terms and conditions of any given fund's corporate governance, he is amongst other things responsible for property selection, pricing, due diligence (legal, commercial and technical), negotiating property purchases, financing the purchases, and the subsequent asset management of the properties and sales strategy. He is very closely involved in all aspects of the business. Prior to setting up Fprop, Ben was Managing Director of a private property development company, JKL Property Ltd, from 1994 - 2000, in which he held a 30% interest, prior to which he was Finance Director of PWS Holdings plc, a FTSE 350 Lloyd's reinsurance broker. He started his career in corporate finance in 1987 at Shearson Lehman Brothers. He was educated at Rugby School and Cambridge University.

Fund Manager — Martin Pryce, BSc, MRICS, IMC

Martin joined Fprop in 2001 following its acquisition of Propertytrade plc, of which he was Managing Director. He is involved in the asset management, purchase and sale of properties held by the funds managed by Fprop throughout the UK, Poland and Romania. Martin has over 25 years experience in the property market. He was a partner at Donaldsons Chartered Surveyors until 2000, where he specialised in retail and leisure, focusing on maximising value from asset management opportunities. His clients included Hammerson, Capital & Regional, Rank Leisure Group (responsible for coordinating the development and acquisition program for Mecca Bingo, Odeon Cinemas, Grosvenor Casinos and the nightclub and bar division of Rank), Lloyds TSB and Whitbread. Prior to Donaldsons Martin spent 3 years at Edward Erdman and became a Member of RICS in 1986. He graduated in Estate Management from Oxford Polytechnic in 1983.

Associate Fund Manager — Jay Dodhia, CFA, MA (Cantab)

Jay joined Fprop in 2010 to assist the Property Director in the identification of suitable acquisition properties in the UK, undertaking commercial due diligence, financial analysis and negotiations of these along with their post acquisition asset management. Prior to joining Fprop, Jay was an M&A analyst within the Investment Banking Division at Goldman Sachs focusing on financial institutions and alternative investment firms. He graduated in 2006 from Cambridge University with first class honours and holds a Masters Degree in Economics with Management. Jay is a CFA charter holder.

Analyst — Anthony Griffin, BA (Hons), MSc

Anthony joined FPAM in 2011 as an analyst with responsibilities for fund raising and support of the property and asset management side of the business.
He graduated from Newcastle University in 2010 and completed his Masters Degree in Real Estate in 2012, finishing with distinction. Anthony is currently studying for the Investment Management Certificate (IMC) and training to become a qualified member of the Royal Institute of Charted Surveyors (RICS).

Managing Director, First Property Poland - Premyslaw Kiszka, MA, CFA

Przemek joined Fprop in 2006 to manage its Polish subsidiary, First Property Poland Sp. z o.o., which now employs 19 staff. His key responsibility is asset management, which involves enhancing the value of assets by renegotiating lease terms, and streamlining property operating costs and tax structures. He is also responsible for acquisitions, liaising with lending banks, and mitigation of risk exposures with derivatives instruments. Prior to joining First Property Przemek was the senior analyst for a Polish private equity fund and corporate analyst for an open investment fund (Invesco TFI). He graduated in 2001 from Warsaw School of Economics and holds a Master Degree in Finance and Banking. He is CFA chartered since 2007.

Head of Asset Management, First Property Poland - Jeremi Slominski, MA, BA

Jeremi joined Fprop in 2006 as head of asset management for its existing property portfolio. He also performs a key role in the acquisition of new properties. Prior to joining Fprop Jeremi was Reporting and Tenant Relations Coordinator with Apsys Polska, one of Poland's biggest retail gallery operators following a period with Central European Retail Property Fund, a Fund developing and managing Wola Park, at the time Warsaw's biggest shopping centre. Jeremi holds an MA in Modern History, a BA in Political Science and Journalism, and a Graduation Certificate in International Relations, all from Warsaw University.

Associate Director, First Property Poland - Krystian Modrzejewski, BA

Krystian joined Fprop in 2011 as a retail asset manager. He focuses on the Group's retail centres and assists with any new acquisitions. Prior to joining Fprop, Krystian spent a year at CBRE where he was the Director of Property Management Department and Senior Member of the EMEA Strategic Executive Group. Before this, he spent two years as Head of Asset Management for London and Cambridge Properties (LCP) Sp. z o.o., the Polish division of the UK based privately-owned property investment company which has some €4.5 billion of assets under management across Europe. Krystian holds a BA in Sociology from Warsaw's Collegium Civitas where he majored in Social Psychology. In addition to his native Polish, Krystian speaks fluent English and a high standard of German.

