Property Lending Barometer 2023

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

It has been another tumultuous year since the last edition of the Property Lending Barometer—a period marked by economic stagnation, minimal growth, record inflation, and a significant upswing in interest costs, all contributing to an atmosphere of uncertainty and overall market pessimism.

These factors have had adverse effect on the real estate market and its financing. On the other hand, there are several positive trends, including a decline in inflation, and in some cases also in interest rates, some economic recovery, and a more positive outlook for the years to come. Even during the COVID period and the following turbulent years, banks financed commercial real estate and its development. Although a decline to pre-COVID levels of interest expense cannot be expected in the near future, it will certainly come close to a level which will facilitate a more significant recovery of the real estate market.

The objective of this report is to assess the prospects and sentiment for bank financing in the real estate sector in CEE, based on the answers of bank representatives from 10 countries. The 2023 Barometer includes input from 48 banks, collected primarily via online questionnaires and in-depth interviews. Representatives of leading financial institutions have provided their views on the key issues influencing property lending.

In the first section of the report, we provide an overview of the Central and Eastern European market as a whole, by focusing on key issues such as the strategic importance of real estate financing for banks. We also consider areas such as various banks' average contracted loan terms and their changes. Furthermore, the opportunity for new financing and banks' asset class preferences have also been considered.

We devote one section to the development of the share of problematic loans and a comparison between individual countries. As last year, the final section will deal with ESG and the impact on the bank financing of real estate.

Let me thank all of those who participated in this survey, as 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 financing. If you would like to receive any clarification or discuss this year's survey results, please feel free to contact us.

Pavel Kliment

Partner, Chief Operating Officer
Head of Real Estate Practice in Czech Republic

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Methodology

METHODOLOGY AND SAMPLE PROFILE

Our survey provides an analytical overview of banks' current approach to real estate financing in Central and Eastern Europe. The following countries are represented in the 2023 survey: Bulgaria, Croatia, Czech Republic, Hungary, North Macedonia, Poland, Romania, Serbia, Slovakia and Slovenia. Survey data was primarily collected via online questionnaires and through in-depth interviews with bank representatives. Depending on the organizational structure of survey participants, we interviewed heads of real estate, project financing or risk management departments. Selected banks represent leading financial institutions operating in each individual country. In total, 48 banks took part in the survey, with all of them active in the real estate market in Central and Eastern Europe over the last year.

Data collection for this survey took place in November 2023. In previous years, the collection of data was carried out in June to July.

The survey also uses information obtained from certain public sources that are deemed reliable by KPMG. This information includes market reports published in 2022 and 2023 by Colliers, Cushman & Wakefield, the Economist Intelligence Unit, EurActiv.cz, the European Central Bank, the International Monetary Fund, the central banks of individual countries, tradingeconomics.com, the OECD, The European Commission, Erste Group Research and Real Capital Analytics.

The following limitations should be considered:

- When the answers to specific questions were not sufficient to provide reliable information on a specific country, we have either indicated this in the text or the country was omitted from that part of the analysis.
- Survey findings may be considered indicative but not representative.
- Just like in the previous years, our assessment of the residential sector does not include residential projects with construction costs under 10 million euros.
- To ensure the comparability of information (interest margins and loan parameters, e.g. loan-to-value and loan-to-cost ratios) for the Czech Republic, in some answers, we only provide information given by the five largest banks operating in this country (CZE*).

GEOGRAPHIC ABBREVIATIONS:

ALB – Albania;

BUL – Bulgaria;

CEE – Central and Eastern Europe;

CRO – Croatia;

CZE – Czech Republic;

HUN – Hungary;

NM – North Macedonia;

POL – Poland;

ROM – Romania;

SLO – Slovenia;

SRB – Serbia;

SVK – Slovakia

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Real estate market overview

ECONOMIC OUTLOOK

The global and european economic landscape for 2023 has steadily continued the last years' effort to return to pre-pandemic levels. Although, being less turbulent than the last four years as far as major economic shocks are concerned, the recovery momentum has seen a significant slowdown or lost. The Autumn European Forecast projects GDP growth in 2023 at 0.6% in EU. Going forward, growth (1.3% in 2024 respectively 1.7% for 2025) is expected to rebound middly as consumption recovers with rising real wages, investment remains supportive and external demand picks up. The growth outlook continues to face challenges marked by energy prices, inflationary pressures, supply chain disruptions, topped with persistent budget deficits. The war in Ukraine continues for the second year, and a new conflict in the Middle East represent increased uncertainty to economic outlook.

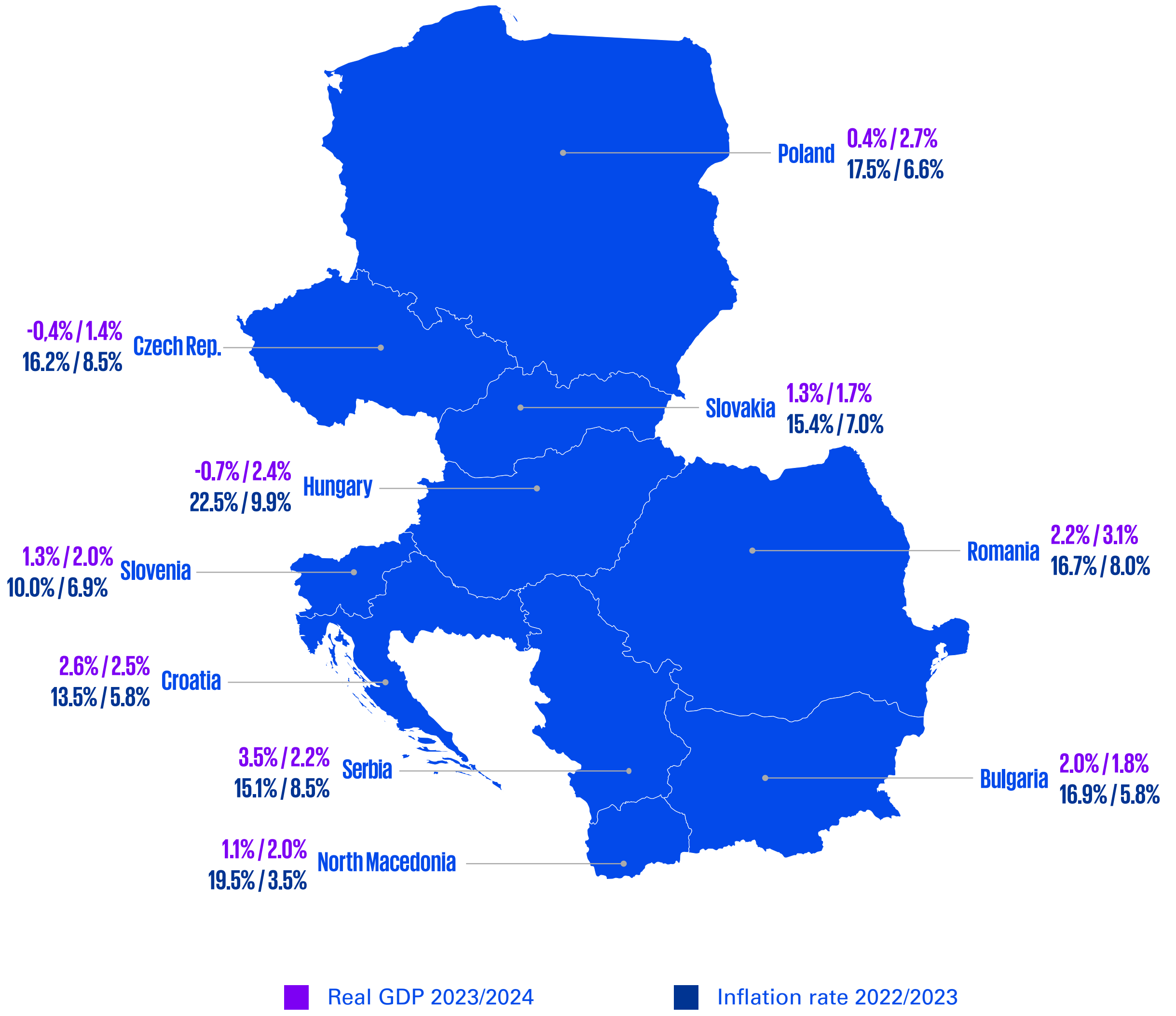
The expected real growth rate of the Central Eastern Europe is at 0.5% - a slight improvement from earlier projections in December 2022. Not only across Europe, but disparities are seen within the region as well. The combination of stringent monetary policies with tight credit conditions, and weaker external demand has generally tempered with the regional growth. The strength of regional currencies and commodity prices will be pivotal factors influencing economic dynamics in the coming months.

According to the European Commission, the EU labour market continued to perform strongly in the first half of 2023, despite the slowdown in economic growth. In the second quarter of this year, activity and employment rates reached their highest level on record, and in September the unemployment rate remained close to its record low. There is still sectoral or skills mismatches to the labour market with some sectors, mainly healthcare, construction, hospitality, and IT, experiencing major labour shortages. Going forward, the labour market is set to remain resilient, but there are signs of some cooling including slow pace of job creation in 2023.

