



OPERATIONAL COSTS AND SERVICE CHARGES in office buildings

in the years 2011-2019



Eight years ago we decided to analyse data from the previous years concerning operational costs in office buildings. We wanted to check how they changed depending on various factors - location, size, type, etc. At first, the analysis only concerned the real properties included in the portfolio managed by Knight Frank. Over the years however, the portfolio has expanded and the recent analyses have incorporated data from facilities belonging to owners with whom we cooperate in a different field and who made their data available to us. These data concern both the office buildings in Warsaw, split into the ones located in the centre and outside the centre of the city, as well as in the regional cities.

At first, the topic did not gain popularity, since the operational costs alone made up for a small portion of total costs borne by the lessees and their awareness of the market is highly limited. Currently, due to the constantly growing costs and the fact that they constitute an ever greater share in the total costs, both the lessees and the owners are more interested in continuous control, comparison, detailed analysis and finding a method of limiting them.

When analysing costs related to the rental of space from the point of view of the lessee, the value of those components that remain beyond their direct control remains a determining factor, namely rental rates and service charges. With relatively even rent prices, shaped by market mechanisms of supply and demand, it happens ever more often that a decision to rent space in a given building depends on the level of service charges.

The analysis of costs making up for service charges allows identifying the components that have the greatest impact on their level, thus indicates the areas to which particular attention should be paid both when executing the current budget and when planning budgets for the years to come as well as when planning rational actions aimed at limiting these costs.

This year the pandemic has additionally spurred interest in operational costs. The crisis it has triggered and the need to save have focused the attention of the lessees in particular on operational costs generated by office buildings and have mobilized owners and managers to think how and where the savings should be made.



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Operational costs and service charges

Operational costs constitute the total of expenses incurred by an owner for the purpose of maintaining the real property. They are incurred by a lessee and settled in line with the provisions of the rental agreements, the vast majority of which are based on the rule of making monthly advance payments and a settlement on an annual basis.

A service charge is a part of operational costs that is settled directly by a lessee in the form of making monthly advance payments calculated per one square metre of rented space.

Rental agreements contain a list of operational costs covered as part of service charges. Such a list is usually non-exhaustive and covers all costs of ongoing property maintenance. Costs of utilities incurred directly by the lessee as a result of using the rented space and - ever more frequently - of the majority of utilities used for the purpose of ongoing operation of the property are excluded from the list.

The amount of operational costs and the amount of a service charge calculated per one square metre of the rented space depends on numerous factors. They

include, among others: location, size of the building, technical advancement, geographical location, land ownership form, degree of wear and many more. In order to illustrate the differences resulting from the location of a building, data concerning the level of service charges in the Central Business Area in Warsaw, in other parts of Warsaw and regional cities have been singled out.

TABLE 2: SERVICE CHARGES IN THE YEARS 2011-2019 MINUS RECHARGED UTILITIES (PLN/m²/month)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Warsaw, Central Business District	18.97	19.70	19.66	18.87	19.07	19.76	20.66	20.45	20.08
Warsaw, other districts	18.78	19.37	19.68	18.46	18.17	17.38	17.84	18.06	18.35
Regions	15.65	16.40	16.35	15.39	14.53	15.94	15.60	16.21	15.73

TABLE 3: AVERAGE SERVICE CHARGES IN THE YEARS 2011-2019 INCLUDING UTILITIES (PLN/m²/month)

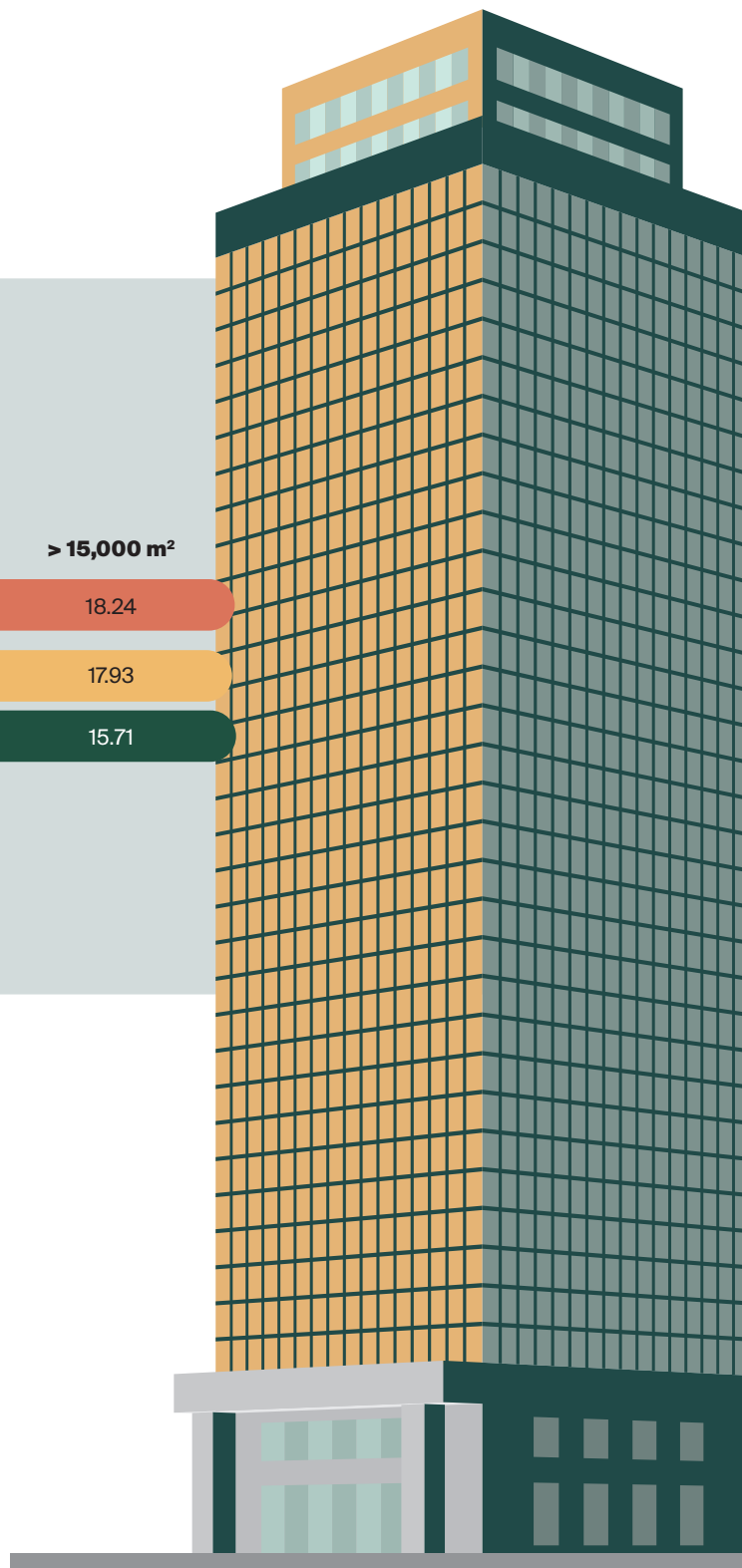
	2011	2012	2013	2014	2015	2016	2017	2018	2019
Warsaw, Central Business District	23.17	24.20	23.84	22.23	22.69	22.36	23.63	23.41	28.40
Warsaw, other districts	23.67	24.11	23.95	21.92	20.56	19.79	20.24	20.49	25.25
Regions	20.14	21.87	20.84	19.40	19.81	20.34	20.45	21.23	23.47

Costs according to the building area

	< 7,000 m ²	< 15,000 m ²	> 15,000 m ²
Warsaw, Central Business District	24.93	20.22	18.24
Warsaw, other districts	20.60	20.30	17.93
Regions	19.78	15.32	15.71

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The size of an office building has a direct impact on the level of costs. In 2019 average costs in buildings located in the Central Business District of Warsaw with an area of less than 7000 m² amounted to as much as PLN 24.93, while in facilities at least twice as large - only to PLN 18.24. In regions the difference is not that spectacular, as the cost of perpetual usufruct, which does not take place in the majority of regional office buildings, has a certain impact on the situation.



