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The Price of Land In Poland

A Real Estate Valuation Method for a New Market Economy

October 1990

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INTRODUCTION

Technical assistance was provided to the Polish Government in the Fall of 1990 by teams under the aegis of USAID, U.S. State Department. The teams were sent to various cities to consult on issue of housing, municipal government, development and land evaluation.

The authors of this report comprise a three person team who spent over two weeks in Warsaw advising municipal governments on land development and appraisal. Warsaw has been the subject of interest from both local and foreign developers, and the government needed assistance in determining how to evaluate proposals for lease and/or sale of government owned land. The "privatization" of this land is very complicated since there have been few sellers or buyers of property in cities in Poland since the end of World War II - no conveyance law, few banks, no mortgage lending, etc.

The team worked predominantly in Warsaw, but visits were made to outlying cities to see what similarities and differences there were, and to determine whether an evaluation process could be used by all cities and towns.

PURPOSE

Our purpose was to help officials in Poland with the valuation of real estate sites which are being proposed for development. The essence of the problem is that property valuation, and all of the normal factors influencing value such as other real estate sales, zoning, legal structure, financing etc., are in nascent stages in Poland. One half a century ago, Russian communists presumably pondered how to convert this formerly capitalistic society into communism. Today, the Polish people are rewriting the book, in reverse, and people are grappling with how to change into a fully capitalist society in the short time span required by the modern world.

Warsaw and other parts of Poland have opportunities from foreign and local investors who are eager to fill the vacuum. New companies, real estate developers, entrepreneurs are coming to Warsaw, but with reservations due to the general uncertainties that exist. The mayors and other officials reflect that uncertainty in the basic questions they ask: How do we evaluate proposals? How should we convey property? How can we provide incentives to investors while reassuring our citizens we are not giving property away? What is the value of property? How do we charge for it now when there is 40-50% inflation per year? These are questions we take for granted in a world where capitalism is working fairly well.

In response to these questions, we presented and discussed traditional appraisal techniques. The "comparable sales approach" to valuation is impossible due to lack of sales. As an alternative, we designed and utilized a modified "capitalization of income" approach, whereby in simple terms, property value is derived by deducting all anticipated costs and profit from revenue to determine what is available for land purchase. However, this too is extremely difficult since the estimate of development costs by us, or even by the actual developer, is bound to be low. There will be unforeseen labor costs, difficulty of getting materials, infrastructure problems, and changes of laws in mid-stream.

The legal and financing structure for real estate development is also complicated. In the last six months there have been eighty new laws. Some officials indicated that the next law they would like to pass is one which prohibits any new laws for five years. They understand that giving some certainty and stability to the legal side of the development process is critical to creating value.

Property ownership is in flux. Some land is private; some is state owned; some is municipally owned; some is municipal with claims by former owners before World War II; some is owned by small cooperatives, etc. The chain of title is unclear in some areas because of many transfers by decree, not by recorded conveyance.

In the context of these new beginnings, we established an appraisal methodology and criteria for evaluation of proposals. The model can be used equally well on all residential, commercial and industrial projects. We applied this method to one development site in Warsaw in order to provide an example.

CAVEATS.

Certain qualifications should be stated regarding this report.

First, while there is general discussion of the government, the economy, laws, labor resources and so on, it must be noted that the team did not analyze all of these aspects. To the extent that they were informative and useful in discussions on the philosophy of property valuation, they are included. Specific details in every area, however, were not deemed critical to our work. For example, the fact that government structure has changed and there is a move toward decentralization, particularly of land ownership is important. However, exact descriptions of the National Assembly, the Deputies and Senators, Council of Ministries is not critical to the valuation methodology.

Second, the technical assistance program was for a period of 18 days. Many things are in flux, and the rules are changing regularly. We perceived our goal to be to develop a method and strategy for the valuation of developable land areas which could be understood and implemented in a short period of time. We recognize that the users of this work method will refine and adapt it to meet their needs as relevant issues continue to change.

Third, the issue of inflation and monetary exchange was not thoroughly analyzed. Because of the variations that these factors can add to the valuation methodology, we made assumptions that development proposals and land values were measured in constant hard currency, and inflation affected all things in a similar manner. It should be stated that investors with foreign currency may use property in foreign lands as a kind of bank until repatriation of the currency is beneficial. In these cases, the value of the property may become less significant than the actual fluctuations between the currencies. While this can have a dramatic impact, it cannot be accounted for in a valuation methodology.

Finally, while we noted that the legal structure, conveyance laws, and property ownership and title issues are all relevant to the valuation of property, we made no legal study of the body of law affecting these issues. It is not yet clear whether the developing body of law is fully effective in property transfers and development. We cite this as a risk to development and a factor lowering values, but have not tried to quantify this effect.

SUMMARY AND CONCLUSIONS

- There are many factors affecting the value of property. In Poland, these factors are just as relevant as in more mature market economies, and in some cases have greater impact. We divide these factors into: site characteristics; ownership issues; financial factors; and government.

- Site characteristics have much the same impact as anywhere in the world, although we found utility infrastructure to be an extremely important issue. The lack of utilities, or the uncertainty of their longevity, has caused many problems for developers and subsequently for agreement to be reached on property value.

- Ownership is also more complicated. Most land transfer has occurred by legislative mandate since World War II, and there are currently issues as to which level of government owns the land. In addition, there are claims by owners prior to World War II now being made on government property. This uncertainty caused a significant impact on property value. Most importantly, there is the political uncertainty as to whether new regulations and laws will affect property use and ownership in the middle of development. Many laws are being passed, in the long-term interest of assuring a democratic market economy, but the short-term flux causes much uncertainty.

- There are various methods utilized in the valuation of real property. The most basic is a Sales Comparison Approach whereby a subject property is compared to recent sales of similar properties. In Poland, since there are very few sales, there is not a mature enough market to determine property value by comparison approach. As an alternative, one can evaluate property much like a business, by the capitalization of an anticipated net income stream. The capitalization of income is the most effective approach able to be used in this type of developing market economy. We created a modified approach in order to separate land from improvements.

- Since some of the office and hotel real estate is currently being fueled by outside investors and users (i.e. free market investors), these products are already able to be valuated given existing data. Real estate product which is subsidized such as some types of housing, is more complicated. Currently, there is government subsidized rental housing; government subsidized owner housing; co-operative housing; incentive programs for new privately built housing; and free market speculative housing construction. It must be noted that the valuation model, any valuation model of this type, is based upon a free market where prices reach a peak at the equilibrium of supply and demand. Where supply is artificially stimulated as in the case of incentive programs, or where price is manipulated through subsidy, the valuation model should be used only as a guideline.

- The valuation of real property is not the sole criterion for evaluating and implementing a development proposal. There are many kinds of financial and legal structures which might vary dramatically from the base valuation in determining who pays what. Joint ventures, participating leases, sales and lease-back are all methods by which a "value" of the property is changed in order to meet other objectives of both the seller and buyer. We demonstrate that the valuation model can provide the base price, but the "deal" structure may create variations in the price.

