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## Lease as Form of Municipal Land Management – Case Study

**Abstract:** This paper presents information about different forms of land management, especially land leasing. Land lease transactions in Poznan, one of Poland's regional cities, have been analyzed. The research has shown that, in Poland, long-term leases have been used in a very limited (partial) scope so far. Most often, lease agreements are concluded for up to three years with the possibility of extension, although the law provides for the possibility of concluding contracts for longer periods. During the years of 1996–2014, the city of Poznan concluded only 18 long-term lease agreements, which is caused by the dominant form of managing public lands – perpetual usufruct.

**Keywords:** land lease, rent, local government, perpetual usufruct

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## 1. Introduction

According to the legal regulations of Poland, land real estate may be the subject of sale, lease, and perpetual usufruct (this right applies only to real estate owned by public entities; i.e., the state treasury and local governments or their unions). The most powerful law is the right of ownership occurring in all legal orders, which is a negotiable, transferable and a hereditary right. The right of perpetual usufruct, in principle, does not occur in other countries, although the scope of the rights of the holder of this right has some similarities with the legal institutions popular in other countries (perpetual lease). Perpetual lease, like perpetual usufruct and long-term lease in Poland, allows the holders to carry out investments on someone else's land and ensure the stabilization (in the time specified in the agreement) of owning a real property. Hence, apart from ownership, these are the forms of land management that enable the investment to be implemented by potential investors.

In Poland, long-term leases have been used in a very limited (partial) scope so far. Most often, lease agreements are concluded for up to three years with the possibility of extension, although the law provides for the possibility of concluding contracts for longer periods.

The above-mentioned forms of land management make it possible to implement investments on someone else's land. Before making a decision about the choice (ownership, perpetual usufruct, or long-term lease) of the land right, the investor assesses the profitability of each of these forms of ownership.

Among the discussed rights, the most powerful law is ownership, then perpetual usufruct (perpetual lease in other countries), and long-term lease. Thus, for a law that is valued higher, the investor (potential buyer) is willing to pay a higher price.

In turn, the owner of the land would be interested in providing the land to a potential investor in such a form of power that would ensure the maximization of its financial benefits (provided that this is the criterion of choice).

In the decision-making process regarding the selection of the form of land ownership, both the owner and potential investor (buyer) assess the profitability of each of these forms, taking into account their own (usually different) criteria, motives, and objectives. The choice as to the forms of real estate management (sales, perpetual usufruct, or lease) is made taking into account the law, objectives, and criteria for managing land property owners as well as the expectations and benefits of potential buyers, perpetual usufructors, and tenants.

## 2. Legal and Economic Aspects of Lease

The real estate located in the area of a commune that are components of the communal property as well as those owned by people from other entities constitute a statutory source of income for the commune. The income obtained by municipal-

ities from real estate management comes from various sources and has a diverse character. Depending on the type of commune (rural, urban, or urban-rural), the size and diversity of the property resource located in the commune, the implemented strategy (or lack thereof) for managing these properties, and the financial effects are (perhaps) differentiated.

Among the proceeds from the commune's assets, the revenues from municipal real estate play a significant role. This turnover includes not only the purchase (the sale of the full property rights of real estate) but also the trading of other bundles of rights connected with the properties.

The most common are perpetual usufruct, long-term lease, rental, and permanent management. These types of property rights are related to certain incomes earned by municipalities.

For example, making communal land available for perpetual usufruct involves proceeds to the commune: the first fee of 15–25% of the property price and annual fees for perpetual usufruct that amount to 1–3% of the property price. The commune council may reduce the annual fee (depending on the purpose of the land). On the other hand, the sale of municipal flats to existing tenants constitutes "savings" in the incurred expenses related to the operation, ongoing maintenance, and repairs of municipal buildings and the management of common property.

The financial effects of trading in municipal real estate can be treated as a source of power for communal budgets in the short and long terms. Under the pressure of current needs, municipalities often treat the sale of communal property as an *ad hoc* form of saving the communal budget. The decision to not sell every communal property is equally beneficial for the commune. The sale of communal flats (especially in low-standard resources) is certainly more profitable from both a short- and a long-term perspective than the sale of municipal lands (which may be used for investment purposes). In the current realities, the funds obtained from the sale of municipal real estate are most often used to cover current needs.