Group Chief Financial Officer & Company Secretary — George Digby, BA (Hons), ACA, IMC

George joined Fprop in 2003 and has overseen the rapid expansion of the fund management division during this period, including the development of the operation in Poland, involving in total 34 separate companies to date. Prior to Fprop, George spent 10 years as FD of Fired Earth plc until its MBO in 1998, during which period he oversaw its listing on the London Stock Exchange, a tripling of its turnover and a doubling of its pre-tax profits. He qualified with Price Waterhouse in 1981, followed by positions with Collins Publishers and Nikon UK Ltd. After Fired Earth he set up and ran an accounting consultancy for five years, of which Fprop was one of its clients. George brings broad financial experience to the Group. He is a member of the Institute of Chartered Accountants in England and Wales and is a holder of the IMC certificate.

Senior Fund Operations Manager — Jill Holmes

Jill joined Fprop in 2009 as Deputy Compliance Officer, HR Manager and Company Secretary of the Group's subsidiary and underlying fund companies. Prior to joining she headed up the UK new business operations team for Ogier, a leading global operator and fiduciary services firm, where she handled the client take on and launch of a number of UK and offshore funds ranging from Real Estate and Infrastructure to Private Equity. Jill has a strong financial and regulatory background, having been the Senior Financial and Regulatory Accountant for Thomas Miller & Co.

Director, Business Development — Jeremy Barkes, BA (Hons)

Jeremy joined Fprop in 2009 to raise equity for investment into funds and joint ventures on behalf of FPAM. His background is in equity sales, following ten years with JP Morgan and KBC Peel Hunt, latterly specializing in real estate. Prior to commencing his commercial career, Jeremy held a commission in the British Army.

Fprop plc

Fund Manager
Case Studies: Poland

Lodz, Central Poland

Sector	Retail
Tenant	Carrefour
Fund	FOP
Purchase Date	Oct-2010
Yield at purchase[1]	8.0%
Purchase Price[2]	€19.7m
Valuation 30-Sep-12	€19.7m
Rent at purchase	€1.6m
Rent at 30-Sep-12	€1.6m

Krasnystaw, East Poland

Sector	Shopping Ctr
Tenant	Multi-let
Fund	FOP
Purchase Date	Dec-2010
Yield at purchase[1]	18.4%
Purchase Price[2]	€5.3m
Valuation 30-Sep-12	€6.6m
Rent at purchase	€0.98m
Rent at 30-Sep-12	€0.62m

Warsaw City Centre

Sector	Office
Tenant	Multi-let
Fund	n/a
Purchase Date	Dec-2008
Yield at purchase[1]	8.7%
Purchase Price[2]	$12.5m
Valuation 30-Sep-12	$19.4m
Rent at purchase	$1.1m
Rent at 30-Sep-12	$1.4m

Warsaw CBD

Sector	Office
Key Tenant	Citibank
Fund	USS
Purchase Date	Aug-2007
Yield at purchase[1]	6.3%
Purchase Price[2]	€41.5m
Valuation 30-Sep-12	€49.6m
Rent at purchase	€2.6m
Rent at 30-Sep-12	€4.6m

[1] Gross (excluding purchase and debt costs).
[2] Excluding purchase and debt costs

Fprop plc

Fund Manager

Selection of Polish Tenants

- MarcPol
- asseco POLAND
- SKANSKA
- TESCO
- INDESIT
- Grontmij
- orange™
- Deutsche Bank
- SIEMENS
- IBM®
- citibank
- ING BANK
- ROSSMANN
- JERÓNIMO MARTINS
- Carrefour

Appendices

Investor giving Polish commercial property a miss will be losing out

By Ben Habib, Property Investor Europe
Published 4 June 2012

I first visited Poland in 1990, shortly after the Iron Curtain came down. I was in my mid-20s and had never had any interaction with Soviet Bloc countries before. After my first visit, I felt I had not missed anything. Warsaw was dreary, the food of poor quality and the coffee undrinkable; it was not a destination of choice. I made a few trips in the early 1990s and then did not visit again until 2005. The period between my initial visits and 2005 was spent investing entirely in the UK. But a major change occurred in the UK market in 2004, which forced me out of the comfort zone in my home market: the spread between investment yields and borrowing costs disappeared. It was no longer possible to finance British property investments profitably without relying on capital gain to make up returns. Capital gains are difficult to predict at the best of times and so First Property began selling in the UK and looking for new markets.