Particular components of operational costs

When categorizing basic groups of operational costs we have already singled out nine main groups. Since the cost of waste disposal from the property has become increasingly important, we have decided to extend the list by the tenth component - waste disposal - starting from 2019.

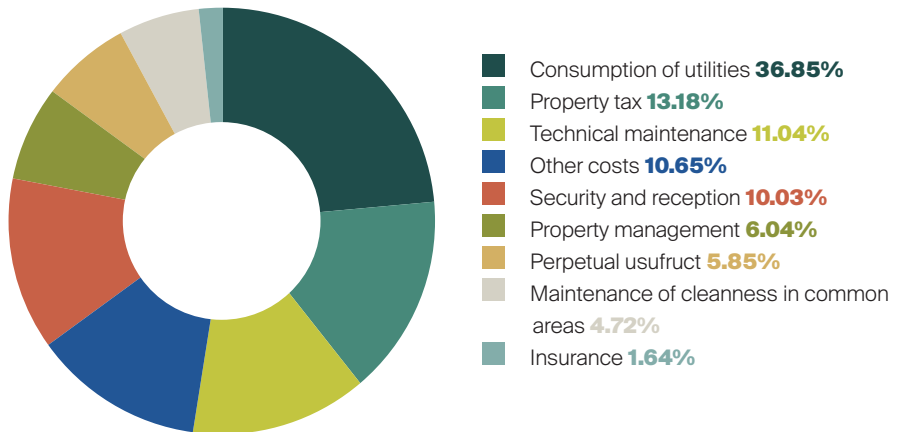
1. **COST OF UTILITIES CONSUMPTION**
2. **TECHNICAL MAINTENANCE**
3. **PROPERTY MANAGEMENT**
4. **MAINTENANCE OF CLEANNESS IN COMMON AREAS**
5. **SECURITY AND RECEPTION**
6. **INSURANCE COST**
7. **PROPERTY TAX**
8. **PERPETUAL USUFRUCT**
9. **WASTE DISPOSAL**
10. **OTHER COSTS**



According to the data from the years 2011-2018, the level of the highest costs looks as follows:

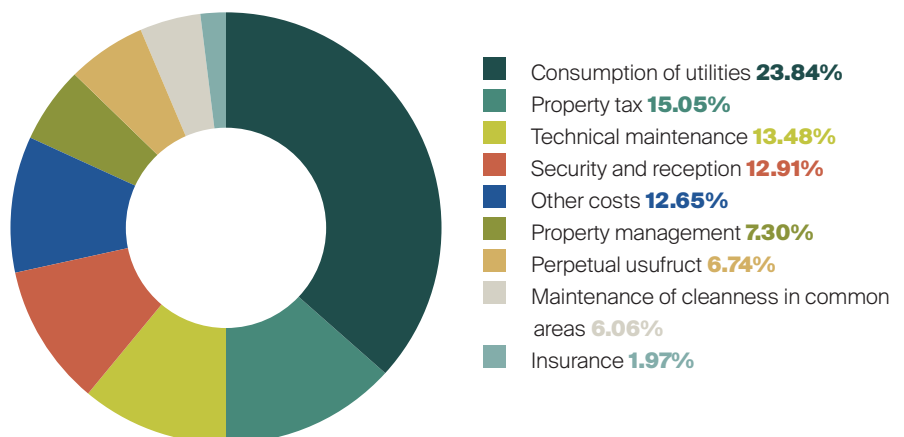
Utilities represent the highest cost (36.85%), followed by taxes (13.18%), facility management (11.04%) and security (10.03%). Taking into account that the operational costs also include that part of the costs of utilities that is in practice settled directly in the form of a monthly recharging, the actual share of particular cost groups in service charges changes.

AVERAGED COSTS (INCLUDING UTILITIES) FOR THE ENTIRE COUNTRY FOR THE YEARS 2011-2019



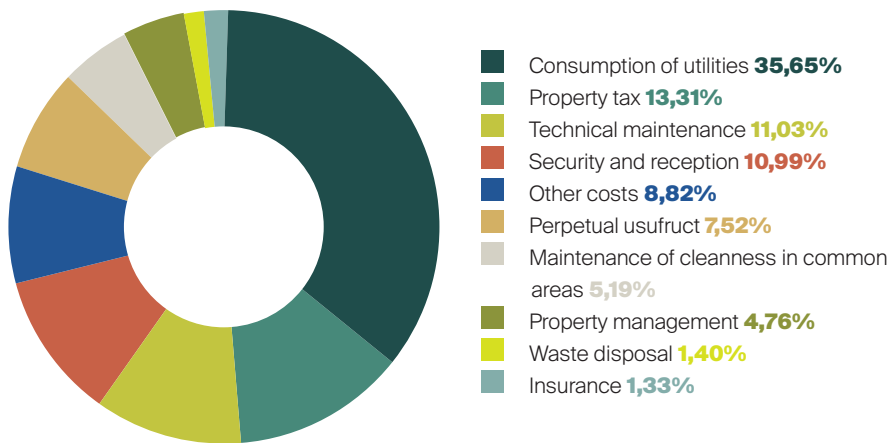
In the analysed period the highest cost by far in the group of operational costs are the utilities consumed in common areas (nearly 24%), followed by taxes (over 15%), facility management (nearly 14%) and security (nearly 13%). This breakdown of share closely resembles the one from the previous year.

