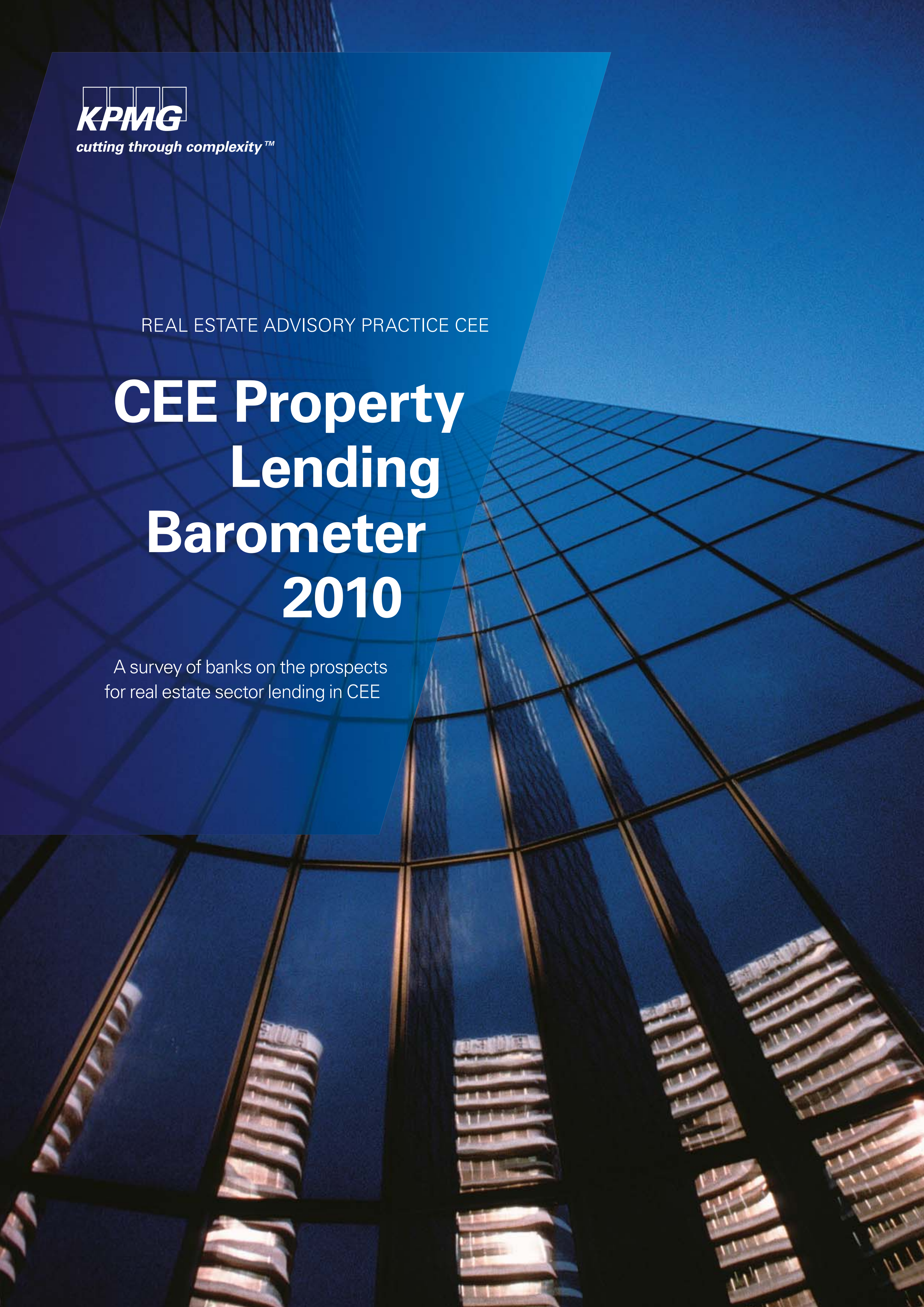

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REAL ESTATE ADVISORY PRACTICE CEE

CEE Property Lending Barometer 2010

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

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Dear Reader,

I am delighted to present the Central and Eastern European (CEE) region Property Lending Barometer 2010. At present, the financing of CEE real estate remains unclear, due to a large reduction in transactions, the variable performance of real estate according to country and asset class, and the performance of banks at country and regional levels.

With the ultimate purpose of assessing the prospects for bank financing in the real estate sector in CEE, we have conducted a survey amongst leading banks in the region. The barometer includes input from over 50 banks active in real estate in CEE. Mainly through in-depth interviews, representatives of leading financial institutions have provided their views on the key issues affecting property lending. The following countries were included in the KPMG survey: the Baltics, Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania and Slovakia.