- Property and land are the governments most prized assets. To lease or joint venture these properties too cheaply would be to undermine the future of the areas. On the other hand, the fear of undervaluing property can, and perhaps has in our opinion, lead to paralysis of decision making. As we have pointed out, it may be to the advantage of a city to lease land cheaply in order to generate other benefits such as job creation, new infrastructure, or improvement of underutilized neighborhoods.

- It is clear from our work that government officials could continue to benefit from ongoing technical assistance in areas of valuation and development proposal review, especially related to the more complicated issues of housing. While our work there, our presentations, findings, and this report outline a method for official use, putting it in practice will require experimentation and trial and error. In order for the government to make the fewest errors, it would be extremely useful for them to have assistance in reviewing development proposals on an ongoing basis.

- It is our recommendation that immediate technical assistance should be focused in the following two areas.

  1. Assistance in inventorying available sites for development.

  2. Assistance in reviewing specific development proposals for these sites.

In addition to these focused goals, we found a general lack of information in the following areas. Future assistance should be considered in:

- Insurance and/or warranties on title issues and other development problems.

- Understanding title and land use law.

- Thorough analysis of financing mechanisms as new banks develop.

- Linkage concepts, whereby commercial developers provide assistance for financial help for housing; housing infrastructure provides opportunities for commercial developers etc.

- Infrastructure funding.

APPROACHES TO VALUATION

MARKET VALUE.

"Market Value is defined as the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, with the buyer and seller, each acting prudently, knowledgeably and assuming the price is not affected by undue stimulus".

Implicit in this definition is the completion of a sale under conditions whereby:

1. Buyer and seller are typically motivated.

2. Both parties are well informed and acting in what they consider to be their own best interest.

3. A reasonable time is allowed for exposure in the market place.

4. Payment is made in cash, or financing which is on terms generally available in the community.

5. The price represents normal consideration for the property, unaffected by special financing amounts, terms or other structures of the transaction.

VARIOUS METHODS.

There are various approaches currently utilized in the estimation of market value. The most commonly applied are described below:

A Cost Approach is relevant when improvements are new and the value is directly related to the total cost of the project. This method is typically used in insurance appraisals, but has little relevance in establishing value for unimproved land.

A Sales Comparison Approach is a technique used were there are many recent and competitively similar properties which have recently sold. These sales are compared and related to various characteristics of the property being appraised. Through an adjustment process, a price for the subject property can be established by comparison to the other recent sales. This technique is excellent for both land and improved real estate, but requires a mature market. Since there have been little or no sales in the urbanized areas in Poland, it is currently impossible to utilize this technique with any degree of accuracy. When more sales occur over time, this will become a technique that can be appropriately used. In our experience in Warsaw, we became aware of people who are already misusing this technique by comparing many sites throughout the city to a few joint venture's which have recently occurred. In some cases, under these joint ventures, land value was determined as a benchmark for the joint venture, but had little relevance to true market value.

An Income Capitalization Approach is best applied to those properties that are bought and sold in the open market for their ability to produce net income. This is a method which treats a building as if it were a business, capable of producing a gross income, incurring costs, and ultimately a net operating income. Net income is capitalized, or divided by a preferential and anticipated rate of return of investment, in order to create a total project market value. We modified this approach in order to establish the value of land, as well as any other facets of the development. Our approach applies to all real estate including housing, office, retail, or industrial projects.

The relevance of earning power to the valuation of income-producing properties is obvious. Such properties are developed and purchased as investment opportunities; the objective of developers and purchasers alike is to realize a profit on their investment. The greater the earning power, the greater the profit and, therefore, the higher the value of the investment. The income capitalization approach, therefore, consists of a number of steps for measuring or estimating the extent of reasonably expectable future benefits and translating these benefits into a lump-sum value at a particular point in time.

While this approach also requires some maturity of markets, the markets are more plentiful, smaller, and more easily defined. For example, one must develop a good understanding of existing and future rental rates, the cost of construction, management expenses etc. Since there are many more variables in this method than in a comparative sales method, each one will have a smaller impact on value. It is less likely that misinformation in any one of these smaller areas would significantly contribute to inexact estimations of ultimate value.

In the United States as in other market economies, there are complexities for valuation by any of these methods. In a country like Poland, these factors are that much more difficult to understand. They are more in flux then in mature economies. That is why appraisal is considered an art as much as science. Valuers of income producing properties are students of the market, and their education is rarely complete. For this reason, a much higher rate of return is likely to be demanded by investors. Such return will serve to cushion investors against the unforeseen as well as the uncertainty inherent in an economy in flux.

FACTORS AFFECTING VALUE

GOVERNMENT.

There are many aspects of government at national, state and local levels that affect the value of property. In the United States, most of these relate to land use laws and government policies on taxation, fiscal policies, etc. However, in a country like Poland, where government is in an extreme state of change from communist to capitalist economies, there are many more factors. As important as the reality of the myriad changes, is the perception of change by people who wish to make investments. The purpose of this section is not to indicate how efficiently the changes are being made or whether they are in the right direction. Rather, it is to demonstrate that the effect and perception of the changes will be factors dramatically influencing value.

Political stability is the overall framework necessary to create high value. Any government in a state of flux causes levels of uncertainty which are detrimental to real estate investment. Where changing laws may be beneficial ultimately to the investor, the process of that change can be unnerving. Ultimately the investors will look for the following criteria which we believe will add value to real estate:

Internal political stability.

Clear decision making authority.

Clear land use policy on national and local levels.

Clear taxation policy for both users of and investors in real estate.

Beneficial laws that are consistent with one another.

Longer term appointment and election of officials.

This is not an exclusive list, but they are the factors that are most important to maintain property value. "Certainty" is the key word. Investors will want to know that the projections for their investments will not be undermined by changing political circumstance. There are no guarantees of this in any country, but those that are more successful in projecting an image and reality of stability are more desirable for investors. It is very important for the Mayor's and President of Warsaw to provide this certainty.

FINANCIAL.

Financial factors affecting value include: the ability to finance a project through debt; the control or incorporation of inflation; government processes for investment; fiscal and tax policy affecting the investment.

Banking.

More alternatives in methods of financing will generally help to increase the realization of property value. Most important is the ability to finance projects through banks, providing for the leveraging of additional capital on relatively smaller amounts of equity.

In Poland, financing of real estate and commercial projects is relatively new. Currently, banks are doing business as follows:

- The National Bank of Poland regulates the circulation of currency, fixes foreign exchange rates and supervises foreign-currency transactions. Recently, it allowed the creation of 9 new commercial banks and one for mortgage financing.

- The Bank Handlowy w Warszawie S.A. (Foreign Trade Bank) handles the financing of foreign trade and extends foreign currency credits to Polish enterprises. The Bank Handlowy also issues, accepts and endorses commercial paper denominated in foreign currencies, issues bonds, and deals in international money and capital markets.

- Private banks are being created. There are currently 40 licensed and 9 in operation. These banks may provide the greatest usefulness to investors in real estate. The Bank PEKEO S.A. conducts retail banking operations in local and foreign currencies and handles foreign commercial and financial operations of the private sector. It maintains foreign exchange saving accounts of individuals and handles remittances from and to abroad. It is currently providing some mortgage lending on a limited basis.

