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ANALYSIS OF PROFITABILITY OF TRANSFORMATION OF THE PERPETUAL USUFRUCT RIGHT INTO THE RIGHT OF PROPERTY AT VARIOUS TIMES IN THE DURATION OF THE PERPETUAL USUFRUCT RIGHT

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Abstract— In view of the growing interest of foreign investors in investments in Poland, especially since Poland's accession to the European Union, this article analyzes the profitability of the transformation of the perpetual usufruct law into the right of property at various times in the duration of this right, on the basis of the empirical formula presented in Polish law (the legal act) – The Ordinance of the Council of Ministers on the valuation of real estate and the estimated cadastre survey. It was analysed how the fee for the transformation of the perpetual usufruct law into the right of property changes depending on the assumed rate of capitalization, interest rate on the annual fee, the number of years in the unused period of usufruct.

Keywords— perpetual usufruct right, capitalization rate

I. INTRODUCTION

The legal institution of perpetual usufruct is closely related to the specific character of Polish law. This form of land use is not found in the other EU countries. Since May 1, 2004 when Poland accessed the European Union, foreign investors have been showing considerable interest in investments in Poland. One of the most confusing problems for them proved to be the so-called temporary ownership of land, i.e. perpetual usufruct. Both in Poland and (especially) abroad no comprehensive publications are available on the assessment of profitability of the transformation of the perpetual usufruct right into the right of property to real estate. This paper presents an analysis of profitability for the transformation of the perpetual usufruct right into the right of property at different times of the duration of this right.

Presently binding Acts make it possible to exchange the perpetual usufruct right and redeem the right of property when the perpetual usufructuary is a physical person and the property was used for housing purposes or garages, although it is also possible in case of a landed property. Regulations are contained in the Act of the 29th July 2005 on the transformation of the perpetual usufruct right into the right of property to real estate (the official Gazette Dziennik Ustaw of 2005, no. 175 item 1459). The value of the

perpetual usufruct right is as a rule lower than that of the right of property. The redemption of the right of property to real estate consists in the determination of the value of both rights and next the determination of the difference between these rights, the difference being the object of redemption. In the local markets transactions concerning the right of property are more common, while rights connected with perpetual usufruct are rarely the objects of trade. Thus the legislator permits of the solution of this problem based on a formula, which expresses the dependence between the value of the perpetual usufruct right (unknown value) and the right of property (known value).

The aim of this study was to analyze the empirical formula used to determine fees connected with the transformation of the perpetual usufruct right into the right of property to real estate. The aim is to verify how the fee for the acquisition of the right of property changes depending on the number of years of the unused perpetual usufruct right, the rate of capitalization and the interest rate on the annual fee.

A complementary aim of the study was to assess the profitability of the redemption of the right of property at various times in the duration of perpetual usufruct. Profits for the perpetual usufructuary from the transformation of the perpetual usufruct right were analyzed depending on the duration of perpetual usufruct and the annual fee.

II. MATERIAL AND METHOD

The paper is a methodological study, in which changes in the fee for the transformation of the perpetual usufruct right into the right of property may be observed, based on the correction index proposed by the legislator. The analysis includes possible cases, both when the perpetual usufructuary may transform the perpetual usufruct right into the right of property in concordance with the Act on the transformation of the perpetual usufruct right into the right of property, but also in a situation not allowed by the Polish law, although potentially applicable in the future.

According to the binding regulations the perpetual usufruct right is valued using the formula (The Ordinance of the Council of Ministers on the valuation of real estate and the estimated cadastre survey, § 29 item 3; the official Gazette Dziennik Ustaw no. 207 item 2109):

$$Wk = (1 - \frac{Sr}{R}) \times \frac{t}{T} + 0,25 \times \frac{T-t}{T}$$

where: Wk – the correction index, Sr – interest rate on the annual fee not higher than 3%, t – the number of years of the unused perpetual usufruct period, T – the number of years for which the perpetual usufruct was established, R – average rate of capitalization defined on the basis of a real estate market survey by a real estate valuation expert, not lower than 0.09 and not higher than 0.12.

III. RESULTS

A. The amount of a fee for the transformation of the perpetual usufruct right into the right of property depending on the number of years of unused perpetual usufruct

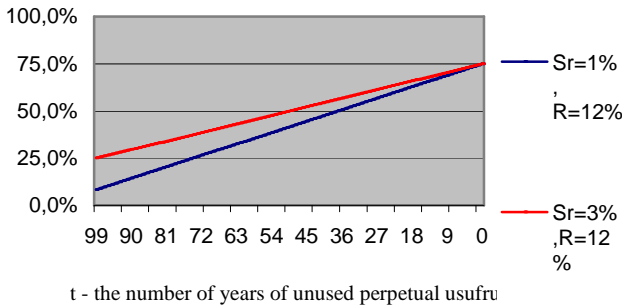


Fig.1 The amount of a fee for the transformation of the perpetual usufruct right into the right of property depending on the number of years of the unused perpetual usufruct period – for T=99, Sr=1% and Sr=3%, R=12%

Source: the authors' study

The amount of a fee for the transformation of the perpetual usufruct right into the right of property increases systematically with the passage of time (Fig. 1). At the time of the release of the land property for Sr = 1% and Sr = 3% it is 8.3 and 25%, respectively. In turn, the closer it is to the expiry of this right, the more the value of perpetual usufruct decreases and as a consequence the amount of the fee for the transformation of the perpetual usufruct right increases. In the last year of perpetual usufruct (for t = 0) the value of this right is equal to 25% value of the right of property for

each possible case, irrespective of the rate of capitalization and interest rate on the annual fee, which in turn results in the fee being 75% of the right of property.

