Property Lending Barometer 2015

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

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cutting through complexity

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6th
edition of annually performed survey

Interviews conducted with banks from
21
European countries

Input from more than
90
banks

Dear Reader,

We are pleased to present the Property Lending Barometer 2015, which is the 6th edition of our annually performed survey of banks' real estate financing. Our report provides an insight into lending market conditions in Europe and also gives a separate snapshot of the participating countries to highlight their unique characteristics.

Our aim is to assess the prospects and sentiment for bank financing in the real estate sector in Europe based on interviews conducted with banks from 21 European countries. This year a number of countries have been included in the survey for the first time: Cyprus, Greece, the Netherlands, Spain, Turkey and Italy.

Overall, the economic conditions have become more favourable in Europe since last year with improved outlook and less restrictive business sentiment. 2014 was a turning point in Europe since the onset of the global financial crisis. It saw both economic growth and the long-awaited boost in most of the real estate markets. According to analysts' projections, growth is expected to further strengthen during 2015 with easing credit standards and downward pressure on margins across the markets. Even though there are positive improvements in bank financing it is considered to be still tight in comparison to the pre-crisis level. The current uncertainties about China's slowdown, the Greek debt crisis and the tension between Russia and Ukraine might threaten the positive business sentiment in Europe.

The lending sentiment among banks in general has improved and they are becoming more open to financing real estate projects. They realized that they need to overcome their difficulties if they want to keep their market share as alternative lenders are becoming more active. The current macroeconomic environment with record low interest rates and greater availability of financing both from banks and alternative lenders made real estate investments more appealing for investors. As a consequence, transaction volumes have been significantly increasing, leaving less quality prime products in the market.

The debt sale market is also becoming more active with a narrowing gap between banks and opportunistic non-performing loan (NPL) portfolio investors pricing expectations; however, this trend is mainly apparent in Italy and Spain. With the sale of NPL portfolios, banks will be able to accelerate their lending activity. The initiative by the ECB also supports this goal by coordinating an asset purchase programme that injects liquidity into the banking system.

This report is an analysis of the findings of our survey of the leading banks active in the countries in scope over the past 12 months. The barometer includes input from more than 90 banks active in these markets, collected primarily via in-depth interviews and online questionnaires. Representatives of leading financial institutions have provided their views on the key issues affecting property lending.

In this report we first provide 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 raise issues such as various banks' average and preferred loan/deal size. Furthermore, the opportunity for new financing and banks' asset class preferences were also considered.

Finally, for each participating country, we have addressed the prospects and terms available for developers and investors to finance new real estate developments and income-generating properties and have presented what they expect for the next 12-18 months.

We would like to take this opportunity to thank all of the participants 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 financing. 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 involved in this survey.

Yours sincerely,

Stefan Pfister 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 2015 survey: Austria, the Baltics[1], Bulgaria, Croatia, Cyprus, the Czech Republic, Germany, Greece, Hungary, Italy, Netherlands, Poland, Romania, Serbia, Slovakia, Spain, Sweden, Turkey and the United Kingdom. Even though banks operating in Switzerland did not participate in the survey, we also provide a separate overview of the Swiss real estate financing market, based on secondary market research data.

The data for the survey was primarily collected through in-depth interviews with bank representatives and via online questionnaires. 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. The survey participants included over 90 banks, all of which were active in the real estate market in Europe over the last year. Data collection for this survey took place during the period May-July 2015.

Approximately 12% of survey participant banks were local banks, i.e. those operating predominantly within one European country, whilst the majority of respondents were regional or multinational banks.

Comparison of the surveyed countries

In order to provide better benchmarking between the surveyed countries, we allocated them into three categories considering the following factors: i) overall size of their economy in terms of the total GDP volume, ii) population and iii) the risk profile represented by 5 year CDS premiums. Based on these factors we prepared the following three categories for the purpose of our comparison:

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 the overall market conditions at the European level. In this category we included the United Kingdom, Germany, Italy and Spain.

Established economies: Similarly 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, the Czech Republic, the Netherlands, Poland, Slovakia and Sweden.

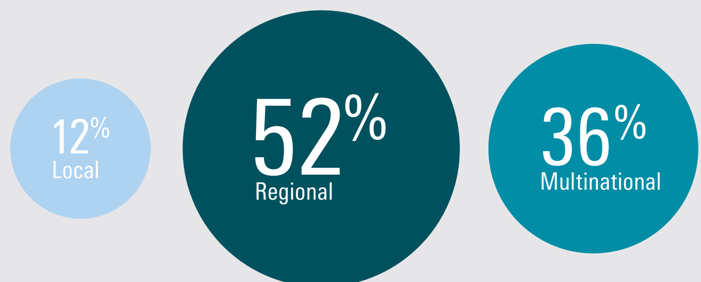
Other economies: In general, these markets have a higher risk profile in comparison to the more established countries. Also the size of some of the markets in this category is not large enough to merit inclusion among the established markets. In this category, we considered the Baltics, Bulgaria, Croatia, Cyprus, Greece, Hungary, Romania, Serbia 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 some 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 with construction costs below EUR 10 million.

