THE REAL ESTATE M&A AND PRIVATE EQUITY REVIEW

FOURTH EDITION

Editors
Adam Emmerich and Robin Panovka

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PREFACE

Publicly traded real estate companies and real estate investment trusts (REITs), with help from real estate private equity, have transformed the global real estate markets over the past 25 years. Their principal innovation, and secret sauce, is 'liquid' real estate. Unlike traditional property ownership, equity in publicly traded real estate vehicles is highly liquid, and can be bought and sold in large volumes, literally in minutes, on numerous global exchanges.

Publicly traded real estate vehicles have an aggregate market capitalisation of approximately US$1.7 trillion globally, including over US$1 trillion in the United States and approximately US$200 billion in each of Europe and Asia. As public REITs and other vehicles have aggregated these properties and grown in scale and sophistication, so too have real estate-focused private equity funds, playing an important role catalysing hundreds of billions of dollars of REIT and real estate M&A transactions and IPOs.

However, despite the massive growth, the potential growth is far larger both in long-standing REIT markets and in newer REIT jurisdictions, where the trend is more nascent. With increasing development and urbanisation, the world is producing more and more institutional-grade properties, and a growing percentage of this expanding pool – an estimated US$5 trillion and counting, so far – will inevitably seek the advantages of liquidity by migrating to the publicly traded markets. The growth is expected to be both local and cross-border, with approximately 40 countries already boasting REIT regimes.

REITs and other publicly traded vehicles for liquid real estate have grown because they are often a superior vehicle for stabilised assets. Greater liquidity and transparency – and often superior governance – are attractive to investors, resulting in a lower cost of capital and superior access to vast amounts and varieties of capital in the public markets. In addition to cheaper capital, REITs and other public vehicles benefit from efficiencies of scale, sophisticated management and efficient deal structures, to name just a few advantages. With these advantages, the global march of real estate to the public markets seems unstoppable.

This publication is a multinational guide for understanding and navigating the increasingly complex and dynamic world of liquid real estate and the transactions that mostly produce it. The sea change in the markets, sometimes called the 'REIT Revolution', has meant that major real estate transactions have migrated from 'Main Street' to 'Wall Street'. They now often take the form of mergers, acquisitions, takeovers, spin-offs and other corporate transactions conducted in the public markets for both equity and debt. They have grown exponentially in complexity and sophistication, and increasingly represent cross-border multinational transactions fuelled by the now global real estate capital markets and M&A deal professionals. And they are often intermediated by international investment banks rather than local brokers, and financed with unsecured bonds or commercial mortgage-backed securities. In a fair number of cases they are catalysed by private equity firms or similar actors, sometimes building portfolios to be taken public or sold to public real estate companies, and sometimes through buyouts of public real estate companies for repositioning or sale.

To create this publication, we have invited leading practitioners from around the globe to offer practical insights into what is going on around the conference tables and in the markets in their jurisdiction, with an eye to cross-border trends and transactions. As will quickly become evident, the process of liquefying real estate and the transactions involving public real estate companies require a melding of the legal principles, deal structures, cultures and financial models of traditional real estate, public company M&A and private equity. None of this, of course, happens in a vacuum, and transactions often require expertise in tax, corporate and real estate law, not to mention securities laws and global capital markets. Each of our distinguished authors touches on these disciplines.

We hope this compilation of insight from our remarkable multinational authors produces clarity and transparency into this exciting world of 'liquid real estate' and helps to further fuel the growth of the sector.

Adam Emmerich and Robin Panovka
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Chapter 17

POLAND

Izabela Zielińska-Barłożek, Łukasz Szegda, Michał Nowacki, Michał Wons, Maciej Szewczyk, Radosław Wasiak and Marcin Pietkiewicz[1]

I OVERVIEW OF THE MARKET

The Polish real estate market continues to grow and, after several years of impressive and steady increase in the value of transactions, has maintained its reputation as the most important real estate market in Central and Eastern Europe (CEE). Moreover, it has been reported that 2018 was a record year in terms of investments for the real estate market in Poland. In 2018, the total volume of investment transactions reached a record level of €7.2 billion compared to €5.1 billion a year earlier. This amount comprised more than 100 transactions covering a total of 200 properties, which also represents an increase compared to 2017.[2] Thus, Poland maintained its leading position among the six CEE countries, this time with a market value record high of 50 per cent (compared to 19 per cent generated by the Czech Republic and 14 per cent by Hungary).[3] That increase was noticeable in all segments of the real estate market. There was an overall improvement in Poland's economic situation (GDP growth by 5.1 per cent, increase in private consumption by 4.5 per cent and in public investments by 10 per cent, as well as a very low unemployment rate of 5.8 per cent).