AVERAGED COSTS (UTILITIES CONSUMED IN COMMON AREAS / MINUS RECHARGES FOR LESSEES) FOR THE ENTIRE COUNTRY FOR THE YEARS 2011-2019



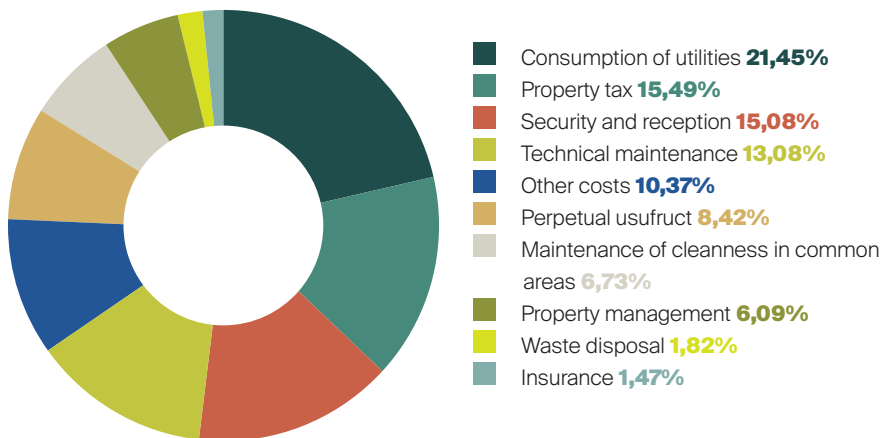
Operational costs - averaged costs analysed separately for 2018 do not diverge greatly from the average distribution for the entire analysed period:

**AVERAGE CHART FOR ALL AREAS / OPERATIONAL COSTS
- AVERAGE SHARE OF ALL COSTS + RECHARGES FOR 2019**



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Total costs in 2019 are very similar to the ones in the previous years. Utilities remain the highest cost - over 35%, followed by taxes - over 13%, technical maintenance - 11% and security - nearly 11%.

AVERAGE CHART FOR ALL AREAS MINUS UTILITIES RECHARGES FOR 2019



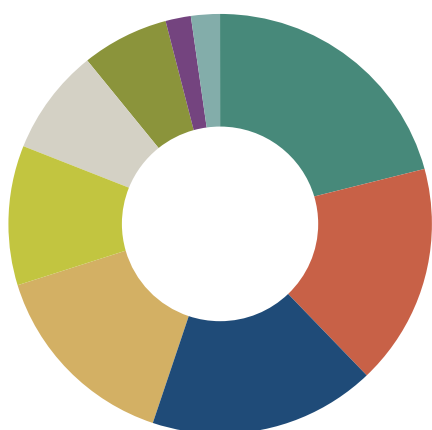
Operational costs of facilities less the utilities

Division of costs into utilities and other components is applied on the market ever more frequently. The former are fully recharged every month to the lessees, while the latter represent the service charge. Recharging in the part

concerning the rented area is made on the basis of indications of meters, while as regards the common space - most frequently in proportion to the occupied area. The three charts below illustrate the division of operational costs into particular

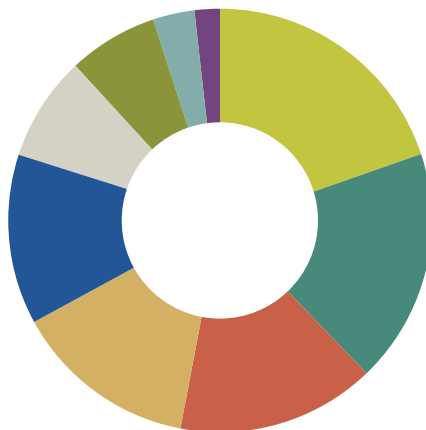
components in 2019 in buildings located in the centre of Warsaw, outside the centre of Warsaw and in regional cities, minus the costs of all utilities consumed in the facility.

WARSAW, OTHER DISTRICTS / COSTS WITHOUT UTILITIES



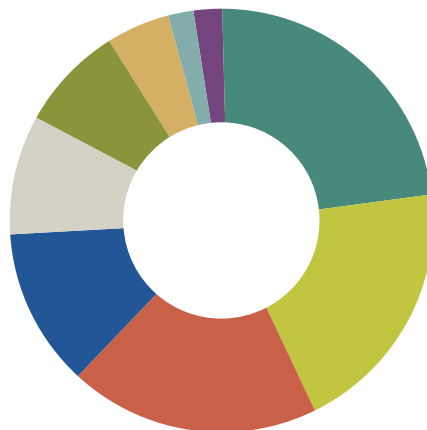
- Property tax **21%**
- Security and reception **17%**
- Other costs **17%**
- Perpetual usufruct **15%**
- Technical maintenance **11%**
- Maintenance of cleanness in common areas **8%**
- Property management **7%**
- Waste disposal **2%**
- Insurance **2%**

WARSAW, CENTRAL BUSINESS DISTRICT / COSTS WITHOUT UTILITIES



- Technical maintenance **20%**
- Property tax **18%**
- Security and reception **15%**
- Perpetual usufruct **14%**
- Other costs **13%**
- Maintenance of cleanness in common areas **8%**
- Property management **7%**
- Insurance **3%**
- Waste disposal **2%**

REGIONS / COSTS WITHOUT UTILITIES

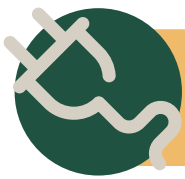


- Podatek od nieruchomości **23%**
- Technical maintenance **20%**
- Security and reception **19%**
- Other costs **12%**
- Maintenance of cleanness in common areas **9%**
- Property management **8%**
- Perpetual usufruct **5%**
- Insurance **2%**
- Waste disposal **2%**

By comparing the costs making up for the total operational costs in 2018, we can see that the proportions and figures are similar to the averaged values from the previous years.

The highest costs definitely include the utilities (34%), taxes (14%), security (12%) and facility management (10%). A visible change in the level of security costs results from the introduction of statutory minimum wage and minimum hourly rate.

Analysis of operational costs by groups

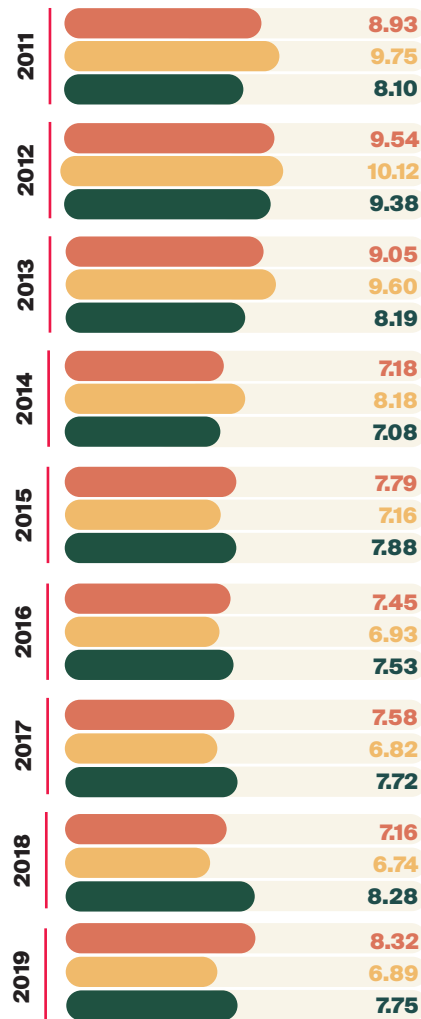


UTILITIES

They make up for over 1/3 of the operational costs. These include costs of purchasing and delivery of electricity, heat or fuel (gas) as well as water consumption and wastewater disposal. The highest cost in this group is the cost of electricity, which grows year on year both due to the increasing purchase price of electricity and due to the increased demand and number of devices and systems powered by electricity. The costs of heat/gas and costs of water and wastewater disposal grow successively each year as well.

