Property Lending Barometer 2016

A survey of banks on the prospects for real estate sector lending in Europe

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7th
annual edition of the survey

Interviews conducted with banks from
21
European countries

Input from close to
100
banks

Dear Reader,

It is our pleasure to present the Property Lending Barometer 2016, which is the 7th edition of our annual survey of the finance market for real estate. The Barometer gives insight into lending market conditions in Europe and also provides separate snapshots of the countries surveyed to highlight the specific characteristics of their lending markets.

The purpose of our report is to assess the prospects and sentiment for bank financing in the real estate sector in Europe, based on interviews conducted with bank representatives from 21 European countries. This year Belgium and Ireland have been included in the survey for the first time, while Russia and Slovenia return in our research.

A gradual improvement of lending conditions seems to be a sustained trend, though the outlook and general business sentiment are less rosey for the surveyed countries. Analysts believe growth is expected to continue throughout 2016, though its intensity may taper off by the end of the year. Even though there have been notable improvements in bank financing, most countries' markets are considered to have remained tighter compared to pre-crisis levels. Limiting factors to further improvement in business sentiment include the economic slowdown in China, the tension between Russia and the European Union, and the increasing number of terror attacks in Europe. The implications of the UK "Brexit" vote to leave the European Union are as yet unforeseeable, but the result has created additional macroeconomic and political uncertainties throughout Europe and further afield.

Lending sentiment among banks in some of these countries is slightly less positive than last year, but financial institutions are clearly open to financing real estate projects. With relatively low interest rates and ample availability of finance, both from banks and alternative lenders, the macroeconomic environment is making real estate investment an appealing option for many investors. Overall, transaction volumes significantly increased throughout 2015, but showed a general decline in early 2016, although there are great differences in investment trends between European countries.

This report is an analysis of the findings of our survey of the leading banks active in these countries. The Barometer 2016 includes input from close to 100 banks active in these markets, collected primarily via in-depth interviews and online questionnaires. Representatives from leading financial institutions have provided their views on the key issues affecting property lending.

First, this report provides an overview of the European market as a whole, by focusing on key issues such as the strategic importance of real estate financing for banks, the proportion of impaired loans and banks' views on how to manage these loans. We also examine banks' average and preferred loan/deal size, as well as the length of the loan contract term. Furthermore, the opportunity for new financing and banks' asset class preferences were also considered.

The second half of the report includes a profile for each country surveyed. In this section we have addressed the prospects and terms available for developers and investors to finance new real estate developments and income-generating properties, and survey participants' expectations for the next 12-18 months.

We would like to take this opportunity to thank all of those who participated in this survey. Their co-operation was key to the success of this initiative.

We hope you will find our report informative and enlightening in supporting your future business decisions related to real estate finance. If you would like to receive any clarification or discuss this year's survey results, please feel free to contact us or any member of KPMG's Real Estate Advisory Practice.

Yours sincerely,
Hans Grönloh and Andrea Sartori

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Methodology and sample profile

This survey aims to provide an analytical overview of the current approach of banks to real estate financing in Europe. The following countries are represented in the 2016 survey: Austria, Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Germany, Hungary, Ireland, Italy, the Netherlands, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Spain, Sweden, Turkey and the United Kingdom.

The data for the survey[1] was primarily collected through in-depth interviews with bank representatives and via online questionnaires. Depending on the organizational structure, interviewees were the heads of real estate, project financing or risk management departments. Banks were selected from among the leading financial institutions operating in each individual country. The survey participants included close to 100 banks, all of which were active in the real estate market in Europe over the last year. Data collection for this survey took place in May-July 2016.

Approximately half of survey participant banks were local banks, i.e. those operating predominantly within one European country, whilst the other half of respondents were regional or multinational banks.

Comparison of surveyed countries

In order to provide better benchmarking among the countries surveyed, they have been placed into three categories according to the following factors: i) overall size of their economy in terms of the total volume of GDP; ii) population; and iii) the risk profile represented by 5-year CDS premiums. Based on these factors, we created the following three categories for the purposes of our analysis:

Dominant economies: These countries represent a larger proportion of the total GDP volume in Europe and they have relatively stable markets. The performance of these countries can greatly influence overall market conditions at European level. In this category we included the United Kingdom, Germany, Italy and Spain.

Established economies: Similar to the dominant economies, established markets also have relatively low risk profiles. However, due to their size, they have less influence on the overall European market. In this category, we included Austria, Belgium, the Czech Republic, the Netherlands, Poland, Slovakia and Sweden.

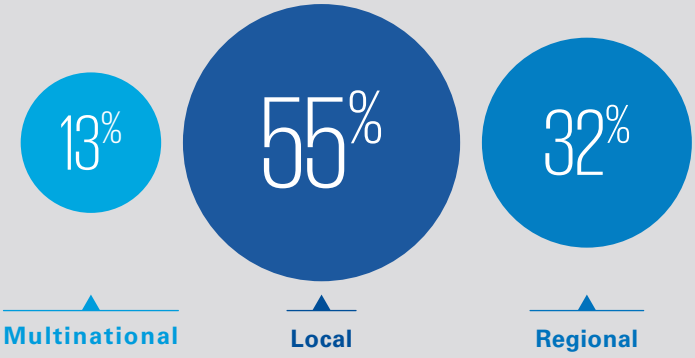
Other economies: In general, these markets have a higher risk profile in comparison to the more established countries. Also the size of some of the markets in this category is not large enough to merit inclusion among the established markets. In this category, we considered Bulgaria, Croatia, Cyprus, Hungary, Ireland, Romania, Russia, Serbia, Slovenia and Turkey.

Survey limitations

The following limiting factors should be noted:

- When the answers provided to specific questions were not sufficient to provide reliable information on a specific country, we have indicated this, or the country was omitted from that part of the analysis.
- In the case of some parameters and cross-tabulations, the output of the survey may be considered indicative but not representative due to the low number of responses to some questions.
- As in previous years, our assessment of the residential sector excluded residential projects whose construction costs were below EUR 10 million.
- Most of the interviews were conducted in the weeks before the UK vote on leaving the European Union. The uncertainty regarding a potential "leave" or "remain" result is understood to be implicit in the majority of responses collected.

Geographic orientation of the banks included in the surveyed sample



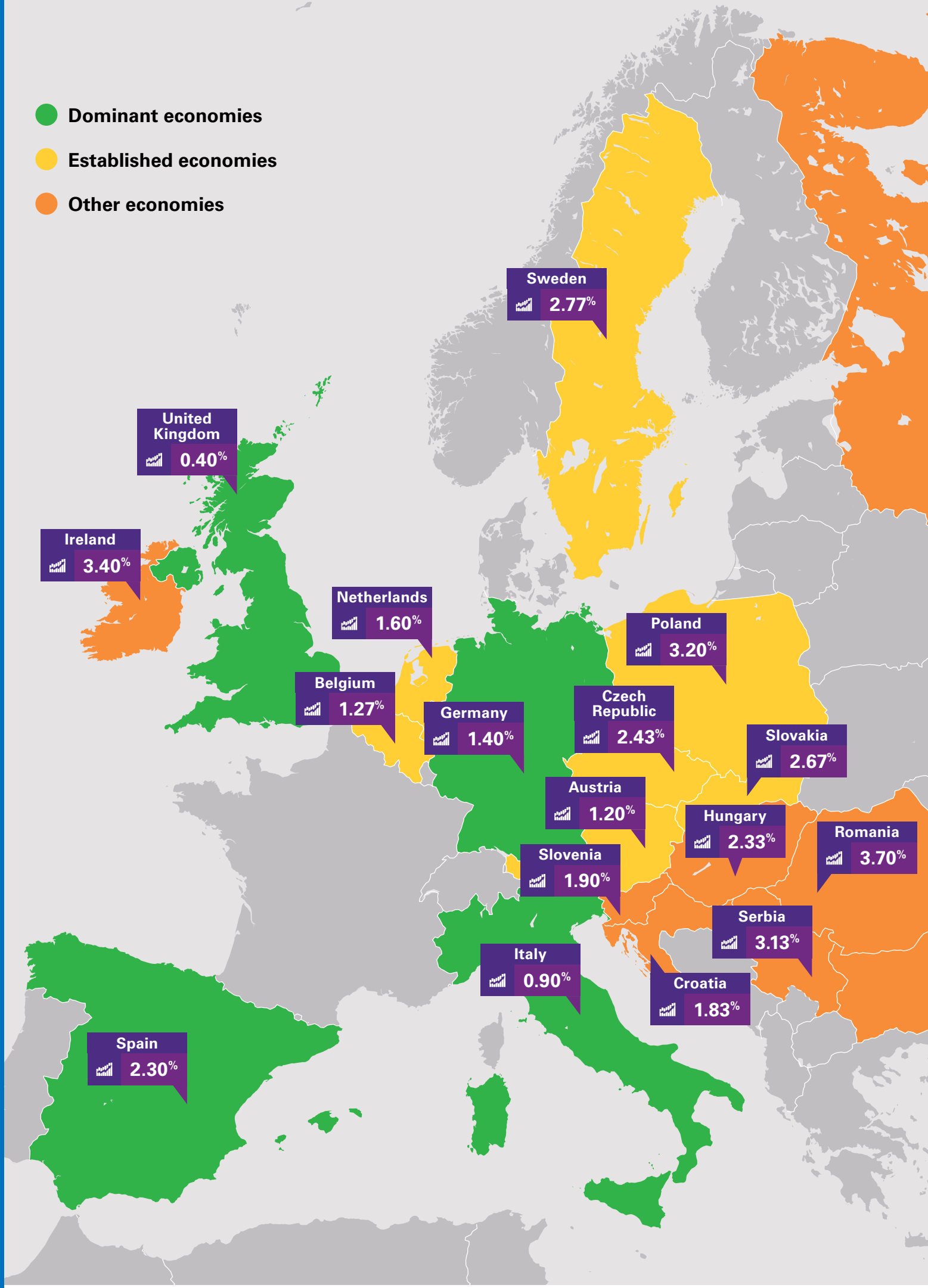
Note: *Local: Banks which are active in not more than 2 countries*
Regional: Banks which are active in at least 3 countries excluding multinationals
Multinational: Banks which are active on at least 3 continents