Although initial market analyses conducted in 2019 show a 27 per cent drop in the value of transactions compared to the average value of Q1 transactions in 2016–2018, we are quite optimistic as to the market's future. This applies in particular to Warsaw, where the demand for office space is the highest countrywide and continues to grow, and also to the steadily growing real estate markets in regional cities such as Wroclaw, Crakow, Poznan, Gdansk and Lublin. Foreign private equity and institutional investors dominate the Polish real estate M&A market. International investment platforms, strong funds investing social security premiums from Germany or the United Kingdom, as well as US-based private equity funds are, for the time being, too strong competitors for Polish private equity investors, whose activities remain marginal given the size of the Polish market. The lack of legal regulations allowing the creation of REITs does not encourage Polish investors. So far, 70 per cent of the capital invested on the Polish market has come from US, South African, German and UK investors. Investors located in South East Asia (including Singapore, Malaysia and the Philippines) have also become more active in the Polish market.[4]

Another significant feature of the Polish real estate M&A market is its growing maturity. In transactions, there is an upward trend of 'earn-out' structures, where the parties share

1 Izabela Zielińska-Barłożek, Łukasz Szegda, Michał Nowacki and Michał Wons are partners, and Maciej Szewczyk, Radosław Wasiak and Marcin Pietkiewicz are senior associates at Wardyński & Partners.
2 http://europaproperty.com/news/2019/01/all-time-record-real-estate-investments-in-poland-5479.
3 https://www2.colliers.com/en-PL/Research/Raport-Roczny-Market-Insights-2019.
4 ibid.

the risk and link the final price of a company to enterprise income at the time of closing.[5] Similarly, a fall can be seen in the liability level of sellers for a breach of representations and warranties, which is caused, inter alia, by market security and predictability as well as due to the fact that most of the transactions between investment funds is subject to W&I insurance and/or title insurance.

To sum up, Poland is the first choice for private equity funds interested in investing in CEE.[6] The country's major assets include not only a highly absorbent domestic market and a fast pace of economic growth, but also a mature real estate market.

Nevertheless, in the near future the real estate market in Poland may face threats that result from an interest rate increase expected in 2019 (limiting the availability of loans), as well as new legal regulations that may affect individual market segments. An example of such regulations is the gradually introduced ban on Sunday trading that has already affected the profitability of investments in commercial real estate and that will be extended in 2020 to include all Sundays. Moreover, we can expect in the near future major investments of the State Treasury in the housing sector, as the government is getting ready to launch a subsidised affordable-housing program. Involvement of public funds may constitute competition for developers and entities investing in residential real estate for rent. On the other hand, new regulations, friendly to private developers investing on the housing market, have also been passed. These regulations introduce a number of exemptions from the general regulations on housing investments and, consequently, should fasten the process of collecting various permits and reclassifying land to allow housing developments thereon. Further, current restrictive regulations on trading farmland are to be liberalised, allowing acquisition of up to one hectare of farmland and of shares in companies holding up to five hectares of farmland without permission of the public authorities or without the involvement of pre-emption rights. Also, amendments to the Construction Law as well as a regulation on local zoning are expected in the near future. The aim of these changes is to facilitate the process of obtaining investment permits, limit the number of requirements that investors must meet, and open new lands to property investments.

II RECENT MARKET ACTIVITY

Poland still lacks relevant legal regulations allowing entities in the form of REITs to operate on the market. Although some initiatives have been taken, the legislative process is still frozen and there are no signs of change.

The year 2018 abounded in numerous real estate transactions in all its segments. The most active investors were Griffin Real Estate, Mapletree, Globalworth, EPP, Revetas/Goldman Sachs, Blackstone, Atrium European RE, Employees Provident Fund, European Logistic Investment BV, Madison International, NIAM, ISOC, Generali and GLL Real Estate Partners.

5 CMS European M&A Study 2016: www.cms-cmck.com/CMS-European-MA-Study-2016.

6 Private Equity in Poland – Facts and Opinions, report by KPMG: assets.kpmg.com/content/dam/kpmg/pdf/2016/06/pl-raport-kpmg-rynek-private-equity-w--polsce-2016.pdf.

