

PROPERTY MANAGEMENT



SERVICE CHARGES OF OFFICE BUILDINGS IN POLAND

2011 - 2013



SERVICE CHARGES OF OFFICE BUILDINGS IN POLAND IN 2011–2013

TRENDS FOR THE COMING YEARS



The analysis of service charges applicable to office buildings in Poland has been prepared and powered by 26 selected properties of class A+/A and B+/B, located in Warsaw, Kraków, Poznań, Wrocław and Gdańsk, with lettable floor areas of 3,000 – 31,000 sq m. The subject properties were constructed in the period of 1998-2013.

This study covers service charges in 2011, 2012 and 2013. All costs are presented in PLN.

SERVICE CHARGES DEFINITION

Service charges incorporate all property related costs to provide property maintenance at the required standard. The exceptions include:

- ◆ initial costs incurred during development process, including design, construction and fit outs as well as project finance;
- ◆ tenants' fit out costs which form part of the development budget;
- ◆ costs of property improvement and/or modernisation to enhance the property value (the acting property manager is obliged to constantly monitor the technical condition and economic use of the property);
- ◆ sinking fund for future modernisation and/or redevelopment;
- ◆ costs of services performed by the property manager or other service providers on behalf of the owner such as debt recovery/collection, letting fees, legal fees, office refurbishment/redevelopment;
- ◆ costs incurred in favour and by request of tenants;

A standard service charge description with a list of relevant costs forms part of a standard lease agreement and is not exhaustive.

CONSTITUENT SERVICE CHARGES

For the purposes of this report the service charge costs have been divided into the following categories:

- ◆ utilities
- ◆ facility management
- ◆ property management
- ◆ security
- ◆ cleaning of common space
- ◆ insurance
- ◆ taxes and perpetual usufruct charges
- ◆ others costs

Service charge costs in office buildings

Each cost item selected for our analysis varies depending on property location as well as technical standard of the property along with its size and construction of the lease agreement. This comparison includes properties located in the Central Business District (CBD) in Warsaw, other areas in Warsaw outside the CBD and regional cities (Kraków, Poznań, Wrocław and Gdańsk).

The relevant cost items comprised in service charges in Warsaw and regional cities in 2011-2013 are shown below.

The analysis of the data below indicate that the costs of utilities' usage make up the largest proportion of the operating costs, regardless of the location of the property.



CHART 1
Service charges - average contribution of various cost items (2013)

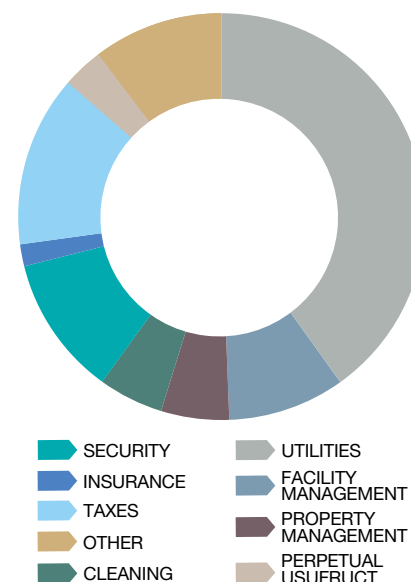
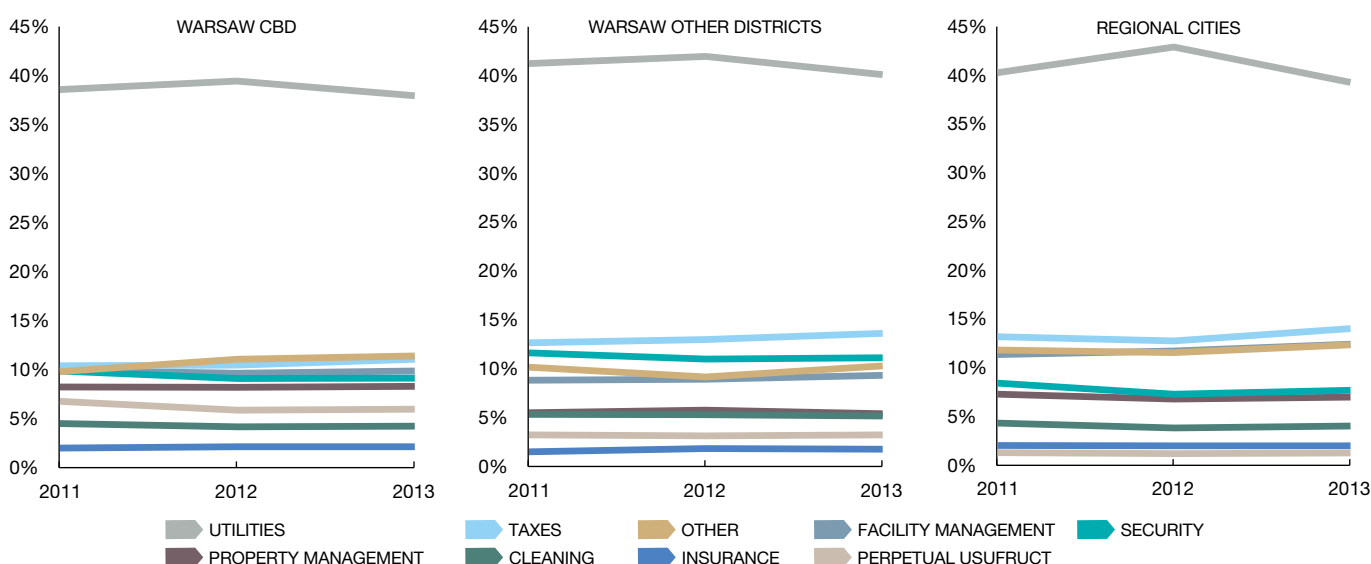