AVERAGED COSTS OF UTILITIES CONSUMPTION IN THE YEARS 2011-2019 (PLN/m²/month)

- Warsaw, Central Business District
- Warsaw, other districts
- Regions



In 2019 the data analysis indicates the increase in the cost of utilities. Even greater changes should be expected in 2020, as the electricity rates have gone up considerably.

Certainly, power consumption will be lower due to the lockdown and remote work introduced by the majority of lessees, therefore the costs, on balance, may turn out to be on the same level as in 2019. The pandemic has caused the rates for 2021 sink considerably. The difference is up to even PLN 40 per 1 MWH.



TECHNICAL MAINTENANCE

The group covers the costs of technical maintenance services (technical team directly dedicated to providing property services and/or mobile services) and inspections of technical systems. In the majority of cases full technical maintenance of all building systems is provided by a selected technical company (facility management), except for the maintenance of lifts and escalators that is outsourced to specialized entities. In the case of new facilities covered by warranty, some systems may be maintained by specialized entities, in line with the provisions of the warranty agreement.

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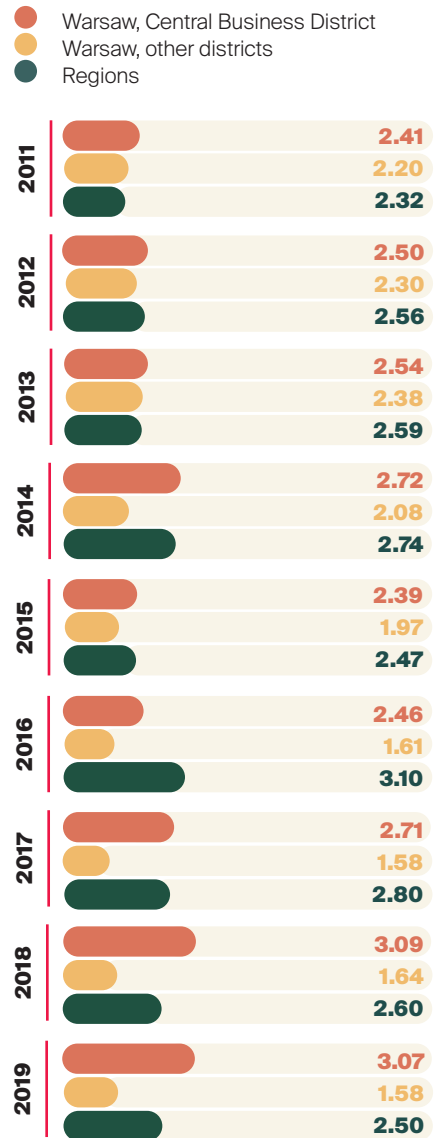
Generally, in 2019 the cost of technical maintenance did not change. Fluctuations are marginal. Due to the fact that in the recent years the cost of technical maintenance has remained stable, we can expect its increase, which can be caused by the unavailability of qualified workers. The most experienced ones ever more frequently resign from providing maintenance services in buildings while switching to better paid and less stressful jobs.



MAINTENANCE OF CLEANNESS IN COMMON AREAS

Cleanliness maintenance services in commercial buildings include cleaning of the common areas inside a building, including garages, and maintenance of the external areas. Typically, the maintenance costs also include the purchase of necessary materials. Statistically, internal common areas in modern office buildings (without the garage area) constitute between 3% and 7% of the entire building area, which significantly impacts the costs of maintaining cleanliness.

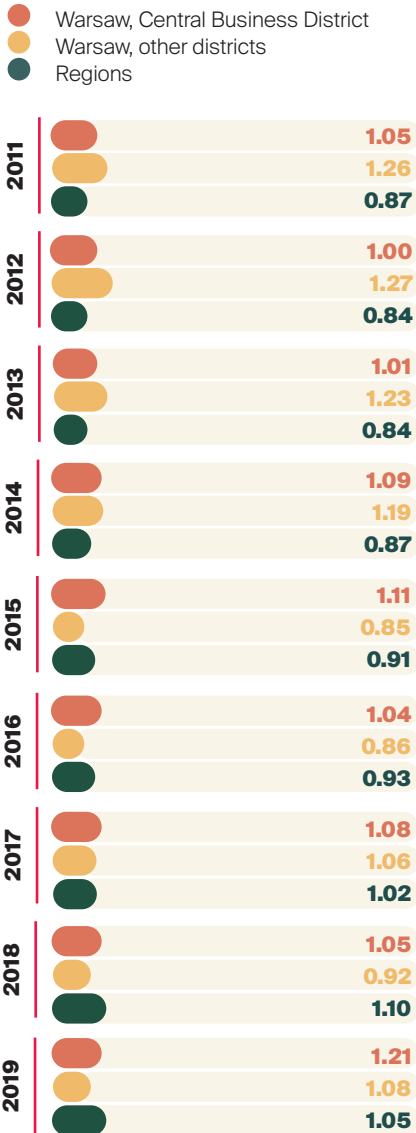
AVERAGED COSTS OF TECHNICAL MAINTENANCE IN THE YEARS 2011-2019 (PLN/m²/month)



In 2019 we observed an increase in the cost of technical maintenance at a similar level. The increase is caused by the lack of staff and more and more maintenance services in office buildings. In 2019, recently the remuneration for technical maintenance services has increased.

Annual increases in the minimum wages for technical maintenance services due to the pandemic will certainly impact the costs. Disinfection of surfaces can also increase the costs.

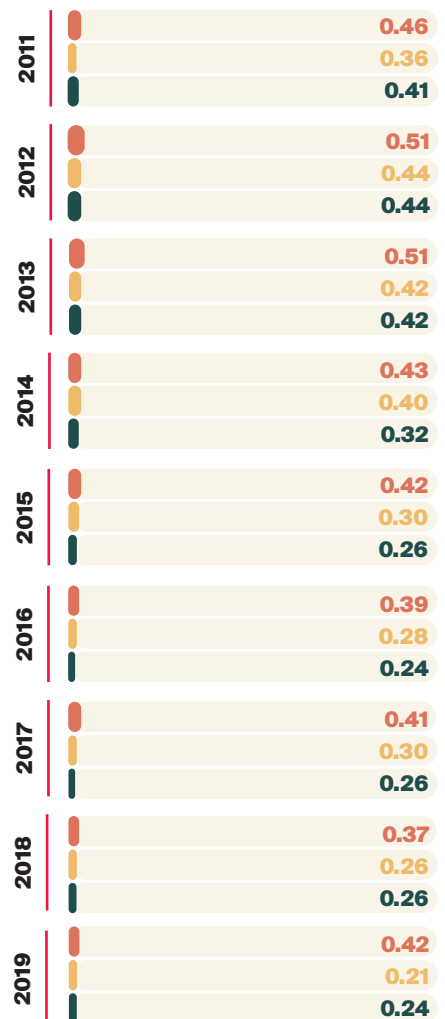
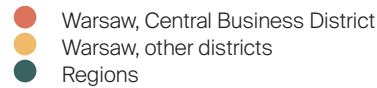
AVERAGED COSTS OF CLEANING THE COMMON AREAS OF OFFICE BUILDINGS IN THE YEARS 2011-2019 (PLN/m²/month)



INSURANCE

Costs of insurance include annual fees for full insurance of the property and civil liability insurance of the property. In most cases the policies also contain clauses concerning insurance in respect of terrorist acts. Loss-of-profit insurance should be concluded by a facility owner, unless something else constitutes the subject matter of the rental agreement.

