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## **ANALYSIS OF REAL ESTATE MARKET BASED ON BALANCE SHEET DATA OF MAJOR DEVELOPERS IN POLAND**

**Abstract.** This article presents the situation on the Polish real estate market during the global financial crisis. Assessment of the real estate market is made by examining the financial condition of major developers in Poland.

Seven big development companies, which are listed on the Warsaw Stock Exchange (WSE) were selected for study: Echo, Polnord, LCC, Gant, Dom Development, Ronson and JW. Construction. The analysis encompassed financial data from balance sheets and from profit and loss account in the period from January 1, 2008 to September 30, 2009.

**Key words:** Polish real estate market, development companies, analysis financial data.

### **I. ANALYSIS OF REAL ESTATE MARKET BASED ON BALANCE SHEET DATA OF MAJOR DEVELOPERS IN POLAND**

The present global economic situation has forced major developers in Poland to cut their development plans. Estimations of the Polish Association of Development Companies (PADC) show that 80% to 90% of the investments planned by the PADC members have been stopped. This factor seems to be reliable in determining a rather pessimistic outlook for the real estate market in Poland for the present and next year.

The year 2009 turned out to be the year of a serious crisis on the housing market. The situation on the market was mainly influenced by:

- decline in financing mortgage loans for individual buyers to the level of 40% (the final result may be more favourable as results for the last quarter of 2009 may turn out to be similar to the analogous period of the last year),
- slump in sales in the first quarter of the year (by 70% when compared with the first quarter of 2007), and then improvement in the second quarter and stabilization in the next period,
- unprecedented slowdown on some markets of new investments , reaching e.g. 70 % on the Warsaw market in comparison with the previous year (taking the first three quarters into account) .

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Over three quarters of 2009 the number of flats sold on 6 markets declined by 30% when compared with the year 2008. The aggregate sale in the third quarter of the present year reached 5,300 items and it was 500 items lower than in the second quarter. Łódź was the only city where the number of flats sold in the third quarter of 2009 was considerably higher than the one recorded in the second quarter. It is worth mentioning, however, that the sales on the Łódź market did not exceed 240 flats in the third quarter (0.3 flat per 1,000 inhabitants) and the growth in reality relates to 70 flats. (Cf. Table 1).

In the third quarter the share of finished flats in the whole range of flats offered by developers was growing. The growth was most dynamic in Cracow where finished flats constituted a notable 43 % of the whole offer.

Table 1. Sales of flats by developers in 2009

	I quarter	II quarter	III quarter
Łódź	101	165	238
Poznań	404	759	425
Trójmiasto	536	779	767
Wrocław	730	832	818
Kraków	966	1244	1047
Warszawa	1671	1990	1969
Total sales	4408	5769	5264

Source: REAS.

During the nine months of 2009 development companies started construction works on ca 29,9 thousand flats i.e. 45,1% less than in the same period of 2008. However, we need to take into account that in many cases the started construction works are either conducted on a much smaller scale (e.g. only one building is under construction), or the start is of formal character only (digging a spade into the ground), so the scale of the slowdown is much bigger than the statistics show. The decision on signing the contract with the contracting company and starting a new project is mainly based on whether or not the developer is able to find financing for the project and, as it was mentioned above, the access to financing has not become easier.

When analysing average prices of flats offered by developers in 2009 we need to pay attention to a further slight decrease in their indexes in the following markets: Warsaw, Cracow, Wrocław, and the Tricity. In Poznan and Łódź the average price indexes rose; it was the result of offering flats whose prices were much higher than the average (in Poznań), or higher sales of cheaper flats – offer reduction (in Łódź). The phenomenon of adjusting flat prices to the requirements of the government programme “Family on Its Own” was observed on all the monitored markets.

The latest real estate reports show that the year 2009 brought the beginning of stabilization of prices. According to data from AMRON offer prices of flats have stabilized, too.

Transaction prices which, on average, are 10%–15% lower than the offer prices are presented in Table 2.