TABLE 1
Share of service charges' cost components

		Utilities	Facility management	Property management	Cleaning	Security	Insurance	Taxes	Perpetual Usufruct	Other
Warsaw CBD	2011	39%	10%	8%	5%	10%	2%	10%	7%	10%
	2012	39%	10%	8%	4%	9%	2%	10%	6%	11%
	2013	38%	10%	8%	4%	9%	2%	11%	6%	11%
Warsaw other districts	2011	41%	9%	5%	5%	12%	2%	13%	3%	10%
	2012	42%	9%	6%	5%	11%	2%	13%	3%	9%
	2013	40%	9%	5%	5%	11%	2%	14%	3%	10%
Regional cities	2011	40%	11%	7%	4%	8%	2%	13%	1%	12%
	2012	43%	12%	7%	4%	7%	2%	13%	1%	12%
	2013	39%	12%	7%	4%	8%	2%	14%	1%	12%

CHART 2
Share of service charges' cost components



Operating costs and service charges

Standard lease agreements have a provision of recovering service charge costs from the property's tenants by way of the tenant's obligation to cover such costs. In most cases the list of cost items included in the service charge is not exhaustive. The variance between the operating costs and service charges may arise owing to:

- ◆ lease agreement provisions for direct settlement of utilities' accounts by tenants, based on meter readings or proportionally to the occupied office space. Depending on the leased floor area, office space layout and its technical infrastructure, the utilities' costs could be eliminated from the service charge in part or in some cases up to 100%, reducing such costs by up to 40%.
- ◆ tenants' growing awareness of the increasing perpetual usufruct charges as a component of the service charge and potential pressure on property owners to remove this cost item from the service charge.

CHART 3
Average service charges
(PLN/sq m/month)

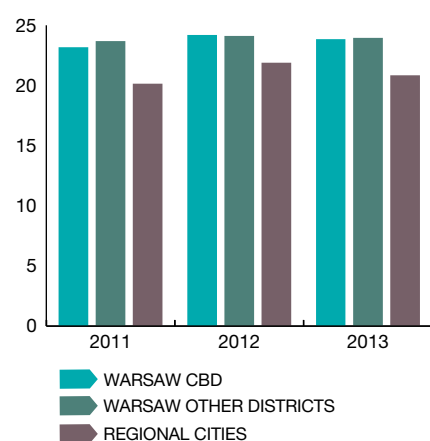


TABLE 2
Service charge levels (PLN/sq m/month)

	2011	2012	2013
Warsaw CBD	17.2-25.4	18.6-23.1	18.3-23.4
Warsaw other districts	14.9-21.6	15.6-22.7	15.8-22.7
Regional cities	12.2-20.7	13.5-21.5	12.8-21.4

It is worth noting the significant differences in service charges in respective locations and dates.

Service charges in selected locations

An important factor influencing the operating costs and service charge levels is the property's location. Chart 3 indicates a clear variance between the operating costs in Warsaw and the regional cities. The latter result primarily from the limited volume of perpetual usufruct interest held by the office property owners where only 30% of vendors hold such interest, the remainder being in freehold ownership.