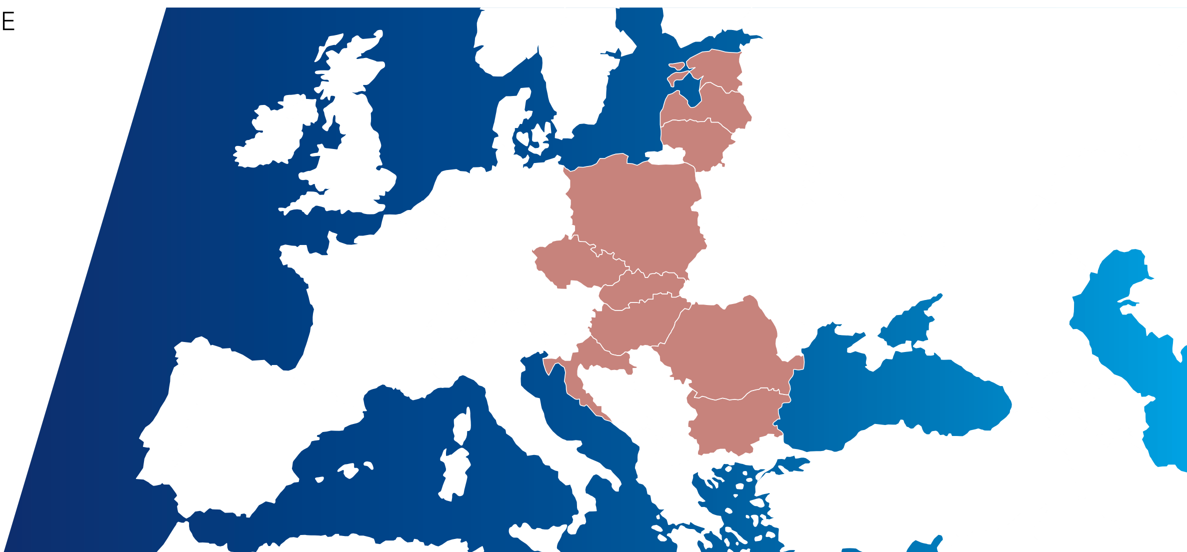
In the current market, banks are finding themselves with significant real estate loan portfolios to manage; some of these are non-performing. In this report, we first focus on how banks manage these non-performing loans, then we assess how banks approach their real estate lending strategically and what they expect for the next 18 months. Finally, we address the prospects and terms available for developers to finance real estate projects.

We trust that the enclosed results provide relevant insights for developers and investors alike on the future prospects of real estate financing, and enable banks to benchmark their practices with their peers.

Some highlights from the CEE Property Lending Barometer 2010 include:

- The prospects of the real estate market in a country are generally linked to the macroeconomic outlook.
- Banks have not relaxed their strict lending policies in relation to real estate financing.

■ Surveyed countries in CEE



- Banks are looking to restructure existing loans, rather than seeking foreclosure. Higher quality projects with a potentially strong business model have a better chance of successful restructuring.
- Banks are reopening to finance good quality projects.
- Despite the plummeting values seen since the last quarter of 2008, fewer than one-third of banks surveyed reported low, or very low reliance on valuations.
- The hotel sector is the least preferred by banks in terms of financing, but again good projects may receive reasonable terms for financing.
- Not surprisingly, when looking at their recent GDP performances and future prospects, the Property Financing Sentiment Index indicates that Poland is the best country in the region for financing real estate projects, closely followed by the Czech Republic.

I would like to take this opportunity to thank all of the participants in this survey. Their co-operation has been key to the success of this initiative.

As the initiator and coordinator of this survey, I 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 the survey results, please feel free to contact the Real Estate practice of KPMG in Central and Eastern Europe or myself.

Yours sincerely,

Andrea Sartori

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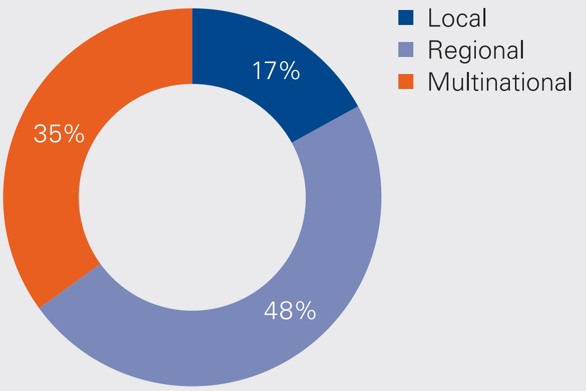
Methodology, sample profile and survey limitations

This survey aims to provide an analytical overview of banks' approaches to real estate financing in the Central and Eastern European region. The following countries are represented: the Baltics[1], Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania and Slovakia.

Data collection for the survey was primarily made through in-depth interviews with bank representatives. Depending on the organisational 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. Survey participants included over 50 banks active in the real estate market in CEE. Data collection for this survey took place from July through the first half of September 2010.

Approximately half of the banks providing data were regional banks, i.e. they are active in at least three countries within CEE.

Geographic orientation of the banks included in the surveyed sample



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

Source: KPMG in CEE Property Lending Barometer 2010

Survey limitations

The following limiting factors of this survey should be noted:

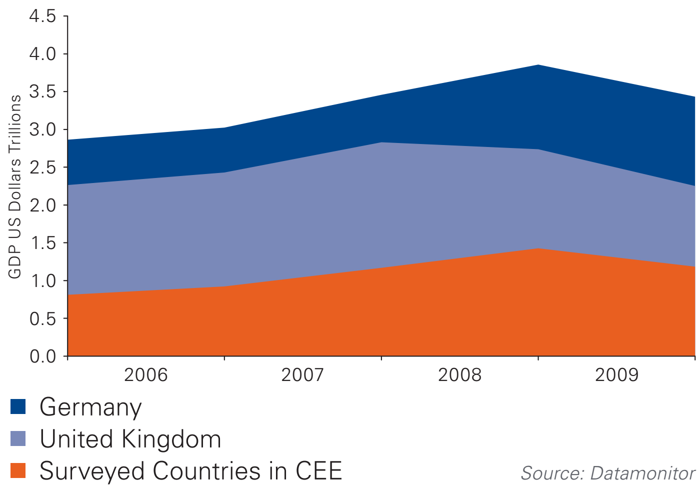
- When the answers provided to specific questions were not sufficient to provide reliable information on a specific country, the given country was omitted from that part of the analysis.
- In the case of some parameters and some cross tabulations, the output of the survey may be considered indicative but not representative due to a lower number of responses.
- Our assessment of the residential sector excluded residential projects with construction costs below EUR10 million.
- Some of the answers to the survey's queries should be considered the expression of opinion or may be timely market information that is subject to change over time.