- In 1987, the Bank Rozwoju Eksportu, the Export Development Bank, began its operations. It was established in order to provide financial resources for manufacturing enterprises interested in expanding export sales.

- The domestic banking system is being decentralized. Starting from January 1, 1989 several new commercial banks were established with branches all over the country. At the same time the interest rate policy was partially deregulated, leaving the banks free to set their lending and deposit rates within the limits established by the central bank.

- It is also expected that many wholly or partially foreign-owned banks will gradually start their operations in Poland.

- In general, the banking industry is still being formulated, and financing of projects in Poland will be complicated. Inflation has slowed or stopped projects, particularly housing, since banks were free to raise interest rates. However, projects are being developed despite the relative newness of this industry, and the authors feel that emerging banking practices will improve investment opportunity and values in a relatively short period of time.

Review of International Investment.

The Foreign Investment Agency, part of the national government, has general review over all issues of foreign investment in real property. It serves in an advisory capacity in some private property situations, but take a much more serious review and issues permit for those involving municipal land.

The Minister of Internal Affairs also has review authority. The policy of the national government is that private property owners may sell the fee simple rights of property to foreigners, only with a permit from the Minister of Internal Affairs. This is generally given, particularly where proposed use of the property is something like manufacturing, offices, hotels, etc. On the other hand, municipally owned or state owned land cannot be transferred in fee simple to foreign owners under any circumstances. The best that can be accomplished is a ninety-nine year lease or joint venture. These ventures also require a permit from the Minister.

Once invested, a foreigner can take profits out of the country under the following scenario:

Year	Percent
1991	15%
1992	30%
1993	50%
1994	75%
1995	100%

This is currently the law for U.S. investors and is likely to be the same for all foreign investors as of next year. In addition, profits not taken out of the country can be carried forward and accumulated to more advantageous years. This is relatively progressive and should be very helpful in creating the flexibility necessary for investments.

Where a development deal has been struck, and subsequently there are "original owner" claims on property, the claims would typically be against the mayor of the municipality that leased the land. The mayor must settle the claims, and therefore it is a government responsibility. In cases of land which are centrally located and important to the government, it is the unwritten government policy that money will be paid to the owner rather than land returned. This is under discussion in Parliament, and remuneration may take the form of stock in newly privatized corporations. The Mayors of districts should identify potential problems on their development sites as early as possible, and resolve them if possible before a venture is negotiated.

Typically, real estate developments have taken place under the following circumstances. The Polish partner will provide the land as its investment and the foreign investors will come up with the money for capital expenditures. This has caused some criticism regarding under valuation of land. The ability to joint venture is also very beneficial for investors and should help to stabilize property value.

Taxes.

Clarity of tax policy is critical to investors in real estate. Currently, taxes can be summarized as follows:

1. Corporate Income Tax - Maximum 40% - affects all companies, but foreign subjects are exempt for three years. Revenue goes to national government.

2. Tax on Dividends - Up to 30%

3. Turnover Tax - Similar to a sales tax and will not be in effect next year. Revenue goes to national government.

4. 1991 Value Added Tax - 15-20% of value of each item sold. This will replace the turnover tax.

5. Local Municipal Taxes - Transfer tax on real estate sales at 5% of total value accrues to greater Warsaw government. Property tax is currently $1./sm of building and 3¢/sm of land.

New local taxes need a 30% positive vote by public referendum. At this point since most tax revenue goes to the national government, municipalities do not see much benefit in creating new taxes. The authors anticipate that the property tax will be increased if it is redirected to provide revenue to districts. The uncertainty of an increase will have an impact on values.

SITE CHARACTERISTICS.

Ownership.

In about 1945, the Russian Communists established a new law in Poland whereby lands in the city proper were taken for the government. It is our understanding that they also tried to take land from the country-side, but the farmers resisted, and the takeover was unsuccessful in those areas. Thus, the ownership of land throughout Poland was roughly 75% private, 25% public. Originally in Warsaw, most of the land and buildings were owned by the new communist government. Homeowners were expelled from the property and the government often promised to make remuneration. Many of those property owners emigrated to other parts of Europe and the USA, but apparently no remuneration was ever made.

The City of Warsaw was expanded, and land which was once outside the boundary (thus largely privately owned) is now included but still private. Thus, the Ochota District is divided at the old city boundary by privately held land and government held land.

As the communist government has recently fallen, new laws have been created to allow privatization of the land. First, former owners (original owners) have been allowed to reclaim their property if it is a residence which is currently standing and is no greater than 20 rooms. There is a process currently underway whereby former owners from all over the world are making such claims. Resolution of those parcels can be unclear, since title is often complicated. But it is government policy to purchase rather than give back sites that are important to the city.

Second, national ownership of these lands has been or is in the process of being turned over to municipalities government. As some municipalities have also been divided into districts, the ownership will be by districts.

Thus, the district of Ochota owns all of the land that was originally held by the communist government and not now claimed by original owners. This can be complicated by hybrids of ownership, generally in apartment buildings, where neighborhood cooperatives have purchased the buildings. In general, title must be fully clear (perhaps with government warranties) before true value can be established.

Master Plan and Zoning.

The City of Warsaw, and thus the district of Ochota, is subject to a master plan which has been developed over the last several years. (The master plan is a short term plan to the year 1995). However, the government has held off approving the plan because of the major changes in municipal authorities which are taking place. The master plan creates the underlying zoning, but we were advised that the zoning should be treated flexibly and that the mayor of the district would be able to negotiate amendments as he needed. General guidelines were to be upheld, such as the following:

- Land in the outlying areas should be restricted to residential and farm uses in general, except near the airport.
- Residential use in these outlying areas should be no greater than one unit per 3,000 square feet of land.
- There are environmental and park areas which have been delineated in and near which development will be scrutinized. (see next section)
- Land near existing utilities is zoned generally for higher densities.
- Land closer to the central business district should be used for offices, hotels, retail, commerce etc.
- Mixed use is encouraged, and housing in the central business district is also considered to be desirable.

In general, the district of Ochota, as well as Warsaw and the national government, feel a great need for housing. Not only are there not enough housing units, but average citizens are unable to afford them. Other unwritten policies for the zoning include a desire for moderate price hotels, and industrial growth adjacent to the airport.

ENVIRONMENTAL.

In the district of Ochota there are few environmental restrictions affecting the use of property. One exception is near the airport, which is considered both a noise zone and an airflow zone. A noise zone is generally restricted from residential use because of the noise problems. The airflow zone is a special area which some people consider to be critical to the airflow of the region.

The government also recognizes that there are severe environmental problems concerning water quality and sewage disposal. They have not dealt with this, however, in a restrictive or regulatory way. Instead, they are striving to promote improvements in this infrastructure, sometimes by payment from developers.

The government is also aware of the impact on these facilities and the environment through increments of growth. They recognize that they can approve one hotel complex and it will not make much difference on water quality and sewage disposal. However, there is some point when the cumulative impact of these developments is significant. This knowledge has not been clearly articulated in any regulatory programs. However, they may ultimately require funds to be paid by each developer toward improvements in these systems.