Table 2. Average transaction prices (in zloty per sq. m.)

	Warsaw	Katowice	Łódź	Wrocław	Gdańsk	Cracow	Poznań
2008							
I kw	8774	3715	4322	6634	6342	7077	6360
II kw	8519	3708	4222	6622	6182	7153	6339
III kw	8143	3580	4136	5922	5825	7077	6183
IV kw	7913	3407	4167	5866	5370	6917	5710
2009							
I kw	8091	3595	4010	5823	5141	6897	5816
II kw	7945	3398	3907	5644	5263	6695	5714
III kw	7853	3393	3861	5837	5799	6526	5952

Source: AMRON databasis.

The variety of flats on offer becomes a pure fiction, as what is offered by developers fails to meet the expectations of potential buyers. The most sought after flats are one or two-bedroom flats whose prices do not exceed 400–500 thousand zlotys in Warsaw, 300 thousand zlotys in Cracow, Gdańsk and Poznan and 250 thousand in Lodz and Katowice. Unfortunately, a vast majority of developers' offer does not come up to these expectations.

According to the Polish Banks Association (PBA) data 286,000 mortgage loans were granted in Poland in 2008, and their total value was equal to 57,1 billion zlotys (to compare with 2007 – 311, 000 loans were given and their total value exceeded 56 billion zlotys).

Table 3. Number and value of newly-granted housing loans

	2008				2009		
	I quar.	II quar.	III quar.	IV quar.	I quar.	II quar.	III quar.
Loan numbers	62,7	82,3	82,9	58,7	37,9	45,6	52,9
Loan value in bln zlotys	12,1	16,4	16,8	11,9	7,6	9,4	10,1

Source: Polish Banks Association.

In the first half of 2009 the number of granted loans decreased by 26% (in annual approach i.e. comparing the data from July 1, 2008 to June 30, 2009 with the numbers for the period of July 1, 2007 and June 30, 2008). In the second

quarter of the year the banks have granted almost 45% fewer mortgage loans than in the analogous period of 2008. However, when we compare the second and the first quarter of 2009 it becomes clear that the banking sector has recorded an increase in credit actions by 20% . The third quarter brought even more positive energy as the number of granted credits rose by 16% when compared with the second quarter of 2009 .

Two questions arise here – How are the main Polish development companies doing under the present market crisis ?

What picture of the present situation on the housing market emerges when companies' financial data are analysed?

Seven big development companies, which are listed on the Warsaw Stock Exchange (WSE) were selected for our study : **Echo, Polnord, LCC, Gant, Dom Development, Ronson oraz JW. Construction.** The analysis encompassed financial data from balance sheets and from profit and loss account in the period from January 1, 2008 to September 30, 2009.

The first thing worth stressing here is that development of th construction sector has contributed to eliminating the seasonal character of sales of new flats. At present, developers are able to provide flats to prospective tenants throughout the year.

When we analyse the actual **sales** and study data for all the selected development companies we can notice in 3 cases (comparing the average quarterly value for 2008 with the average quarterly value for 2009) **an increase in average quarterly sales value** which, most likely, results from contracts signed at the end of 2007 and the beginning of 2008. The three companies are: **Gant**, which recorded the highest increase, and then **Ronson** and **JW Construction.**

Table 4. Sales Income

Data for period (in thous. zł.)	1.01.09 – 30.09.09	1.01.09 – 30.06.09	1.01.09 – 31.03.09	1.01.08 – 31.12.08	1.01.08 – 31.03.08
ECHO	328 570	230 398	134 381	438 189	89 659
POLNORD	170 228	103 551	22 505	242 651	74 228
LCC	35 328	24 297	12 239	136 498	46 128
GANT	318 006	225 783	83 427	51 755	12 776
DOM DEV	514 716	382 582	190 628	924 704	266 768
RONSON	77 951	42 070	15 156	12 688	12 688
JW. CONSTRUCTION	491 079	331 153	240 539	651 046	126 219
TOTAL	1 935 878	1 339 834	698 875	2 457 531	628 466

Source: Author's own calculations based on data from financial reports.

