PRS market in CEE

AUSTRIA | CZECH REPUBLIC | POLAND | HUNGARY | ROMANIA

MARCH 2023

Contents

Executive summary

The Private Rented Sector (PRS) market in Central and Eastern Europe (CEE) is rapidly developing and growing, with each jurisdiction presenting unique challenges and opportunities for investors.

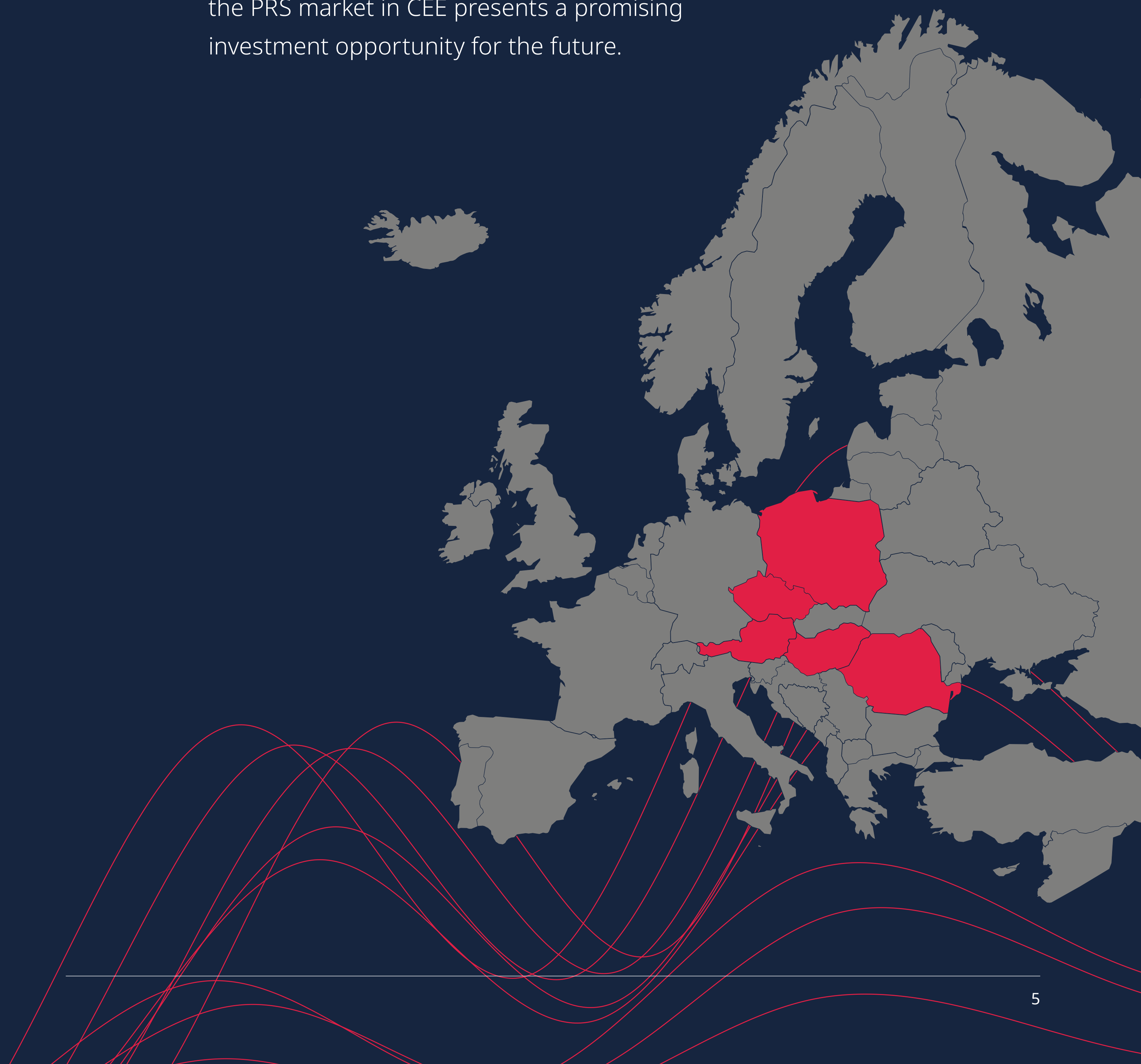
Austria has a well-established PRS market driven by demand for rental housing, low-interest rates, and tax incentives. Investors are now focusing on micro-living for young professionals and student housing. The Czech Republic is seeing growth in the market due to high real estate costs and a housing shortage. In Prague, around 4,780 units are currently available, and more are under construction. Hungary's market is still emerging, but a cultural preference for homeownership, high financing costs, and low yields pose significant challenges. Poland's PRS market is rapidly expanding, driven by a younger generation's preference for renting due to high apartment prices and a lack of affordability. The total investment in the PRS sector in Poland exceeded EUR1.8 billion by the end of 2022, with nearly EUR750 million recorded in 2021. Romania's market is small and still in its early stages, but affordable housing shortages and changing attitudes towards renting present potential opportunities for growth.

The PRS market in CEE faces common challenges such as regulatory uncertainty, tighter debt markets and identifying quality assets. Investors must carefully consider the form of the project company, location and zoning, and due diligence before initiating a PRS project in the region. Despite these challenges, investors are attracted to the market due to the strong demand for rental housing and relatively low levels of competition.

ESG requirements are also playing a growing role in the PRS market, with investors increasingly focused on building, self-sustainability, and the well-being of tenants.

Given the lack of modern rental assets and the old age of existing housing stock in some CEE countries, the PRS market may soon become a leader in sustainability in the region.

Looking to the future, the PRS market in CEE presents significant opportunities for growth. The COVID-19 pandemic has accelerated the trend of people seeking more flexible and affordable housing options, and the PRS market is well-positioned to meet this demand. Investors must navigate the challenges unique to each jurisdiction, but with careful consideration, the PRS market in CEE presents a promising investment opportunity for the future.



Introduction

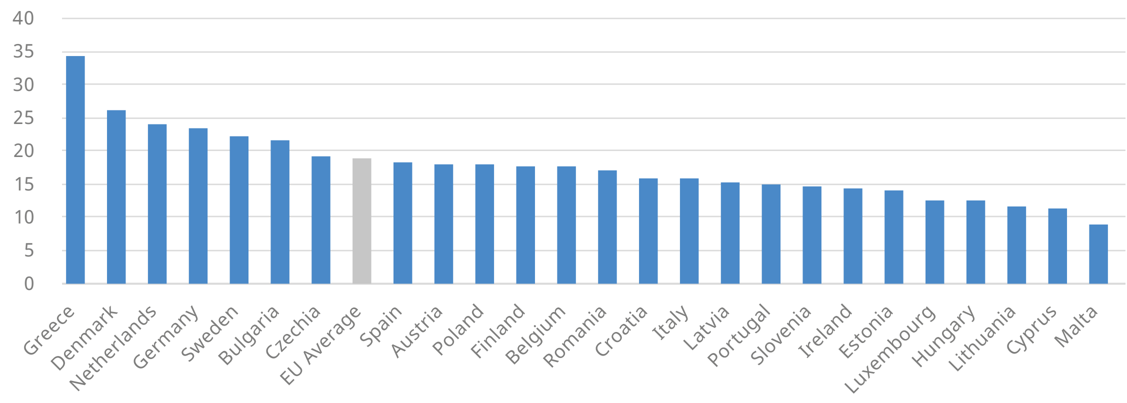
Housing in CEE countries that used to be socialist went through dramatic changes after the fall of communism. The motto my house my castle was transformed into my flat my castle. This led to the fact that the highest shares of ownership of flats were observed in CEE countries: Romania (95% of the population lived in a household owning their home), Slovakia (92%), Hungary (92%), and Croatia (91%). In the non-communist EU Member States, with the exception of Germany, owning is more balanced with renting. In Germany, renting was slightly more usual with just a little over 50% of the population being tenants. Austria (46%) and Denmark (41%) followed.

Although Austria is the obvious CEE leader in terms of the rental market development, over the last couple of years its CEE peers also began to follow the rental path. The Czech Republic started its journey in the PRS market with the first development delivered in 2008, before the financial crisis unfolded. Poland had to wait seven years longer for its first institutional rental scheme, while Romania saw their first PRS projects delivered in 2016. Hungary's record apartment price growth over the last decade has also led to increased interest in renting. When it comes to capital cities, Vienna still has the largest number of rented apartments (over 300,000). Interestingly, Warsaw, despite having its first projects launched later, managed to slightly exceed Prague in terms of existing PRS stock, reaching nearly 5,000 units. Warsaw has moved considerably ahead of the Czech capital when it comes to new PRS developments, with a four-times-larger construction pipeline. There is a growing popularity in Polish regional cities among PRS investors, with three of those cities already offering over 1,000 PRS units each and 6,000 units under construction outside of Warsaw.

Although it is hard to imagine any of the four countries catching up with Austria in terms of share of the entire rental market in the housing stock in the foreseeable future, they are highly likely to succeed over time. However, all of them need to overcome some challenges ahead.

Until 2021, PRS market participants usually tended to cite changes in living habits and attitude towards renting, in particular among younger generation, as major forces driving the development of institutional build-to-rent market. This trend was observed despite already high housing prices, with growth rates frequently exceeding salary growth, as was the case in Prague and Warsaw. However, once credit started to become expensive again, the term 'housing affordability', defined differently for various purposes, began to resonate stronger in many expert discussions, making the rental market more attractive.

Share of housing costs in disposable household income [%; 2021]

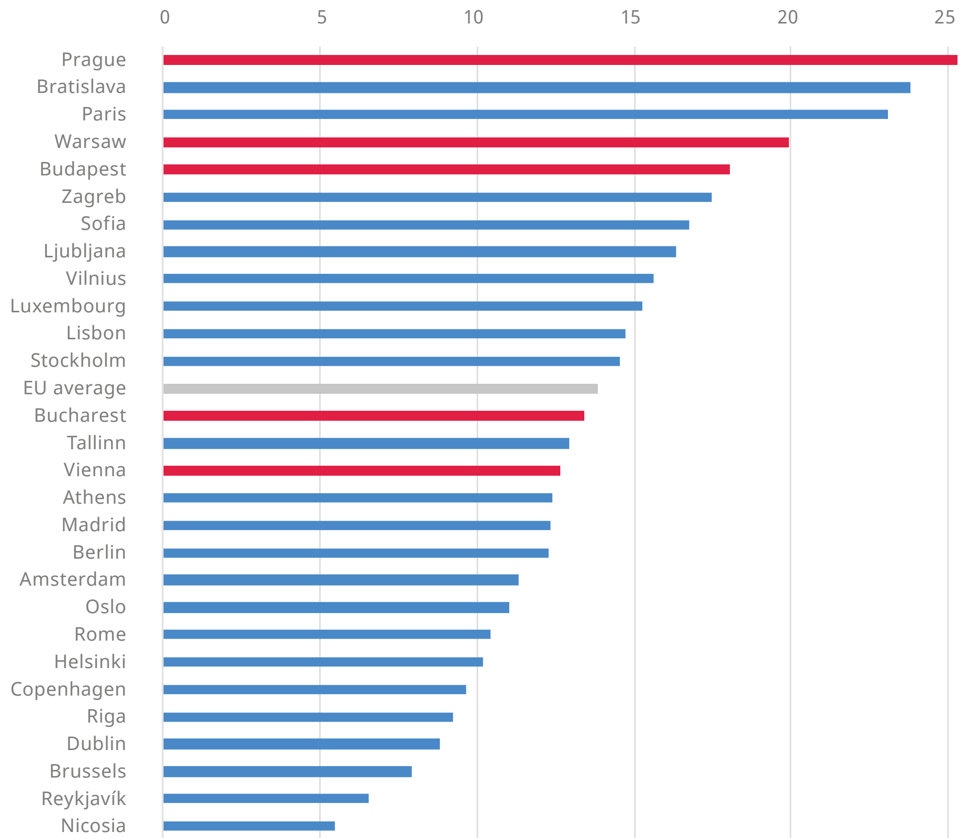


Source: Eurostat

Affordability issues in CEE become even more obvious if we consider, how long it takes to save for a purchase of a 75 m² apartment in each capital city in EU.

Among the most expensive markets there is only Paris, representing Western Europe and four countries from the CEE region, with Prague topping the list.

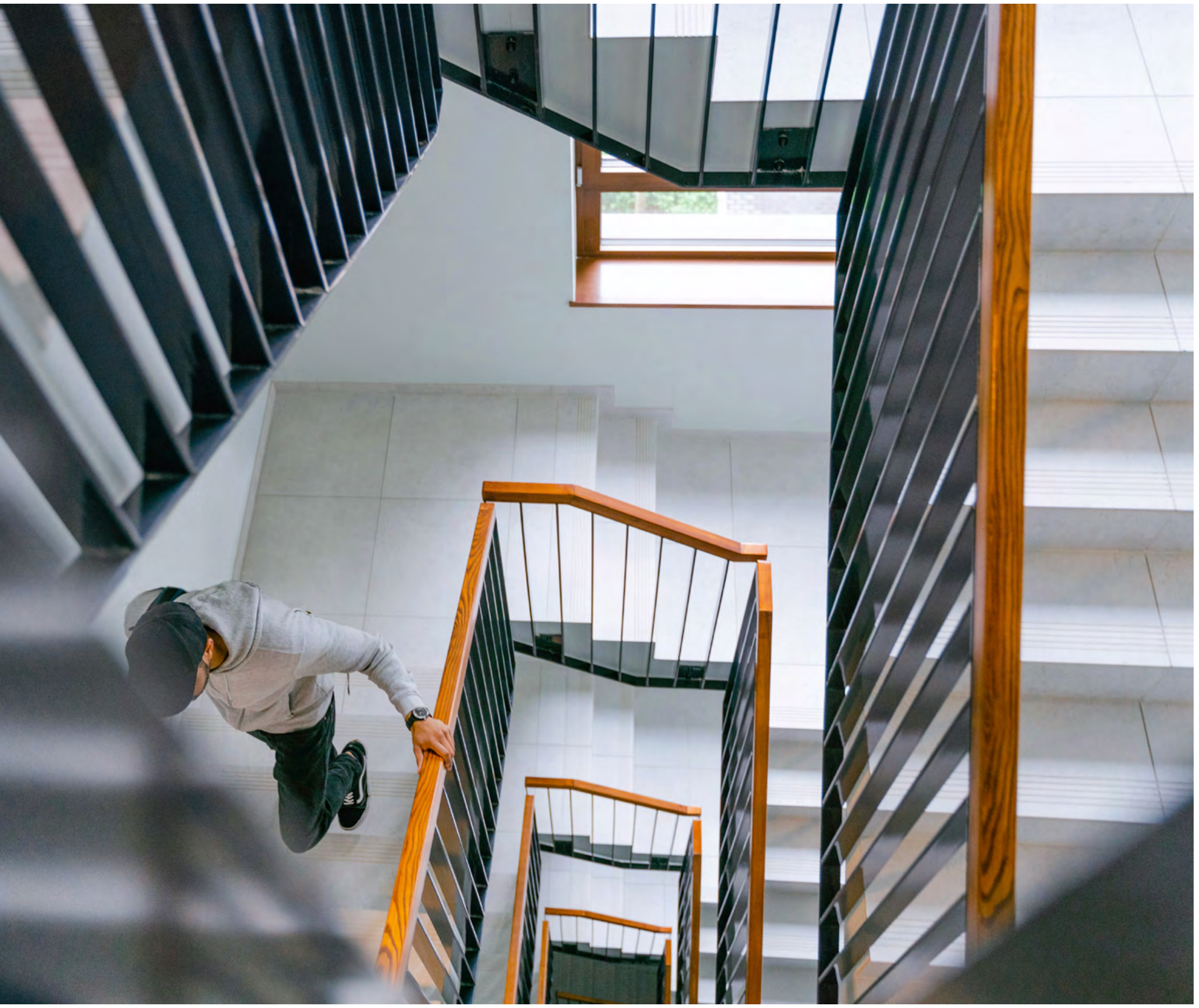
Years needed to buy a 75 m² flat on an average salary



Source: The Hungarian National Bank

A total shift in monetary policy aimed at curbing inflation caused mortgage cost to grow considerably within ca. one year between 2021 and 2022 across the entire CEE region. At first, this may seem entirely beneficial for the PRS market, as the absence of significant and market-wide price drops in the residential sector, limiting housing affordability means more people are priced out from the ownership market into the rental one. At the same time, fighting inflation means a significantly higher cost of debt financing for institutional investors. In the case of euro area, including Austria, this may not look as bad as it sounds, with a 3% main refinancing rate. In countries like Poland and Czech Republic, the monetary shift translates into current reference rates of 6.75% and 7%, respectively, and the total cost of debt reaching up to even 11% per year. There are questions whether PRS investors could try to offer euro-denominated rents in a wider scale and how such provisions in lease agreements would be treated by various supervision authorities in countries outside the euro area?

Should high inflation become persistent for years to come, another question arises: are institutional owners able to keep passing on growing cost entirely to tenants? It might be particularly challenging, if salary growth does not keep up with increasing consumer price index. Rents have already increased by double-digit percentages over the last decade in all CEE countries, while in some, such as Poland, by over 20% in just over one year. This is largely a result of an influx of refugees from Ukraine.



The CEE region will continue its journey with the PRS market for years to come.

In Austria, the average household spends 30% of their income on housing, largely due to developed subsidized rental sector creating competition for private landlords. In Prague, an average one-person household already spends over 40% of its income on rent alone, without considering the cost of utilities and common area upkeep.

High construction and energy costs also make investors look for alternatives such as redevelopments of old residential or even office buildings into modern rental schemes. In some jurisdictions, like Poland, commercially-zoned land may also allow for development of buildings to fulfil rental purposes, sometimes greatly benefiting from fewer design restrictions. Co-living and student housing investors could likely excel in the field.

Last but most definitely not least, ESG requirements will be playing a growing and in some cases, critical role when assessing new projects. If yesterday property investors were asking about building certification, and today, they are asking about certification levels, tomorrow the questions regarding carbon footprint, building self-sustainability and well-being of tenants will be on their daily agenda. The PRS market is no exception here, but among all real asset classes, it may soon become one of the leaders in sustainability in the CEE. This potential stems from the lack of modern rental assets, the old age of existing housing stock, like that in the Czech Republic and Romania, and in some countries, like Poland, will be fueled by the fundamentally large housing gap expressed by the small number of 0.4 dwellings per capita.

Overall, it seems that the rental market in CEE countries will continue to grow and evolve in the coming years, despite some resistance from lawmakers. The challenges ahead are significant, but the potential benefits of a thriving rental market are clear.

We hope this report will bring you closer to the PRS market and answer any questions you may have.

PRS Market in CEE

Austria

Rented housing in Austria is one of the most affordable in the EU.

Austria's long tradition of renting makes it more similar to other DACH countries than to its CEE peers. The PRS market accounts for around 42% of the total housing stock in the country. Most PRS units are located in Vienna, with over 77% of the rented stock, followed by Graz, Linz and Salzburg.

Compared with other markets presented in the report, the greater popularity of renting in Austria is generally also due to well-developed forms of the non-private rental market. Those include communal apartments and limited-profit housing associations (LPHA), which account for nearly one-fourth of the total housing stock countrywide and 43% of residential inventory in Vienna. And the capital city residential development is heavily supported by city subsidies, which finance ca. 80% of newly built flats. However, the PRS market, though more expensive than other types of rent and consuming 26% of a household's income on average, is still attractive, as shown by housing satisfaction statistics.

Vienna continues to set the European standards in delivering affordable housing by the radical introduction of the 'subsidised housing' zoning category, under which all developers in such areas need to provide 2/3 of subsidised units if their planned schemes exceed 5,000 m^2.

A high share of subsidised housing and rent regulations set the average rents at significantly lower levels than in many other EU capitals. It is enough to mention that open-market rents account for less than 8% of Vienna's housing stock.

Over the last couple of years, key demand drivers in the rental market have included population growth, higher acquisition costs as indicated by a 23% growth in the residential property price index over the last two years alone and the search for higher flexibility of living. As the number of citizens is expected to grow by nearly 6% over the next two decades, population growth will remain a vital demand driver in the PRS sector. Having a developed rental market does not mean a lack of challenges: the high cost of financing, economic contraction and regulation changes are issues PRS investors interested in the Austria market will likely have to confront, at least in the near term.

Sebastian Scheufele
Managing Partner
Modesta Real Estate
An International Associate of Savills

Christoph Mager
Country Managing Partner
DLA Piper

PRS Market – well-established and regulated

There are significant differences when housing costs are compared by legal status. The median housing costs for owner-occupied houses is monthly EUR411 and EUR459 for owner-occupied apartments. Inhabitants of private rented dwellings (PRS) have the highest expenditures – the median of total housing costs is EUR718 per dwelling and month. These costs on the household level correspond to the following housing costs per square metre: EUR11.3 in privately-rented dwellings, EUR5.7 for owner-occupied apartments, and EUR2.5 for owner-occupied houses (median).

Half of Austria's private households spend up to 15% of their household income on housing, while a quarter must spend 24% or more on housing. Households in private main rental apartments (PRS) have the highest housing cost burden – the housing cost share measured against household income in this segment is 26% (median).

Status: 2022

Average living space in square meters and average number of living spaces per dwelling and per person by legal status 2021

LEGAL STATUS	TOTAL MAIN RESIDENTIAL ACCOMODATION IN 1,000	∅ LIVING SPACE IN SQUARE METERS PER DWELLING	∅ LIVING SPACE IN SQUARE METERS PER PERSON	∅ NUMBER OF LIVING SPACES (ROOMS) PER DWELLING	∅ NUMBER OF DWELLINGS PER PERSON
Home ownership	1,481	144.7	54.6	5.1	1.9
Apartment ownership	443	84.4	43.4	3.4	1.8
Municipality apartment	276	61.4	29.5	2.7	1.3
Cooperative apartment	662	70.8	36	3	1.5
PRS	746	70.1	36.4	2.9	1.5
Other	408	98	57.3	3.8	2.2

Status: 2022

Main rental dwellings by legal relationship and dwelling-specific characteristics 2021

HOUSING-SPECIFIC CHARACTERISTICS	PRIMARY TENANCY IN TOTAL	COMMUNAL TENANCY	COOPERATIVE TENANCY	PRS
Amount of primary tenancies in 1,000	1,685	276.9	662	746
Median of the length of rental agreements in years	5.6	13	8.2	2.9
Share of new leases (rental agreement under 2 years) in percent	23.1	8	14.6	36
Share of old leases (rental agreement over 30 years) in percent	12.1	19.8	13.4	8
Share of fixed-term agreeements in percent	23.1	2.5	5.1	46.5

Status: 2022

Housing satisfaction by tenure status from 2017 to 2021 (average between 1 and 10)

	2017	2018	2019	2020	2021
House ownership	8.8	8.9	8.8	8.9	8.9
Flat ownership	8.6	8.7	8.6	8.6	8.6
Communal housing	7.2	7.1	7.1	7.4	7.4
Cooperative housing	7.9	8.1	8	8	7.9
PRS	7.5	7.4	7.7	7.7	7.6
Others	8.3	8.6	8.6	8.6	8.6
All persons 16 years and older	8.3	8.4	8.4	8.4	8.4

Status: 2022

Housing costs in the rental sector

Status: Q3 2022

Cooperative

- 64% pay less than 700 euros per month in housing costs
- 16% pay between 700–900 euros per month in housing costs
- 20% pay more than 900 euros per month in housing costs

Communal

- 32% pay less than 700 euros per month in housing costs
- 23% pay between 700–900 euros per month in housing costs
- 35% pay more than 900 euros per month in housing costs

PRS

- 34% pay less than 700 euros per month in housing costs
- 23% pay between 700–900 euros per month in housing costs
- 43% pay more than 900 euros per month in housing costs

Rent levels in the residential segments

The third quarter of 2022 saw different levels of rent increase depending on the rental segment.

Communal apartments saw the highest increase, with rent including running costs rising from EUR7.3 to EUR7.5 per square meter, representing a 3.8% increase compared to the second quarter of 2022. This rise can be attributed to the presence of benchmark level rent in Vienna's communal housing.

Privately rented dwellings (PRS) experienced a 3.6% increase to EUR10.3 per square meter (including running costs) with no distinction between those subject to benchmark level rent and those on the free market.

The least change was recorded in the **cooperative housing segment**, which saw a 1.2% rise to EUR7.7 per square meter (including running costs). These figures indicate that the price per square meter of cooperative and communal apartments are becoming more similar

Status: Q3 2022

Residential sector overview

Comparison with EU housing supply average, e.g., number of dwellings per capita

Austria

- Average space per capita (main residential property): 46.3 m²*
- Number of main residences: 4.02 mln.
- Population: 9.04 mln.

Vienna

- Average space per capita (main residential property): 36.8 m²
- Number of main residences: 926,000
- Population: 1.95 mln.

Status: 2022

Overcrowding rate

Austria

- Shares of primary residences with overcrowding: 3.8%
- Share of people affected by overcrowding (PRS): 7.4%

Vienna

- Shares of primary residences with overcrowding: 8.5%
- Share of people affected by overcrowding: 17.5%

Overcrowding is much less common in owner-occupied housing. Most often, flats in communal buildings (*Gemeindebauwohnungen*) are overcrowded. In Austria, 13.3% of communal flats and 29.4% of the people living in such flats are affected.

In the private rented sector, 7.4% of households or 15% of the persons living there are affected by overcrowding. This corresponds to 216,100 tenants in overcrowded apartments.

Status: end of 2021

Share of owner-occupied and rented apartments

Austria is a country of tenants: The rental rate of main residential dwellings is 42%, their ownership rate is 47.9%. The remaining 10.2% is accounted for by rent-free or free housing or service and in-kind housing. Thus, the Austrian home ownership rate is clearly below the European average of about 70%.

Vienna has the highest rental rate – more than three-quarters of households live in rented flats. At 22% of all households, the share of communal housing is also the highest in a federal state comparison. Slightly more than every fifth Viennese household lives in a cooperative flat and one-third in another main rental flat. The ownership rate also shows a completely different composition in Vienna, as it is dominated by flat ownership. While 13% of all Viennese households live in condominium ownership, only 6% of all households are homeowners.

* In a ten-year comparison, the available living space per m² has increased by 3.4 m²

See below for an exact breakdown of ownership types and rental types for AT and Vienna:

AUSTRIA

Total: 4.02 mln. main residences

A. Ownership: 47.9%
- Home ownership: 36.9%
- Flat ownership: 11%

B. Rent: 42%
- Cooperative flat: 16.5%
- Communal flat: 6.9%
- Other main rent/ private rental sector: 18.6%

C. Distribution of all tenants by tenancy type (if 42% was 100%)
- Cooperative flat: 40%
- Communal flat: 16%
- Other main rent/ private rental sector: 44%

D. Others: 10.2%
- Sublet: 1%
- Rent-free + free of charge: 8.8%
- Service and in-kind flats: 0.4%

VIENNA

A. Ownership: 19%
- Home ownership: 6%
- Flat ownership: 13%

B. Rent: 76%
- Cooperative flat: 21%
- Communal flat: 22%
- Other main rent/ private rental sector: 33%

C. Distribution of all tenants by tenancy type (if 76% was 100%)
- Cooperative flat: 28%
- Communal flat: 29%
- Other main rent/ private rental sector: 43%

D. Others: 5%
- Sublet: 1%
- Rent-free + free of charge: 8.8%
- Service and in-kind flats: 0.4%

New vs. dated residential stock, both owner-occupied and rental

Three out of ten households in Austria occupy a residence that was built after 1990. A total of 26.2% live in a residential property built in the 1960s or 1970s, and 14.5% in housing built before 1919.

In Vienna, the share of flats in buildings constructed before 1919 is the highest (almost one third of all households). The share of flats built after 2000 is comparatively low at 14.1%.