The easing of energy prices has played a pivotal role in the gradual decline of increased headline inflation across Central and Eastern Europe. With the average of 13.9% in 2022 a notable decrease started mid-year and continues. Looking ahead to 2023, the forecasts are optimistic that most countries in the CEE will have single-digit headline inflation rates by the end of the year. However, the process of decline is slow. Even though the overall inflation is getting better, the core inflation, which excludes food and energy prices, is still high. This suggests that there are still some ongoing pressures on prices. Worth noting is also the growth of nominal wages, which could exert additional upside pressure on prices in the CEE region.

The fiscal sustainability remains a significant concern for the region, as governments grapple with the complexities of maintaining fiscal prudence amidst economic uncertainties. Striking a balance between supporting key sectors, addressing energy-related challenges, investing in infrastructure, and meeting defence needs presents an ongoing challenge. Reluctance to reduce energy and other subsidies has led to limited fiscal adjustments for the current year, as governments maintain their support for businesses and households despite declining inflation.

REAL GDP FORECAST 2023/2024 AND INFLATION 2022/2023



Source: Statistical offices (Annual inflation November 2022, October 2023), Real GDP (European Economic Forecast, Autum 2023, Serbia, North Macedinia – statistical offices Q2/2023, Tradingeconomics.com – forecast 2024)

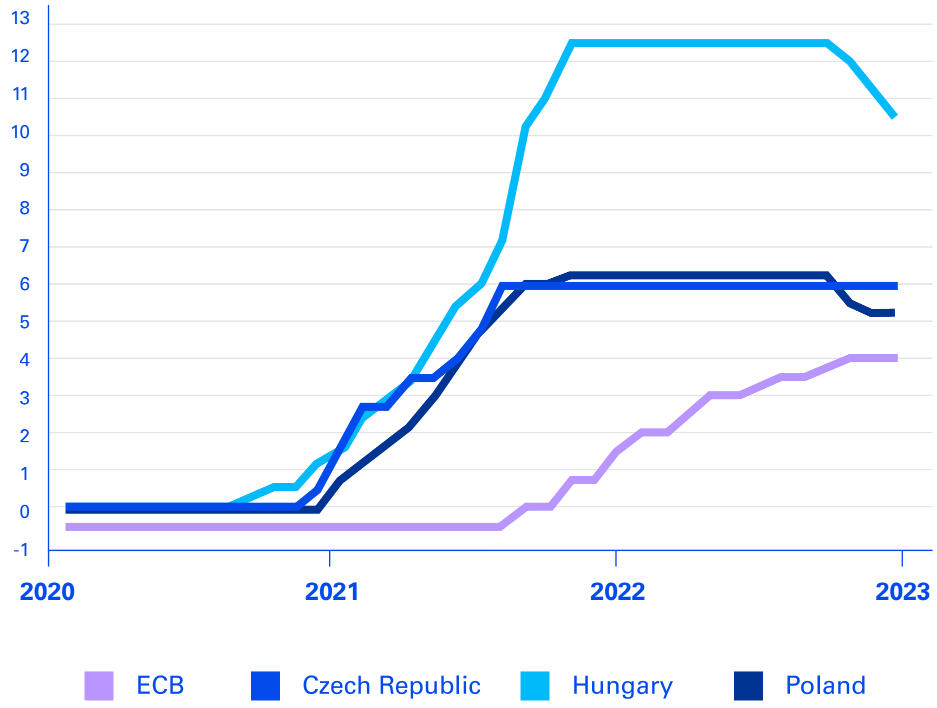
BANK LENDING

In 2022 and 2023, the European Central Bank increased its key interest rates a total of six times – with the last increase on September 20th, 2023 – due to how inflation has been developing across the Eurozone. In case of deposits, the ECB interest rate has increased by 450 basis points since June 2022, with the latest increase in September 2023. High interest rates and lower volume of investment are also a combined cause of a continued and substantial decrease in net demand for bank loans in 2023. Based on its current assessment, ECB predicts that interest rates are at a level that, if maintained for a sufficient amount of time, will contribute significantly to the 2% inflation medium-term target. Starting in June 2023, no long reinvestment of the principal payments from maturing securities of the asset purchase program (APP)[1] should also work in favour of reaching this goal. Reflecting market expectations in November 2023, EURIBOR 3-month futures suggest that, after peaking at 4% in October, Eurozone short-term nominal interest rates will gradually decrease and reach 3% by the end of 2025.

Local central banks in the region increased their interest rates significantly in 2022 already, with inflation slowdown in the Q1 and Q2 of 2023 allowing them to stabilize interest rates and slowly move to quantitative easing. With inflation now heading in the positive direction, some central banks – in Poland and Hungary, for instance – have started lowering their interest rates in 2023 already. The same is expected from other central banks, including the ECB itself, in 2024 at the latest.

Looking ahead, the shift in monetary policy of the central banks sets the stage for a potential rebound in borrowing activities and costs of new loans are expected to start dropping in 2024. It is very likely that the financing costs will go back to the norm we were used to in the previous years, likely dropping as low as to reach 2000-2010 levels.

KEY INTEREST RATE (THE LOWEST) OF SELECTED CENTRAL BANKS 2020-2023 (IN %)



Source: Central banks; ECB (Eureopean Central Bank – Deposit facility), Poland (Polish national bank – Deposit rate), Hungary (Hungarian National Bank – overnight central bank deposit); Czechia (Czech National bank – discount rate)

[1] The Eurosystem started to purchase securities under the asset purchase programmes of its APP in October 2014. The stock of Eurosystem APP bonds stood at €3249 billion at the end of October 2023

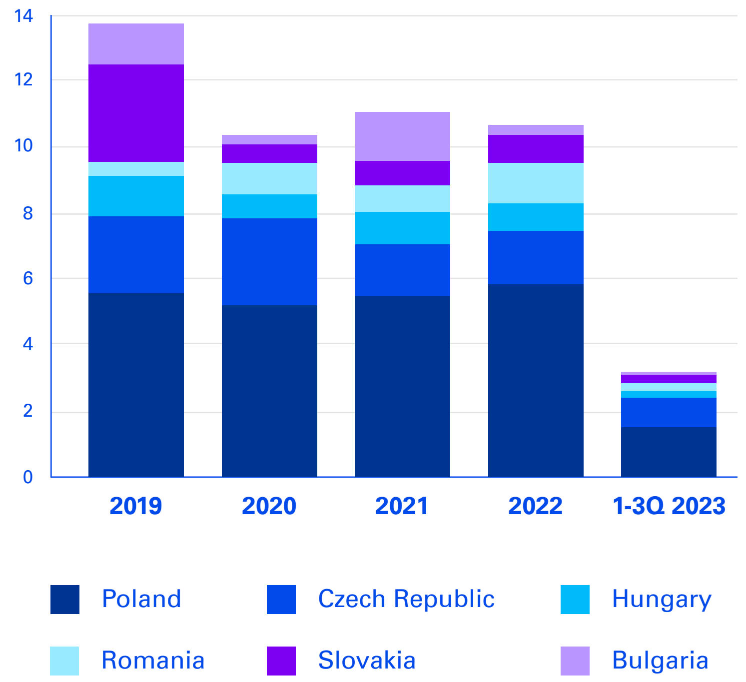
REAL ESTATE MARKET IN CENTRAL AND EASTERN EUROPE

The total investment volume in the CEE region amounted to 3.2 billion euros between Q1 and Q3 of 2023 – only 30 % of the 2022 total transaction volume. Sales predictions until end of year expect 2023 to be the weakest year, transaction-wise, since 2009 when the market felt the full impact of the latest economic crisis. Simply to say - growing interest rates improved performance of non-real estate investments. (e.g. shares).

The number of sales transactions completed under pressure and stress is minimal, with a large difference in buyer and seller expectations. This difference in price expectations, combined with high interest rates, remains the key obstacle preventing the return of more lively transactional activity. Limited construction in the covid years also had its effect, with many projects getting postponed or halted. Were it not so, they would have been nearing completion between the second half of 2022 and the first half of 2024. The lack of transactions causes also another problem, and that is the uncertainty of real estate valuations - which increases the general level of risk and hence the interest premium when it comes to real estate financing.