The largest deal on the retail market, finalised in 2018, was the acquisition by Chariot Top Group BV, managed by Griffin Real Estate, of a portfolio of 28 properties consisting of 9 'M1' branded shopping centres, four amusement parks, 12 supermarkets and three construction DIY markets. The transaction value amounted to €1 billion.[7]

Another major transaction finalised on the retail market in 2018 was the acquisition of a complex of three department stores (Wars, Sawa and Junior) located in Warsaw city centre. The transaction was concluded between Atrium European Real Estate (the buyer) and PFCEE – a fund managed by CBRE Global Investors. The value of this transaction was €300 million.[8]

In the office-space market segment, Revetes and funds managed by Goldman Sachs Asset Management acquired from TPG Real Estate the entire Tri Grant portfolio, i.e. a total of approximately 173,000 square metres of office space. This transaction included the sale of Bonarka Business Park in Cracow and Silesia Tower I in Katowice, as well as projects under construction such as the B4B H in Cracow. The estimated value of the transaction amounted to €450 million.[9]

In addition to the above, other significant transactions involving office space were concluded with respect to properties located in Warsaw. Madison International Real Estate Liquidity Fund VI LP acquired from Ghelamco a 50 per cent share in Warsaw Spire A (an office tower 220 metres tall) for approximately €175 million.[10] A similar transaction has already taken place in 2017 when the other 50 per cent share in the Warsaw Spire A tower with an area of 64,500 square metres was sold. Both transactions confirmed the estimated value of this investment at €350 million.

The sale of two office buildings in Gdański Bussiness Center in Warsaw (53,000 square metres) was finalised between HB Revis and Savills Investment Management (acting on behalf of a global pension fund) at over €200 million.[11] CPI Property acquired from Peakside Capital the Atrium Centrum and Atrium Plaza office buildings, holding approximately 32,000 square metres of office space.[12]

Globalworth Poland was very active on the market. It bought Warta Tower for €55 million from Kulczyk Real Estate Holding[13] and purchased Spektrum Tower from Europa Capital (approximately 29,500 square metres of office space), also located in Warsaw.[14] Globalworth Poland was also active outside Warsaw. It bought a complex of five office buildings located in Quattro Business Park in Cracow from Starwood Capital Group for €139 million.

7 http://www.propertynews.pl/centra-handlowe/miliardowa-transakcja-griffina-znalazla-swoj-final,60530.html.

8 https://retailnet.pl/2018/10/24/141434-wars-sawa-junior-w-rekach-atrium-transakcja-przejecia-sfinalizowana/.

9 http://eurobuildcee.com/?page=news&id=33995.

10 https://www.jll.pl/en/newsroom/madison-international-realty-partners-with-ghelamco-to-acquire-50-stake-in-iconic-warsaw-spire-tower.

11 https://hbreavis.com/pl/aktualnosci/hb-reavis-sprzedaje-gdanski-business-center-ii-za-ponad-200-milionow-euro/.

12 http://europaproperty.com/news/2018/06/cpi-property-group-acquires-atrium-centrum-and-atrium-plaza-office-buildings-in-warsaw-4841.

13 http://www.propertynews.pl/biura/griffin-kupil-biurowiec-kulczyka,62398.html.

14 http://www.propertynews.pl/biura/gigant-stal-sie-jeszcze-wiekszy-globalworth-kupil-spektrum-tower,65575.html.

As to the warehouse segment of the real estate market, it should be noted that the largest single transaction on that segment took place in 2018. European Logistic Investment BV managed by Griffin Real Estate acquired a portfolio of nine logistics parks (including locations in Warsaw, Lodz and Cracow), constructed by Panattoni Europe. The entire gross lease area of these centres amounts to 300,000 square metres. The estimated value of the transaction is €200 million.[15]

When talking about logistics parks, besides the aforementioned purchase transaction, we should bring up significant lease transactions concluded in 2018, among them leases of BTS projects for Amazon (167,000 square metres in three differed locations), Leroy Merlin (124,000 square metres near Lodz) and Zalando (121,000 square metres in Olsztynek).[16]

The new trend can also be observed on the residential real estate market, which so far has been concentrated on selling apartments to individuals. Starting with 2018, there has been a number of portfolio transactions also in this segment. For example, the largest transaction on the residential market, finalised already in 2019, was the one-off sale of an entire development of 175 apartments to a financial investor.[17]

III REAL ESTATE COMPANIES AND FIRMS

i Publicly traded REITs and REOCs – structure and role in the market

Unfortunately, despite market expectations in 2018, regulations governing REITs were still not adopted.