**JW. Construction** differs significantly from the other two companies in that it not only deals in construction and sale of relatively cheap flats, but it also operates in other sectors of business activity.

In case of **Polnord** – a very big development company, which is the owner of the biggest land bank in Poland – the average, quarterly value of sales in 2008 was slightly above 60 billion zlotys. In the first three quarters of 2009 the average sales value totalled only a slightly lower sum – 56.7 million zlotys .

**Dom Development** is, in turn, a company solely concentrated on the Warsaw market, whose average quarterly value of sales reached 231 million zlotys, but in 2009 the sales slumped to the level of 171.6 million zlotys .

The sales of **Echo, LCC and JW. Construction** reached a peak in sales in the first quarter of 2009., **Polnord, Gant i Dom Development** had the best sales in the second quarter, while for **Ronson** the third quarter turned out to be the best.

Comparing the data on the aggregate sales for all the 7 companies it can be noticed that in 2009 **a rise in value of sales by 5,3%** occurred (compared with 2008), yet a simultaneous **increase in selling costs by 13.84%** was also observed. Majority of the analysed companies suffered **a decrease in sales profitability**. In 2008 selling costs for all the analysed developers amounted to 370 454 thousand zlotys per one quarter .For the three quarters of 2009 the costs reached 421 729 thousand zlotys per a quarter, on average.

Table 5. Selling cost

Data for period (in thous. zl.)	1.01.09 – 30.09.09	1.01.09 – 30.06.09	1.01.09 – 31.03.09	1.01.08 – 31.12.08	1.01.08 – 31.03.08
ECHO	-123 283	-87 829	-55 204	-177 852	-40 315
POLNORD	-132 340	-87 329	-15 515	-128 996	-29 980
LCC	-8 800	-6 098	-3 049	-74 796	-28 406
GANT	-220 035	-157 230	-64 201	-33 541	-9 533
DOM DEV	-370 044	-260 398	-120 193	-568 243	-162 007
RONSON	-50 345	-26 709	-9 407	-6 539	-6 539
JW. CONSTRUCTION	-360 341	-241 923	-178 063	-491 850	-97 100
TOTAL	-1 265 188	-867 516	-445 632	-1 481 817	-373 880

Source: Author's own calculations based on financial reports.

When revenue and costs are compared then the biggest **decrease in sales profitability** was recorded for: **Polnord (by 31,6%), Ronson (by 20,2%), Dom Development (by 14,5%) i Gant (by 6,34%)**. Three companies: **LCC (by 120%), Echo (by 8,2 %) and JW. Construction (by nearly 3 %)** improved their sales profitability in 2008.LCC was the company to record the biggest rise in profitability yet its sales were seriously limited.

The increase in sales costs in 2009 can be attributed to : a real increase in cost of purchase of construction services and a rise in the cost of external financing which was accumulated in stocks .

Moreover, considerable differences in **sales profits** of individual companies are noticeable. **Polnord** company experienced a dramatic **fall in sales profits**. Over the first three quarters of 2009 the company managed to make ,on average, only **44,5%** of the average quarterly profit earned in 2008 (and expressed in zlotys ).

**Dom Development** was another company which recorded a **decline in average quarterly profit** to the level of **46 %** of the average quarterly profit in 2008., while **LCC** managed to reach the level of **57 %**.

Simultaneously, smaller developers reached a considerable **rise in profit** in 2009 , when compared with average quarterly gross profit from sales in 2008. **Gant** company recorded a rise from 4.5million zlotys in 2008 to 32,6 million zlotys in 2009 , and **Ronson** from 1.54 million zlotys in 2008 to 9.2 million zlotys in 2009. **JW. Construction** and **Echo** were the two big players who managed to improve their operational profits.