Service charges according to building size

CHART 4
Average level of service charges in
correlation to the office building size
(PLN/sq m/month)

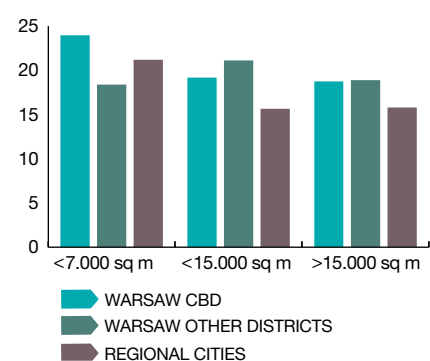


TABLE 3
Average level of service charges in correlation to the office building size
(PLN/sq m/month)

	< 7,000 sq m	< 15,000 sq m	> 15,000 sq m
Warsaw CBD	23.95	19.16	18.72
Warsaw other districts	18.37	21.12	18.89
Regional cities	21.17	15.63	15.79

The size of the property and lettable floor areas have a definite influence on the service charge levels, in particular the annual perpetual usufruct charges as well as the cost of security.

The service charges are the highest in Warsaw CBD in class A+/A buildings of up to 7,000 sq m in floor area. They require intensive maintenance and are burdened with high costs of property holding such as property taxes and perpetual usufruct

charges. For buildings above 15,000 sq m in size the differences in the service charge levels are minimal.

Analysis of service charge cost items

Utilities

TABLE 4
Average costs of utilities (PLN/sq m/month)

	2011	2012	2013
Warsaw CBD	8.93	9.54	9.05
Warsaw other districts	9.75	10.12	9.60
Regional cities	8.10	9.38	8.19

The cost of utilities comprises of the usage of electricity, heating, gas, water and sewerage. The above analysis exclude the impact of the air conditioning and humidifying systems as all the analysed buildings have such provisions.

Within the cost of utilities the electricity consumption comprises 60%-70% of the total. Since the energy market liberation in 2012 the energy suppliers can be freely selected and energy prices are negotiable. Property owners and managers of large property portfolios are currently able to use the economies of scale to achieve competitive pricing.

Facility Management

TABLE 5
Average costs of facility management (PLN/sq m/month)

	2011	2012	2013
Warsaw CBD	2.30	2.33	2.35
Warsaw other districts	2.09	2.15	2.23
Regional cities	2.29	2.56	2.59

The cost of facility management is made up of technical support (a permanent group of technical support or a mobile service), technical installations service as well as the lift service. In buildings with an integrated management system (Building Management System - BMS), a physical facility management presence is limited, allowing for a significant reduction in facility management costs.

In regional cities, the availability of qualified technical staff as well as the size of the market for such services is much smaller, therefore increasing the contracting prices of facility management.

CHART 5
Average costs of utilities (PLN/sq m/month)

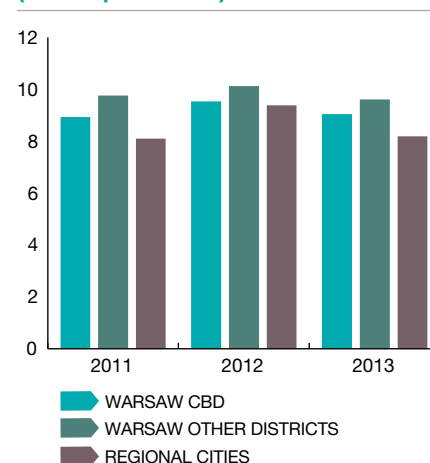
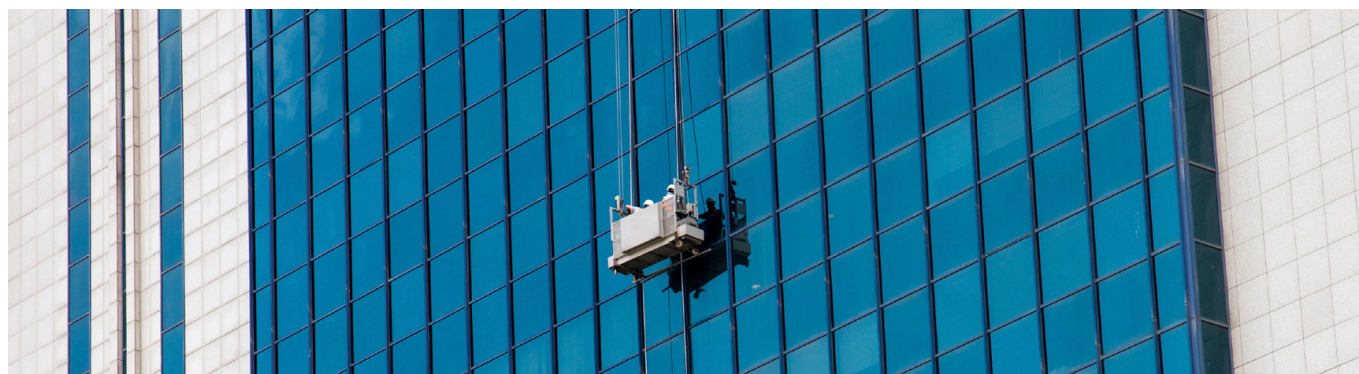
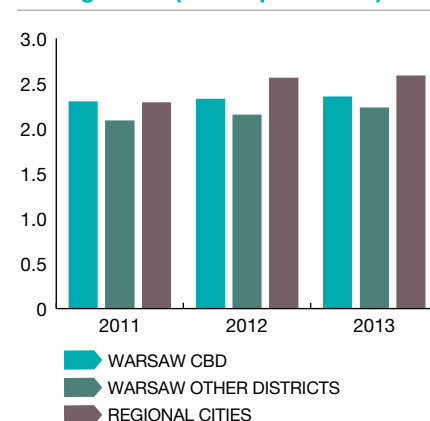