Source: KPMG Property Lending Barometer 2016

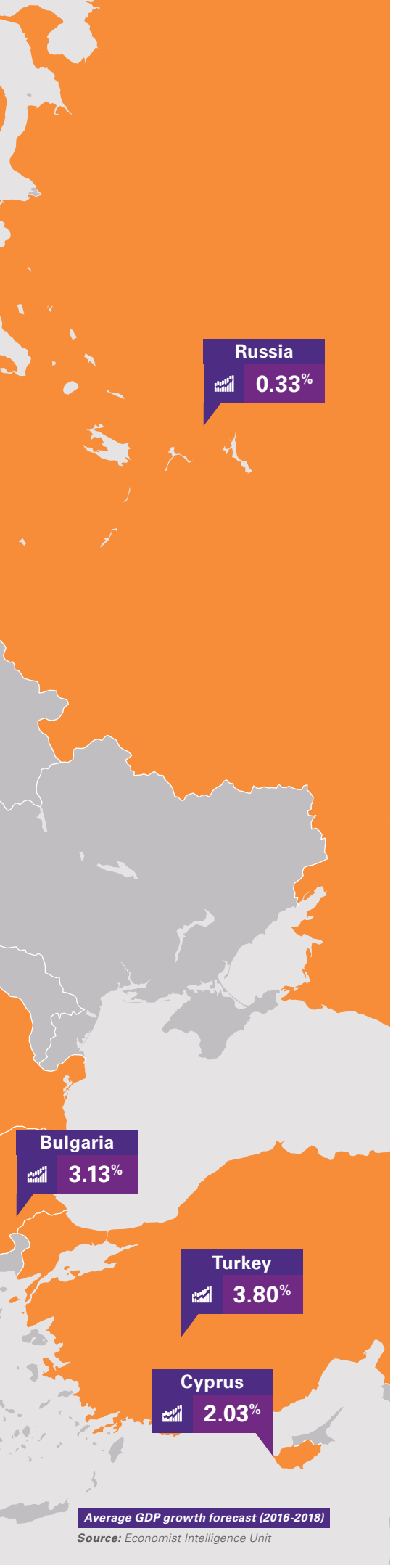
Geographic abbreviations

AUT – Austria; BEL – Belgium; BUL – Bulgaria; CEE – Central and Eastern Europe; CRO – Croatia; CYP – Cyprus; CZE – Czech Republic; EMA – Europe, Middle East and Africa; GER – Germany; HUN – Hungary; IRE – Ireland; ITA – Italy; NLD – Netherlands; POL – Poland; ROM – Romania; RUS – Russia; SRB – Serbia; SVK – Slovakia; SLV – Slovenia; ESP – Spain; SWE – Sweden; TUR – Turkey; GBR – United Kingdom

1 *The survey also uses information obtained from public sources, which KPMG believe to be reliable. The information and market reports were published in 2015 and 2016 by BNP Paribas Real Estate, Colliers International, Cushman&Wakefield, Danos Real Estate, Economist Intelligence Unit, Jones Lang Lasalle, Knight Frank, National Bank of Belgium, Real Capital Analytics and Savills.*



Overview of the European real estate market



Average GDP growth forecast (2016-2018)

Source: *Economist Intelligence Unit*

Macroeconomic outlook of the region

The economic landscape of the European Union has been cast in a favorable hue for over a year, reflecting the synergy of various positive developments. This tendency is expected to abate somewhat by 2017. Amid the current circumstances, macroeconomic risks may limit growth prospects, as the region faces challenging geopolitical tensions originating from both close by and further afield, which are testing the symbiotic economic relations of the European Union.

The positive developments of the past year have been somewhat counterbalanced by external events, ultimately causing growth to remain moderate in the countries included in the survey, which registered an average 2.5% GDP growth in 2015 – exhibiting a 52% increase in growth compared to 2014. However, ongoing macroeconomic events and conditions will continue to influence the EU's current economy; hence, an anticipated drop in GDP growth to 2.2% in 2016, followed by 2.0% for 2017. These numbers are supported by several fundamental factors.

First, global oil supplies, despite robust demand, are at a record-high level, mostly accounted for by the steady production of OPEC and Russia. Prices have dropped more than 70% since 2014. This has had effects upon European economic activity, which has been stimulated by persistent low oil prices throughout 2015, with further implications in early 2016, leading to both a reduction of commodity prices and an increase in disposable income. In addition, the measures taken by the European Central Bank (ECB) have also eased and encouraged investment through an extension of the asset purchase program, which has been gradually expanded to an average of EUR 80 billion purchases monthly, and also broadened asset-wise, for example to include the purchase of corporate sector bonds. These measures have benefitted financing prospects in the region, with the ECB expecting positive results to materialize in the medium term.

Furthermore, a slowdown of China's economy is a source of risk with regards to both global and European economic prospects. Chinese annual GDP growth has shown a decline since 2010 (10.6%) to a level of 6.7% in H1 2016. One result of the global financial crisis is that China has become a key driver of worldwide growth, accounting for a third of global output growth since the beginning of 2010; its slow-down is expected to have further implications for global macroeconomic conditions.

Influenced by the above and a range of additional macroeconomic factors, investment increased in 2015, gaining momentum towards the end of the year. The positive tendency, however, is predicted to last only temporarily, as the price of oil and other energy sources is expected to grow, increasing inflation gradually in H2 2016. Furthermore, how much such macroeconomic factors will affect various economies in the EU varies, depending greatly on the countries' respective macroeconomic attributes and policy stances.

In 2015, structural issues gained an increasingly important position in the EU's agenda in order to preserve fruitful collaboration between members and in regards to overall competitiveness as one whole economic unit. Applying the necessary structural measures is inevitable for the favorable functioning of the EU. The surge of refugees who arrived to the European Union last year has created significant challenges to the host economies. At a global level, continuing conflicts in Ukraine are prone to elevating international tensions via numerous sanctions imposed by the EU against the Russian Federation. Meanwhile, the issue of unemployment is still on the EU agenda, although the numbers have been showing some positive signs in recent years. The effects these matters are exerting upon various economies are expected to continue through 2016 as well, testing the adaptive and reorganizational capabilities of the markets in question.

Meanwhile, the United Kingdom leaving the European Union became a significant issue. Increased economic and political uncertainty and a prolonged period of exit negotiations within the EU are some of its immediate implications. Expert opinions vary in terms of whether countries in continental Europe are expected to benefit overall or suffer from the medium to long-term consequences. At a global level, higher volatility is expected, as the UK accounts for 16% of the European Union's GDP.

Bank lending

As in the previous two years, a recovery phase is apparent in connection with bank lending, stemming from an ample supply of loans for corporations and elevated demand across all loan groups. The phenomena of negative and near-negative interest rates across Europe have fuelled borrowing activity thus far, but there is great uncertainty whether this will be sustained in the future.

The continuing quantitative easing activity of the European Central Banks is foreseen as a determinant factor in increasing borrowing opportunities and spurring investor appetites. The ECB introduced the expanded asset purchase program last year, aiming to further stimulate the economy and combat deflation. Currently, on average, EUR 80 billion is the combined monthly amount spent on the ECB's deleveraging activity entailed in its asset purchase programs. However, it remains uncertain whether the extra liquidity will lead to an increase in lending volumes in all of the economies in question, due to the fragile regional financial system, increased regulatory pressure and the high rate of non-performing loans in some of the peripheral economies.

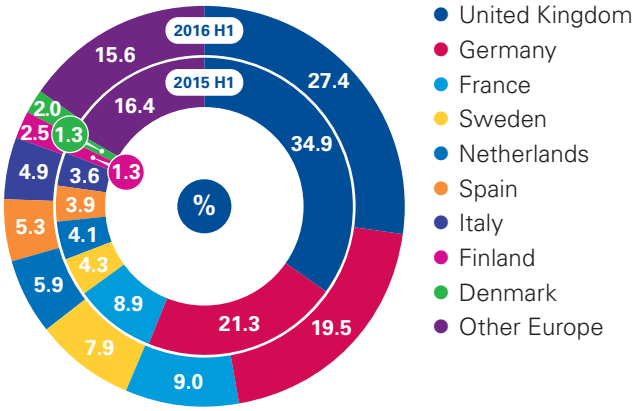
Intensive deleveraging activity took place in European markets in 2015. Its volume has increased and the loan sales reached EUR 104 billion in total value completed across 30 surveyed European countries. The UK market saw the greatest volume of loan sales deals, followed by Ireland, while the loan sales markets were also quite active in Italy and Spain. These four countries were jointly responsible for more than 75% of total deleveraging activity in Europe. As for the future of the market, the combat against non-core and non-performing assets is likely to remain on the agenda.

Real estate market in Europe

Compared to the exceptionally strong year of 2015, real estate investment in Europe declined in the first half of 2016. Investment totaled EUR 107.5 billion in the first 6 months, which is 30% lower than the comparable figure for the previous year. Among other factors, uncertainty on a range of political issues is understood to have caused the sharp decline. Due to concerns about the potential market implications of these issues, shaken investor confidence and increased risk aversion have created more competition for higher quality assets.

As for the geographical distribution of real estate investment activity, the UK and Germany preserved their first and second positions from the previous years, accounting for over one-fourth and one-fifth respectively, of the total investment volume in H1 2016. However, their overall performance declined by half in the UK and by one third in Germany, compared to the first 6 months of 2015, underperforming the market average, which contracted by 30%. France regained third place, which it held in 2014, with investments close to EUR 10 billion. Among the largest investment markets in the first half of 2016, Finland and Sweden saw the largest year-on-year increases, with 34% and 29% respectively.

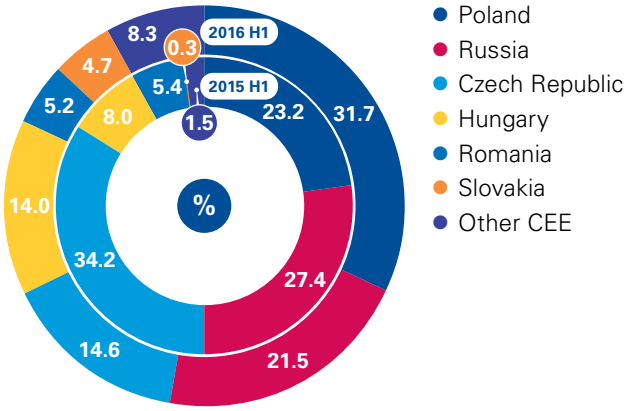
Breakdown of real estate transaction volume – Europe



Source: *Real Capital Analytics*

Central & Eastern Europe, including Russia, represents a small fraction of the aggregate European investment transaction volume, with a total value of approximately EUR 6.5 billion in the first half of 2016. Nevertheless, it has proved to bear strong growth potential. Remarkable investment activity was experienced in H1 2016 in the region, having increased by 50% over the respective half of the previous year. Poland was a top target for investments in the region (EUR 2.07 billion), while high levels of interest have returned to Hungary (EUR 910 million), as well. Russia recorded significant growth of 46% in H1 2016, with respect to the same period in the previous year, attracting approximately EUR 1.4 billion of investment despite continuing political sanctions against it and market volatility.