Table 6. *Gross profit from sales*

Data for the period (in thous. zl. )	1.01.09 – 30.09.09	1.01.09 – 30.06.09	1.01.09 – 31.03.09	1.01.08 – 31.12.08	1.01.08 – 31.03.08
ECHO	205 287	142 569	79 177	260 337	49 344
POLNORD	37 888	16 222	6 990	113 655	44 248
LCC	26 528	34 792	9 190	61 702	17 722
GANT	97 971	68 553	19 226	18 214	3 243
DOM DEV	144 672	122 184	70 435	356 461	104 761
RONSON	27 606	15 361	5 749	6 149	6 149
JW. CONSTRUCTION	130 738	89 229	62 476	159 197	29 119
TOTAL	670 690	488 910	253 243	975 715	254 586

Source: Autor's own calculation based on financial reports.

Until the end of the first quarter of 2009 **stocks**, i.e. started investments and finished goods as of the end of financial period, were growing. In total , for all the analysed companies the level of stocks increased from the value of 4 770 423 thousand zlotys at the end of 2007 to 6 603 509 thousand zlotys at the end of March 2009 . These figures prove that over the whole year 2008 and the first quarter of 2009 there was a slowdown in sales of started investments. Stocks levels as for the end of the subsequent quarters of 2009 show a slight downturn trend. Taking into account all the seven companies we can observe a 5% decline when we compare the level of stocks for September 30, 2009 with the level for December 31, 2008.

Table 7. *Stocks*

Stocks levels (in thous. zł.)	30.09.09	30.06.09	31.03.09	31.12.08	31.03.08	31.12.07
ECHO	431 193	440 718	451 625	486 655	512 141	455 619
POLNORD	1 359 260	1 403 366	1 392 924	1 349 390	1 044 109	937 159
LCC	963 952	928 652	903 416	879 155	816 389	674 665
GANT	536 068	569 029	640 471	682 494	525 676	503 789
DOM DEV	1 415 554	1 445 078	1 464 407	1 458 133	909 773	862 358
RONSON	641 052	629 116	611 336	577 010	483 118	457 774
JW. CONSTRUCTION	1 034 758	1 069 845	1 139 330	1 279 238	900 220	879 059
TOTAL	6 381 837	6 485 804	6 603 509	6 712 075	5 191 426	4 770 423

Source: Author's own calculations based on data from financial reports.

Simultaneously, the balance sheets of the analysed companies show a substantial increase in **investment properties**.

Investment properties are properties which are not purchased to construct new buildings or to be used as a source of income from a leasehold but mainly for speculation reasons. At the end of 2007 the total value of investment properties amounted to **2 350 873 thousand zlotys** but for the end of March 2009 it totalled **4 110 696 thousand zlotys** going down slightly to **3 975 258 thousand zlotys** at the end of September 2009.

Table 8. Investment properties

Value for the day (in thous.zł.)	30.09.09	30.06.09	31.03.09	31.12.08	31.03.08	31.12.07
ECHO	3 417 164	3 527 817	3 608 654	3 192 569	2 463 304	2 034 700
POLNORD	158 878	115 774	90 295	68 425	398	487
LCC	0	0	0	0	0	0
GANT	386 803	394 183	399 377	378 444	312 978	303 421
DOM DEV	0	0	0	0	0	0
RONSON	0	0	0	0	0	0
JW. CONSTRUCTION	12 413	12 388	12 370	12 352	12 267	12 265
TOTAL	3 975 258	4 050 162	4 110 696	3 651 790	2 788 947	2 350 873

Source: Author's own calculations based on data from financial reports.

The increase in the value of speculation investments resulted from updating investment value. It can be observed that the rise in value of investment property does not correspond in any way with the profits of developers who, after all, are active on the real estate market.

The profit and loss accounts of developers, with and without updates of real estate investment, are presented in Tables 6 and 7.