CHART 6
Average costs of facility management (PLN/sq m/month)



Property Management

The scope of property management services in Poland vary widely in comparison to other countries. It includes lease agreements' management, tendering for property services, accounting/bookkeeping, debt recovery, budgeting, reporting, service charge optimisation, landlord representation before public authorities, service providers and tenants, technical monitoring and refurbishment planning. Depending on the landlord, the property management can also include other services including tenders for property modernisation or redevelopment as well as arranging property insurance.

CHART 7

Average costs of property management of office buildings (PLN/sq m/month)

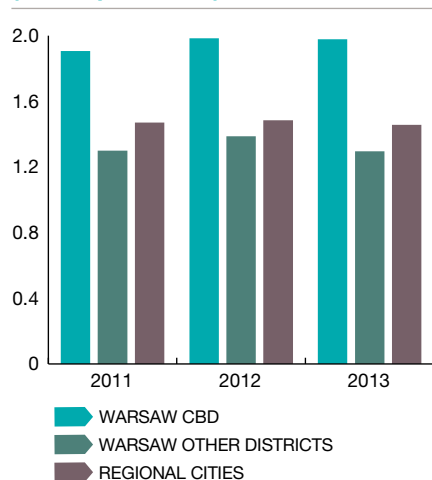


TABLE 6

Average costs of property management of office buildings (PLN/sq m/month)

	2011	2012	2013
Warsaw CBD	1.91	1.98	1.98
Warsaw other districts	1.30	1.39	1.30
Regional cities	1.47	1.48	1.46

The property management services exclude statutory company accounting or facility management, which are contracted separately.

In accordance with Polish legislation and contracts for property services, the responsibility of a Polish property manager is a derivative of his scope of work. By comparison the range of property management services provided in the UK is usually limited to rent collection under the FRI fully repairing and insuring lease contracts. In Germany the property management services are mostly limited to general administration.

Higher cost of the property management services calculated per 1 sq m of the property rentable area in the Warsaw's CBD results from higher rents, to which this cost is directly related.

Cleaning of Common Space

CHART 8

Average cost of cleaning common areas of office buildings (PLN/sq m/month)

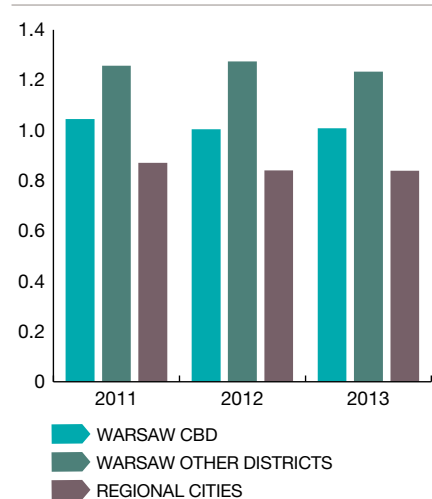


TABLE 7

Average cost of cleaning common areas of office buildings (PLN/sq m/month)

	2011	2012	2013
Warsaw CBD	1.05	1.00	1.01
Warsaw other districts	1.26	1.27	1.23
Regional cities	0.87	0.84	0.84

The cost of cleaning common spaces relates to the provision of cleaning services in all common areas of the property (car parks or external areas) and products essential to carry this out, along with refilling hygiene products in bathrooms and common kitchen areas.

The cost of cleaning of 1 sq m of common area of the property generally depends on the structure of the building and the design of letting space - the smaller the premises, the higher the expense.