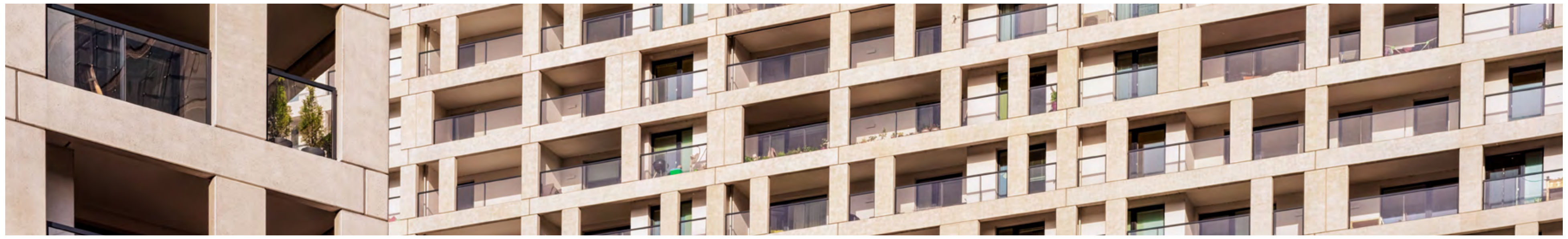
Status: 2022

Construction period of main residentials

	AUSTRIA	VIENNA
Total number of mainw residences	4.02 mln.	926,000
YEAR	SHARE IN %	
Before 1919	14.5%	28.1%
1919–1944	6.6%	9.4%
1945–1960	9.8%	10.9%
1961–1970	12.7%	13%
1971–1980	13.6%	10.1%
1981–1990	11.4%	7.8%
1991–2000	11%	6.7%
2001–2010	10.7%	5.9%
2011 and later	9.7%	8.2%

Relation of total mortgage cost to disposable income (per capita or per household)

- Gross disposable income was EUR113,628 million in September of 2022 (Eurostat)
- Mortgage credit interest rate was 2.03% in September 2022



Household indebtedness to gross disposable income ratio in Austria Q1 2007 to Q3 2021

Q1 2007	Q2 2007	Q3 2007	Q4 2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	Q3 2009	Q4 2009
84.66%	83.26%	83.11%	83.54%	83.16%	82.54%	83.82%	84.8%	84.03%	83.88%	84.54%	84.96%
Q1 2010	Q2 2010	Q3 2010	Q4 2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012
85.74%	87.44%	87.39%	88.27%	87.04%	88.3%	89.22 %	87.81%	87.3%	86.1%	85.39%	85.72%
Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015
84.95%	85.12%	86.23%	85.36%	85.45%	85.69%	85.54%	85.05%	86.42%	86%	86.07%	86.48%
Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018
87.22%	87.15%	87.58%	86.54%	86.81%	85.58%	85.38%	85.31%	84.42%	84.56%	84.92%	85.04%
Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	
84.3%	84.54%	84.81%	84.68%	84.97%	87.71%	88.19%	87.5%	88.54%	88.01%	88.22%	

Relation of total renting cost to disposable income (per capita or per household)

AUSTRIA

- average rent including operating costs per m² EUR8.80
- average rent without operating costs per m² EUR6.50

Status: Q3 2022

VIENNA

- average rent without operating costs per m² EUR10.25–17 (depending on the district, inner districts have the highest rents, followed by mansion areas (western side), then south-east and north-east Vienna)

Status: Q4 2021

- Households in private rental apartments spend an average of 30% of their income on housing,
- Cooperative and community tenants approximately 25%
- Apartment owners approximately 16%
- Homeowners approx. 11% – the lowest proportion of expenses

Published: 05.07.2022

AVERAGE RENT (in general) (incl. operating costs)

- Communal apartments: EUR413.1
- Cooperative apartments: EUR509.1
- PRS: EUR644.7

Self-perceived financial burden and share of housing costs in household income 2021 (data compiled May 2022)

CHARACTERISTICS	TOTAL (=100%) IN 1,000	NO BURDEN	CERTAIN BURDEN	HEAVY BURDEN	HOUSING COST SHARE >40%	HOUSING COST SHARE >25%
House ownership	1,478	45	49	6	3	6
Flat ownership	450	60	36	4	5	16
Communal housing	359	34	48	18	12	47
Cooperative housing	625	43	45	12	11	42
Other main tenants	731	40	45	15	20	55
Others	370	51	44	-5	5	16
All households	4,014	45	46	9	8	26

Estimated size of market-rent sector and subsidised-rent sector or private vs. state-owned rental stock

AUSTRIA
Number of primary residences: 4,019,700

VIENNA
Total number of primary residences: 926,000

Status: end of 2021

Distribution

- Subsidised units owned by the municipality (communal): 220,000
- Units owned by cooperative nonprofit associations: 200,000

Status: end of 2022

In May 2021, Vienna's subsidised housing market represented 44% of the city's rental stock. Since a big chunk of the population live in subsidised housing due to its efficient system, this gives incentives for the private rental sector to also keep the rents feasible. In the past 10 years, rental prices have risen by approximately 15% in the subsidised sector and 40% in the private sector, yet they are both still lower than average in other major cities in Europe.

Historic development of the PRS stock

Major events, market or macro shifts that historically influenced the PRS market

Introduction of the Housing Act 2018: The Housing Act 2018 was introduced to regulate the Austrian housing market and the private rented sector. It introduced new regulations to the rental market, such as rent caps and rent freezes, as well as an increase in tenant rights. This has had a significant impact on the private rented sector, as it has made it more attractive to investors, as well as providing tenants with more security and protection.

Increase in demand for rental housing: Over the past few years, there has been an increase in demand for rental housing in Austria. This has been driven by a number of factors, such as an increasing population, rising living costs, and a desire for more flexible living arrangements. This increased demand has resulted in more investors entering the market, as they see it as a lucrative opportunity.

Low-interest rates: Low-interest rates have also had an influence on the private rented sector in Austria. Low-interest rates make it cheaper for investors to borrow money, which in turn has made it easier for them to invest in rental properties. This has resulted in an increase in rental properties being built and purchased, as investors see it as a more attractive investment opportunity.

Tax incentives: The Austrian government has introduced several tax incentives to encourage investors to invest in the private rented sector. These incentives have made it more attractive for investors to enter the market, as they can benefit from lower taxes. This has resulted in more investors entering the market and more rental properties being built and purchased.

Current and expected situation in the PRS market

Demand drivers

The demand for rental real estate has grown significantly in Vienna due to the protection of tenants provided by the Austrian Landlord and Tenant Act MRG. This law stipulates the maximum rent that can be charged for a flat, depending on its category, as well as regulations concerning fixed-term contracts. As a result, tenants can feel secure in the knowledge that their rights are protected, making rental accommodation more attractive.

The prognosis for the population in Austria is over the next 20 years (from 2022 to 2042) expected to increase by 5.8% which means that the need for housing will continue to grow in parallel.

Despite a pandemic and a crisis related to other matters, the residential real estate market in Austria has stood strong, as the residential property price index (RPPI) has increased as follows: 222.6 in 2020, 248.8 in 2021, and 274.4 in 2022.

About 80% of flats built in Vienna are financed by the city's housing subsidy scheme. Vienna's local government plans a 30% boost in housing construction implying that about 13,000 new homes will be built in Vienna every year, up from the current 10,000.

Number of projects under construction (incl. number of units)

In 2020, Austria had the highest number of initiated dwellings per 1,000 citizens (10.9) among the twenty-three European countries surveyed. This was the highest number recorded compared to the other twenty-two countries.

In 2021, a total of approximately 14,500 residential apartments were completed in Vienna. Of these, circa 35% were freehold, 25% built-to-rent, 30% subsidised and 10% special form/unknown. The prognosis as of March 2022 was the following total number of apartment completions:

- 2022: approx. 22,000
- 2023: approx. 16,000
- 2024: approx. 7,500

Top 10 Developers (residential) 2022 in Austria

BUWOG
UBM Development
JP
ARE
Süba
Haring Group
Strabag Real Estate
C&P
Mischek
Arwag
Catella (Austrian location since 1st Feb 2022)

Source: Real Estate Brand Institute Issue no. 9 (https://reb.institute/)

Key challenges facing investors

Lack of transparency in transactions: there is a lack of transparency and clarity in the PRS market, especially in Austria, as there is no centralised database or market for this subcategory in residential real estate transactions. This makes it difficult for investors to gauge market trends and identify potential investment opportunities.

The current financial climate has also made it harder for investors to qualify for financing for residential real estate investments, as lenders are increasingly requiring higher credit scores and more experience before approving a loan. Additionally, many lenders are looking for lower loan-to-value (LTV) ratios and higher down payments from potential borrowers. This has created an environment where many investors struggle to qualify for financing, which can make it difficult to purchase residential real estate. In December 2021, the interest rate for housing loans was at 1.23% per annum, and as of December 2022, it has increased to 2.85% per annum. This may make it difficult for investors to secure a loan with a favorable interest rate.

The Austrian economy is expected to experience a contraction in the coming years, similar to other European markets. Consumer confidence has stabilised but remains low, likely leading to a decrease in discretionary spending as food and energy prices rise. This is likely to have a significant slightly negative impact on the economy in 2023 and beyond.

Difficulties identifying quality assets: investors are often faced with challenges when it comes to identifying quality assets in the PRS market. While there are some online platforms that provide information on rental properties, these are often limited in scope and do not provide information on all available rental properties.

Regulatory uncertainty: the regulatory environment in Austria is constantly changing, making it difficult for investors to understand the legal requirements associated with investing in the PRS market. This makes it difficult for investors to properly assess the risks and rewards associated with a potential investment.

Institutional rent in practice

Most common lease periods

According to the Austrian Tenancy Act, the shortest lease period allowed for fixed-term leases is a minimum of 3 years, and there is no maximum term. In the case of an extension of a fixed-term lease, a minimum extension period of three years must also be observed. Open-ended contracts also exist but are not as common as fixed-term contracts. They are valid until one of the contracting parties terminates the contract. The legal minimum period of notice is one month.

By the end of 2021, 46.5% of the rental contracts were in the PRS sector. The proportion of fixed-term contracts in the portfolio is escalating annually, as three-quarters (75%) of new private leases are arranged for a fixed period. By contrast, the prevalence of fixed-term contracts in communal apartments of municipalities (3%) and non-profit building associations (6%) is negligible.The average lease period in Austria is 4.2 years, and in Vienna is 4.6 years. This refers to all possible tenancy types (PRS, communal flats, cooperative flats). In the Austrian PRS sector, the average rental period is 4 years.

Rent indexation – is it commonly applied?

Fundamental to whether and how the rent may be increased is the question of whether or not the tenancy agreement is fully covered by the Tenancy Act (MRG). In the full scope of the MRG, tenancy agreements for flats usually contain an index-clause.

The rent indexation in Austria is based on the consumer price index: https://www.statistik.at/en/statistics/national-economy-and-public-finance/prices-and-price-indices/consumer-price-index-cpi/-hicp

As the table to the right displays, the increase of CPI was exponential during 2022, due to the market fluctuations, uncertainties, and price increases in the second half of the year.

Consumer price index

YEAR / MONTH	% TO PREVIOUS YEAR	CPI 2020	CPI 2015	CPI 2005	CPI 2000	CPI 96
⌀ 21	2.8	102.8	111.2	123.1	149.0	156.8
January 22	5.0	105.3	113.9	126.1	152.7	160.7
February 22	5.8	106.6	115.3	127.7	154.6	162.7
March 22	6.8	108.8	117.7	130.3	157.8	166.0
April 22	7.2	109.1	118.0	130.7	158.2	166.5
May.22	7.7	110.0	119.0	131.8	159.5	167.9
Jun22	8.7	111.5	120.6	133.6	161.7	170.1
Jul.22	9.4	112.6	121.8	134.9	163.3	171.8
Aug.22	9.3	112.6	121.8	134.9	163.3	171.8
Sep.22	10.6	114.5	123.9	137.2	166.0	174.7
Oct.22	11.0	115.6	125.1	138.5	167.6	176.4
Nov.22	10.6	115.9	125.4	138.8	168.1	176.9
Dec.22	10.2	116.1	125.6	139.1	168.3	177.2
⌀ 22	8.6	111.6	120.7	133.6	161.8	170.2

Legal and tax considerations of PRS projects

Business model

Setting up a corporate vehicle to develop PRS projects

In general, Austrian law does not govern a certain business model for PRS investment. The market standard is (also depending on the size of the project) to conclude a memorandum of understanding/head of terms as well as exclusivity and confidentiality agreements (including penalties) before commencing the due diligence process followed by signing and closing.

Any legal entity that can be incorporated in Austria, namely a limited liability company (GmbH), stock company (AG) or even an open, or limited partnership with a limited liability company in the role of the general partner (GmbH und Co OG or GmbH und Co KG) may be and are used as an investment vehicle. The investment vehicle can be set up as a single investor entity or a joint venture (JV) between the investor and the developer, the second option being widely used in such projects where a building is newly erected. It is very common to set up a Special Purpose Vehicle (SPV) for the purpose of acquiring a PRS project. There are two types of deals:

Share Deal

The SPV acquires the shares in the legal entity that owns a property. Since acquiring 100% in a legal entity that owns a real estate triggers Real Estate Transfer Tax (RETT), often specific structures are set up to avoid it. To give a highly simplified example, having two SPVs of which one acquires more than 5% of the shares (such structures should always be made subject to specific tax advice because further considerations must be made). The downside of a share deal is that acquiring a legal entity bears the risk that also economic risks will be transferred and thus, the due diligence has to be more detailed compared to the Asset Deal since the property, as well as the legal entity, have to be analysed.

Asset Deal

The alternative is to directly buy the property. This triggers RETT (3.5%) and land register registration fees (1.1%), but the due diligence is limited to the property. It should be noted that the amount from which these percentages are calculated not only comprises the purchase price but also anything else to be provided/delivered by the seller, hence including the construction costs.

Type of deals: Forward Purchase model or Forward Funding model

A. Forward purchase

In this model, the investor and the developer agree to sign a purchase agreement while the investment is still being developed. The payment of the purchase price together with the transfer of the ownership under the purchase agreement takes place after the occurrence of a predetermined condition precedent, most notably the completion of the works and the filing of the notice of completion with the competent building authority or the achieving of a certain occupancy rate. However, it is also common market practice that during the period after the signing of a purchase agreement, funds are often released upon the completion of predetermined milestones, making this model closer to the forward funding model. In this model, the construction risk remains with the seller.

B. Forward funding

Contrary to the forward purchase model, here the investor and the developer agree on the sale of the property (or the shares in the company, respectively) without the condition precedent of the work being completed. If in this model the transfer is done through an asset deal, particular attention should be paid to the transfer of permits and agreements between the previous owner and the new owner, so that the construction process can continue without being disrupted by any legal obstacles.

Tax issues connected with share deals/asset deals

As mentioned above, RETT in the amount of 3.5% of the purchase price could be triggered. Furthermore, in case of an asset deal, an additional 1.1% will become due as registration fees. For any mortgage, an additional 1.2% in registration fees will become due. By law, both parties to the respective agreement (purchase or loan) owe these fees, but it is market standard that the buyer and borrower bear these costs.

Both the asset deal as well as the share deal require a notary public, but since the asset deal only requires certified signatures whereas the share deal requires a notarial deed, the costs for the former are much lower. There is a statutory tariff, under which the costs depend on the transaction value. However, mostly the costs can be negotiated upfront.

Preparation phase

Location: zoning

It is within the nine Austrian federal states' competence to set a framework on zoning, which means the respective laws differ from state to state. However, while details vary, there usually is a zoning for purely residential purposes and one for other (commercial or mixed) purposes. The states will also enact regional planning schemes, within which limits the municipalities will set the local regional zoning. Naturally, the respective zoning sets the tone for future investment and is thus vital both from the perspective of its potential economic viability and the available methods of commercialisation and use, i.e. the legal forms under which the premises can be rented (residential or commercial area). It is up to the investor's appetite whether or not he/she wishes to invest in this certain area. It is possible to locate PRS projects in areas with various designated purposes, the designation of the chosen area as residential is not necessarily a must. An upcoming form of renting is so-called "micro-living" which can, under certain circumstances, be operated in a mixed zoning, although the building and operating permit will then include significantly more conditions, shaped for the more commercial use of the building. On the other hand, it allows the investor a great deal of freedom in drafting the lease agreements.

Rezoning might be possible depending on the municipality since the zoning plan has to be amended by a decision of the municipality council.

Type of investment: single building or PRS as a part of a bigger investment or separate apartments

Given that PRS investments are not very special, all these kinds of investments exist. However, the bigger the investor, the more unlikely it is that it will only invest in separate apartments. Some investors sell part of the units upfront (built-to-sell) to cross-finance the building phase.

Bank loans are one of the primary sources of external financing.

Due diligence (performed by the investor, lender, and developer)

The due diligence of a PRS project shall always cover the following areas:

- Historical land registry excerpt as far back as possible
- Title to the property for the last ten years
- Access to the property (usually no issue)
- Cadastral maps, zoning plans
- Access to the property, as well as a right of way for third parties that is not registered with the land registry
- Encumbrances to the property (pledges, easements, pre-emptive rights etc.)
- Register of potentially hazardous sites (Verdachtsflächenkataster)
- If applicable depending on the project: existing financing, insurance, lease agreements, permits, agreements with suppliers
- In the case of a share deal, the due diligence should be more extensive and cover all risks associated with the company, such as corporate structure, bookkeeping, employment contracts, litigation, permits, insolvency, etc.

Financing: obtaining external financing

A. Financing model

There are no express Austrian regulations or limitations regarding the funding of PRS projects and the financing may cover the construction and/ or operating phase thereof. Bank loans are one of the primary sources of external financing. Such loans may cover only one project or extend over several locations in one portfolio, which are financed under a credit facility. Notably, financing conditions have become stricter and more conservative since 2022. The standard parameters for LTC (Loan to Cost Ratio) and LTV (Loan-to-Value ratio) are approximately 80%. Loan amortisation is usually at the level of 1–3% per year. The borrowers are usually SPV companies, jointly and severally liable towards the financing bank (depending on the structure and transaction). Financing granted to the parent company and then redistributed to SPVs within the group may be significantly impeded by Austria's strict capital maintenance rules and has to be assessed on a case-by-case basis if feasible. Depending on the structure of the transaction, the bank may verify the agreement with certain parties to ensure that the project is being managed professionally.

B. Collateral

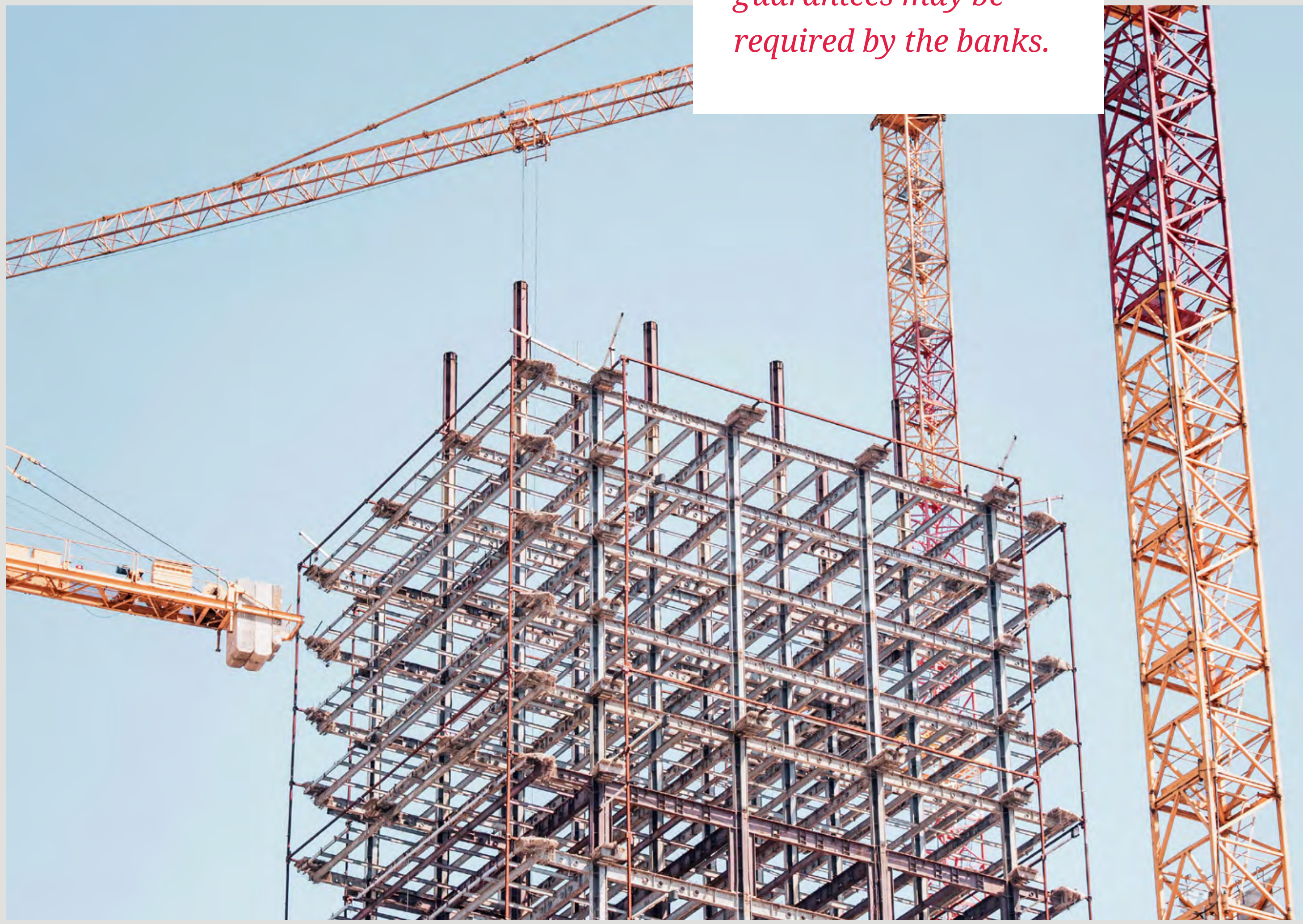
The collateral structure is standard for commercial projects and includes mortgage, pledges over the assets, bank accounts of the borrower(s) and receivables, as well as assignment of rights under insurance agreements and project documents, subordination agreements, and account blocking instructions (not always common). In the construction phase, cost overrun guarantees may be required by the banks (in the operational phase they can be replaced by sponsor's guarantees).

Acquisition

The acquisition of a real property for the purpose of developing a PRS project is no different from the normal acquisition of real property in Austria. The subject of the transaction may be the ownership right to the real property. While the acquisition of freehold (as UK law would call it) was the only relevant form of acquisition in the past, in recent years, it has become increasingly popular to acquire leasehold, by which the property in the plot and the erected building can be separate. Both rights are transferable, alienable, and mortgageable. Under Austrian law, the lawful and proper transfer of the title to a real property to a buyer requires the conclusion of the agreement with certified signatures and the registration of the transaction in the land registry (if an asset deal) or the conclusion of a share purchase agreement in the form of a notarial deed.

If the real property is acquired during the construction process, legal construction issues (e.g., the transfer of the permit to the new owner, transfer of the building agreements) should also be considered in the transactional documentation.

In the construction phase, cost overrun guarantees may be required by the banks.



Operational phase

Residential use (lease agreement) vs. commercial use (accommodation service)

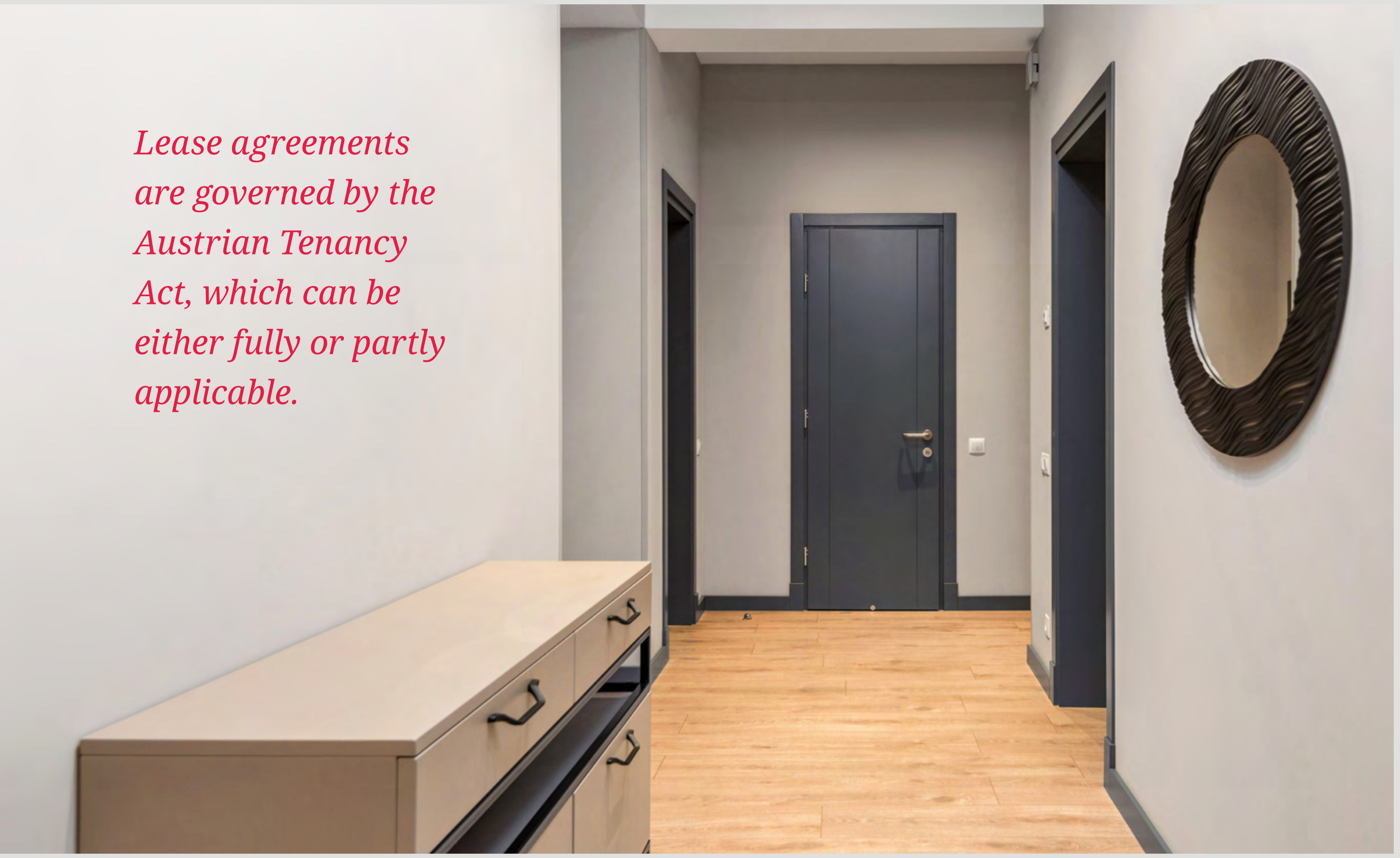
Depending on the zoning (see above), following the completion of the construction works a PRS project may be operated under typical residential lease agreements or accommodation agreements.
The most relevant difference is that lease agreements are governed by the Austrian Tenancy Act, which can be either fully or partly applicable. In respect of recently erected buildings, it will generally be partly applicable only, except for cases where the building was erected using subsidies and is solely owned by the investor, in which case the building would fall under the full scope of the Act (having major implications including rent control, the details of which would go beyond the purpose of this report). This is also the reason why investors try to buy an entire building and buy out all the tenants, to then tear the building down and build it new as it would then not fall under the full scope.

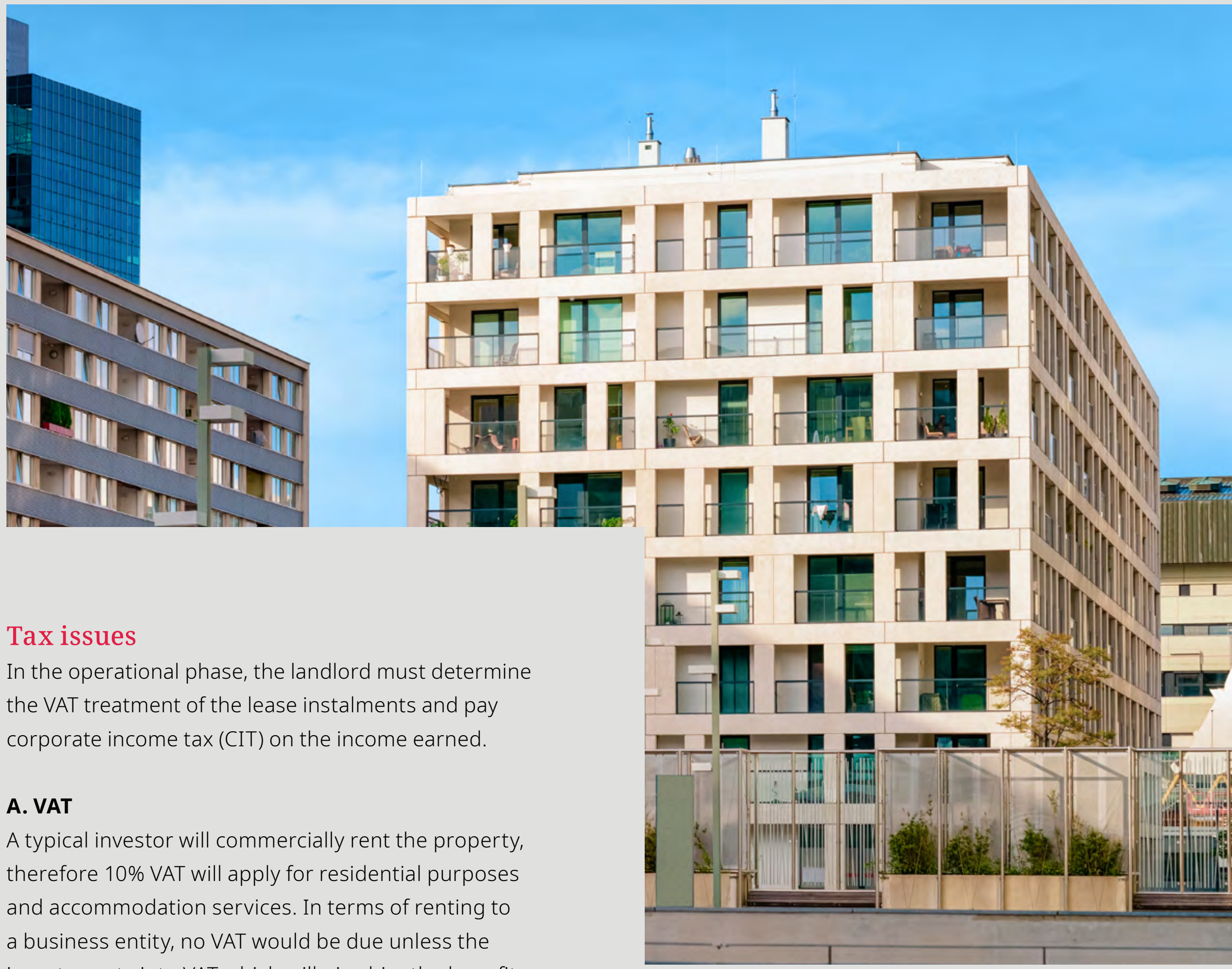
Within the part scope of the Act, here the legal implications are much less, only imposing a minimum term of three years where the agreement has a fixed term, and, conversely, if concluded for an indefinite period, the agreement is only terminable for cause.