[1] *Based on the responses received from the banks surveyed, the three Baltic countries may be grouped together from a bank financing point of view.*

Overview of the CEE Real Estate market

Before the global financial crisis, investors viewed individual countries within CEE more as part of one region, whose GDP comprises one-third the size of Germany's. This resulted in the differences between the countries' investment markets narrowing. In reaction to the global financial crisis and the reappraising of risk, investors are increasingly looking at each country and their economy individually. Given that 2009 was a challenging year for everyone, this divergence and a search for quality has produced a mixed picture in the region.

GDP Comparison of Surveyed CEE Countries vs Germany and UK



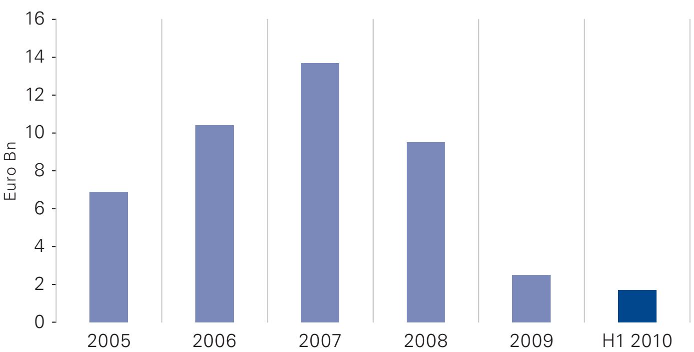
Source: Datamonitor

The more mature markets of Poland and the Czech Republic have thawed out more than the other countries during 2010, as investors focus on better performing economies. Poland's GDP was the best in Europe in 2009 at +1.7%, the only country in the EU to maintain positive GDP growth throughout the year. This has also been maintained during H1 2010. In the Czech Republic, Oxford Economics forecasts a growth of 1.45% for 2010, accelerating to 2.6% in 2011.

Some countries, such as Romania and Bulgaria, are suffering after excessive speculative investments, whilst others, such as the Baltic States, are reacting negatively to huge gross domestic product (GDP) contractions. In the long term, the region's residential sector may offer the most hope due to the substantial discrepancy between living space per capita in CEE and in the EU-15.

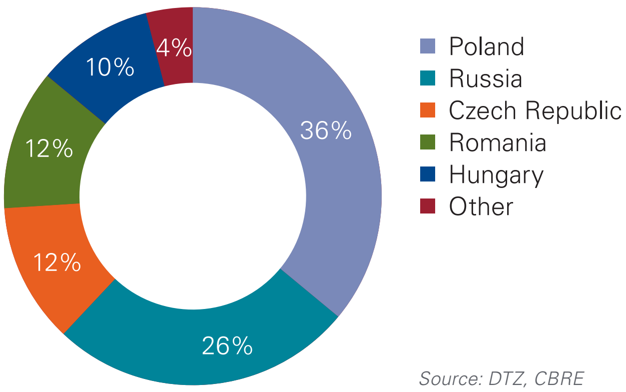
Can one really speak about sector recovery without the resuming of financing?

Total Real Estate Transactions in the CEE region



Source: DTZ, CBRE
Note: CEE includes the following countries: Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania, Russia, Serbia, Slovakia, Ukraine.

H1 2010 CEE Real Estate transactions broken down by country



Source: DTZ, CBRE

Real estate transactions in the CEE region totalled EUR1.7bn in H1 2010, which is roughly 10% of the UK figure for the same half-year. Poland was the most active investment market. This EUR1.7bn shows improvement based on total 2009 transactions of EUR2.5bn, but it is still significantly lower than 2 years ago. In CEE, yields have fallen for prime properties, but the rate of decline is slowing and heading for a period of stability.

While debt financing is still problematic for many developers, the liquidation of large numbers of asset portfolios has not yet taken place, and has not led to a sizeable price collapse in the current environment. Companies bearing large amounts of equity prefer to wait in a predatory fashion, looking for the best opportunities. Although the markets and confidence have risen during 2010, the state of the economy in the USA and the Eurozone has led to a debate regarding the likelihood of a double dip recession.

In recent years we have seen huge increases in supply to cater for high demand. Today, fewer projects are being launched mainly due to the lack of development finance. Our survey takes a closer look at whether financing is the real obstacle to the sector's recovery and what opportunities exist today.