In modern office buildings the common spaces (not including the car park area) make up some 3%-7% of the total floor area of the building, which has a substantial influence on the cost of cleaning. For properties located outside the city centres, the property size, external parking areas and other areas adjacent to the property (a common road) have a significant influence on the costs of cleaning.

Security

TABLE 8
Average costs of security in office buildings (PLN/sq m/month)

	2011	2012	2013
Warsaw CBD	2.28	2.20	2.18
Warsaw other districts	2.75	2.65	2.66
Regional cities	1.69	1.60	1.60

The cost of security includes reception staff, active during normal office working hours, as well as security of the entire premises. The number of employed security guards depends not only on the size of the property but also on its architectural design. The current requirement is a minimum of 2 security guards working 24/7. Their additional tasks (apart from physical security) include overseeing the functionality of the building's systems and reporting to the facility manager as well as the property manager as required under the BMS system.

Class A/A+ offices require security and reception staff with higher than average qualifications, which may increase the hourly cost by up to 15%. Properties located outside of the city centres usually have external car parks, requiring additional surveillance, which increase the total costs of security.

Insurance

TABLE 9
Average costs of insuring office buildings (PLN/sq m/month)

	2011	2012	2013
Warsaw CBD	0.46	0.51	0.51
Warsaw other districts	0.36	0.44	0.42
Regional cities	0.41	0.44	0.42

The insurance costs cover a full range of property insurance policies as well as civil liability insurance. It is also common practice to insure the property for business interruption and terrorism.

The cost of insurance is largely dependent on the size of the property portfolio and the possibility of negotiating insurance policy rates.

An important element of optimising the cost of property insurance is setting out the excess level for each policy.



CHART 9
Average costs of security in office buildings (PLN/sq m/month)

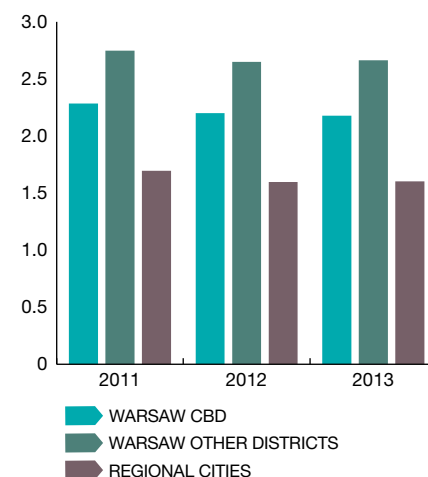


CHART 10
Average costs of insuring an office buildings (PLN/sq m/month)

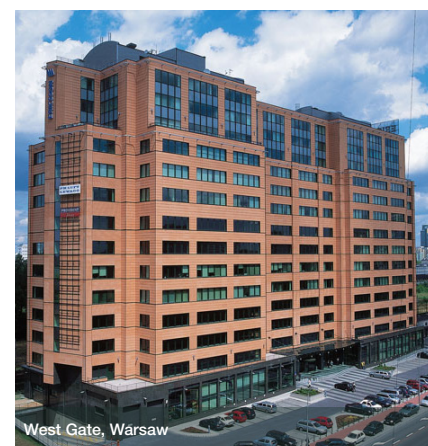
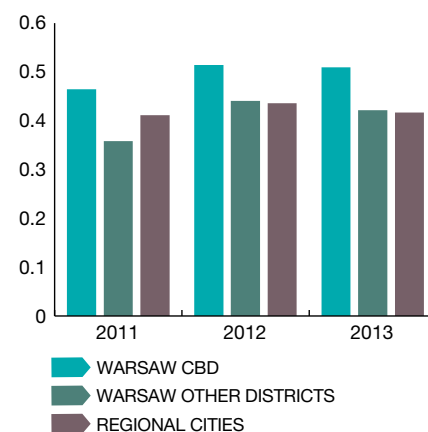


CHART 11

Property taxation rates for offices (rates per sq m of the land area/ PLN/year)