AVERAGED COSTS OF OFFICE BUILDING INSURANCE IN THE YEARS 2011-2019 (PLN/m²/month)



In recent years no significant changes in the rules and scope of real property insurance have been observed and its share in the costs in 2019 grew marginally compared to the previous years, reaching the level of 1.35% of total costs. Insurance is included in the group of costs that are independent from the real property owner, although it is negotiated by them and depends on a selected insurance company, number of properties in the portfolio as well as determining a deductible with respect to particular events.



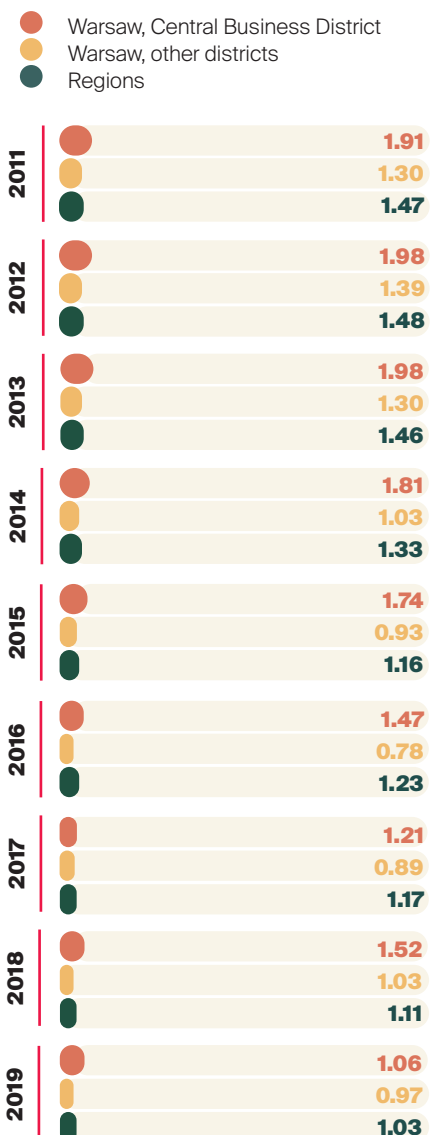
The costs of cleaning in Warsaw. The rates in the regions remained on a level. Changes in minimum wages and hourly rates. Cleaning companies also often we can see foreigners (mainly from the Eastern Europe) providing services. Previously, employing foreigners aimed at generating savings, but the generation of local and foreign workers has equalized. Wage and hourly rates as well as additional duties imposed on cleaning companies mainly trigger an increase in the costs of this service in the years to come. Cleaning carried out by specialized entities represents an additional cost.



PROPERTY MANAGEMENT

The term 'property management' under Polish conditions encompasses a broad spectrum of activities related to property services - far broader than in the Western Europe. In Poland the management covers all ongoing administrative and technical activities necessary for efficient and safe operation of real property, including the planning and execution of operational budget, supervision over the execution of the capex budget and a broad scope of tasks from the accounting and financial area, including the settlement and recovery of rents and operational fees (excluding the accounting services for special purpose vehicles of owners). Usually one entity is entrusted with providing all services related to property management.

AVERAGED COSTS OF OFFICE BUILDING MANAGEMENT IN THE YEARS 2011-2019 (PLN/m²/month)



Following a slight increase in the costs of property management in 2018, the year 2019 brought about a new decline. Apart from standard competition on the management companies market, this could have been influenced by ever more frequently applied changes in the algorithm that calculates remuneration of managers. Previously, remuneration of a managing entity was defined as a fixed percentage rate from invoiced revenue generated by rents - excluding discounts.

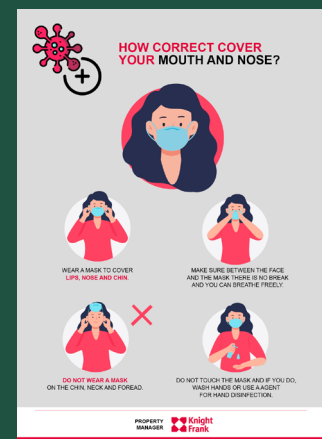
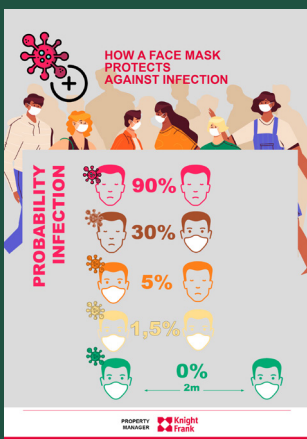
Currently, there are situations where discounts are deducted or a manager is also responsible for recovery, therefore their remuneration is calculated on the basis of actual proceeds from the lessees. Despite considerable extension of the scope of manager's duties (e.g. by recovery, marketing, etc.), the remuneration is lower. It represents less than 5% of the entire operational costs of an office building, although a lot depends on a good manager. Since the expectations of building owners towards managers continuously grow, it seems that in the forthcoming years we should expect an increase in property management rates or a considerable decline in the quality of this service. The abovementioned data showing the share of management costs concern this service as provided by external companies - mainly specialized agencies. In the case of independent management by an owner or their dedicated companies, the cost may be even twice as high.

MANAGEMENT IN THE TIMES OF PANDEMIC

The year 2020 marks a challenge for every individual and every sector. The pandemic - a situation completely new to us - has also placed new tasks before real property managers. Suddenly it turned out that the lockdown and the slowing down of life has accelerated the work of managers who quickly had to prepare the office buildings for this difficult situation. Every day new procedures emerged concerning facility users and servicing teams as well as procedures for conduct in the event of a confirmed case of COVID-19.

At first, such situations were both a shock and a new experience for the real property market, based on which a group of managers started expanding their own knowledge and creating strategies in this regard for the future. Apart from special procedures, we have also developed a special information campaign and have remained in constant and close contact with the lessees. Still, the most important element of a safe office building is communication, in order to be able to react quickly and protect building users from any hazards. Insofar

as the lockdown period itself was a certain shock for managers, then afterwards we proceeded to a little more peaceful management. Procedures have been deployed, tested and we all know what and how to organize. Some lessees returned to work in offices, some work in shifts and some have remained within the remote work scheme. Office buildings function normally, if we can talk about normalcy these days.



COVID-19 AND OPERATIONAL COSTS

It is more and more frequently heard on the commercial real property market (including office buildings) that the two-month lockdown period has caused a considerable decrease in property maintenance costs. Such are the expectations, but the reality is different. None of the office buildings has been completely closed during lockdown and what follows is that it had to be maintained in a standard manner. Service teams had to perform their work (sometimes delayed,

but still effective), sometimes even to a greater degree, as this is a case with the cleaning personnel performing additional disinfection. It is usually performed as part of a standard flat-rate fee. Only the costs of security in selected facilities may have decreased, when the security team could be shrunk, e.g. external round guards or parking lot guards.

