# MANAGEMENT BOARD'S REPORT OF ACTIVITIES OF

# DOM DEVELOPMENT S.A.

# IN 2011

**CONTENTS**

## APPROVAL BY THE MANAGEMENT BOARD OF THE MANAGEMENT BOARD'S REPORT OF ACTIVITIES OF DOM DEVELOPMENT S.A. IN 2011

This Management Board's report of activities of Dom Development S.A. in 2011 was drafted and approved by the Management Board of the Company on 29 February 2011.

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# INTRODUCTION

The joint stock company Dom Development S.A. (the „Company") is the parent company of Dom Development Capital Group (the "Group"). The Company has been entered into the National Court Register under number 0000031483 maintained by the District Court for the capital city of Warsaw, 12th Commercial Division of the National Court Register. The registered office of the Company is in Warsaw (00-078 Warsaw, pl. Piłsudskiego 3).

Dom Development was established in 1995 by a group of international investors, and Polish management staff joined it in November 1996. Participation of the international investors guaranteed implementation of Western European experience and standards as regards housing developments in the Warsaw market.

As at 31 December 2011 the Company was controlled by Dom Development B.V. with registered office in the Netherlands which held 61.91% of the Company's shares.

# 1. GENERAL INFORMATION ABOUT DOM DEVELOPMENT S.A.

## 1.1. Group's Structure

The Group's structure and the Company's interest in the share capital of the entities comprising the Group as at 31 December 2011 is presented in the table below:

| Entity | Country of registration | % of the share capital held by the parent company | % of the votes held by the parent company | Consolidation method |
|---|---|---|---|---|
| **Subsidiaries** | | | | |
| Dom Development Morskie Oko sp. z o.o. | Poland | 100% | 100% | full consolidation |
| Dom Development Grunty sp. z o.o. | Poland | 46% | 100% | full consolidation |
| **Moreover, the Group was engaged in the joint venture:** | | | | |
| Fort Mokotów sp. z o.o., under liquidation | Poland | 49% | 49% | proportionate consolidation |

## 1.2. Activities of the Company and the Group

The main area of activity of the Company is the construction and sale of residential real estate. All development projects of the Company are conducted directly within the Dom Development organisational structure.

In the twelve-month period ended 31 December 2011:

- the Company did not discontinue any of its activities;
- The Company did not make any material deposits or capital investments. All free cash was invested by the Company in short term bank deposits.

## 1.3. Information on core products

The main aim of the Company has always been the construction of affordable flats in the so-called popular segment (mid market). The Company's offer is supplemented with other market segment products.

Currently, the Company's product mix is as follows:

- Multi-family buildings (flats and apartments), which can be divided into the following market segments:
  - *Popular flats (mid-market)* – flats in residential buildings and housing estates are usually located outside of the immediate city center, normally with at least 200 flats.
  - *Apartments* – apartments in residential buildings or small groups of buildings located in Warsaw's city center and in popular residential districts (Żoliborz, Mokotów, Śródmieście, Ochota).
  - Flats and apartments are offered in two standards: "turn-key" and unfinished. The unfinished flats/apartments are finished by buyers on their own account. Various finishing options are available for "turn-key" flats/apartments.
  - *Luxury apartments* – apartments in residential buildings located in Warsaw's immediate city center or in old Mokotów, adjacent to attractive green areas and parks, at the price over PLN 25 000 per $m^2$.
  - *Commercial space* – mainly shops constructed by the Company as part of residential buildings. The revenues from the sale of such space account for an insignificant part of the total revenue but they enable the possibility to offer such facilities as shops, which increases the attractiveness of a given project.
- Single-family houses (detached, semi-detached and terraced houses).

In addition to this, the Company's tasks include the management of housing estates constructed under development projects conducted by the Group. Management will be performed only through a limited period of time, i.e. until the final management company is chosen by the common hold associations which take over the managerial duties from the Company.

In 2011, the Company's revenue from the sale of products and services related to real estate management were as follows:

| **REVENUE STRUCTURE** | **01.01-<br>-31.12.2011<br>in thousand PLN** | **01.01-<br>-31.12.2010<br>in thousand PLN** | **Change<br>2011/2010** |
|---|---|---|---|
| Revenue from the sale of flats/apartments, houses and commercial space | 568 082 | 501 632 | 13.3% |
| Revenue from the sale of real estate management services | 1 758 | 5 313 | (66.9)% |
| Revenue from other sales | 14 654 | 6 838 | 114.3% |
| **Total** | **584 494** | **513 783** | **13.8%** |

## 1.4. Information on the markets, customers and sources of supply of production materials

In 2011 the activity of the Company was mainly concentrated in Warsaw and its vicinity. In 2011, the changes in portfolio of housing products offered by the Company continued, i.e. there was a further increase in the share of popular flats in the structure of the planned investment projects. This has already been reflected in both, the sales structure in 2011 and the structure of planned investment projects. At the beginning of 2011 the Company established its division in Wrocław to run real estate development projects, and in March 2011 commenced the first project, namely Oaza estate, in the Wrocław market.

### 1.4.1 Dom Development S.A. sales structure

| **NUMBER OF PRODUCTS SOLD BY PRODUCT GROUPS** | **2011** | **2010** | **Change** |
|---|---|---|---|
| Popular (mid-market) apartments | 1 668 | 1 260 | 32% |
| High-end apartments | 60 | 107 | (44)% |
| Luxury apartments | - | - | na. |
| Single-family houses | 7 | 19 | (63)% |
| **Total** | **1 735** | **1 386** | **25%** |

The Company does not depend on any of its customers because the sales are dispersed amongst a large, varied and changing group of buyers of residential and commercial units. The majority of the Company's customers are natural persons.

### 1.4.2 Major contractors

The main costs incurred by the Company in the real estate development activity are the costs of construction services provided by third parties, not related to the Company, under a general contracting system and the purchase costs of land for the investment projects.

As regards the land, despite individual transactions of significant value, the Company does not depend on one supplier. The Company entered into one major land purchase agreement as described in section 2.1.3.

As regards the construction services, contractors are chosen in internally organised tender procedures. The Company uses the services of various construction companies operating in the Warsaw market.

The Company's major contractors in 2011, in terms of the value of services purchased in this period, were:

| CONTRACTOR | 01.01--31.12.2011 in thousand PLN |
|---|---|
| UNIBEP S.A. | 96 383 |
| HENPOL Sp. z o.o. | 50 408 |
| WARBUD S.A. | 39 041 |
| ERBUD S.A. | 82 778 |
| KALTER Sp. z o.o. | 37 297 |
| Mostostal S.A. | 47 423 |
| Budbaum S.A. | 27 898 |
| Unimax Sp. z o.o. | 15 358 |

The turnover shown above accounts for approximately 90% of the sum spent by the Company on construction and design services in 2011.

# 2. OPERATIONS OF DOM DEVELOPMENT S.A.

## 2.1. Operations of Dom Development S.A. in 2011

In 2011 the Company continued its development activities, being the construction and sale of residential real estates. The construction works are conducted in the general contractor system, and the works are contracted to specialized third-party building companies.

There are several development projects that are simultaneously conducted by the Company. The Management Board of the Company regularly reviews and gives its opinion on:

- current projects during their implementation in relation to both, the progress of construction works, and current and anticipated sales revenue,
- the best possible manner in which the plots of land from the land-bank may be used,
- the potential plots of land which may be purchased for further development projects to be carried out in the following years, also in major Polish cities other than Warsaw,
- optimization of financing of the Company's operating activities.

### 2.1.1 Development projects commenced and completed

In 2011, the following material changes in the portfolio of the Company's real estate development investments under construction took place:

Projects commenced in the period from 1 January until 31 December 2011

| Project | Standard | Number of apartments |
|---|---|---|
| Akropol | Popular | 366 |
| Wilno, phase 2 (stage 2A) | Popular | 117 |
| Wilno, phase 3 | Popular | 132 |
| Derby 14, phase 1 | Popular | 174 |
| Adria, phase 2 | Popular | 230 |
| Oaza, phase 1 | Popular | 116 |
| Oaza, phase 2 | Popular | 130 |
| Saska I, phase 2/2 | Popular | 144 |
| Saska I, phase 2/3 | Popular | 105 |
| Regaty, phase 6 | Popular | 160 |
| Opera B | Luxury apartments | 11 |

Projects ended (completed) in the period from 1 January until 31 December 2011

| Project | Standard | Number of apartments |
|---|---|---|
| Derby 9 | Popular | 258 |
| Derby 11 | Popular | 87 |
| Derby 20 | Popular | 90 |
| Adria, phase 1 | Popular | 256 |
| Klasyków, phase 1 | Popular | 135 |
| Regaty, phase 4 | Popular | 202 |
| Saska I, phase 1/1 | Popular | 325 |
| Saska I, phase 1/2 | Popular | 145 |

### 2.1.2 Current and future development projects

As at 31 December 2011, the projects under development account for 2 921 apartments in total. The new development projects for 7 929 apartments in total are defined and planned by the Company.

### 2.1.3 Agreements significant for the business activity of the Company

Due to the nature of the business activity conducted by the Company, a major agreement is one with a value exceeding 10% of the shareholders' equity.