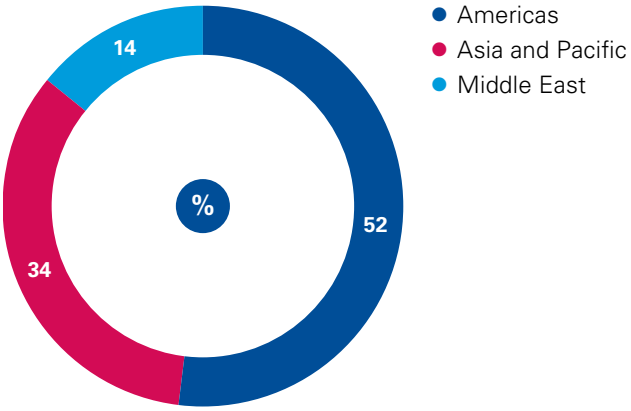
Breakdown of real estate transaction volume – Central and Eastern Europe (including Russia)



Source: *JLL*

In terms of cross-border investment, a significant upturn was experienced in 2015 in the European Union. While domestic investors continued to dominate the market, non-European investment accounted for a significant percentage of the deals. The United States was undoubtedly number one in 2015, and strengthened its position in Q1 2016 as well, most probably as a result of the strong dollar. Asian investors, including most notably China and Singapore, occupied second place in terms of non-local real estate investment volume towards the EU, followed by investors from the Middle East, such as Qatar and UAE. Regarding the destination of real estate investment, there is a tendency of increasing interest in non-UK property, as a form of diversification. The German market has felt the greatest consequent impact, increasing its share from 15% to 20% of total inflow of cross-border investment to the EU. The most preferred cities to invest in included London, Paris, Stockholm, Berlin, Birmingham and Munich.

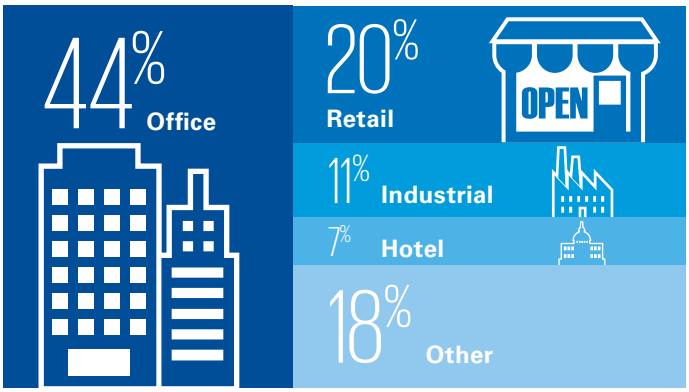
Real estate investment capital inflows to Europe by region (2015)



Source: *Cushman & Wakefield Research*

The preferences of investors in terms of asset classes are not exhibiting a notable change in comparison to the previous year: in the first 6 months of 2016 the office sector was the most favored (44%), dropping 18% to EUR 46.7 billion of investment, followed by retail (20%), industrial (11%), hotel (7%), and other (18%). A general contraction of the investment market was reflected in all sectors, though to varying degrees. The industrial sector decreased by 10%, while a 43% decrease was seen for retail, and a 44% drop for the hotel sector.

Investment by asset type in Europe (H1 2016)



Source: *Real Capital Analytics*

In line with the trend seen in recent years, a significant compression of prime yields has been seen, and is expected to continue in 2016. No significant changes have been administered regarding rental fees, which remain at relatively low levels across Europe, continuing to lure investment. The low cost of capital is expected to stay unchanged and, together with the promised quantitative easing activity, will most probably lead to an inflation of asset prices. The future of the real estate investment market is affected greatly by the current high level of uncertainty reflected by increased levels of volatility. Diversification will presumably gain further momentum, illustrated by greater activity in the markets of Scandinavia, Southern and Central-Eastern Europe. Nevertheless, core markets shall continue to attract the highest interest.

Managing impaired loans

Financing in the real estate sector is prone to being impacted by economic cycles; hence, the global economic crisis has had a detrimental effect on banks' lending activity. The extent of its impact varied across Europe. Countries in other economies saw the proportion of impaired real estate loans increase the most, partly because significant part of loans were denominated in foreign currency. While banks have various options when dealing with impaired loans, such as restructuring, foreclosing or selling these non-performing loan (NPL) portfolios, due to improving market conditions, the gap between the price offered by investors for NPL portfolios and banks' expectations has narrowed, which has led to more transactions. However, NPL portfolio transactions are more common in Western European countries, so banks in the less established markets are still facing difficulties caused by the sizeable proportion of non-performing loans in their loan portfolios.

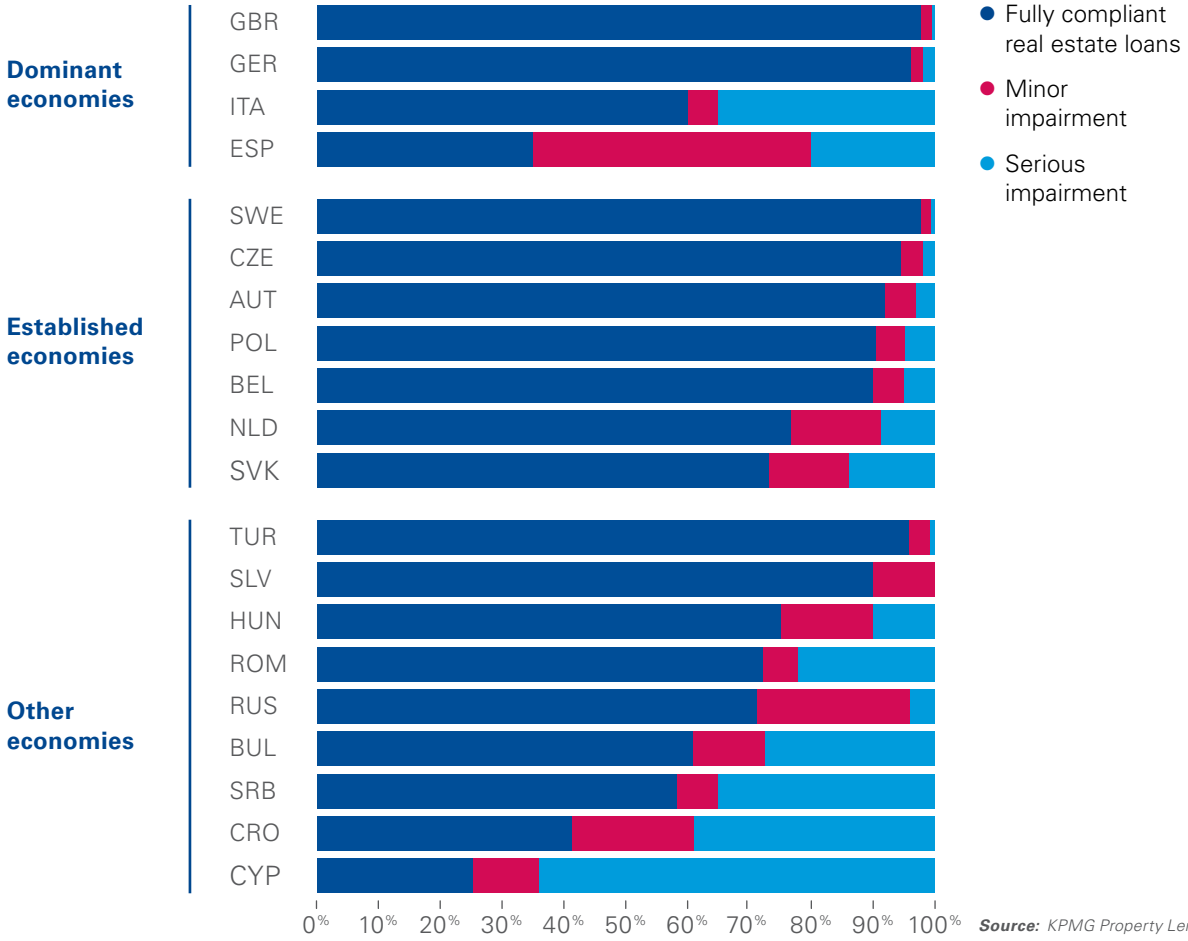
In this part of the survey we focus on banks' options to manage real estate loans where there is a technical breach of contract, or where debtors cannot pay their capital and/or interest on time.

Current state of and future expectations for impaired loans

Fully compliant loans are, in general, more common in dominant and established economies, than in other economies. The proportion of fully compliant loans was in the range of 73-98% in these countries, with the exception of Italy (60%) and Spain (35%), where the financial sectors are still suffering from or have only recently managed to get through the impact of the global financial crisis. Due to structural reforms and increased activity in the real estate sector, the ratio of non-performing loans by banks in Spain is expected to decrease. Among established economies, the highest ratio of fully compliant loans is in Sweden at 98%, the Czech Republic (95%) and Austria (92%).

Responses from other economies vary greatly, in a range between 25% and 96%. Cyprus is at the bottom of the list, with 64% of real estate loans reported to be seriously impaired, and an additional 11% having minor impairment. Banks in Croatia and Serbia also reported a high proportion of impaired

Proportion of impaired real estate loans per country



Source: *KPMG Property Lending Barometer 2016*

loans: 59% and 42% respectively. However, banks in Turkey and Slovenia have fully compliant real estate loans in over 90% of their portfolios. According to our survey of participating banks, in the case of Italy, the proportion of real estate loans with serious impairments increased significantly in 2016 compared to last year.