From Q1 to Q3 of 2023, most transactions in the CEE region – 47% of them – happened in Poland, followed by Czechia with a 27% share. However, the drop in transaction volume is obvious in the entire CEE region, matching the trend present in other European countries, but also in Asia and the US. Future improvement of real estate investment market depends on inflation and interest rates. Expected decrease of the interest rates will likely change market sentiment towards real estate investments

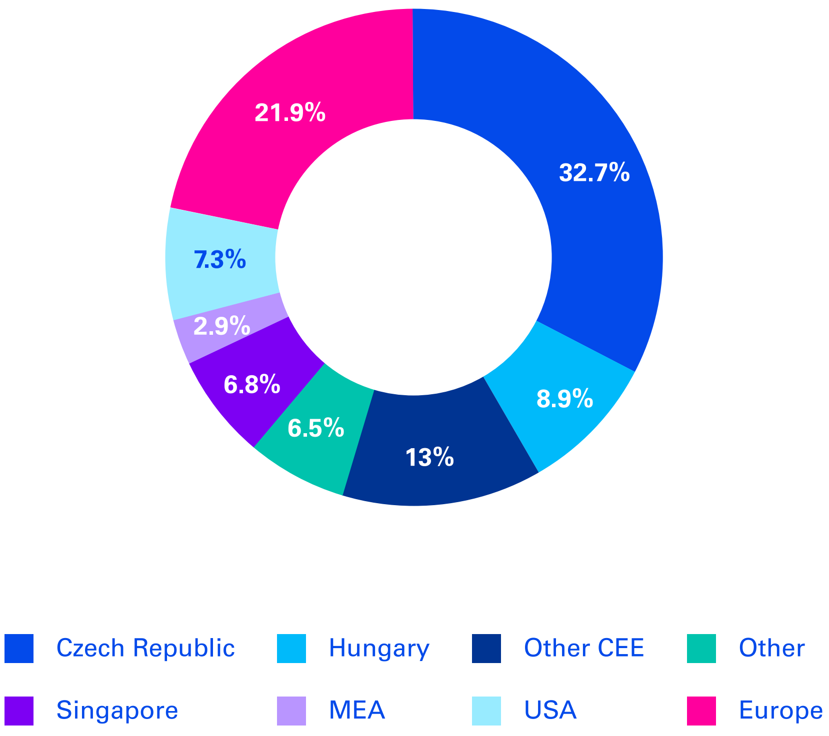
INVESTMENT VOLUME (IN BILLION EUR)



Source: Colliers

CEE INVESTOR STRUCTURE IN Q1–Q3 2023

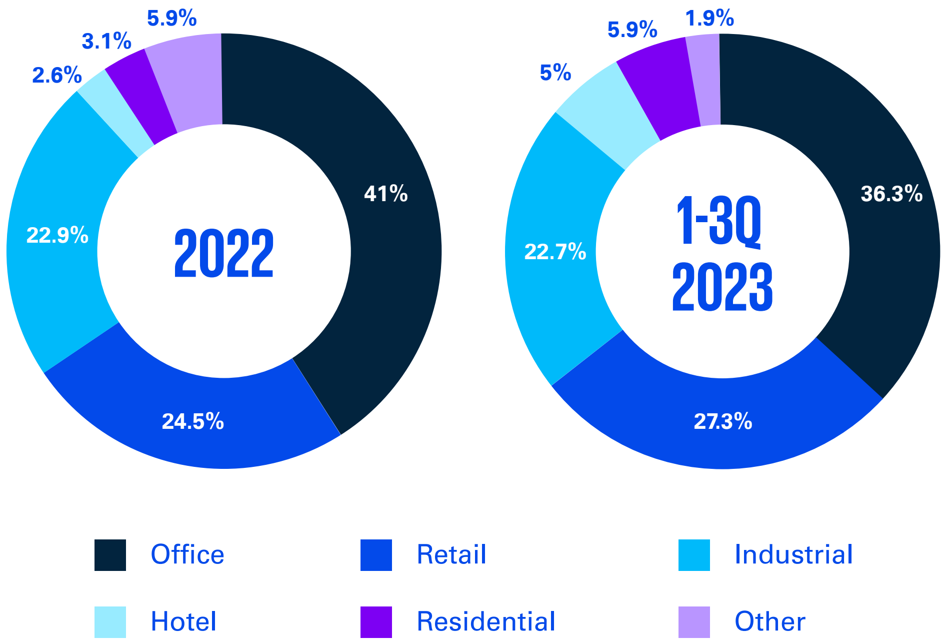
A large shift in investor structure (origin of investment capital) was mainly caused by the significant drop in the transaction volume. Czech investors were the largest group within the CEE region, with a share of 32.7%. That might seem like a sharp increase, but in reality, Czech investors are the only group maintaining a stable level of investments in the CEE, matching that of the previous years. This means that the spike in the total share is mainly caused by the drop in investments by others. Capital coming from other CEE countries made up a total of 13% of investments, with other European countries taking 21.9% of the pie chart, followed by the USA at 7.3% and Singapore at 6.8%.



Source: Colliers

INVESTMENT BY ASSET TYPE – CEE, SEE, BALTICS, H1 2023

In the first three quarters of 2023, the largest volume of investment went into office buildings, making up 36.3% of the total amount and showing a slight drop compared to 2022. Investment volume in retail (27.3%) and logistics and industry (22.7%) is similar to that of the last year. Other segments like hotels (5.9%), residential (5.9%), and other (1.9%) real estate are still making up only a minor part of the total amount. However, the limited availability of suitable investment opportunities is showing in these sectors as well.



Source: CBRE

YIELD TRENDS

Different price expectations between buyers and sellers and a low total amount of transactions are a challenge for investors who need to set a market yield level. However, performed transactions indicate a steep growth in yield compared to H1 2022 in almost all segments of the real estate market. This growth is mainly propelled by the increase in interest rates. In a year-to-year comparison, the yield increased somewhere between 75 and 125 basis points in office and industrial buildings and 50 to 75 basis points in retail across Europe. The growing yields will therefore affect the real estate values, particularly in the western markets where the yield increase is proportionately higher than in CEE region.

The effect of growing yields on real estate value is partially compensated by growing rents.

COUNTRY / REGION	OFFICE PRIME YIELDS 2Q / 2023	YEAR ON YEAR / CHANGE	INDUSTRIAL YIELDS 2Q / 2023	YEAR ON YEAR / CHANGE (BS)	HIGH STREET RETAIL YIELDS Q2 / 2022	YEAR ON YEAR / CHANGE (BS)
Czech Republic	5.25%	+75	5.00%	+125	5.50%	+50
Poland	5.50%	+100	5.90%	+120	6.00%	+65
Slovakia	6.00%	+100	6.25%	+100	5.50%	+50
Hungary	5.75%	+100	6.75%	+125	6.75%	+150
Romania	7.00%	+50	7.25%	+25	7.00%	+25
Europe overall	4.85%	+92	5.06%	+100	4.60%	+53
Germany	3.97%	+107	4.15%	+105	3.78%	+52
United Kingdom	5.67%	+103	5.18%	+124	4.75%	+38

Source: Cushman & Wakefield

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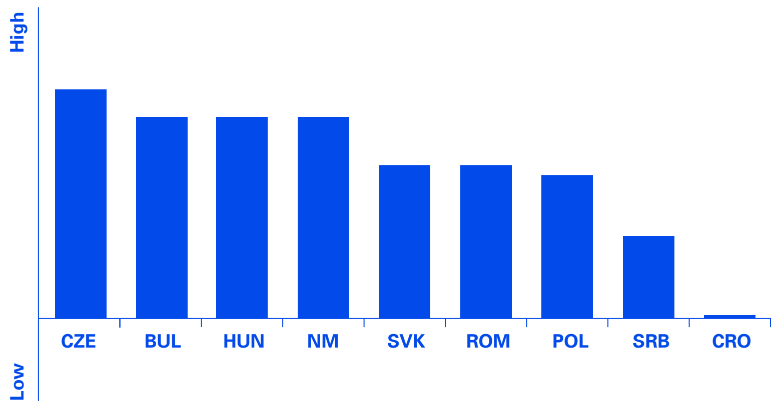
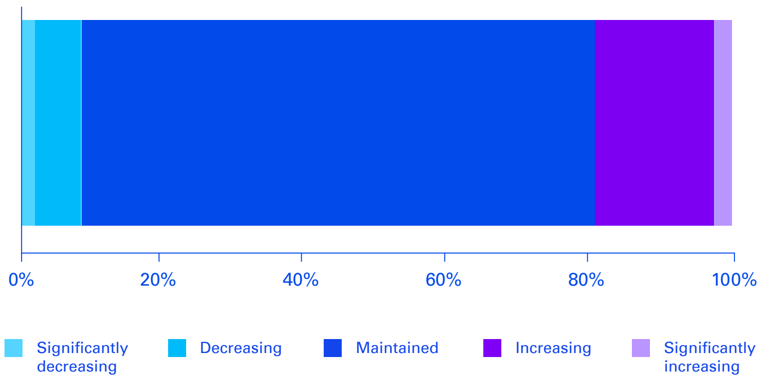
Prospects for real estate loan portfolios

Photo: J&T Real Estate, a.s.