In the financial year, the major agreements were concluded with the following contractors.

| CONTRACTOR | Agreement date | Project name |
|---|---|---|
| Henpol Sp. z o.o. | 21-06-2011 | Akacje 7 |

#### Other major agreements

On 2 September 2011 Dom development S.A. and Wojskowe Towarzystwo Budownictwa Społecznego "KWATERA" Sp. z o.o. (*the Army Association for Social Cantonement Construction*) entered into agreement for the transfer of ownership title to the undeveloped property located in Warsaw, Żoliborz district, at ul. Powązkowska no. 7/13, with an area of 98.879 sq.m..

On 11 October 2011 the Company entered into a facility agreement with Powszechna Kasa Oszczędności Bank Polski S.A. for the amount of PLN 160 000 000. The purpose of the facility is the statutory objectives of the Company and the SPVs, in which the Company holds more than 50% shares or contributions.

### 2.1.4 Financial agreements

The major financial agreements concluded by the Company in 2011 were the agreements pertaining to contracted bank loans. Information concerning these agreements are presented in section 2.1.3.

### 2.1.5 Agreements with shareholders

Dom Development S.A. has no information on any possible agreements between the shareholders concluded in 2011.

### 2.1.6 Cooperation agreements

In 2011, Dom Development S.A. did not conclude any significant cooperation agreements with other entities.

### 2.1.7 Transactions with related entities

All transactions made by the Company or its subsidiaries with related entities are based on the arm's length principle.

Transactions with the related entities are presented in note 7.41 to the financial statements for the period ended 31 December 2011.

### 2.1.8 Litigations

#### Proceedings before the courts, arbitration or public administration authority

As of 31 December 2011 there was no individual proceeding before any court, authority competent for arbitration or public administration body, concerning the liabilities or receivables of the Company or its subsidiary, the value of which would be at least 10% of the Company's shareholders' equity.

As of 31 December 2011 there were not two or more proceedings before any court, authority competent for arbitration or public administration body, concerning the liabilities or receivables, the value of which would be at least 10% of the Company's shareholders' equity.

As of 31 December 2011, the Company was a party to proceedings concerning liabilities and receivables, the total value of which was approx. PLN 19 022 thousand, including the total value of proceedings concerning liabilities at approx. PLN 18 663 thousand and the total value of proceedings concerning receivables at approx. PLN 359 thousand.

The proceedings involving the Company have no significant impact on the Company's activity.

## 2.2. Development of Dom Development S.A., risk factors

### 2.2.1 Significant risk factors and factors important for development of the Company

Significant risk factors and threats to the business activity conducted by the Company have been presented below.

#### Macroeconomic factors

The Company's business activities are significantly affected by global developments, in particular by their impact on the Polish economy. The most important macroeconomic factors for the Company's financial condition and results include: economic growth rate (risk of growth deceleration), unemployment rate (risk of growing unemployment), standing of financial institutions (risk of a decrease in trust). The business activities of the company are affected by the following macroeconomic factors, which have impact on the standing of the Polish economy: GDP, level of investments, household income, interest rates, inflation, unemployment and the condition of the real estate development and construction industries, and the real estate market.

#### Availability of mortgages

Stricter lending criteria applied by banks when assessing credit worthiness of their customers led to a situation where many new potential buyers of apartments hit a creditworthiness barrier. The demand for new apartments and houses may be limited as a result of a lack of new lending solutions and difficult access to loans. In addition to this, the Family's Own Home (*Rodzina na Swoim*) programme comes to an end in 2012. This program is a very popular way to finance purchase of an apartment in popular segment.

#### Foreign exchange risk

At the beginning of 2012 the availability of foreign currency loans was restricted. Most banks decided not to grant loans in Euro, and those which still grant foreign currency loans have implemented major restrictions (e.g. the required family income must be at least PLN 12 thousand per month) and significantly increased their margins.

As a result of high exchange rates persons who financed a purchase of their apartments by a CHF or EUR loan 3-6 years ago and would like to exchange their apartment for a bigger one have to postpone their transaction decisions as their debt exceeds the market value of the apartment.

#### Concentration of operations in the Warsaw market

The Company's present and planned activity is concentrated in the Warsaw market. This makes the Company's results highly dependent on the situation in this market. However, it can be assumed that in the long-term this will be the most dynamic residential real estate market in Poland, and the Company already has a well established position and therefore the possibility of further development. Moreover, the Company has been operating in the Wrocław market since 2011. A further expansion of the Company is also considered.

### Opportunity to purchase land for new projects

The future success of the Company is founded on the ability to continually and effectively acquire attractive land for new development projects at the right times and competitive prices. This will allow the generation of satisfying project contributions.

### Administrative decisions

The nature of real estate development projects requires a number of licenses, permits and arrangements to be obtained by the Company at every stage of the investment process. Despite significant caution applied in the project execution schedules there is always a risk of delay in their obtainment, challenges of decisions which have already been issued (also due to appeals with no consequences for appellants) or even failing to obtain them. All these affect the ability to conduct and complete the executed and planned projects.

The fundamental activity adopted by the Company so as to reduce the exposure to market risks is proper assessment of potential and control of current development projects based on investment models and decision-making procedures developed in the Company. The adherence to such procedures is closely monitored by the Management Board of the Company.

There has been a formalised risk management procedure in operation within the Company since 2000. Under this procedure the risk is managed through the identification and assessment of the risk areas for all aspects of the activities, in which the Company and the Group are involved, together with defining activities required to reduce or eliminate such risks (including through the procedures and internal audit system) The risk management procedure is subject to periodic revision and is updated by the Management Board jointly with the key management staff and third party advisers.

Additionally, the Audit Committee is in place in the Company pursuant to the corporate governance rules adopted by the Management Board and approved by the General Shareholders' Meeting.

## 2.2.2 Perspectives for the development of the Company's business activities

The recovery was observed in the residential real estate market in 2001 as compared to the previous years in respect of both, the demand and supply. The situation of households in Warsaw, which is the Company's primary market, improved as compared to 2010. Meanwhile the year 2011 brought about number of changes in the mortgage market.

Year 2012 seems to be a year of challenges and trials, not only for the real estate development industry but for the entire economy. The residential real estate market will be affected mostly by macroeconomic factors (GDP, level of investments, household income, interest rates, inflation, unemployment and the condition of the real estate development and construction industries, and the real estate market) as well as changes in the "Rodzina na swoim" (*Family's Own Home*) program. Moreover, real estate development companies must align their operations with the new requirements defined in the Real Estate Development Act. At the end of 2011 a record offer of new apartments was observed in the primary market, and since the new regulations will apply to investments, the sale of which started before the Act entered in force, further increase in supply may be expected as a result of intending to complete investment projects on the old terms. Consequently the increasing disproportion between the supply and demand might result in an increased price competition between developers. Bearing in mind the growth of the Polish economy and the social and economic trends, the Management Board strongly believes that both mid-term and long-term real estate market perspectives are promising.

The major objective and task of the Management Board, having considered the rapidly changing situation in the real estate market, was to prepare the Company to face new challenges. The major steps undertaken in this respect included:

- ensuring that adequate sources of finance are available to the Company, both for current and future real estate development projects, with due care from the perspective of the Company and its customers,
- co-operation with banks, and strong assistance to customers in obtaining mortgages for purchase of an apartment,
- adjusting the sales offer to the market demand, with particular attention to leverage the government-subsidised programmes that support purchases of apartments,
- aligning land purchase outlays to Company's existing and future needs,

- the best possible use of the land-bank in the best possible time,
- intensification of sales-stimulating activities and improvement of their efficiency,
- maintaining and building upon customer confidence in the Dom Development brand,
- restructuring the organization and employment to the anticipated level of operational activities,
- optimising overhead expenditure.

The above-mentioned measures taken by the Management Board will be continued in 2012. In addition to this, in the next twelve months Dom Development S.A. will focus, in particular, on the further increase of sales volume as compared to 2011 and the increase of its share in the Warsaw real estate market. This will be possible due to:

- the well-established position in the Warsaw residential property market,
- the potential of the Company's management,
- the worked out know-how in respect of operational execution of development projects,
- accumulated experience in selling and financing development projects,
- the land bank (for both, ongoing and future projects).
- very good liquidity of the Company.

In the upcoming twelve-month period it is also planned to:

- further focus on the operating activities in the popular flat segment and maintain activities in the remaining product groups within the offered product range,
- concentrate all of the Group's operations in Dom Development S.A. and further reduce the significance of other entities operating within the Group,
- develop operations of the Group outside the Warsaw market (in particular in Wrocław).