Developers and investors will become aware of this uncertainty. If such charges remain low, it will not be a great disincentive to development; although developers will tend to deduct such costs directly from land value. If these costs become a significant cost to the project, ("significance" will vary, but a few % of total cost may be considered significant) they may not proceed with the project. These systems are described in more detail in the following section.

INFRASTRUCTURE

Water System.

Water for the City of Warsaw comes from the Vistula River, through a central treatment plant and is distributed under pressure throughout the city. The water has become very salty in the river due to pollution from mining, and it is heavily chlorinated at the plant. The result is an extremely hard water, allegedly carcinogenic, which is considered unfit to drink. In addition, the distribution system is inadequate. (The water pipes are too narrow for distribution due the chemical deposits.)

The reason for the heavy chlorination is that the filtration plant no longer works property. It is probably necessary to replace the entire plant, possibly at a different location. Noone has been able to estimate the cost of this replacement, although it is a goal of the city to have investors and developers participate in this cost. Clearly this is a regional issue and the full city government must participate. The cost of replacement of the filtration system must be determined before developers can be asked to contribute.

At this stage, there is no plan or even remote solution. Occasionally, deep wells have been privately completed for single projects, but this requires a permit. There appears to be a large aquifer under the city, and some people believe that this should be utilized by large projects. However, the Department of Defense feels that this aquifer should be used only as a reserve. In addition, no one knows how large the aquifer is and whether a relatively few amount of users could deplete it.

Heat.

There are several central heating plants which supply piped heat to buildings and residences throughout Warsaw. Although there is no central heating station in Ochota, the distribution is in much of this district. This system provides steam heat as well as hot water. It is known that the pipes are too narrow to provide additional supplies, and there are technical problems in tapping into the system. While the central heating plant seems to be the least expensive way to produce heat, people often supplement heat or hot water with on site systems.

Again, there is no solution in sight to this regional problem, and a large developer would either have to contribute to the city or provide his own system on site. It appears that an on site system would be desirable from the developers perspective, although the city may have difficulties with sources of pollution or extreme uses of electricity depending upon the fuel for the heat.

Electric.

Of all utilities, the electric system appears to be the most adequate. The authors were unable to find clear technical information on the system, but we heard of no problems with blackouts or brownouts. Developers could contribute to infrastructure on or around sites by improving cables and transformers. Estimations of generating plant capacity should be made to determine how much growth could be added to the system. Generator backups on site should be provided.

Sewage.

Sewage is currently not treated. It is disposed of through the city's sewer and storm drain system directly into the Vistula River. While this is obviously an increasing problem for water quality down-stream, the disposal system is technically adequate. Growth could be accommodated in the existing pipe system and would not be a concern to a developer. However, again, the cumulative impacts of this kind of growth will eventually lead to a need to treat sewage, and developers may be asked to contribute in some way to a treatment plant.

Communications.

Telephone communications present the worst problem to the city and its potential for new growth. For example, the Mayor of Ochota has one outside line in his office. He would not be able to get an extra line for several months. There are long waiting lists for any phone lines and multiple ones are very difficult to obtain.

It is agreed that there are enormous opportunities for telecommunications companies to invest in Warsaw. A Spanish company has already been interested in reconstructing the system, and it is said that an agreement with the city has been reached. However, the prevailing perception is that phones will not be improved to modern standards for three to five years, and growth will obviously suffer during that period.

Summary.

In general, infrastructure utilities are the largest problem in the area for development. While developers of specific sites may be asked to contribute to the solution for this problem, it is unrealistic to assume that a few developers will solve it. First, it is a city-wide issue and all districts must participate. Secondly, it appears that it will take enormous resources, probably from a large lending institution such as the World Bank. On a city wide basis the money should be borrowed and the utility project should be built. Perhaps developers would be asked to contribute to debt service. At the most, developers would have to provide all utilities on site. However, where on site utilities have to be linked to city wide utilities, the developer's improvements cannot provide a total solution. It is our opinion that proximity to utilities will certainly add value to properties, but the links are so weak that until city wide solutions are clarified, there will be a disincentive to investment, a reduction of property values, and/or a higher return demanded by investors.

GENERAL SUMMARY.

General characteristics such as access, site configuration and size, soil, water table, etc. all have significant impact on the usefulness and value of property. While some factors are obvious, for example high water table causes construction problems, site size and configuration vary with importance. For example, in some cases, a very regular square plot would be best for development, whereas in others triangular or rectangular might better fit desired uses and design.

Each of the general characteristics will have to be evaluated on the basis of the desired use and design of the property. Review of these factors at an early stage is critical to a project, and the more an owner can do before a proposal is made, the stronger a position he is in to negotiate with the buyer. Often, buyers will use these factors and their potential negative impacts as a means to negotiate and lower offering prices.

Again, there are no absolute pluses or minuses regarding any of these characteristics that would increase of decrease value. The importance is to understand all of the characteristics and to determine, on balance, how they affect the site.

VALUATION MODEL

GENERAL.

As described in the introduction to this report, the valuation method that should be used in Poland is an Income Capitalization Approach. To restate, it is the authors opinion that this is the only reasonable method in an area such as Poland where there is not a mature market of comparable sales.

The concept is to treat a building or real estate development much like a business, in the same way that a future investor will look upon it. The building is capable of generating a net income. That income, divided by a desired or anticipated rate of return, will determine a total project value. From the project value, all cost of development can be valuated after remaining factors such as costs of construction are known. In our case, we estimate all costs of development except for the purchase of initial property, which is therefore estimated by a deductive process. Whatever amount remains is what someone will be willing to pay for the property.

The subject of capitalization (the conversion of income expectancy into a capital sum) deserves an in-depth examination of the relationship of income and value. There is a predictable relationship between income and value. Knowing that real estate is only one of many investment opportunities, the behavior of buyers and sellers in other investment markets should give us a clue about the income/value relationship. The stock market and the bond market are good examples. The phrase price/earnings ratio is popular in the stock market to express the relationship of price or value to earnings. Yield rate is commonly used in the bond market to express the relationship of income to value. It dces not matter whether the relationship is expressed as multiplier or a rate. In either case, the object is to measure the relationship between income and value. The market for real estate investments is not the same.

If a plausible relationship between income and value can be established, the value can be estimated when only the income is known. Suppose that the relationship of annual net operating income to selling price for a certain type of property is desirable in the 8% range. We could predict the probable selling price of any property in the same class by dividing it annual net income by the rate .08. The formula is

$$\text{Value} = \frac{\text{Net Income}}{\text{Rate}}$$

All capitalization techniques employ the same rationale. Some of the techniques refine the process with more elaborate mathematics, but the fundamentals are the same. In one form or another, the procedure is to ascertain the expectable benefits, establish the proper relationship between these benefits and value (the rate of return), and perform the necessary mathematics to obtain an indication of value.

The separation of the land value, or for that matter any other variable, is the variation which the authors have brought to this capitalization of income approach.

In order to "fill in" the variables in this formula, several steps must first be taken. Many of these steps are often implemented by the developer, although it is to the seller or government's advantage to also have first hand information. In the following sections, we discuss these variables conceptually. Subsequently, we apply try to quantify the variables in the income formula in order to establish general estimates of value on a specific site in Ochota.