Table 9. Gross Profit/Loss from economic activity with update of real estate investment

Data for the period (in thous.zł.)	1.01.09 – 30.09.09	1.01.09 – 30.06.09	1.01.09 – 31.03.09	1.01.08 – 31.12.08	1.01.08 – 31.03.08
ECHO	110 291	87 685	65 039	145 365	32 871
POLNORD	42 267	20 563	15 630	60 164	28 962
LCC	12 697	9 067	3 725	53 853	12 731
GANT	14 526	45 822	15 638	12 820	-1 057
DOM DEV	86 102	80 096	51 749	260 280	86 180
RONSON	15 085	7 721	3 323	2 251	2 251
JW. CONSTRUCTION	83 934	57 813	44 575	72 948	14 356
TOTAL	364 902	308 767	199 679	607 681	176 294

Source: Author's own calculations based on data from financial reports.

Table 10. Gross Profit/Loss from economic activity without update of real estate investment

Dane za okres (w tys. zł)	1.01.09 – 30.09.09	1.01.09 – 30.06.09	1.01.09 – 31.03.09	1.01.08 – 31.12.08	1.01.08 – 31.03.08
ECHO	253 867	-96 440	-269 797	-312 773	32 206
POLNORD	-11 904	-18 400	-6 240	42 152	28 962
LCC	9 907	-8 284	-26 870	17 486	12 731
GANT	11 688	32 408	-4 512	12 820	-1 057
DOM DEV	86 102	80 096	51 749	260 280	86 180
RONSON	15 085	7 721	3 323	2 251	2 251
JW. CONSTRUCTION	83 934	57 813	44 575	72 948	14 356
RAZEM	448 679	54 914	-207 772	95 164	175 629

Source: Author's own calculations based on data from financial reports.

It is worth stressing here that the total sum of **3 975 258 thousand zlotys**, which gives the value of investment properties as of 30 September, 2009, contains already the **sum of investment updates equal to 1 304 666 thousand zlotys** related to the period from January 1, 2007 to September 30, 2009.

It means that the analysed companies managed to increase **the value of investment properties by nearly 48,8%** which was reflected in their financial results.

Consequently, it can be expected that in case when transactions on real estate investments are concluded a considerable fall in profitability of companies' operational activity will take place. When we look closely at the analysed companies' balance sheets what we can also notice is a **fall in financing stocks by prospective buyers**. As of March 31, 2008 payments made by clients of all the analysed developers accounted for **26,69 %** of the total stocks. The stock level for December 31, 2008 was equal to **22,07 %** while for September 30, 2009 the percentage went down to **14,45 %**. It means that the companies are forced to incur more liabilities with banks. (Cf. Chart 1)



Moreover, development companies adopted a principle that the cost of interest on credit and loans should be capitalized. These costs are not included in profit and loss account for a current period but they increase the stocks value. Thus in future it can be expected that the profit margin on sold flats will be decreased by the value of financial costs which are at present hidden in the stocks value.

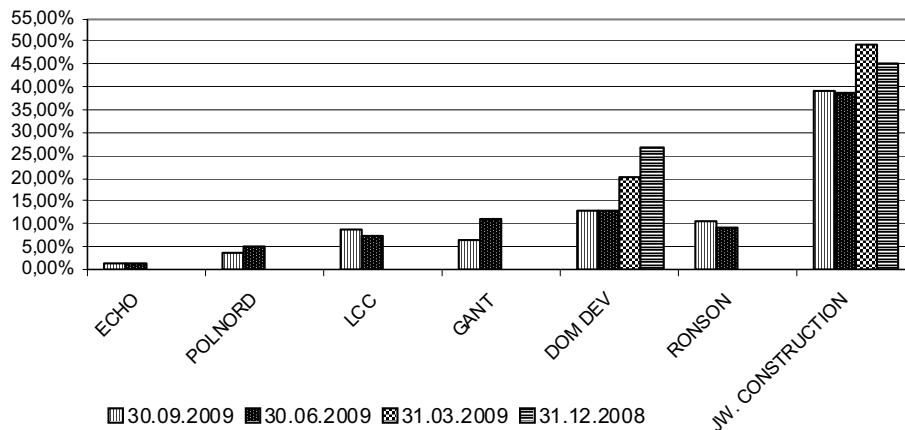


Chart 1. Share of stocks financing by client payments

Source: Author's own calculations.