Accommodation agreements allow the conclusion for any period and are a way to circumvent the rent control if the building is in non-technical terms older and has been revitalised as part of the PRS projects. However, it would mean that certain services must be provided to the tenants.

In respect of both agreements, it should be noted that Austrian Consumer Protection Agencies are currently looking closely into agreements concluded by bigger investors whether they are in line with statutory law. Also, given that investors usually use the same contract repeatedly, the contract is qualified as general terms and conditions and additional legal control mechanisms apply.

Lease agreements are governed by the Austrian Tenancy Act, which can be either fully or partly applicable.





Tax issues

In the operational phase, the landlord must determine the VAT treatment of the lease instalments and pay corporate income tax (CIT) on the income earned.

A. VAT

A typical investor will commercially rent the property, therefore 10% VAT will apply for residential purposes and accommodation services. In terms of renting to a business entity, no VAT would be due unless the investor opts into VAT which will give him the benefit of deducting input tax for the construction works. This is recommended in many cases, as most businesses can in turn deduct input tax on the rent.

B. CIT

From the profit shown in the annual accounts, 25% CIT will become due. In the mid of every quarter, the corporate body must pay tax prepayments.

C. Additional taxation

In addition, the owner of a real property is obliged to pay real estate tax. Local authorities determine the rates of this tax within statutory limits.

Lease agreements with business entities will trigger a 1% stamp duty if signed. This is calculated from the gross rental income for the first three years (if indefinite period) or for the entire period (if fixed-term contract, but 18 years max). This is only a very rough overview; stamp duty law is very complicated in detail and there is also often some room to avoid stamp duty.

Currency of the rent

EUR.

Exit plan

The investor can usually freely choose from the various options that exist (sell the SPV, sell the whole building, sell individual units). In relation to accommodation services, the first two will be preferred. The last option will be attractive where the investor has already sold part of the units (see above) because the potential total of the entire purchase price will be higher and the burdens of establishing condominium property have long been completed. Whether the SPV can be sold, depends, as always, on the attractiveness of the investment and the power of the contractual partners, depending on the demand and the offered purchase price. In various scenarios, buyers may not be willing to buy in risks that reside in a company.

The sale process would then, however, not be very different from a typical sale of shares. Also, the sale of the whole building and the individual units will be the same as other sales of real estate properties.

PRS Market in CEE

Czech Republic

The PRS market in the Czech Republic is developing, although it is still relatively small compared to other European countries.

Czech Republic, and Prague more specifically, is firmly in the cross-hairs of PRS investors, albeit the relatively immature market is facing what could be best described as teething problems. The current high cost of CZK denominated debt combined with rental income typically being paid in local currency, has resulted in a slow-down of what was shaping up to be a rapidly growing sector. Notwithstanding this, the number of PRS units in Prague already exceeds 4,700 and there are over 1,100 units under construction currently. High occupancy rates, increasing rents, and a discerning tenant base with good levels of disposable income are some of the appealing factors investors consider when assessing the PRS opportunity in Czech. This is coupled with a housing market that has seen rapid price growth, to the point that home ownership is now out of reach of many would-be owners. It is important to consider the form of the project company, location and zoning, and due diligence before initiating a PRS project in the Czech Republic. Both share deals and asset deals are feasible in Czech jurisdiction.

Stuart Jordan
Managing Director
Savills

David Padyšák
Of Counsel | Head of Real Estate
DLA Piper

PRS market – attracting investors, but increasingly expensive

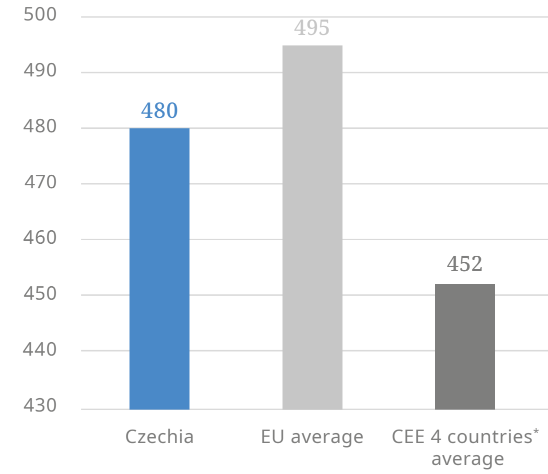
Residential sector overview

The Czech Republic sits in the middle of the European league table with 480 dwellings per 1,000 inhabitants – roughly the equivalent to one dwelling for every second person living in the country (population 10.5 million).

The overcrowding rate is defined as the percentage of the population living in an overcrowded household. A person is considered as living in an overcrowded household if the household does not have at its disposal a minimum of rooms equal to:

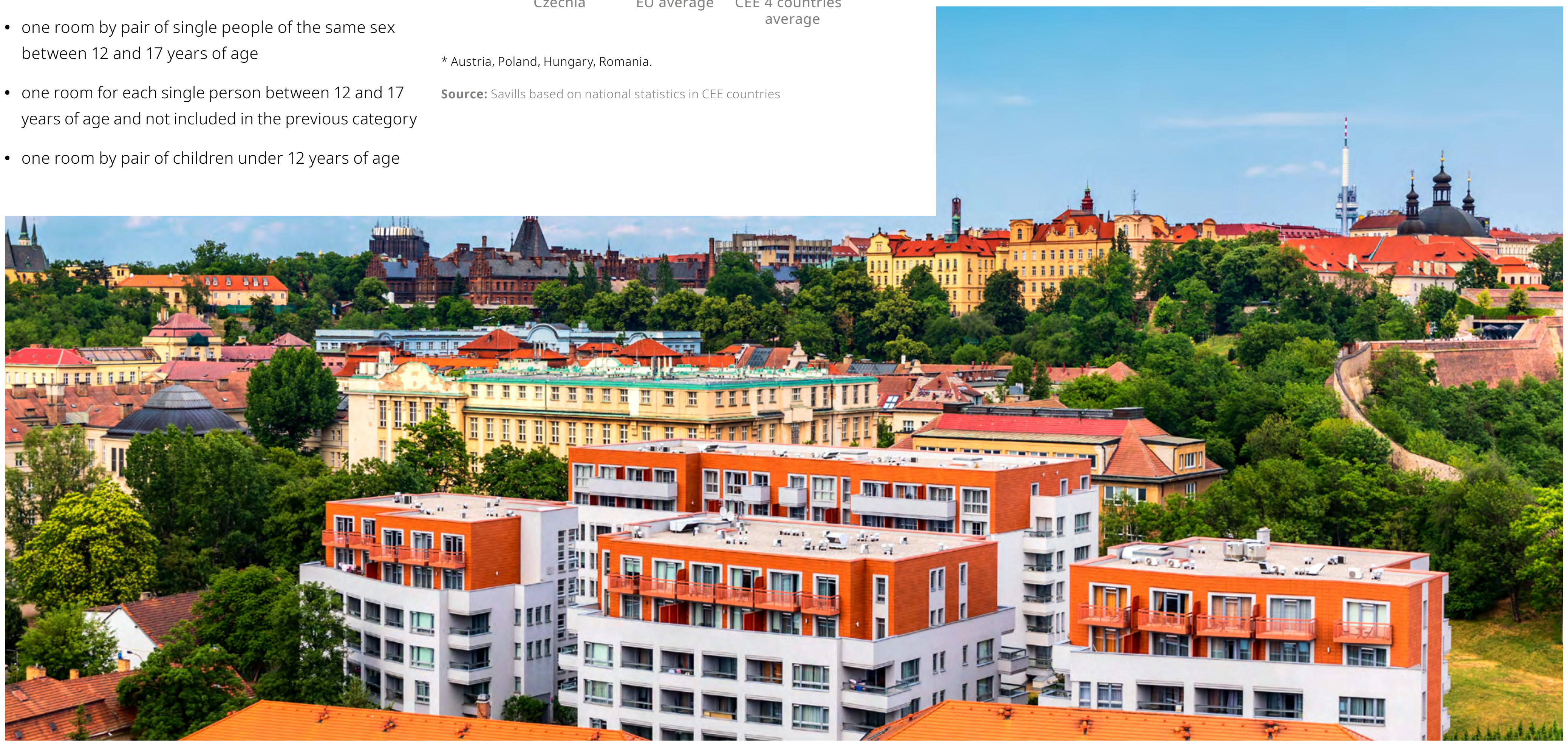
- one room for the household
- one room by couple in the household
- one room for each single person aged 18 and more
- one room by pair of single people of the same sex between 12 and 17 years of age
- one room for each single person between 12 and 17 years of age and not included in the previous category
- one room by pair of children under 12 years of age

Number of dwellings per 1,000 citizens

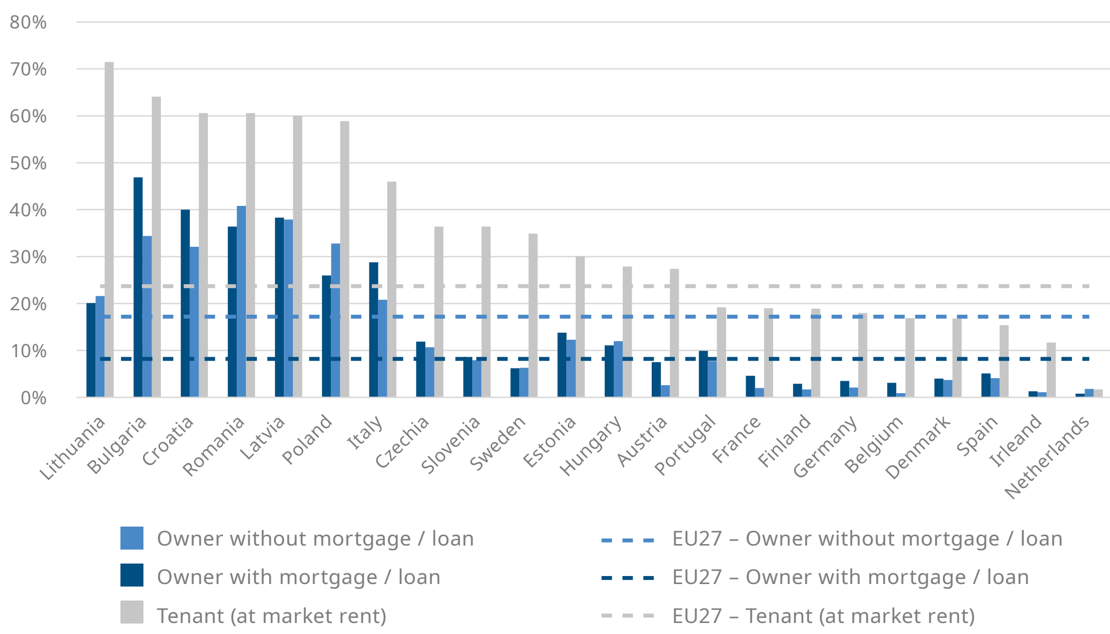


* Austria, Poland, Hungary, Romania.

Source: Savills based on national statistics in CEE countries



Percentage of population living in an overcrowded household in 2021

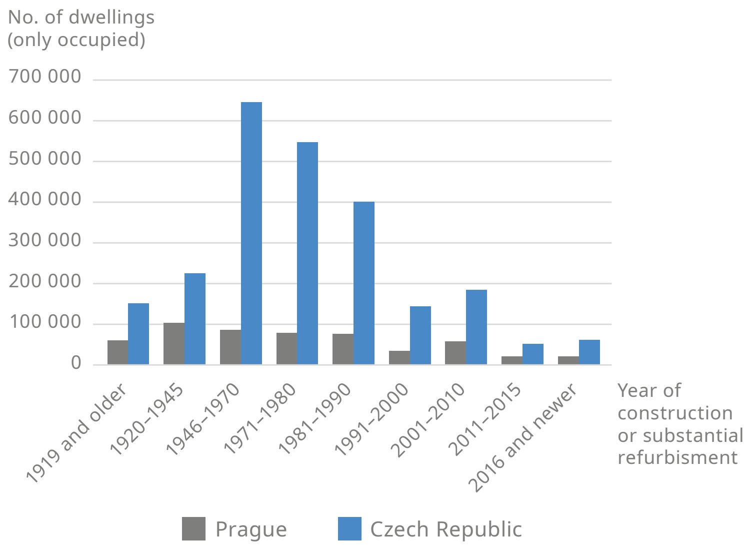


Source: Eurostat

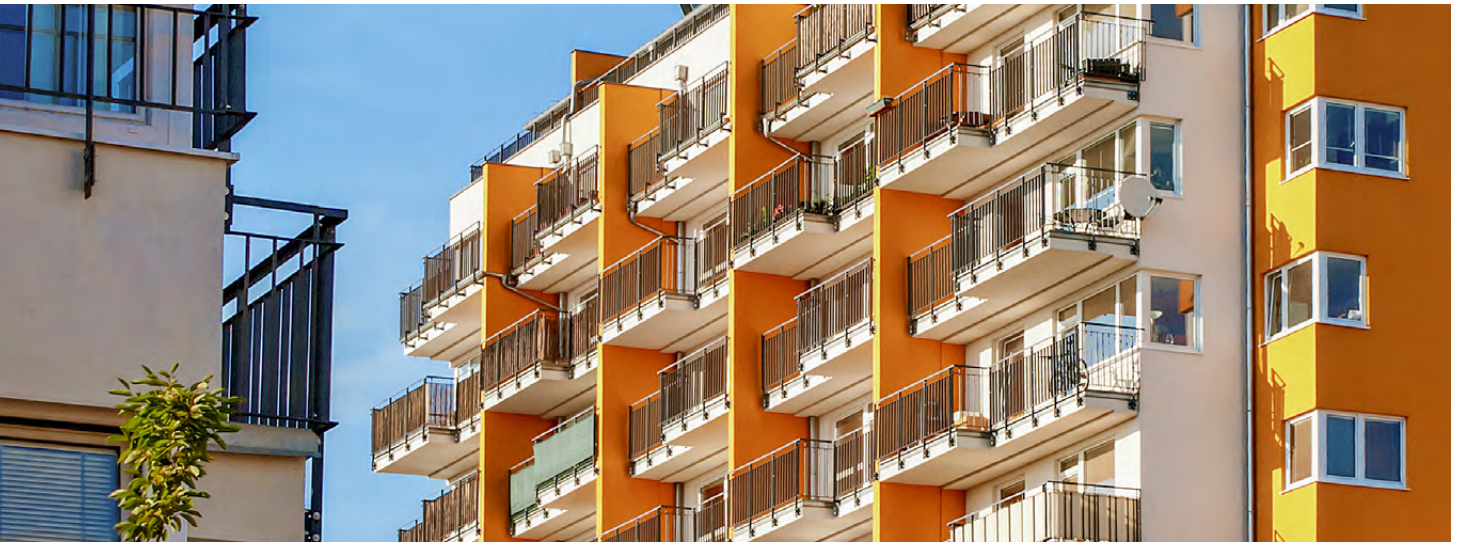
Nationwide the rate of home ownership is 78.3%, which has been consistent within <1% for the last 8 years. In Prague the figure reduces quite significantly to around 68% of the city's population owning their own homes (and even further to around 45% for the age bracket 19–29)

The average age of the total housing stock in the Czech Republic is increasing and reaches around 50 years.

Occupied dwellings – property age



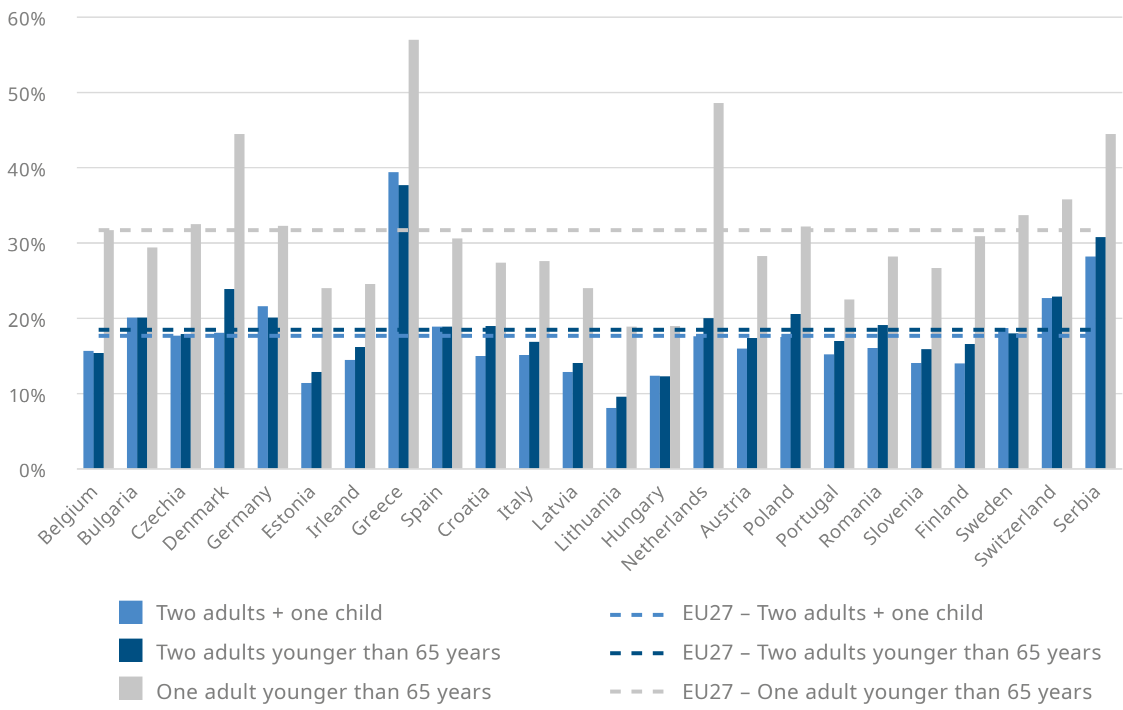
Source: Czech Statistical Office



Housing costs in the Czech Republic include rental or mortgage interest payments but also the cost of utilities such as water, electricity, gas, or heating. Such costs are considered as an excessive burden when they represent more than 40% of disposable income. Czech Republic sits at the EU average when considering both single and two person households. We note that these figures are national averages however, and that in Prague the affordability ratio will be diminished due to the elevated cost of housing in the capital city against the rest of the country.

Moreover, the latest mortgage rules recommend that the total value of mortgage cannot exceed 9.5 times the net annual income for applicants under 36 years of age and 8.5 times for those aged 36 and over. At the same time, applicants must prove that monthly mortgage repayments of all their loans do not exceed 45–50% of their net monthly income.

Share of housing costs in disposable household income in 2021

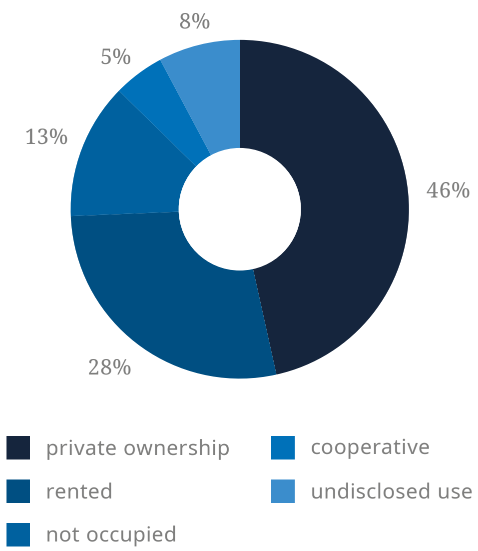


Source: Eurostat

With rents in Prague increasing over 25% y-o-y during 2022, average rental costs for a one-person household as a percentage of average income is now well over 40%; excluding other occupancy costs such as utilities, common costs, etc. Depending on location and quality standard, renting a two-room apartment with a kitchenette in Prague costs on average between CZK17,000 – 25,000 per month (excluding utility costs), while one-bedroom apartments of around 30 m² typically cost between CZK12,000 – 17,000 (approx. EUR500 – EUR700) a month. The average net salary in Prague stood around CZK38,600 (approx. EUR1,600) per month in Q3 2022, while the more precise median salary in Prague is expected to be around CZK32,000 (approx. EUR1,350).

According to Census 2021, there were 4,480,139 occupied dwellings in the Czech Republic (plus an additional 859,894 that were not occupied) and of the total occupied housing stock, 20% were rented. In Prague, the total inventory of occupied flats reached 627,705 (and a further 93,627 were not occupied), and rented apartments represented a share of 32%.

Prague housing stock in 2021



Source: Czech Statististical Office – Census 2021

The largest portfolio of rental apartments in Prague is owned by the city itself (according to data as at 07/2021, the city owned 30,345 flats). These flats are mostly rented under indefinite lease contracts concluded before 1989 and at rents significantly below the market. Nowadays, public housing is offered on a priority basis to specific social groups that are disadvantaged by age, disability, etc. or to public sector employees. The majority of these city-owned buildings are also in a need of substantial refurbishment.

The total inventory of municipal housing has been reduced by approximately three quarters over the last 20 years, as a result of the ongoing privatization of city-owned housing. Prague city districts continued selling their flats to private owners (mostly long-term tenants of those flats).

Historic development of the PRS stock

The Apartmány Praha Albertov complex was completed by the CTR Group in 2008 and is considered to be the first modern scheme offering short to long-term rentals, in a purpose-built PRS asset.

The total stock of PRS is comparatively low (against other European capitals) in Prague and indeed nationally. Historically this is due to a culture of home ownership combined with relatively low prices to purchase one's own dwelling. As the cost of buying housing has increased, dramatically in recent years, as a proportion of income, it has forced greater numbers of would-be buyers into rental accommodation. We are yet to see a macro-sized shift towards rental housing development given the historically low-risk environment for developers in the 'B to C' market, though an increasing number of developers are now identifying rental housing development as an option as sales of new apartments have, for want of a better phrase, 'fallen off a cliff' in the last 12 months. An example of this is the push to rental housing by the developer AFI, who plans to build and manage more than 800 beds in Prague in the short to medium term.

Current and expected situation in the PRS market

There are approximately 4,780 PRS units in Prague (includes properties with over 20 units) in 42 buildings. Half of these buildings provide 4,220 units, whilst the remaining half of buildings provide 560 units i.e., there are a significant number of properties containing a small amount of units. From an investment point of view, this makes attaining scale quite difficult from the existing stock base.

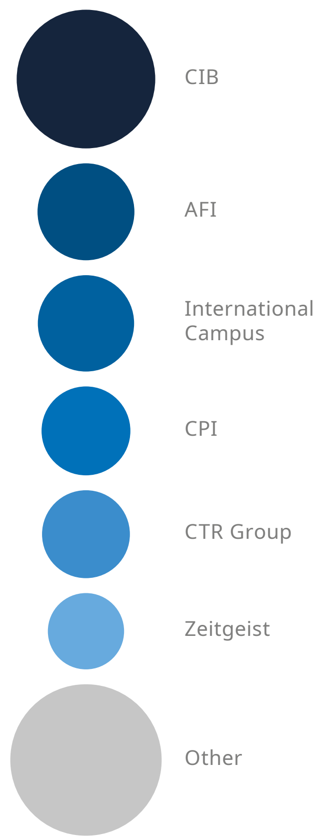
More than 1,100 units are under construction in Prague and are to be delivered during 2023 and 2024. At least a further 4,500 units are known to be planned with delivery scheduled during the next 5 years.

Of the 42 buildings in Prague with over 20 units, four landlords own 20 of them. The largest landlord in Prague by number of units is CIB GROUP, a Czech domestic property company, with 1,117 units. Outside of the capital city, CPI, a Czech domestic property company, owns a regional portfolio of c. 12,000 units. Heimstaden, a Swedish residential real estate company, owns a portfolio of c. 42,700 units in the country's third most populace city, Ostrava.

We consider that there are three main demand drivers for PRS:

1) affordability,
2) housing shortage, and
3) lifestyle trends.

Rental Apartments in Prague – largest owners (by number of units)



Arguably the most significant demand driver of the PRS market is the high cost of purchasing real estate, which is a barrier to entry for a large chunk of the potential market. This of course pushes people into rental accommodation as they cannot afford to purchase their own dwelling. In Czech generally and in Prague even more so, there is a perpetual undersupply that results in not enough dwellings being available to purchase to satisfy the demand side drivers (this of course ties in heavily to the high cost of purchasing dwellings). Also, these other demand drivers are coupled with the shifting trend that gives higher priority to lifestyle & flexibility, especially amongst the younger cohorts (i.e. previously what would have been first-time buyers). Within this is both the desire to 'not be tied down' to either a mortgage or to one location and the lifestyle expectation of wanting the best – location, building, furnishings, etc. – which are quite often unaffordable to purchase but more accessible via rental accommodation.

There are 9 PRS developments under construction, scheduled to open between 2023 and 2025. These will provide an additional 1,157 units.

Currently, the most significant challenge is the high cost of CZK debt (Czech central bank base rate is at 7%). As most investors underwrite their modelling assuming CZK income (rental payments in EUR in Czech are not very common in the residential sector, though this an aspect of the market that investors are keen to explore in more detail) it is natural to then assume taking on CZK denominated debt. However, this is currently prohibitively expensive, especially against the returns possible through the sales prices that developers/owners expect. An additional challenge is the fact that in the Czech Republic there are a limited amount of large cities with enough depth to absorb PRS accommodation, which reduces the possibility of (easily) building any significant scale in the country (however, we do consider there to be enough demand-side opportunity to easily sustain > 1,000 beds across the main cities, and so only the largest of investors may perceive this point as a challenge). Other than this, Czech, and especially Prague, face little challenges for PRS and the sector has got a bright and very viable future here.

Of the 4,780 PRS units in Prague, 1,476 of them are over ten years old. A number of the city's units are in old buildings that have undergone full refurbishment, however these generally provide a high standard and would not be considered as 'dated'. The recent growth of the PRS market in Prague is perhaps best highlighted by the fact that 2,153 units have been delivered to the market since 2020, i.e. in the last three years the size of the market almost doubled.

Institutional rent in practice

Cost typically covered by tenants vs. cost incurred by landlords: as the market is still quite immature, there is not necessarily a 'typical' structure established in the PRS sector. Of the existing stock, we see varying approaches of true triple net and 'all in' monthly payments, through to examples where rent (apartment, parking and storage split out separately), common cost, and private utility consumption are individually charged to each tenant.

There is no maximum term limit for a lease period, but most Czech residential contracts are typically for a 12-month period or an indefinite period (with notice periods then governing termination provisions).

We expect a gross to net ratio of something in the order of 25%, much the same as the wider European market. With the increased occupancy costs via energy bills, it may be that landlords have to subsidise some of this and so incur a higher rate of leakage (though with rental demand so high, it is still a landlords' market and so competing for tenants via subsidised offers is not necessary in the current market climate).

Rent indexation isn't common in the Czech Republic. Rents are agreed between the parties, usually with no defined indexation provisions. Annual expiries essentially provide the opportunity for the landlord to capture any rental gain.

Legal and tax considerations of PRS projects

Business model

Setting up a corporate vehicle to develop PRS projects

This brings the advantage of risk spreading and diversification. At the same time, it makes it possible to control and get rid of unprofitable or no longer wanted SPVs (Special Purpose Vehicles). This model is also used in the case of new developments, i.e., if a development project fails, it can be easily cut off. When choosing the form of a project company, it is necessary to consider the following: the need for funds for the project, the need for tax optimization, the flexibility of selling participation in the company, and the administrative complexity of managing the company.

Type of deals

A. Share Deal

The first option is to buy the legal entity that owns the property (i.e., the share in the company). In the Czech Republic, such a legal entity is often organized as a limited liability company (in Czech: *s.r.o.*) or a joint stock company (in Czech: *a.s.*). Where the shares in a limited liability company are to be transferred, statutory law requires that signatures of the parties on the share purchase contract are notarized or authenticated in other permitted ways. Notarization is not required for the transfer of shares in a joint stock company. As with asset transfers, due diligence in advance is highly recommended.