STRATEGIC IMPORTANCE OF REAL ESTATE FINANCING FOR BANKS



FOCUS ON REAL ESTATE FINANCING WITHIN THE BANKS' LENDING ACITVITIES COMPARED TO ONE YEAR AGO



Source: KPMG Property Lending Barometer 2023

The trend of banks becoming more interested in and focused on financing of commercial real estate has slowed down compared to the previous year. Only 19% of surveyed bankers reported growing focus on real estate financing compared to 43% of surveyed bankers in 2022, with approximately 8% of bankers reporting a decreasing interest in this sector. For 73% of respondents, the interest remains the same. Some bankers in Bulgaria and Romania have reported a declining interest in the real estate sector, while in other countries, mainly Croatia and Serbia, its strategic importance has increased compared to last year. For banks in the Czech Republic, real estate financing still holds the position of the most important sector.

Despite of current situation, 38% of surveyed bankers expect their bank's portfolio to grow in next year, compared to 56% who expressed such expectations last year. Portfolios are expected to stay roughly the same by 38% of bankers compared to 28% in 2022. Most optimism was expressed by bankers in North Macedonia and Serbia, while Bulgaria and Romania are the least optimistic.

In terms of real estate loans maturing in the near future, on average, 17% of real estate loans are due within 12 months and 32% of the loans are due within two years.

KEY FACTORS AFFECTING REAL ESTATE LOAN PORTFOLIOS

Increased financing costs	★★★★★
Macroeconomic conditions in the local market	★★★★
Macroeconomic conditions in Europe	★★★
Lack of prime properties	★★★
Lack of equity	★★
ESG	★★
Lack of active investors	★★
High construction costs	★★
Activities of European Central Bank / National Banks	★
Change in property values	★
Exposure limits for individual investors/developers	★
New strategy	★

Survey participants identified key drivers affecting real estate portfolios of their banks, just like in the previous years.

Currently, increased financing costs have the strongest effect on banks and their financing of commercial real estate, pushing local macroeconomic conditions to the second place. Macroeconomic conditions in Europe and lack of prime properties remain high on the agenda but are perceived as less significant. However, ESG has become more important compared to the last year, while actions and activities of the ECB or national banks have lost some of their influence.

ALTERNATIVE FINANCING

Survey respondents maintained a negative view on providing other forms of financing apart from senior loans (e.g. junior, mezzanine) to finance real estate projects. However, 18% of respondents are open to consider providing such loans to some selected clients and in special cases. Most of those expressing this stance were bankers from the Czech Republic, Slovakia, Poland, and Croatia.

Roughly 25% of respondents are very open to participating in syndicated loans, with most openness expressed by bankers from Serbia, Slovakia, and North Macedonia.

ALTERNATIVE LENDERS (COMPETITORS)

Banks were also asked which alternative lenders they consider to be their strongest competitors in term of banks' traditional real estate lending (except competiton of local banks). As in the previous year, their responses indicated that overall, banks see non-local commercial banks as their key competitors (except for local banks). This perception is strongest in Poland. Apart from that, banks also see competition in private equity, debt funds, bond market and insurer/ pension funds, in that order. Many also confirmed that apart from local banks, they do not see alternative lenders in their market as competition.

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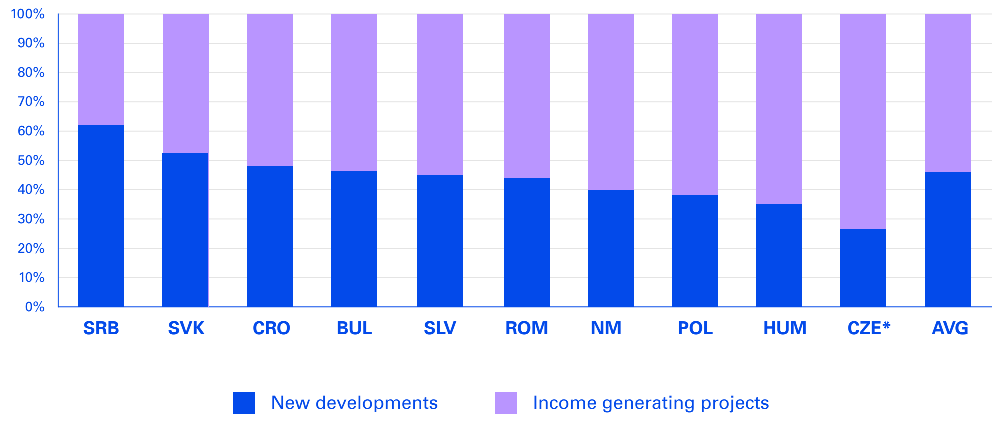
Opportunities for financing new real estate projects

Survey participants revealed their attitude towards opportunities in terms of bank financing of real estate projects. Most respondents expressed a stable view on the topic of new development financing, meaning that in most banks, their stance remains a positive one.

AVERAGE LOAN SIZE

15% of respondents confirmed that the average loan amount has decreased compared to last year, most of them being bankers from Bulgaria and Slovenia. 34% of bankers reported an increase in the average loan amount, which is a significant decrease compared to last year.

TOTAL VOLUME OF REAL ESTATE BANK LOANS



Source: KPMG Property Lending Barometer 2023

CRITERIA FOR FINANCING

Representatives of those surveyed identified the most important criteria for selecting which real estate projects they will finance. Similiarly to previous years, banks participating in our survey confirmed that in a majority of countires the most important criteria for obtaining financing for a real estate project are a strong business model and quality of the asset.

BANKS' MOST IMPORTANT CRITERIA WHEN CONSIDERING REAL ESTATE FINANCING

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

BANK LOANS IN OTHER THAN DOMESTIC CURRENCY

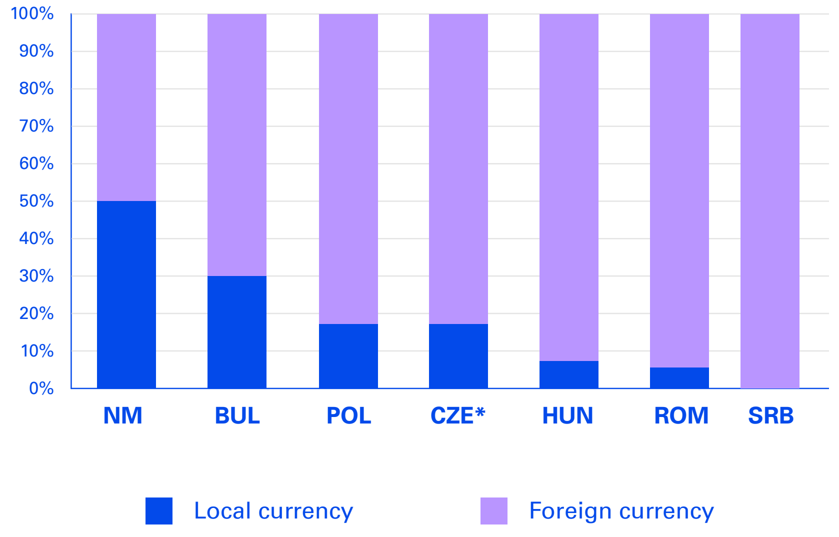
North Macedonia is the only country with a balanced ratio between loans provided in both domestic and foreign currency, with all other countries (non-euro countries) reporting a prevalence of loans in foreign currency. In a year-to-year comparison, 60% of respondents reported no change in percentage of domestic currency loans – a trend that could be explained by already high increase of this percentage in the previous years, but also by an increase of EURIBOR and a partial drop of benchmark rates in certain countries within the region.

BENCHMARK INTEREST RATE

CURRENCY AREA	BENCHMARK RATE	DEC.,2022	VARIANCE TO EURIBOR	OCT., 2023	VARIANCE TO EURIBOR
Eurozone	3M EURIBOR	2.06%		3.37%	
Czech Republic	3M PRIBOR	7.26%	5.20%	7.01%	3.64%
Romania	3M ROBOR	7.81%	5.75%	6.34%	2.97%
Serbia	3M BELIBOR	4,95%	2.89%	5.72%	2.35%
Poland	3M WIBOR	7.02%	4.96%	5.66%	2.29%
Hungary	3M BUBOR	16.18%	14.12%	11.40%	8.03%