Work is under way on new regulations in this area. However, in relation to original assumptions, the concept of classic REITs benefitting from tax preferences is to be significantly curtailed. REITs are to be replaced by companies that invest in rentals of real estate (FINN). Such entities are to take the form of joint-stock companies whose sole business will be to invest in residential properties for rent. Both FINNs and their subsidiaries and shareholders are to benefit from tax allowances on revenues to be generated by these investments. The final shape of the new regulations is not yet known. However, this is certainly not what investors were expecting as there is no rationale for limiting the use of such investment vehicles only to the residential sector. Moreover, we do not expect that even these limited but long-awaited regulations will be adopted in the near future.

ii Real estate PE firms – footprint and structure

The Polish real estate investment fund market is diffuse, and different-sized players can be found. At the top level are companies such as Griffin Real Estate, managing funds with investments in all major Polish cities, including shopping centres, offices and a student hostel chain (Student Depot) in its portfolio, as well as undeveloped properties treated as a 'land bank'. At the other end of the scale are small investors, often individuals, who join forces through special purpose vehicles (SPVs) to acquire undeveloped property and sell it after its

15 http://www.thecity.com.pl/Magazyny/Wiadomosci/European-Logistic-Investment-BV-nabylo-9-nieruchomosci-magazynowych.

16 *The Polish Real Estate Guide 2019 Edition Poland* – EY.

17 https://www2.deloitte.com/pl/pl/pages/press-releases/articles/deloitte-przeprowadzil-najwieksza-transakcje-pakietowa-na-rynku-mieszkan-na-wynajem-solec.html.

development (or redevelopment) and when the space is fully leased. It is worth noting that companies such as Griffin, apart from investing their own resources, also frequently provide management services for assets of global investment funds.

IV TRANSACTIONS

i Legal frameworks and deal structures

Poland is a civil law jurisdiction, and specific regulations that apply to M&A transactions (in general) and M&A real estate transactions (in particular) are stipulated in several legal acts. Although transactions encompassing shares and assets (specifically involving real property) are very broadly codified in Polish law, the Polish market is very much 'internationalised'. This is not only in terms of the parties involved in transactions, but also with respect to legal instruments and structures actually utilised. This internationalisation of the market means that numerous legal institutions commonly recognised in global transactions (whether originating from common law or continental legal systems) have been implemented in Polish transactional practice.

It is worth mentioning the general legal constraints that actually affect parties' flexibility in adjusting contracts to their individual needs and global market standards.

First, as regards transactions directly involving real property, Polish law requires a disposal contract to be concluded in the form of a notarial deed drawn up by a Polish notary public. Accordingly, in the case of share deals involving shareholdings in the most popular company type, the limited liability company, while less formalised, notary involvement, however limited, is also necessary.

Second, a disposal of real estate cannot be on a conditional basis (see below concerning acquisition agreements terms).

Third, in asset deals as well as share deals (where properties are only indirectly involved), certain legal constraints affect the transferability of a transaction object depending on, for example, the identity of a prospective buyer[18] and the market effect of a transaction (including any competition aspects).

One essential issue that distinguishes the two transaction types is the scope of legal protection provided to the buyer by law. In asset deals, an acquirer of real estate, as part of an enterprise or organised part of an enterprise, enjoys protection of the warranty of public reliance on the land and mortgage register. This principle means (subject to certain limitations) that if there is a discrepancy between the legal status of real estate disclosed in a land and mortgage register and its actual legal status, the content of the land and mortgage register will decide in favour of a party that acquired ownership or another right to the property in a transaction with the party or entity disclosed in a land and mortgage register as the rightful holder. In other words, even if the seller was not the owner of the real property, but was entered in the land and mortgage register as its owner at the time of the transfer and there were no other entries or annotations in the register entries that could raise doubts about the purchaser, the acquisition will be valid. This naturally does not mean that buyer prudence at the pre-transactional stage should be limited, and verification of technical parameters

18 For example, nationality or country of registered office and, pursuant to a new recent law, occupation, with regard to agricultural land.

should still be regarded as indispensable. However, with regard to the very essence of a transaction – that is, effective acquisition of the proper legal title to real estate – it functions as a far-reaching protective measure.

As for direct real estate acquisitions, a significant restriction must be considered, namely the statutory right of pre-emption with respect to real estate under which certain public entities are provided a right of priority to acquire real estate. If a statutory pre-emption right exists, it is necessary for the parties to first conclude an agreement promising to sell the property on the condition that the holder of a pre-emption right does not exercise the right.

In share deals and generally in transactions involving the merger, division or transformation of companies, an acquisition of real estate will not be protected by the warranty of public reliance on the land and mortgage register. This is because the subject of a transaction is the shares in a company, and not its assets, including real estate. In the case of a merger, division or transformation of companies, the warranty of reliance does not function, because the transaction involves the acquisition of assets as an entirety of rights through universal succession. Therefore, in such transactions, due diligence should include an assessment of the correctness of the real estate acquisition.