In the Czech Republic, reliable shareholder registers do exist. An exception is joint stock companies with more than one shareholder, as such companies are not obliged to record the current shareholders in the Commercial Register and ownership can be proven by an extract from the list of shareholders maintained either by the company itself or by the Central Depository. It is therefore necessary to keep an unbroken chain of previous transfers. At the same time, it is important to keep an eye on any restrictions on the transfer of the shareholding under the founding deed (e.g., shareholder approval or restrictions on shareholder pre-emption rights). The share transfer agreement must contain the conditions prescribed by law to be valid and have legal effects. Transfer of shares in a limited liability company must be registered in the Commercial Register based on the relevant application and documents.

B. Asset Deal

The other way is the purchase of the asset. This is also possible, however, less frequent. However, since the real estate transfer tax was revoked in 2020, the asset deal became nowadays a comparable option to the share deal. The buyer can acquire the property directly from the property owner. All legal formalities must be complied for such a transaction to be effective, in particular, the Land Register requirements.

The memorandum of understanding or head of terms is usually drawn up and signed before the actual asset transfer agreement is signed. Exclusivity and confidentiality agreements with penalty provisions in the event of a breach are valid and enforceable and are widely used.

Unlike other jurisdictions, Czech law does not require the filing of an application by a notary. However, the certified signature (in Czech: *úředně ověřený podpis*) of the asset transfer agreement is required to register the property within the Land Register. And the parties must submit the application to the Land Register.

Tax issues connected with share/asset deals

As mentioned above, the real estate transfer tax has already been abolished. Thus, the specifics of the individual case must be considered. In relation to the ownership of a share in a limited liability company or public limited company, income tax applies to the payment of profits, and, in some cases, value-added tax. The tax treatment of the sale of the share depends on whether the share is classified as a business asset and in situations where the value of the original share increases.

Preparation phase

Location: zoning

A territorial plan (in Czech: *územní plán*) sets out the basic strategy for the development of the municipality, the protection of its values, its layout, its landscape, and the necessary public infrastructure. The functions of the territorial plan include delimiting the developable area. For a settled area, the municipality may also issue a regulatory plan (in Czech: *regulační plán*). These plans are quite rigid, and their changes may be problematic. Thus, it is desirable, if the area of interest is already designated for the required purpose, i.e., as the residential area, or mixed residential area. We would recommend taking this into account within the preparation phases of the PRS projects and the consequent due diligence.

Construction and refurbishment may, in principle, only be carried out following the grant of planning permission (in Czech: *územní rozhodnutí*) and subsequently of building permission (in Czech: *stavební povolení*).

Planning permission is issued as part of the process of spatial planning. The subject of the planning permission might be the location of the relevant building, subdivision and land consolidation, and alterations to the impact of the building on the use of the area. This permission must comply with the territorial plan and/or regulatory plan.

Building permission is issued subsequently to the planning permission and, in it, the building authority lays down the conditions for the development of the structure and, if necessary, for its use.

Once the construction has been completed the designated use of a building needs to be approved by the Building Authority by the use permit (in Czech: *kolaudační rozhodnutí*).

Any change in the use of a building, in its operational facilities (the equipment in a building necessary for its operation), in its method of construction or any substantial extension of or change in the activity carried on there, the effects of which could endanger life or public health, the life or health of animals, safety or the environment, is permitted only on the basis of an approval or a permit issued by the responsible Building Authority.

Finally, a new Building Act will be implemented in the Czech Republic, and under the worst-case scenarios it may prolong and complicate any development in the coming years.

Type of investment: single building or PRS as a part of a larger investment or separate apartments

We can see that this is very individual in the Czech Republic. PRS projects do not have a long tradition in the Czech Republic, but they become more and more popular. We provide more examples of recent PRS investments conducted in the Czech Republic below.

In the last few years, we have seen that a leading European residential real estate investor and manager acquired over 40,000 apartments in the Czech Republic (in Pilsen, Prague, and Moravian-Silesian region), which they acquired, mostly, as an existing portfolio of rented apartments.

On the other hand, the new development projects growing in the capital are usually a combination of built-to-sale and built-to-rent apartments within one project. In such cases, it is necessary to adjust relationships within such condominium of the sold units and the rented units.

There are also some newly constructed or reconstructed projects purely for rent.

PRS projects do not have a long tradition in the Czech Republic, but they become more and more popular.

An interesting option may be a right of construction (in Czech: *právo stavby*), which was newly established under the Czech Civil Code in 2014. Briefly, it allows one to build and maintain, or acquire and maintain, a building on someone else's land. One of the reasons for the establishment of the right of construction has been to allow residential construction on third parties' land, especially in the ownership of the municipalities. The right of construction may be established for a fee, or free of charge. However, this right is only temporary, and it cannot last longer than 99 years. After this period the right of construction ceases to exist, and the landowner shall pay the reimbursement to the holder of the right of construction.

Due diligence

Taking into consideration the specifics of the real estate projects, it is important to carry out a thorough survey of the land, which may reveal environmental contamination or other technical risks associated with the project's implementation. The legal and technical audit should therefore be carried out within a reasonable time so that a decision can be made on whether to proceed based on the project's findings. Moreover, verification of title to the property is a necessary step in starting a project. It is usually verified at least the continuous succession of the owners of the property over the last ten years and the last preceding acquisition title ten years back.

In asset deals, the following categories are usually further investigated:

- cadastral maps, conveyance plans, plans of buildings
- access to the property
- available utility networks
- restitution claims (due to the historical confiscation of private property)
- encumbrances to the property (such as pledges, easements, real burdens, building rights, pre-emptive rights, etc.)
- construction work (e.g., if all appropriate permits by the Building Authorities and all contracts for works and relevant guarantees are available)
- lease contracts with the tenants
- contract with suppliers (in particular, supplies of utilities, maintenance, property management)
- financing and insurance

In the share deals, the due diligence should be even more extensive. It should cover the following aspects:

- financing and insurance
- risks associated with the project company's corporate structure
- regulatory risks (e.g., competition law)
- ownership of movables
- ownership of intellectual property
- financing of the company
- commercial contracts
- human resources (i.e., employees, contractors)
- litigations, etc.

There are many types of risks, which are related to the individual case, therefore due diligence should not be underestimated.

The risks discovered during due diligence are then usually reflected in the (asset, or share) transfer agreements under the representations and warranties by the seller, borrower, or current investor when a new investor enters.

In summary, it can be said that the extent of the due diligence depends on the kind and the respective stage of the project, type of deal, and intended business model.

Financing: obtaining external financing

A. Financing model

There is no special Czech regulation regarding the financing of PRS projects. PRS projects financing involves financing or refinancing the acquisition and/or development and/or operation of the property where the principal debt is generally secured by the capital value of the property and the debt is services from the income generated by the occupation of the property.

A lending institution may conduct its own due diligence, which should cover market and location analysis, review of profitability, tenant analysis, and recoverable and non-recoverable costs.

PRS projects financing is possible with long-term and short-term loans. In both cases, there is a risk of rising interest rates. Fixed interest rates are usually used to minimize such risk. If the loan is extended or the follow-up financing is concluded, hedging by the derivates, in particular, by interest rate swaps, is recommended.

B. Collaterals

The standard securities created to secure real estate financing are applicable also in the case of PRS projects. These are usually a mortgage over the property which is the subject of the financing, a pledge or assignment of receivables arising out of the relevant project agreements (in particular lease agreements), a pledge

or assignment of receivables arising out of insurance policies, a pledge or assignment of bank accounts receivables, a pledge of the relevant SPV's shares/ ownership interest, and finally bank guarantees or parent guarantees.

The parties may agree to subordinate an existing debt to another by a subordination agreement in which one creditor agrees that the claims of another creditor must be fully paid before there is any payment to the subordinated creditor. The parties may also agree to a second-ranking mortgage over the property.

In addition, it is common to enter into agreements in the form of notarial deeds consenting to the direct enforceability of the relevant borrower's payment obligations.

Moreover, the lending institution has a reasonable interest in the preservation of the value of the property as well as in the provision of the required income under the lease agreements, so a duty of care agreement may be concluded as a measure of providing extra security.

There are no restrictions on granting security to foreign lenders. Should the foreign lender be a bank, specific requirements relating, in particular, to banking licenses must be satisfied. And, of course, all lenders are subject to the Anti-Money Laundering regulation.

Acquisition

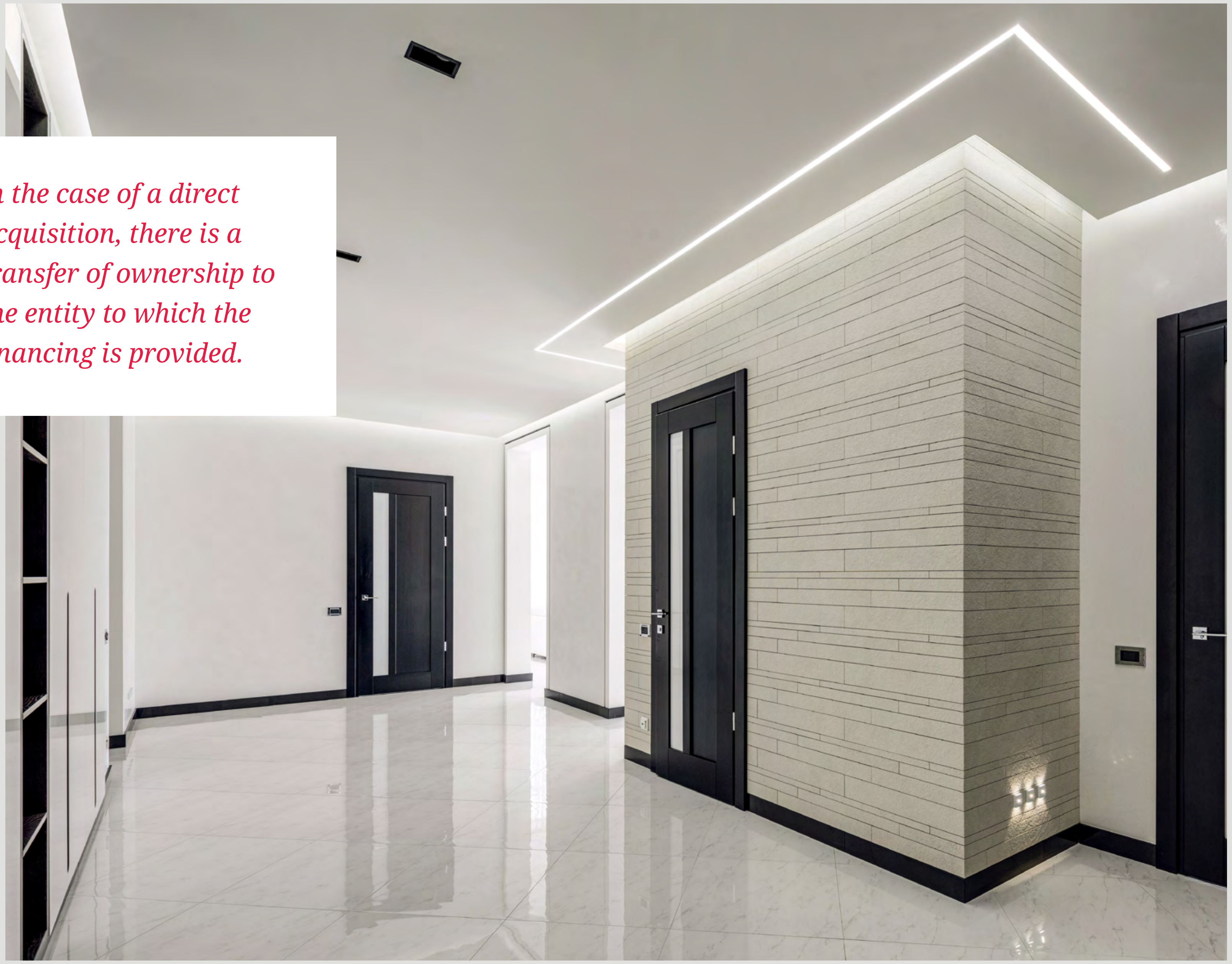
No specific requirements for these specific projects apply, so the general regulation of acquisitions can be followed.

In the case of a direct acquisition, there is a transfer of ownership to the entity to which the financing is provided. This fact entails the need to incorporate this factor into the financing structure. It is in the bank's interest to provide the financing after the title to the property has been registered in favor of the purchasing entity, whereas it is in the selling entity's interest to obtain the purchase price before or at the latest at the time of the conclusion of the purchase contract. It is a matter of commercial negotiation to determine how the transaction is structured and what risks the parties are willing to assume.

It is also possible to use mortgage financing, i.e., for the bank to provide financing in connection with the concluded purchase contract, i.e., before the registration of the title in favor of the buyer in the Land Register, but in principle, without exception, banks insist that the property shall be provided as security for the bank's future claim on the buyer before the purchase contract is concluded. The only way to structure the transaction in this way is for the seller to establish this security in the form of a pledge in favor of the bank.

In the area of competition law, it is necessary to examine whether there is a distortion of competition. If the criteria laid down in the law are exceeded, it is necessary to seek approval of the merger transaction in proceedings before the Czech Office for the Protection of Competition.

In the case of a direct acquisition, there is a transfer of ownership to the entity to which the financing is provided.



Operational phase

Residential use (Lease agreement) vs. Commercial use (Accommodation service)

Czech law does not know of any specific lease agreements that would differ from the usual ones for PRS projects. Therefore, the lease provisions will apply.

A. Residential use:

Residential leases are regulated significantly more than commercial leases of immovable property used for business purposes, as Czech law provides greater protection for the tenant as the weaker party. For this reason, the tenant is entitled to special protection in comparison to the non-residential cases (e.g., restrictions on rent increases, maximum deposit and contractual penalties, legal grounds for termination of the lease, etc.). The lease agreement should also specify which services related to the use of the apartment are the responsibility of the landlord. If such services are not provided for, the landlord provides the necessary services such as water, waste management, lighting, and cleaning of shared areas.

B. Accommodation services

The Czech Civil Code also regulates an accommodation contract (temporary lease). In an accommodation contract, the accommodation provider undertakes to provide temporary accommodation to the accommodated person for an agreed period, or for a period resulting from the purpose of the accommodation in a facility designed for this purpose. This legislation applies to accommodation in hotels, hostels, and similar establishments. The customer undertakes to pay the accommodation provider the agreed price for the accommodation provided and for the services connected with the accommodation. The main difference between residential use and accommodation service is the purpose and the agreed period. The lease agreements are concluded for fulfilling the tenant's housing needs for a longer period. On the other hand, the accommodation contracts are concluded for the purpose of accommodation for a short period of time.

Tax issues

A. Value-Added Tax (VAT)

Under Czech law, the rental of real estate is exempt from value-added tax. However, such exemption does not apply to the short-term rental of immovable property, rental of premises and places for parking vehicles, rental of safety boxes, machines and other fixed equipment, and other exceptions. It can therefore be generalized that long-term rentals used for permanent residential purposes are not subject to VAT. To assess whether the lease of immovable property is exempt from VAT or not, the Czech Tax Office determines what purpose is registered in the Land Register.

Every natural person owning real estate is obliged to pay property tax, as are most legal entities.

B. Income Tax
The rent itself is then subject to income tax. It can be applied in the actual amount or at a 30% flat rate up to CZK600,000 (approx. EUR25,000) per year. If it is applied to the actual amount, the total rental income can be reduced by the demonstrably incurred costs. It is therefore necessary to keep and store all documents relating to income and expenditure for this purpose. In the case of actual expenditure, it uses the owner for the costs of renovations, repair costs, costs of furnishing the flat, depreciation, repair fund costs, and insurance of the flat. Also included are the costs of acquiring the apartment, whether mortgage interest to financial institutions, real estate agent commissions, or property tax. The income tax rate is 15%. Income from the sale of immovable property is also subject to tax, with certain exceptions.

C. Real estate Tax
The law distinguishes between tax on buildings and tax on land. If a building is built on land, the land is not subject to tax and the subject is only the building. Every natural person owning real estate is obliged to pay property tax, as are most legal entities. The tax is based on the built-up area in m². The rate for flats is CZK2 per 1 m². In the case of flats, the basic coefficient is 1.22 if the ownership of the flat includes a share in the land and 1.20 in other cases. In addition, a local coefficient is added to the tax, which depends on the size and number of inhabitants in the municipality to which the flat belongs in the land register. This coefficient takes the form of values of 1–5.

Currency of rent
Rent can be paid in Czech crowns or foreign currency. The currency is subject to agreement between the landlord and the tenant. In the current economic situation of the Czech Republic, the inflation rate as of January 2023 is 15.8%. Regarding inflation, the law directly allows the parties to agree on annual rent increases, e.g., through a so-called inflation clause. These institutes and the agreement on the currency are purely a matter for the parties. However, the charges that relate to the housing (waste fees, etc.) are usually in Czech crowns. For better clarity, it is recommended to arrange the payments of rent and charges in the same currency.

Exit plan

Ownership transfer: project vs. single building vs. separate premises
All three scenarios are possible. A whole project (i.e., existing assets with rented units) may be sold to the new investor, or the individual units may be sold directly to the tenants, or third parties.

A. Sale of the investment project
In general, the sale of a project is treated like any other type of business sale and the law does not require any specifics. The sale of a project is usually done by selling the project company that has been set up for the project. It is also possible to use a contract for the sale of a business share or for the transfer of shares of the project company. Besides that, the sale of the project can be carried out based on a comprehensive purchase contract. The basic parameters of a purchase contract from a financing point of view are the maturity of the purchase price, the need for refinancing, and the pricing. The final investor conducts a legal due diligence of the project company, based on which the acquisition structure and contractual documentation are adjusted. If the final investor acquires shares in a project company that is a debtor to banks, it is necessary to determine whether the loan agreement contains restrictions on transfers of shares in the project company (change of control clause). If so, the bank's consent to the transfer of shares should be sought, or at the time of closing repay the loan to the bank from the funds provided to the project company under a new loan from another bank or the investor. For these purposes, confirmation of the amount of the loan (pay-off letter) is usually required from the existing bank and subsequently, a certificate of release of collateral (release of security). The actual transfer may take place sometime after the conclusion of the contract, usually several weeks.

B. Sale of the units
The ownership right to the unit is acquired by registration in the Land Register based on a valid and effective contract of transfer of ownership. In the case of the sale of separate units (i.e., apartments), the legislation on housing co-ownership is also applied, where the owner of the unit is the exclusive owner of the defined exclusive part and at the same time a special share owner of the common parts of the divided property jointly with other unit owners. Unless agreed otherwise, a unit owner's share is determined as a ratio of the unit's floor area to the total floor area of all units in the building. The unit owners are members of a legal entity founded for the purposes of building administration and maintenance (in Czech: *společenství vlastníků jednotek*).

C. Sale of the single building
At the outset, it may be noted that this form is not usually used due to tax disadvantages and the need to transfer all contracts (except leases) relating to the project, which are not terminated on sale, despite the advantages of reducing the risks associated with the history of the project company (hidden liabilities, etc.).

PRS Market in CEE

Poland

The PRS market in Poland is still relatively small compared to other European countries, but it is growing rapidly.

The younger generation in Poland is being forced out of the ownership market due to high apartment prices and falling mortgage affordability. As a result, renting has become a popular alternative despite soaring rents in 2022. The COVID-19 pandemic accelerated the trend of people seeking more flexible and affordable housing options, and the PRS market is well-positioned to meet this demand.

The total investment in the PRS sector in Poland exceeded EUR1.8 billion by the end of 2022, with nearly EUR750 million recorded in 2021. Currently, there are 70 operational projects with 11,640 units for institutional rent offered, and there is potential for PRS investors to provide high-quality, well-designed products with the country's large share of aged housing stock.

Warsaw, Wrocław, and Cracow account for nearly 75% of the total PRS stock, and the top three investors, Resi4Rent, Rental Housing Fund, and Vantage Rent, account for over 58% of the market. However, investors face challenges such as geopolitical risks, high borrowing and construction costs, and potential new taxes, while new opportunities include converting existing office buildings and adapting older tenement houses to institutionalized rental market. Different VAT rates or exemptions apply during the operational phase and rent in euros is possible. Various methods of setting up a business on the PRS market in Poland are available, and models from other PRS markets can be used in Poland.

Overall, the PRS market in Poland is seen as a promising investment opportunity due to the strong demand for rental housing and relatively low levels of competition. However, the market was still in its early stages, and there were some regulatory and legal issues that needed to be addressed to support its further development.

Kamil Kowa
Board Member | Head of Corporate Finance & Valuation
Savills

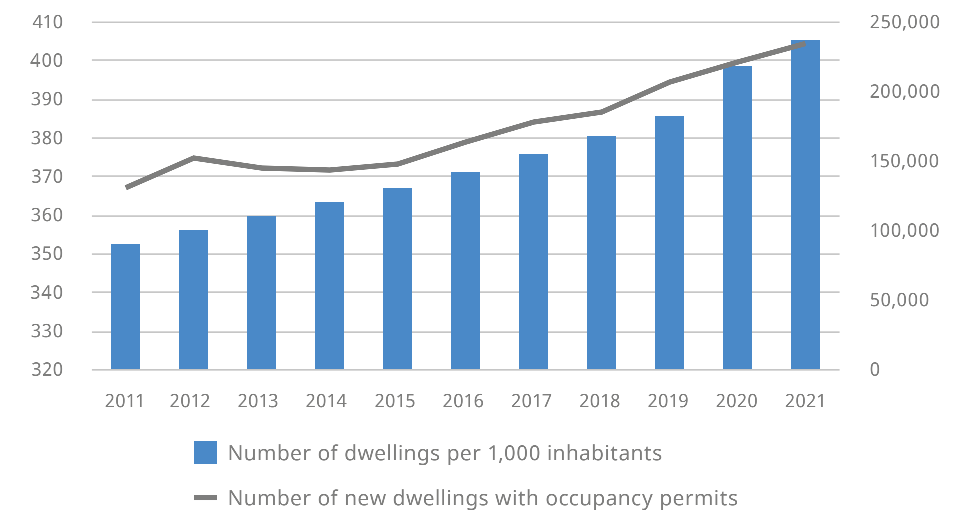
Michał Pietuszko
Partner | Head of Real Estate
DLA Piper

PRS market – will regional cities narrow the gap to Warsaw?

Residential sector overview

Poland has been consistently ranked among the countries with the lowest number of dwellings per 1,000 inhabitants. However, due to dynamic growth of the residential market over the last decade, the situation has improved. While in 2012 there were on average 356 existing dwellings per 1,000 inhabitants vs. European average estimated at 487, in 2021 the ratio for Poland stood at 399, meaning the gap to then European average of 495 dropped by 27%. This was possible thanks to expanding development activity as measured by the number of new dwellings with occupancy permits, which grew by 79% over a decade.

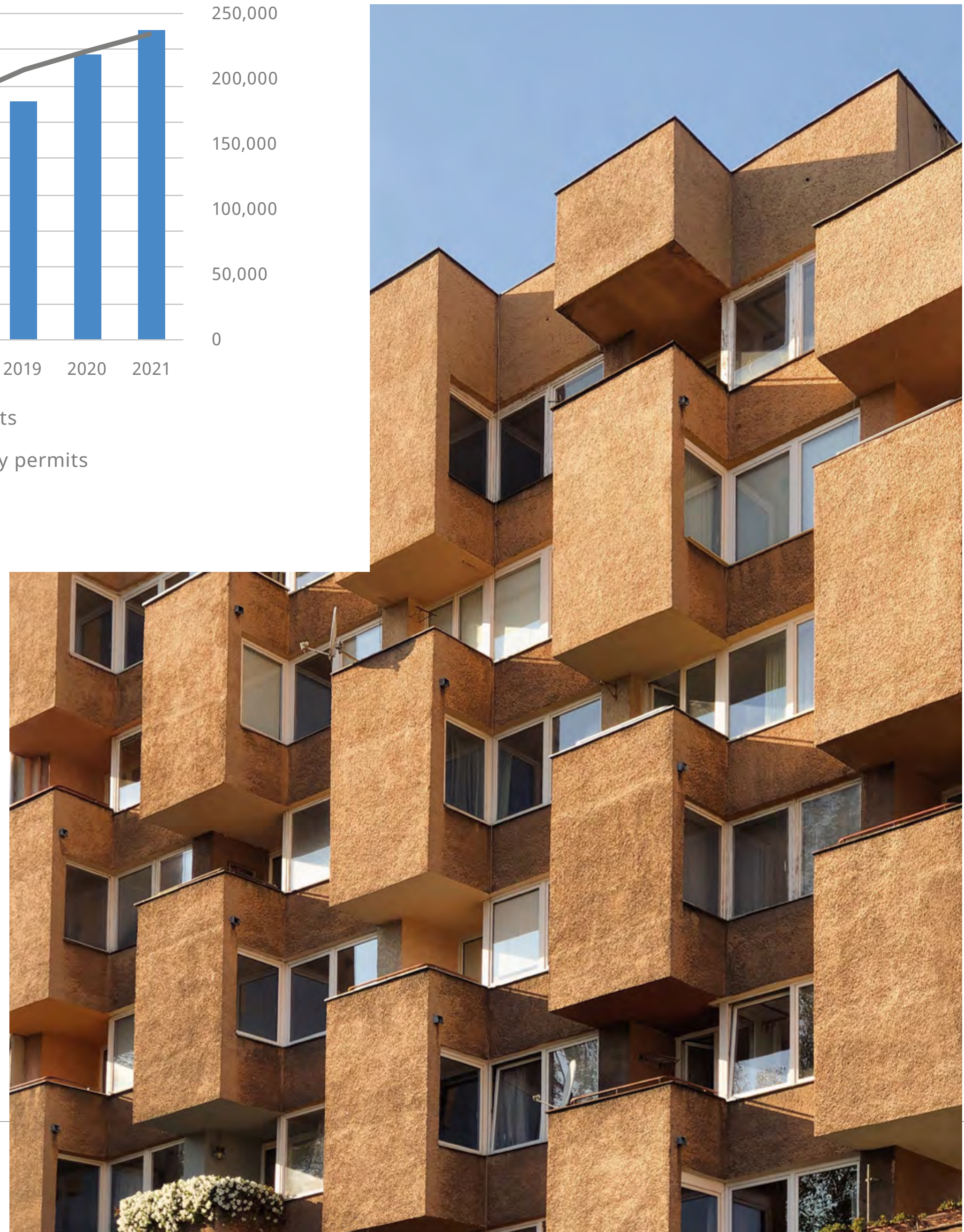
New buildings and housing stock per capita in Poland



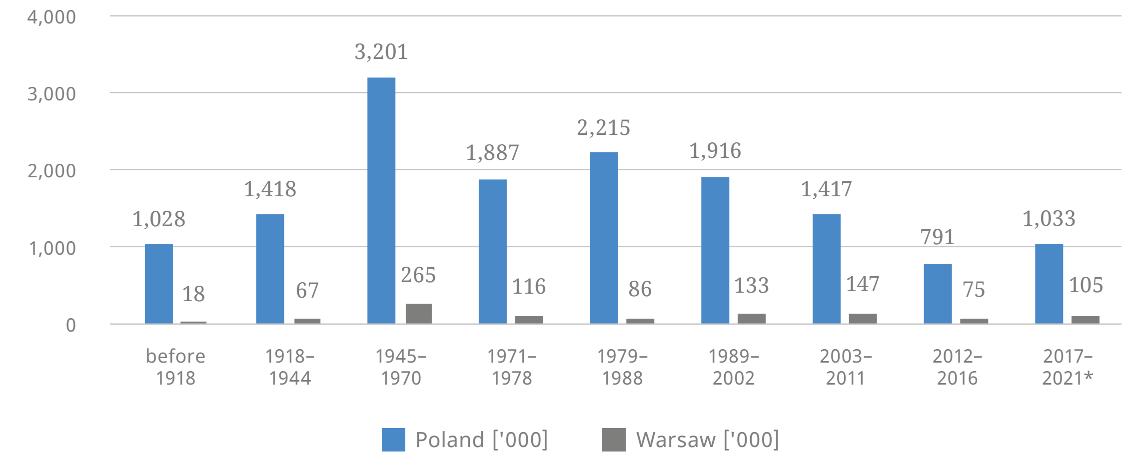
Source: Statistics Poland

Although the size of housing stock has gone up in recent years, Poland still lags in terms of quality of the stock. According to Eurostat, 36% of the population in Poland was living in overcrowded households in 2021. This figure was over twice as high as the EU 27 average of 17%.

Another important characteristic of the housing market in Poland is the age of buildings. 78.3% of all residential stock is estimated to be developed in the XX century, while only a fifth is ca. 20 years old or younger. In Warsaw, this statistic looks better, as more than one-third of the stock has been developed since 2000. The graph below summarises data on building age grouped by development periods.