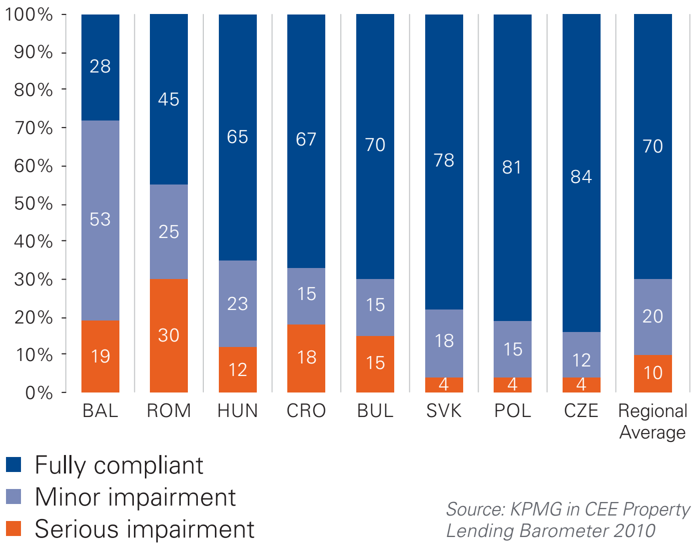
Managing impaired loans

Many banks in the region have large real estate portfolios, a large proportion of which are not performing. In this chapter, we focus on banks' opportunities to manage real estate loans where debtors cannot pay their capital and/or interest on time.

Current state of and future expectations for impaired loans

Based on the responses collected, the highest ratios of impaired real estate loans are in the Baltic countries (19% serious and 53% minor impairment), and in Romania (30% serious and 25% minor impairment), while the highest proportions of fully compliant loans are in the Czech Republic (84%) and Poland (81%). These results tend to reflect the overall macroeconomic conditions of the countries under review.

Proportion of impaired real estate loans per country



Source: KPMG in CEE Property Lending Barometer 2010

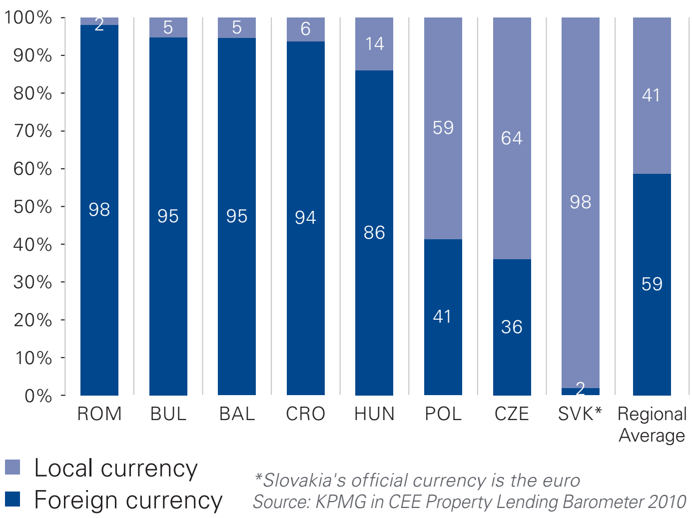
Banks are looking to restructure existing loans rather than seeking foreclosure

As the results of Poland and the Czech Republic demonstrate, a higher proportion of local currency loans seems to correlate with a higher proportion of fully compliant loans in a country. This is also true of Slovakia which is part of the Eurozone.

"Quality projects still have a future – as the downturn in the real estate market exposed those projects that were originated based on overly optimistic assumptions."

Bank representative, Poland

Proportion of foreign and local currency real estate loans

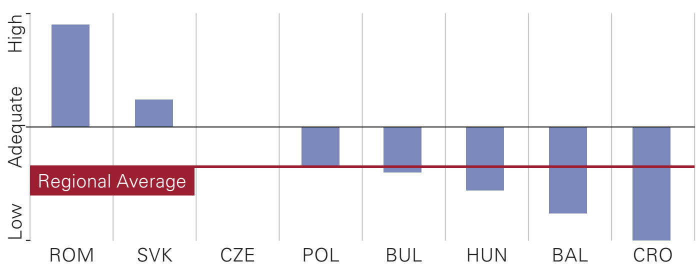


**Slovakia's official currency is the euro*

Source: KPMG in CEE Property Lending Barometer 2010

Provision levels are considered relatively low in most countries, while they are considered relatively high in Romania and Slovakia.

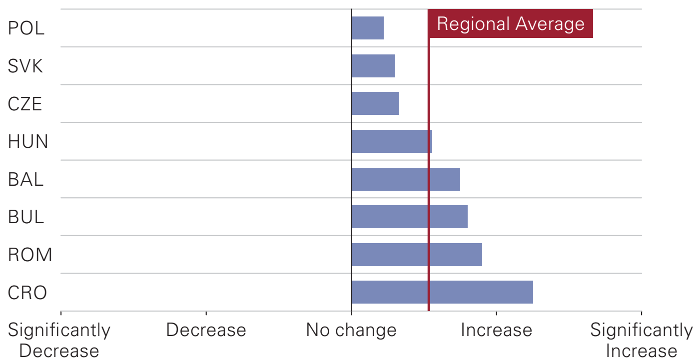
Banks' perception on level of provisions regarding real estate loans



Source: KPMG in CEE Property Lending Barometer 2010

The amount of provisions (value adjustments) is expected to increase in all countries surveyed by the end of 2010. In Romania and Slovakia, banks expect provision levels to increase by the end of 2010, although they considered these levels to be more than adequate when interviewed in the summer of 2010.