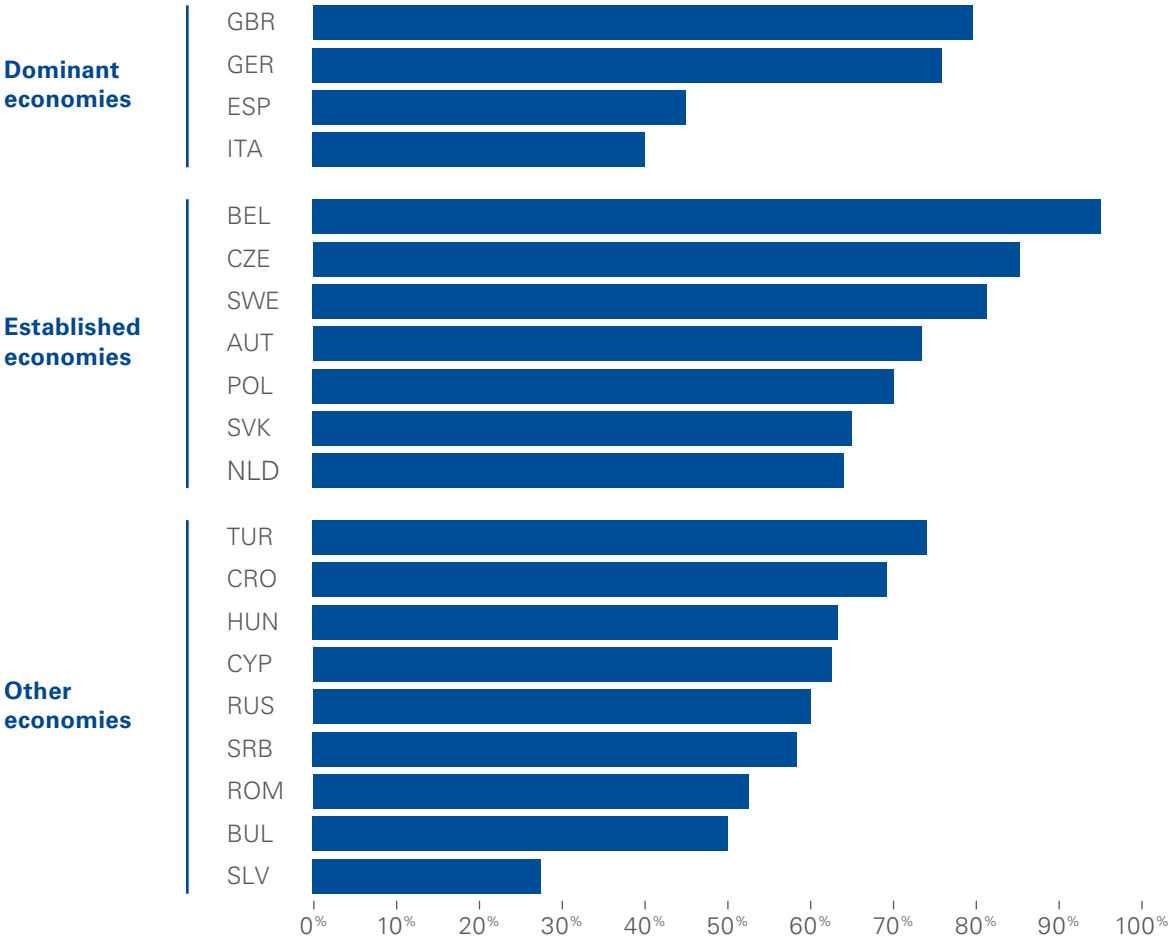
Restructuring as an opportunity to manage impaired loans

The responses of bank representatives queried in our survey confirmed that over two-thirds of their impaired real estate loan portfolios can be successfully managed through restructuring. This sentiment confirms that the rescheduling or restructuring of loans is still a preferred approach by banks for managing problematic loans.

The highest average ratio of impaired loans that may be managed through restructuring was reported by financial institutions in Belgium (95%), the Czech Republic (85%) and Sweden (81%). Meanwhile, banks in Slovenia (28%), Italy (40%) and Spain (45%) indicated significantly smaller proportions, which suggests that banks in these countries do not think that restructuring can resolve the most problematic loans.

When banks do not consider the rescheduling or restructuring of their impaired loans a manageable solution, and they do not seek foreclosure, they may opt for selling their non-performing loan portfolios to specialized investors. Such investors aim to achieve higher recovery from these problematic loans compared to banks, as it is their core competence to manage distressed portfolios.

Proportion of impaired real estate loans that may be managed successfully through restructuring



Source: *KPMG Property Lending Barometer 2016*

Prospects for real estate loan portfolios

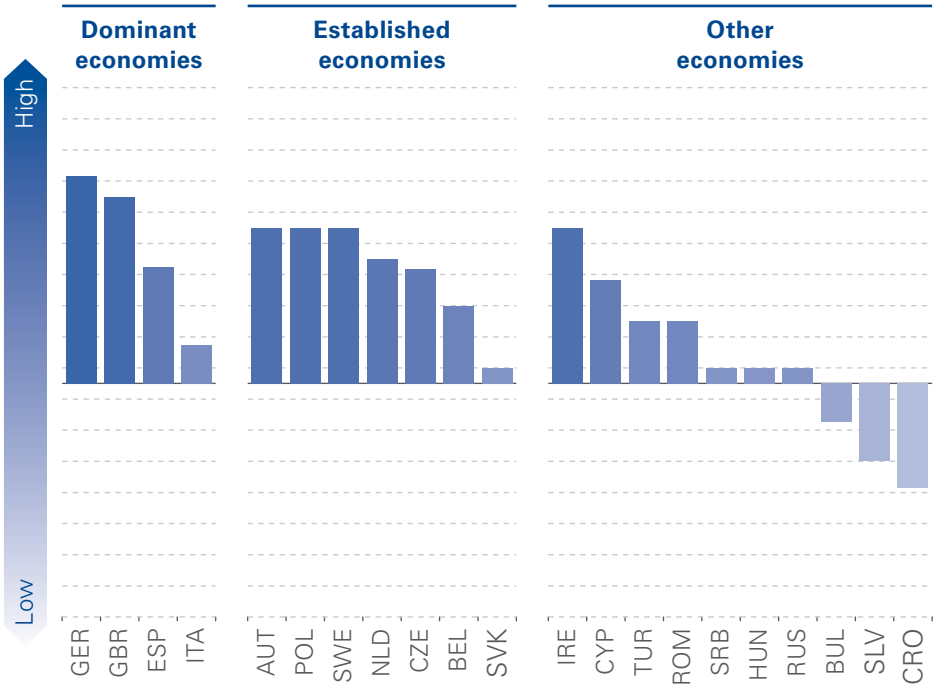
In this section, banks' expectations for the future of their real estate loan portfolios are assessed in light of recent developments and their strategic approach to real estate financing.

Strategic importance of real estate financing
Overall, real estate financing is strategically more important for banks operating in dominant and established economies. Among the other economies, answers vary greatly, with Ireland and Cyprus indicating a relatively high strategic importance for real estate financing compared to their peers.

Among the dominant and established economies, banks in Germany and the UK assigned the highest importance to real estate financing, while Slovakian and Belgian banks ranked it at a lower level of importance. Regarding banks operating in other economies, bank representatives from Croatia, Slovenia and Bulgaria indicated that real estate financing is not considered strategically important for banks.

We note that these findings do not fully reflect the underlying macroeconomic conditions of the surveyed countries and might not prove to be enduring.

Strategic importance of real estate financing for banks



Source: *KPMG Property Lending Barometer 2016*

Change in focus on real estate financing within the banks' lending activities

Banks were also asked how their focus has changed towards real estate financing as part of their lending activity compared to one year earlier.

Only a minority (27%) of the respondents from the dominant economies indicated some extent of increase since last year, whereas in the case of the established markets, 29% of the banks held this opinion. Forty-eight per cent of bank representatives in the dominant countries indicated that their lending activity maintained its focus on real estate financing, compared with 61% of responses from banks operating in established economies.

In the other economies the proportion of respondents stating that there was an increase in their bank's focus on real estate financing was 28%. Similarly to answers from dominant and established markets, 54% of respondents from banks operating in less established markets indicated that their focus on real estate financing was maintained compared to the previous year.

Most important factors affecting real estate loan portfolios

Banks were also asked to identify the key drivers affecting their real estate portfolios.

Overall, the most significant factor for banks in Europe was the macroeconomic conditions in the local market. The responses show that 2016 brought more uncertainties to local economies that may significantly affect banks' lending activities.

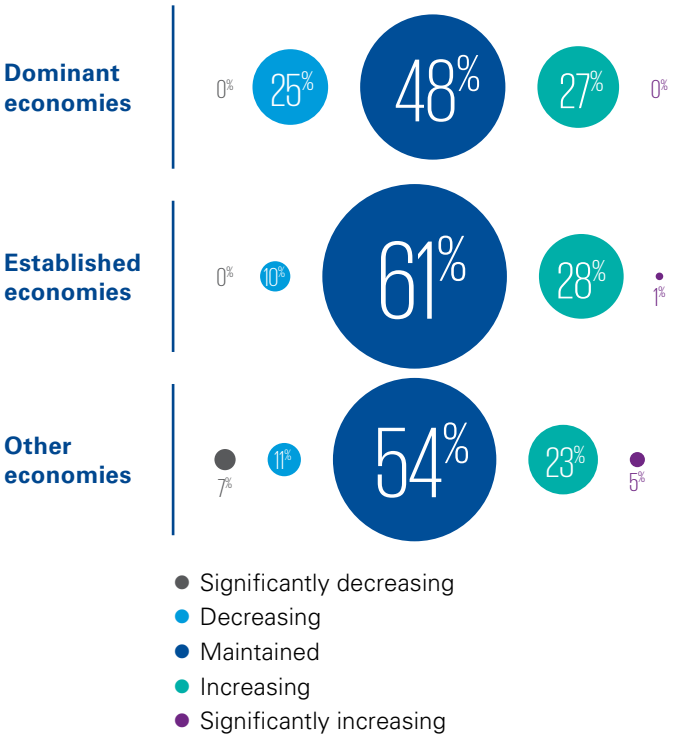
In dominant economies, the second most important factor was the lack of prime properties, which highlights in these more mature markets that the increased investment activity is expected to result in a lack of quality properties which could negatively impact loan portfolio prospects. It remains an open question whether investors and banks are willing to take significantly higher risks in order to expand their portfolios by investing in or financing more risky assets.

In established economies, the activities of the European Central Bank and/or National Banks were indicated to be the most important factor, presumably because they are the primary beneficiaries of the ECB's current programs. Local and European macroeconomic conditions, as well as the lack of prime properties, also received relatively high scores.

In the other economies, similar to last year, the local macroeconomic environment was identified as the most significant factor, followed by the lack of active investors. The lack of prime properties is not considered to affect the loan portfolios of banks operating in these markets as significantly compared to banks in dominant and established economies.

Overall, on average, fear of a potential setback regarding macroeconomic conditions in local markets has gained importance since last year among the survey respondents. This has become a key risk consideration, not only for banks in other economies, but also for banks operating in dominant and established markets.