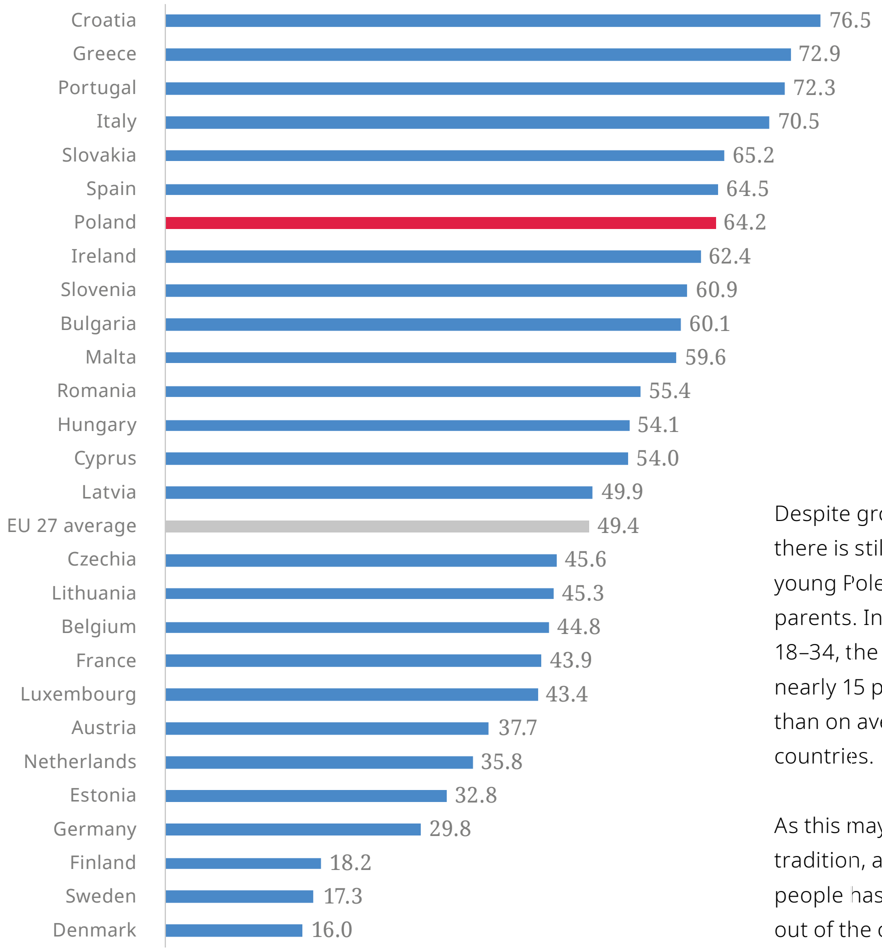
Dwellings by age of building construction



* Data for 2017–2021 includes also residential developments under construction as of 2021.

Source: Statistics Poland

Share of young adults aged 18–34 living with their parents in 2021 [%]

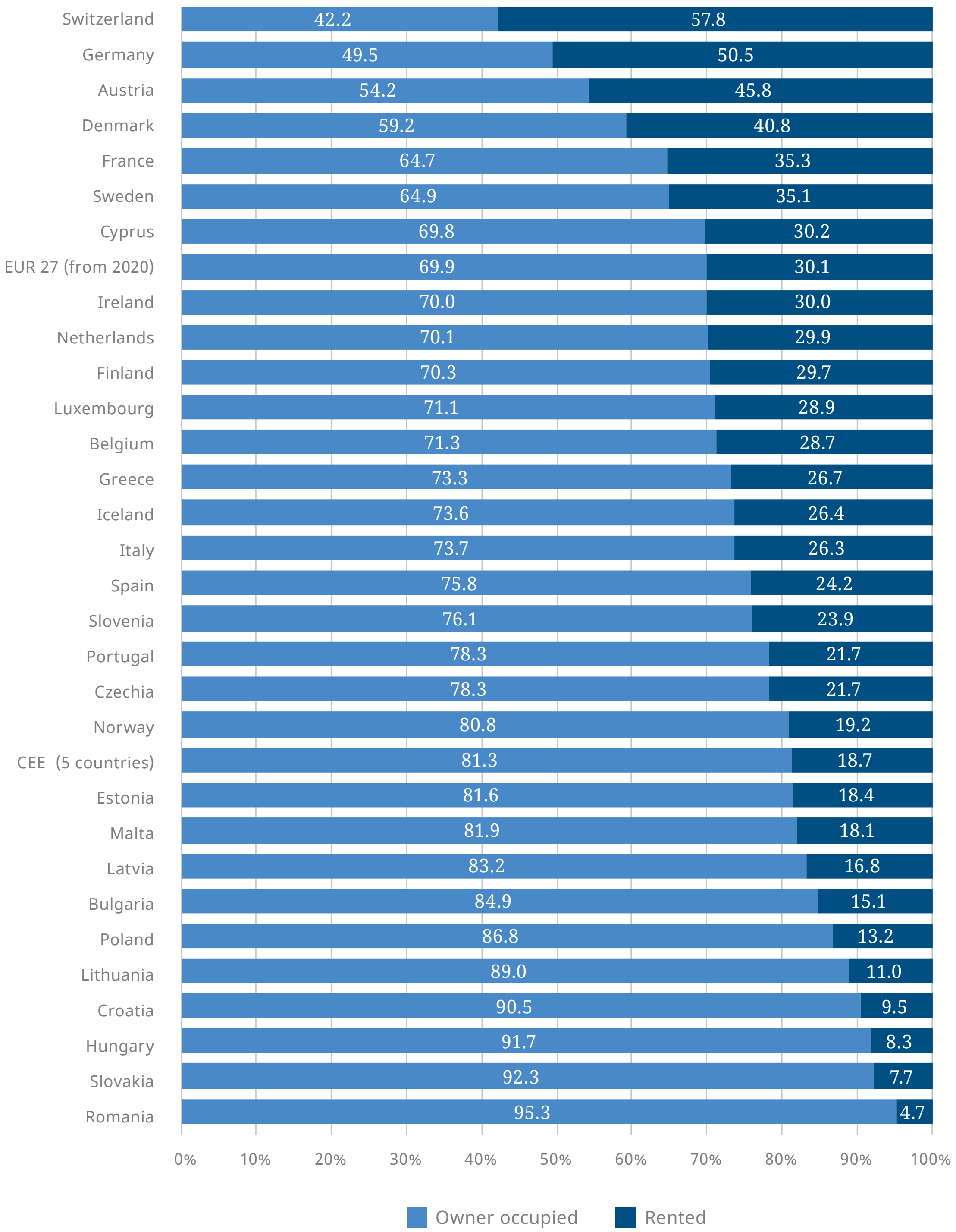


Despite growing housing stock, there is still a significant share of young Poles who live with their parents. In 2021, in the age group 18–34, the share for Poland was nearly 15 percentage points higher than on average in the EU 27 countries.

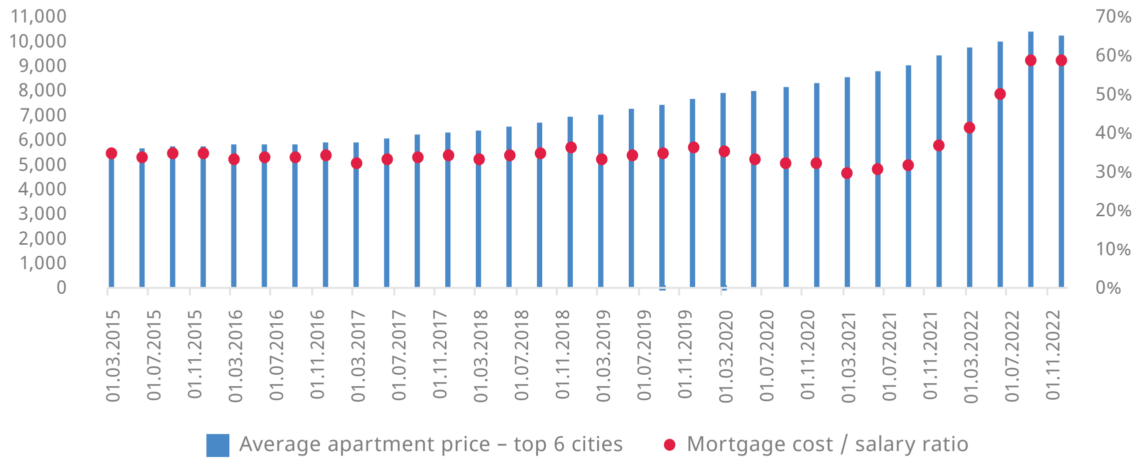
As this may be partly attributed to tradition, a vast majority of young people has been recently forced out of the ownership market due to growing apartment prices and falling mortgage affordability.

The average transaction price for top 6 cities grew by nearly 80% over a period of 8 years (2015–2022). As the ratio of average mortgage payment to average salary was relatively stable until Q3 2021, not exceeding 35%, it went up to nearly 59% as of end of 2022. It clearly shows that large part of society, including the younger generation, have to look for living opportunities other than buying their own flats or homes.

Owner-occupied vs. rented dwellings



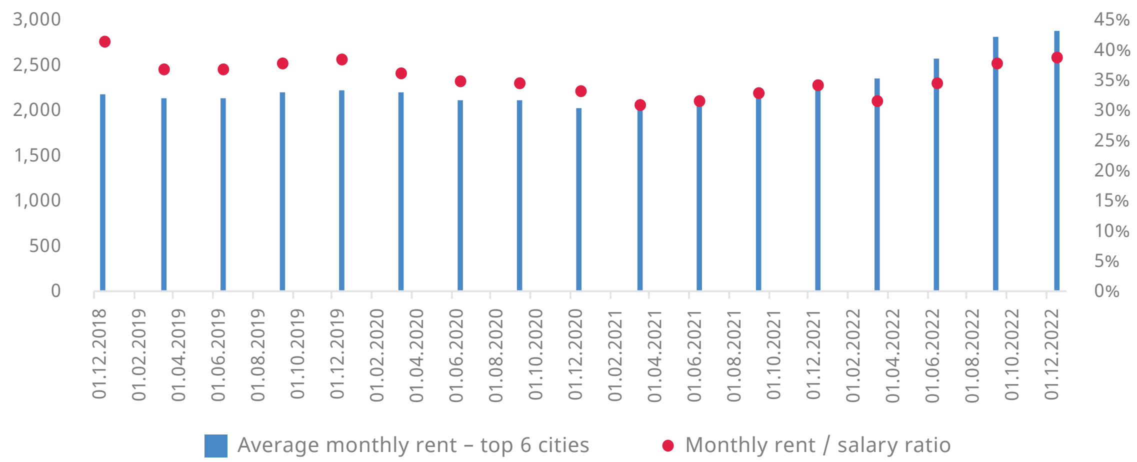
Apartment price vs. mortgage affordability of a single person



Source: National Bank of Poland, Savills

On the other hand, the rental market remains an interesting alternative despite soaring rents in 2022. If compared with the same data on salaries in top 6 cities, rent expenses account for 39% of average person's monthly salary, while we estimate the average ratio over the last 4 years was ca. 35%.

Monthly rent vs. salary



Source: Savills based on data from otodom.pl

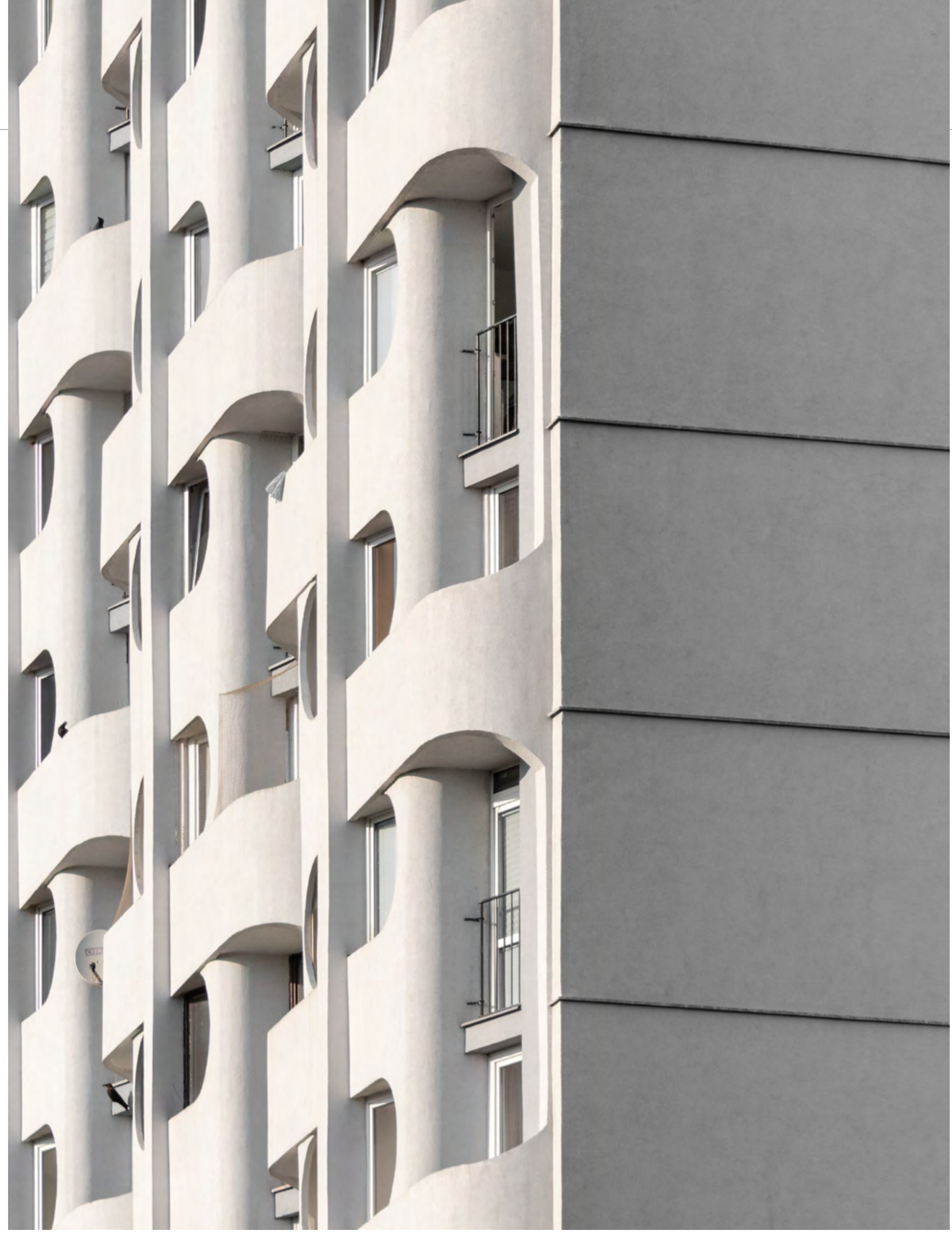
Though renting has grown in popularity, market rent is only a fraction of the entire rented stock. Based on the latest national census data from 2021, there are over 15.2 million apartments in Poland, marking a 12.8% growth over a decade. Based on data published by the Ministry of Finance in 2021, ca. 808,000 individual taxpayers declared taxable rental revenues on a personal income tax level. This number does not account for landlords, who avoid paying taxes (grey zone) and does not allow to differentiate between landlords with one or those with more than one unit for rent. If this figure, along with 11,640 units available to institutional investors, are assumed to be a proxy for the current size of the entire individual rental market, we can say that only 5.4% of all existing apartments are rented out at market rates.

This statistic shows considerable potential for PRS investors in Poland. Moreover, a large share of aged housing stock creates additional headroom for investors focused on delivering high-quality and well-designed product, as well as headroom for ESG-aware capital.

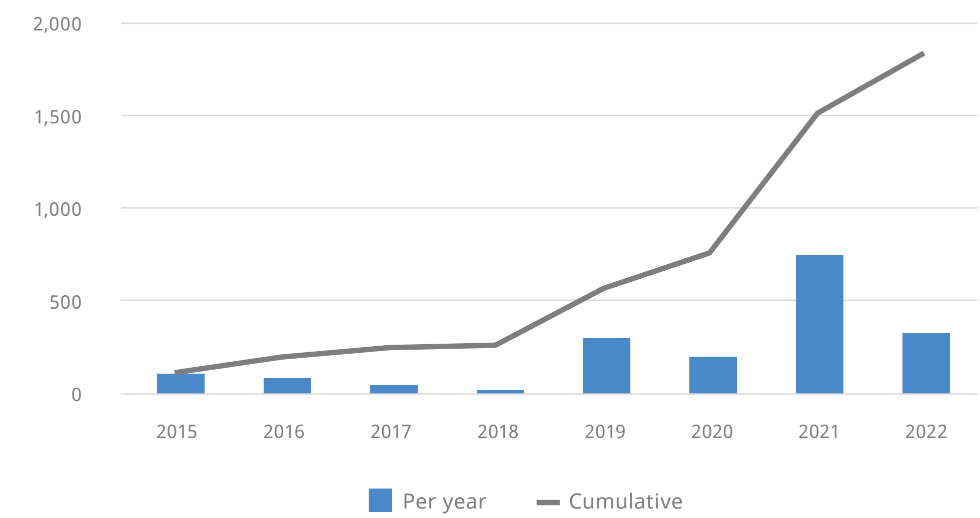
Historic development of the PRS stock

The institutional rental market in Poland started with establishment of the state-owned Rental Housing Fund (FMnW) in 2014, which launched its first three projects comprising in total 380 apartments in 2015. Other investors, such as Catella and Bouwfonds Investment Management followed acquiring their first assets in Warsaw in 2016 and today's largest PRS investor, Resi4Rent, started its journey in 2018, delivering its first assets in 2019 in Wrocław and Łódź. It should be noted that some of the early acquired assets were initially designed for individual build-to-sell market.

According to estimates, the total investment in the PRS sector in Poland had exceeded EUR1.8 billion by the end of 2022, and recorded the highest value of nearly EUR750 million in 2021. The presented data is based only on transactions between unrelated institutional capital and developers, excluding acquisitions and construction expenditures of the likes such as Griffin Capital Partners (both platforms) or Vantage Rent.



PRS Investment volume in Poland* [mln EUR]



* Including 4 transactions comprising both, PRS and student housing assets, without data on value of each asset type.
Due to early stage of market development majority of investment volume in the PRS sector comprises forward agreements.

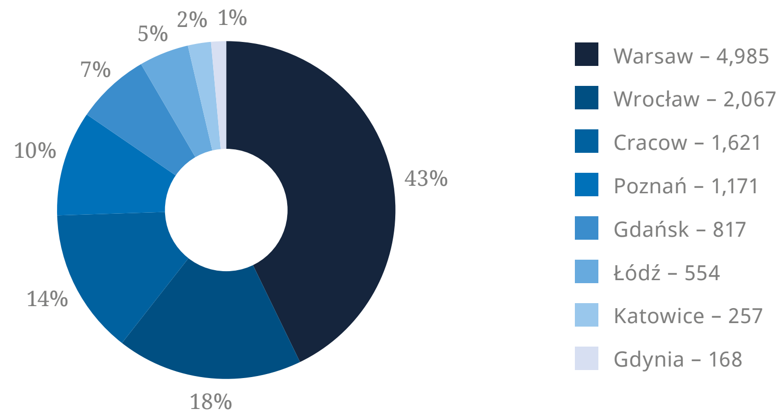
Source: Savills

Current and expected situation in the PRS market

Number of existing projects and rental units

The PRS market is still in the early days of development with only 11,640 units for institutional rent offered across 70 operational projects. Contrary to most of the other CEE countries mentioned in the report, the market has been developing in Warsaw and 7 regional cities. And while these cities may differ in demand for PRS units, achievable rents and yields, they offer the possibility of geographically diversifying the portfolio within a single country and thus a single legal and tax jurisdiction.

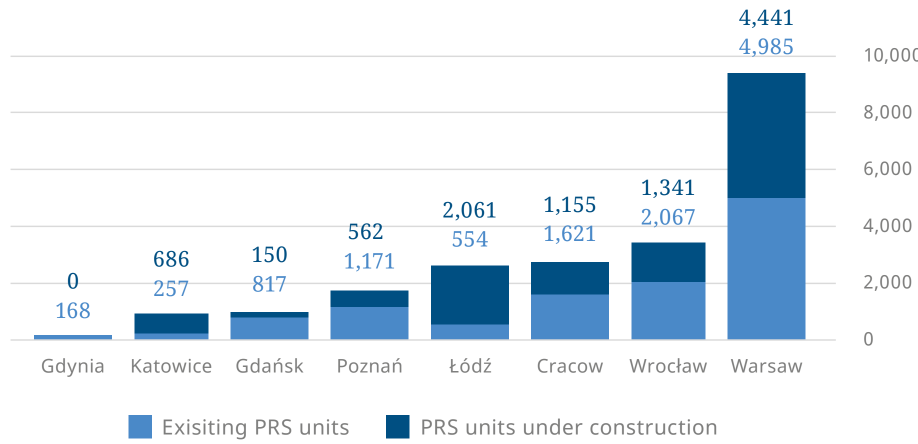
Number of existing PRS units by city



Source: Savills

Close to 5,000 units, which makes up 43% of total available PRS stock is offered in Warsaw, but interestingly it's Wrocław that is currently taking the number 2 spot with 18% of existing PRS units. Cracow, which is the 2nd largest city in Poland by number of citizens and the most popular tourist destination in the country offers 1,622 units accounting for 14% of the market. Those three cities account for nearly 75% of the total PRS stock in Poland. Including pipeline, which is currently under construction and comprises 44 projects, only confirms the potential of regional cities for PRS investors. Łódź, which has experienced a period of economic hardship and demographic challenges after the collapse of communism, is nearly catching up with Cracow in this comparison, partly due to relatively low land prices.

PRS units by city – existing & under construction

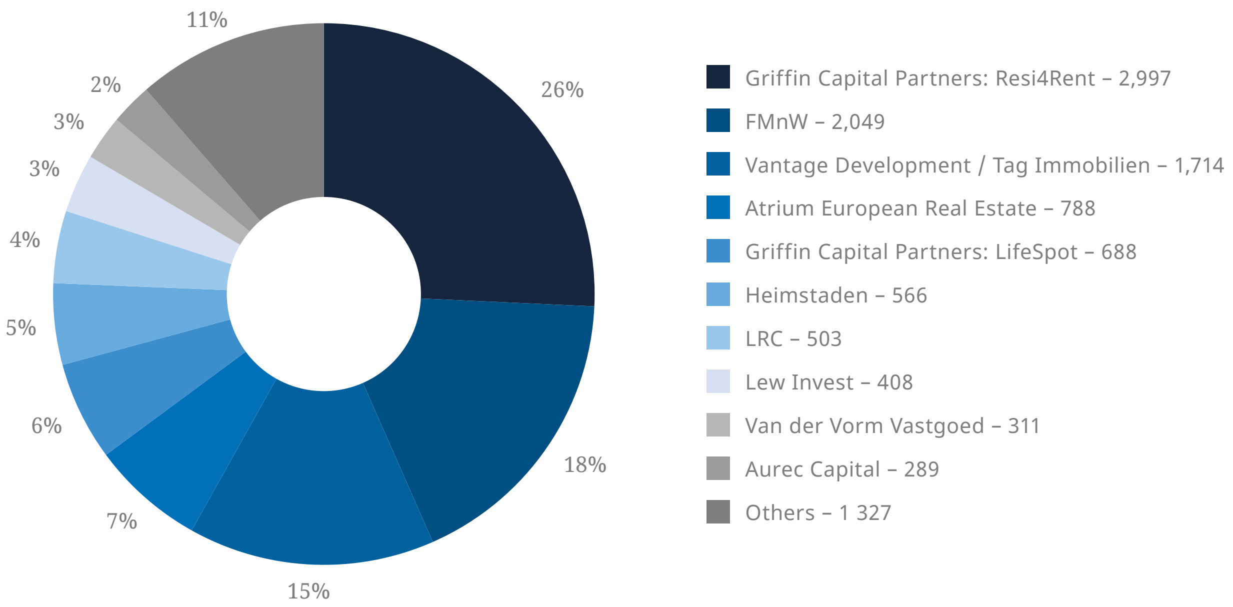


Source: Savills

Major players and their market share

Currently, there are 20 investors active in the PRS market, with the largest single Resi4Rent managed by Griffin Capital Partners which operates nearly 3,000 units and accounting for 26% of the market. R4R is followed by state-owned Rental Housing Fund (PL: *Fundusz Mieszkan na Wynajem*) with 2,049 units and Vantage Rent (owned by TAG Immobilien) with 1,714 units. The top three investors account for over 58% of the market.

Largest PRS investors



* Resi4Rent and LifeSpot platforms are presented separately due to different investors behind them.

** State-owned PFRN, apart from FMnW, manages also an affordable housing portfolio with over 3,300 apartments, which is not categorized as PRS for the purposes of the Report due to i.a. availability of rent-to-buy option.

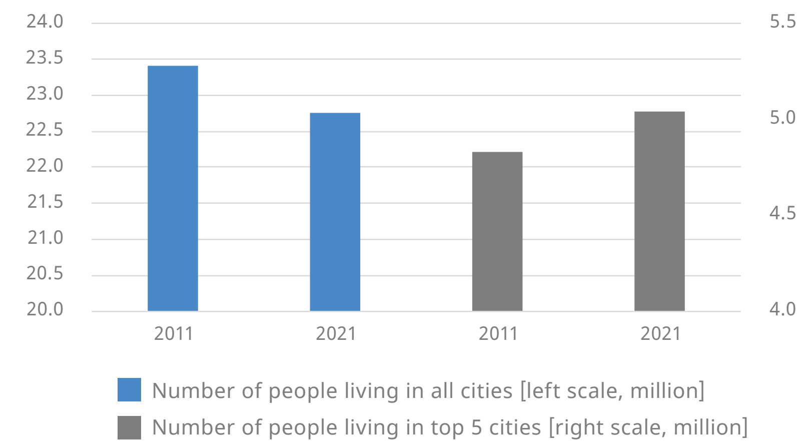
Source: Savills

We estimate the total PRS pipeline for Poland at nearly 47,700 units, including projects at the planning stage without a specified delivery date. This figure fluctuates with new declarations of further investments or the withdrawal of some investors from previously planned PRS deals, but if assumed to reach the 50,000 threshold within the next 5 years, it would still account only for ca. 6% of the total rental market (at market rent) and barely 0.3% of the entire housing stock in Poland.

Demand drivers and key challenges facing investors

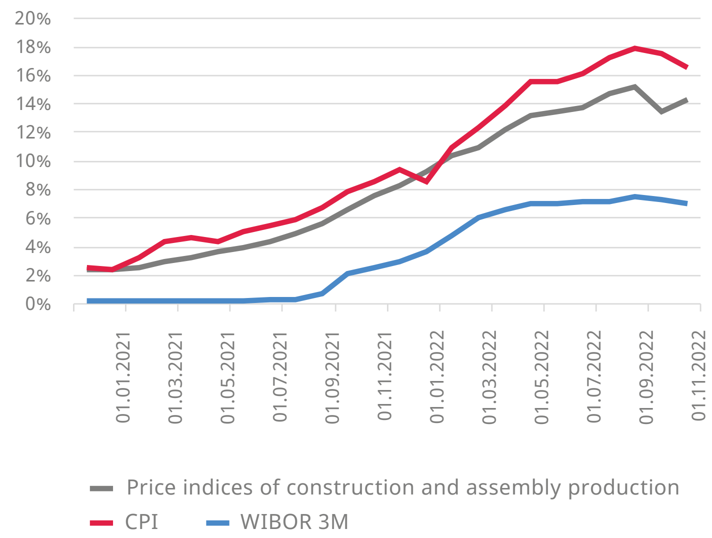
Decreasing housing affordability combined with a limited supply of modern and comfortable housing, as described earlier, create significant potential for further growth of the sector. As 'generation rent' has been largely priced out of the ownership market, its representatives turned to the rental market, which will also benefit the PRS sector. Although data on urbanization in Poland show 2.8% fewer people living in all cities across Poland in 2021 vs. 2011, the largest 5 cities being also top PRS locations recorded population growth of 4.2% over the period, despite Łódź and Poznan decreasing in population by 8% and 1.4%, respectively.

Urbanization trends in Poland – 2021 vs. 2011



Source: National census 2021

Challenging environment for new investments



PRS investors are currently facing several challenges. For a group of potential newcomers, geopolitical risk associated with the war in Ukraine is still an important factor holding them back from entering the market. This is further enhanced by high borrowing cost in Polish zloty and growing construction cost. While the former levelled off in the second half of 2022 with WIBOR rate hovering around 7%, the latter keep growing largely due to soaring energy costs, which reinforce fears of further inflation growth.

To make matters worse, the government's announcement of a potential new tax to be levied on investors buying more than five apartments and declared restrictions on new acquisitions aimed at institutional capital create additional negative sentiment around the PRS market. Fortunately, investors who already entered the market in previous years are still looking for new opportunities.

On the other hand, new opportunities arise. One of them is the potential conversion of existing office buildings into modern PRS schemes. Based on our discussions with PRS investors and owners of office buildings, it is estimated that Warsaw's Służewiec district, colloquially known as 'Mordor', allows for an additional ca. 1,130 units to be delivered this way. Another concept is to adapt older tenement houses to requirements of institutionalized rental market, currently still rarely used and there are 2 such buildings offering 229 apartments in total, which equals to only 2% of the entire stock. Although not trivial and potentially fraught with additional constraints due to monument protection provisions, if optimized in terms of areas and properly managed they may be interesting for more ESG-focused investors, as by being standing structures they may reduce embedded carbon footprint within a PRS portfolio.

Institutional rent in practice

There are at least four ways institutional landlords express rent and other cost in PRS projects in Poland:

- Cold rent and service charges are presented as one figure and tenants additionally cover utility costs in apartments;
- One figure of all-in rent including 'cold rent', service charge, and tenant utilities is offered to tenants;
- Cold rent is presented without any details on service charge and individual utilities;
- Cold rent and total additional cost, including a sum of service charges and individual utilities is offered.