# 3. FINANCIAL SITUATION OF THE COMPANY, FINANCE MANAGEMENT

## 3.1. Basic economic and financial figures disclosed in the annual financial statements of the Company for 2011

### 3.1.1 Selected data from the balance sheet

#### Assets

Structure of the Company's assets as at 31 December 2011, and changes as compared to the figures as at the end of 2010.

| ASSETS | 31.12.2011 in thousand PLN | Share in assets | 31.12.2010 in thousand PLN | Change 2011/2010 |
|---|---|---|---|---|
| **Total fixed assets** | **8 438** | **<1%** | **24 180** | **(65.1)%** |
| **Current assets** | | | | |
| Inventory | 1 465 828 | 77% | 1 118 968 | 31.0% |
| Trade and other receivables | 49 269 | 3% | 42 600 | 15.7% |
| Other current assets | 13 248 | 1% | 3 398 | 299.9% |
| Cash and cash equivalents | 376 833 | 20% | 430 751 | (12.5)% |
| **Total current assets** | **1 905 178** | **100%** | **1 595 717** | **19.4%** |
| **Total assets** | **1 913 616** | **100%** | **1 619 897** | **18.1%** |

#### Equity and liabilities

Structure of the Company's shareholders' equity and liabilities as at 31 December 2011, and changes as compared to the figures as at the end of 2010.

| EQUITY AND LIABILITIES | 31.12.2011 in thousand PLN | Share in equity and liabilities | 31.12.2010 in thousand PLN | Change 2011/2010 |
|---|---|---|---|---|
| **Shareholders' equity** | | | | |
| Share capital | 24 560 | 1% | 24 560 | - |
| Share premium less treasury shares | 231 535 | 12% | 231 535 | - |
| Reserve and supplementary capitals, and accumulated unappropriated profit (loss) | 579 157 | 30% | 516 752 | 12.1% |
| **Total shareholders' equity** | **835 252** | **44%** | **772 847** | **8.1%** |
| **Liabilities** | | | | |
| Long-term liabilities | 318 974 | 17% | 412 925 | (22.8)% |
| Total short-term liabilities | 759 390 | 40% | 434 125 | 74.9% |
| **Total liabilities** | **1 078 364** | **56%** | **847 050** | **27.3%** |
| **Total equity and liabilities** | **1 913 616** | **100%** | **1 619 897** | **18.1%** |

### 3.1.2 Selected data from the income statement

Income statement of the Company for the year ended 31 December 2011 as compared to 2010.

| | 01.01--31.12.2011 in thousand PLN | sale % | 01.01--31.12.2010 in thousand PLN | Change 2011/2010 |
|---|---|---|---|---|
| Sales revenue | 584 494 | 100% | 513 783 | 13.8% |
| Cost of sales | 393 969 | 67% | 384 134 | 2.6% |
| Gross profit on sales | 190 525 | 33% | 129 649 | 47.0% |
| Operating profit | 103 528 | 18% | 58 884 | 75.8% |
| Profit before tax | 103 637 | 18% | 50 187 | 106.5% |
| Net profit | 82 839 | 14% | 39 689 | 108.7% |
| Earnings per share (in PLN) | 3,35 | n/d | 1,61 | 109.3% |

### 3.1.3 Selected information from the cash flow statement

| | (in thousand PLN) | | Change |
|---|---|---|---|
| | 2011 | 2010 | |
| Cash and cash equivalents – opening balance | 430 751 | 225 828 | 90.7% |
| Net cash flow from operating activities | (39 829) | 269 547 | na. |
| Net cash flow from investing activities | (1 176) | (2 733) | na. |
| Net cash flows from financing activities | (12 913) | (61 891) | na. |
| Cash and cash equivalents – closing balance | 376 833 | 430 751 | (12.5)% |

Cash balances amounted to PLN 430 751 thousand at the beginning of 2011 and they amounted to PLN 376 833 thousand at the end of the year. Therefore in the period from 1 January until 31 December 2011 the balance of cash increased by PLN 53 918 thousand.

In 2011, the Company recorded a net cash outflow from the operating activities in the amount of PLN 39 829 thousand. Bearing in mind the size of the Company this is a result of balanced operating activities in 2011 where, in addition to significant revenue from the sale of apartments in new investments and the sale of fully furnished apartments, the Company decided to make significant investments in the purchase of new properties as well as the commencement of numerous new development projects.

In 2011, the Company recorded a net outflow of cash from investing activities in the amount of PLN 1 176 thousand. This value results from the outlays for intangible assets (PLN 2 904 thousand) and proceeds from the liquidation of Towarzystwo Ubezpieczeń Wzajemnych "Bezpieczny Dom" under liquidation (PLN 1 674 thousand).

In 2011, the Company recorded a net cash outflow from the financial activities in the amount of PLN 12 913 thousand. The excess of financial outflow over the inflow is mainly due to increased balance of loans (net cash outflow in the amount of PLN 9 272 thousand) and the payment of dividends by the Company in the amount of PLN 22 104 thousand.

## 3.2. Forecasts

Both, Dom Development S.A. Capital Group and the parent company did not publish financial forecasts for 2011.

## 3.3. Finance management in the Company

In 2011, the finance management of Dom Development S.A. in respect of construction of residential buildings was focused on seeking and structuring sources of external financing for the projects under construction and on maintaining a safe level of liquidity. The Management Board analyses the current and plans the future optimum financing structure on a regular basis in order to achieve planned ratios and financial results, and at the same time, to ensure liquidity and the comprehensive financial security of the Company. In 2011, the activities of the Company generated a positive result at each level of the income statement.

The Management Board is of the opinion that the net assets and financial standing of Dom Development S.A. at the end of 2011 demonstrate the strong and stable financial position of the Company. This results from the well established position of the Company in the housing market, appropriate operational experience and potential in place, both in terms of execution of residential development projects, and the sale and financing of these projects. The net assets and financial standing of the Company has been demonstrated by liquidity and debt ratios presented further in this report.

Having considered the situation in the Polish real estate market in recent years, the financial results achieved by the Company in 2011 can be considered good. After the year 2010 when no residential estates were completed (but the construction of a dozen or so estates was commenced), the Company started to deliver new residential estates from May 2011. In effect notably greater number of apartments was delivered in 2011 as compared to the previous year. As a result the financial result achieved in 2011 is better as compared to 2010 (which is demonstrated by the profitability ratios presented below). However, the result on the current activities expressed in the number of apartments sold in 2011 is 25% higher (i.e. 349 apartments) as compared to 2010. This should be considered as a positive result.

### 3.3.1 Profitability ratios

The ratios showing profitability of the business activity pursued by the Company in 2011 have significantly improved as compared to the previous year. It predominantly results from the fact that the number of apartments delivered to customers was 85% higher (i.e. 588 apartments) in 2011 than in 2010. The increased number of deliveries translated into an increase in the operating profit and net profit.

Higher growth rate of net profit margin (84% increase) as compared to the growth rate of operating margin (52% increase) demonstrates a moderate increase in selling costs and general administrative expenses as compared to the growth rate of Company's operating margin.

| **PROFITABILITY RATIOS** | **2011** | **2010** |
|---|---|---|
| Operating profit margin<br>*EBITDA / net sales revenue* | 18.1% | 11.9% |
| Net profit margin<br>*Net profit / net sales revenue* | 14.2% | 7.7% |
| Return on assets (ROA)<br>*Net profit / total assets* | 4.3% | 2.5% |
| Return on equity (ROE)<br>*Net profit / shareholders' equity* | 9.9% | 5.1% |

### 3.3.2 Liquidity ratios

In view of the difficult situation in the market where the Company operates, special attention should be given to the fact of that financial liquidity has been well secured.

All the liquidity ratios still remain very high, despite the relative decrease in their levels in 2001 as compared to 2010. This is due to a number of long-term decisions and actions taken by the Company's Management Board during the economic downturn (years 2008-2009) and when the situation in the residential real estate marked picked up (years 2010-2011). To this end, the activities related to the management and financing of current investments (including decisions when to commence the construction of individual residential estates and concerning the product mix offered for sale), the strategy of buying new properties and maintaining suitable employment and related expenses.

The credibility of the Company in the financial market continues to increase which is reflected by a diversified financing structure and by the willingness of banks and other financial institutions to grant new loans and other form of finance (bonds) to the Company despite the difficult market situation.

When comparing the liquidity ratios for 2010 and 2011, an additional factor that contributed to the particularly high level of quick ratio and Cash ratio at the end of 2010 should be taken into consideration. This was a significant land sale transaction (gross amount of PLN 116 million, the funds received in December 2010) that resulted in major increase in the cash balance, with the concurrent decrease in the inventory.

| **LIQUIDITY RATIOS** | **2011** | **2010** |
|---|---|---|
| Current ratio<br>*current assets / short-term liabilities less deferred income* | 4.41 | 6.68 |
| Quick ratio<br>*current assets less inventory / short-term liabilities less deferred income* | 1.02 | 1.99 |
| Cash ratio<br>cash and cash equivalents / short-term liabilities less deferred income | 0.87 | 1.80 |

### 3.3.3 Leverage ratios

Appropriate operating policy (i.e. proper commencement and pace of projects as well as controlled purchases of land) and financial policy (the financing structure), made values of the presented ratios remain at a safe level for the business activity and they support the Company's creditworthiness. All the leverage ratios that do not take into account cash and cash equivalents, were at similar levels at the end of 2011 and 2009.