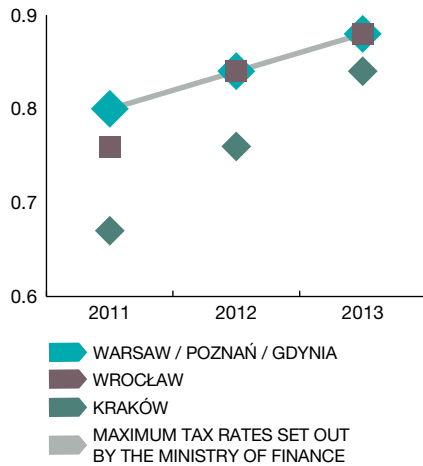
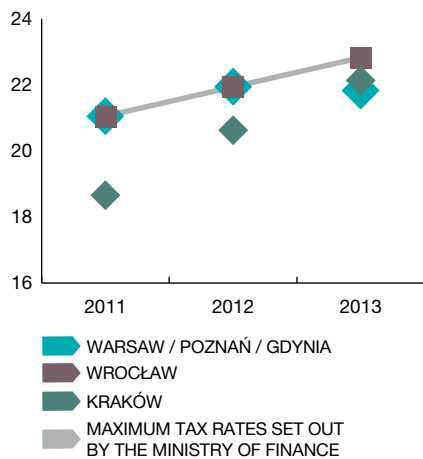


CHART 12

Property taxation rates for offices (rates per sq m of buildings or their parts/PLN/year)



Taxes and Perpetual usufruct charges

This cost item consists of property taxes as well as annual perpetual usufruct charges. Each cost item has to be looked at separately as perpetual usufruct cost does not apply to properties in freehold ownership.

Property tax

Property taxation relates to plots of land, buildings, structures and building sites or their parts used for business purposes. The property tax is calculated based on rates per sq m of land and a total floor area of the building (depending on the type of business activity).

In the case of building sites, the tax rate equates to 2% of their book value. The property taxes are collected locally by municipalities. The Ministry of Finance sets out the maximum property tax rate and annual charges to be adopted by the local authorities. Most of the local authorities (over 90%) set the highest rates or as close as possible to the maximum allowed.

The property tax levels show an increasing trend. The exception is Kraków, where over the last 3 years the tax rates have slightly decreased from the maximum rate set by the Ministry of Finance.

TABLE 10

Property taxation rates for offices (PLN/sq m/month)

	2011	2012	2013
Warsaw / Poznań / Gdynia			
Tax rates for land per sq m	0.80	0.84	0.88
Tax rates for building and structures per sq m	21.05	21.94	21.82
Wrocław			
Tax rates for land per sq m	0.76	0.84	0.88
Tax rates for buildings and structures per sq m	21.04	21.92	22.82
Kraków			
Tax rates for land per sq m	0.67	0.76	0.84
Taxes for buildings and structures per sq m	18.65	20.62	22.13
Maximum tax rates set out by the Ministry of Finance			
Tax rates for land per sq m	0.80	0.84	0.88
Tax rates for buildings and structures per sq m	21.05	21.94	22.82

Higher property taxes outside the central locations are the result of larger sites, location, the layout of the plot of land including external car parks, pavements, ramps, lights, electrical sub-stations etc.

TABLE 11

Average rates of property tax for offices (PLN/sq m/month)

	2011	2012	2013
Warsaw CBD	2.41	2.53	2.63
Warsaw other districts	3.00	3.13	3.27
Regional cities	2.65	2.79	2.92

Charges for perpetual usufruct of land

The law of perpetual usufruct of land in Poland is based on the premise of a long land lease where the landowner is either the State Treasury or a local municipality or city authority. The long leaseholder of the land (perpetual usufruct) has the right to use the land in a similar way to the property owner for a fixed term of 40-99 years. The perpetual usufruct is usually applicable in urban areas.

The annual perpetual usufruct charges are paid by 31st March in advance and equate to 3% of the market value of the land used for commercial purposes and 1% of land used for other purposes.

TABLE 12

Average annual charge of perpetual usufruct of land (PLN/sq m/month)

	2011	2012	2013
Warsaw CBD	2.22	2.22	2.22
Warsaw other districts	1.36	1.33	1.36
Regional cities	1.19	1.19	1.19

The market value of the land can be updated once every three years should the value of the land increase. In the last few years there have been an increased number of appeals by the perpetual usufruct holders owing to raised charges upon land revaluations.

The annual charge of the perpetual usufruct of land is added to the operating costs of the property, excluding the initial instalment.

It is common practice in the Polish property market to add the annual perpetual usufruct charges to the operating costs covered by tenants via the service charges.