Various approaches to quoting rent and other rental costs sometimes make it difficult to quickly compare rents between existing schemes.

Most common lease periods

Lease periods vary among PRS schemes, ranging from short-term leases of one month to contracts exceeding one year, which is largely due to investors' assumed rental strategy. Moreover, differences in building classification in practice also impact the effective length of the lease or accommodation contract, which in the case of service-zoned assets usually does not exceed 12 months due to related VAT treatment.

Average gross-to-net ratio

We estimate the average ratio of net operating income to rental revenues to be around 75%, translating into average OPEX leakage of 25%, with observable values never exceeding 28%. Cost items differentiating this figure among existing projects have usually included RPU cost and difference in the RETT tax rate, both particularly unfavourable in the case of service-zoned projects. Though some projects were reaching net-to-gross ratios exceeding 80% in 2022, due to surging rents, they may be unsustainable in the long run as in most cases they do not account for growing OPEX charges being based on agreements signed with media and service providers before inflation took off.

Rent indexation – is it commonly applied?

As frequently lease periods do not exceed one year, rent indexation provisions do not appear in all lease contracts, but in the case of some investors building their portfolios predominantly on residential plots and offering longer lease periods, such as Vantage Rent or Rental Housing Fund, rent indexation is a common contract clause.

Legal and tax considerations of PRS projects

Business model

Setting up a corporate vehicle to develop PRS projects

In Poland, investments are usually implemented in one of two models: (i) solely by an investor or (ii) as a JV between the investor and the developer. The second model is more common when there is a need to engage a large number of resources and construction know-how. The most common forms of the JV vehicle are a limited liability company or a limited partnership with a limited liability company in the role of the general partner (*komplementariusz*).

Type of deals: Forward Purchase model or Forward Funding model

A. Forward purchase

In this model, the investor and the developer agree to sign a preliminary sale agreement concerning the property or the shares in the company while the investment is still being developed. The transfer of ownership under a transfer agreement takes place after the occurrence of a predetermined condition precedent, which may be, for example, the obtaining of an occupancy permit in the case of an asset (property) deal or the conclusion of an operation agreement in the case of the purchase of the shares in the company owning the property. It is common market practice that during the period after the signing of a preliminary sale agreement, funds are often released upon the completion of predetermined milestones, making this model closer to the forward funding model.

B. Forward funding

In this model, the investor and the developer agree to sign an agreement concerning the sale of the property or the shares in the company without the condition precedent of the work being completed. In this model, particular attention should be paid to the transfer of permits and agreements between the previous owner and the new owner, so that the construction process can continue without being disrupted by any legal obstacles.

Tax issues connected with share deals/asset deals

In the case of an asset deal (i.e. the direct purchase of an interest in real estate by a corporate vehicle or individual), where the seller is not an entity carrying on a business, a 2% tax on civil law transactions (PCC) is payable, based on the market value. This is normally the purchase price but can sometimes be assessed at a higher level by the tax authorities using an authorised expert's opinion. The obligation to pay PCC rests with the buyer. If the seller is an entity carrying on a business, VAT is usually payable. Generally, the standard rate of 23% applies. With respect to subsidised housing – a rate of 8% applies.

The most common forms of the JV vehicle are a limited liability company or a limited partnership with a limited liability company.

If shares are transferred to the buyer, PCC at the rate of 1% is payable, calculated based on the market value of the shares. In most cases, this is the purchase price; however, if this does not correspond with the market value, the tax authorities will request a correction and may finally assess the value using an authorised expert's opinion.

Transaction costs are normally 1% of the purchase price, including the court fee and notarial fee of up to PLN10,000 plus 23% VAT, but not including potential legal costs.

The question of which party bears the costs are subject to negotiation and agreement between the buyer and the seller. Normally, the buyer pays the transaction costs and – pursuant to the law – the PCC.

Preparation phase

Location: zoning

A proper analysis of where a PRS project is to be located is vital both from the perspective of its potential economic viability and the available methods of commercialization, i.e. the legal forms under which the premises can be rented. Zoning conditions play a key part in this analysis. It is possible to locate PRS projects in areas with various designated purposes – the designation of the chosen area as residential is not necessarily a must.

If the area chosen for a PRS project is designated as a residential area, the issue is quite straightforward. A range of long- and short-term rents is possible. This allows the investor a great deal of freedom in choosing the potential business model. Usually, institutional tenancy is chosen as the preferred legal form of renting as it provides much-needed security to the landlord.

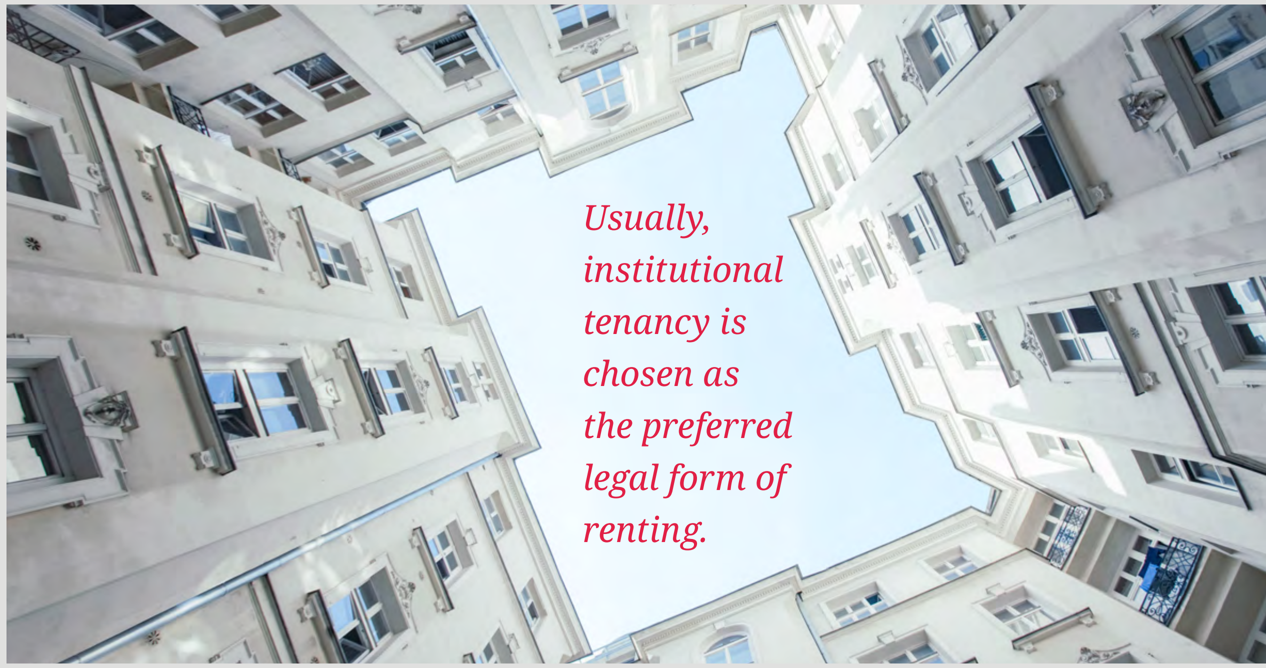
However, if a PRS project is located in an area not designated as a residential area, the choices are limited. Should the relevant area allow the provision of services or hotels, a PRS project could still be viable, but not without inherent risks. In such a case the investor should be aware that his project should be commarcialised via accommodation agreements. Note that the residential leases are executed due to the satisfaction of the permanent housing and as such are governed by the Act on the Protection of Tenants' Rights.

Type of investment: single building or PRS as a part of a bigger investment or separate apartments

As a relatively young segment of the Polish real estate market, the PRS sector focuses more on providing new space for lease rather than investing in existing projects. This results in forward funding/purchase transactions being the dominant form of investment. These involve assigning the task of building a PRS project to a professional developer, whose financing is provided by the investor. Upon completion of the project, the investor is required to purchase the completed PRS project from the developer.

In the forward funding/purchase model, the investor and the developer enter into an agreement before the construction of the PRS project begins. This results in the most common scenario being the construction of a predominantly residential building and its acquisition by the investor upon completion.

It should also be noted that as part of the construction of larger residential developments, it is possible to develop a part of the investment under the build-to-sale model and the rest under the build-to-rent model.



In the case of such developments, it is particularly important to pay attention to maintaining a good relationship and securing the use of the PRS project in conjunction with the other unit owners.

It is also worth noting the possibility of buying individual units to run as a PRS investment. This model tends to be proposed for the smallest investors and comes at a high cost and risk due to planned legislative changes to restrict the wholesale of flats.

Due diligence (performed by the investor, lender, and developer)

The risks specific to the PRS sector are those related to the business model chosen by the investor, in particular the legal form under which the apartments are rented.

Depending on the zoning conditions, the choice of the legal form under which apartments can be rented can be narrowed down to just one – the accommodation agreement. This agreement must have specific features (e.g. the apartment is not being let to meet the housing needs of the lessee but to satisfy a temporary need for accommodation, the lease period is short, and there is a wide scope of additional services) and the failure to properly balance them may, for example, lead to the agreement being reclassified as a standard residential lease agreement.

Another common risk relates to the lessee conducting business activity in the premises, which may result in a significantly higher tax burden for the landlord.

Financing: obtaining external financing

A. Financing model
There are no Polish regulations or limitations regarding the funding of PRS projects and the financing may cover the construction and/or operating phase thereof. Bank loans are one of the primary sources of external financing. Usually, several locations in one portfolio are financed under a credit facility. The standard parameters for LTC (Loan to Cost Ratio) and LTV (Loan-to-Value ratio) are 55–60%. Loan amortisation is usually at the level of 1–3% per year. The borrowers are usually SPV companies, jointly and severally liable towards the financing bank (although recently we have also seen transactions in which the financing was granted to the parent company and then redistributed to SPVs within the group). The bank also verifies the agreement with the PRS operator to ensure that the project is being managed professionally.

There are no Polish regulations or limitations regarding the funding of PRS projects.

B. Collateral
The collateral structure is standard for commercial projects and includes mortgage, pledges over the assets and bank accounts of the borrowers, assignment of rights under insurance agreements and project documents, subordination agreements, powers of attorney to the borrowers' bank accounts, account blocking instructions and submissions to enforcement in the form of a notarial deed. In the construction phase, cost overrun guarantees are usually required by the banks (in the operational phase they are replaced by the sponsor's guarantees).

Acquisition

The acquisition of real property for the purpose of developing a PRS project is no different from the normal acquisition of real property in Poland. The subject of the transaction may be the ownership right to the real property or the right of perpetual usufruct (a right which is quite similar to ownership). Both rights are transferable, alienable, and mortgageable. Under Polish law, the lawful and proper transfer to a buyer of the title to a real property requires the conclusion of the transaction in the form of a notarial deed and the registration of the transaction in the land and mortgage register, which is necessary in the perpetual usufruct (in Polish: *księgi wieczyste*).

If the real property is acquired during the construction process, legal construction issues (e.g., the transfer of administrative decisions to the new owner and the transfer of the design copyright) should also be considered in the transactional documentation.

Operational phase

Residential use (lease agreement) vs. commercial use (accommodation service)

In Poland, a PRS project may be developed and then operated under a residential lease model (based on a lease agreement) or an accommodation services model (based on an accommodation agreement).

A. Lease agreement
This model provides for the renting of units exclusively for residential purposes. It is regulated by the Civil Code and Act on the Protection of Tenants' Rights. It is possible to conclude a lease agreement on the basis of general civil law regulations or to conclude an institutional lease agreement (*Umowa najmu instytucjonalnego*), which, although burdened with additional formal requirements, provides better security for the landlord.

B. Accommodation services
This model consists in renting units as an accommodation service, with short-term rentals, and for a specified period usually not exceeding 12 months, and linked to a specific temporary purpose of accommodation such as work or education, not to satisfy permanent housing needs. In the absence of a statutory definition of short-term rentals, this approach is based on the principle of freedom of contract and creates a new type of service on the rental market called "an accommodation agreement", originating from hotel services, employee hotels, and student housing, underlining the difference between the accommodation service and residential lease.

Tax issues

In the operational phase, the landlord has to determine the VAT treatment of the lease instalments and pay corporate income tax (CIT) on the income earned.

A. VAT

The services that landlords provide can benefit from various VAT solutions. Leasing an apartment in a residential project exclusively for residential purposes benefits from a VAT exemption. Accommodation services consisting of the short-term leasing of premises for residential purposes (e.g. hotels, motels, student housing, employee hotels, etc.) is taxed at a reduced VAT rate of 8%. However, if business activity is conducted in the apartment or if the tenant is a corporate entity and the apartment is occupied by its employees, the leasing activity is subject to taxation at the standard VAT rate – which is currently 23%.

The VAT treatment of lease payments earned by the lessor determines the lessor's right to deduct input VAT incurred upon the acquisition of the apartment.

B. CIT

The lessor has to calculate its CIT and pay it on a monthly basis. The statutory rate is 19%, but taxpayers with an annual turnover of less than EUR2 million may be entitled to pay the reduced rate of 9%. Depreciation write-offs on residential buildings and residential apartments must not be deducted for CIT purposes. This limitation does not apply to "commercial" projects (hotels, student housing, etc.).

C. Additional taxation

In addition, the owner of real property is obliged to pay real estate tax. Local authorities determine the rates of this tax within statutory limits. The maximum rates are indexed annually.

There has been public discussion concerning the potential additional taxation of companies/individuals that own several apartments; however, no legislation has yet been introduced.

Currency of the rent: PLN or EUR?

Given the current state of the law, it seems possible for PRS rent payments to be made in EUR. Neither the Act on the Protection of Tenants' Rights nor other legal provisions prohibit the payment of rent in a foreign currency, which means that general rules apply, i.e. a monetary benefit in the meaning of the Civil Code is not only a benefit expressed in PLN, but also in a foreign currency (e.g. in EUR). Therefore, in practical terms, the insertion of the so-called 'effective payment clause' in a lease agreement means that the tenant is obliged to pay the rent only in a specific foreign currency.

However, the use of EUR in the residential rental sector (and related accommodation services) is controversial. Concerns have already been expressed on the market about whether contractual clauses specifying payment in EUR could be classified as abusive (and therefore prohibited). However, this does not apply to provisions determining the main benefits of the parties, including the price or remuneration, if they have been formulated unambiguously. It should be noted that in the case of a lease agreement, the determination of the rent in a foreign currency covers the main benefit payable by the lessee, and therefore, on this basis alone, it is not obvious that such a clause would be classified as abusive.

Exit plan

Sale of individual units

The most natural exit from a PRS project is to sell individual units to third parties. This appears to be the most favorable option from the point of view of the expected return, although it has the serious disadvantage of being dependent on the administrative process of separating each of the units and engaging in negotiations and sale agreements with multiple buyers. It should be pointed out here that it is possible to sell non-residential premises – built on land with commercial use. There are no legal obstacles to the separation of the non-residential premises from the whole building, but in such a case this process should be carried out with particular regard to planning regulations and the scope of obtained permissions, as it may make separation impossible or can drastically reduce the usability of individual premises, without engaging in a lengthy process of amending the relevant decisions or regulations, which in turn reduces attractiveness of the product.

Sale of the whole building

A process similar to other sales of commercial buildings on the property market. It should be preceded by a standard legal and technical due diligence.

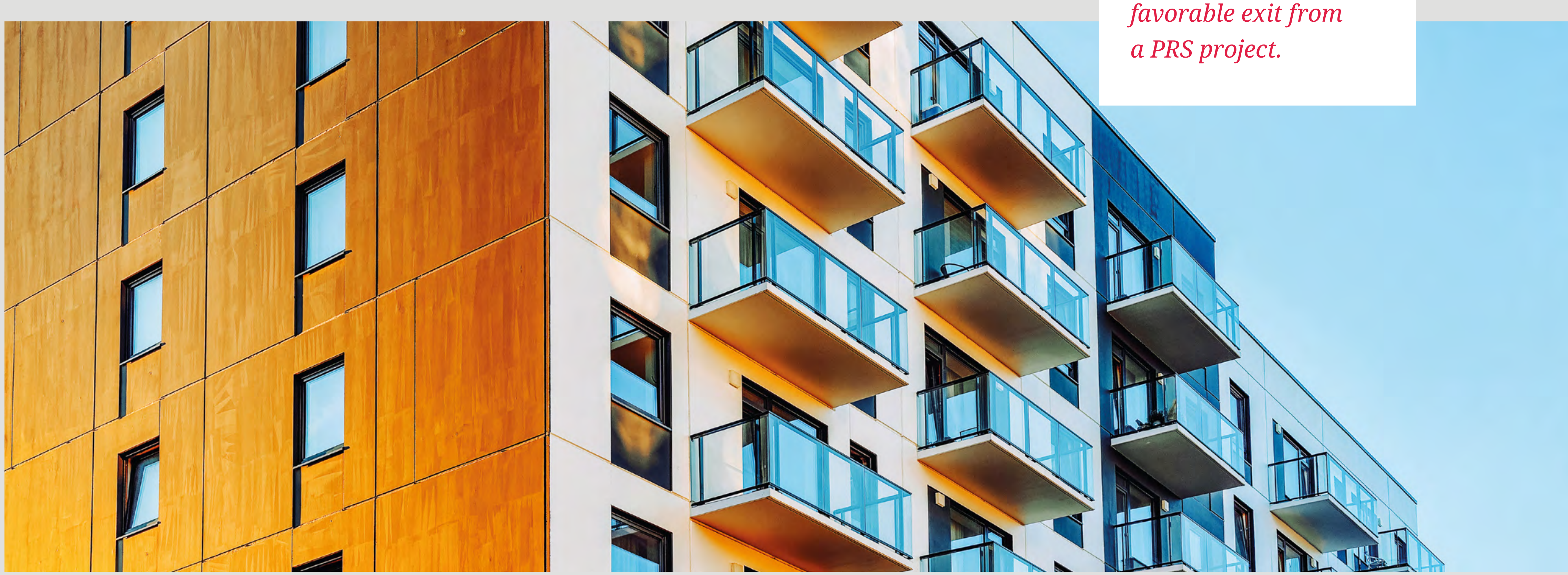
Please note that this process can be very lengthy and costly if the building is sold with separate units.

Sale of a business

Similar to other sales of businesses, it should be preceded by a legal and technical due diligence process, with a particular focus on the relationship between the operating companies holding the rights to the projects and the holders of the units.

Please note that in all the above exit plans, it is possible to sell a leased project, which can have a significant impact on its attractiveness.

Sale of individual units appears to be the most favorable exit from a PRS project.



PRS Market in CEE

Hungary

The PRS market in Hungary is still emerging due to tenant-protective laws and lack of financing options.

The institutional PRS market in Budapest is relatively small, with only 1,500 to 2,000 institutional rental apartments, and most rental offerings are managed by private individuals or small companies. However, there is a high demand for professional rental units due to various factors. Challenges facing the PRS market in Hungary include a strong cultural preference for home ownership, limited availability of suitable land for development, high financing costs and relatively low yields, a lack of professional property management services, and the difficulty of balancing profitability with maintaining high standards of tenant services. Institutional rentals are typically for one semester or one year, with owners covering larger refurbishments and tenants paying rent and routine maintenance costs. The increasing housing prices and cosmopolitan attitude in the country may create potential for the PRS market to grow and improve in the future.

Attila Balogh
Head of Capital Markets
ESTON
An International Associate of Savills

Gábor Borbély
Head of Finance,
Real Estate Sector Head
DLA Piper

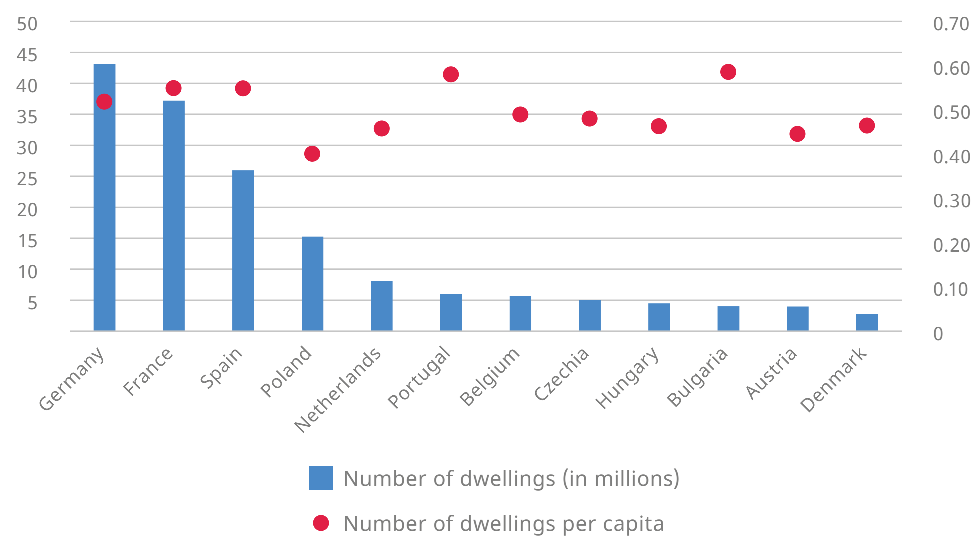
PRS market – institutional capital is yet to arrive

Residential sector overview

Supply, overcrowding rate and ownership rate

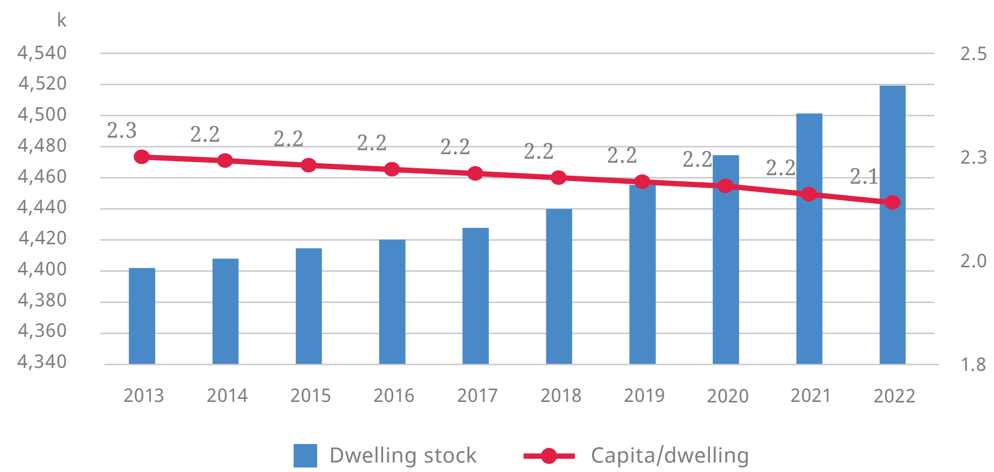
Housing stock in Hungary has been continuously growing over the past decade. In 2021, there were 4.5 million dwellings in the country. With a total population of 9.7 million, the average number of dwellings per capita was 0.46, which is similar to other EU countries.

Housing supply (2021)



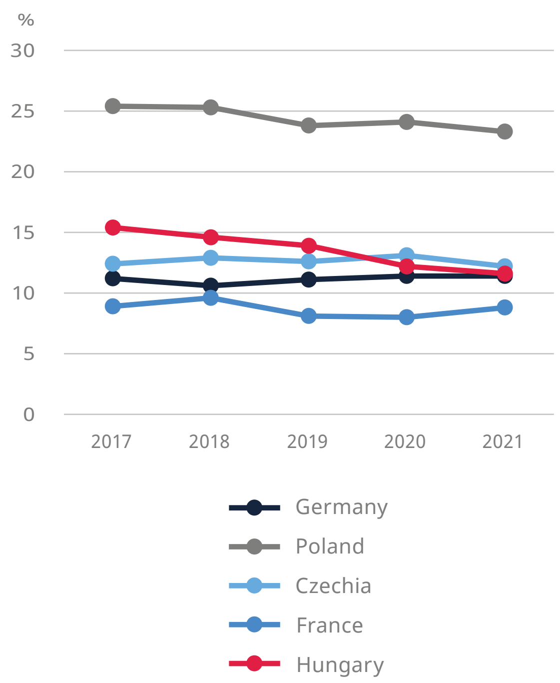
Source: Statista

Housing supply: Hungary



Source: HSO

Overcrowding rate



Source: Eurostat

Compared to other EU countries, Hungary has an average overcrowding rate. In 2021, 4.7% of the population was living in an overcrowded household*. The share between dwelling ownership and tenancy clearly shows that the population of the CEE region is more traditionally attached to home ownership. In Hungary, nearly 92% of the flats were owner-occupied. This is mainly due to the fact that residential real estate is seen as one of the safest assets for wealth accumulation.

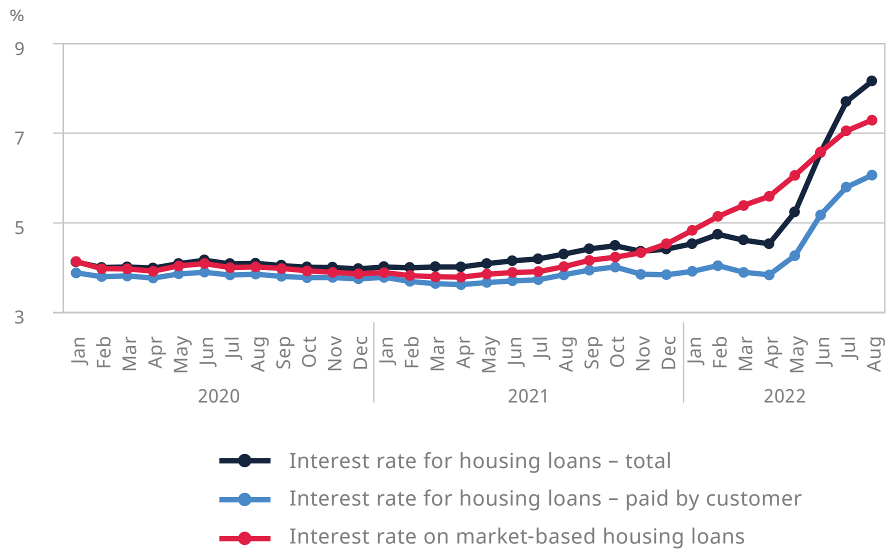
* A person is considered as living in an overcrowded household if the household does not have at its disposal a minimum number of rooms equal to:
- one room for the household;
- one room per couple in the household;
- one room for each single person aged 18 or more;
- one room per pair of single people of the same gender between 12 and 17 years of age;
- one room for each single person between 12 and 17 years of age and not included in the previous category;
- one room per pair of children under 12 years of age.

Housing prices, mortgage costs and rents

Until the beginning of 2022, homeownership was supported by favourable financing costs, as well. In 2022 Q2, there was a record-setting volume of housing loan contracts. However, starting from June loan disbursements declined year-on-year. In 2022 Q3, banks tightened the conditions of access to loans, and almost all institutions saw a decline in credit demand. Looking ahead, tightening may continue, and most banks expect to see further decline in credit demand.

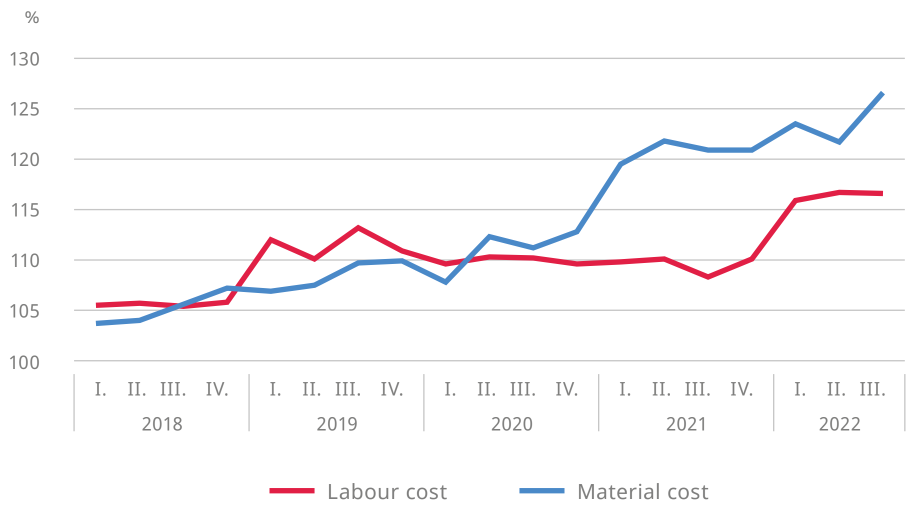
The historically stable increase of house prices not only continued, but even accelerated during the Covid-pandemic across many markets in Europe due to the increasing construction prices, inflationary pressure and supply shortages. The unexpected events and their consequences of the past three years have been significantly driving up construction labour costs and material prices. In 2022 Q3, overall housing construction costs increased by 22.8% on an annual basis, the cost of materials increased by 26.6% year-on-year, and labour costs rose by 16.6%. This tendency is expected to remain in the short term.