On the other hand, restrictions arising from the statutory right of pre-emption discussed above will not, in general, apply in such transactions, with one exemption: when a company that is the subject of a transaction owns agricultural properties with an area exceeding five hectares.

Finally, since real estate transactions often do not relate to land alone, but also to certain projects designed or contemplated for a given property or partially performed event, it is worth noting a practical and remarkable difference between share and asset deals. In the case of share deals, a buyer practically steps into the shoes of the seller, with the acquired company not only holding the real estate in question but also all applicable administrative decisions concerning real estate development and construction (e.g., a decision on construction terms or a building permit). On the contrary, in asset deals, a buyer only purchases property and the rights and decisions that are directly attributable to the property. All other rights and decisions must be separately transferred to the buyer or otherwise be reobtained.

ii Acquisition agreement terms

As already outlined, a transfer of title to real estate under Polish law cannot be conditional, and accordingly all prerequisites, conditions precedent and the like must be met by the time of the conclusion of a final contract that effectively transfers legal title to real estate. However, this does not preclude parties' right to structure relevant deals in a manner assuring that any applicable conditions to a successful transaction or other covenants are, in fact, fulfilled at the time of title transfer.

In the Polish legal framework, such conditions encompass not only purely business matters (such as furnishing a property in an agreed-upon manner) or acquiring any necessary contractors' consents (e.g., for a transfer of contracts related to the property, which is of specific importance if the property is a shopping or office centre), but specifically all relevant administrative consents and approvals. The latter group particularly relates to the receipt of a merger clearance (if a transaction itself affects or may affect competition) and acquisition permits for the acquisition of real property by foreigners within the meaning of a relevant Polish law. Such investors (deemed foreigners), as a rule, must obtain an acquisition permit issued by the Ministry of Internal Affairs and Administration. There are numerous exceptions to this rule, in particular for foreigners from the EEA or Switzerland. However, if a permit must be obtained, it affects the structure of a transaction, as the transfer of a title to real property without a permit is invalid. Usually, the parties conclude a preliminary conditional sale agreement in which a condition precedent for closing is the receipt of an acquisition permit.

There are also specific far-reaching restrictions related to the sale of agricultural land. Generally, since 30 April 2016, only an individual farmer can purchase agricultural land barring the exceptions set out in the relevant law. The agricultural property market is also protected in the case of a sale of shares in a company being an owner or perpetual usufructuary of agricultural property – in such cases, a state agency has a statutory pre-emption right to the shares. These regulations apply to agricultural properties exceeding an area of one hectare and companies holding more than five hectares of farmland.

The aforesaid legal constraints pertaining to the conditional transfer of real property practically mean that as long as parties to a contract wish to make it conditional on something, they must divide a transaction into two parts. First, a preliminary or obliging contract is signed. Each of the two legal types of such contracts, although having different practical consequences, generally creates the parties' firm obligation to finalise a transaction by signing, respectively, a final or transfer contract once relevant conditions are met.

Although Polish law includes a rather complex regulation regarding seller liability and the corresponding rights of a buyer, these matters are always an issue of the utmost importance when negotiating contracts. Polish law contracts – specifically contracts concluded between entrepreneurs (who by nature usually are parties to real estate transactions that are of interest for this publication) – may stipulate certain deviations from statutory terms. Such deviations mainly refer to the issue of seller liability, its scope and the time within which a buyer may raise claims under a contract. Therefore, it is common market practice to exclude the application of a statutory warranty in full or in part, and to contractually agree on the liability mechanics applicable to the transaction parties. Such contractual structuring of liability usually signifies its limitation; for example, to circumstances covered by relevant representations and warranties or specific indemnities, and with an exclusion of respectively disclosed matters. Furthermore, transactional contracts usually provide for liability thresholds and limit the time during which the parties may effectively raise claims under contracts. It is worth noting that while contractual freedom in the discussed area is quite extensive, it is anyhow subject to certain limitations that generally encompass fraudulent actions or other forms of wilful misconduct that cannot serve to exclude or limit a given party's (usually the seller's) liability.

iii Hostile transactions

The Polish capital market does not provide many examples of companies listed on the Warsaw Stock Exchange that have fallen victim to a successful hostile takeover. It is also difficult to indicate any hostile takeover transactions with regard to real estate companies.