Focus on real estate financing within the bank's lending acitvity compared to one year ago



Source: *KPMG Property Lending Barometer 2016*

Most important factors affecting real estate loan portfolios

	Dominant economies	Established economies	Other economies
Macroeconomic conditions in the local market	•••••	•••••	•••••
Lack of prime properties	••••	••••	••
Macroeconomic conditions in Europe	•••	••••	•••
Lack of active investors	•••	•	••••
Decreasing/negative interest rates	••	•••	••
Lack of equity	••	•	•••
Activities of European Central Bank/National Banks	•	•••••	•
New strategy	•	•	••

Source: *KPMG Property Lending Barometer 2016*

When bank representatives were asked from which sources they expected additional funds to come from if the overall size of their share in financing decreases, the majority of respondents stated that additional funds may come from private equity, followed by insurers/pension funds. Extra equity from the developer/investor was also indicated as a source of potential additional funds in Germany, Spain and Russia. Bonds were also mentioned as potentially significant sources by Swedish, Austrian and Polish banks.

Disposing of loan portfolios

The general tendency that banks in other economies are more inclined to dispose of part of their loan portfolios was confirmed this year. On average, 40% of the banks in these markets indicated their willingness to dispose of part of their loan portfolios. Among banks in dominant and established economies, the proportion of banks considering a disposal is significantly lower at only 30% and 20% respectively. According to market research data, even though banks in other economies are more willing to dispose of part of their loan portfolios, there are more transactions closed in the dominant and established economies.

Over two-thirds of those surveyed in Russia, Cyprus and Croatia stated that they are considering selling part of their commercial loan portfolios in the next 12-18 months. Furthermore, in Spain, Italy and Bulgaria, half of the participants also responded affirmatively. Whereas in Germany, Belgium, Austria, as well as in Ireland, Turkey, and Slovenia, none of the banks are considering disposing of their loan portfolios.

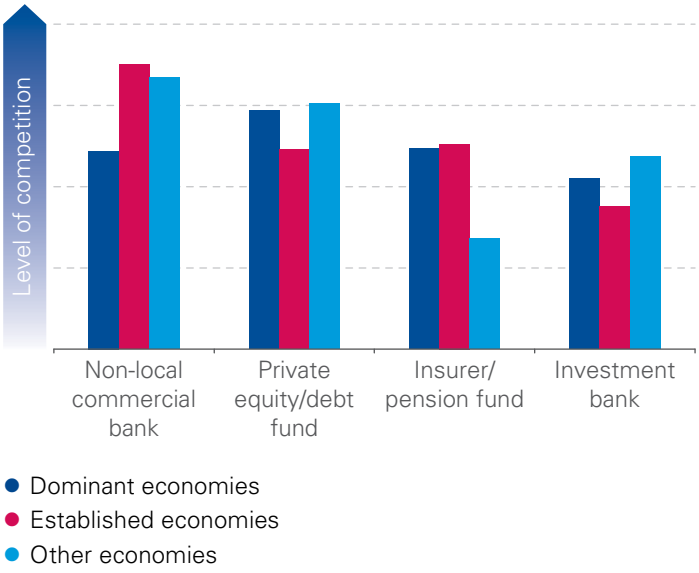
The answers show that, in general, banks in those countries which have a larger proportion of impaired loans are more inclined to dispose of their loan portfolios. Among those banks that are considering disposing of part of their loan portfolio, 50% have indicated a strategic exit as the main reason behind their decision. Other factors such as capital adequacy were also mentioned by banks.

Regardless of banks' potential willingness to dispose of part of their loan portfolios, the complexity of such transactions reduces the demand for these investment opportunities. For investors, it is complicated to manage loan portfolios due to often complex regulatory and tax structures.

Alternative lenders

Bank representatives were asked which alternative lender they considered to be their biggest competitor in terms of banks' traditional real estate lending. Their responses show that banks in established and other economies consider non-local commercial banks as their key competitor, while in dominant economies private equity/debt funds are considered to be banks' main competitors.

Competition with alternative lenders



Source: *KPMG Property Lending Barometer 2016*

When queried as to how they expect the activities of alternative lenders to change in 2016 compared to 2015, in terms of real estate lending, respondents expected all alternative lenders to become more active than before. The consensus among banks operating in established economies reflected a higher level of expected activity for alternative lenders, but there is no significant difference between the responses in all country groups.

Regarding which alternative lenders have more positive growth prospects in terms of their lending activity, responses varied widely based on the maturity of the markets respondent banks are operating in. In dominant economies, private equity/debt funds are expected to expand their lending activity the most, followed by non-local commercial banks. In established markets, insurers/pension funds are deemed to have stronger prospects in that respect, relatively in line with non-local commercial banks and private equity/debt funds. In other economies, private equity/debt funds are expected to increase their lending activity the most by far in 2016.

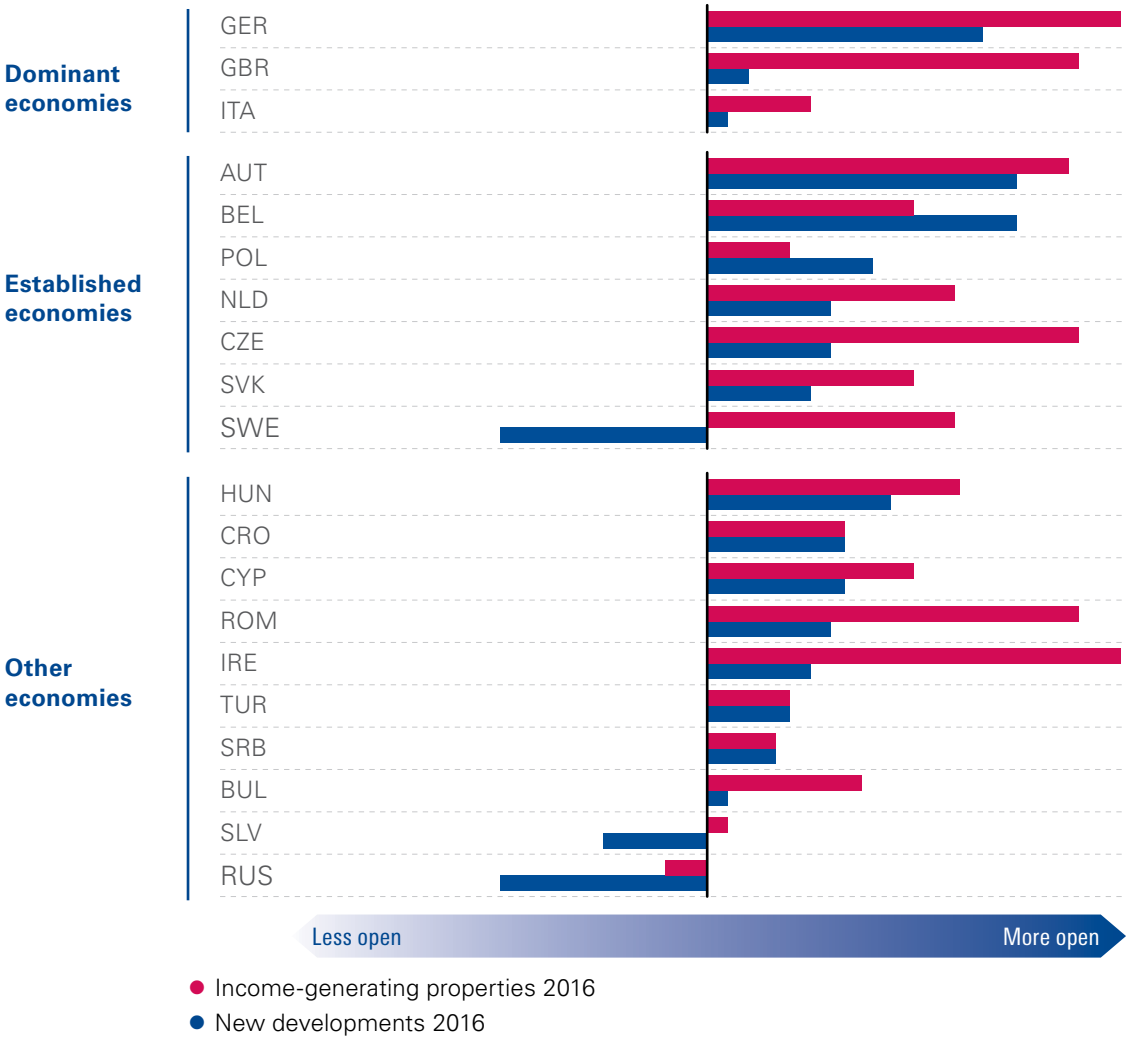
Opportunities for financing new real estate projects

This section assesses the opportunities for developers in obtaining bank financing for real estate projects.

New financing
With a couple of exceptions, banks in most of the markets appear to be showing at least some extent of openness for financing income-generating projects. On average, banks in dominant and established economies are somewhat more open to financing real estate projects, especially income-generating projects.

Banks in Germany, the UK, Ireland, Romania, Austria and the Czech Republic are the most open to financing income-generating projects. Respondents from Spain and Russia indicated that their banks are least open to finance income-generating properties.

Openness of banks to finance development/income-generating projects



Source: *KPMG European Property Lending Barometer 2016*

However, when it comes to new developments, banks in general are still more risk averse and less willing to finance such projects, even in more mature markets.

In the dominant economies surveyed, banks in general did not show a great degree of openness towards financing new developments, with the exception of Germany, where respondents indicated moderate openness. Among the established markets, Austrian and Belgian banks are quite open to financing such projects.

Among the other economies, banks in Hungary exhibited the greatest openness towards financing new development projects. Respondents from Russia and Slovenia indicated that their banks are less open to financing such projects.