Other costs

TABLE 13

Other costs (PLN/sq m/month)

	2011	2012	2013
Warsaw CBD	2.27	2.68	2.72
Warsaw other districts	2.40	2.21	2.47
Regional cities	2.38	2.53	2.58

This item covers a broad range of costs for each property, for example repairs and refurbishments, supplies, servicing of different systems, monitoring of technical services, building check-ups (annual and every 5 years), doormat rental, DDD, reception and/or seasonal decorations, snow removal etc. These costs vary so it is

CHART 13

Average rates of property tax for offices (PLN/sq m/month)

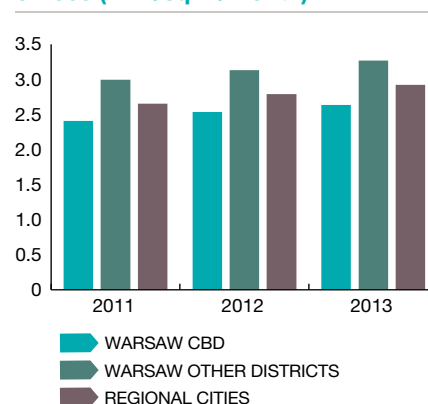


CHART 14

Average annual charge of perpetual usufruct of land (PLN/sq m/month)

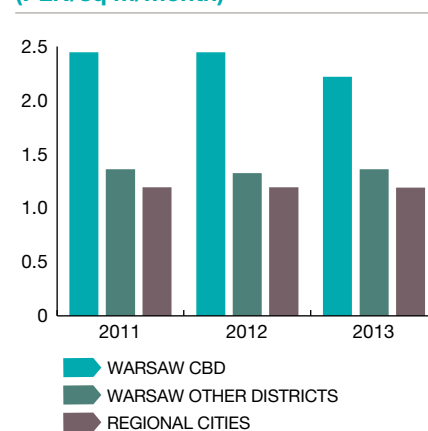
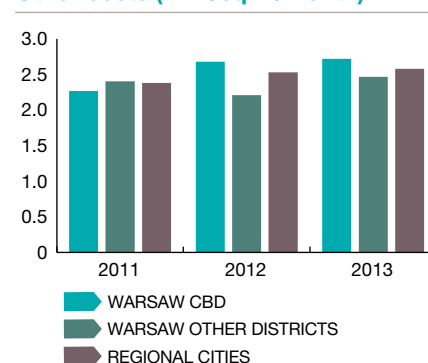


CHART 15

Other costs (PLN/sq m/month)





possible that some larger repairs or 5-year check-ups are evenly spread over a few years, however such arrangement is only possible if specified in the lease agreement.

Trends

It is expected that the level of some operating costs of properties is likely to show a falling trend whereas other costs may increase.

Utilities

The freeing up of the energy market enabled the property managers to buy energy from all suppliers on the market, achieving substantial savings. The negotiated prices for a portfolio of properties under Knight Frank management were significantly lower in 2013 than in previous years.

In the case of other utilities such as heating, water supply and sewerage, similar changes are expected in the next few years.

Property Management

In the last 3 years there has been a noticeable reduction in the property management fees in the office market with falls by up to 20% due to increasing competition and deregulation of the property management services. However, it is envisaged that in the next few years the cost of property management services should stabilise.

Cleaning and security

The cost of cleaning common space and security is largely regulated by the human factor. The planned increase in a minimum wage in 2015 as well as the expectations of fluctuation of workers of these services may trigger a significant increase in the cost contribution of these services to the service charge levels. There is a noticeable trend of limiting employment of security staff in place of computerised security systems.

It is highly likely that buildings constructed prior to 2000, but equipped with the BMS system will be able to limit their number of physical security staff.

The changes could lead to the increase in autonomy and informing technical services directly, should any issues arise, as well as creating 24-hour mobile intervention staff. This would allow a limitation in costs for physical staff out of office hours.



Charges of perpetual usufruct of land

It can be expected that the State Treasury and local authorities would make more frequent use of their right to revalue the land and increase the perpetual usufruct charges. On the other hand, tenants are more aware of the issue and may question the reasoning behind the allocation of such charges into the service charge. This could possibly lead to pressure to remove the annual charges from service charges covered by tenants under the terms of their lease agreements.

Service charges and green building certificates

An increasing number of new office buildings are delivered to the market with a green building certificate namely BREEAM or LEED. These buildings are equipped with rain water systems, energy efficient appliances, optimal heat and sound insulation amongst other solutions. Such provisions allow for a decrease in the costs of utilities and the service charge levels. A thorough analysis of the impact of green solutions on the levels of service charge in office buildings will be available in the next few years.