The sale of municipal properties leads to a reduction in its resources and, consequently, to a reduction of income from this property in the future, which may worsen the future financial situation of the commune and will affect the level of meeting the needs of a given community. Generally speaking, the sale of municipal real estate should be treated as a one-time source of power for the commune's budget, and the proceeds obtained from other forms of real estate trade as a fairly regular and permanent source of communal budgets in the longer term.

In addition, the sale of municipal real estate (especially land) restricts the possibility of disposing of property in the future; i.e., their contribution to the companies in which the commune is a shareholder, locating future public investments in these areas. The commune also loses the source of income from year-round fees related to perpetual usufruct, long-term lease, or permanent management.

In turn, land lease is a form of using the land for a specified period of time, an alternative to perpetual usufruct (this applies to land owned by the public) or sale.

Lands that may be used for other purposes due to their development potential in the future should not be intended for sale. The lack of management strategies for this resource, lack of local development plans, limited investment opportunities resulting from the financial situation of communes, or lack of private investors to locate investments in specific areas constitute circumstances in favor of a temporary form of development in these areas. Hence, it is necessary to make this land available to entities that are interested in this form of land management.

Pursuant to legal regulations, local government units acting in the sphere of civil law relationships may share the rights to use real estate owned by them with natural persons or legal entities (in particular, by concluding long-term lease and rental agreements).

The legal regulations for long-term lease and rent agreements as a civil law institution are contained in the provisions of the Civil Code (Articles 659–709). Pursuant to the provisions of Article 693 of the Civil Code, the lessor undertakes to give the lessee the right to use and collect benefits through a lease agreement for a designated or unlimited period, and the lessee undertakes to pay the renter the agreed rent. The economic effects of a lease agreement apply to the benefits and amounts of the rent. Under free market conditions, the increase in demand for land under a given use pattern affects the prices of land with a different less profitable use. Both the rarity and limited resources of lands with certain parameters and an increase in land demand due to the location of various functions in space cause an increase in the value of the land. A higher value of land should be reflected in higher rental rates. Can this pattern be observed on the lease market? Is there a relationship between the market value of the leased land and the rent level? If so, what relationship is it? To what extent does the level of the lease rate secure the interest of the commune (owner), and is it attractive from the point of view of a potential investor? To what extent does the level of rental rates result only from market rights, and to what extent is the effect of the spatial policy conducted by local authorities? When deciding on the form of property development, should the municipality prefer their need to ensure the spatial order, quality of the environment, and lives of the residents, or do they seek to determine rental rates at a level corresponding to the rates of the leasing of lands that are not communal properties?

For a certain group of entities (investors), a long-term lease is a form of land management that especially enables the implementation of investments (running a business) for a certain period of time. In the profitability account, the lessee should consider the fact of periodic benefits. In turn, the commune (owner of the land) offering the land for lease does not bear the costs associated with maintaining the order on the property (ensuring the security) and gains periodic inflows for the duration of the lease. Lands whose intended destination is different (they constitute a reserve of land for the implementation of public purposes in the future) or their future destination is not ultimately defined (lack of local development plans) are most often leased.

### 3. Sale or Lease of Lands – Points of View of Owner and Lessee

Lease is one of the forms of public and private land access. In Poland, public real estate may be subject to perpetual usufruct, and long-term lease (up to 30 years) is used to a relatively very small extent.

Municipalities most often lease land for a fixed period (up to three years) with the option of extending the lease contract. Lands whose intended destinations are different (they constitute a reserve of land for the implementation of public purposes in the future) or their future destinations is not ultimately defined (a lack of local development plans) are most often leased. When leasing a land, the owner does not bear the costs of maintaining the order on the property nor ensuring security, for example, and during the lease of the property (land), the owner obtains proceeds from the rent. A lease may also be a source of inconveniences or difficulties (not mentioned here) for the parties to the contract.

The scope of using a lease as a form of property management or detailed decisions regarding the conditions included in the agreements are varied in individual countries and change over time. The long-term management of someone else's land without the necessity of buying it and the ownership of the buildings or facilities built on this land<sup>1</sup> occurs in many countries with a market economy, although the occurrence of this form varies depending on socio-economic and financial conditions [1–3].