Looking at two important indexes : **current solvency** and **general indebtedness** one can notice a „worsening” of their results of most the analysed developers.

Table 11. Current solvency index

Value for the day (in thous. zł)	30.09.09	30.06.09	31.12.08
ECHO	1.39	1.62	2.14
POLNORD	3.22	2.98	4.17
LCC	3.15	3.02	3.27
GANT	1.05	2.06	1.53
DOM DEV	1.80	3.52	2.82
RONSON	2.17	2.11	2.97
JW. CONSTRUCTION	1.31	1.30	1.12
TOTAL	1.84	2.24	2.18

Source: Author's own calculations.

Table 12. General indebtedness index

Value for the day (in thous. zł.)	30.09.09	30.06.09	31.12.08
ECHO	59,00%	54,10%	54,47%
POLNORD	45,39%	48,63%	48,21%
LCC	44,27%	43,34%	42,18%
GANT	79,61%	53,97%	63,12%
DOM DEV	81,21%	55,84%	61,28%
RONSON	56,64%	56,47%	55,94%
JW. CONSTRUCTION	75,45%	77,07%	81,68%
TOTAL	61,45%	55,07%	57,59%

Source: Author's own calculations

The decrease in the solvency index of the analysed companies is strongly influenced by a change in credit policy of the Polish banks. At present, banks are extremely unwilling to grant long-term credits to developers yet they have increased their offer of short-term credits. This tendency can be easily traced in company balance sheets where long and short-term liabilities are given. Indebtedness index has increased considerably in case of two developers. It is well-known that creditors prefer small indebtedness index, on the other hand company owners may benefit from higher indebtedness by using the so called leverage. A fully objective analysis of the value of this index in particular companies would require a more detailed analysis of financial results of companies as well as in-depth knowledge of their present activities and future investment plans.

To sum up the above analysis it can be said that the decrease in the number of signed flat sale contracts took place at the end of 2007. Due to technological reasons the signed contracts are implemented by developers within 18 months since the start of construction works. Thus, numerous projects were started and continued without any guarantee of successful sales. The situation resulted in substantial increase in stocks which, obviously, also include costs of debt servicing.

Keeping stocks, financed from external sources, at high level may prove dangerous for developers. An example of the Spanish developer Martins-Fades shows the scale of the possible risk. The company, which is one of the biggest players on the European market, is currently threatened by bankruptcy. Their problems have been caused by the lack of possibility of servicing debts incurred for land purchase.

Although the present financial results of the analysed companies are not bad, at the end of 2009 a deterioration of their financial results related to operational activity can be expected for two main reasons:

- lower revenues,
- unproportional cost rise.

Real estate market experts stress the fact that if the housing market is to enter a growth path, it is absolutely necessary for developers to liquidate flats which are under construction. Moreover, it is necessary to increase availability of mortgage loans which are still a basic source of financing flat purchase.

Finally, it seems vital for the real estate market to regain positive energy and optimism which will encourage potential buyers to incur loans and purchase flats.

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#### **ANALIZA SYTUACJI NA RYNKU NIERUCHOMOŚCI W OPARCIU O DANE BILANSOWE GŁÓWNYCH DEWELOPERÓW W POLSCE**

Artykuł ten prezentuje sytuację na rynku nieruchomości w Polsce w czasie globalnego kryzysu finansowego. W związku z sytuacją ekonomiczną na świecie główne firmy deweloperskie w Polsce znacznie ograniczyły plany dotyczące ich rozwoju. Oceny rynku nieruchomości mieszkaniowych dokonano analizując kondycję finansową głównych firm deweloperskich.

Do badania wybrano siedem dużych firm deweloperskich : Echo, Polnord, LCC, Gant, Dom Development, Ronson oraz JW. Construction, które notowane są na Warszawskiej Giełdzie Papierów Wartościowych. Analizie poddano dane finansowe z bilansów i rachunków wyników w okresie od 1 stycznia 2008 do 31 marca 2009.