Interest rate for housing loans



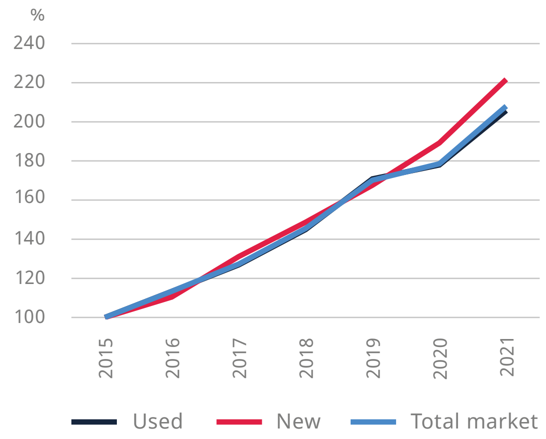
Source: HNB

Construction industry price indexes [same quarter of previous year=100%]



Source: HSO

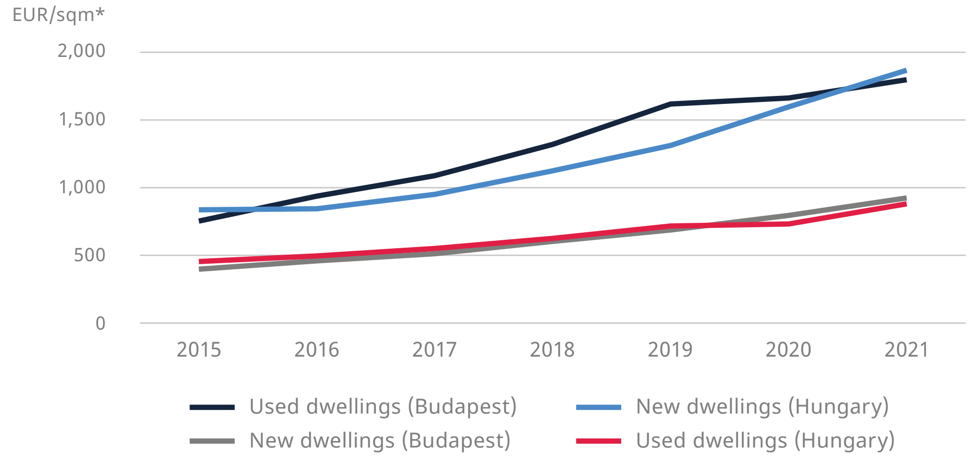
Housing price index: Hungary [2015=100%]



Source: HSO

Cumulative house price increase in the CEE region since 2010 was the highest in Hungary (+120%). The price rise in the country was significant primarily in provincial towns and in Budapest. House prices in Hungary – similarly to the international trends – rose dynamically in the first half of 2022 as well. In real terms, house prices rose by 12.8% year-on-year in the second quarter of 2022. Based on preliminary data of the Hungarian National Bank, the annual growth rate of house prices in real terms is expected to decelerate to 1.7% in 2022 Q3.

Housing prices in Budapest and Hungary

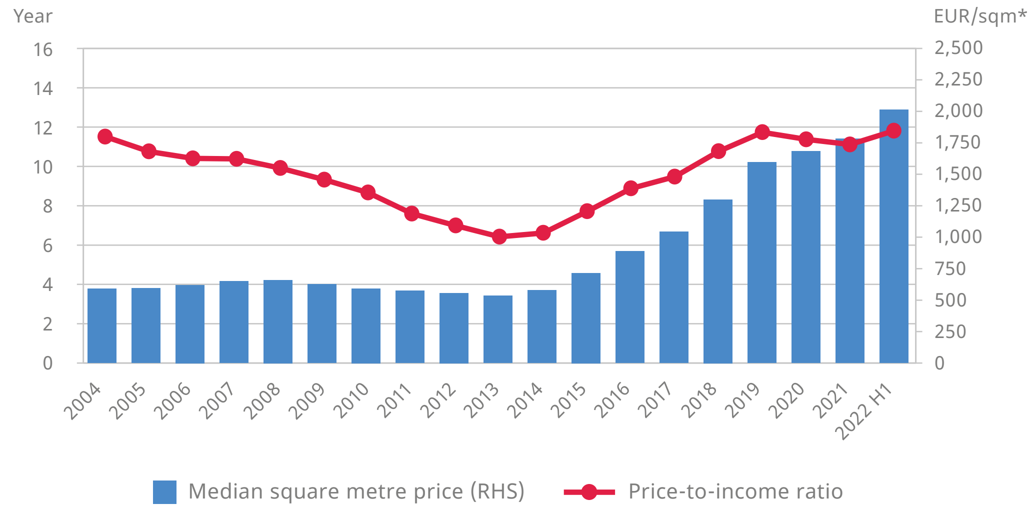


* Exchanged from local currency, 1 EUR=385 HUF

Source: HSO

In 2022 Q3, Budapest was the fifth least affordable capital in Europe in terms of the price-to-income ratio. Economic growth accounted for massive salary growth (especially with a labour shortage occurring across the CEE region by 2018), yet wages could not keep pace with the housing price increase in many countries. House price appreciation exceeded the increase in incomes in all regional centres in the countryside. Following a temporary improvement in the period after the outbreak of the coronavirus pandemic, the relative size of house prices compared to incomes started to rise again in 2021, indicating deterioration in housing affordability. This trend continued in 2022 H1, and in addition to Budapest, the house price-to-income ratio increased significantly in all regional centres in Hungary. The highest rate was registered in Debrecen, where 13.3 years of total average net income was required to buy a median priced flat of 75 square metres in 2022 H1 compared to 11.8 years in 2021.

Price-to-income ratio

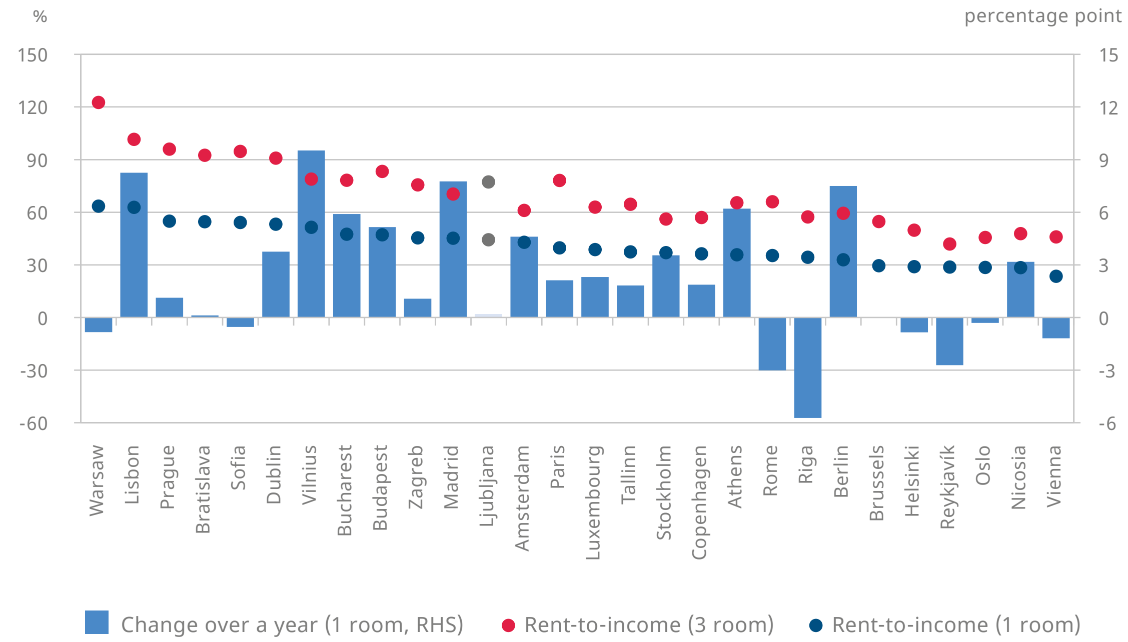


* Exchanged from local currency, 1 EUR=385 HUF

Source: HNB

As sale prices rapidly increase, rents also follow. Housing affordability in the rental market of Budapest deteriorated over the past year. The rent for a typical three-bedroom or one-bedroom flat in the Hungarian capital is 83.3% and 47.1% of the average net wage in Hungary. One year ago, these ratios were 74.4 and 42%, which shows that growth in incomes has not kept pace with rental growth.

Rent-to-income ratio in European capitals (Q3 2022)



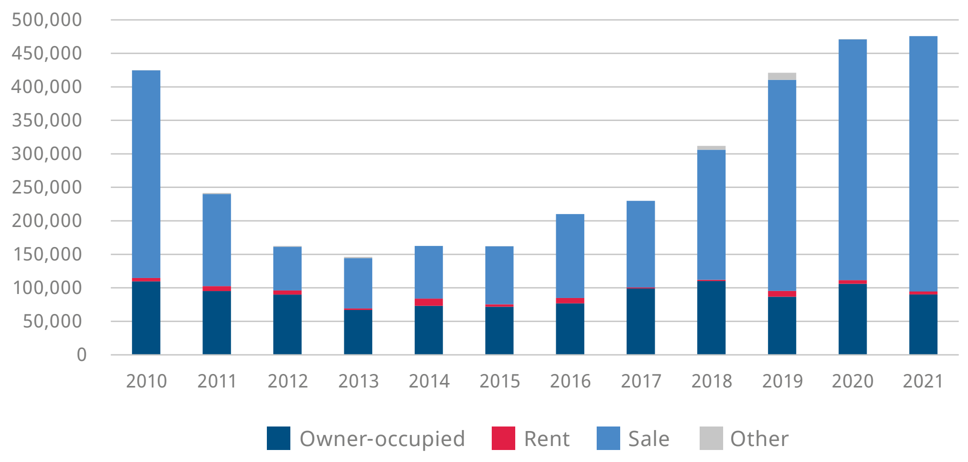
Source: HNB

Current situation in the PRS market

Supply

In Hungary, the institutional PRS market is based on a relatively low number of projects, the dwelling rental market generally lacks professional owners and operators. Most of the rental offerings are managed by private individuals or small companies. Based on our primary research, there are currently around 1,500 to 2,000 institutional rental apartments in Budapest. One of the first institutional rental properties was a dormitory for Central European University in Budapest, and due to the heavy inflow of international students to Hungary, student housing is one of the pillars of the PRS market in the country. A few of the most involved market players in the Hungarian PRS sector are Forestay, Divinus, and Metrodom (Flatco). Forestay Group's primary PRS product is student housing, while Divinus Group group currently has 262 apartments for rent, and they are planning to hand over 262 new built-to-rent flats in 2024. Metrodom, generally operates with a build-to-sell strategy, but in case there are units not sold, they do monetize them by renting. Furthermore, Metrodom introduced Flatco Real Estate, which offers premium flats for rent, currently with 714 apartments in their portfolio. One of the largest real estate developer in the country, Market, as of 2023 Q1, has an ongoing urban development project, where new residential properties are located immediately next to the new head-quarters of the MOL Group, leading Hungarian oil and gas company, hence 70 of the residential units were acquired by the company with the purpose of accommodating expat and visiting employees instead of using short-term accommodation services. Some of the units were also utilised as home-office spaces for subcontractors.

Dwelling completions based on planned purpose of use (Budapest)



Source: HSO

Demand

According to one of the interviewed market players, there is a high demand for professional rental units, as they experienced a 100% occupancy of their two buildings within three-months of opening the rental process. Even though in the past 10–15 years demand for rental units was increased by international tourism (Airbnb), international students, immigrant workers, increasing mortgage costs, and a shift in open-mindedness towards renting, professionally managed rental supply did not follow due mainly to the country-specific limitations and challenges of the market.

Key Challenges of the PRS market

Home-ownership sentiment

As mentioned before, the population of Hungary is generally socialised to aim for owning their home instead of renting it, hence the outstandingly high share of ownership within the stock. Up until recently, this was supported by favourable mortgage costs as well. However, rising interest rates and recently transformed economic circumstances may increase demand for the rental market. This is also supported by the attitude of younger generations towards housing, which includes flexibility as an important feature and is less attached to ownership.

Availability

While there is currently a significant pipeline of large-scale residential projects in Budapest (ca. 8,000 new apartments) that could potentially contain a built-for-lease element, local developers mainly plan to sell the apartments. Rising house prices are partly driven by a shortage of supply, relative ease and low cost of debt, and the desire for people to invest in an effort to earn more money on their savings than they would receive in the bank. However, there are also other factors at play, such as the shortage and rising costs of suitable land plots, drawn-out and uncertain permitting processes, and the shortage and subsequent rise in costs of both construction labour and materials. Current prices and the stable demand for housing makes exit more favourable than managing and operating the properties, especially when considering that 27% VAT is applicable for rent while only 5% is applicable for sale. At the moment, selling an entire building to institutional investors would also be less profitable for developers due to the lack of gradual price increases during the different construction phases, which is present in the case of single-unit deals.

However, developers should consider the fact that despite a potentially lower profit, selling or forward selling to an investor can result in the capital being returned far more quickly than during the individual unit sale process. This can also be a way of funding the development throughout the construction phase, therefore enabling the developer to move to the next project or run more projects simultaneously, based on the construction capacity in the market.

Financing & Profitability

From the investor point of view, the PRS market has limitations due to the combination of a strict mortgage policy and the relatively low yield. High financing costs are accompanied with long lending terms, while return on investment is calculated around 4–5%. As of 2023 Q1, most PRS developments require 100% capital, since in the current financing environment it is nearly impossible to gain profit with a loan involved in the process.

Professional Operating

The PRS sector, more so than most other property types, requires significant attention to tenant services and the upkeep of standards. As of 2023 Q1, there are a lack of professional property management service providers in Hungary that specialises in the residential sector.

Institutional rent in practice

Based on our interviews with currently active market players, who are mainly involved in student housing, the typical term of institutional rentals is either one semester or one year. In terms of share of costs, the owner generally covers the cost of any amortization and larger refurbishments, while tenants are expected to pay rent and a service charge which covers routine maintenance works. In the rare case of the rental term exceeding one year, rent indexation is applied, but normally after the expiry of the contract, there is a renegotiation before renewal. Most landlords prefer a fixed-term (usually one-year) contract, which may be prolonged at the end of the initial 12 months or may be transformed into a lease with an indefinite term.

Legal and tax considerations of PRS projects

Business model

Setting up a corporate vehicle to develop PRS projects

As a general rule, Hungarian legislation does not provide rules that differentiate between the form for PRS investments and other types of real estate investments. Therefore, the corporate vehicles available for investments are those generally used for all types of real estate investments, namely: (i) limited liability companies ("kft."), (ii) companies limited by shares ("nyrt." or "zrt."), or (iii) real estate funds.

A limited liability company is the most common corporate vehicle used for business activities in Hungary (including real estate investments), as it has a distinct legal personality, it has unlimited liability to its creditors to the full extent of its assets, but the members of the company, as a rule, are not liable for the company's obligations. Additionally, it may be established with a minimum registered capital of HUF3,000,000 (approx. EUR7,800).

Type of deals

Real estate transactions in Hungary are executed in the form of either a share deal or an asset deal.

A. Share deal

A share deal, i.e acquiring the special purpose vehicle (SPV) holding the property (or the development) itself, is generally easier to execute as only the share in the SPV needs to be transferred, external financing already in place may also be retained provided that the bank is happy to continue lending to the new owner.

The drawback is of course that the SPV is inherently acquired with all historic liabilities. This, however, can be mitigated to some extent with thorough due diligence, warranties and indemnities given by the sellers ideally backedup by a security.

B. Asset deal

An asset deal, i.e., acquiring the real estate itself, is a bit more complicated to execute. Although already concluded lease agreements (if any) are automatically transferred to the new owner of the property by the force of law, tenant securities, architect and contractor warranties, supply agreements, and other contracts of interest must be transferred to the new owner, in many cases requiring the approval of a third party not involved in the transaction.

On the other hand, in an asset deal, the real property is acquired generally clear of any historic liabilities incurred by the seller (save for e.g., the buyer of a real estate may be held responsible for the environmental contamination of the purchased property under certain circumstances).

Tax issues connected with share deals/asset deals

A. Asset deal

Transfer tax: The acquisition of real estate in Hungary as part of a purchase, exchange, or similar transaction is normally subject to real estate transfer tax, payable at 4% of the market value. A reduced rate of 2% applies to a value above HUF1 billion (approx. EUR2.6 million). Nevertheless, the transfer tax payable cannot exceed HUF200 million (approx. EUR520,000) per real estate. The tax authority will normally accept the consideration stated in the transfer agreement as the market value unless it is too low.

The main exceptions to the general transfer tax rate are:

- a 2% rate applies to the purchase of property by Hungarian real estate funds;
- a 2% or 3% rate applies to the purchase of property by certain property dealers and finance lease providers (providing the property is sold/leased within two years), and;
- a 2% rate applies if the property is purchased by a REIT (real estate investment company) or one of its wholly owned special purpose vehicles.

The transfer tax is paid by the buyer.

VAT: As a general rule, the sale of real estate qualifying as 'old property' (i.e., where the first occupancy permit or the permit relating to a functional change in the use of the property issued by the competent authority became final more than two years ago) is VAT exempt. However, the seller may opt for VAT-able treatment of the sale of 'old property'. A special VAT regime applies in relation to certain real properties (e.g., building plots).

B. Share deal

Transfer tax: The acquisition of 75% or more of the shares (including shares held by close relatives, related parties, etc.) in a company holding Hungarian real property (for transfer tax purposes) is subject to transfer tax provided that the balance sheet value of the company's Hungarian real property (or properties) exceeds 75% of the company's total balance sheet value (subject to certain adjustments). In such cases the general tax rate, i.e., 4% applies. Nevertheless:

- a reduced rate of 2% applies to the value above HUF1 billion, and the transfer tax payable cannot exceed HUF200 million per real estate asset; and
- if the acquirer is a REIT (real estate investment company), a reduced 2% rate applies (regardless of value).

The definition of a company holding Hungarian real property (for transfer tax purposes) also includes companies which themselves are not owners of real property, but have, directly or indirectly, an equity interest of at least 75% in another company (other companies) owning Hungarian real property. If no adjustment applies as prescribed by the respective regulation, the tax base is the market value of the real property (or properties) owned by the acquired entity (or entities) in proportion to the shares held by the acquirer.

The transfer tax is paid by the buyer.

VAT: The transfer of shares is exempt from VAT.

Preparation phase

Location: zoning

The general sources of zoning are the Construction Act (Act LXXVIII of 1997) and Government Decree no. 253/1997 on the National Settlement and Building Requirements (in Hungarian: OTÉK). These primary sources of zoning laws apply throughout the entire country. Based on these primary sources, local governments and municipalities must adopt their structural plans, zoning maps, and local building and townscape codes applying to the given locality or municipality. However, in very particular cases, if a development is qualified as being of national economic importance, such development may be subject to specific zoning parameters determined by the Hungarian Government overriding the local regulation.

In general, the local development plan and local building code describe the uses allowed in different areas of a city in a very detailed manner, specifying building heights, maximum floor-space ratios, minimum landscaped areas, etc. Any change to the zoning of property requires an amendment of the applicable local development plan (i.e., decision of the local municipality).

Type of investment: single building or PRS as a part of a bigger investment or separate apartments

Built-to-sale model is the common residential real estate investment form, PRS market is still emerging in Hungary.

Due diligence (performed by the investor, lender and developer)

Prior to the acquisition of real estate (irrespectively from whether it is structured as an asset or a share deal), investors usually carry out legal, financial, technical and environmental due diligence regarding the target property and the target SPV (in case of share deals). The legal due diligence exercise is carried out normally with respect to the title, building, occupancy, and other permits, leases and contracts relating to the real estate (development) and the target SPV (in case of share deals), as well as zoning regulation in case of contemplated developments.

Due diligence is usually started after the signing of a letter of intent (heads of terms), including also an exclusivity period in most cases, and is completed before the acquisition document is executed as the issues discovered during the due diligence process are usually resolved in the acquisition document.

Before acquiring real property, the buyer is recommended to investigate among others the following with respect to the property: (i) applicable zoning and town planning provisions which will demonstrate whether the proposed use of the property is permitted; (ii) encumbrances of the property, as well as restrictions and special obligations relating to buildings subject to some form of cultural heritage protection; (iii) building permit which the construction of the building must have been complied with; and (iv) occupancy permit which certifies that the building meets the environmental, fire, and health and safety requirements prescribed by the building permit and is safe for use.

The local development plan and local building code specify building heights, maximum floor-space ratios, minimum landscaped areas, etc.

Financing: obtaining external financing

A. Financing model

The funding of potential PRS projects is not subject to special regulations or limitations. The funding of real estate projects and the financing may cover the construction and/or operating phase. Bank loans are one of the primary sources of external financing.

B. Collateral

The standard collateral structure for real estate financing projects includes mortgage, options, pledges over the assets and bank accounts of the borrowers, pledges and assignment of rights and receivable of insurance and project documents, subordination agreements, collection rights over bank accounts, accounts agreements, in most cases in the form of a Hungarian notarial deed.

Acquisition

The acquisition of a real estate property is the same, regardless of the project to be developed in the end, so no specific conditions must be met in case of acquiring a property for the purpose of developing a PRS project.

The subject of the transaction is usually the ownership of the real property. The lawful and proper transfer to a buyer of the title to a real property requires the conclusion of the transaction in the form of a notarial deed or a private deed countersigned by an attorney and the registration of the transaction in the land register.

If the real property is acquired during the construction process, legal construction issues (e.g., the transfer of administrative decisions to the new owner and the transfer of the design copyright) should also be considered in the transactional documentation.

Operational phase

Residential use (lease agreement) vs. commercial use (hotel regime)

A. Lease agreement
In Hungary, the legal framework of lease agreements currently consists of the Hungarian Civil Code (which provides the general rules) and a specific Lease Act (Act LXXVIII of 1993 on residential and non-residential leases). The tenant's obligations include the payment of rent and keeping the property in good order, while the landlord's main obligations are to guarantee that the real property is suitable for use during the lease period and to repair and maintain the structure of the real property. In general, contrary to commercial leases, residential leases are more regulated, and from a legal standpoint, Hungarian legislation protects the tenant of a residential lease. For example, at the request of the tenant, the court shall reduce the amount of the security deposit if it exceeds the amount of three months' rent.

Additionally, based on the rules of Act LIII of 1994 on Judicial Enforcement, if the lease agreement is terminated, but the tenant refuses to leave the property, the landlord must initiate court proceedings for eviction. While it is more and more common to request an eviction declaration incorporated in a notarial deed from tenants to facilitate the enforcement of eviction, even if such an eviction declaration is enforced or the court decided on the eviction order, the bailiff shall postpone the evacuation of a residential property for a time following the period between 15 November and 30 April if the tenant is a private individual.

B. Hotel regime
There is no prohibition regarding the commercial use of the PRS projects for accommodation purposes, to which category the short-term lease of apartments for accommodation purposes falls into. Accommodation services, however, are regulated by a separate regime, i.e., by the Commercial Act (Act CLXIV of 2005) and such accommodation services are subject to specific licensing requirements.

Local municipalities may set restrictions regarding the number of days that may be used for accommodation services in a calendar year in private accommodation facilities (like an apartment) in their territory; such restrictions must be checked on a case-by-case basis.

The line between leases and accommodation services may sometimes be a bit murky; the court practice established that it is of fundamental importance to analyze in each case whether the rights and obligations of the parties refer to a lease-type contract or a contract for accommodation, considering all circumstances.

Tax issues
As a general rule, the income resulting from rental activities is subject to the general corporate income tax (CIT) regime (flat rate of 9%). The CIT base is the pre-tax profit adjusted by statutory tax base adjusting items.

As a general rule, the lease of rental properties is not subject to VAT. However, the landlord may opt for VAT-able treatment of leasing out of real properties.

Rental fees and other fees invoiced by the landlord to tenants should be subject to local business tax (LBT) in Hungary. Local municipalities are authorized to levy LBT. The tax base is the net sales revenue decreased by certain items (such as costs of goods sold, costs of subcontracting and material costs as well as R&D costs subject to further conditions). The tax rate is determined by the municipality between the range of 0%–2% tax rate. LBT is a deductible expense for CIT purposes.

The innovation tax base is the same as the LBT tax base. The tax rate is 0.3%. Innovation tax is deductible for CIT purposes. Exemption from innovation tax is available for small and medium-sized enterprises (SME). The potential SME status needs to be determined on a consolidated basis.

The potential applicability of land tax/building tax needs to be observed on a case-by-case basis.

Currency of the rent: HUF or EUR?
There is no statutory limitation whether to determine and pay the rent in EUR or HUF, the parties freely decide on this question.

Exit plan

Sale of business, individual units or the whole building
Built-to-sale projects are the usual model in Hungary, so the most common exit from a residential project is to sell individual units to third parties.

No specific legal provision is applicable to the sale of buildings developed as a PRS project or to the sale of a PRS business project. It must be highlighted that if such project is transferred as 'business unit', the main aspects of asset deal transactions must be considered (e.g., transfer of supply agreement, permits, leases, etc.).

PRS Market in CEE

Romania

The PRS market in Romania is still in its early stages, mainly focused in Bucharest, with around 800 apartments across two large and 20 small projects.

It is expected to grow rapidly in the coming years. AFI Europe is planning the largest project to date with 450 apartments. Investors face challenges such as the local mentality of wanting to own a home, a small market with a declining population, and changes in taxation and lack of government incentives. However, the COVID-19 pandemic has increased demand for flexible models, such as built-to-rent investments.

Corporate vehicles available for PRS investments in Romania are limited liability companies (LLC) and joint stock companies. The forward funding model is not commonly used due to the complexity of obtaining necessary endorsements and authorizations.

The small investment type of PRS, such as a single building, is most likely to be found on the market in Romania.

Overall, the PRS market in Romania was seen as a promising investment opportunity due to the strong demand for rental housing, the country's relatively low levels of competition, and the government's efforts to support the development of the sector. However, there were some challenges that needed to be addressed, such as the need to streamline the permitting process for new developments, the lack of a legal framework for long-term rentals, and the need for greater transparency and standardization in the rental market.

Oana Popescu
Head of Residential
Crosspoint Real Estate
An International Associate of Savills

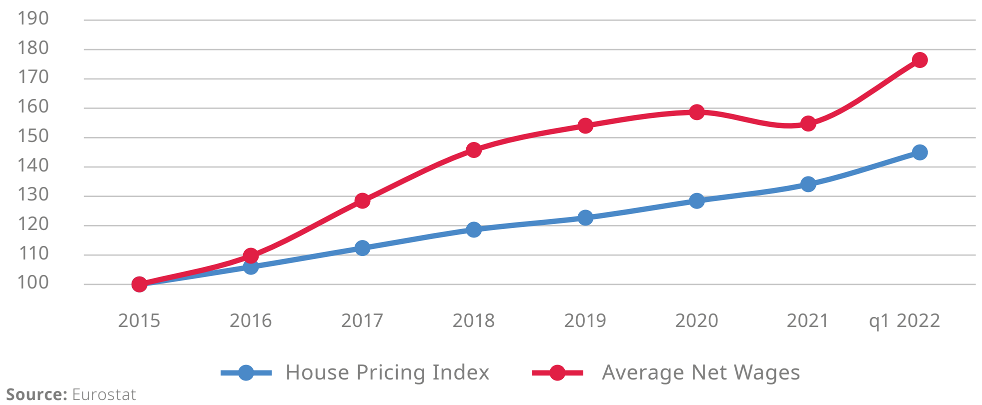
Alin Buftea
Partner | Head of Real Estate
DLA Piper

PRS market – can citizens overcome high attachment to ownership?

Residential sector overview

Among a total population of 19 million inhabitants, there are 9.5 million households in Romania. The overwhelming majority of the residential stock is built before 1990, with new dwellings (built mainly after the year 2000) making up for about 13% of the total housing stock. The new market has been growing steadily in recent years, especially in Bucharest, where new dwellings have a share of 14% in total stock and large academic cities such as Cluj-Napoca, Timisoara and Iași, where urbanization, a growing middle class, and internal migration (approximately 80,000 Romanians migrate from rural to urban areas annually) have led to a strong demand for modernized housing.