Following a review of European markets it did not take long to alight on Poland. It had just joined the EU, was the beneficiary of large inflows of capital, was growing at a good rate from a low base, was a deep market, had a balanced economy with a vibrant export and domestic sector, a healthy banking system and a good level of education. And crucially, property yields were high and borrowing costs low. Warsaw had also become a first-class city: it was vibrant, the food was excellent and the coffee perfectly good. It had transformed itself within 15 years. The result: we now have some £300m of AUM in Poland, across 30 properties and some 300 tenants. Our experience has been a good one. We are not without our battle stories but, crucially, the income across our portfolio has held up. Indeed, on a like for like basis, the income on our portfolio is higher now than it was in 2007.

Poland has done everything we hoped of it: it did not go into recession during the credit crunch; it is one of the fastest growing EU economies and has broadly healthy government and consumer finances. It is also forecast to continue growing, albeit more slowly due to the growth deceleration across Europe. The last six months of 2011 were not good for property investment anywhere but Poland has come through this well, with lending appetite still strong from well-capitalised banks. The only significant adverse change resulting has been a material tightening in terms on euro-denominated bank debt. Rents and therefore properties are usually euro denominated and so a tightening hits property values - even if we do not expect large reductions in value. With this one exception, we are bullish on Polish property. The tightening lending terms are in fact opening up new opportunities as the balance of negotiating power shifts from sellers to buyers. We are now able to structure purchases in a way which materially reduces our investment risk and underpins returns.

Within Poland we favour retail warehousing and strip malls. We are not particularly concerned about where these are located as long as they dominate their local catchment area and the catchments are big enough to support them. We also favour CBD offices in major cities, especially cost effective office space in prime locations. Poles are cost conscious people and there is always demand for cost effective product in good locations. A potential risk is Poland's reliance on foreign capital. Selling assets therefore depends on international demand, which does wax and wane. We address this risk by targeting properties that are high yielding enough for the income return to provide sufficient liquidity and by being prepared to hold assets for the long term. It is usual to be able to acquire good properties on high single-digit yields, and these can be as high as 30%, or more, higher than the equivalent in the UK. Investors wishing to attempt to predict the trajectory of the Polish investment market need do only one thing: look at where the country was in the aftermath of Communism, the enormous progress made in the last 20 years and the hunger of the hard-working Polish people to do well. In my view, investors giving Poland a miss will be losing out.■ bh

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Polish property offers good prospects
By Ben Habib, FT Adviser, published 23 January 2012

It was the only EU member country not to go into recession following the onset of the credit crunch and its growth has accelerated in the past couple of years. GDP is set to grow by some 4 per cent this year.

The Polish economy is a large one, the seventh largest in Europe by GDP and sixth largest by population. Its size has allowed it to develop a vibrant internal economy and, unlike most other countries in central and eastern Europe, it is not mainly reliant on exports. Indeed, exports only account for some 40 per cent of its GDP.

In addition, the populace is not debt ridden and government finances are relatively healthy. Although the country is running twin budget and current account deficits of 5.5 per cent and 4.8 per cent respectively, by comparison with some western European countries these deficits are low and steps are being taken to reduce them.

The country's finances are also underpinned by the fact that its government debt is locally financed and very largely denominated in Polish zlotys. The government also has automatic access to a $30bn (£19.6bn) credit facility made available to it by the International Monetary Fund (IMF).

Attractive environment

As a result, Poland's economy represents an attractive environment for property investment. Occupational demand and levels have remained relatively high throughout the credit crunch, and demand for retail and office space in the main cities is now rising. There are some new retail and office schemes being developed in Poland, but the rate of delivery is not so high as to undermine the prospects for growth in rents.

One of the most attractive aspects of investing in Polish commercial real estate is that properties can be acquired on relatively high yields with the added attraction of good prospects for rent increases.

Yields on prime property in London are at 3.5-5.5 per cent, whereas equivalent properties in Warsaw can be acquired at yields of 6.5 per cent or higher. Furthermore, as a result of the relative health of Polish banks, it continues to be possible to borrow against commercial investment property in Poland, more often than not on better terms than available in the UK.

Transacting commercial property in Poland is not an expensive exercise. Stamp duty varies between zero and 2 per cent depending on the age of the building. In the UK, this can be up to 4 per cent.

The higher yields available on property investments combined with these lower costs mean that the income return quickly defrays purchase costs, more often than not within the space of a few months. The equivalent period in the UK, for a similar property, can be as long as one and a half years.