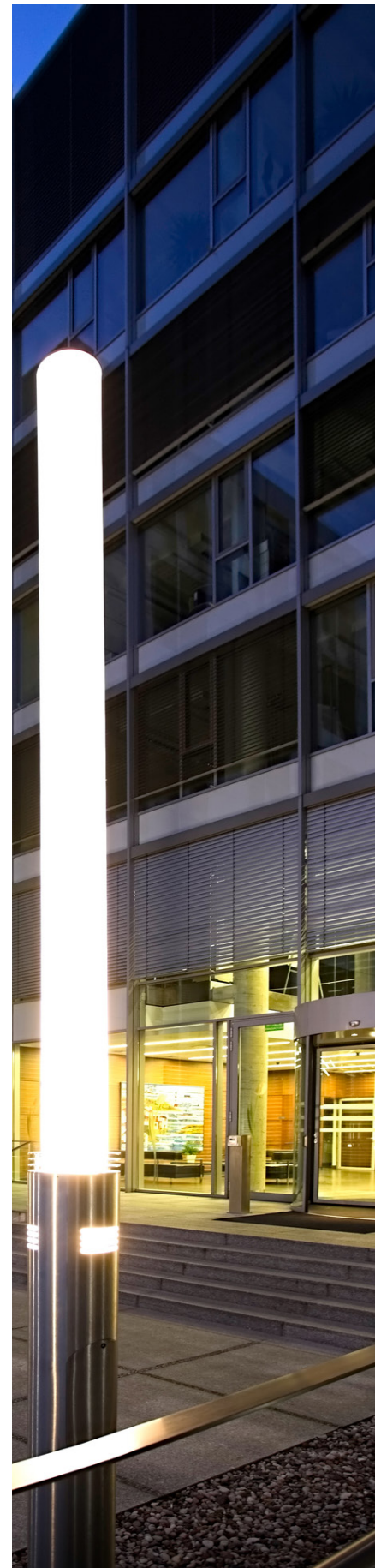
Service charges upon engaging a property manager at the design stage of office development

The involvement of a professional property manager at the design stage of an office development allows the elimination of non-functional and high cost generating solutions. It is gradually becoming noticeable that the engagement of a property manager at the design stage often results in the most optimal solutions and generate substantial cost savings during the buildings' occupation.

Forecast

The analysis of service charges of office buildings indicates price increases in the selected cost items and price reductions in others. This may translate into a slow rise in the average service charge levels, assuming that the price rises of some cost items will be largely mitigated by the reduction in other costs.

Services such as facility management, security or cleaning of common spaces, provided by external companies, have a guaranteed contractual price rises in line with inflation. However, the market is forcing a resignation of the right to indexation hence the average cost of these services should not increase significantly.





Property Management Services

Our Property Managers formulate the property management strategies based on the landlords' requirements. Such strategies are geared towards maximising the property value and investment returns. The property management process comprises a range of operational management tasks incorporating as follows:

- ◆ Building and plant maintenance
- ◆ Energy maintenance
- ◆ Insurance management
- ◆ Fire and health safety
- ◆ Environmental control
- ◆ Rent collection
- ◆ Operating costs budgeting
- ◆ Service charge management
- ◆ Rent/service charge accounting
- ◆ Tenant liaison

We utilise comprehensive software solutions (TrackRecord, Novo Property Management, help desk tool) to produce accurate and transparent reporting formats for clients. Each property is maintained in the "ready to sell" condition.

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Kontakty w Polsce:

+48 22 596 50 50
www.KnightFrank.com.pl

RESEARCH

Elżbieta Czerpak
elzbieta.czerpak@pl.knightfrank.com

ASSET MANAGEMENT

Monika A. Dębska - Pastakia
monika.debska@pl.knightfrank.com

ASSET MANAGEMENT - OFFICES AND LOGISTICS

Bartłomiej Łepkowski
bartlomiej.lepkowski@pl.knightfrank.com

ASSET MANAGEMENT - RETAIL

Agnieszka Mielcarz
agnieszka.mielcarz@pl.knightfrank.com

CAPITAL MARKETS

Jakub Jonkisz
jakub.jonkisz@pl.knightfrank.com

COMMERCIAL AGENCY - LANDLORD REPRESENTATION

Izabela Potrykus-Czachowicz
izabela.potrykus@pl.knightfrank.com

COMMERCIAL AGENCY - TENANT REPRESENTATION

Marek Ciunowicz
marek.ciunowicz@pl.knightfrank.com

COMMERCIAL AGENCY - RETAIL

Paweł Materny
pawel.materny@pl.knightfrank.com

PROPERTY MANAGEMENT

Magdalena Oksańska
magdalena.oksanska@pl.knightfrank.com

VALUATIONS

Grzegorz Chmielak
grzegorz.chmielak@pl.knightfrank.com

Kontakt w Londynie:

INTERNATIONAL RESEARCH

Matthew Colbourne
matthew.colbourne@knightfrank.com