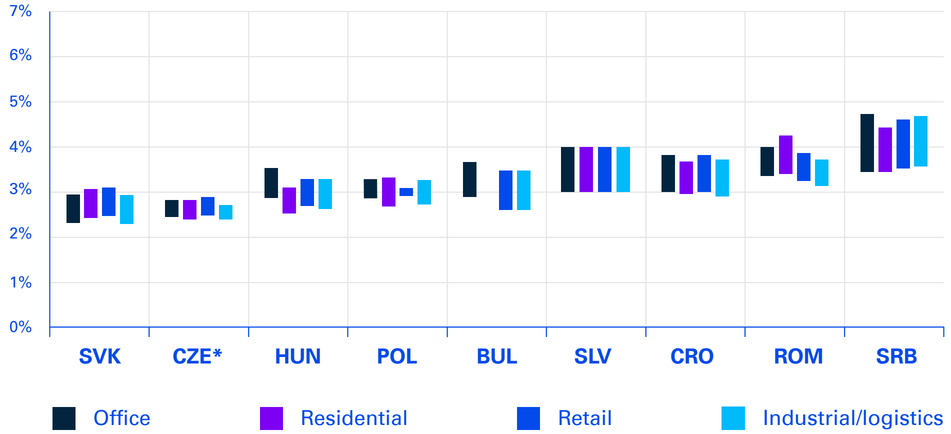
Source: National banks

PROPORTION OF FOREIGN AND LOCAL CURRENCY REAL ESTATE LOANS PROVIDED DURING THE LAST 12-18 MONTHS

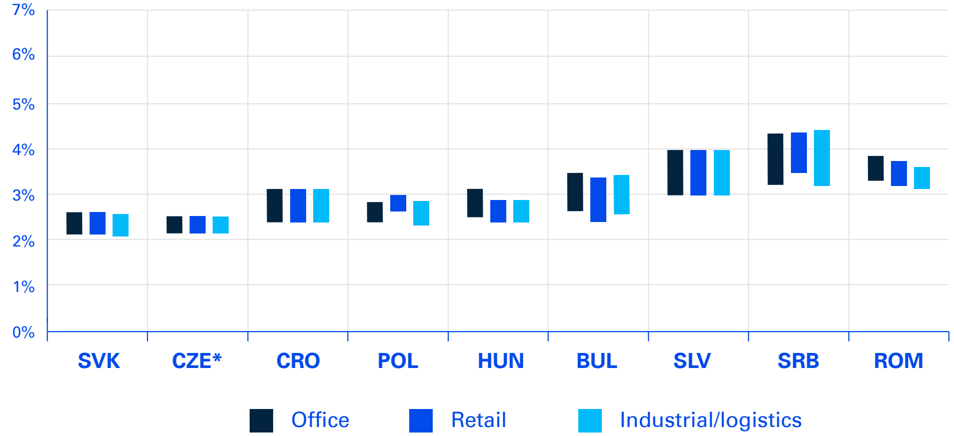


Source: KPMG Property Lending Barometer 2023

LOAN INTEREST PREMIUM APPLIED BY BANKS FOR HIGHLY RATED REAL ESTATE DEVELOPMENT PROJECT IN SELECTED COUNTRIES



LOAN INTEREST PREMIUM APPLIED BY BANKS FOR HIGHLY RATED INCOME GENERATING PROJECT IN SELECTED COUNTRIES



Source: KPMG Property Lending Barometer 2023

INTEREST PREMIUMS (MARGINS)

Banks were asked about the interest premium range they would apply on a 3-month EURIBOR basis if a developer or an investor of outstanding reputation with a solid business plan approached them.

Among the surveyed economies, Czech and Slovak banks (similar to last year) said they would apply 4the lowest premiums, with the highest premiums in Romania, Serbia and North Macedonia.

63% of respondents stated that, compared to the previous year, there has been a slight or significant increase in this premium, while 29% of banks see no change year on year.

For individual assets, the largest decline in premiums was observed for hotels due to the continued recovery of the tourism sector and residential projects.

Similar to last year, most of the surveyed banks require higher interest premiums for development projects than for those generating income. The greatest difference here is reported by Czech and Hungarian banks.

The trend of convergence of required interest premiums across asset types continued this year, with the exception of hotels.

INTEREST RATE HEDGING

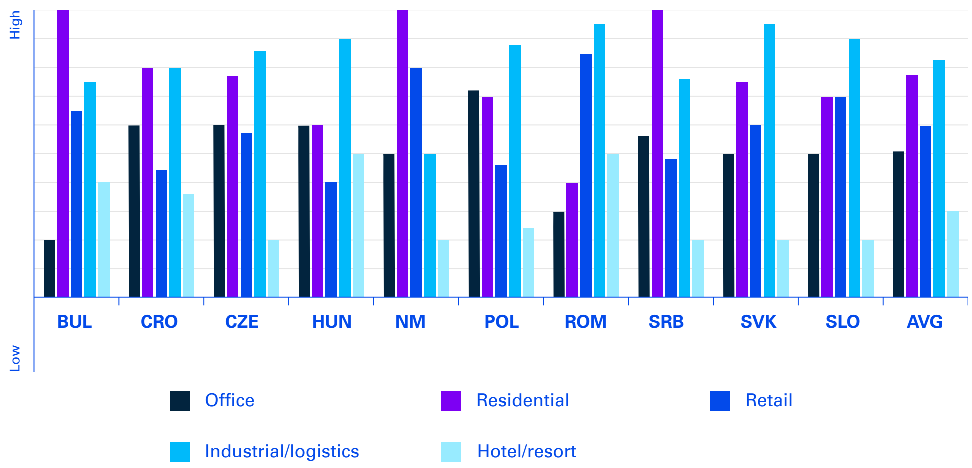
We asked individual banks about their requirements for clients to hedge interest rate risk associated with variable interest rates. The vast majority of banks require the relevant derivative instrument to represent more than 50% of the loan volume and 22% of respondents said their bank requires this to be more than 80% of the loan volume. Banks in Poland and Slovenia are the most conservative, with half of respondents in each country requiring a hedge of at least 80% of the loan volume.

ASSET CLASS PREFERENCE

Banks were also queried about their preferred asset class for development financing. Banks in the CEE have the least preference for providing development financing to hotels and resorts. The most preferred asset in most countries is industrial and logistics. This can be considered a big shift from last year, where providing residential financing was the most preferred.

Compared to previous years, the banks surveyed mentioned their effort to diversify their loan portfolio and represent all asset classes (with exception of hotels and resorts).

BANK'S SECTOR PREFERENCES IN PROVIDING DEVELOPMENT FINANCING BY ASSET CLASS



Source: KPMG Property Lending Barometer 2023

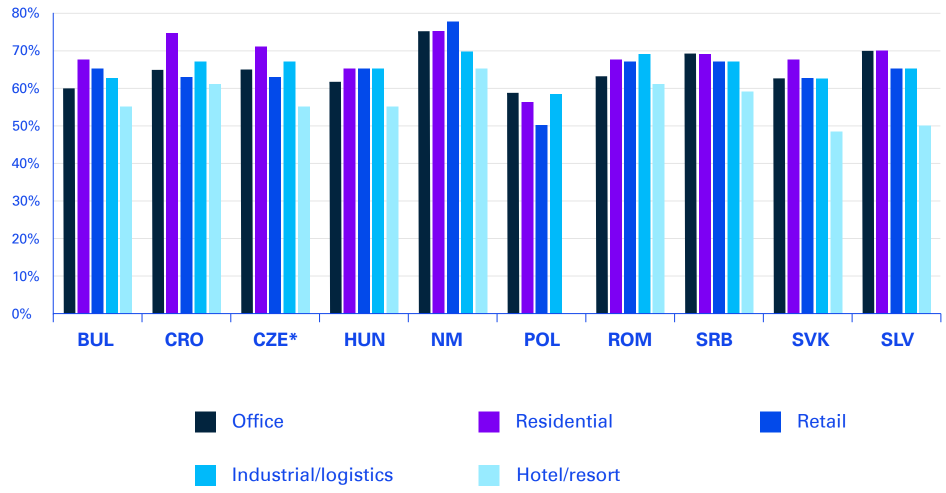
LOAN-TO-COST RATIO

We asked bank representatives about their technical criteria for financing. The loan-to-cost ratios they indicated varied by country and asset type.

Survey respondents in the CEE indicated loan-to-cost ratios for the office, residential, retail, industrial/logistics and hotel sectors in a range from 0.56 to 0.73 (i.e., reflecting a capital structure of 56–73% debt and 27-44% equity).

On average, the residential sector has the highest LTC ratio of 0.68. Hotels/resorts require the highest equity ratios in the most surveyed.

LOAN-TO-COST (LTC) RATIO EXPECTATIONS FOR FINANCING HIGHLY RATED REAL ESTATE DEVELOPMENT PROJECTS



Source: KPMG Property Lending Barometer 2023

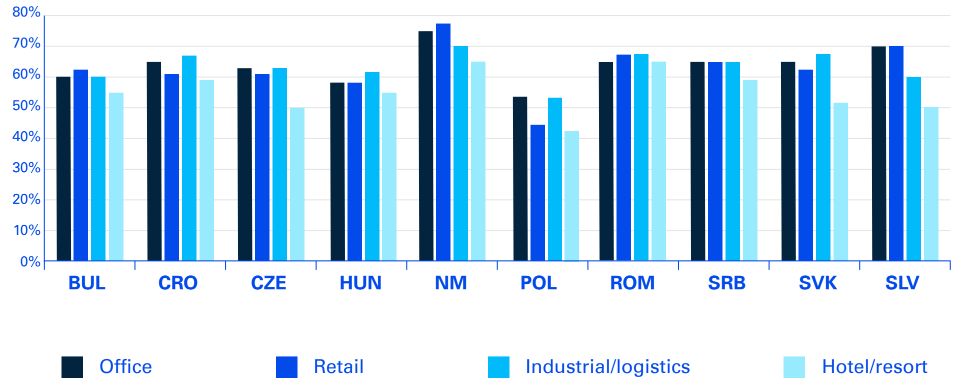
LOAN-TO-VALUE RATIO

In those countries surveyed, the loan-to-value ratios for the office, retail and industrial/logistics sectors range from 0.50 to 0.74 (i.e., reflecting a capital structure of 50–74% debt and 26–50% equity).