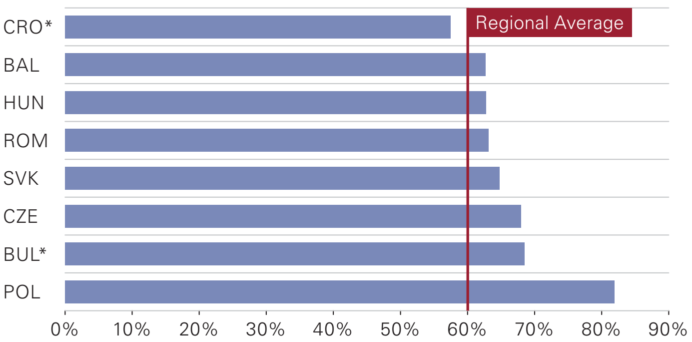
Expectation for change in the amount of provisions for real estate loans from the end of 2009 to the end of 2010



Source: KPMG in CEE Property Lending Barometer 2010

These results, overall, suggest that banks are not positive about a potential quick recovery of the real estate market in any country, with the possible exception of Poland, the Czech Republic and Slovakia, where, comparatively, the market has not suffered to the same extent as in other countries from the crisis.

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



**answers varied significantly in this country*
Source: KPMG in CEE Property Lending Barometer 2010

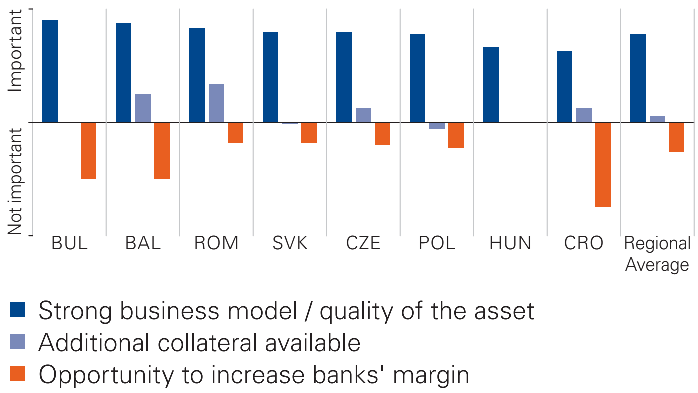
Restructuring as an opportunity to manage impaired loans

Banks in all countries believe that in the majority of cases, impaired loans may be managed successfully through restructuring. Responses were especially positive in Poland, where more than 80% of respondents believe that impaired loans may be restructured successfully.

These results confirm that banks are doing their best to actively manage their real estate loans rather than immediately seeking foreclosure. The rescheduling or restructuring of loans is understood to be a good approach, at least in the short term. However, it is not clear whether restructuring might be a long-term solution or just a temporary one.

A primary precondition before any restructuring is the cooperative behaviour of debtor companies' management. Once this condition is met, a strong business model is the most important factor to drive successful restructuring in all countries, followed by additional collateral.

Criteria for successfully restructuring impaired real estate loans



Source: KPMG in CEE Property Lending Barometer 2010

Our survey suggests that banks are primarily interested in financing high quality projects, and this remains their primary concern even in challenging times.

"As long as the debtor is able to pay on regular basis, at least the interest, we see the respective financed business as viable under existing market conditions".

Bank representative, Czech Republic

Overall prospects of the banks' real estate portfolios

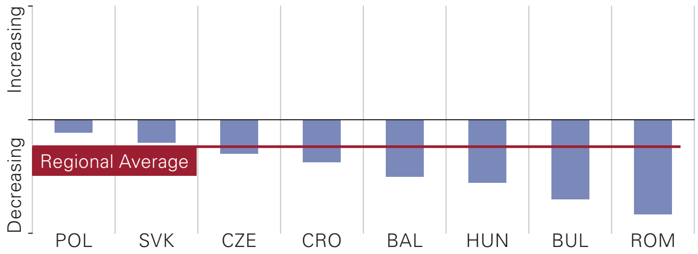
In this chapter banks' expectations on the future of their real estate loan portfolios are assessed in light of recent developments and banks' strategic approach to real estate financing.

There is a general decline regarding banks' focus on real estate financing in all the countries surveyed. The greatest decline is in Romania and Bulgaria, while only a very moderate decline is apparent in Poland. These results suggest that banks feel the pressure on the real estate market themselves and do not foresee a quick recovery from the crisis.

Real estate projects are strategically more important to banks in the Baltic countries, Hungary, Romania and the Czech Republic, while in the rest of the countries they had moderate importance, with none of the survey participants in any country indicating they had significantly low importance.

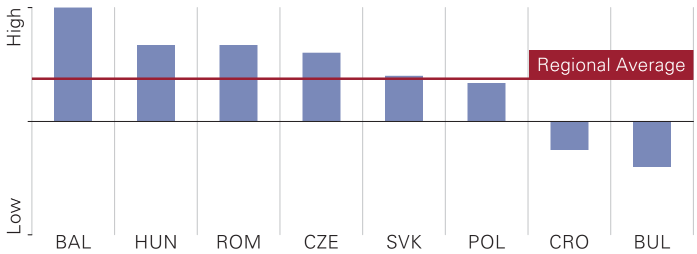
This may suggest that banks are cautiously positive about the long-term prospects of the real estate market and are continuing to monitor developments. However, this may also reflect the fact that a number of banks have significant non-performing real estate loan portfolios that they have to manage.