With a modest degree of leverage, these higher yields can be converted into rates of return on equity in the low teens, with the added prospect of rental growth and therefore capital gain.

On the back of this attractive investment proposition, turnover in commercial investment property has risen since its low of ¤700m (£583.5m) in 2009. Turnover in 2010 was ¤2bn and for the first half of 2011 has been ¤1.8bn.

The effects on Poland and its property market from the recent market turmoil and the realisation of slower global growth are not yet fully known but a few consequences are probable.

For instance, GDP growth is likely to slow in 2012, as will the rate of reduction in unemployment and wage growth.

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Polish property offers good prospects (cont.)

The Polish zloty has already weakened to reflect the above. This should provide a degree of support for exports but the Polish authorities will have to remain vigilant for signs of imported inflation and so interest rates are unlikely to be reduced materially from their current level of 4.5 per cent. Additionally, investor interest in Polish property is liable to reduce as international investors repatriate capital.

However, none of this is likely to materially change Poland's immediate, medium and long-term prospects. The country has grown rapidly since the fall of the Iron Curtain and this growth will continue.

The case for investment in Polish commercial property remains strong, though it would be sensible to refine one's investment strategy to suit the new environment in which we now find ourselves. This could be achieved in a number of ways.

Reduction

First, in view of the likely reduction in wage growth and the rate of employment generation, investing in retail property will have to be undertaken more carefully. The fortunes of retailers are naturally very sensitive to levels of consumer spending. While this is forecast to grow in Poland by some 50 per cent in the next 10 years, there is likely to be a dip in the rate of growth in consumer spending in the coming year.

One of the largest costs for a retailer is its rent. Within the retail sector, targeted investment in retail warehousing, where rent rates are lower and leases longer, may be a better proposition than investments in shopping centres. This is not a nationwide truism but the generality should be borne in mind.

Second, for similar reasons, investments in well-located office blocks, particularly in Warsaw, become more compelling. Rents as a proportion of an office tenant's costs tend not to be as significant as the proportion for retailers.

Third, it can never be wrong to move towards investments in which the main tenants are of good covenant strength and have signed long leases. Investments subject to short leases are only really attractive when rental growth is high. The current environment requires greater caution.

Finally, on a positive note, it would appear that Poland has large reserves of shale gas, potentially the largest cubic amount in Europe. These reserves largely lie in a band from the northwest of Poland in the Baltic Sea to the southeast of the country, and there is apparently enough gas in the basin to supply Poland's internal needs for at least the next 100 years.

Not only will the economy at large grow with this discovery but it will be a great benefit for those landlords with properties in the cities and towns near extraction points. Investment demand is likely to grow in these key hot spots along the shale band. This could be a real game changer for Poland and for the lucky landlords who own property in these strategically important locations.

But above all, and what has not been mentioned thus far in this article, is the work ethic of the Polish people themselves. There is a natural disposition for Poles to try very hard to succeed and this ethos has travelled with them to the UK (and is well known in the industries they routinely work in). The country also has a literacy rate exceeding that of the UK and the average age is 38, providing a young workforce for the next 10 years.

This adds to the already compelling case for investment in Poland. And if the reserves of shale gas are as high as experts believe, the Polish economy and property values should continue to grow for many years to come.

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CEE's largest economy offers institutional opportunities
By Ben Habib, IPE Real Estate Magazine, published 1 November 2011

Poland is the seventh largest economy in the EU and, with a population of 38 million, the largest economy in Central and Eastern Europe (CEE). Over two thirds of Poland's GDP is generated internally which is exceptional amongst CEE countries. The Czech Republic, for example, a country Poland is often compared to, is almost the reverse - with some two thirds of its GDP generated from exports.

At the onset of the credit crunch, Poland could rely on this strong domestic economy to avoid recession and was, in fact, the only country in the EU (not just CEE) to have done so. Poland's lowest point was in 2009 when GDP grew by 1.8%. GDP growth rose to 3.8% in 2010 and is forecast to be some 4% in 2011.

Poland's banking sector also performed well in the downturn. The market is dominated by local banks or subsidiaries of international banks and typically these did not get involved in some of the more "sophisticated" practices of their Western counterparts. Consequently, they did not suffer in the same way either. Indeed the banking sector has remained profitable throughout the credit crunch.