This year there was a continuing trend towards equalling LTV for individual asset classes except hotels. The average value of residential, retail and industrial/logistic reached 63% in the region.

Hotel/resorts, on average, require the highest ratio of equity, with the average LTV ratio for countries included in the survey being 0.55. While banks in most countries in this group are quite restrictive, banks in North Macedonia are willing to provide 74% credit in proportion to the total apprised real estate value for these types of assets.

LOAN-TO-VALUE (LTV) EXPECTATIONS FOR FINANCING HIGHLY RATED INCOME GENERATING PROJECTS



Source: KPMG Property Lending Barometer 2023

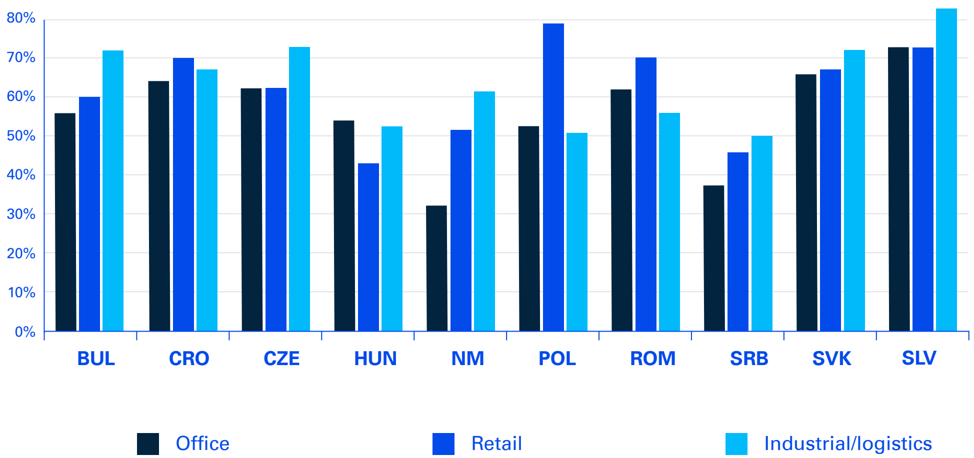
PRE-LET RATIOS

Serbian banks request the lowest pre-let ratio (45%) on average, while Slovenian banks have the most restrictive requirements (76%). North Macedonian banks request the lowest pre-let ratio for office projects (36%), and Serbian for industrial and logistics projects (50%).

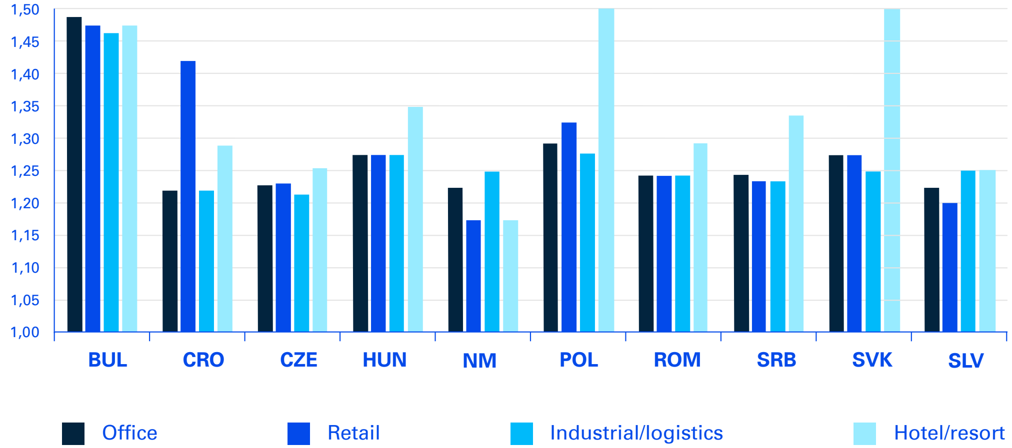
DSCR RATIOS

Banks were also asked about debt service coverage ratios (DSCR) expected for income-generating projects for investors with excellent reputation and sound business plans.

PRE-LET RATIO EXPECTATIONS FOR FINANCING HIGHLY RATED REAL ESTATE DEVELOPMENT PROJECTS



DEBT SERVICE COVERAGE RATIOS EXPECTATION FOR FINANCING HIGHLY RATED INCOME-GENERATING PROJECTS

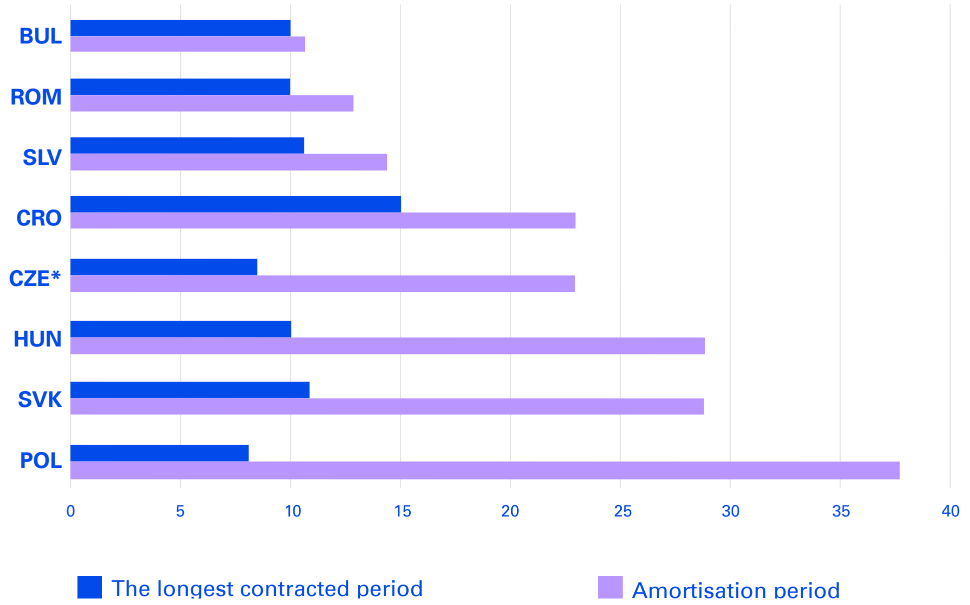


Source: KPMG Property Lending Barometer 2023

LENGTH OF THE LOAN

Bank representatives were asked about the minimum required average annual loan amortization rate that would be applied at the required LTV level for highly rated real estate projects, as well as what the longest contracted term of the loan would be for financing prime investment/income generating properties. We have calculated the implied maximum amortization period from the minimum amortization rate, and cross checked that with the longest contracted term banks apply. The difference reveals insights into the market conditions the banks in various economies operate in. The maximum difference between the amortization period and the length of the loan agreement is typical for many Western European countries.

MAXIMUM AMORTIZATION PERIOD[1] AND LONGEST CONTRACTED TERM AVAILABLE (IN YEARS)



Source: KPMG Property Lending Barometer 2023

[1]Implied maximum amortization period expressed in years which is calculated from the minimum annual amortization rates (expressed as a percentage) provided by survey participants

04

Managing impaired loans

Our survey shows that despite economic slowdown and increased financial costs, the number of problematic loans did not increase in any significant way. On the other hand, however, there is an obvious increase in the amount of loans with minor problems (e.g., technical breach of covenants). As in previous years, the quality of portfolios continues to improve in the countries with the highest percentage of impaired loans within the region.

Czechia and Serbia still boast the lowest percentage of impaired loans, just like in the previous years. The biggest improvement (more than 7% decrease in impaired loans) was observed in Romania and Hungary.

Over 73% of surveyed bankers believe that the volume of problematic loans in their total real estate lending portfolios will not change by the end of 2023 when compared to 2022. Furthermore, 13% of bankers reported that they expect an increase in the number of problematic loans compared to the previous year and 13% of bankers expect a decrease.

DISPOSING OF LOAN PORTFOLIOS

Similar to last year, some bankers from Bulgaria, Poland and now Romania are considering selling their non-performing property loan portfolios within the next 12-18 months, mostly aiming at a strategic exit. In other countries, bankers have not expressed any such plans for the foreseeable future.

Only one of the surveyed bankers in the region is considering selling performing property loans in the same timeframe to optimize their loan portfolio. Thus, the situation is identical to that of the last year.