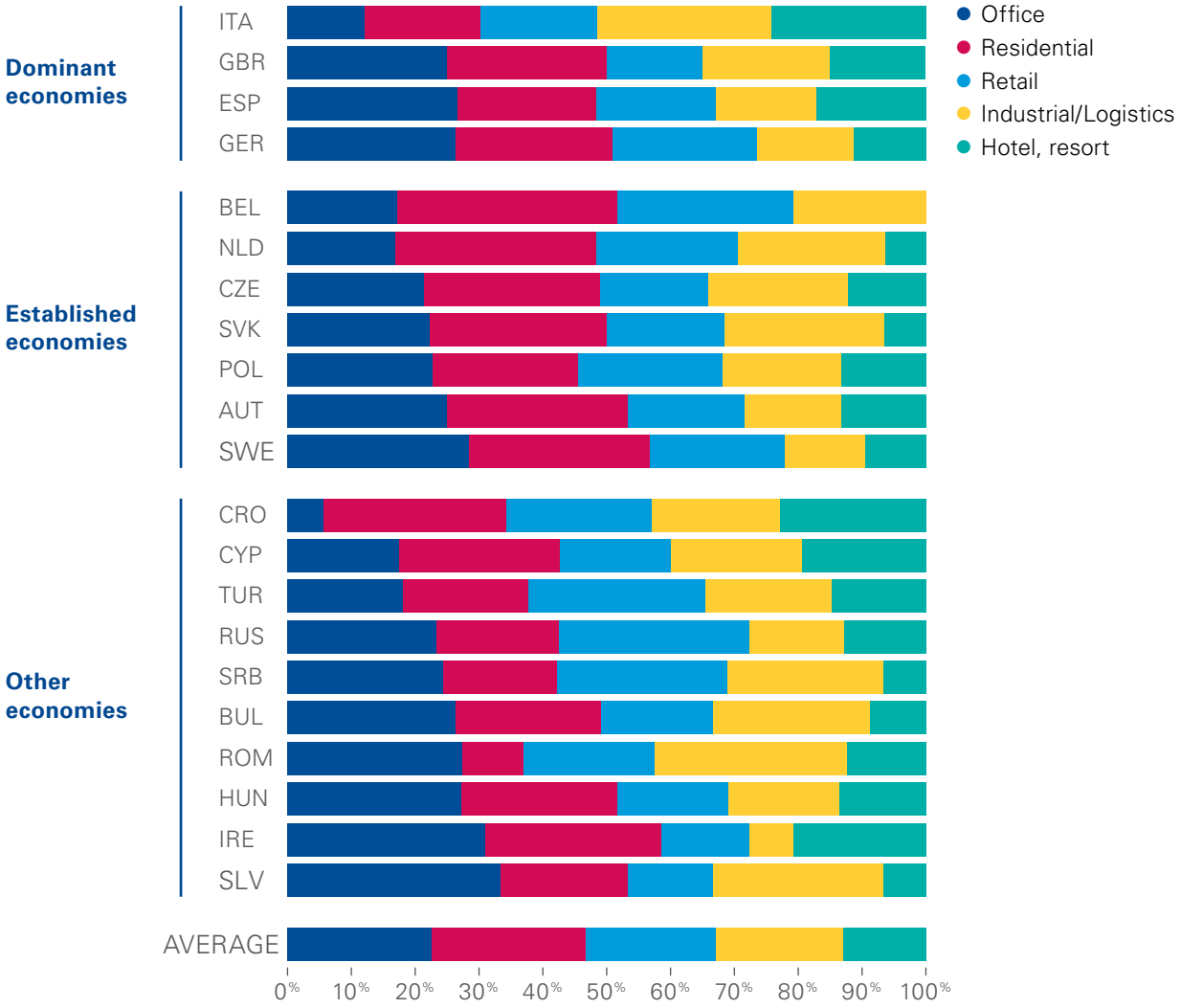
Asset Class Preferences

Banks were also queried as to their preferred asset class for development financing in each country.

Office and residential are the most preferred asset classes among the surveyed banks in the dominant economies. In established economies, residential is clearly the most preferred asset class. The second most preferred asset class is office, closely followed by retail and industrial. The most favored asset class among banks operating in other economies is office space, followed by the retail, residential and industrial sectors. The popularity of the residential sector decreased in certain countries such as Romania, Bulgaria or Serbia among banks operating in other economies compared to the last year. However in Hungary or Cyprus banks prefer residential projects more than last year. In the established economies, the office sector gained in preference compared to 2015. Among the dominant countries in terms of preference of financing industrial properties, the most significant increase was observed in Italy.

Similarly to previous years, the least preferred asset class on average in all three market groups was the hotel sector. Relatively higher preference for the hotel sector was indicated by Croatian, Cypriot, Italian and Irish banks.

Banks' sector preferences in providing development financing by asset class



Note: *The longer the colored bar, the more preferred the asset class is for the banks.*
Source: *KPMG Property Lending Barometer 2016*

Criteria for financing

Having seen how open banks are to financing properties, and having considered their asset class preferences, the following section analyses the criteria in question when selecting projects to finance.

Like last year, there is a consensus among the surveyed banks, regardless of the size and the risk profile of their markets, that the most important criterion for obtaining financing for a project is a strong business model and the quality of the asset.

The reputation and references of the developer/operator is also ranked very high, especially in dominant and other economies. Other important criteria in all market groups were the financial background of the developer/investor and the level of owner's equity. In other economies, the pre-letting/pre-sale level of the project was also indicated as one of the most important criteria when considering real estate financing.

The lowest ranked criteria by all the market groups were the existence of an independent feasibility study/valuation and the size of the requested loan.

Banks' most important criteria when considering real estate financing

	Dominant economies	Established economies	Other economies
Strong business model/quality of the asset	•••••	•••••	•••••
Reputation and references of the developer/operator	•••••	••••	•••••
Financial background of the developer/ investor	••••	•••	••••
Level of owner's equity	•••	••••	••••
How well the project is planned, status of permitting process	•••	•••	•••
Pre-letting/pre-sale level	••	•••	••••
Existence of an independent feasibility study/ valuation	•	•	••
Size of the requested loan	••	•	•

Source: *KPMG Property Lending Barometer 2016*

Loan-to-cost ratios (LTC)

Banks were asked to report on their technical criteria for financing. When questioned about loan-to-cost ratios, responses varied by country and asset type.

When comparing the results of the market groups we can observe that, on average, banks in more established countries require less equity from developers. Similar to last year, surveyed banks from the dominant markets were more conservative in this regard compared to banks in established economies. In general, they require more equity when financing a development project.

The loan-to-cost ratios in the dominant economies for the office, residential, retail, industrial/logistics and hotel sectors are in the range of 0.51 and 0.75 (i.e. reflecting a capital structure of 51-75% debt and 49-25% equity). On average, the residential sector has the highest LTC ratio at 71%, followed by office and retail at 63% and 62% respectively.

In the case of the established economies, the loan-to-cost ratios are between 0.48 and 0.80 (i.e. reflecting a capital structure of 48-80% debt and 52-20% equity). In these markets the residential sector also has the highest LTC ratio on average at 70%, followed by office and retail equally at 68%.

In general, banks in "other" economies require more equity from developers, mainly due to the more risky nature of these markets, which has resulted in more conservative lending policies followed by the respective banks. The loan-to-cost ratios are in a range of 0.48 and 0.75 (i.e. reflecting a capital structure of 48-75% debt and 52-25% equity). In these markets the LTC ratios are the highest on average for the office and retail sectors at 63%, followed by residential and industrial at 62%.

As in previous years, the hotel sector requires the highest equity ratio in most of the countries in the range of 35-50%.

Loan-to-value ratios (LTV)

The ranking is similar among the country groups when taking the average LTV ratio of the asset classes per country group. In general, banks in other economies are being more risk averse and require a higher proportion of equity when financing an income-generating project, while banks in more established economies are willing to provide more credit in proportion to the total appraised real estate value.

In the case of the dominant economies, the loan-to-value ratios for the office, residential, retail and industrial/logistics sectors range from 0.53 to 0.72 (i.e. reflecting a capital structure of 53-72% debt and 47-28% equity). The office and retail sectors, on average, have the highest LTV ratios, both 64%, followed by industrial and hotel equally at 61%.

The range is slightly broader in the case of the established economies, at a ratio of between 0.55 and 0.75 (reflecting a capital structure of 55-75% debt and 45-25% equity). The lowest average proportions of equity are required for the office and retail sectors (32%), while the most equity is needed for hotel and resort projects (39%).

The loan-to-value ratios by banks in other economies range from 0.28 to 0.75 (reflecting a capital structure of 28-75% debt and 72-25% equity). The least equity is required for office and retail (38%) projects, on average, while the most equity is required for hotel and resort projects (43%).

The hotel sector's loan-to-value ratio is still the lowest among all the asset classes in all market groups, with an average of 59%. On average, the highest LTV ratio is provided to retail and office projects in each market group.

Pre-let ratios

The pre-let expectations of banks also vary greatly across countries and sectors. On average, pre-let ratios for the office sector are lower in most of the markets compared to retail, and even more so compared to the industrial sector.

In line with last year's survey results, answers from respondents confirmed that banks in more established economies tolerate less risk in relation to the speculative nature of real estate projects and require developers to achieve a higher pre-let ratio when financing a project.

Pre-let ratios for office and retail projects in the dominant economies are on average 56% and 59% respectively, while for industrial it is 66%.

In established markets, banks' average pre-let requirement for office developments is 59%, 65% for retail developments and 78% for industrial developments.

In regard to banks operating in other economies, the pre-lease requirements of banks for office developments on average is 49%, 53% for retail and 58% for industrial.

Based on the answers from respondents involved in our survey, banks are less open to speculative developments of industrial properties. Reflecting the fact that, it is more common in the industrial segment to develop properties according to a "build to suit" concept, which means that the property is developed based on the (dominant) tenant's specific needs and requirements.

Debt service coverage ratios

The debt service coverage ratios (DSCR) expected for income-generating projects initiated by investors with excellent reputations and sound business plans were also examined.

Particularly in dominant and established economies, banks indicated a wide range of DSCR expectations even within the country groups. German and Swedish banks require significantly higher DSCR ratios compared to their peers, presumably because in many other aspects they are ready to offer very favorable terms for clients, hence their expectation for cash flows to cover close to or over 200% of the relatively lower debt service.

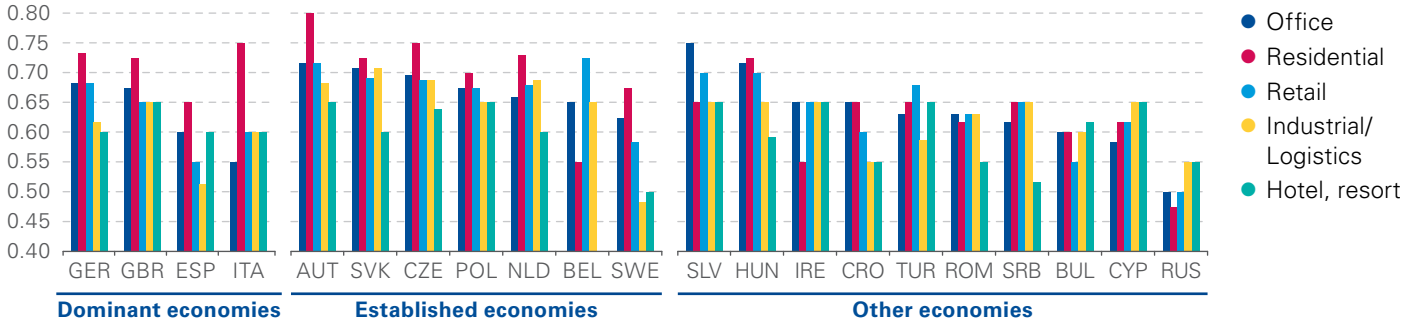
Considering all responses, on average, the required DSCR ratios were the lowest in the office and retail sectors, followed by industrial and hotel.