INCOME:

Income means the income generated by the finished real estate or development project. Again, it is comparable to a business whereby the building is simply a vehicle for producing rent or sales. The development of a reliable projection of income expectancy is prerequisite to any capitalization approach to valuation. The most sophisticated capitalization valuation effort is useless without a well supported projection of likely income. It is generally based on actual level of income in other projects at the time of valuation; but this does not mean that the investor gives no consideration to the future. Projections of future income are just as important, but difficult to estimate in a rapidly changing economy. Some definitions: Income is usually referring to a gross annual income. Net Operating Income (NOI) means annual income after operating expenses of the building are deducted. In the valuation formula, it is the net operating income, after expenses have been deducted, that is divided by the anticipated rate of return.

The establishment of income, before a project is constructed, is a major undertaking involving a complete program of research of the current rental market, market trends, and future probabilities. This process is generally called market research and may evolve to a "market feasibility report". It may require a lot of interviewing, long hours on the telephone with colleagues, discussions with real estate representatives and building owners. Its importance cannot be overstated in determining what anticipated income will be. In the case of office buildings, we consider income to be the rent paid for the space. In the case of hotels, income first starts with revenues generated from room rentals. In the case of housing, income may be revenue derived from rental or sale of units.

The estimation of expenses is also critical to determine the correct net operating income. Expenses can be divided into three categories: fixed expenses such as real estate taxes; variable expenses such as utility costs; and reserves for replacements and repairs. All of these expenses can be estimated by researching buildings that are similar to the development project. With experience, investors can determine the cost of each of these expenses on a square meter basis.

RATE SELECTION.

The selection of the appropriate rate of return also requires market research. This is not to say that rate selection is always supported by specific market transactions. However, real estate investors are influenced by rates prevailing in other markets. Capital will not be attracted to income producing real estate if the investor feels that he can satisfy his objectives better in other markets.

Generally, the safest bank rate of return is considered to be minimally acceptable in a real estate venture. Since the risk of real estate is considerably larger than putting ones money in the bank, the rate is usually considerably higher. For a fully leased income producing building, the rate may be closer to a "safe rate" but for an undeveloped speculative building, the rate must be high. Obtainable yields in the bond market may have an influence on the real estate market. Bond yields are a bellweather for mortgage interest rates because bonds represent an alternative investment opportunity for mortgage lenders. The stock market may also play a role in mature market economies.

All of this is more difficult in the emerging economy in Poland. As there is yet no stock market, and mortgage lending is minimal, the establishment of rates are based more upon investors experience in the outside investments. In addition, with the uncertainties of inflation, government policy and so on, investors may demand higher rates of return to reflect their perceived risks. In general, the development of a rate of return my be very precise in mature markets based upon alternative forms of investment. In Poland at this time, it is much more likely that an investor will simply affix a relatively high rate of return, based more upon subjective measures than quantitative standards.

VALUE.

With income and rate researched and estimated, simple division indicates a total project value. This value may be the final result of an investor's effort, in the case of a fully completed project. However, this total project value can also be used to further establish values of parts of the project. We use this variation or refinement in order to meet the objective of valuing raw land in Ochota. What is required is a further breakdown of total project costs. The total project consists of a building, some land, some infrastructure, some architectural engineering and legal services, some carrying costs and developers profit. Through deduction, we can determine any one of these variables.

In our method, we take the total project cost and we research and estimate all costs of construction and profit in order to deduce the value of the land. Costs of construction can be estimated at an early stage, but only refined after construction drawings have been completed and construction bids have been obtained. Similarly, other costs of the projects will be more refined as the project proceeds. However, it is possible to provide accurate enough estimates at early stages of the project concept in order to establish a value of the land.

The following costs are included in a total project cost:

- Hard construction costs including materials, labor, and contractors fee.
- Infrastructure costs on-site.
- Infrastructure off-site if required.
- Architectural, engineering, legal and other services.
- Cost of funds during construction for one to two years.
- Developers fee for managing project.
- Initial property cost.

Thus, the process is to: 1) establish the total project cost; 2) subtract all costs through the developers fee; and 3) by deduction determine the amount available for the purchase of the initial property. This amount available should reflect the true market value of the property.

CASE STUDY - OCHOTA DISTRICT

GENERAL.

Part of the objective of our work was to use the model for valuation on a specific site in Ochota.

The property consists of about 10 hectares of land located on the Avenue Jerozolimskie, near the West Train Station (see plan in Appendix). The property is large, considering its proximity to the central business area and to excellent roads and the train station. The West Train Station is designed for future improvements, and the bus station is also adjacent. On the South side, across Werykostrzewy Street there is an area designed for construction of sports facilities. To the East, there are various buildings including housing and a school. (See Appendices for detail).

As an example of a review of site characteristics, we found the following information relevant to valuation:

SITE CHARACTERISTICS. Triangular in shape, the property lends itself to an interesting form which would allow for good light and air exposure. Only one side of the property abuts any buildings, and therefore any new project would have excellent exposure and visibility. Since the site is large, it allows the developer great control over his surroundings as well as economies of scale for construction. On the other hand it is difficult to develop on a piecemeal basis with many developers participating. For this reason it is probably best suited to a single large developer. In general, the site size and configuration are generally beneficial to its value.

Access. Access to the site is via Jerozolimskie, a large four lane road, as well as train and bus routes. Close to the central business area, it is also on the route to the airport. The access is superb and adds value. However, with the property slightly out of the central business area it would not be quite as valuable as more centrally located sites.

Land Use/Zoning. The area is generally slated for higher intensities of development. It is appropriate for mixed use development, including housing, supermarkets, offices, shopping, and perhaps hotel. Total minimum floor area is to be 80,000 square meters. Desired number of housing is a maximum of 500 units. "Zoning" for this mixed use approach provides great flexibility to a developer and generally enhances value. Specifically, the program for development is as follows:

infrastructure. The uncertainty of the systems and the cost to improve them causes significant impact on value. We urged officials to fully determine these costs before further negotiations with developers.

Ownership. The property is currently owned by the Municipal Government. However, there may be some unresolved claims. It does not appear to be serious at this point, but again we urged the officials to clarify title before further negotiations.

Summary. While there are problems with the site ranging from subsurface soil conditions to procurement of utilities, on balance, the authors thought the site was generally very favorable for development. Its shape, flatness, size, location and accessibility make it one of the better sites available.

DEVELOPERS PROPOSAL.

There is already some interest in the site. Specifically, a French firm has made a general proposal for development. The próposal can be described as follows:

1. Build a mixed use commercial and residential project on the site.

2. Make full payment for the land, price established on the basis of current land prices.

3. Submit an economic and financial analysis of the proposed project.

4. Obtain full approvals from all levels of government before beginning specific design of the projects.

5. Pre-lease commercial spaces.

6. Determine all infrastructure costs and future demands before permits are issued.

7. Transfer a percentage of the profit from the project to the Ochota District in the first quarter of each year. This is unclear as to whether this is the payment of purchase price and for how long this continues.

8. Pay for the infrastructure on the land. It is unclear how much of the off-site infrastructure is proposed to by paid for by the developers.