The specific situation in the real estate transactions market means that experts do not perceive it as being particularly exposed in terms of hostile takeovers. It is possible that more investors will seek opportunities for such acquisitions in Poland in coming years because of improved prospects and higher profit margins than those found in western Europe or the United States, but this will most probably affect other businesses (e.g., natural resources mining, pharmaceutical or IT sectors) where it is easier to underestimate the price of shares than in a publicly traded real estate companies. It should also be borne in mind that there have been just a few attempted hostile takeovers in Poland so far, and that the majority of them were unsuccessful.

Hostile takeovers of listed companies fall within the general rules relating to acquisitions of companies listed on the stock exchange in Poland, which implement the EU Takeovers Directive.[19]

A very important aspect of hostile takeovers is the measures made available to the management board in a takeover attempt, as well as ways to protect a company against such takeovers. In Polish legal reality, preventive defence measures come to the fore and are quite commonly used by Polish listed companies. They are designed to deter a purchaser from attempting to acquire control by making a company less attractive legally or economically, or by significantly impeding or preventing its takeover against the will of the management board. These measures stem from the organisational structure of a company formed in statutes by its shareholders. Most are introduced well in advance, even at the stage where a company is only planning its initial public offering. Most popular among these measures are restrictions on disposals of shares, the introduction of voting preference shares, restrictions on voting rights on a specific holding (e.g., 10 per cent) and rights personally granted to a shareholder to, for example, appoint management or supervisory board members.

Polish legislation does not provide for an automatic exclusion or limitation of the effectiveness of preventive measures to defend against takeovers (i.e., the breakthrough principle) and does not restrict defensive actions that may be taken by a management board in the face of an attempted hostile takeover (i.e., the neutrality principle) by putting these decisions into the hands of shareholders. That said, companies themselves may introduce such principles by including relevant provisions in their statutes and making the management board responsible for compliance towards shareholders. However, companies very rarely decide to adopt these solutions in their statutes.

The lack of automatic application of the breakthrough principle causes a situation where the means of defence provided in company statutes may, in practice, prevent the takeover of a listed company. This is particularly important for those shareholders whose holding of approximately 30 per cent of share capital secures de facto control over a company through relevant statutory provisions.

iv Financing considerations

Typical sources of financing for real estate transactions in Poland, in addition to sponsor equity (in the form of either share capital of shareholder loan), include bank loans, non-banking financing, leasing and bond issuance. Regulatory pressure on banks limit their appetite for more risky assets, thus giving room for alternative sources of financing in this segment. Asset class and investor reputation on the market are key factors for credit committees.

Mezzanine and other junior debt financing sources are also increasingly popular on the market. One example of such recent transactions was a mezzanine financing provided by a US fund in a newly developing asset class on the Polish real estate market – student housing.

A number of real estate companies benefit from the status of a listed company to collect funds on the public market. The introduction of a REIT regime in Poland was expected to

19 2004/25/EC.

create a new promising source of financing in the future, although discussions on a draft law introducing REITs are extensively prolonged and the current draft is widely disappointing for a lot of market players.

As for traditional bank lending, this source of funding is very easily accessible in high volumes, mostly owing to low borrowing costs and solid fundamentals. According to Cushman & Wakefield, the level of bank financing for properties in Poland is stable, averaging approximately 60 per cent of each property's value. In addition to Polish general and mortgage banks, foreign banks are also very active on the Polish market, especially German and Austrian ones. This is particularly visible in the investment loan segment.

There is a broad selection of banks competing against each other in the cost-of-financing, available leverage and tenor, and other specific conditions (e.g., the required pre-let level or scope of required sponsor support). Bank financing is widely available not only in the Polish currency, but also in foreign currencies (in particular, the euro).

Banks are also extending the range of assets they are willing to finance. In additional to core segments such as office, retail and industrial, alternative investments, including hotels, apartments for rent, student housing or nursing operators, are increasingly popular.

Bonds may be issued either as listed securities or within a private offer. The advantage of bond financing is that it is very often covenant-loose and is less frequently secured with underlying assets.

As regards cross-border financing, its structuring is heavily affected by tax considerations.

On the documentation side, the Loan Market Association form of finance documents (adjusted to Polish law) is commonly used by Polish banks. Banking documentation is typically very detailed in listing various types of covenants, including financial, general and information covenants.

As for collateral, banks typically require a mortgage on real estate, security assignment of receivables under lease agreements, insurance policies and, in the case of projects at a development stage, also through key project agreements (such as contracts with a general contractor and architect) as well as a pledge of shares or other equivalent rights of a borrower. All bank accounts are pledged for the benefit of the lender, and all equity injected into a project is subordinated. To secure continuity of debt service in the case of incidental problems with debt service, security deposits are often required.