The dominant economies' banks require the lowest DSCR ratio for the industrial asset class at an average of 1.44. This is followed by hotel, office and retail; however, the difference between the DSCR ratios in various asset classes is relatively insignificant.

Banks operating in the established economies expect the lowest average ratio for offices (1.33) followed by retail (1.35), industrial (1.43) and hotel/resorts (1.51).

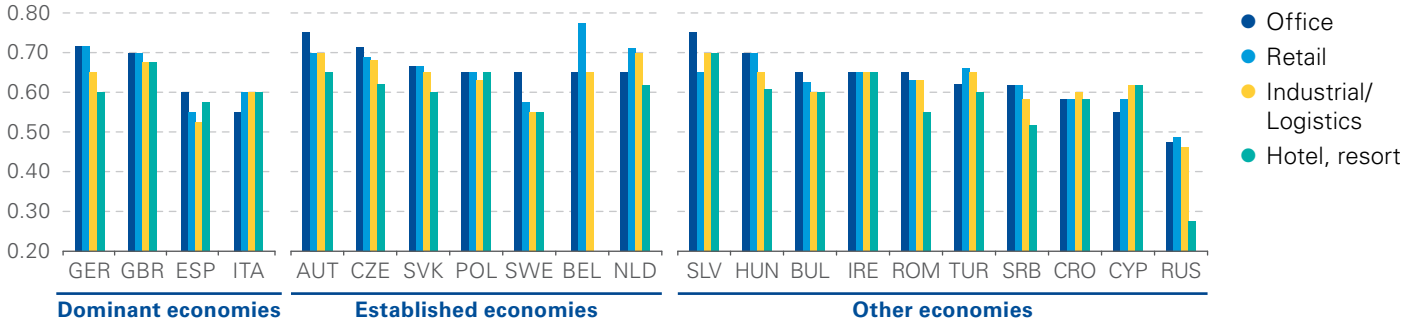
The lowest DSCR requirements of banks operating in other economies are for retail and office with an average of 1.33. The required average for the industrial asset class is 1.35 and 1.37 for hotel/resort assets.

Loan-to-cost (LTC) ratio expectations for financing highly rated real estate development projects in the next 12-18 months



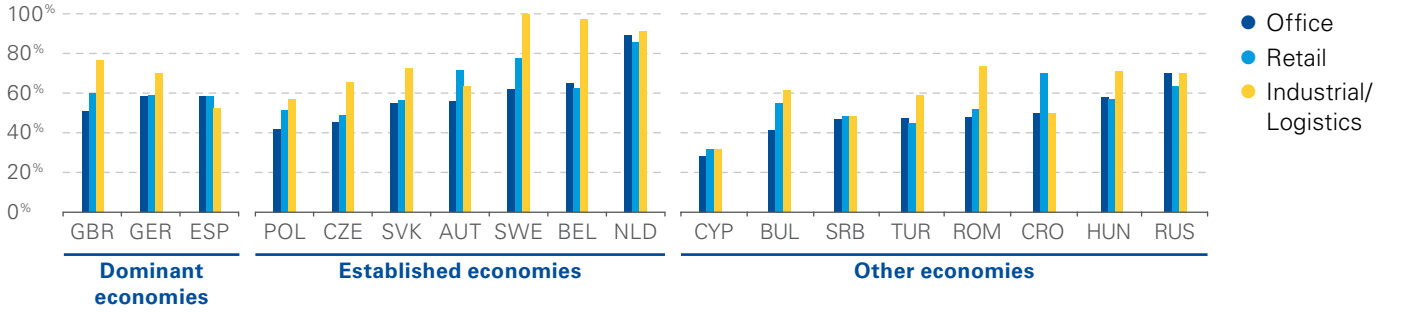
Source: *KPMG Property Lending Barometer 2016*

Loan-to-value (LTV) ratio expectations for financing highly rated income-generating real estate projects in the next 12-18 months



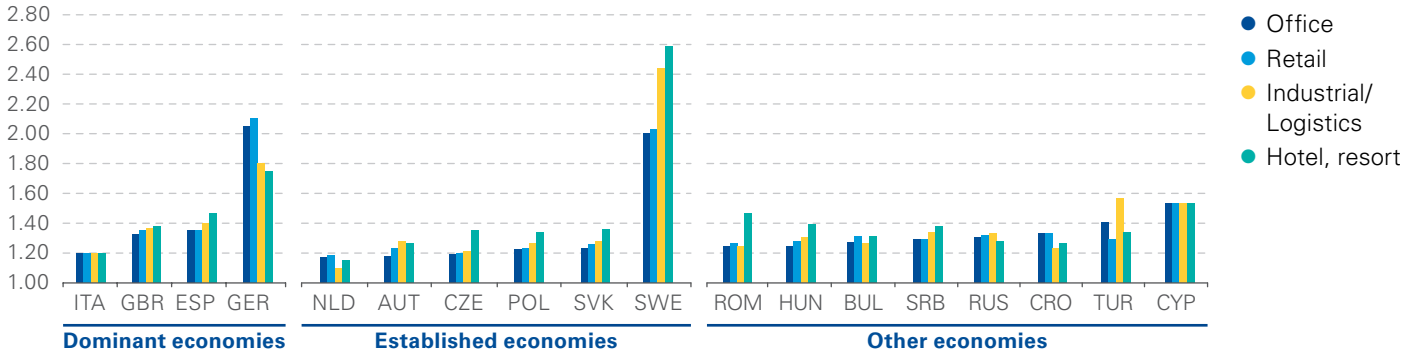
Source: *KPMG Property Lending Barometer 2016*

Pre-let ratio expectations for financing highly rated office, retail and logistics real estate development projects in the next 12-18 months



Source: *KPMG Property Lending Barometer 2016*

Debt service coverage ratio expectations for financing highly rated income-generating real estate projects for selected countries in the region



Source: *KPMG Property Lending Barometer 2016*

Interest premiums

In addition, banks included in our survey were asked to state a range for the interest premium they would apply on a 3-month Euribor basis, if a developer or investor of outstanding reputation with a solid business plan approached them.

Here we only present two asset classes, office and retail, i.e. those which were typically key focus sectors from a real estate investment perspective in Europe in 2016. Premiums for all the asset classes in each country are presented in the country profile section of this report.

The lowest loan interest premiums are available in economies with low risk profiles and well established real estate markets. Recent increased competition among financing institutions in these economies has also contributed to the more favorable conditions available to borrowers.

Last year, the improved economic environment across Europe resulted in the easing of financing conditions among banks, hence they required relatively low interest premiums in most markets. Taking the average of responses, the required interest premiums indicated by representatives of the banks included in our survey do not show any significant change compared to last year.

According to them, the premium applied on new office and retail developments in the dominant economies currently ranges from 1.6-3.0%. On average, German banks require the lowest premiums.

For the established economies, the applied premium by banks for office and retail developments is in a range of 1.3-4.3%. Banks in Belgium require the lowest premiums, while the highest are required in the Netherlands.

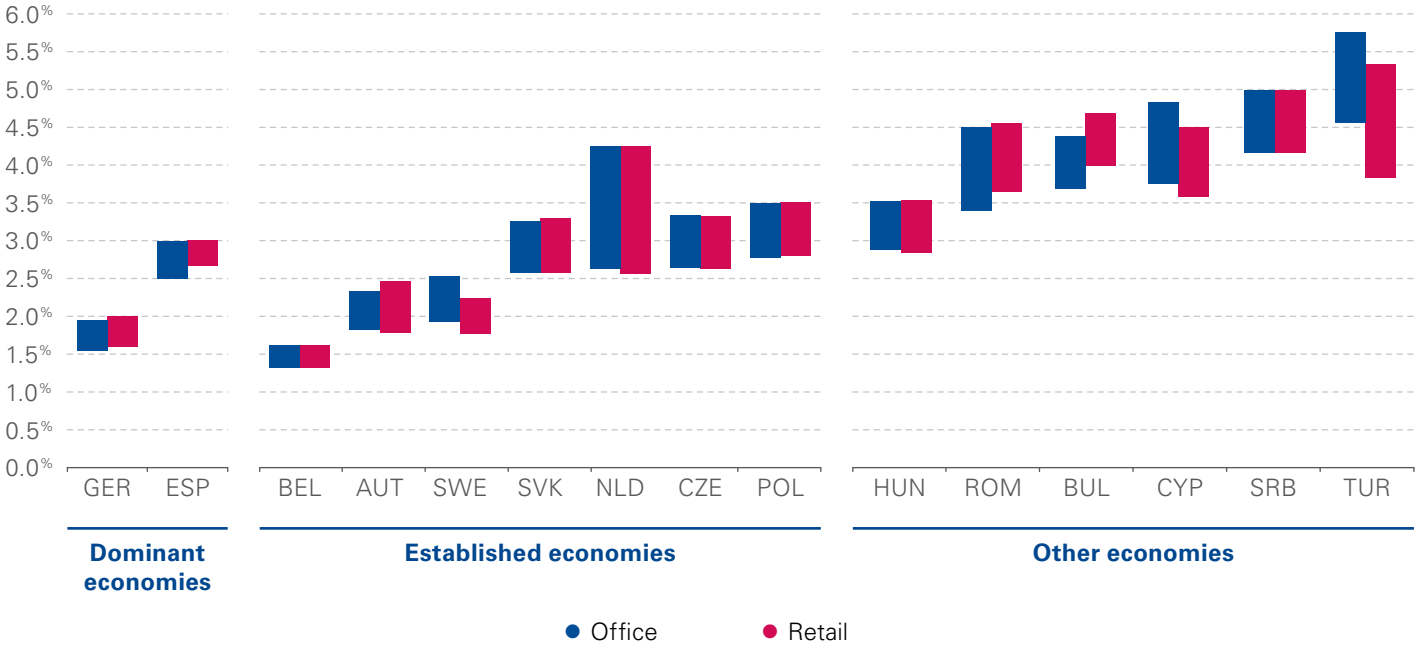
Among the other economies, the premiums required by banks for office developments are in a range of 2.9-5.8%, while the premium range is 2.8-5.5% for retail. Hungarian banks require the lowest premiums, while banks in Serbia and Turkey set the highest premium levels.