1. Shopping Center - 10,000 square meters.

2. Supermarket - 5,000 square meters.

3. General marketing - 500 square meters.

4. Pewex - 1,200 square meters.

5. Restaurant - 5,000 square meters.

6. Commercial and Medical Facilities - 4,000 square meters.

7. Foreign Company Offices - Unknown.

8. Banks, Insurance - Unknown.

9. Hotel (400 beds) - 5,000 square meters.

10. Hostel - 200 beds.

11. Tourist Center - 1,500 square meters.

12. Entertainment - 2,500 square meters.

Environment Issues. There was discussion that this area was important to airflow from the prevailing westerly winds. However, it was not clear whether the project would have serious impact on airflow. Other than that, there were no environment issues cited and therefore no impact on value.

Soils, Ground Water. The area is reported to have a high water table, sometimes a few feet below the surface. Upon site investigation, this appeared to be true and could have a serious impact upon subsurface parking garages. In addition, there are reported areas of peat, an organic soil condition which is very difficult for construction and generally requires piles. If this is substantial, subsurface foundation cost could be up to 50% greater than normal. This is an example of a condition that would seriously impact value.

Infrastructure. In very brief summation: municipal water is located in the road and appears to be adequate. Sewers are nearby in several of the streets, although adequacy and treatment is in question. Gas is not available. Power is available and adequate, but construction of at least two power stations will be required. Telephone service is not currently available. The city heating system is not linked to the area, and heat must be provided from own sources. In general, there are some significant questions regarding

While the proposal appears to represent a real interest in the property, it is sufficiently vague that it should be considered a letter of intent. This is understandable, since there are still unknowns about the property, but we indicated to the Mayor of Ochota that more specifics would be needed to seriously evaluate the development proposal. On the other hand, the proposal concept combined with the desired use as stated by the Ochota District create the basis for a good hypothetical development on the site. We have used this combination as the basis for a general valuation of the site in the following section.

VALUATION OF SITE.

In order to value the site, the valuation model needs to be applied for each use proposed in the development. Each use will have a different income level, possibly different rates of return, and different valuations per square meter. Given the assumptions we need to make, it is impossible and pointless to try to evaluate at this stage every use including hotels, housing, small retail, supermarkets, banks, insurance business etc. This would require so much more specific information than is currently available, that the ultimate process and value would be misleading. In addition, while each of these uses may reflect a different value for the land, on balance they will blend together to reflect a single value paid.

It is important to note that certain uses will generate higher values for land than others. Where an area is zoned for many uses, the rates a developer will pay will be an average, with the understanding that one use may be more profitable than another, but on balance the project will work. Specifically, more intense uses with very high demand will be most valuable to the developer and allow him to pay the highest value for the land. For example, if there is demand, 100 units of luxury housing will allow a higher land value than 100 units of low cost housing. Similarly, 200 units of any housing will allow a higher value of land than 100 units. These variations will always exist, and ultimately that is why it is better to value each use independently and then on an aggregated basis.

For the purposes of our overview, we have looked at office use as a characteristic use of the site. Typically, offices generate a fairly high amount per square foot - not the highest, such as may be possible in a hotel, nor the lowest such as may be created in lower value housing. Again, we emphasize that with much more specific information, a more precise valuation could be done by valuing every use of the property. But given the available information, it is possible to provide an overview valuation use by the investigation and analysis of one typical use such as an office building.

Our hypothetical office building is a 30,000 square meter ten story building with a 3,000 square meter footprint with an additional 12,000 square meters additional land for surface parking and landscaping. Total land area is roughly 3.5 acres.

Based upon preliminary market research, our assumptions for variables are as follows:

Rent - $300/square meter per year.

Operating Expenses - approximately 20% of income.

Rate of Return - 20-25% depending on risk.

Construction Costs - $800/square meter.

Architectural & Engineering Services - 2½% of construction cost.

Cost of Funds During Construction - 15%, pro-rated as funds are spent over 15 months.

Developers Fee & Profit - 3% of all costs except land.

These are general assumptions based upon information available at this time and given the amount of research possible by the authors. In order to give some idea of the level of research and sources used to make these assumptions, we outline the following findings made by us during our stay:

1. Older office building rents: This was estimated by brokers in the vicinity of $12/square meter/month or $14/square foot per year. One of the banks that was interviewed was paying approximately $17/sf/yr in a building which had been under renovation, but the rent had changed three times within one year.

2. New building office rents average between $30 and $40/square foot with a high range possible above $50/square foot. Specifically, the Marriott office space is renting for approximately $36-42/square foot per year; the "Silver" Building is also said to be renting for $42/square foot.

Depending upon how inflation continues and how many office buildings are built, we anticipate that rents will be in the mid-thirties to low-forties per square foot. We have been conservative on the rent for the subject building, because it may not be considered a first class location warranting prices as high as the Marriott.

3. Regarding operating expenses, very little research was able to be done regarding such expenses as management and maintenance, utilities, etc. Property taxes were found to be low and clearly labor costs are low. Generally in the United States, operating expenses tend to be between 25% and 35% of gross revenues. We anticipate lower costs for these expenses in Warsaw due to the lower cost of labor. The total of expenses aggregates to approximately 20% which we feel is an appropriate level for this area.

4. Construction costs estimates varied between $25./square foot for lower cost housing to $130/square foot for luxury hotels. In general, it seems that construction costs were slightly lower than in the United States. There were significant savings in single family housing, where local laborers could be used over longer periods of time for extremely low rates. However, mid and high rise construction is relatively new to construction workers in Poland, and most projects had contractors and subcontractors from foreign countries. This would cause an increase in labor cost rather than reduction. In addition, many materials needed to be imported which would cause increases. Basically, we settled on an estimate of $800/square meter which would represent low to moderately priced office construction in the United States. If there are some savings through labor in Poland, funds could be shifted to a slightly higher grade of finish. Again, at this point this cost is an assumption and only through refined construction drawings and construction bids would it become a more accurate number. (We include in the Appendices a thorough analysis of labor and materials for a single family house which was provided to us. Unfortunately, it is not able to be generalized for mid and high rise construction.)

Based upon the above assumptions, we developed the valuation model for the office building as follows:

<u>DEVELOPMENT PROJECTION</u>

Office Building Example: 30,000m^2
3,000m^2/floor for 10 floors
12,000m^2 add'l parking/landscape

I. Annual revenue from building

Rent = 30,000m^2 x \$300/m^2	= \$ 9,000,000
Marketing/Commissions @ 10%	(900,000)
	\$ 8,100,000
Management & Maintenance @ 4%	360,000
Legal, Leasing etc.	50,000
Utilities @ \$5/m^2	150,000
Property Tax	50,000
Repairs	75,000
Operating Reserve @ 2%	180,000
	(865,000)
Net Operating Income (NOI)	\$ 7,235,000

II. Model: $\frac{\text{NOI}}{\text{Rate of Return}}$ = \$Total Project Cost

$\frac{\$7,235,000}{23\%}$ = \$31,500,000

III. Project Cost

Construction @ \$800/m^2	\$24,000,000
Infrastructure (est)	800,000
Architectural and Engineers 3%	600,000
15% Cost of \$ during Contractor	2,900,000±
Developers Fee	640,000
Total Cost Without Land	\$28,940,000
Available for Land (Available - Cost)	\$ 2,560,000

SUMMARY OF VALUE.