As a result of the relative health of Polish banks, it continues to be possible to borrow against commercial investment property in Poland, more often than not on better terms than available in the UK. It is the combination of Poland's strong macro-economic fundamentals, skilled and well educated work force and healthy banking sector that has set Poland apart from Western Europe and its peer group of countries in CEE. Its commercial property market has followed suit.

Occupancy levels in Poland have remained high throughout the credit crunch and are now growing again. The dearth of new office and retail space, resulting from banks' marked reduction in appetite to fund new developments, has meant that demand for space has once again begun to outstrip supply. Office and retail rents in Warsaw are also rising, although the majority of other main cities in Poland are seeing rents stabilise and forecasts suggest that commercial property rents should increase over the next few years.

Despite these healthy occupancy levels, investors have been slow to return to the Polish commercial investment property market. The total turnover in 2010, of €2 billion, was significantly higher than the 2009 level of €700 million but markedly below levels achieved in 2006 and 2007 of €4.75 billion and €2.8 billion respectively.

So where are the opportunities in Poland?

For the conservative institutional investor Warsaw is a very good place to start. Even though values have increased and yields have reduced to a post credit crunch low, yields for prime Warsaw commercial investment property (6.25% to 7%) are some 50% higher than they are in prime London (4% to 5%).

Coupled with a degree of moderate leverage, rates of return on equity of some 10% plus can be earned on prime property; with the prospect of rental growth.

Within Warsaw we strongly favour the Central Business District (CBD) over the newer office parks in the Mokotow (Southern Warsaw) and Wola (Western) districts. In our view, the discount in rent applicable to the peripheral locations in Warsaw is not great enough to attract us to these regions. The CBD is constrained for space and is likely to hold its value well. I

n addition, a new underground train line is being built in an East/West direction, through the heart of the CBD. This will be the second such underground train line in Warsaw, with the first of these two already servicing connections to the CBD from the North and South of Warsaw. Properties acquired in close proximity to underground train and tram stations in the CBD are likely to do well over time.

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CEE's largest economy offers institutional opportunities (cont.)

The other significant commercial property investment opportunity in Poland and Warsaw in particular, is in retail property. Consumers are getting richer as the economy grows and consumer spending is forecast to grow by over 50% in the next ten years. This is excellent for the prospects of retail warehousing and shopping centres across Poland.

The Poles are an aspirational race and are prepared to travel in order to shop. Shopping centres in, or on the edge of, smaller towns often attract shoppers from a much larger catchment than we might be used to in Western Europe. It is not unusual to find that shopping centres such as these have no competition within a radius of 30 km or more.

Investor appetite for the purchase of retail property has returned but it has largely been restricted to towns and cities with a population of over 100,000 people. Such investment opportunities are rare. Yields for such properties are now down at 7% or lower. At these levels such properties can generate respectable rates of return but there are better returns available in smaller conurbations.

What to avoid…

Investors would be well advised to avoid first generation shopping centres in Poland, which are now generally out of date and unattractive. It would also be advisable to avoid property which was let in 2007 and 2008. Rents in the Polish commercial investment property market are generally paid in Euros and the Polish Zloty was very strong in 2007 and 2008. Consequently rent levels in properties let in 2007 and 2008 were set at high levels. Ideally, we seek retail properties let in 2009, 2010 and 2011, or in periods before 2007.

Industrial warehousing is another sector in which investors need to tread carefully. There is no shortage of road side plots on which such properties can be developed and the defensive nature of these properties is limited. To make matters more confusing, Poland's network of roads is continuously expanding and changing as the country improves its infrastructure. A well located industrial warehouse today may not be well located in the future. The yield at purchase for such properties is currently in the 8% to 9% range and does not offer a big enough discount to office and retail property yields to make the asset class particularly attractive.

Notwithstanding the above, an institutional quality industrial warehouse, located in a special economic zone, or at the junction of a main arterial road and let to a good covenant on a long lease, would be worth considering. Although there are not many properties available to purchase such as these, when on occasion they do become available they can offer good value. The standard Polish lease provides for rent to increase each year in line with increases in the consumer price index. The purchase of a property let on a long lease allows an investor to hold it for a period, experience a level of rental growth and be able to sell it with a long period remaining on the lease.

As I write there is a great deal of uncertainty surrounding the developed markets. The United States has just been downgraded by Standard & Poor's, the Euro is under enormous pressure and there are riots across London and the UK. All of this is likely to have an adverse effect on the Polish economy but it starts from a much healthier position than the developed world and is likely to be one of the winners coming out of all this turmoil. This is a good time to be judiciously buying into Poland and its commercial investment property market.

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