Change in the focus of real estate financing within banks' lending activities compared to three years ago



Source: KPMG in CEE Property Lending Barometer 2010

Strategic importance of real estate financing for banks



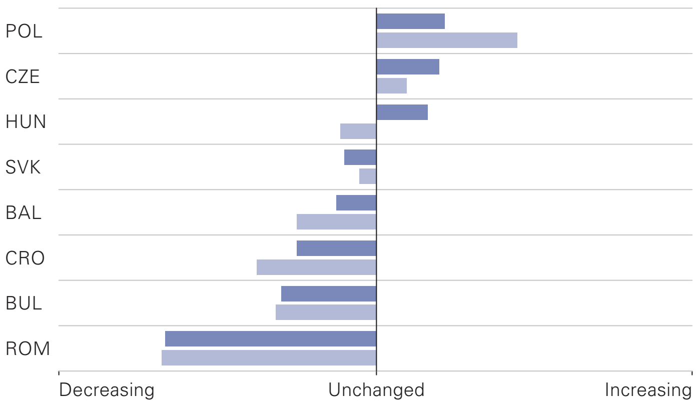
Source: KPMG in CEE Property Lending Barometer 2010

Poland and the Czech Republic have come through the downturn ahead of the other CEE countries surveyed

The future of real estate loan portfolios

Banks' sentiments on their own and their countries' real estate loan portfolio size varies greatly from country to country. There is moderately positive sentiment in Poland, the Czech Republic and Hungary. In the remainder of the countries surveyed, banks expressed rather negative expectations, i.e. they expect the size of their real estate loan portfolio and that of other banks to decrease.

Banks' forecast on the change in size of the loan portfolio



- Forecast on the change in size of their own real estate loan portfolio in 12–18 months
- Banks' forecast on the change in size of the bank sector's real estate loan portfolio in 12–18 months

Source: KPMG in CEE Property Lending Barometer 2010

There is an interesting point in Hungary, where banks are positive about their own real estate portfolios' future and to a certain extent negative about the bank sector's real estate portfolio.

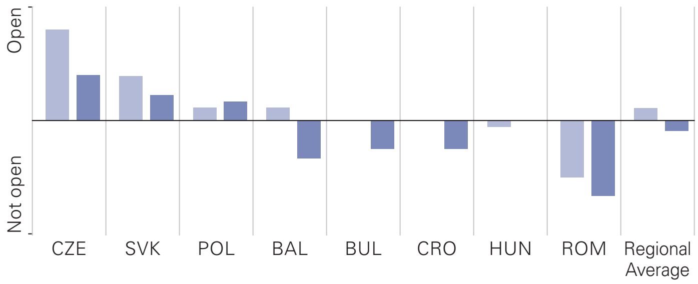
Overall, responses seem to link the prospects for real estate financing with the general macroeconomic outlook in each country. Hence, Poland leads the field, followed by the Czech Republic.

Opportunities for financing new real estate projects

In this chapter we analyse the opportunities for developers to obtain bank financing for their real estate projects, as this is the most important issue that developers must overcome in the current environment.

The majority of the banks interviewed were neither clearly open nor explicitly negative about financing real estate projects. However, their approach to providing financing for real estate development projects varies greatly across the region.

Openness of banks to finance development/income-generating projects



Source: KPMG in CEE Property Lending Barometer 2010

Perhaps unsurprisingly, the most positive responses are from the three countries that have the highest proportion of fully compliant real estate loans: the Czech Republic, Slovakia and Poland. Meanwhile, banks in Romania and in the Baltic countries have a more negative approach. However, the good news for property developers and investors is that it seems that there are some banks in all of the surveyed countries that are relatively open to finance income-generating properties.

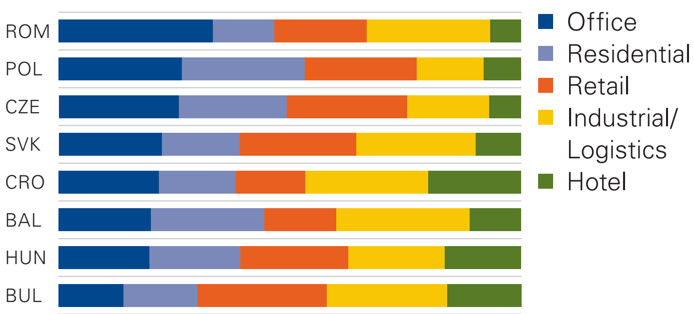
Banks are reopening to finance prime quality projects

Asset Class Preferences and Interest Premium

After reviewing banks' general openness to lending, a review of their preferred asset class in each country has been performed.

Banks' preferences are inconsistent and vary from country to country. In Hungary, the Czech Republic and Bulgaria, retail is the first priority, whilst in Poland and Romania the office sector is the most preferred. In Slovakia, Croatia and the Baltic countries, the industrial/logistics sector is at the top of the priority list, whilst the hotel sector is generally the least preferred sector, except in Croatia and Hungary. The hotel sector does not appear at the top of the priority list in any of the countries investigated.

Banks' sector preferences in providing development financing by asset class



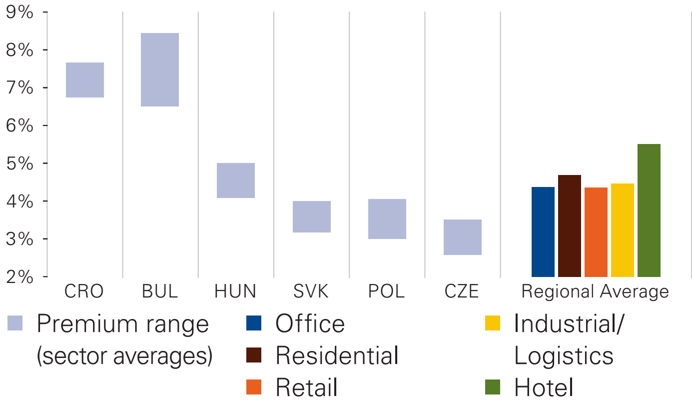
Note: the longer the bar, the more prefered the asset class is for the banks.
Source: KPMG in CEE Property Lending Barometer 2010

These preferences for financing are a result of local supply and demand characteristics and the outlook of individual sectors in each country. For example in Poland, where the office sector is the most preferred, the office vacancy rate is 7% and current demand is fairly strong with recent completions being approximately 57% pre-let[2].