The most common issues that are resolved when concluding lease contracts are as follows:

- ownership of buildings or other objects built by lessee,
- duration of contract and possibility of its extension,
- settlement for expenses incurred on land,
- level and update of rental rates,
- possibility of buying land by lessee,
- possibility of sub-leasing,
- method of land development,
- other arrangements; e.g., proper maintenance of buildings, real estate insurance, etc. [4].

The source of potential problems related to the operation of leases may be as follows [5]:

- lack of adequate changes in lease rates in relation to changes in value of lands,
- resistance and opposition from lessees caused by changes at level of lease rates [6, 7],
- difficulties and costs related to valuation and security of interest of each party to lease contract,

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<sup>1</sup> These issues are comprehensively described both in the legal and economic literature, e.g. in building law, the law of a long-term lease or the right of perpetual usufruct [1–3].

- problems with method of establishing rental rates (these are most often estimated rates, not market rates),
- common occurrence of individual negotiations instead of market or tender procedures,
- costs related to lease may be higher than costs of selling land on property,
- lack of benefits for owner in event of uneconomical use of land by lessee; lease is not able to pay rental rate set in contract.

The choice of the most favorable form of access to the land (here: sale or lease) by the owner/municipality from the point of view of maximizing the financial benefits is possible by comparing the benefits of each of the forms under consideration.

In the case of making a decision to sell a property, the price should be at least equal to the market value of the property:

$$P \geq MV,$$

where:

- $P$  – property market price,
- $MV$  – current value of inflows corresponding to market value of property.

The proceeds from the sale constitute a one-time source of power for the owner's budget, whereas the lease of land to the landowner provides the owner (municipality) with an inflow of funds during the lease period.

The second possible way is to lease the property. Putting the property in a lease is profitable for the owner from the point of view of financial benefits when the updated proceeds from the lease and the subject of the lease (after the termination of the lease agreement) are higher ( $PV_d$ ) than the market value of the property ( $MV$ ):

$$PV_d > MV.$$

In turn, for a potential investor (tenant), the purchase of land for ownership is profitable when the cost of acquiring ownership ( $C$ ) is lower than the updated expenses related to its lease ( $PV_s$ ):

$$C < PV_s,$$

in the opposite situation ( $C > PV_s$ ), lease is profitable.

To establish these relationships, it is important to adopt assumptions regarding, for example, the following:

- market value of property,
- duration of lease contract,
- rent level,

- rules for valorizing rental rate,
- expected increase in market value of property,
- expected level of discount rate,
- share of own resources in financing purchase of real estate,
- repayment period and loan costs to finance purchase of land for ownership<sup>2</sup>.

#### **4. Importance of Lease in Land Management (on Example of Poznan)**

In Poznan in 2010, the largest share in the structure of leased lands in terms of their area was occupied by the lands for agricultural and vegetable production. The adjacent lands (115.4 ha) and storage lands (80 ha) have a large share. In 2017, the number of lease contracts for lands was 7,945 ha, the largest of which concerned the lease of lands designated for adjacent areas (2,950 ha), garages (2,687 ha), and areas included in estates.

However, when it comes to the occupied area, the largest share is still occupied by agricultural activity lands (463.6 ha), recreation (63.52 ha) and lands included in the property (14.2 ha). The area of leased lands (without long-term lease) amounts to 689.2 ha (which increased by 67.7 ha as compared to 2010).

Land owned by the city can be leased for specific purposes (either tender or non-tender) for a fixed period of up to three years or an indefinite period.

The current rules for the lease of municipal lands are regulated in the Order of the mayor of Poznan of December 24, 2015.

Within the city of Poznan, four zones have been distinguished (central, mid-town, middle, and peripheral) for which rental rates are set, taking into account the land function. These rates are updated annually according to changes taking place on the market.

Examples of changes in lease rates for selected purposes are presented below (Figs. 1–3).

In 2017, the level of lease rates is at a lower level as compared to 2010, although these rates have increased over the subsequent years (after a significant decrease in 2011).

Analyzing the presented measures, it can be noticed that, in the analyzed years, rental rates for land for pavilions in the city center zone are at a lower level in 2017 than in 2010 (similar to the rental rates for kiosk lands).