The net interest bearing debt ratio increased at the end of 2011. Its value at the end of 2010 was remarkably low due to the exceptionally high cash balance as at 31 December 2010 (caused largely by a significant land sale transaction with gross value of PLN 116 million; the funds received in December 2010).

| **LEVERAGE RATIOS** | **2011** | **2010** |
|---|---|---|
| Equity ratio (assets/equity)<br>*shareholders' equity / total assets* | 43.6% | 47.7% |
| Debt to equity ratio<br>*Total liabilities / shareholders' equity* | 129.1% | 109.6% |
| Debt ratio<br>*total liabilities / total assets* | 56.4% | 52.3% |
| Interest bearing debt ratio<br>*interest bearing liabilities / shareholders' equity* | 58.3% | 61.8% |
| Net interest bearing debt ratio<br>*interest bearing liabilities less cash and cash equivalent / shareholders' equity* | 13.3% | 6.1% |

## 3.4. Information on loans and borrowings, sureties and guarantees

### 3.4.1 Borrowings contracted or terminated

As at 31 December 2011 and 31 December 2010 the Company did not have borrowings. The Company did not take or repay any borrowings in 2011 and 2010.

### 3.4.2 Loans contracted or terminated

| LOANS DUE WITHIN | | 31.12.2011 in thousand PLN | 31.12.2010 in thousand PLN |
|---|---|---|---|
| Less than 1 year | | 57 134 | 100 532 |
| More than 1 year and less than 2 years | | 25 000 | 107 330 |
| More than 2 years and less than 5 years | | 135 000 | - |
| Over 5 years | | - | - |
| **Total loans** | | **217 134** | **207 862** |
| including: | long-term | 160 000 | 107 330 |
| | short-term | 57 134 | 100 532 |

As at 31 December 2011 and 31 December 2010 all the loans taken by the Company were expressed in Polish zloty.

In addition to the loans specified in the table above, as at 31 December 2011, the Company had one overdraft facility which was not drawn as at the balance sheet date.

#### Loan agreements terminated in 2011

The Company did not terminate any loan facility agreement in 2011.

#### Bank loans contracted in 2011

| Bank | Loan type | Loan amount as per agreement in thousand PLN | Currency | Drawn loan amount in thousand PLN | Outstanding loan amount in thousand PLN | Interest | Due date |
|---|---|---|---|---|---|---|---|
| PKO BP S.A. | Investment loan | 15 000 | PLN | 5 314 | 0 | WIBOR 3M + bank margin | 31.05.2012 |
| Bank Millennium S.A. | Investment loan | 15 000 | PLN | 12 134 | 12 134 | WIBOR 1M + bank margin | 30.06.2012 |
| PKO BP S.A. | Non-revolving working capital loan | 160 000 | PLN | 160 000 | 160 000 | WIBOR 3M + bank margin | 31.12.2016 |

### 3.4.3 Borrowings provided

The Company did not provide any borrowings in 2011.

### 3.4.4 Sureties provided and received

The Company did not provide or received any sureties in 2011.

### 3.4.5 Guarantees provided and received

The Company did not provide any guarantees in 2011.

The performance guarantees and retention bonds received in 2011 are presented in the table below.

| Company | Guarantee type | Guarantee amount in thousand PLN |
|---|---|---|
| HENPOL Sp. z o.o. | Insurance guarantee | 6 596 |
| HENPOL Sp. z o.o. | Bank guarantee | 1 224 |
| ERBUD S.A. | Bank guarantee | 5 543 |
| UNIBEP S.A. | Bank guarantee | 4 401 |
| KALTER Sp. z o.o. | Bank guarantee | 3 245 |
| WPBP Nr 2 WROBIS S.A. | Bank guarantee | 1 902 |
| UNIMAX Sp. z o.o. | Bank guarantee | 1 425 |
| BUDBAUM S.A. | Bank guarantee | 1 242 |

## 3.5. Use of proceeds from the issue of securities

The Company did not issue any securities in 2011.

## 3.6. Assessment of the possibility to implement investment projects

**Assessment of the possibility to implement investment projects, including capital investment versus the resources held, with consideration of possible changes in the financing structure of investment activity**

Dom Development S.A. is fully capable of financing the currently executed investment projects. The Company intends to finance the execution of real estate development projects from the shareholders' equity, bank loans and issue of commercial papers. The Management Board attempts to adapt the maturity structure of the bank loans and commercial papers mainly to the duration of individual development projects, with particular consideration given to gradual replenishment of the land bank for future development projects.

Currently, almost all activities of the Dom Development Capital Group are conducted directly in Dom Development S.A.. Nonetheless, the Company does not exclude the possibility of executing the projects through subsidiaries or jointly-controlled entities with the financing (special-purpose loans) for these projects being provided directly by those companies or through Dom Development S.A.

## 4. STATEMENT ON THE APPLICATION OF CORPORATE GOVERNANCE

**Company's corporate governance rules and the location, where the text of corporate governance rules is publicly available**

In 2011, Dom Development S.A. followed the corporate governance rules described in the Code of Best Practice for Warsaw Stock Exchange Listed Companies, adopted by the Supervisory Board of the Warsaw Stock Exchange on 4 July 2007 and amended on 19 May 2010 by Resolution No. 17/1249/2010 of the WSE Supervisory Board.

The Code of Best Practice for Warsaw Stock Exchange Listed Companies is publicly available on:
http://www.corp-gov.gpw.pl/publications.asp

Dom Development S.A. has adhered to all of the rules described in the Code of Best Practice for Warsaw Stock Exchange Listed Companies.

**Company's corporate governance rules adopted voluntarily and the location, where the text of such corporate governance rules is publicly available**

In 2011, Dom Development S.A. followed the corporate governance rules published in the Code of Best Practice for Customer-Developer Relations drafted by Polski Związek Firm Deweloperskich (*the Polish Union of Developers*).

The Code of Best Practice for Customer-Developer Relations is publicly available on:
http://www.pzfd.pl/kodeks-dobrych-praktyk.html

Dom Development S.A. has adhered to all of the rules described in the Code of Best Practice for Customer-Developer Relations.

### 4.1. Share capital, shareholders

#### 4.1.1 Shareholders

As at 31 December 2011 the Company was controlled by Dom Development B.V. which held 61.91% of the Company's shares.

The table below shows the list of shareholders who have, directly or indirectly through subsidiaries, significant shareholdings as at 31 December 2011:

| | Status as at the date of drafting of the financial statements | | | | Change in the period from publication of the financial statements for the year ended 31.12.2010 |
|---|---|---|---|---|---|
| | Shares | % of capital | Number of votes at the GSM | % of votes at the GSM | Shares |
| Dom Development B.V. | 15 206 172 | 61.91 | 15 206 172 | 61.91 | (290 214) |
| Jarosław Szanajca | 1 534 050 | 6.25 | 1 534 050 | 6.25 | - |
| Aviva Powszechne Towarzystwo Emerytalne Aviva BZ WBK SA *) | 1 313 383 | 5.35 | 1 313 383 | 5.35 | no data |
| Grzegorz Kiełpsz | 1 280 750 | 5.21 | 1 280 750 | 5.21 | - |

*) Shareholding of Aviva Powszechne Towarzystwo Emerytalne (*General Pension Society*) Aviva BZ WBK S.A. has been presented as per the latest notice as of 11.07.2011 received by the Company from Aviva PTE Aviva BZ WBK S.A

### 4.1.2 Special control rights

**Persons holding any securities with special control rights, and description of these rights**

Pursuant to paragraph 6.2.2 of the Articles of Association of Dom Development S.A., a shareholder holding at least 50.1% of shares in the Company is personally vested with the right to appoint and dismiss half of the members of the Management Board, including the President of the Management Board and the Vice President of the Management Board who is responsible, pursuant to the Management Board bylaws, for the Company's finances. For an odd number of Management Board members, a shareholder who holds at least 50.1% of the shares in the Company is authorised to appoint, accordingly: three (for a 5-person Management Board) and four (for a seven-person Management Board) Management Board members. The above right is exercised by way of serving written statement to the Company on appointment or dismissal of a given Management Board member. The remaining members of the Management Board shall be appointed and dismissed by the Supervisory Board.

Pursuant to paragraph 7.4 of the Articles of Association of Dom Development S.A. a shareholder holding at least 50.1% of shares in the Company is vested with the personal right to appoint and dismiss half of the members of the Supervisory Board, including 1 Vice Chairman thereof. For an odd number of Supervisory Board members, a shareholder holding at least 50.1% shares in the Company is authorised to appoint, accordingly: three (for a 5-person Supervisory Board), four (for a seven-person Supervisory Board) and five (for a nine-person Supervisory Board) Supervisory Board members. The above right is exercised by way of serving written statement to the Company on the appointment or dismissal of a given Supervisory Board member.

On 31 December 2011, Dom Development B.V. with registered office in Rotterdam, the Netherlands was the shareholder who held at least 50.1% of shares in the Company.

### 4.1.3 Limitation of right in shares

**Indication of restrictions on voting rights, such as restricted voting rights by persons holding a specific portion or number of votes, and temporary restrictions on voting rights or provisions, according to which, in cooperation with the Company, capital rights attached to securities are separated from possession of securities**

Pledgees and beneficial owners of shares of Dom Development S.A. are not entitled to exercise voting rights attached to shares.