On the other hand, in Croatia where the hotel sector is a high preference, the number of overnight stays increased 6% and the number of tourist arrivals increased 3% compared with the same period last year[3].

In addition to sector preferences, banks were queried as to what loan interest premium they would apply on a 3-month Euribor basis, if a developer of outstanding reputation and with a solid business plan approached them. No meaningful average figures for the region were apparent, as premiums vary enormously across countries.

Loan interest premium applied by banks for highly rated real estate projects in each country



Source: KPMG in CEE Property Lending Barometer 2010

This variance may partly be explained by varying country risks, as reflected by Credit Default Swap (CDS) values. Those countries perceived as high risk and that command the highest premiums are Croatia followed by Bulgaria.

[2] Source: *Cushman & Wakefield*
[3] Source: *Croatian National Tourist Office*

The lowest premiums are in the Czech Republic and Poland, which denotes their lower risk profiles and perhaps more competition from other banks to lend to highly rated real estate projects.

CDS premium in surveyed countries (basis points)

Country	End of July 2010	Country	End of July 2010
Slovakia	81.0	Croatia	266.0
Czech Republic	93.0	Bulgaria	286.0
Estonia	98.0	Latvia	328.0
Poland	134.0	Hungary	335.0
Lithuania	240.0	Romania	355.7

CDS premium in selected countries (basis points)

Country	End of July 2010	Country	End of July 2010
Switzerland	36.6	Slovenia	77.0
Germany	36.9	Russia	166.2
Australia	50.0	Ukraine	514.3
United Kingdom	58.3	Greece	751.5

Source: Thomson Reuters (average of 18 market maker spreads, 5y senior CDS, end of day composite prices USD dominated government bonds)

As for sectors, the hotel sector had the highest premiums and the largest variance in responses. Possibly this is because the global financial crisis has hit the leisure and tourism sector hard in CEE with values per room falling 15–25% by the start of 2010[4].

"Actually we do not like hotels, but the only project we have financed recently was a hotel, because it was a sound project."

Bank representative, Hungary

Fundamental Criteria for Financing

Having seen how open banks are to financing properties, and their sector preferences, the following section reviews the criteria considered for selecting projects to finance.

In terms of criteria before providing financing, participating bank representatives expressed that a strong business model and the high quality of assets were the most important considerations, together with the level of equity provided by a developer or investors.

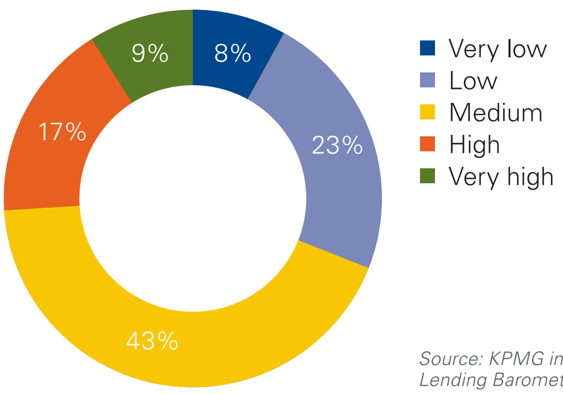
Banks' most important criteria for considering real estate financing

Strong business model/Quality of the asset	● ● ● ● ●
Level of owner's equity	● ● ● ● ●
Reputation and references of the developer/operator	● ● ● ●
Financial background of the developer	● ● ● ●
How well the project is planned, status of permitting process	● ● ●
Existence of an independent feasibility study / valuation	● ●

Source: KPMG in CEE Property Lending Barometer 2010

Independent valuation had more moderate importance. However it is still important, as only less than one-third of participating banks reported low or very low reliance on valuations provided by external service providers.

Banks' reliance on valuations provided by external service providers



Source: KPMG in CEE Property Lending Barometer 2010

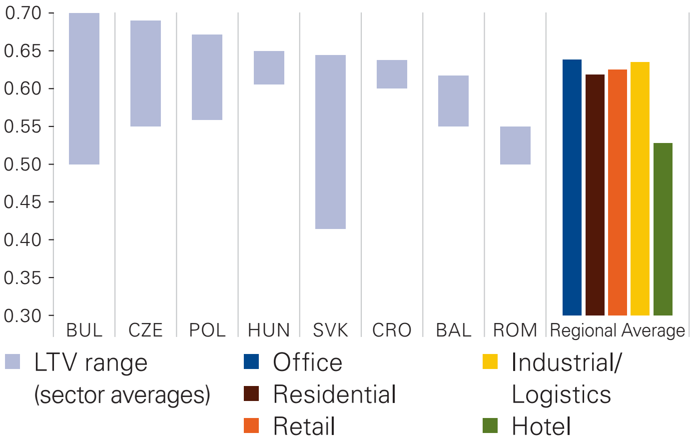
[4] Source: *HVS*

Technical criteria for financing

Banks were asked to spell out their technical criteria for financing. When questioned about loan to value ratios, the responses differed greatly across each country. The office, residential, retail and industrial/logistics sectors have an overall loan-to-value ratio between 0.6-0.7 (i.e. reflect a capital structure of 60-70% debt and 30-40% equity).