After the lockdown some lessees returned to offices. Some of them work in shifts,

composition of some teams may be incomplete, but office buildings must operate in a way that guarantees safe access for every user.

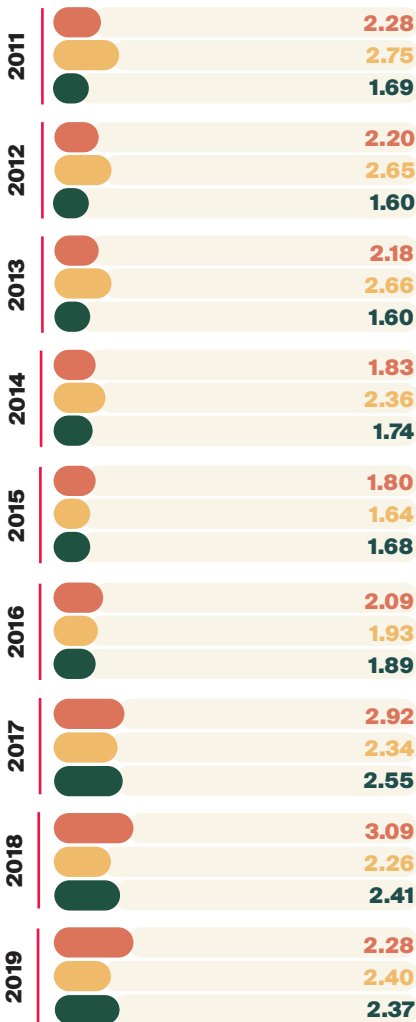
The only savings that will become evident will be the consumption of utilities. Remote work contributes to lower electricity and water consumption in offices.



SECURITY AND RECEPTION

AVERAGED COSTS OF SECURITY IN THE YEARS 2011-2019 (PLN/m²/month)

- Warsaw, Central Business District
- Warsaw, other districts
- Regions



Security services include temporary reception tasks, constant presence of physical security workers in the facility and mobile intervention patrols. Composition of the security team present in the facility depends on the size of the property and the required manner of protection that results from its functionality, structure of the real property and actual needs. It usually includes two workers in the evenings and at night. The lessees ever more frequently use the facility in non-standard hours, which also triggers the need for extending the security provision to the 24-hour working mode.

Due to the requirements concerning service quality and security of the facility, the security services are normally provided by specialized and certified companies. As regards higher-class facilities, where very demanding lessees have their headquarters, the reception desk services are provided more and more often by specialized companies employing a more qualified personnel. Receptionists meticulously care for their appearance, ensure high quality of customer services, speak foreign languages and the scope of their duties is far broader than usually. The above features are obviously reflected in a higher cost of such service.

In recent years annual changes in the minimum wage and hourly rates have result of these increases, direct costs for entities providing security services,

Such situation has persisted since 2015, while

It has encouraged the real property owners and managers to limit the number of them with various state-of-the-art technical solutions. However,

In 2019 the costs of security also grew, while the data presented for the Central difference between analysed properties. In the previous years we included only large facilities located in the centre of Warsaw in the analysis. The total cost is completely different area

The forthcoming years will most likely show similar increases in the costs of and hourly rate for the

CHANGES IN THE MINIMUM WAGE AND HOURLY RATE IN THE YEARS 2015-2020

Term	Minimum wage (gross) [PLN]	Percentage growth	Minimum hourly rate [PLN]	Inflation rate
1. 01.01.2015 – 31.12.2015	1750			-0.9%
2. 01.01.2016 – 31.12.2016 (*)	1850	5.7%		-0.6%
3. 01.01.2017 – 31.12.2017	2000	8.1%	13.0	2%
4. 01.01.2018 – 31.12.2018	2100	5.0%	13.7	1.6%
5. 01.01.2019 – 31.12.2019	2250	7.1%	14.7	2.3%
6. 01.01.2020 – 31.12.2020 (**)	2600	15.6%	17.0	
7. 01.01.2021 – 31.12.2021	2800	7.7%	18.3	
Forecast 2022-2024				
8. 01.01.2022 – 31.12.2022	3330	11.0%	21.8	
9. 01.01.2023 – 31.12.2023	3670	10.2%	24.0	
10. 01.01.2024 – 31.12.2024	4000	9.0%	26.2	

(*) – in 2016 an obligation to pay social security contributions from civil law contracts was introduced

(**) – from 01.01.2020 onwards the length-of-service allowance has not been included in the minimum wage

triggered considerable changes of security costs in office buildings. As a result, where the main component is the cost of employing workers, have grown. The highest growth was observed in 2017.

number of physical security workers as much as possible, through replacing

However, this is related to additional financial outlays.

Central Business District in Warsaw are slightly different. It results from a comparison of office buildings of a moderate size, while in 2019 we managed to incorporate costs very often the same in a large and small facility, but it is distributed over a longer period - thus the differences.

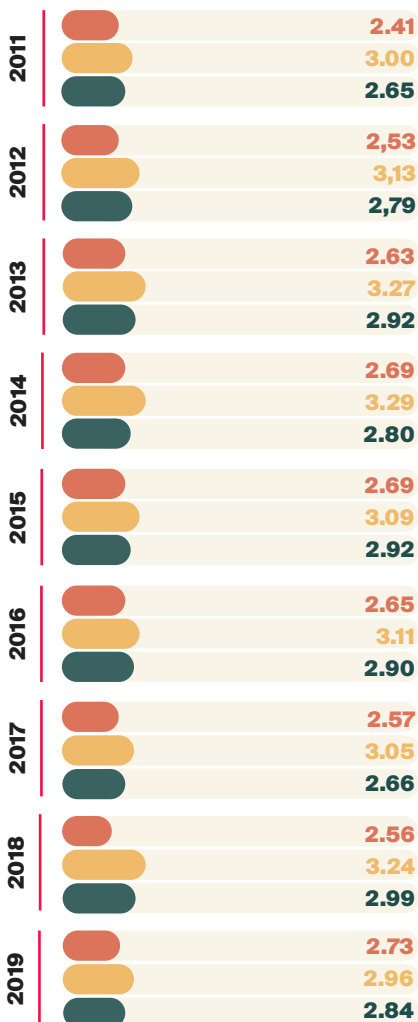
of this service, as suggested by a forecast of changes in the minimum wage for the years 2021-2024.



PROPERTY TAX

AVERAGED COSTS OF PROPERTY TAX IN THE YEARS 2011-2019 (PLN/m²/month)

- Warsaw, Central Business District
- Warsaw, other districts
- Regions



Land, buildings or their parts related to the performance of business activity as well as structures are subject to taxation. Based on the data in stock and the rates communicated by local governments, each year an owner calculates the amount of tax due and files a tax return.

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In 2019 a change in the maximum total tax rate in the majority of cities and communes took place and it now amounts to PLN 23.47 per square metre of the building area and PLN 0.93 per square metre of the land area. Among the main regional cities only Cracow did not opt for applying the maximum rate.