PROPORTION OF IMPAIRED REAL ESTATE LOANS PER COUNTRY

Source: KPMG Property Lending Barometer 2023

05

ESG and real estate financing

The upcoming years will prove pivotal in setting a new market practice for financing real estate and have a fundamental impact on the future shape of financial markets. First and foremost, the implementation of EU and ECB regulations regarding ESG puts pressure on financial institutions and property owners to adapt to changing circumstances.

At the top of the list are disclosures related to the EU Taxonomy, which involve publication of information regarding environmentally sustainable activities. Banks are already actively working on their readiness for full reporting, which will encompass an assessment of alignment with the criteria for all six environmental objectives set out in the EU Taxonomy and calculation of multiple KPIs such as green asset ratio (GAR).

Another significant disclosure obligation imposed on the financial sector will be to publish detailed data on sustainable investments of asset managers and investment companies, in accordance with the Sustainable Finance Disclosure Regulation. New upcoming the legislation and more demanding market expectations will lead to a significant shift in lending criteria in the near future, as sustainable finance is playing a key role in business transformation.

Banks' attention towards ESG factors has been constantly growing also in the CEE region, especially regarding the sustainable practices in financing real estate. The survey findings indicate a predominant trend of increasing focus on ESG in the lending activities of banks in the CEE region. More than 90% of the surveyed banks reported an increase or a significant increase in their focus on ESG within their lending policies when compared to the previous year, while only a few did not notice any changes.

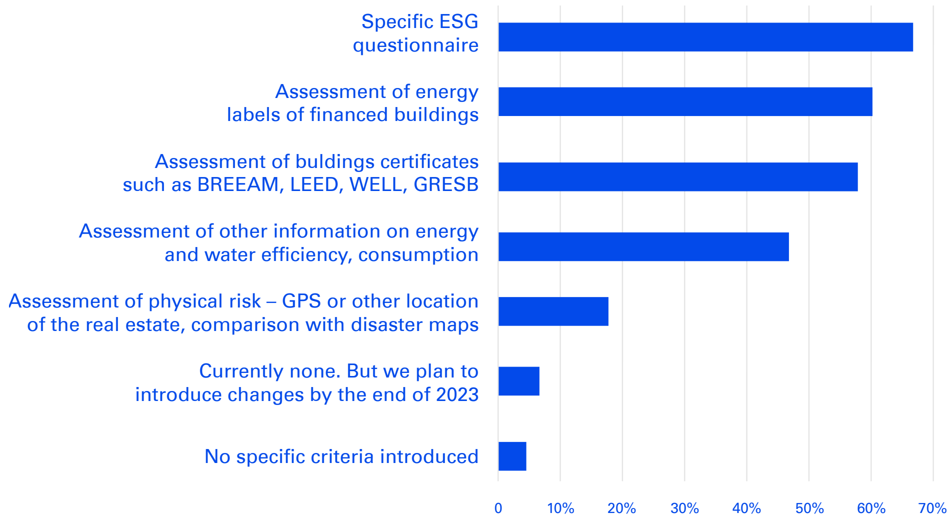
CURRENT STATUS OF ESG IMPLEMENTATION IN REAL ESTATE FINANCING

Source: KPMG Property Lending Barometer 2023

While progress is evident, the survey results suggest there is still room for more comprehensive adoption of ESG principles. The relatively low percentages for solutions like special ESG-focused products (e.g. green financing with lower margin), partnerships with green building developers or issuing green bonds show that banks are selective with ESG-related initiatives. Only selected banks, mainly from Bulgaria, Croatia, Czechia, Poland and Slovakia, are taking initiatives to offer financial products with lower margins aligned with sustainable objectives, while some have formed partnerships with developers.

While a considerable number of banks (34 out of 45) have implemented various sustainability-related assessment criteria for real estate lending, it is worth examining in detail which aspects they take into consideration. The majority of respondents (nearly 60% and more) have introduced specific ESG questionnaires and evaluate multi-criteria building certification, including energy labels, which indicates a comprehensive approach adopted by a significant number of banks spread across various CEE countries. Nevertheless, there is still room for including a wider spectrum of these criteria into the lending policies for more holistic evaluation of real estate. So far, less than half of the respondents evaluate additional information related to energy and water consumption, which seems to be the key data relating to resource efficiency. This may suggest a moderate focus on utility consumption and resource efficiency in lending assessments.

SPECIFIC EVALUATION CRITERIA FOR LOANS CONSIDERING ESG



Source: KPMG Property Lending Barometer 2023

SPECIAL FINANCIAL PRODUCT FOCUSED ON ESG

The survey results illustrate a varied landscape in terms of diversity between ESG-focused financial products and standard loans. A number of respondents developing special financial products focused on ESG, did not change significantly within the last year, with only selected banks offering financial products aligned with sustainable objectives. While 13 banks, mainly from Croatia, Czechia, Hungary, Poland, Romania and Slovakia, offer lower interest rates, while only a few furnish an additional offering including lower annual loan amortization or a higher LTV ratio. It is worth noting that a considerable share of respondents from the CEE region indicated that their ESG products do not distinctly differ from their regular loan offerings.

NON-COMPLIANCE WITH ESG REQUIREMENTS

Changing legal regulations and evolving market standards influence banks to adopt stricter ESG compliance measures in their lending policies. Although the survey results show that 44% of the banks did not refuse financing to investors owing to non-compliance with internal ESG requirements within the past year and 10% of the surveyed banks did not have specific requirements in place, banks integrate sustainability into their lending decisions. These results imply that compliance with ESG criteria has not been a significant factor driving lending decisions within last 12 months. On the other hand, a number of banks that refused bank financing to investors due to non-compliance with their ESG requirements (solely or in combination with other factors) has doubled within the last year. Banks are increasingly focusing on sustainability to align with the evolving legal and market expectations, leading to significant shift in lending policies in the near future.

Also, one of the key drivers for integration of sustainability practices in the financial sector is the attitude of local central banks in CEE region. We may see broad range of practices ranging from proactive Hungarian approach to passive approach represented by other central banks in CEE region.

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06 Conclusions

Photo: Penta Real Estate

- In 2023, global and European economy has been on track to return to pre-pandemic levels. Despite turbulence and uncertainty cause by the war in Ukraine and the conflict in Middle East, real growth of 0.5% is expected in the CEE region, though some countries will show a decline in their economy.

- To facilitate more stable prices and bring inflation down to single digits, central banks increased their interest rates significantly. And although these have stabilized in Q3 and Q4, and some central banks even started decreasing them again after achieving the desired effect on inflation rates, they still remain in multiples of what the region and entire Europe were used to just a few years ago.

- High interest rates, inflation, and economic stagnation are the key factors behind a drop in total volume of bank loans taken out by both businesses and individuals.

- 2023 is expected to be the weakest year, transaction-wise, since 2009 due to the impact of ongoing economic crisis. Total investment volume in CEE region amounted to 3.2 billion EUR between Q1 and Q3 of 2023 –only 30% of total transaction volume in 2022. This is largely driven by improved return of deposits and cash equivalent investments due to increased interest rates. Future development highly depends on the interest rates, expected decrease will likely change market sentiment towards real estate investments.

- The number of sales transactions completed under pressure and stress is minimal, with large difference in buyer and seller expectations. This difference in price expectations, combined with high interest rates, remains the key obstacle preventing the return of more lively transactional activity.

- Performed transactions indicate a steep growth in yield compared to Q1 of 2022 in almost all segments of the real estate market. This growth is mainly propelled by the increase in interest rates. In a year-to-year comparison, the yield increased somewhere between 75 and 125 basis points in office and industrial buildings and 50 to 75 basis points in retail across all Europe. Proportionately, the yield increase is higher in Western Europe than in CEE, where historically higher yields were observed.

- Financing of commercial real estate remains very important for banks, although surveyed bankers are less optimistic now, with most not expecting any significant change in the sector, save for maybe some small growth. Furthermore, they will soon have to face the challenge of refinancing large portions of their portfolios, with loans maturing in the next two years.

- Despite economic slowdown and increased financial costs, the number of problematic loans did not increase in any significant way. On the other hand, however, there is an obvious increase in the amount of loans with minor problems (e.g., technical breach of covenants). As in previous years, portfolio quality continues to improve in countries with the highest percentage of impaired loans within the region.

- Most bankers from non-EUR countries reported an average of 80% of loans provided in foreign currency (EUR). Continuing growth in the share of foreign currency loans matches the difference between benchmark rates of individual countries and EURIBOR. Now, the share of foreign currency loans stopped growing, likely reaching its maximum – partially due to the share of assets generating income in local currencies and growing EURIBOR rates in 2023.

- Financing of new development within CEE, on average, stayed proportionally stable compared to last year. In countries like Croatia and Serbia, financing of new development has gone up while Slovakia, Poland and Hungary shifted their focus on income generating projects.

- Unlike dramatic increases in interest rates, interest margins that banks take home remained relatively stable with only minor growth, same as last year.