For the hotel sector the ratios vary significantly across the countries surveyed. Slovakia, for example, has a ratio below 0.5% denoting very high risk, while in Croatia the loan-to-value ratio applied for quality hotel projects is 0.6% on average.

Loan-to-value ratio expectations for financing highly rated real estate projects in the next 12–18 months

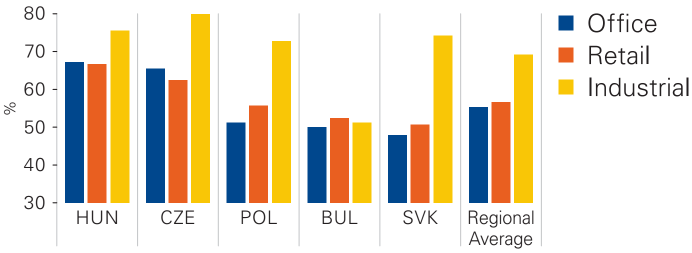


Source: KPMG in CEE Property Lending Barometer 2010

Since the global financial crisis, banks have become more risk averse and increased their criteria for pre-let and presale ratios. The expected ratios vary greatly across countries and sectors. Hungary has the highest ratios on average, closely followed by the Czech Republic.

The pre-letting ratios of the office and retail sectors are similar at approximately 55–60%. For logistic projects, banks typically expect pre-letting ratios in a range of 70–75%. In relation to the pre-sale ratio of residential projects, expectations range between 35–40%.

Pre-letting ratio expectations for financing highly rated real estate projects in the next 12–18 months in selected countries

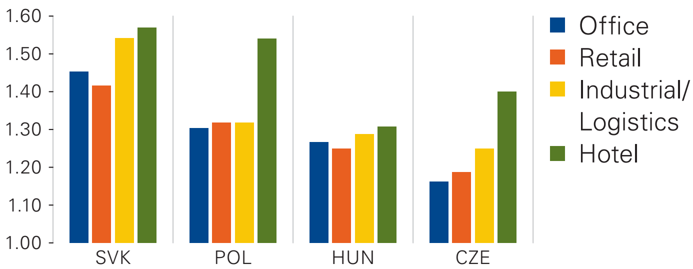


Source: KPMG in CEE Property Lending Barometer 2010

We also examined what income cover ratios[5] banks expect for income-generating projects initiated by investors with an excellent reputation and a sound business plan.

In all countries, the hotel sector ratios tend to be higher than for any other asset class.

Income cover ratio expectations for financing highly rated income-generating real estate projects for selected countries in the region



Source: KPMG in CEE Property Lending Barometer 2010

[5] Average debt service coverage ratio

Property Financing Sentiment Index

As a conclusion of our survey, we have prepared an index – the Property Finance Sentiment Index – to represent how positively banks approach financing real estate projects in each country covered by this survey.

The index was calculated using responses to the following 10 issues:

- An increasing or decreasing change in focus on real estate financing within the bank's lending activities compared to three years ago
- Proportion of fully compliant, minor impaired and seriously impaired real estate loans per country
- Proportion of impaired loans that may be managed successfully through restructuring
- Expected change (increasing or decreasing) in size of a bank sector's real estate portfolio in the next 12–18 months
- Openness of banks to finance new development projects
- Openness of banks to finance income-generating properties
- Loan interest premium applied by banks for quality real estate projects[6]
- Loan-to-value ratio expected by banks for quality real estate projects[6] in the next 12–18 months
- Pre-letting ratio applied by banks for quality real estate projects[6] in the next 12–18 months
- Income cover ratio applied by banks for income-generating properties.

Based on a ranking of the eight countries for each one of the 10 issues assessed, the following scores were achieved[7]:

Property Financing Sentiment Index

Overall ranking	Country	Index score
1	Poland	1.83
2	Czech Republic	2.00
3	Slovakia	3.67
4	Hungary	4.33
5	Bulgaria	4.94
6	The Baltics	5.43
7	Croatia	5.64
8	Romania	7.50

As is apparent from our Index, Poland leads the pack, with the Czech Republic following closely behind. In these countries, banks are more positive about financing real estate projects, than elsewhere in the region.

In the years preceding the global financial crisis, the real estate market within CEE had gone through a period of outstanding economic growth as billions of euros were invested into the region. However, in the subsequent years, CEE has been affected like the rest of the world by the economic downturn. Bank financing can play a vital role in the recovery and for the development of the real estate sector in the region.

Overall, results show that there is financing available for high quality real estate projects, and the financial sentiment is more positive in countries that have proven to be resilient to the global financial crisis.

[6] *Quality projects have been defined in our survey as follows: a project initiated by a developer/investor with an outstanding reputation and a solid business plan.*

[7] *In terms of methodology countries were ranked based on their results for each of the 10 issues considered to determine the Property Financing Sentiment Index of each country part of this survey. First place was awarded to the country showing the most positive result in relation to each given issue, while the bottom placing (place 8) was assigned to the country with the most negative result for the same issue. The arithmetic average of the sum of the 10 rankings of each country was finally calculated to determine the Property Financing Sentiment Index.*

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