Analyzing the presented measures, it can be noticed that, over the last four years, the rate of lease for the land for pavilions in the intermediate zone was characterized by an upward trend.

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<sup>2</sup> Issues related to the determination of rental rates ensuring the interests of each of the parties are discussed in greater detail [8].

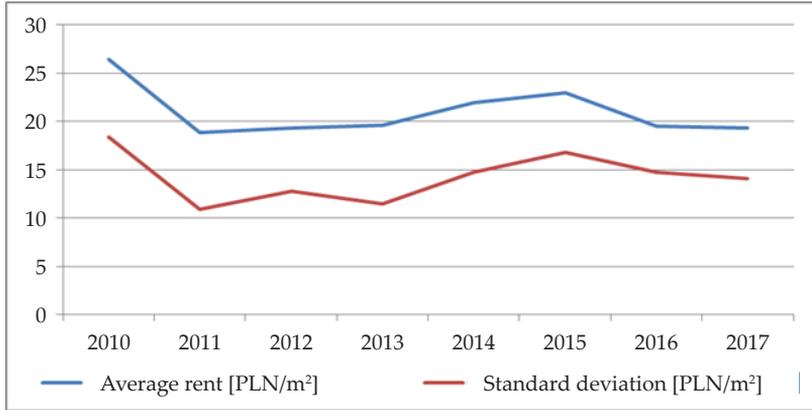


Fig. 1. Land rental rates for kiosks in city center zone in 2010–2017

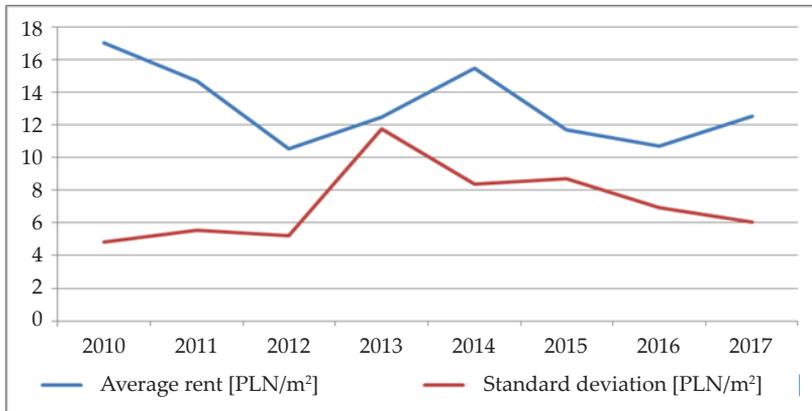


Fig. 2. Land lease rates for pavilions in city center zone in 2010–2017

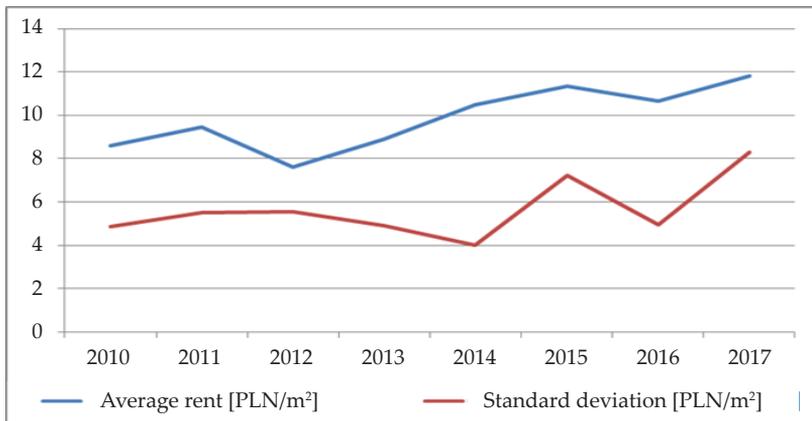


Fig. 3. Land lease rates for pavilions in intermediate zone in 2010–2017

The analysis of the presented charts shows that the rates of land rent in the city center zone in 2017 did not reach the 2010 level. This state of affairs results from the ongoing changes in the structure and organization of trade; a consequence of these changes is the declining profitability of trade in the city center (kiosks and pavilions).