Although a mortgage in Poland is effective only upon its registration (which may take several weeks to several months, depending on the court), it is a market standard that banks accept only a filing for such registration as a sufficient condition precedent for utilisation of a loan without a need to wait for the registration itself.

The financing structure and typical timetable may differ depending on whether a financed transaction is a share or asset deal. In the case of an asset deal, because of the noted prohibition on conditionality of real estate acquisition transactions, escrow accounts are often set up to secure the safe transfer of the purchase price. Funds are released from the escrow once the property is transferred and a mortgage is established for the benefit of the lenders financing a transaction.

v Tax considerations

Among the different transaction structures outlined above, asset deals have prevailed in practice in the case of real estate transactions, mainly for tax reasons.

As regards income tax, in the case of an asset deal a step-up of the tax value of real estate can be achieved. From the seller's perspective, income tax of 19 per cent applies (in the case of small taxpayers, a 9 per cent income tax may apply).

As for transactional taxes, in the case of an asset deal the parties usually opt for VAT taxation. In such cases, VAT is paid by the seller and is recovered by the buyer. Opting for VAT taxation excludes a transaction from 2 per cent transfer tax (civil law transaction tax), which is less favourable because it constitutes an additional transaction cost for the buyer. Opting for VAT taxation is also often important to the seller because it does not raise the issue of correction of input VAT deductions made by the seller when buying or developing real estate. An asset deal is beyond the scope of VAT and is subject to transfer tax (2 per cent for real estate) if the object of a transaction is classified as a going concern. On occasion, tax authorities tend to claim that in the case of a commercial real estate transaction (e.g., shopping centre, office building already leased to tenants), it is more proper to classify the transaction object as a going concern.

In the case of share deals, a capital gains tax of 19 per cent applies, unless the seller is protected by a double taxation treaty without a real estate clause (a clause under which capital gains from a disposal of shares in real estate companies can be taxed in Poland).

As a rule, a share deal is not subject to VAT, but instead to transfer tax of 1 per cent due from the buyer (a transfer tax exemption can apply if a company has the form of a joint stock company).

To manage tax risks related to a transaction (e.g., the right to opt for VAT or the classification of a transaction object as not constituting a going concern), each party can apply for a tax ruling or both parties can file a joint application for a tax ruling (recommended option).

On 15 July 2016, a general anti-avoidance rule was introduced into the Polish tax system: this should be taken into account when tax structuring a real estate transaction.

In 2018, a minimum income tax for taxpayers with commercial property (including shopping malls and office buildings) was introduced and was subject to substantial changes starting from 2019. It applies to all taxpayers who own or jointly own buildings in Poland that are used for chargeable purposes under a lease, tenancy or similar agreement. The tax rate is set at 0.035 per cent per month of the initial tax book value of the real property, but there is a tax free amount of PLN 10 million. The minimum income tax is deductible from CIT. The tax free amount is split between asset-owning company and its asset owning subsidiaries in the proportion reflecting the ratio of the income from the taxpayer's building to the total income of all the related entities from the building. There is a possibility to apply for the refund of minimum tax that was not deducted if the tax authority identifies no irregularities in the tax liability or loss amounts calculated in the submitted tax return, and in the amount of the tax on revenue from buildings, in particular where the costs of debt financing incurred in connection with the purchase or creation of the building, as well as other revenues and costs, were determined on market terms. In practice, such application substantially increases the risk of tax audit.

vi Cross-border complications and solutions

Transactions between European real estate investment funds increasingly comprise multi-jurisdictional acquisitions of entire portfolios scattered across several countries.

If such a deal is based on an 'all or nothing' arrangement, it is sometimes very difficult to coordinate the timing of simultaneous transfers of title of all real property. If there are conditions precedent for closing, it is not possible in some jurisdictions (including Poland) to transfer ownership or perpetual usufruct (a proprietary right close to ownership) to a property on this condition, thus another notarial deed transferring title will have to be drawn up upon fulfilment of the final condition. Such transactions are, therefore, structured with rights to withdraw from a contract to enable a party step back from a deal in some jurisdictions if there is a deal breaker in another jurisdiction. Such a mechanism requires complex unwinding procedures and strict discipline between the parties and other involved entities (legal advisers, notaries public and financing institutions). Another instrument that can make such a transaction easier to coordinate is a master agreement providing a substantial mechanism for the sequence of events and general payment terms applicable to all jurisdictions, while all individual purchase agreements in a form specific for a transfer of real property in each jurisdiction are complementary and are governed by the master agreement to the extent possible under the relevant jurisdiction.