The value of land for the prototypical office is \$2,560,000 for approximately 5,000 square meters of land or the equivalent of \$170 per square meter of land.

A more appropriate way to measure land value is by the amount of square meters of building that are able to be built upon it. For example, the value of land at \$2,560,000, is for a site on which a 30,000 square meter building is being built. The value of land is therefore approximately \$85 per square meter of building for the land site. By measuring the value this way, it accounts for differences of density of building and intensity of use. In generalizing about the value of the entire property in question, we can reach the following conclusions:

1. At $170 per square meter of land, a site total of 100,000 square meters is worth $17,000,000 in total.

2. Using the measure of land value as $85./sm of building that can be built, we can see that approximately 200,000 square meters of building must be built in order to achieve a $17,000,000 value for the site.

As stated before, the best evaluation will be made use by use, site by site. All potential uses can be valued the same way as in the development projection for office use. In housing, the income input is annual rent or sales; in hotels, annual rent or percentage of gross hotel revenue; in stores the same as office of percentage or gross income; etc.

REALIZATION OF VALUE

The value of the property is independent of the decisions the municipal government may make in realizing the value. By way of simple example, the value of the property may be $10.00. However, the municipality may take $2.00 and participate in 25% of the profits over time. Or, as an alternative, the government may take $1.00 per year over fifteen years. Or in the alternative, the government may take less money from a developer because of the differences of proposals, indirect benefits from one or the other, less environmental impacts, more faith in the credibility of the developer, etc. In short, there may be social and other intangible goals which are better met through certain proposals which pay less money. Again, philosophically this is based on how the municipal government wants to realize the value of the property, and does not actually change the true value.

At some point in negotiations, the municipal government of Ochota will have to consider trade offs between a single sum fixed fee and participation in a joint venture.

The former allows the government to obtain up front funds for infrastructure, or other desirable goals such as providing funds to the housing sector. However, in order to pay large sums in this unstable market, the developer will require a deep discount of what would ordinarily be a continuous rental income pay out. Over ninety-nine years, especially with inflation, the one time fixed development fee or rental fee may appear to be very low as time passes.

The way for the government to avoid losses due to inflation or other factors is to participate with the developer. The trade-off is that typically there will be smaller payments made up front, and the government participates at similar levels of risk as the developer. We outline the various options below:

GROUND LEASES.

It is the current policy for the Municipality not to sell property (give fee title), but instead it will enter into long term ground leases for up to 99 years. Under a 99 year lease arrangement it is a general practice in the global real estate market to require a premium be paid for the lease at its commencement, roughly equivalent to a discounted negotiated value as a freehold.

Negotiations may vary considerably depending upon the desirability of any proposed development or project, but it is normal for a 99 year lease to contain provisions for periodic reevaluations and rental adjustment at some predetermined negotiated rate. For example, the lease may specify that at the end of the first 15-25 years that the property be revalued, and that the rental be pegged at a percentage of this revaluation, and that each successive 15-25 years thereafter a similar reevaluation take place. The Municipality should anticipate that a developer may wish a longer term fixed rental during the first portion of a 99 year lease in order to preserve as much capital as possible for the development itself. In any event, most 99 year leases in which a substantial premium is paid at the commencement provides for an automatic small percentage increase, in the absence of a reevaluation provision.

There may be considerable variations from lease to lease. A traditional long term fixed ground lease is the most secure income stream that can be developed for the benefit of the governing District.

SHORT-TERM GROUND LEASE.

Shorter term ground leases may be a practical approach to specific properties where development is not as intensive as a high-rise office building or hotel commercial project might be. This type of improvement could include car washes, fast-food markets, minimal commercial enterprises catering to the local market in which the buildings or improvements will probably be amortized within a period of 15-25 years. The shorter term lease for the benefit of definition in this discussion would be leases up to 25 years the end of which possession of the property and any improvements then existing would become the property of the Municipality.

JOINT VENTURES.

It is most likely that major development proposals will approach the pure joint venture as their first option since it divides the risk of the success of the development between the developer and the owner of the land proportionately. The joint venture is a partnership arrangement in which the land is contributed to the joint venture at a predetermined negotiated value; and the developer's interest and contribution is also clearly defined; and the interests of the two parties share proportionately in the benefits and possible failures of the joint venture entity. The joint venture carries the highest degree of risk for any properties placed in the joint venture by the Municipality but also has the benefit of direct proportionate participation in the successes of development.

MODIFICATION OF JOINT VENTURE - LONG-TERM GROUND LEASE.

There are many variations that combines the benefits of the lease and the joint venture. The long term ground lease may be negotiated to provide for some agreed upon minimum rental increase irrespective of the success and/or failure of the project and carry a provision that there be some participation in any future successes. Provisions may be negotiated that provide some limited degree of income security plus the opportunities for enhancing that income as the value of land improves as a residual of the economic success of the development. This form of a modified joint venture-fixed ground lease has the advantages of providing some meaningful early financial benefits as well as having some degree of participation in the benefits of future value growth.

While other modifications can be considered, at the early stages of the development in the District of Ochota, new development consistent with public need and political objectives should be facilitated by a comprise between substantial commencement of lease premiums and the higher risk pure joint venture arrangements. The District of Ochota may very well be justified in granting liberal ground lease terms to a qualified developer-user who is willing to put substantial capital into a development project and become the primary occupant/user, versus the speculative type of developer who is building space for anticipated or expected uses that may or may not be properly predetermined.

Emphasis should be placed on the integrity of the developer, to ensure identifiable market objectives are achievable. The District must be willing to assume some of the risks due to the many problems of infrastructure and uncontrollable factors innumerated above in order to encourage new developments. Early projects will attract other developments as there is increased experience in the marketplace.

QUALIFICATIONS OF DEVELOPER/USER.

The qualification and experience of any proposed developer interest should be carefully examined prior to any in-depth negotiations. This process should involve a preliminary question routine along the following lines.

(a) Financial qualifications and banking resources (verifiable).

(b) An opportunity to review the projects represented to have been undertaken by the proposed developer.

(c) Differentiate between a speculator/broker interest from a bonafide user/developer interest.

(d) Other reference checks. It is very unlikely that a bonafide and qualified developer will resist a pre-screening. Is the developer or developer interest politically acceptable?

COMPARISON TO OTHER AREAS

Part of the team spent a day in each of three towns about 1½ to 3 hours from Warsaw in order to become acquainted with their individual housing and valuation problems and to determine the similarities and differences to those of Ochota. Our results are as follows:

<u>LODZ</u>

This is a town of 860,000 + inhabitants, about 1½ hours Southwest of Warsaw. It was a typical large factory town in Poland, and as a consequence had a good deal of pollution. The town had several post-war tall buildings of 20-30 stories and about 8-10, ten story buildings, as well as the usual number of 3-5 story buildings befitting a town of its size.

<u>Issues.</u>

<u>Title:</u> State land owned by the central government was in the process of being returned to its original owners or to the local government. However, when the property was seized after the war, the Communists destroyed all documentation related to it making it difficult to settle title questions. One particularly tragic note comes from the fact that about 50% of Lodz was Jewish, but the owners and most descendents no longer exist.