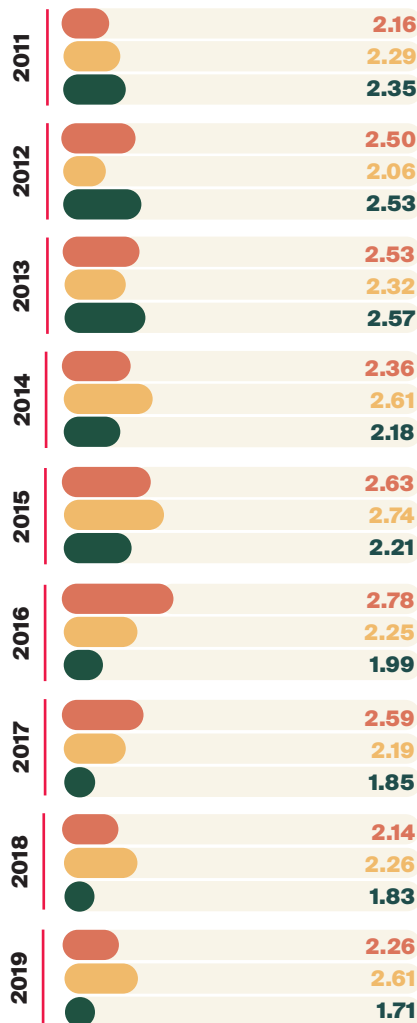
Warsaw:	23.47	0.93
Poznań:	23.47	0.93
Wrocław:	23.47	0.93
Gdynia:	23.47	0.93
Cracow:	23.10	0.91
Łódź:	23.47	0.93
Lublin:	23.47	0.93



OTHER COSTS

AVERAGED OTHER COSTS IN THE YEARS 2011-2019 (PLN/m²/month)

- Warsaw, Central Business District
- Warsaw, other districts
- Regions



This is a group of costs with the most varied components, depending on the type and specificity of a real property, technical infrastructure and general technical condition.

It includes such costs as: costs of repairs, ongoing renovations and failure removal, costs of operational materials and maintenance services for selected systems, disinfection, pest and rodent control services, controls and inspections required by law, seasonal/special work and decorations, external works related to greenery or snow removal etc.



WASTE DISPOSAL

This is a new category of costs covered by the analysis and we were encouraged to single it out mainly as a result of a considerable growth and frequently changing regulations concerning the manner of waste collection. In recent years the regulations on waste collection have changed several times. Managers of commercial real properties had to cope with continuous problems. It mainly concerned Warsaw, where the waste collection companies had problems dealing with the amount of

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In 2019 an average percentage share in the total costs is slightly higher in the group of other costs (outside the regions) that in the previous years. A clear assessment is difficult due to the need to take account of too large a number of factors (e.g. weather - draught or snowfall, incidental failures, etc.).

On the one hand, the percentage share in other costs decreases proportionately in relation to other costs that visibly grow, but on the other hand, it grows in absolute terms due to an increase in actual prices of particular services and due to the “ageing” of a real property.

collected waste. They often failed to collect waste from selected locations at all and to make the collector operate according to the schedule was impossible.

The chaos was caused by new rules and an obligation to transfer waste to communes, that in turn did not feel responsible for this despite collecting fees in the form of taxes, therefore they referred any complainants directly to waste collecting companies selected on the basis of a tender. Such state of affairs lasted until September 2020 when a new law was introduced and commercial facilities were freed from the obligation to pay fees for collecting waste in the form of taxes and transfer it to communes. Currently, managers and owners of office buildings can conclude a direct agreement with a selected collector. It will considerably streamline the organization of the sole waste collection process and will allow healthy competition on the market in terms of prices.

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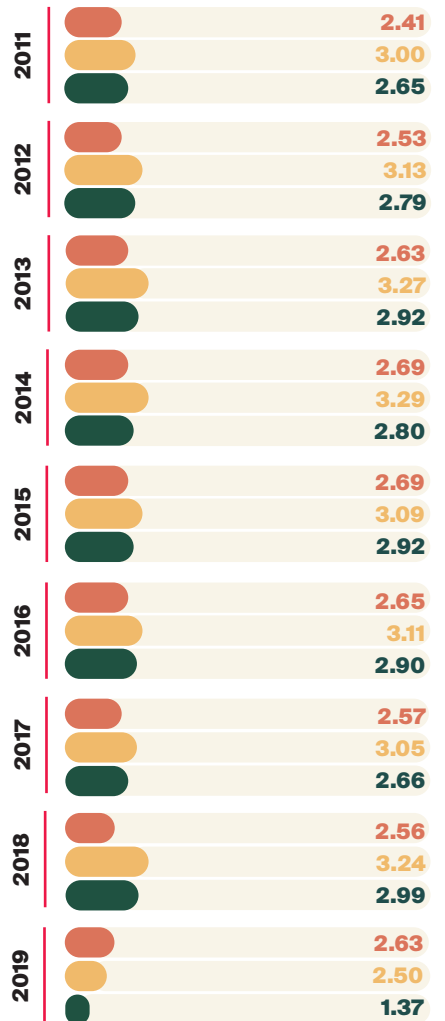
In 2019 a regulation concerning the transferring of waste to communes and making a payment in the form of a tax was still in force. The cost of waste disposal for office buildings in Warsaw and in regions amounted to PLN 0.30 per square metre and the total costs amounted to 1.40 % of all costs. However, the forecasts clearly indicate an increase of waste disposal costs in the years to come.



PERPETUAL USUFRUCT

AVERAGED COSTS OF AN ANNUAL FEE FOR PERPETUAL USUFRUCT OF LAND IN THE YEARS 2011-2019 (PLN/m²/month)

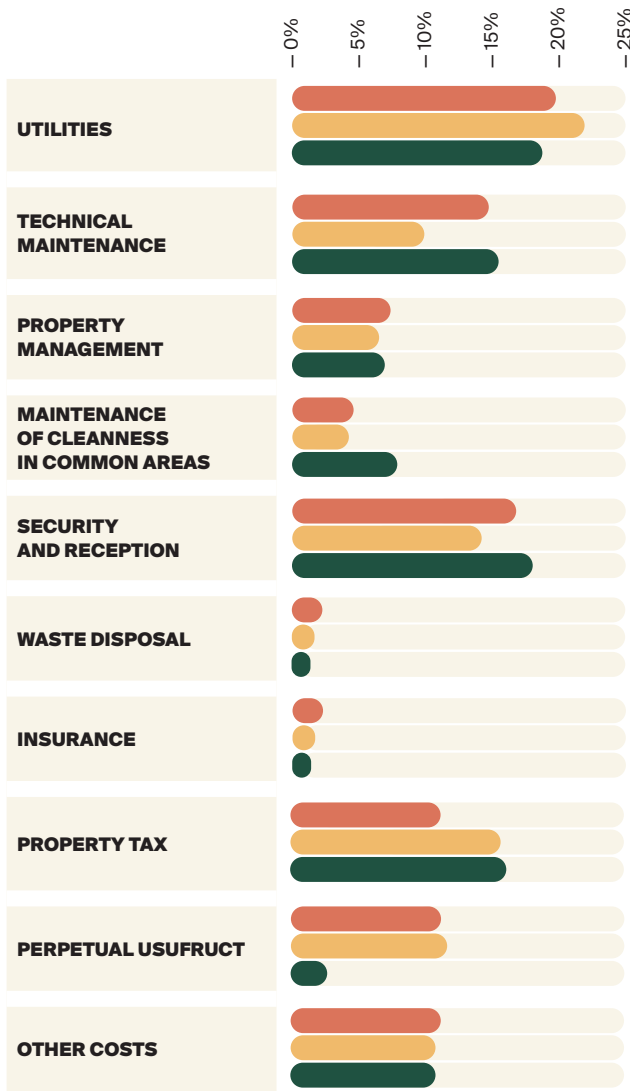
- Warsaw, Central Business District
- Warsaw, other districts
- Regions



The right to perpetual usufruct of land is a form of usufruct of land that is valid in several Central European countries - among others, in Poland. The State Treasury or a local government unit (commune, poviát, voivodeship) owns the land and determines the value of the land through valuation. A standard annual fee for commercially developed land amounts

to 3% of the value determined through valuation on an annual basis.