If the acquiring party is deemed a foreigner within the meaning of a relevant law and does not originate from the EEA or Switzerland, the transaction must then include a two-step agreement in which the purchaser will have to obtain an acquisition permit from the state authorities during the period between signing and closing (conclusion of a final sale agreement). As a rule, the acquisition permits must first be obtained even if the purchaser is a company founded under Polish law but is controlled by a foreigner (within the meaning of the relevant law), or if a foreigner intends to purchase a Polish company holding title to real estate and, as a result of the acquisition of shares, the company becomes controlled by a foreigner.

V CORPORATE REAL ESTATE

In terms of the corporate structure of real estate investment funds investing in Poland (funds purchasing already developed office, retail or warehouse premises), there is usually an SPV for each property or at least for each location. Such an approach facilitates the management of projects, distribution of cash flow, control of costs and liquidation of an SPV once a property is again sold on the market.

An 'opco/propco' structure is also used in a holding structure, albeit not exactly for the purpose of REIT spin-offs, but rather for having a clear division of know-how and management services within a group and allocation of assets to specific property companies, apart from cost optimisation.

VI OUTLOOK

The forecast for the Polish market in the near future remains optimistic. It may be challenging to improve the record-level results achieved in 2018, but, in terms of the value and volume of transactions, the situation should stabilize at this high level. The same economic factors will stimulate growth and strengthen its position in the CEE region: the low cost of credit, higher return rates than in Western Europe, a stable and mature market and the development of transport infrastructure. It also seems that the GDP will continue to grow, of course subject to the global market situation. Most investment funds will likely focus more in the next few years on properties in regional cities (Crakow, Lodz, Poznan and Wroclaw, as well as the Tri-city area or even cities in Poland's eastern part such as Lublin or Rzeszow), however we do not expect any threat to the position of Warsaw as the main real estate investment market. The Polish market follows global or European tendencies where the volume of real estate transactions increases. A specific segment of the market that will be of special interest in the near future is logistic and warehouse properties, as a result high demand for warehouses (owing to the dynamic growth of e-commerce). We also expect higher investment in the hotel sector, as a number of hotel construction projects has been announced recently.

The introduction of REITs has been postponed and we are not too optimistic about its final approval by parliament. This may impact and stabilise the current structure of the real estate investment market. Recent years have been dominated by European (particularly German) funds. Now there is an increasing presence of capital from more distant countries such as the United States, South Africa, Arab oil-financed economies and Asian investors. It is also possible that after Brexit, some funds concentrated until now in the saturated but very stable UK market will turn their eyes to Poland and other countries in the region.

Appendix 1

ABOUT THE AUTHORS

IZABELA ZIELIŃSKA-BARŁOŻEK

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Izabela Zielińska-Barłożek is an attorney-at-law and partner in charge of the firm's M&A practice. She also heads the Poznan office. She provides legal support for M&A transactions and ongoing advice on corporate law.

In her long practice, she has advised on transactions and coordinated legal support for the acquisition and sale of enterprises and assets as well as shares in companies, also in cooperation with foreign law firms on global transactions. She has taken part in many enterprise-restructuring projects, including mergers and reorganisations. For many years, she has headed teams of lawyers conducting comprehensive due diligence projects.

She is involved in the activities of international associations, serving as co-chair of the Real Estate Committee of the International Bar Association, among other posts.

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Łukasz Szegda is an attorney-at-law and partner who heads the banking and finance practice. He handles financing of transactions, including corporate acquisitions, real estate transactions, development projects, debt restructuring and refinancing. He has taken part in some of the largest debt restructuring projects in Poland and is a permanent adviser to Polish banks. He represents clients in litigation and bankruptcy proceedings. He advises clients on regulatory issues such as cash pooling, outsourcing, securitisation and consumer credit.

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He handles issues of securities law and the laws of capital markets and financial institutions, capital markets transactions, corporate governance, particularly in public companies, as well as outsourcing and compliance issues.

He is involved in drafting documentation connected with the issue of shares, bonds and structured products. He advises on fundraising on capital markets, takeovers, the and acquisition of significant positions in the shares of public companies, performance of reporting requirements related to capital markets transactions, offering of foreign securities in Poland, and regulatory aspects of the operations of financial institutions (brokerages, banks, investment funds and insurance companies), the offering of financial products and outsourcing of services. He represents clients in proceedings before the Polish Financial Supervision Authority.

He participates in project finance work (credit agreements, share acquisitions and specific types of financing), purchasing of receivables and related collateral and securitisation matters.

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