**Indication of any restrictions on the transfer of ownership title to the issuer's securities**

No other restrictions have been in place in Dom Development S.A. regarding the transfer of ownership title to shares in Dom Development S.A.

## 4.2. The General Shareholders' Meeting

**The procedure for and major rights of a General Shareholders' Meeting, and description of the rights of shareholders and manner for these rights being exercised, in particular the rules resulting from General Shareholders' Meeting bylaws, if such bylaws were adopted and if the rules in this respect do not directly result from legal regulations**

The General Shareholders' Meeting holds its sessions as Ordinary or Extraordinary General Shareholders' Meetings, and as a governing body of the Company it acts pursuant to the provisions of the Code of Commercial Companies Act dated 15

September 2000 (Journal of Laws No. 94 item 1037, as amended), the Articles of Association of the Company and provisions of unclassified and publicly available General Shareholders' Meeting Bylaws dated 5 September 2006 as amended by resolution No. 27 by the Extraordinary General Shareholders' Meeting of Dom Development S.A. dated 15 May 2008 and resolution No. 31 by the Extraordinary General Shareholders' Meeting of Dom Development S.A. dated 21 May 2009.

An Ordinary General Shareholders' Meeting is convened by the Management Board. It takes place in Warsaw within 6 months following the end of each financial year. Shareholders are entitled to participate in the General Shareholders' Meeting provided that they were shareholders of the Company 16 days before the date of the General Shareholders' Meeting. No invitations are required for members of the Company's Management Board and the Supervisory Board to participate in a General Shareholders' Meeting. Other persons, in particular statutory auditors and experts, as invited by the Management Board, may participate in a session or an appropriate part thereof, should their participation be justified by the need to have their opinions on the discussed matters presented to the participants in the Meeting. A statutory auditor should be present at a session of the General Shareholders' Meeting where Company's financial matters are addressed.

The General Shareholders' Meeting is valid and may adopt resolutions only if shareholders holding at least 50.1% of all votes are represented at the Meeting. Resolutions are adopted by an absolute majority of validly cast votes, unless the Code of Commercial Companies or the Articles of Association provide otherwise. An electronic system for casting and calculating votes may be used for voting. Pledgees and beneficial owners of shares are not entitled to exercise voting rights attached to shares.

A resolution on the removal of certain matters from the agenda of the General Shareholders' Meeting or the abandonment of certain matters included in the agenda or placed on the agenda by a motion of shareholders requires a majority of three-fourths of the votes cast and the express prior consent of all present shareholders who have filed such motion, for it to be valid.

The Chairman puts the agenda to vote, having the attendance list signed and checked. The General Shareholders' Meeting may adopt the suggested agenda without changes, change the order of debate or remove certain matters from the agenda, subject to the provisions of the Articles of Association. The General Shareholders' Meeting may also put new matters on the agenda and discuss them, however without adopting any resolutions on such matters. The Chairman of the Meeting has no right to remove matters from the agenda or alter the same without the consent of the General Shareholders' Meeting.

Each participant in the General Shareholders' Meeting may speak on matters included in the adopted agenda which are currently brought up for discussion. Each participant of the General Shareholders' Meeting may submit a formal motion. The Chairman gives the floor to a participant willing to lodge a formal motion out of turn. Formal motions are the motions concerning debate and voting procedure.

The General Shareholders' Meeting adopts resolutions on matters included in the agenda by voting. Voting is open and is subject to relevant provisions of the Articles of Association and the Code of Commercial Companies.

In 2011, the formally convened General Shareholders' Meeting of Dom Development S.A. was held on 19 May 2011 in Warsaw in the registered office of the Company. The General Shareholders' Meeting had been convened upon a motion of the Management Board of the Company, and shareholders of the Company did not file their motions for the General Shareholders' Meeting of the Company to be convened.

The course of the General Shareholders' Meeting was in line with the provisions of the Code of Commercial Companies, the Company's Articles of Association, unclassified and publicly available General Shareholders' Meeting Bylaws of Dom Development S.A. and the Code of Best Practice for WSE Listed Companies. The shareholders had the possibility to review the content of draft resolutions included in the agenda, in each case not later than 26 days prior to the planned date of the General Shareholders' Meeting. The Company did not question the correctness of documents submitted by shareholders and their attorneys in support of their right to represent a shareholder when verifying shareholders' IDs being the proof of their entitlement to participate in the General Shareholders' Meeting.

The Chairman of the General Shareholders' Meeting ensured that the session proceeded in an orderly and efficient manner. Sessions of a General Shareholders' Meeting have never been cancelled or discontinued. Members of the Management Board and the Supervisory Board present at the General Shareholders' Meeting readily explained all matters within their competences and as required by the law.

The circumstances for adopting resolutions of the General Shareholders' Meeting enabled for the protection of the rights of minority shareholders, including for voicing reservations and objections against the resolutions. None of the resolutions adopted was appealed against in court.

The Ordinary General Shareholders' Meeting of Dom Development S.A. was held within the time limit set forth in article 395 of the Code of Commercial Companies and Partnerships, and the documentation concerning the financial statements for the financial year 2010 was published on the website of the Company more than 2 months before the date of the Ordinary General Shareholders' Meeting. The resolution by the Ordinary Shareholders Meeting concerning distribution of the profit earned by the Company in 2010 and on payment of the dividend was adopted unanimously.

All resolutions adopted by the General Shareholders' Meeting in 2011 were passed in the best interest of the Company and took into account the rights of other stakeholders. Resolutions adopted by the General Shareholders' Meeting are posted on: http://inwestor.domdevelopment.pl/informacje-o-spolce/lad-korporacyjny/wza/19-05-2011

## 4.3. Principles for the amendment of the articles of association

Pursuant to article 430 § 1 and art. 415 § 1 of the Code of Commercial Companies and Partnerships, an amendment to the Articles of Association of Dom Development S.A. requires a resolution by the General Shareholders' Meeting adopted by the ¾ majority of votes and court registration. For a resolution that is to amend the articles of association as to benefits of the shareholders or limit the rights granted personally to individual shareholders under art. 354 of the Code of Commercial Companies and Partnerships, the consent of all the shareholders affected by the resolution is required. An amendment to the Articles of Association is to be filed with the court of registration by the Management Board of Dom Development S.A. The General Shareholders' Meeting of Dom Development S.A. may authorize the Supervisory Board to determine a revised and reinstated text for the amended Articles of Association or to make such other editorial changes as defined in the resolution by the General Shareholders' Meeting.

## 4.4. The Management Board

### 4.4.1 Principles for the appointment or dismissal of the Management Board

**Description of the principles for the appointment or dismissal of managing persons and their rights, in particular the right to decide on the issue or repurchase of shares**

In accordance with the Company's Articles of Association, the Management Board of Dom Development S.A. shall comprise of 4 to 8 members, including the President, with a three-year term of office. The Supervisory Board shall determine the number of members of the Management Board. A shareholder who holds at least 50.1% of the shares in the Company is personally vested with the right to appoint and dismiss half of the members of the Management Board, including the President of the Management Board and the Vice President of the Management Board who is responsible, pursuant to the Management Board bylaws for the Company's finances. For an odd number of Management Board members, a shareholder who holds at least 50.1% of the shares in the Company is authorised to appoint, accordingly: three (for a 5-person Management Board) and four (for a seven-person Management Board) Management Board members. The above right is exercised by way of serving written statement to the Company on appointment or dismissal of a given Management Board member. The remaining members of the Management Board shall be appointed and dismissed by the Supervisory Board.

The Management Board represents the Company in and out of court. For statements to be validly made and signed on behalf of the Company, two members of the Management Board are required to act jointly or one member of the Management Board is required to act jointly with a commercial proxy.

Pursuant to paragraph 3.2.8 of the Company's Articles of Association, the Management Board is authorised to increase the Company's share capital by the issue of new shares with an aggregate nominal value of no more than PLN 1 726 000 (in words: one million seven hundred and twenty six thousand) by way of one or several share capital increases within the limits specified above (authorised capital). The Management Board's right to increase share capital and issue new shares within the limits of the authorised capital up to PLN 1 726 000 shall expire 3 years from the date of the amendment to the Articles of Association made by resolution No. 23 dated 21 May 2009 by the General Shareholders' Meeting being entered in the register of entrepreneurs.

The right to increase the share capital referred to in the foregoing sentence, includes the issue of subscription warrants with subscription rights that expire after the above mentioned period.

Upon the consent of the Supervisory Board, the Management Board may deprive a shareholder of all or a part of its pre-emptive rights in relation to shares issued within the limits of the authorised capital.

A share capital increase by the Management Board within the limits of the authorised capital is conditional upon obtaining a positive opinion in this respect from the Supervisory Board. In other cases, unless otherwise provided by the Code of Commercial Companies, the Management Board may decide on any and all matters related to share capital increases within the limits of the authorised capital.

Pursuant to section 3.2.6. of the Articles of Association of the Company, a purchase of treasury shares by the Company for redemption does not require the consent of the General Shareholders' Meeting (subject to art. 393 item 6 of the Code of Commercial Companies and Partnerships) and only requires the consent of the Supervisory Board.