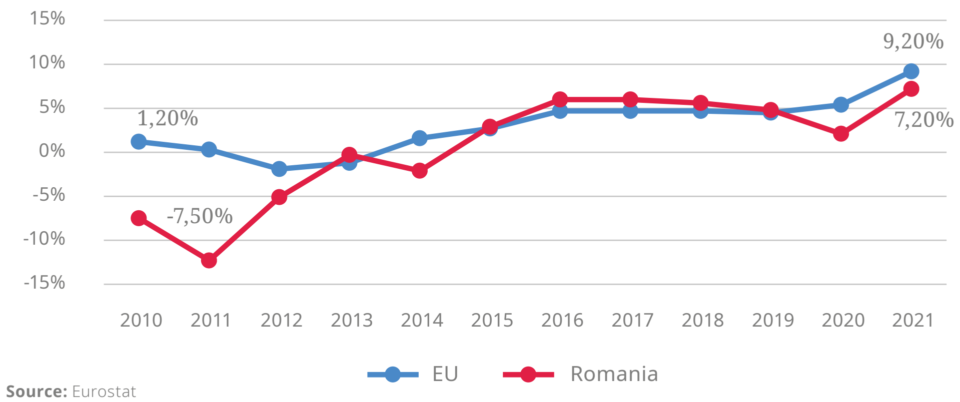
HPI vs. average net wages Bucharest [2015=100]



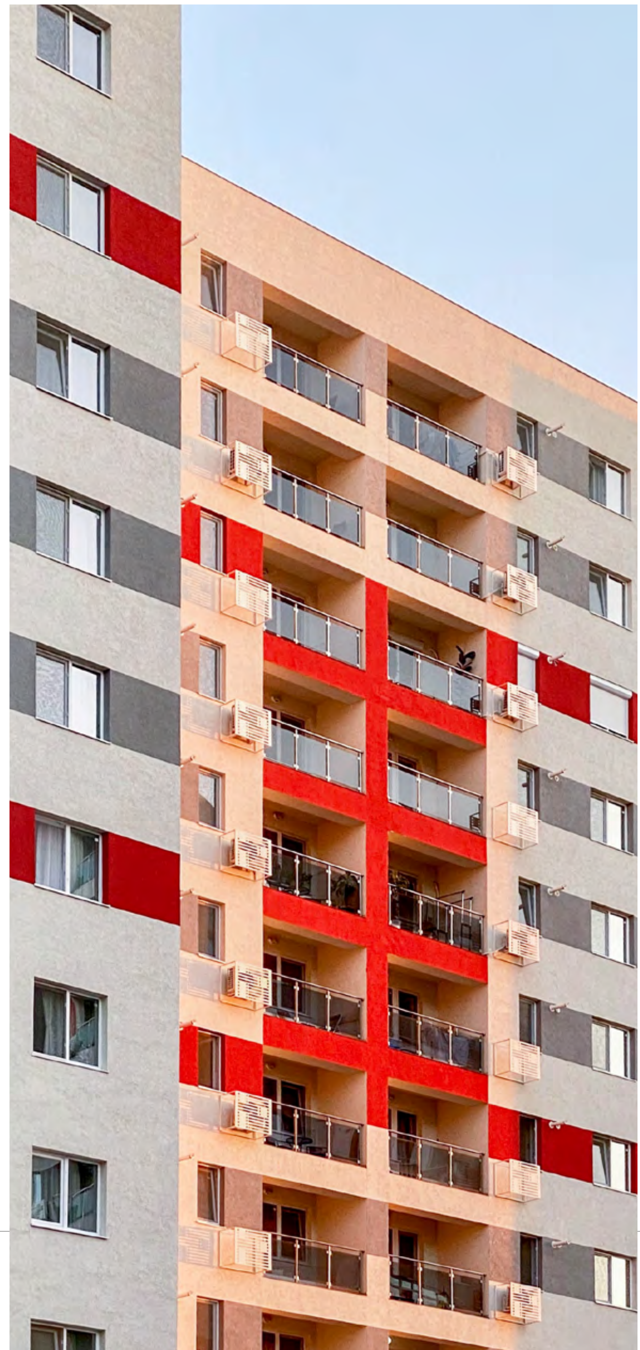
Source: Eurostat

The large breach in housing price evolution between Romania and the rest of the EU has been significantly narrowed in the past ten years when the yearly growth rate in house prices in Romania has aligned with the European trend. The market has evolved from a speculative one before the 2008 crisis, to a more stable one.

Evolution of apartment prices: Romania vs. EU average (2010–2021)

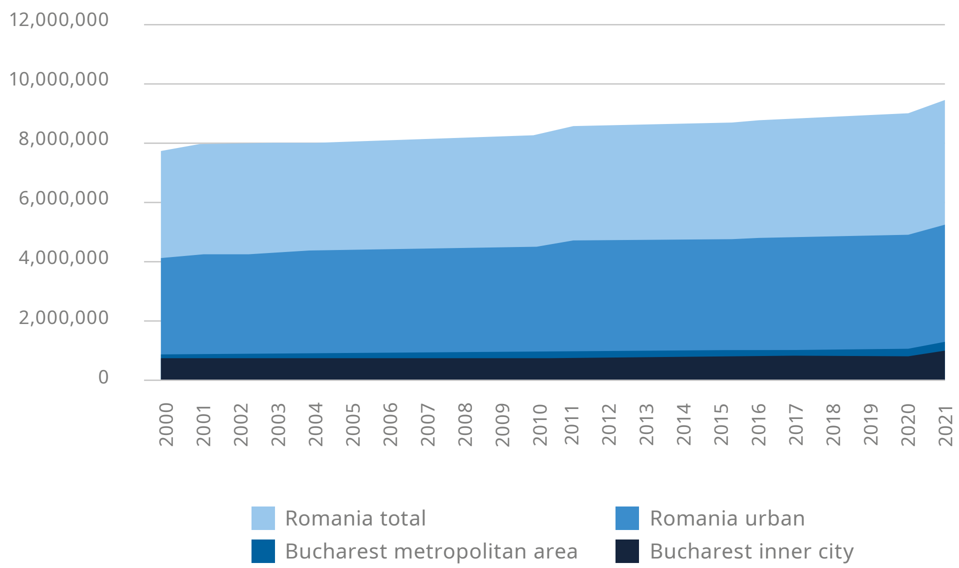


Source: Eurostat



Although 95.3% of Romanians are homeowners (the largest rate in the EU, where the average is 69.9%), 45.1% of dwellings in Romania are overcrowded, while the European average is 17.5%. Thus, the need for new developments in the residential market is extremely high.

Residential stock evolution (2000–2021)

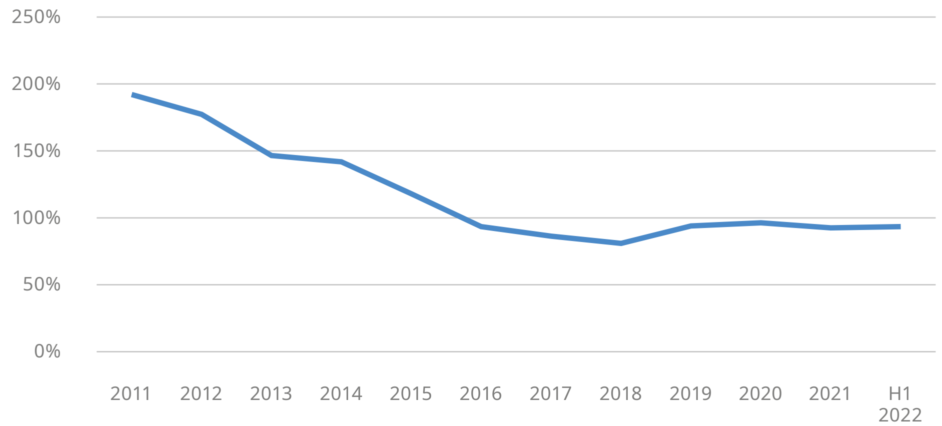


* 2011 and 2021 spikes in stock represent census-related corrections. 2021 data is preliminary.

Source: INS

The preference of Romanians for owning a home instead of renting can be attributed to both mindset and economic considerations: the declining interest rates in the last 10 years have made mortgages more appealing than rents. In 2021, in Bucharest, monthly mortgages were, on average, over 10% cheaper than the average monthly rent. The inflation surge in 2022 has led to a rise in interest rates, making mortgages less affordable. Currently, the balance seems to tilt in favour of rents: the income-to-mortgage ratio per capita for a one-bedroom apartment in Bucharest is 2.3, versus a 2.7 income-to-renting cost ratio.

Mortgage as % of income: Bucharest (2011–H1 2022)



Share of owner-occupied and rented apartments

The Romanian residential rental market is fairly unregulated, with the majority of landlords being individuals renting their second homes. According to Eurostat data, on a national level, out of the 3.9% of Romanians living in rented homes, 2.6% live in state-owned social housing units or in sate-subsidised homes. In the absence of comprehensive legislation regarding the residential rental market which would allow for a clearer image of the size of the market, it is estimated that rented units make up for about 15–20% of the total stock in the two largest Romanian cities, Bucharest and Cluj-Napoca.

Estimated size of the market-rent sector and subsidised-rent sector or private vs. state-owned rental stock

Official data shows the Romanian state as the largest owner of built-to-rent units, with approximately 29,000 units on a national level and over 6,000 units in Bucharest. All of these units are part of a social program and are available for lease only for young people under 35, with the possibility of subsequently acquiring the apartment at a reduced cost.

The PRS market in Romania is currently in its early stages, with under 1,000 delivered units in Bucharest and about 700 units planned or under construction. However, given the current economic circumstances, an increasing number of developers are taking into consideration the shift toward PRS and are willing to explore this opportunity in the upcoming years.

Romanian state is the largest owner of built-to-rent units.

Historic development of the PRS stock

When were the first projects launched and by whom

The first and largest PRS project was launched in Bucharest in 2016 by Bucharest Properties REIT, a company with US-based shareholders. With a third phase delivered last year, the project has a total of 375 units and an occupancy rate close to 100%.

Major events, market or macro shifts that historically influenced the PRS market

Given the nature of the rental market in Romania, individual-owned flats are often located in old buildings and have substandard quality. Moreover, tenants are usually vulnerable to sudden price changes, made to cover repairs and maintenance costs and are exposed to early terminations of lease agreements in the absence of a binding contract. The existing PRS projects have thus been successful so far mainly because they offer a higher standard of living, provide a wide range of facilities and amenities and give tenants a much-needed sense of security.

Expats and multinational corporations are a significant portion of the demand for the PRS market due to their desire for a seamless relocation experience and high living standards.

While apartment sales in Bucharest seemed to be unaffected by the spikes in inflation and interest rates throughout 2022, buyers' interest faded towards the end of the year and developers have started to consider PRS as a "plan B" or safety net in case demand for acquisition will fall in the future.

Current and expected situation in the PRS market

Number of existing projects and rental units

Currently, there are two large projects (over 100 units) and approximately 20 small-sized and boutique PRS buildings in Bucharest, totaling some 800 apartments.

Number of projects under construction (incl. number of units)

AFI Europe is planning its first PRS project in northern Bucharest. The new development will include three residential buildings with 450 apartments, making it the largest PRS project in Romania to date.

An established residential developer, with 3,000 delivered units in 8 projects located in central-western Bucharest, is assessing the shift to PRS for the first phase of one of their upcoming projects, which will include approximately 200 units.

Key challenges facing investors

- **Local mentality** – Romanians want to own a home
- **Small-sized market**, with a declining population
- **Changes in taxation**, lack of governmental incentives

Institutional rent in practice

Cost allocation

A. Tenant: utilities

B. Landlord:

- property tax: 0.1%–0.3% of property value/year
- rental tax: 10% of gross annual rental income
- insurance: mandatory insurance (EUR20/year) + optional insurance
- maintenance and repair costs

Most common lease periods

At present, the common lease period for a residential unit is 12 months.

Average gross-to-net ratio

The net rental revenue is, on average, 80%–85% of the gross revenue. Apart from the taxes detailed above, extra costs will include a yearly repairs and maintenance budget. Apartments in Romania are usually leased fully furnished and equipped. Extra costs will thus require an initial furnishing investment of about 10% of the value of the apartment.

Rent indexation – is it commonly applied?

Usually not inflation-indexed as utilities are paid for by the tenant but up for re-negotiation every 12 months.

Legal and tax considerations of PRS projects

Business model

Setting up a corporate vehicle to develop PRS projects

As a general rule, Romanian legislation does not provide rules that differentiate between PRS investments and other types of real estate investments. Therefore, the corporate vehicles available for investments are those generally used for all types of real estate investments, namely: (i) limited liability companies (LLC), and (ii) joint stock companies. The more common structure is the first one, as it offers more flexibility to investors and is also quicker and cheaper to incorporate, due to the LLCs having no minimum share capital requirement. In respect of joint stock companies, there are specific requirements for corporate approvals for the sale and purchase of real estate, depending on the value of the transaction.

Limited liability companies (LLC) offer more flexibility to investors.

Type of deals: Forward Purchase model or Forward Funding model

A. Forward purchase

Transactions are mostly structured to consist of two phases: (i) the signing of a preliminary sale agreement concerning the property or the shares in the company while the investment is still being permitted or developed, followed by a due diligence, and (ii) the transfer of the ownership under a transfer agreement subject to the fulfillment of various predetermined conditions precedent, such as obtaining the building permit or the works completion reception protocol.

B. Forward funding

This model, when the investor and the developer agree to sign an agreement concerning the sale of the property or the shares in the company without the condition precedent of the work being completed followed by the funding by the investor of the development process, is not commonly applied in the Romanian real estate market, as the process of obtaining the necessary endorsements and authorizations, especially the building permit, is a complex one and usually takes a long time, with investors preferring for these stages to be completed prior to funding being granted.

Tax issues connected with share deals/asset deals

A transfer of shares as opposed to real estate assets allows payment of registration and authentication taxes (which amount to approximately 1% of the purchase price) to be avoided. One of the major benefits of the acquisition of real estate by way of a share deal is that this type of transaction is not subject to VAT. Another advantage of the acquisition of real estate by way of a share deal is the fact that there are no thresholds imposed at the level of the transaction value and any person, irrespective of their nationality, can freely acquire shares.

The following fees are due in an asset deal involving real estate:

- the notary public fees for the authentication of the sale agreements, which vary depending on the value of the transaction. For example, for an immovable asset with a value higher than RON600,001 (approx. EUR122,205), a notarial fee of RON5,080 (approx. EUR1,035) plus 0.44% of the real estate value exceeding RON600,001 is due; and
- fees for registration with the Land Book equal to 0.5% of the purchase price for legal entities, and 0.15% for individuals.

It is market practice for the buyer to pay all fees and taxes relating to the transaction. However, the parties can agree to divide the costs.

Preparation phase

Location: zoning

Overall, the legal procedure through which the necessary endorsements and authorizations are obtained in order to fulfill the mandatory requirements for construction is the same for all types of investments. However, the urbanism regulations provide rules and conditions under which constructions may be built depending on the area of the future projects/buildings.

The relevant legislation provides several general and local urbanism regulations and plans such as the general urban plan, the zoning urban plan, and the detailed urban plan. The importance of these technical documents resides in the fact that they determine, among other aspects, the construction and zoning parameters for real estate. Nonetheless, the existing urbanism regulations may be amended by the investors through a formal procedure of adopting new urbanism documentation (usually a zoning urban plan), but there are some limitations in this respect due to the specifics of the land.

Type of investment: single building or PRS as a part of a bigger investment or separate apartments

In Romania, the real estate market regarding these kinds of projects is still under development and, due to this fact, the small investment type of PRS, such as a single building, is most likely to be found on the market.

The preference in the real estate sector used to be for investments under the built-to-sale model given that for most Romanians buying a home is the most common type of real estate investment.

Since the COVID-19 pandemic, the number of remote/hybrid workers and nomad workers increased and as a result, investors, including institutional investors, are looking for more flexible models in order to satisfy these kinds of needs, such as built-to-rent investments – while steadily growing, the market segment is still emergent.

Due diligence (performed by the investor, lender, and developer)

Besides the usual risks that can be identified in a real estate due diligence analysis, such as ownership title issues, applicable special regulations (e.g., historical monuments, green areas, etc.), improper Land Book and tax registration, etc., an additional focus should be placed on the specific permitting requirements related to the residential sector. Also, in case the business model is qualified as a hotel (rather than a standard residential lease), the supplementary permits which must be obtained in order to be compliant with the specific legislation regarding the hotel sector should be verified.

Financing: obtaining external financing

A. Financing model
The funding of PRS projects is not subject to special regulations or limitations, and the financing may cover the construction phase and/or the operation phase. The primary source of funding is bank financing.

B. Collateral
The most common forms of security created or entered into by an investor who is borrowing to acquire or develop real estate are mortgage over the real estate and mortgage over movable assets such as shares, receivables, contracts, insurances, bank accounts, and any other tangible or intangible assets assigned to the activity of the enterprise.

Acquisition

The acquisition of a real estate property is the same, regardless of the project to be developed in the end, so no specific conditions must be met in case of acquiring a property for the purpose of developing a PRS project.

The subject of the transaction may be the ownership right over the real estate property, namely the land and building, or the right of superficies over the land, meaning the right to build the construction which turns into an ownership right over the building, once the building is completed. The beneficiary of a superficies right has a complex right consisting of (i) the right to own or to construct a building on another person's land and (ii) the right of use over the relevant land. A superficies right can only be transferred through a deed authenticated by a notary public and together with the ownership of the building (as opposed to the ownership of the land, which can be transferred independently).

Under Romanian law, the transfer of the ownership title over a real estate property requires the conclusion of the transaction in the form of a notarial deed. Ownership in real estate must be registered with the Land Book only for publicity purposes at the moment, and therefore, it is not a condition for the validity of the ownership transfer.

Operational phase

Residential use (lease agreement) vs. commercial use (hotel regime)

A. Lease agreement
The Romanian Civil Code provides both the general framework for leases in Romania and the particular framework for residential leases. The special provisions in respect of residential leases, that amend and supplement the general regulations regarding lease agreements, refer to (i) the tenant's right to unilaterally terminate the lease agreement, the notice period depending on the indefinite or fixed period of time of such lease agreement, (ii) the right of first refusal of the tenant at the conclusion of a new lease agreement of the housing unit, (iii) invalid clauses regarding the insurance, the joint or indivisible liability of the tenants for damaging the common areas, the payment in advance for housing repair or the landlord's right to diminish or suppress the benefits undertaken by the agreement and (iv) the eviction of the tenant.

B. Hotel regime
The commercial use of the PRS projects may include the hotel regime, in the case when the relevant public authorities place such leases in the hotel sector rather than the residential one due to the short term of the lease. Also, due to the specifics or purpose of the agreement, the authorities may consider that the agreement is not supposed to be categorized as a residential lease and therefore, they will requalify it as an agreement subject to the hotel regime. In order for an investment to be subject to the hotel regime legislation, a classification certificate (in Romanian: certificat de clasificare) must be obtained, according to Government Decision no. 1267/2010 regarding the issuance of classification certificates, licenses and tourism patents, and other prior specific requirements must be fulfilled, such as setting up a limited liability company with NACE code 55 (hotels and other accommodation facilities) and establishing work points for each of the leased properties under hotel regime.

Tax issues

Legal entities operating in Romania have to pay profit tax for the income resulting from rental activities. Rental income is taxed at 16%, assuming that the company is subject to a corporate income tax regime (other tax regimes may be applied, subject to fulfillment of certain conditions) and the taxable

period is the fiscal year, which may correspond to the calendar year. The tax rate of 16% applies to the financial result of the company, determined by adding all the income obtained in a fiscal year, minus the value of the deductible expenses. Additional fiscal adjustments may arise – to be analyses on a case-by-case basis.

A lease of real estate properties is generally a transaction that is not subject to VAT. However, the landlord can choose to apply the regular VAT regime, which will entitle the landlord to deduct the input VAT on its expenses.

Operating real estate within the accommodation sector (e.g., hotel or similar functions, including the rental of land for camping) is a transaction subject to 9% VAT (under current provisions of the legislation, rates may change).

Currency of the rent: RON or EUR?

As a general rule the Romanian legislation provides that payments, transfers, and any other similar operations between residents, which are the subject of trade in goods and services, are carried out only in the national currency, namely RON, save for some exceptions which do not include payment of the rent. Of course, current and capital foreign exchange operations are carried out freely between residents and non-residents, in foreign currency and the national currency (RON). Also, although paid in RON, the rent or hotel tariffs are usually listed in EUR.

Exit plan

Sale of individual units

A common exit from a PRS project is to sell individual units to third parties. The transfer of the benefits and the liabilities of the lease from the former owner to the new owner as their legal successor depends on the fulfillment of the publicity requirements, namely the registration of the lease agreement in the Land Book. The parties can establish, by mutual consent, the termination of the lease agreement if the leased property is sold.

Sale of the whole building

This type of sale is similar to the common sale of commercial buildings on the real estate market. The sale of the whole building is the least common exit plan from such investments on the Romanian market. Please note that a due diligence analysis is recommended before concluding such a sale.

Sale of a business

The sale of this kind of investment is treated like any other type of business sale, no special provisions are applicable. Please note that an even more extensive due diligence analysis that should include all business components is recommended before concluding such a sale.

ESG – word of the year 2022 and the years to come

Katarzyna Chwalbińska-Kusek
Head of ESG
& Sustainability, Poland
Savills

Dr Kat Martindale
Director,
Head of ESG Research
Savills

ESG stands for Environmental, Social and Governance. It considers a company's performance and risk exposure based on its environmental impact, social responsibility, and how the company is governed.

These standards are at the top of the agenda for many organizations as increasing legislation, enhanced stakeholder concern, and requirements for transparency and disclosure continue to develop. ESG includes standards which are broad in scope and require a holistic corporate approach. ESG must be taken into consideration by businesses today due to social and regulatory requirements.

Investors are increasingly applying these non-financial factors as part of their analysis process to identify material risks and growth opportunities. ESG metrics are not commonly part of mandatory financial reporting, though companies are increasingly making disclosures in their annual reporting or in a standalone sustainability (or ESG) report.

The rise of the letter S in ESG

A building with an ESG strategy will have limited negative impact on the environment and its users. The E (environmental) aspects, which relate to the use of resources, positive impact on the biodiversity, GHG emissions, climate change adaptation and mitigation, and green building certification, among others, are very well understood, and in many cases, required by a growing regulatory environment. However, the S (social) may still sound a bit enigmatic for investors. Buildings need not only to be green, but also create social value. This is especially important in the residential sector.

Today, we observe a rise of social and governance issues, with a focus on diversity and inclusion (D&I), and human rights. The question is how to transfer these aspects to sustainability charters for buildings. In real estate, we examine the impacts our built environment has on the health, well-being and social value outcomes affecting people, supply chains, residents, occupiers and wider communities.

The aspects that should be adopted widely by the industry include a building's diversity and inclusion policy, its impact on the users' long-term health by creating a healthy indoor environment and providing people with healthy choices regarding daily commuting, nutrition and lifestyle in general. The building should be opened to the local community and play an integrating role for in it.

Focus on Net Zero

The European Union is on the pathway to climate neutrality by 2050 and therefore the following changes have been proposed recently in the EPBD (Energy Performance of Buildings Directive):

- New buildings will be zero-emissions from 2028
- Residential buildings will have to achieve at least energy performance class E by 2030, and D by 2033
- Non-residential and public buildings will have to achieve the same energy classes by 2027 and 2030 respectively
- Ban on fossil fuels heating systems by 2035

ESG and the Build-to-Rent Market

Build-to-Rent ("BTR") is an emerging market globally and while this sector is more established in some countries, such as the US, Western Europe and the UK, Savills Research has identified growth in client and investor interest. Analysis from the most recent reports of the Australian BTR market reported that between January 2021 and the third quarter of the following year, AUD 3.5 billion had been raised and committed to the sector. Conal Newland, Head of Operational Capital Markets, Savills Australia, says: "The attention that build-to-rent is gaining is a direct result of increasing housing unaffordability, a slowdown in residential construction and the rapid expected bounce back in migration, which is being encouraged by the federal government to stimulate economic growth and satisfy current skills shortages." While in the UK, the British Property Federation has calculated that this trend continues with 72,244 units under construction and 113,379 in planning, joining almost 80,000 already completed.

While all housing, regardless of ownership and tenure, is subject to the same regulations and building standards, long term involvement in sites by developers offers the opportunity to expand their sustainability offer with the aim of establishing long term residency by tenants. These opportunities include building to energy performance standards, such as Passivhaus, that exceed planning requirements, installing community heating and energy supplied through ground or air source heat pumps, as well as on-site photovoltaic units, and providing energy efficient appliances.

The Covid lockdowns highlighted the benefits of, and increased demand for, green spaces within housing developments. This has resulted in an increase in community gardens, rooftop gardens and communal vegetable plots, while cities, such as Paris and Toronto, are demanding green roofs for some new developments to help mitigate the urban heat island effect and as a part of rainwater management strategies.

On-site community facilities that may be included in BTR schemes are resident lounges, car sharing plans, gyms, bicycle storage, guest accommodation (one or two bedroom units for short term rental), childcare facilities, cafes, managed social activities and additional services, such as dry cleaning, delivered through a concierge.

Authors – Austria

Modesta Real Estate
An International Associate of Savills

Sebastian Scheufele
Managing Partner
scheufele@modesta.at

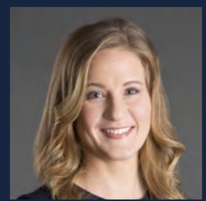
Thea Carlsson
Analyst, Investment
carlsson@modesta.at

Bianca Isak
Marketing & Research
isak@modesta.at

DLA Piper

Christoph Mager
Country Managing Partner
christoph.mager@dlapiper.com

Thomas Stiglbauer
Counsel
thomas.stiglbauer@dlapiper.com



Teresa Andessner
Associate
teresa.andessner@dlapiper.com

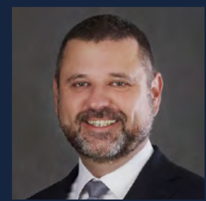
Authors – Czech Republic

Savills

Stuart Jordan
Managing Director
stuart.jordan@savills.cz

Fraser Watson
Director, Investment Advisory
fraser.watson@savills.cz

DLA Piper



David Padyšák
Of Counsel | Head of Real Estate
david.padysak@dlapiper.com

Terezie Vondrášková
Associate | Real Estate
terezie.vondraskova@dlapiper.com

Authors – Poland

Savills

Kamil Kowa
Board Member | Head of Corporate Finance & Valuation
kkowa@savills.pl

Katarzyna Chwalbińska-Kusek
Head of ESG & Sustainability
katarzyna.chwalbinska-kusek@savills.pl

Jacek Kałużny
Associate Director | Residential Capital Markets
jacek.kaluzny@savills.pl

Bartosz Cisło
Associate | Residential Capital Markets
bartosz.cislo@savills.pl

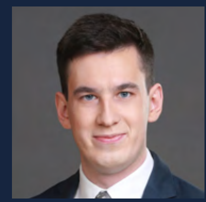
Authors – Poland

DLA Piper

Michał Pietuszko
Partner | Head of Real Estate
michal.pietuszko@dlapiper.com

Marta Bosiak
Senior Associate | Real Estate
marta.bosiak@dlapiper.com

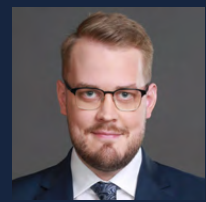
Milena Nerwińska
Senior Associate | Real Estate
milena.nerwinska@dlapiper.com



Wojciech Sulimierski
Associate | Real Estate
wojciech.sulimierski@dlapiper.com

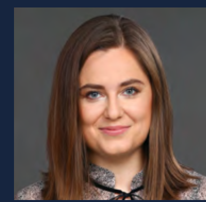
Paweł Szymański
Senior Associate | Real Estate
pawel.szymanski@dlapiper.com

Paulina Galicka
Associate | Real Estate
paulina.galicka@dlapiper.com



Maciej Rafałowski
Associate | Real Estate
maciej.rafalowski@dlapiper.com

David Rapalski
Senior Marketing and Business Development Specialist
david.rapalski@dlapiper.com



Katarzyna Karpik
Senior Marketing and Business Development Specialist
katarzyna.karpik@dlapiper.com

Authors – Hungary

ESTON
(in Association with Savills)

Attila Balogh
Head of Capital Markets
attila.balogh@eston.hu

Natália Varsádi
Analyst
natalia.varsadi@eston.hu

DLA Piper

Gábor Borbély
Head of Finance,
Real Estate Sector Head
gabor.borbely@dlapiper.com

András Posztl
Country Managing Partner
andras.posztl@dlapiper.com

Angéla Tóth
Senior Associate | Real Estate
angela.toth@dlapiper.com

Authors – Romania

Crosspoint Real Estate
An International Associate of Savills

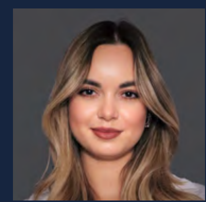
Oana Popescu
Head of Residential
oana.popescu@crosspoint.com.ro

Alexandra Nistor
Senior Account Manager,
Residential
alexandra.nistor@crosspoint.com.ro

Ilinca Timofte
Head of Research |
Crosspoint Real Estate
ilinca.timofte@crosspoint.com.ro

DLA Piper

Alin Buftea
Partner | Head of Real Estate
alin.buftea@dlapiper.com



Miruna Maracine
Junior Associate | Real Estate
miruna.maracine@dlapiper.com

Savills is a leading international consulting firm operating on the real estate market. It was established in 1855 in the United Kingdom. With a network of over 700 offices in the Americas, Europe, Africa, the Asia-Pacific region, and the Middle East, it offers a wide range of professional consultancy, management, and transaction services.

For more information about the firm and the range of services it provides, please visit:

www.savills.com

DLA Piper is a global law firm with lawyers located in more than forty countries throughout the Americas, Europe, the Middle East, Africa and Asia Pacific, positioning us to help clients with their legal needs around the world.

In Poland, the DLA Piper team consists of over 130 lawyers. The Warsaw office is recommended by international rankings: Chambers and Partners, IFLR1000, as well as The Legal 500 EMEA, which distinguishes DLA Piper in all 21 categories for Poland, of which 19 are Tier 1 and Tier 2.

For more information about the firm and the range of services it provides, please visit:

www.dlapiper.com

www.dlapiper.com

www.savills.com