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 2015*

Geographic abbreviations

AUT – Austria; BAL – The Baltics; BUL – Bulgaria; CEE – Central and Eastern Europe; CRO – Croatia; CZE – Czech Republic; EMA – Europe, Middle East and Africa; GER – Germany; GRC – Greece; HUN – Hungary; ITA – Italy; NLD – Netherlands; POL – Poland; ROM – Romania; SRB – Serbia; SVK – Slovakia; SLV – Slovenia; ESP – Spain; SWE – Sweden; TUR – Turkey; GBR – United Kingdom

1 Based on responses received from the banks surveyed, the Baltic countries (Estonia, Latvia and Lithuania) may be grouped together from the point of view of bank financing in the real estate sector.

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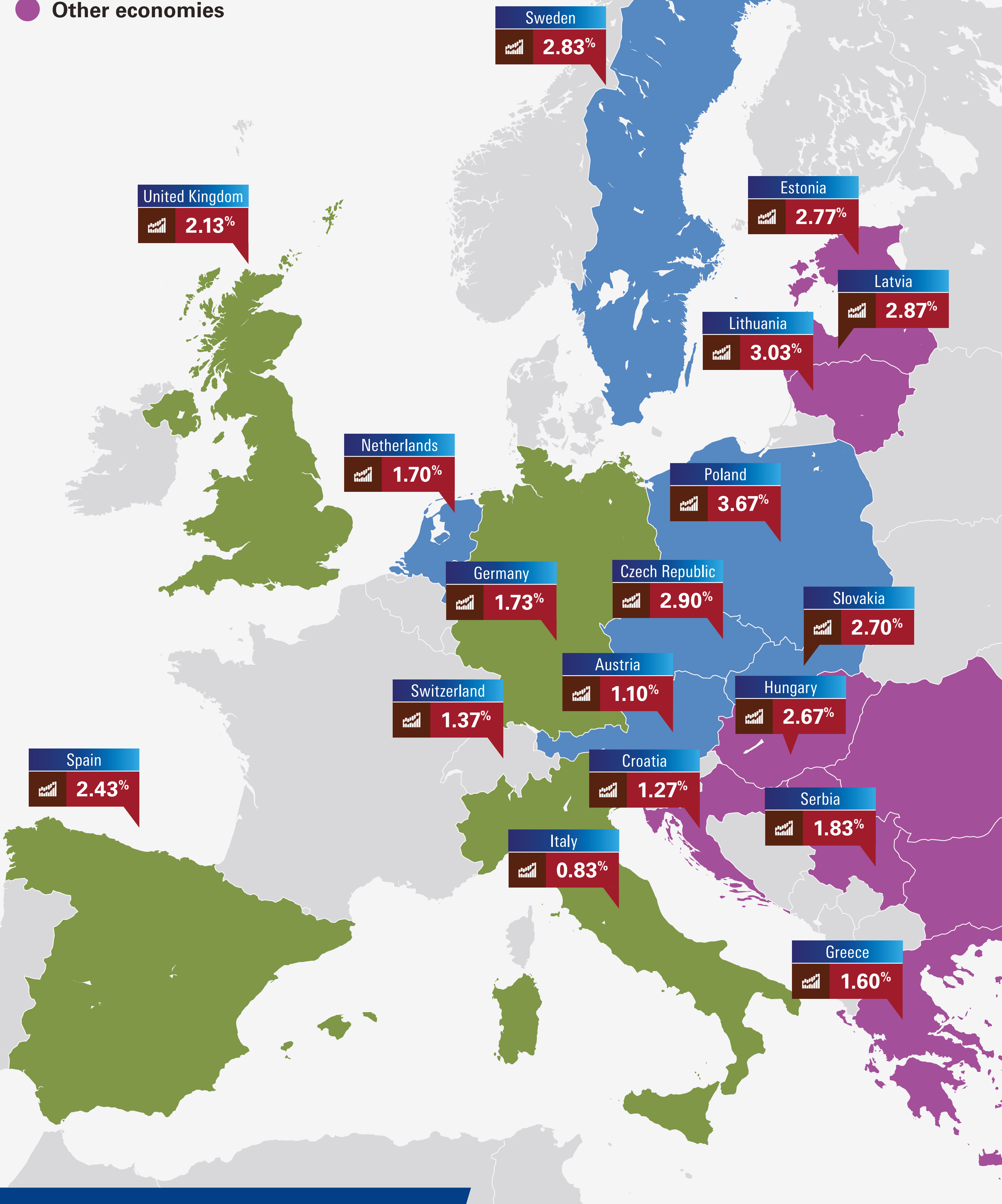

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Overview of the European real estate market

Macroeconomic outlook of the region

The economic conditions in the EU28 countries have been recovering since 2013, and in 2014 most of the countries in the region experienced GDP growth. Even though there are doubts about long-term sustainability of the growth and its uneven nature country-by-country, the short-term outlook for the EU economies has clearly improved. However, some markets, especially the less established ones, are still under pressure to deal with the damage caused by the global financial crisis.