In regional cities most of the land is privately owned while in Warsaw the perpetual usufruct of land still dominates in the land administration structure.

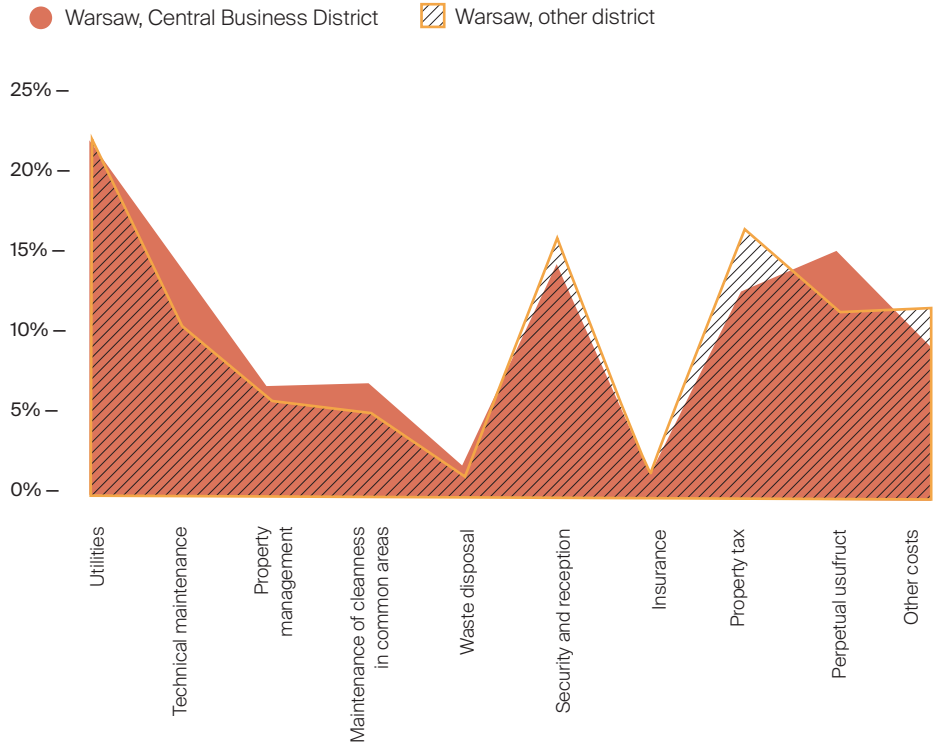


Fees for perpetual usufruct of land represent around 7.5% of all real pro for utilities and around 15% of the costs less all utilities. Perpetual usufru to the regional cities where it concerns only a small part of them. In rec transformed into developed land ownership for housing purposes, whil transformed this way in the forthcom

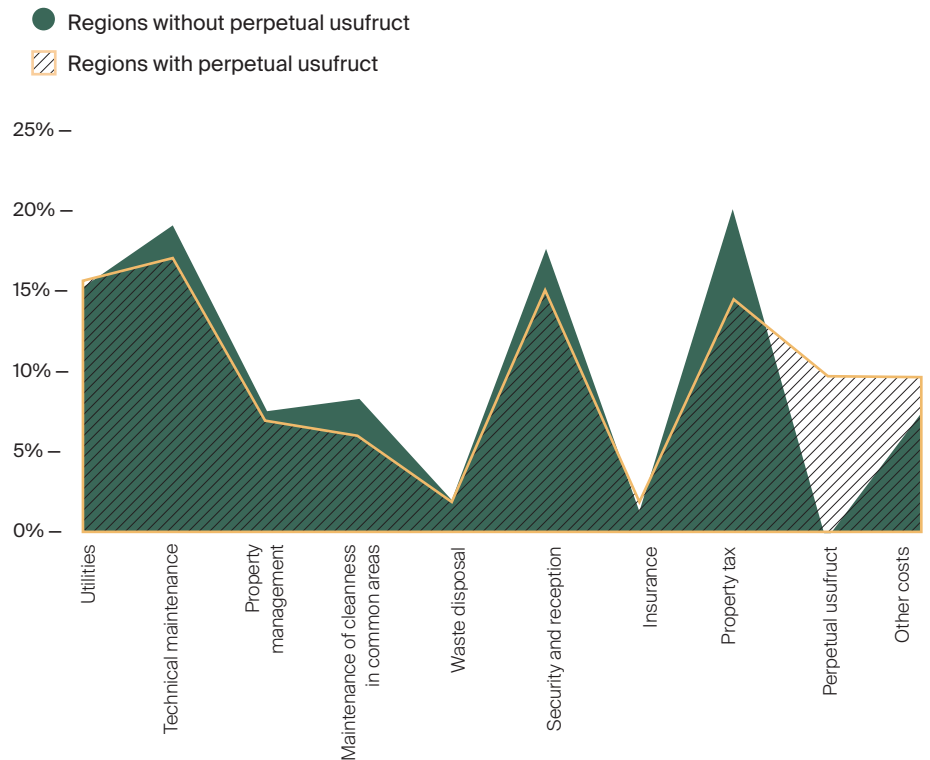


As shown in the overview, as regards real property not burdened by fees for perpetual usufruct of land, the percentage share of costs related to the real estate tax is higher. However, when comparing absolute values and taking account of the fact that the analysed real property groups have an almost identical cumulative GLA, costs of the real estate tax are very similar and the distribution of other costs is alike.

OPERATIONAL COSTS IN SELECTED BUILDINGS WITH PERPETUAL USUFRUCT IN WARSAW (CENTRAL BUSINESS AREA AND OTHER DISTRICTS) IN 2019



AVERAGED COSTS IN BUILDINGS WITH AND WITHOUT PERPETUAL USUFRUCT IN REGIONAL CITIES IN 2019



property costs, 8.42% of the costs less recharges... mainly concerns facilities in Warsaw, contrary... cent years the right for perpetual usufruct was... the commercial real property is supposed to be... ning years.

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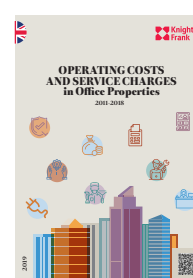
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