### 4.4.2 Composition of the Management Board

In the period from 1 January until 31 December 2011 the Management Board of the Company was composed of the following five members:

- Jarosław Szanajca, President of the Management Board
- Janusz Zalewski, Vice President of the Management Board
- Jerzy Ślusarski, Vice President of the Management Board
- Janusz Stolarczyk, Member of the Management Board
- Terry Roydon, Member of the Management Board

### 4.4.3 Principles governing the functioning of the Management Board

The Company's Management Board acts pursuant to the provisions of the Code of Commercial Companies, the Articles of Association and unclassified and publicly available Management Board Bylaws approved by the Supervisory Board's resolution, and in accordance with the Code of Best Practice for WSE Listed Companies.

The Management Board is an executive body of the Company. It manages the current operations of the Company and represents the same towards third parties. The Management Board decides in all matters concerning the Company not reserved for the General Shareholders' Meeting and/or the Supervisory Board under legal regulations, the Articles of Association or a resolution of the General Shareholders' Meeting.

For statements to be validly made and signed on behalf of the Company, two members of the Management Board are required to act jointly or one member of the Management Board is required to act jointly with a commercial proxy. Resolutions of the Management Board are adopted by an absolute majority of votes. In case of a voting deadlock, the President of the Management Board has the casting vote.

When defining strategic and current objectives for the Company, the Management Board always acted in the underlying interest of the Company and in line with the legal regulations, and took into account the interests of the shareholders, employees and creditors of the Company.

In order to ensure transparency and efficiency of the management system, the Management Board followed the principles of professional conduct within the limits of reasonable economic risk, and took into consideration a wide range of available information, analyses and opinions.

The amount, form and structure of remuneration for the Members of the Management Board have been determined by the Supervisory Board in line with the applicable remuneration policy and on the basis of clear-cut procedures, and have corresponded to the scope of their responsibilities and competences and have taken into account the economic performance of the Company. This remuneration has also corresponded to remuneration of Management Boards in comparable companies in the real estate development market.

## 4.5. The Supervisory Board

### 4.5.1 Principles for the appointment or dismissal of the Supervisory Board

The Supervisory Board shall comprise of 5 to 9 members appointed for a three-year term of office.

The General Shareholders' Meeting shall determine the number of members of the Supervisory Board. In addition to this, the General Shareholders' Meeting shall appoint and dismiss Members of the Supervisory Board, subject to the personal right of a Shareholder holding at least 50.1% of shares to appoint and dismiss half of the Members of the Supervisory Board, including 1 Vice Chairman thereof. For an odd number of Supervisory Board members, a shareholder holding at least 50.1% shares in the Company is authorised to appoint, accordingly: three (for a 5-person Supervisory Board), four (for a seven-person Supervisory Board) and five (for a nine-person Supervisory Board) Supervisory Board members. The above right is exercised by way of serving written statement to the Company on the appointment or dismissal of a given Supervisory Board member.

At least two Members (and their relatives, in particular spouses, descendants or ascendants) of the Supervisory Board appointed by the General Shareholders' Meeting should meet the criteria of the so-called Independent Members, defined in point 7.7. of the Articles of Association of the Company.

### 4.5.2 Composition of the Supervisory Board

In the period from 1 January until 18 May 2011 the Supervisory Board was composed of the following members:

- Grzegorz Kiełpsz, Chairman of the Supervisory Board
- Zygmunt Kostkiewicz, Vice Chairman of the Supervisory Board (Independent Member)
- Richard Lewis, Vice Chairman of the Supervisory Board
- Stanisław Plakwicz, Member of the Supervisory Board (Independent Member)
- Michael Cronk, Member of the Supervisory Board
- Markham Dumas, Member of the Supervisory Board
- Włodzimierz Bogucki, Member of the Supervisory Board (Independent Member)

Mr. Zygmunt Kostkiewicz and Mr. Stanisław Plakwicz resigned from their positions on the Supervisory Board of the Company on 28 March 2011, with effect on the date of the most recent General Shareholders' Meeting of the Company. Mr. Zygmunt Kostkiewicz resigned from his position of a Member and the Vice Chairman of the Supervisory Board, and Mr. Stanisław Plakwicz resigned from the position of a Member of the Supervisory Board.

Both resignations were due to the fact that both Members have been the Members of the Supervisory Board for nearly 12 years and from July 2011 they would no longer meet the criterion of an independent member prescribed for Members of the Supervisory Board of Dom Development S.A. in point 7.7.8 of the Articles of Association of the Company.

On 19 May 2011 the Annual general Shareholders' Meeting of Dom Development S.A. appointed Mr. Marek Moczulski and Mr. Krzysztof Grzyliński as Members of the Supervisory Board. The aforementioned Members of the Supervisory Board were appointed as Independent Members in line with point 7.7 of the Articles of Association of the Company'. In accordance with point 7.9 of the Articles of Association of the Company, these Company Members were appointed for the joint term of office.

In addition to this, on 19 May 2011 the Supervisory Board of the Company acting under point 7.1 of the Articles of Association of the Company appointed Mr. Marek Moczulski as Vice Chairman of the Supervisory Board.

As a result between 19 May 2011 and 31 December 2011 the Supervisory Board was composed of:

- Grzegorz Kiełpsz, Chairman of the Supervisory Board
- Richard Lewis, Vice Chairman of the Supervisory Board
- Marek Moczulski, Vice Chairman of the Supervisory Board (Independent Member)

- Markham Dumas, Member of the Supervisory Board
- Michael Cronk, Member of the Supervisory Board
- Włodzimierz Bogucki, Member of the Supervisory Board (Independent Member)
- Krzysztof Grzyliński, Member of the Supervisory Board (Independent Member)

In addition to this, Mr. Richard Lewis resigned from the position of a Member and Chairman of the Supervisory Board of the Company on 28 November 2011, with effect on 31 March 2012. The reason for the resignation of Mr. Richard Lewis is his retirement effective on 31 March 2012.

### 4.5.3 Principles governing the functioning of the Supervisory Board

The Supervisory Board acts pursuant to the provisions of the Code of Commercial Companies, the Articles of Association and unclassified and publicly available Supervisory Board Bylaws, approved by the Supervisory Board's resolution, that set forth its organisation and manner of operation, and in accordance with the Code of Best Practice for WSE Listed Companies.

The Supervisory Board is a permanent supervisory body of the Company for all areas of its operation.

The Supervisory Board adopts resolutions or issues opinions in the matters reserved for the Supervisory Board under the Company's Articles of Association and in the manner as provided for in the Articles of Association or relevant legal regulations.

The Supervisory Board held its meetings regularly. The meetings were attended by the Members of the Management Board. In 2011 the Supervisory Board held 6 sessions, including 2 teleconferences. The Management Board provided the Supervisory Board with exhaustive information on all important matters concerning the operations of the Company.

The Supervisory Board complied with the requirement of having among its members at least two independent members in line with the criteria of independence set forth in the Company's Articles of Association.

Resolutions of the Supervisory Board concerning: (i) the consent for the Company or a related entity of the Company to make any considerations on any account whatsoever for the benefit of the Members of the Management Board, (ii) the consent for the Company or a related entity of the Company to conclude a material agreement with a related entity of the Company, a Member of the Supervisory Board or the Management Board, or entities related to such members, (iii) the choice of a statutory auditor for the audit of the Company's financial statements, were all adopted upon the consent of the majority of the independent Members of the Supervisory Board.

The remuneration of the Members of the Supervisory Board was determined in a transparent manner and did not constitute a considerable share in the Company's costs affecting its financial result. The amount of the remuneration was approved by a resolution of the General Shareholders' Meeting and was disclosed in the annual report.

The Supervisory Board presented to the Ordinary General Shareholders' Meeting of the Company which was held on 19 May 2011 an assessment of the Company's situation, to include an assessment of the internal control system and the system of management of substantial risk for the Company, and an assessment of the work of the Supervisory Board, prepared in line with the Code of Best Practice for WSE Listed Companies.

### 4.5.4 The Supervisory Board Committees

Two committees, the Audit Committee and the Remuneration Committee, were established within the structure of the Supervisory Board.

#### Audit Committee

In the period from 1 January until 18 May 2011 the Audit Committee was composed of the following members:

- Włodzimierz Bogucki, Chairman of the Audit Committee

- Stanisław Plakwicz, Member of the Audit Committee
- Richard Lewis, Member of the Audit Committee

Due to the resignation of Mr. Stanisław Plakwicz from the position as a Member of the Supervisory Board, in the period from 19 May 2011 until 31 December 2011 the Audit Committee was composed of the following members:

- Włodzimierz Bogucki, Chairman of the Audit Committee
- Richard Lewis, Member of the Audit Committee
- Marek Moczulski, Member of the Audit Committee

The Audit Committee is a permanent committee at the Supervisory Board. It is composed of at least three members appointed by the Supervisory Board from amongst its members, with at least two members of the Audit Committee being Independent Members of the Supervisory Board within the meaning of paragraph 7.7 of the Articles of Association, and at least one of whom shall have qualifications in accountancy or financial audit.