Banks were also asked about the interest premium that they would apply on a 3-month Euribor basis on loans for high quality income-generating property projects.

The ranking of the countries in the case of income-generating projects is similar to that for new development projects. A lower premium is applied by most of the banks for income-generating projects, as there is less risk associated with such projects (i.e. a lack of development and leasing risk). The required risk premiums, because of these risks, vary across the countries. For example, German banks require premiums that are lower by 30-35 basis points for income-generating office and retail asset classes compared to that for new developments. Banks in the Netherlands mandate lower premiums (by 63-92 basis points) for office and retail income-generating projects than for new developments.

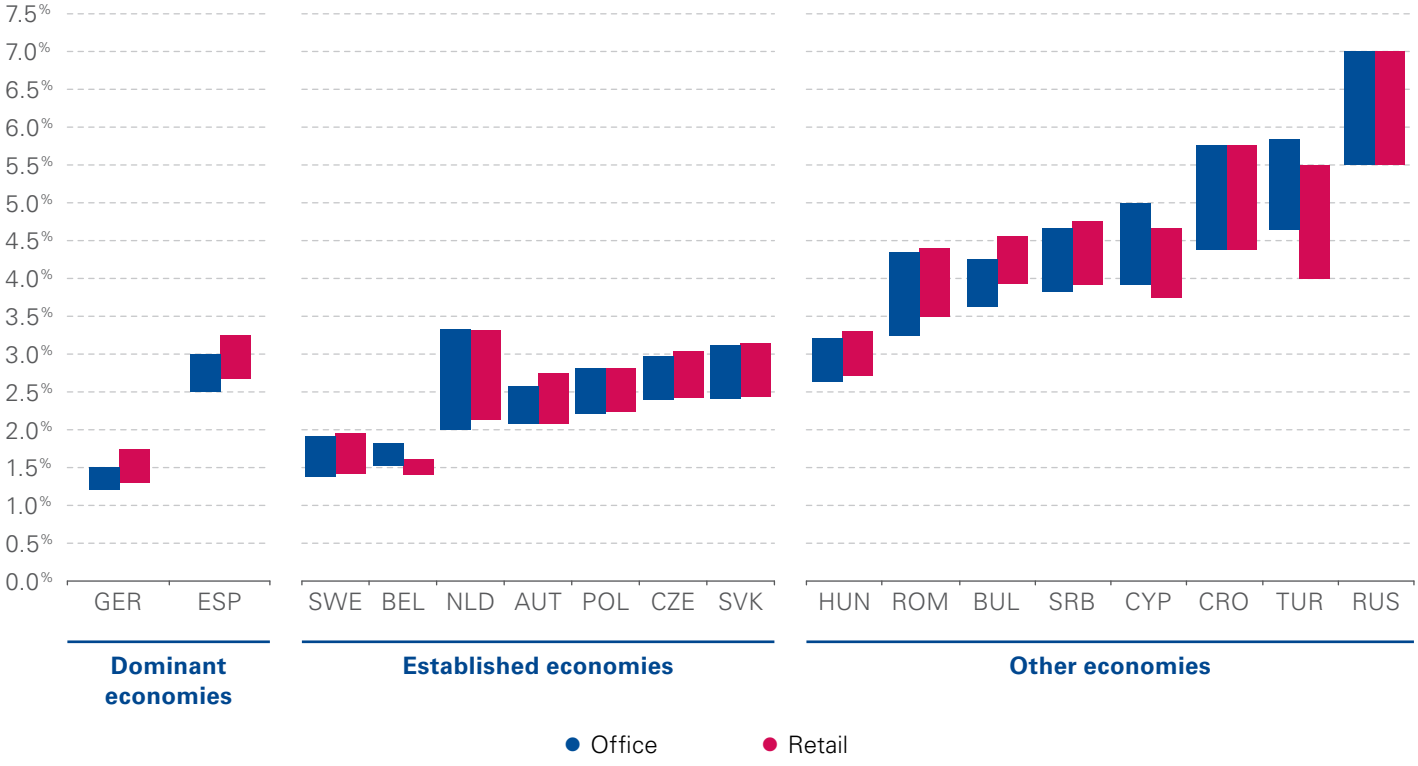
Among the dominant and the established economies, German, Swedish and Belgian banks apply the lowest premiums, while the highest are applied by Slovakian and Czech banks. In the case of the other economies, banks in Hungary require the lowest, while Russian banks require the highest premiums for income-generating projects.

Loan interest premium applied by banks for highly rated real estate development projects in selected countries



Source: *KPMG Property Lending Barometer 2016*

Loan interest premium applied by banks for highly rated income-generating real estate projects in selected countries



Source: *KPMG Property Lending Barometer 2016*

Length of loan

Banks were also asked what the minimum required average annual loan amortization rate would be at the LTV level applied for highly rated real estate projects, as well as what the longest contracted term of the loan would be for financing a prime investment/income generating property.

Calculating the implied maximum amortization period from the minimum amortization rate, and cross-checking that with the longest indicated contracted term banks apply, the difference reveals insights into the market conditions banks in various economies operate in.

Overall, banks in more mature markets operate in competitive environments which drive them to apply low amortization rates; however, their internal policies limit the longest term of the loan they contract for. Consequently, the difference between the implied maximum amortization period and the available maximum contracted length of the loans is much greater in dominant (17 years) and established economies (16 years), than in other economies (4 years).

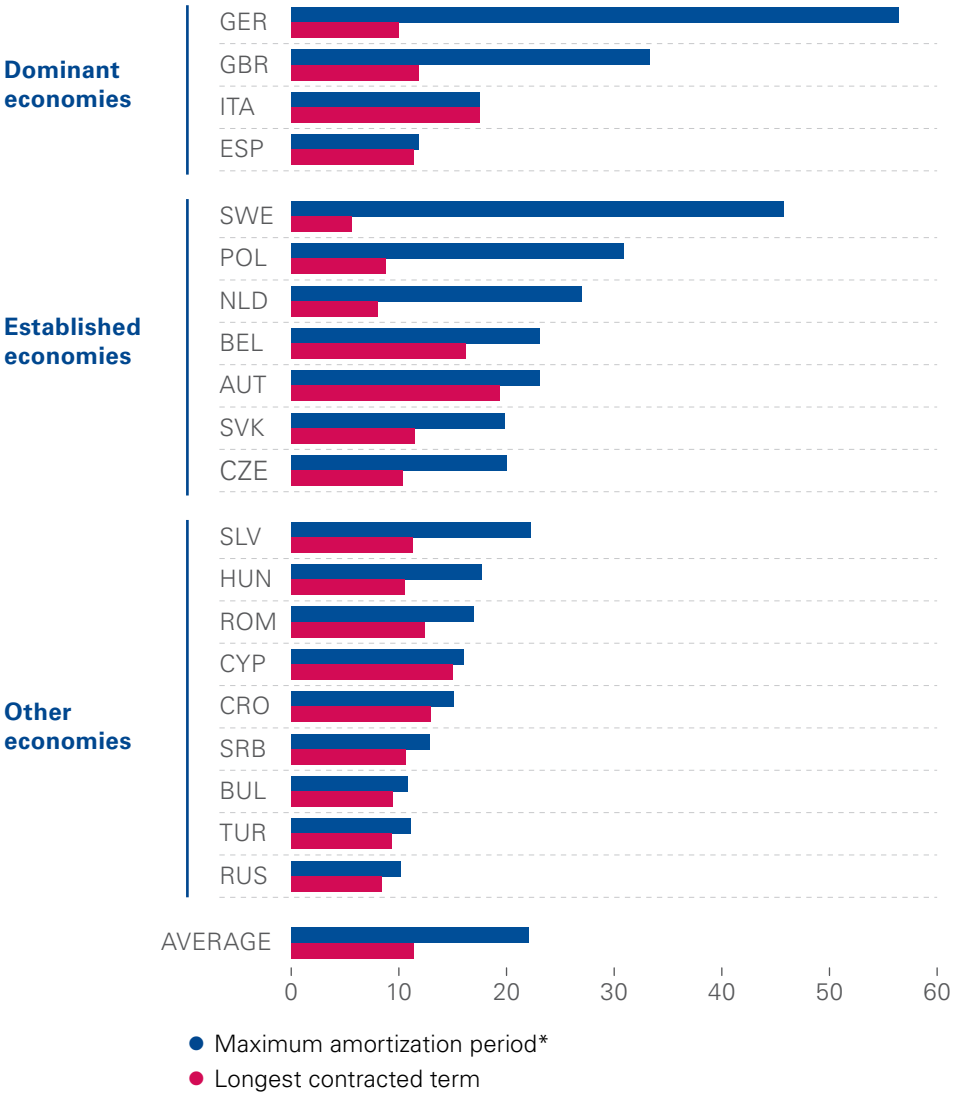
Taking the average of responses, banks operating in dominant and established markets require lower annual loan amortization rates and are ready to sign longer term contracts than banks in other economies. The implied maximum amortization period of the loan and the available maximum contracted length of the loan range between 12-56 years and 10-18 years respectively. German banks, when certain conditions are met, are ready to apply the lowest level of amortization rate (1.8%), and Spanish banks the highest (8.4%) within the dominant economies. Interestingly, the maximum contracted length of the loan is the lowest in Germany (10 years) and highest in Italy (18 years).

In established economies, the implied maximum amortization period of loans ranges from 20-46 years, while the available maximum length of the contracts is in a range of 6-19 years. Similar to Germany, when certain conditions are met, Swedish banks are ready to apply the lowest amortization rates (2.2%) and still their maximum length of contract is the lowest (6 years). The smallest difference between the implied maximum amortization period and the maximum contracted length of loans is in Austria, comparing the implied maximum amortization period (23 years) against the available maximum contracted length (19 years).

In other economies, the lowest amortization rates are applied in Slovenia (4.5%), and the highest in Russia (9.9%). The most restrictive practice is followed by banks in Russia, also in terms of available maximum contracted length of the loan (8 years), while banks in Cyprus are ready to sign loan contracts for 15 years, the longest duration among those in the market group.

In terms of asset classes, taking the average of all surveyed countries, there are no significant differences between the amortization rates applied for different asset classes. The rates range between 5.2-6.1%. Similarly, on average, the available maximum contract length applied by banks for different asset classes ranges from 11.2 to 11.7 years.

Maximum amortization period* and available longest contracted term (in years)



Note: **Implied maximum amortization period expressed in years which is calculated from the minimum annual amortization rates (expressed in percentage) provided by the surveyed banks.*

Source: *KPMG Property Lending Barometer 2016*