However, during the analyzed period, an increase in the rates of rental of lands for pavilions in the intermediate zone was noted. Changes in these rates vary depending on location (housing estate). These rates are higher on the so-called residential markets; consequently, their level increased.

The city also concludes long-term contracts; however, as compared to the agreements mentioned earlier, they are marginal. During the years of 1996–2014, a total of 18 long-term lease agreements were concluded (over 10 years).

These were the contracts concluded for the following periods:

- 10 years – 2,
- 15 years – 4,
- 20 years – 2,
- 25 years – 7,
- 30 years and more – 3.

Under the concluded contracts, 21.8 ha were handed over for long-term leases. The leased land was intended for the following:

- petrol stations with commercial facilities (3 contracts),
- industrial and production buildings (2 contracts),
- advertising (3 contracts),
- construction of depot (1 contract),
- public school (1 contract),
- parking at shopping center (1 contract),
- car showroom (1 contract),
- marketplace (1 contract),
- retail and office buildings (1 contract),
- professional football pitch (1 contract),
- construction of commercial building (1 contract).

Summing up, during the years under discussion, such a small number of lease agreements concluded for ten years and more is due to the fact that, in Poland, the dominant form of making public lands available for a designated period is perpetual usufruct (in Poznan in 2010, the perpetual usufruct was 14.73% of land municipalities; in 2017, this share was 12.83%)<sup>3</sup>.

The lease rates determined on the day the contract is concluded are from PLN 0.08/m<sup>2</sup>/month (goal: professional football pitch) to PLN 2.18/m<sup>2</sup>/month (construction of a commercial building). These rates are indexed on a quarterly basis by a growing indicator of the level of consumer goods and services prices in the

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<sup>3</sup> Information on the status of municipal property, 2010 and 2017, BIP, Poznań [9].

previous quarter. Taking into account the value of real estate leased for a long-term lease, the ratio of the annual rent to the market value at the valuation date with reference to the given examples is 0.08% (public target) and 2.79% (commercial target). The calculated ratio shows the relationship of the annual income to the value of the property at the date of the contract. The adopted method of valorizing the rental rate (the growing rate of price increases for goods and services) does not reflect changes in the value (price) of the real estate. The calculated income rates (capitalization rates) therefore do not reflect the actual profitability of the land lease, neither from the owner's nor the tenant's points of view. The problem of determining lease rates has been raised in various studies; so far, there has been no proposal to determine them, taking into account the interests of each party to the contract.

## 5. Conclusions

Putting land in lease is a form of using the land for a specified period of time, an alternative to selling or giving land for perpetual usufruct (this applies to public lands). In Poland, the lease of public land (especially long-term lease) is marginal. Municipalities most often give land for lease for a fixed period (up to three years) with the option of extending this lease.

The most common circumstances in favor of giving land for lease include:

- lack of land management strategy,
- lack of local spatial development plans,
- limited investment opportunities resulting from poor financial situation of commune,
- lack of interest from private investors to locate investments in specific areas,
- temporary forms of development of areas that secure development needs of commune in future.

The selected land lease issues in Poznan confirm the findings.

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## Dzierżawa jako forma gospodarowania gruntami gmin – studium przypadku

**Streszczenie:** W artykule przedstawiono różne formy władania nieruchomościami ze szczególnym uwzględnieniem dzierżawy. Przeanalizowano transakcje dzierżawy w jednym z miast regionalnych (Poznań). Badania wykazały, że w Polsce prawo dzierżawy wieloletniej wykorzystywane jest w bardzo ograniczonym zakresie. Najczęściej umowy dzierżawy zawierane są na okres do trzech lat, z możliwością ich przedłużenia, aczkolwiek prawo przewiduje możliwość zawierania umów na dłuższe okresy. W latach 1996–2014 miasto Poznań zawarło zaledwie 18 umów dzierżawy wieloletniej (powyżej 10 lat). Jest to spowodowane tym, że w Polsce dominującą formą udostępniania gruntów publicznych na oznaczony czas jest użytkowanie wieczyste.

### Słowa

**kluczowe:** dzierżawa, czynsz, samorząd lokalny, użytkowanie wieczyste