- When asked about their most serious competition, most surveyed bankers mentioned local commercial banks. Some also spoke about non-local banks, even mentioning private equity, but placing it rather far down the list.

- Banks remain willing to participate in club loans or provide syndicated loans.

- In interest premiums, the situation has now stabilized, with possible decrease coming in the future. Due to declining inflation in Europe, stable move towards lower premiums is expected from financial institutions who wish to remain competitive. Macroeconomic stabilization is expected to go hand in hand with this trend.

- Industrial/logistics assets became the preferred type of asset among most surveyed banks, closely followed by residential assets. North Macedonia, Bulgaria and Serbia differed from other banks with residential assets being their preferred asset type, while Croatia has shown that same strong preference of residential and industrial/logistic assets.

- Compared to last year, the surveyed banks require borrowers to have more of their own capital for new loans, meaning lower LTV and LTC rates.

- Lower LTV and LTC rates are closely related to borrowers being required to meet the DSCR. Despite the DSCR itself not changing much across surveyed banks, meeting it has become very difficult for investors and developers taking out new loans due to growing interest costs.

- The trend of banks requiring variable interest rates to be hedged by financial derivates (e.g. interest swaps).

- Almost all participating countries confirmed growing importance of sustainable financing. A key driver of this trend was and will be the alignment of EU legislation (including taxonomy and legislation in development) with company strategy, first among parent companies and then individual banks.

- Over 75% of surveyed bankers said their institution has incorporated ESG criteria into real estate loan evaluation, with roughly the same number of bankers mentioning collection of new data at loan approval stage and during loan contract.

- 82% of bankers confirmed having an approved ESG strategy for the real estate financing sector with Croatian, Czech, Hungarian, North Macedonian, and Slovak banks being 100% ready.

- More than 67% of surveyed banks introduced specific assessment criteria for real estate loans considering their sustainability with Hungarian, Czech and Croatian banks having the strictest criteria.

- Failure to meet ESG criteria requirements can be a reason for loan rejection for 20% of surveyed banks and combined with other criteria, up to 44% of loans can be rejected. Hungarian banks have the most rigid policy regarding ESG non-compliance, where 100% of those surveyed declined financing if ESG criteria were not met.

07

Country Insights & Contacts

Uncertain political and economic environment and lower asset liquidity resulted in low investment volumes in 2023 and market dominated by local investors, while industrial and logistics properties as well as retail parks in both Sofia and regional cities still appear to be an attractive proposition.

The interest rates in the country remained one of the lowest in the EU, in particular the mortgage rates. The Bulgarian National Bank has hinted at possible further monetary tightening, while a strategy of mild gradual increase in interest rates was adopted by the local commercial banks, with more tangible effects affecting the lending activities are expected.

Potential accession to the euro zone with new targeted date in early 2025 is expected to boost international investor confidence. The importance of ESG factors appears to have increased with the top banks on the market already incorporated or currently incorporating ESG analysis into their risk.

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Anticipated stagnation in real estate demand and price stabilization flowing from the current uncertainties is yet to be confirmed. Also, other forms of investment are becoming more accessible and attractive which may have some reflection on the real estate market.

It's correct, with the fact that it should be taken into account that our previous thresholds were significantly below the market, so this is actually the alignment of our financing parameters with the real situation on the market and a clear announcement of our positioning in the industry (vis a vis market share). A moment against the market, but based on our acquired experience, the proven quality of the portfolio and our perception of key investors/developers in the Republic of Croatia.

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The Czech real estate market can still depend on the active participation of domestic investors, maintaining its position as the second-largest market in the CEE region despite a notable decline. Despite the prevailing unfavorable economic conditions marked by stagnation, high inflation, and escalating interest costs, there is a noticeable absence of significant distress sales or a complete halt in development.

Contrary to the prevailing pessimism linked to uncertainties about future developments, the anticipated economic recovery, and declining interest rates, Czech banks exhibit a high level of openness to financing commercial real estate within the country. A majority of Czech banks persist in implementing ESG criteria, with the introduction of a specialized product focusing on ESG being more of an exception, despite a slight increase compared to the previous year. The fulfilment of ESG criteria is increasingly viewed as a necessary condition for loan approval.

Notably, ESG considerations are not exclusive to large banks with foreign parent companies in the Czech Republic; they are also gaining prominence among smaller local banks owned by Czech entities. This reflects a broader trend where ESG factors are becoming integral to the lending landscape in the country.

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Investment activity slowed down remarkably in 2023, showing a 43% YoY decline. Yields increased by +50 to +150 bps. Foreign investors virtually disappeared from the Hungarian market. The cost of borrowing became more expensive (BUBOR was 10.55 to 12.25 as of November 2023) not only because of the increased rates but also due to the increased country risk. Stakeholders expect declining interest rates as the annual HUF inflation will fall below 10% in December 2023.

Green company bonds were introduced in 2020. The National Bank is currently encouraging banks to increase the level of green loans. Developers and investors see the financial advantage of ESG and have started to align their business accordingly.

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Residential remains the most dynamic real estate segment in North Macedonia. Despite the high inflation in 2023, the demand remains strong as the investment in residential premises is perceived as a safe haven. The need for the development of logistics and industrial capacities is observed, with an increased interest of local investors in partnership with international companies to invest in built-to-suit projects. Banks in North Macedonia are mainly focused on financing residential property, followed by retail projects. Mixed-use projects, which usually consist of a residential part on the upper floors, office space on the lower floors and retail space on the ground floors, are becoming more popular among the real estate investors in the country.

The growing importance of ESG is reflected in the strategies of both real estate investors and banks. However, the ESG initiatives implemented by the local banks related to real estate financing remain limited.

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2023 saw a visible slowdown in investment activity in the Polish commercial real estate market due to higher financing costs, changing market sentiment, and a gap in price expectations between asset sellers and buyers. Among entities actively operating in the local market, investors from the CEE region play a crucial role. Warehouse assets are attracting the greatest attention from investors as the logistics market conditions remain favorable, despite slight decreases in both demand and supply. The retail sector is regaining interest from investors post-pandemic, focusing mainly on smaller retail properties. However, 2023 proves to be challenging for the office sector due to investors' cautious approach towards office properties amid the evolution of work models and reduced demand for office space.

Banks are currently approaching property development financing with particular caution due to downside risks in occupiers markets and high construction costs. Simultaneously, lenders are conducting more thorough analyses of asset management plans, especially regarding ESG matters.

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Romania's real estate market has shown a high degree of resilience against COVID, the Ukraine war and double-digit inflation rates, and we expect the upward trend to continue into 2024, fueled by a strong residential market, the expansion of retailers and ESG based investments, especially in the office and industrial sectors.

2024 is an election year, which may make tax rises less likely, particularly in view of the recent changes. Moreover, an expected fall in inflation, a strong labour market and ESG pressure should boost the industrial and retail real estate segments. Nevertheless, growth could be hindered if inflation falls more slowly than anticipated or if interest rates remain high.

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Positive trends persist in the Serbian retail estate market despite rising rental rates amid economic uncertainties. With ongoing construction projects and completed new real estate spaces that were in the pipeline, the market remains active, anticipating a gradual stabilization. Investors will remain cautious as long as interest rates stay at their current levels and uncertainty persists about their future direction. It is expected that banks will tighten financing conditions and be stricter in granting loans. The ESG agenda is influencing banks' perceptions of related risks and borrowers' ESG profile. Some banks are already applying minimum ESG criteria in loan origination, aligning with their ambitious green lending KPIs.

The real estate market in Serbia is expected to continue its growth trend with an overall positive outlook.

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The Slovak real estate market is currently navigating a period with several factors influencing its trajectory. While yields are gradually increasing across segments and regions due to broader market conditions, the residential sector is facing price declines due to rising mortgage rates and a slowdown in overall sales. In the office sector, vacancy rates persist and even increase in older and less sustainable premises, and overall supply growth is projected to remain moderate or even slightly decreasing. These factors have contributed to a deceleration in market activity, with transaction volumes relatively subdued.

Amidst this evolving landscape, banks are intensifying their focus on project quality, scrutinizing developer experience and prioritizing established relationships. Additionally, equity requirements are expected to tighten, reflecting a more cautious approach to lending. Overall, the Slovak real estate market is adapting to the changing economic climate, with a focus on prudence and selectivity. While challenges persist, the market remains resilient, and opportunities exist for those who navigate the evolving dynamics effectively.

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Slovenia revitalized itself after the covid period, that definitely had a negative impact on the volume of transactions in the real estate sector. After this year's interest rate increase, real estate prices have practically not decreased yet, despite the fact that the number of transactions on the market has slowed down significantly. In addition ECB and banks are strongly critical of the proposal for a new tax on the balance sheet total of banks, because it could reduce the motivation of banks to finance even more.

On a positive note, some significant projects have been revived, crucial for the state and regional development with a great focus on sustainability. We can mention Emonika – a modern intermodal travel center valued at around 500 million euros, big on sustainability, focusing on green and smart technologies.

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