B. The amount of a fee for the transformation of the perpetual usufruct right into the right of property depending on the value of the rate of capitalization

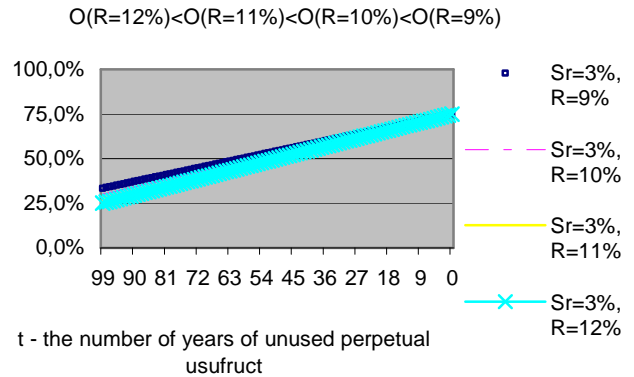


Fig. 2 The amount of a fee for the transformation of the perpetual usufruct right into the right of property depending on the rate of capitalization for T=99, Sr=3%, R=9%, R=10%, R=11% and R=12%

Source: the authors' study

An increase in the rate of capitalization in the valuation of the perpetual usufruct right results in a reduction of a fee for the transformation of the perpetual usufruct right, which may be written as $O(R=12\%) < O(R=11\%) < O(R=10\%) < O(R=9\%)$ (Fig. 2).

It results from the logical analysis of the formula determining the value of the correction index (Wk) that an increase in value R results in an increase of the value of the correction index, and thus leads to an increase in the value of the perpetual usufruct right, which ipso iure affects the reduction of the fee connected with the acquisition of the right of property. It may be generalized that an owner is not interested in such a situation. It may be concluded from the above that a reduction of the rate of capitalization is an option desirable for the owner, at the rather unlikely acceptance on the part of the perpetual usufructuary.

C. The amount of a fee for the transformation of the perpetual usufruct right into the right of property depending on the interest rate on the annual fee

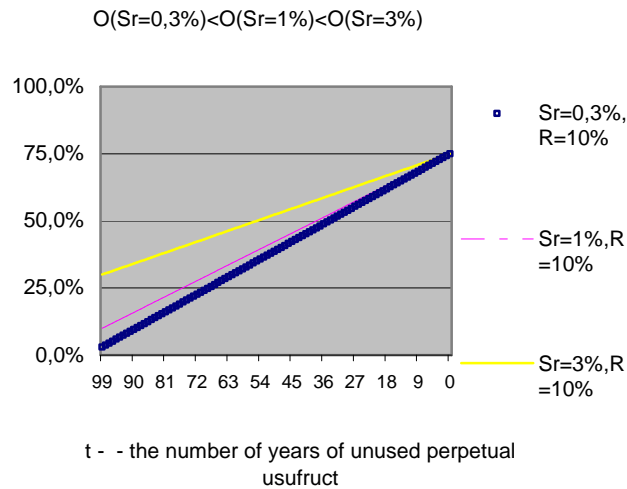


Figure 3 The amount of a fee for the transformation of the perpetual right into the right of property depending on the interest rate on the annual fee

Source: the authors' study

An increase in the interest rate results in an increased fee for the transformation of the perpetual usufruct right into the right of property, which may be written as: $O(Sr=0,3\%) < O(Sr=1\%) < O(Sr=3\%)$. The selection of an interest rate on the annual fee does not depend on the arbitrary decision either of the perpetual usufructuary, or the land owner, i.e. the State Treasury or the local government unit, but it is defined obligatorily and regulated by the provisions of art. 72 item 3 of the Act, which determines the selection of interest rates on annual fees depending on the purpose, defined in the contract, for which a given land property was released.

IV. CONCLUSIONS

It results from the above analysis that the most profitable option for the investor is to redeem the perpetual usufruct right in the initial period of the duration of this right. An earlier application for the redemption of the perpetual usufruct right results in the perpetual usufruct right having a relatively high value in relation to the value of the right of property, i.e. the perpetual usufructuary will incur lower

costs of the acquisition of the right of property. Further benefits include also the elimination of further annual fees for the perpetual usufruct. The acquisition of the right of property at a later date by the perpetual usufructuary yields opposite effects.

The amount of the fee for the transformation of the perpetual usufruct right into the right of property to real estate increases with a reduction in the number of years of the unused perpetual usufruct period, while an increase in the interest on the annual fee results in an increased fee for the transformation of the perpetual usufruct right into the right of property. In turn, an increase in the rate of capitalization gives as a consequence a reduced fee.

Thanks to the conducted analysis, advantageous aspects of the transformation of the perpetual usufruct right into the right of property could be shown for the benefit of potential investors.

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