The duties and competences of the Audit Committee have been set forth in unclassified and publicly available Audit Committee Bylaws approved by the Supervisory Board.

The duties of the Audit Committee include, in particular (i) supervision of the Company's Management Board as regards the Management Board's compliance to relevant laws and other regulations, in particular the Accounting Act dated 29 September 1994, supervision of the preparation of financial information by the Company, in particular in respect of the choice of the accounting policy adopted by the Company, supervision of the application and assessment of the consequences of new legal regulations, supervision of the information on the manner in which estimated items, forecasts etc., are presented in annual reports and supervision of the compliance to recommendations and findings of a statutory auditor appointed by the Supervisory Board, (ii) issuing recommendations to the Company's Supervisory Board concerning the appointment and dismissal of the statutory auditor, (iii) control of independence and objectivity of the statutory auditor, in particular in respect of a possible replacement of the statutory auditor, and their remuneration, (iv) verification of the statutory auditor's work.

In executing its duties, the Audit Committee works with the Supervisory Board, the Management Board, middle management and the external and internal audit unit.

The Vice President of the Management Board responsible for finance, Deputy Financial Director, Financial Controller and representatives of the external and internal audit teams may attend the Audit Committee meetings, if invited. In 2011, the Audit Committee held 7 meetings, including 3 teleconferences.

### Remuneration Committee

In the period from 1 January until 18 May 2011 the Remuneration Committee was composed of the following members:

- Zygmunt Kostkiewicz, Chairman of the Remuneration Committee
- Richard Lewis, Member of the Remuneration Committee
- Stanisław Plakwicz, Member of the Remuneration Committee

Due to the resignation of Mr. Zygmunt Kostkiewicz and Mr. Stanisław Plakwicz from their position as Members of the Supervisory Board, in the period from 19 May 2011 until 31 December 2011 the Remuneration Committee was composed of the following members:

- Marek Moczulski, Chairman of the Remuneration Committee
- Richard Lewis, Member of the Remuneration Committee
- Krzysztof Grzyliński, Member of the Remuneration Committee

The Remuneration Committee is a permanent committee at the Supervisory Board. It is composed of at least three members appointed by the Supervisory Board from amongst its members, with at least two members of the Remuneration Committee being Independent Members of the Supervisory Board within the meaning of paragraph 7.7 of the Articles of Association. The Supervisory Board appoints one member of the Remuneration Committee to the position of the Chairman of the Remuneration Committee. This member serves concurrently as an Independent Member of the

Supervisory Board within the meaning of paragraph 7.7 of the Articles of Association. The Supervisory Board may dismiss any Member of the Remuneration Committee at any time.

The duties and competences of the Remuneration Committee have been set forth in unclassified and publicly available Remuneration Committee Bylaws approved by the Supervisory Board.

The duties of the Remuneration Committee include, in particular (i) a periodic assessment of the remuneration principles for the members of the Management Board and providing the Supervisory Board with relevant recommendations in this respect, (ii) preparation of suggestions as regards remuneration and additional benefits for individual members of the Management Board, including in particular benefits under a management share option programme (options convertible into shares in the Company's share capital) to be reviewed by the Supervisory Board, (iii) submission of projects concerning the Company's remuneration policy.

The President of the Management Board and the Vice president of the Management Board for finance may attend the Remuneration Committee meetings, if invited. In 2011, the Remuneration Committee held 6 meetings, including 2 teleconferences.

## 4.6. Remuneration for and employment contracts with the members of the Management Board and the Supervisory Board

### 4.6.1 The amount of remuneration, bonuses and benefits received by individual members of the Management Board and the Supervisory Board

In 2011, the amount of remuneration (including bonuses) paid, accrued or potentially accrued to individual members of the management or supervisory bodies was as follows:

| Remuneration and bonuses | In the Company in thousand PLN | In other companies operating within the Group in thousand PLN |
|---|---|---|
| **The Management Board** | | |
| Jarosław Szanajca | 1 596 | - |
| Zalewski Janusz | 1 093 | - |
| Janusz Stolarczyk | 849 | - |
| Jerzy Ślusarski | 1 041 | - |
| Terry Roydon | 72 | - |
| **The Supervisory Board** | | |
| Grzegorz Kiełpsz | 600 | - |
| Zygmunt Kostkiewicz | 27 | - |
| Richard Lewis | 72 | - |
| Stanisław Plakwicz | 27 | - |
| Markham Dumas | 72 | - |
| Michael Cronk | 72 | - |
| Włodzimierz Bogucki | 72 | - |
| Marek Moczulski | 45 | - |
| Krzysztof Grzyliński | 45 | - |

In 2011, there was no distributions from profit to members of the management or supervisory bodies of the Company, except for the dividend.

On 19 May 2011 the General Shareholders' Meeting adopted a resolution identifying the persons eligible (including members of the Management Board of the Company) to participate in Programme III, in particular to cover the shares under terms and conditions specified in the resolution by the Supervisory Board. Options for the aforementioned shares were granted contingently by the Supervisory Board on 13 December 2010, as presented in the Management Board's report on the Company's activities for the year ended on 31 December 2010.

Numbers of shares, to which the Management Board members listed below will have the subscription rights pursuant to the above resolutions:

| | Date of conditional grant of share options | Number of shares | Option period | Purchase price per 1 share/PLN |
|---|---|---|---|---|
| **The Management Board** | | | | |
| Zalewski Janusz | 13.12.2010 | 23 534 | from 13.06.2014 until 13.12.2015 | 1.00 |
| Jerzy Ślusarski | 13.12.2010 | 23 534 | from 13.06.2014 until 13.12.2015 | 1.00 |
| Janusz Stolarczyk | 13.12.2010 | 11 767 | from 13.06.2014 until 13.12.2015 | 1.00 |
| Terry Roydon | 13.12.2010 | 11 767 | from 13.06.2014 until 13.12.2015 | 1.00 |
| **The Management Board, aggregate** | | **70 602** | | |
| **The Supervisory Board** | **-** | **-** | **-** | **-** |
| **The Management Board and the Supervisory Board, aggregate** | | **70 602** | | |

### 4.6.2 Agreements with the members of the Management Board in the event of their resignation or dismissal

#### The agreements concluded between the Company and the members of the management which provide for the compensation in the event of their resignation or dismissal from office

Members of the Company's Management Board: Jarosław Szanajca, Janusz Zalewski, Jerzy Ślusarski and Janusz Stolarczyk are employed by the Company on the basis of employment contracts. Pursuant to the provisions of these employment contracts, an individual Member of the Management Board is entitled to receive remuneration throughout the notice period in the case that their employment is terminated. This has been described in note 7.43 in the Company's financial statements for 2011.

## 4.7. Shares held by the members of the Management Board and the Supervisory Board

**Total number and nominal value of all shares in the Company as well as the shares and stocks in the companies operating within the Group held by the members of the management and supervisory bodies of the Company**

The ownership structure of shares and share options in the Company held by the Members of the Management Board and the Supervisory Board as at 31 December 2011 was as follows:

| | Shares | | Share options *) | Total |
|---|---|---|---|---|
| | number | nominal value in thousand PLN | number | number of options and shares |
| **The Management Board** | | | | |
| Jarosław Szanajca | 1 534 050 | 1 534 | - | 1 534 050 |
| Zalewski Janusz | 300 000 | 300 | 123 534 | 423 534 |
| Jerzy Ślusarski | 9 363 | 9 | 109 634 | 118 997 |
| Janusz Stolarczyk | 100 200 | 100 | 64 447 | 164 647 |
| Terry Roydon | 58 500 | 59 | 61 767 | 120 267 |
| **The Supervisory Board** | | | | |
| Grzegorz Kiełpsz | 1 280 750 | 1 281 | - | 1 280 750 |
| Zygmunt Kostkiewicz | 29 500 | 30 | - | 29 500 |

The Members of the Management Board and the Supervisory Board of the Company did not hold any shares in other companies operating within the Group.

## 4.8. Management Option Programmes

### 4.8.1 Existing employee share schemes

**Information on the agreements that are known to the Company and that were concluded in the last financial year which may result in future changes in the proportions of shares held by the current shareholders**

Management Options Programmes are in place in the Company. Options for the Company's shares are granted under these Programme. The exercise of these options will result in future changes in the proportions of shares held by the current shareholders. The Management Option Programmes have been described in the financial statements of the Company in note 7.42.

On 19 May 2011 the General Shareholders' Meeting adopted a resolution identifying the persons eligible (including members of the Management Board of the Company) to participate in Programme III, in particular to cover the shares under terms and conditions specified in the resolution by the Supervisory Board. Options for the aforementioned shares were granted contingently by the Supervisory Board on 13 December 2010, as presented in the Management Board's report on the Company's activities for the year ended on 31 December 2010 (see note 4.6.1).