<u>Housing Rents:</u> If a property finally does pass from The State to the local town its value is adversely affected by the occupancy of individuals placed there by the Communists at extremely low rents. The Presidents of the various towns are faced with the following choices: a) keep the buildings at low rents b) increase rents dramatically c) remove the occupying individual and relocate them to housing that is currently very scarce.

<u>Attitude:</u> Skepticism on the part of local officials greeted us in Lodz and elsewhere. After 10 years of fighting the Communists and finally gaining power, the newly elected officials are tired just when their most daunting task - the reform of the economy - lay before them. People who have spent forty-five years following orders and never thinking individually are now waiting to see what the new Solidarity government will do <u>for</u> them. Forty-five years of government handling their programs, housing, jobs, etc. and discouraging private initiative has created inertia. Also, there is a long Communist history of trying new things that never worked, and any new reforms are now greeted with the skepticism.

Education: The attitude found among the people sparked a call from the mayor for educational work. Themes such as the role of a developer in creating housing, the entrepreneur in business, and explanations of mortgages, are just a few of the educational subjects he would like to see promoted. The mayor was also very eager together with his town planners to speak with and hopefully joint venture with developers to create housing in his town. He wanted to encourage free enterprise and private investment.

RADOM

Radom is a town about 1½ hours Southeast of Warsaw with a population of about 250,000.

Issues: In Radom, the Mayor estimated that 40% of the town was State owned, of which land about half would likely be returned to its former owners. The other land principally belongs to State Industries or to the State Administration which will remain in State hands. The Mayor was now involved in negotiations between his government and the central government as to how much land Radom will likely get from the State. He expects that by the end of the year these issues will be resolved.

Radom is not different than other Polish towns in that title problems abound with past owners. However, given the fact that 90% of the old part of the city is in private hands, there is ample room for purchase and development on property that is not involved in title difficulties.

Housing: The Mayor reported that 30,000 families were on his official list awaiting apartments. Construction to meet demand, however, is minimal. He reported that in Radom during the best of Communist times there were 800 flats per year built but now there are only 400 per year being built. The mayor estimates that about 29% of the people in the city are waiting for housing.

Because most flats are in cooperatives which were formed 4-5 years ago (it takes about 4-5 years to move from membership in a coop to possessing a flat), the soaring cost of completing the flats due to inflation has led to a paradox: some people are unable to take possession of their units because they cannot now afford the cost. They therefore sell their rights to the unit on the free market and pocket the difference between what they have paid and what they can sell the units for. Financing is available for coops, but at a variable rate that scares people and they are unwilling to accept the risk of such a mortgage.

Infrastructure: The Mayor reported the same problems of infrastructure that are present in Ochota and elsewhere. The City has no available money from the State and no loan money to put in infrastructure. The mayor would like loans to for infrastructure so that he can sell improved land to a private developer.

Centralized Taxes: The Mayor also pointed to the tax system as a limitation on his ability to act. Currently, the State collects all taxes and reallocates specified amounts back to the towns. All his revenue came from the central government. Thus, it was difficult for local citizens to tax themselves to increase police protection or education because all monies were raised centrally by the national government.

TORUN

Torun is an old city of about 200,000 people about three hours Northwest of Warsaw. It has many historic buildings (that need great repair) and a lively intellectual atmosphere due to the presence of a university at which Nicholas Copernicus worked.

We were impressed with Torun's local organization. The Town Planners had clearly inventoried all sites either currently owned by the local authority or expected to be so owned. They delineated these sites on maps and prioritized which they wanted to develop first. They also targeted private land for purchase and subsequent development. The local authorities were particularly keen about the prospect of having turned over to them a local Russian Army Base on which they wanted to build 12,500 flats with an average height of 5 stories as well as some single family.

Issues: The Mayor and his deputies reported 20,000 people were waiting for housing and about 1,000 for single family house lots. They expected the demand for single family homes to increase and flats to decrease since private ownership of a house was the preferred form of ownership.

Torun officials named two sites on which they already had 70% of the necessary infrastructure in place. Next year the Mayor hopes to begin completion of the infrastructure and construction of the units. He indicated it would cost about $11M of which amount her already had $3M. He expected the World Bank to contribute another $4.5M and the rest would come from payments from the would-be inhabitants.

Development Structure: Torun officials sought the following structure to meet housing demand: The city would put up the land, the World Bank would lend the money for infrastructure, and a private developer would build and complete the project. On the surface this appeared similar to some American deal structures, with one major difference. The developer's risk was greatly decreased because housing in Poland had always been pre-leased from waiting lists. The "market" was always flooded with waiting buyers. But the "market" was for flats offered at cost, not at market prices with a developer's profit built in.

It is not clear that Torun officials adequately understood the concept of risk and consequent developer profit. Nor was it clear that they understood the concept of the World Bank loan, but when the mechanics were explained to them, Town officials began to understand how it worked. They would have to sell the land outright or they would have to create a sufficient ongoing stream of income from the project to repay the principal and interest for World Bank infrastructure loans. The officials also wanted to sell or participate in profits sufficiently to have a surplus after the World Bank was paid so as to fund ("subsidized") projects for those who could not afford market rate home prices. All the questions regarding fair valuation of these parcels weighed on Torun official in our discussions and thus, they shared the problems faced by the Mayor of Ochota and the subject or our principal work.

In a few instances Torun officials did not wait to value two buildings in the old part of Torun - they gave them away to Polish people who contracted to renovate them, one into an artist's cooperative, and the other into a private hotel. Both were prime sites that officials reasoned should be taken off their books immediately and which they thought might stimulate private investment.

Assistance: Local officials asked for assistance in dealing with developers and private investors, in valuing their property and structuring joint ventures and also to assist them in applying for development aid from entities like the World Bank.

SIMILARITIES TO OCHOTA

Title and ownership problems.

Difficulty in relocating existing tenants in State properties so that these properties could be sold.

Attitudes of citizens who are skeptical about reforms.

Town officials exhausted and overwhelmed by the problems in their areas.

People ask what government will do for them rather than what will government allow them to do for themselves.

Educational assistance needed to inform citizenry of the workings of free markets, as well as how to be a developer, entrepreneur and the use of and responsibility for mortgages and real estate loans.

Eager to try to work with private market on joint venture deals, but unsure of how to proceed.

Large demand for "at cost" housing. Clear demand in secondary market for either "rights" or resale of units, but no quantification of the same.

Infrastructure problems abound with vast sums needed to upgrade and encourage private investment.

Taxing power either unclear or nonexistent which hampers local officials ability to activate programs in housing or development.

Slowly learning the concept of risk. Unsure of political problems inherent in developer profit.

Assistance needed to deal with private investors, to value property and to negotiate sale and joint ventures.

DIFFERENCES FROM OCHOTA

Smaller towns have much more private land (40-60% of town) vs. Warsaw with less than 10%.

Smaller towns do not yet own the State parcels and in many cases do not know whether they will own.

More self-initiative in small towns than large cities possibly because of a larger history of private ownership.

Better inventory and assessment of what is or will be owned.