### Share options granted and exercisable as at respective balance sheet dates, and changes in the presented periods

| **SHARE OPTIONS** | | **01.01-31.12.2011 number/thousand PLN** | **01.01-31.12.2010 number/thousand PLN** |
|---|---|---|---|
| **Unexercised options at the beginning of the period** | **Number of options** | **726 000** | **735 750** |
| | **Total exercise price** | **46 930** | **46 990** |
| Options granted in the period*) | Number of options | 126 000 | - |
| | Total option exercise value | 385 | - |
| Options expired in the period | Number of options | 6 000 | - |
| | Total option exercise value | 388 | - |
| Options exercised in the period | Number of options | - | 9 750 |
| | Total option exercise value | - | 60 |
| | Weighted average exercise price per share | - | - |
| **Unexercised options at the end of the period** | **Number of options** | **846 000** | **726 000** |
| | **Total exercise price** | **46 927** | **46 930** |
| Exercisable options at the beginning of the period | Number of options | 310 800 | 159 150 |
| | Total exercise price | 35 580 | 17 163 |
| Exercisable options at the end of the period | Number of options | 490 975 | 310 800 |
| | Total exercise price | 37 968 | 35 580 |

*) the above table for the 12-month period ended 31 December 2010 does not include 120 000 share options granted conditionally under Programme III.

## 4.8.2 Employee share scheme control system

The Management Options Programmes, which are in place in the Company, have been adopted by the Supervisory Board based on the authorisation contained in a resolution issued by the General Shareholders' Meeting.

### The Management Option Programme II for 726 000 shares in Dom Development S.A.

Pursuant to Programme II, the Supervisory Board of the Company may adopt a resolution naming the people entitled to participate in the Programme. It is also entitled to set the conditions, which must be met by the participants before they subscribe for shares. On 10 August 2006 and 21 May 2009, the Management Board was authorised by the General Shareholders' Meeting to increase the share capital of the Company within the authorised capital and to issue warrants allowing the participants of Programme II to subscribe for shares. The Management Board is then entitled to adopt a resolution concerning the increase of the share capital upon the consent of the Supervisory Board.

Management Option Programme II covers 726 000 shares in Dom Development S.A., subject to a limit of 242 000 shares being granted within any period of 12 consecutive months. As at 31 December 2011, all share options were granted under this programme.

### The Management Option Programme III for 360 000 shares in Dom Development S.A.

Pursuant to Programme III, the Supervisory Board of the Company may adopt a resolution on granting the options, provided that the General Shareholders' Meeting of the Company decides that the persons named in the resolution(s) adopted by the Supervisory Board are entitled to take up the shares on the terms and conditions stipulated in Programme III and in resolution(s) regarding the programme adopted by the Supervisory Board. The Supervisory Board is also entitled to set the conditions which must be met by the participants before they subscribe for shares. On 10 August 2006 and 21 May 2009, the Management Board was authorised by the General Shareholders' Meeting to increase the share capital of the Company within the authorised capital and to issue warrants allowing the participants of Programme III to subscribe for shares. The Management Board is then entitled to adopt a resolution concerning the increase of the share capital upon the consent of the Supervisory Board.

Management Option Programme III covers 360 000 shares in Dom Development S.A. subject to a limit of 120 000 shares being granted within any period of 12 consecutive months. As at 31 December 2011, 120 000 share options were granted under this programme.

## 4.9. Changes in the basic management principles of the Company

In 2011 there were no major changes in the basic principles of management. The development of the organisation calls for improvement of the management procedures in Dom Development S.A.

## 4.10. Internal control and risk management systems

### Description of the basic features of the internal control and risk management systems in place in the Company for the drafting of standalone and consolidated financial statements

The Company's Management Board is responsible for the internal control system in the Company and its effectiveness in the drafting of financial statements and periodic reports prepared and published in accordance with the Regulation by the Minister of Finance dated 19 February 2009 on the current and periodic submissions by securities issuers.

The effectiveness of the Company's internal control and risk management systems in financial reporting was ensured through the following means:

*Defined structure and scope of financial reporting applied by the Company*

The medium term plan (covering a period of at least 3 years) is updated on a yearly basis in the Company. In addition to this, a detailed operating and financial budget which implements the assumptions of the medium-term plan are prepared every year. The process is managed by the Management Board and the middle and executive management of the Company is also involved. The budget, which is prepared annually for the following year, is approved by the Company's Management Board.

During any specific year, the Company's Management Board reviews the current financial results versus the adopted budget. The management reporting methodology applied in the Company is used for this purpose. This reporting is based on the accounting policy adopted by the Company (in line with the International Financial Reporting Standards) and takes into account the form and level of detail of financial data presented in the financial statements of the Company and the Group.

Consistent accounting policies are applied by the company for presenting its financial details in the financial statements, periodic financial reports and management reports.

*Clear division of duties and competences in the process of preparing financial information*

The financial division headed by the Vice President of the Management Board as the Company's CFO is responsible for the drafting of financial statements, periodic financial reports and current management reports of the Company.

The Company's finance statements are drafted by a team of highly qualified employees from the finance and accounting division, with the assistance of the planning and analysis unit. The entire process is supervised by middle management from the financial division. The financial statements, when ready, are verified by the financial controller (responsible for the accounting department and planning and analysis unit) and then by the Vice President of the Management Board as the Company's CFO, prior to being submitted to the independent statutory auditor.

*Regular assessment of the Company's operations based on its financial reports*

The figures used in the financial statements and periodic reports and in the monthly management and operating reports come from the Company's financial and accounting system. Detailed financial and operating management reports are drafted, having all predefined book-closing procedures completed at the end of each month. These reports, in addition to historical financial data, are supplemented with quantitative operating data and forecasts by the planning and analyses unit. These reports are scrutinized by middle and executive management of individual organizational units of the Company and by the Management Board. As regards closed reporting periods, the Company's financial results are scrutinized versus the budgets and forecasts made in the month preceding the reporting period subject to scrutiny. Taking into consideration the specific nature of the sector, not only individual cost groups are scrutinized but also individual investment projects.

Any identified deviations and errors are clarified and corrected in the Company's books on an ongoing basis, in accordance with the adopted accounting policy.

*Verification of the Company's financial statements by an independent statutory auditor*

Pursuant to the applicable legal regulations, the Company's financial statements are reviewed or audited, respectively, by an independent statutory auditor. This is always a prime and highly qualified statutory auditor.

A so-called Audit Life Cycle has been developed in the Company. This is a cyclical schedule of communication between the Management Board, the statutory auditor and the Audit Committee of the Supervisory Board. The purpose of this schedule is to ensure appropriate interaction between the Audit Committee and the statutory auditor as well as appropriate presentation of the results of the above mentioned review and audit.

*Formalised process for significant assessments that considerably affect the Company's financial statements*

The fundamental activity adopted by the Company so as to reduce the exposure to market risks is proper assessment of potential and control of current development projects based on investment models and decision-making procedures developed in the Company. The adherence to such procedures is closely monitored by the Management Board of the Company.

As implied by the accounting policy adopted by the Company in this respect, detailed budgets for individual development projects that are prepared in accordance with the best practice and experience of the Company constitute the grounds for the calculation of revenue from the sale of products and costs of products sold. The budgets for all construction projects are updated at least once every three months, during the execution of the projects. The update is based on the formalised principles in place in the Company and is scrutinized by the Management Board, in particular by the Vice President of the Management Board as the Company's CFO.

*Risk management process and internal audit*

There has been a formalised risk management procedure in operation within the Company since 2000. Under this procedure the risk is managed through the identification and assessment of the risk areas for all aspects of the activities, in which the Company and the Group are involved, together with defining activities required to reduce or eliminate such risks (including through the procedures and internal audit system) The risk management procedure is subject to periodic revision and is updated by the Management Board jointly with the key management staff and third party advisers.

The internal audit unit that is in place in the Company also participates in the process of risk identification and assessment of the control measures. The schedule of internal audits is created based on the risk assessment made in cooperation with the Management Board under the supervision of the Audit Committee. In addition to scheduled audits, there are verification audits to check implementation of recommendations formulated in the previous audits and non-scheduled audits. The findings of internal audits are reported to the Audit Committee and to experts appointed by this Committee.

## 4.11. Auditor

### Information on the agreement for the audit and review of the financial statements and the consolidated financial statements concluded with the authorized auditor

On 31 March 2010, Dom Development S.A. entered into an agreement for the audit and review of the standalone and consolidated financial statements with Ernst & Young Audit Sp. z o.o. (an authorized auditor).

The agreement covers the audit of the financial statements submitted by the Company and the Group for the year ended 31 December 2011 and the review of interim financial statements submitted by the Company and the Group for the six-month period ended 30 June 2011. The total remuneration for the audit of the annual financial statements is PLN 180 thousand and the total remuneration for the review of the interim financial statements is PLN 100 thousand.

Moreover, Ernst & Young Audit Sp. z o.o. provided additional services to the Company for the total amount of PLN 4 thousand, in 2011.

The financial statements of the Company and the Group for the first half of the year 2010 and for the entire year 2010 were, respectively, reviewed and audited by Ernst & Young Audit Sp. z o.o. The total remuneration for the audit of the annual financial statements was PLN 185 thousand and the total remuneration for the review of the interim financial statements was PLN 105 thousand.

Moreover, Ernst & Young Audit Sp. z o.o. provided additional services to the Company for the total amount of PLN 5 thousand, in 2011.