Overall, the average GDP growth of the 21 countries involved in the survey was approximately 0.8% higher in 2014 than in 2013 and it is expected to further increase to a level of close to 2% in 2015. The gloom period seems to have been left behind and the momentum of growth is expected to continue. This expectation is also supported by three key factors.

Firstly, the region is a large net oil importer, hence low oil prices gave a significant stimulus to the region's economy by leaving companies and households more disposable income. Hence, domestic demand increased in almost all countries. Overall positive sentiments boosted consumer confidence, so people are spending more compared to last year. As a consequence, the retail sales volume was growing at its highest rate in ten years at the beginning of 2015. Secondly, the macroeconomic policies were redesigned to provide more support to economic growth. The European Central Bank, followed by a number of central banks in the region, has lowered interest rates, providing liquidity injections whilst also controlling inflation. Therefore, real interest rates fell, which had a positive effect on lending activity. Lower borrowing costs increased demand for loans both from households and companies, and this supported the overall investment activity. Thirdly, the euro exchange rates saw some decreases, positively affecting the volume of Eurozone country exports.

The combined effect of these factors is expected to keep the region's economy on an upward track for the coming years. However, the effects of these factors are not equally beneficial for each economy across the EU. The individual characteristics and structure of each economy will modulate the positive impact of these factors.

There are still a number of structural deficiencies, which the region has to deal with in order to secure sustainable growth and overcome the underlying weaknesses. These are mainly related to products and service offerings, the labour market, productivity and better coordination of public investments as well as simultaneously dealing with high a public debt ratio in some countries.

The implementation of structural reforms in each member state will be crucial in order to maintain the long term competitiveness of the EU. Due to the efforts of the member states, unemployment rates are gradually falling, although from a very high base. Another risk factor is the tension between Russia and the EU, in connection with Ukraine – although, based on an agreement reached between the parties with the cooperation of the EU leaders, this has become less intense. However, the recent uncertainties about China's economic slowdown and the Greek debt crisis may negatively affect the current positive business sentiment in Europe.

Also, an agreement was reached between Greece and the EU regarding a third bailout package. According to the current bailout plan, the execution of a number of austerity measures will be required by the Greek government in order to keep the country in the euro-zone. However, the implementation of the required reforms by the Greek government also incorporates a number of uncertainty factors.

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Bank lending

Continuing the trend started in 2014, bank lending has recovered further with credit terms on loans becoming more favourable, and financing is now more available. Even though the easing in credit standards is still considered to be tight in comparison to the pre-crisis level, this is a big step forward for the European economies after the years of a depressed loan market.

In order to take advantage of the more favourable terms and further boost lending activity, the European Central Bank initiated an asset purchase programme. This initiative is expected to enhance the liquidity position of the banks and make them even more open to providing loans to the private sector. However, due to the fragile regional financial system, increased regulatory pressure and the high rate of non-performing loans in some of the peripheral countries, this extra liquidity might not necessarily lead to an increase in lending volumes.

Deleveraging has been continuing across Europe, with a 2% reduction compared to last year, so now leverage in Europe stands at 53%[2]. This decrease, which is expected to continue further, was predominantly caused by write downs, equity injections and the selling of NPL portfolios in previous years. Also, the proportion of equity grew ahead of debt due to new loan deals, and this all lead to greater decreases in the banks' leverage ratios. Activity rates at non-bank alternative lenders, such as private equity/debt funds and investment banks increased and their market shares rose from 1% to 5% in the period of 2007 to 2014.

The result of the asset quality review (AQR) performed in 2014 showed that, overall, banks are better capitalized than they were before the crisis, hence they are less vulnerable and more prepared to overcome potential losses. The effect of the AQR was not as significant as expected, though it brought discipline to the banks. Additionally, new measures were introduced in relation to amend-and-extend transactions. These measures require banks to report all restructuring activities (such as extended loan term, reduced repayments, reduced loan interest rate) where the debtor is in financial difficulties and where banks are required to create provisions earlier. Due to the stricter reporting policies enforced by the European Central Bank it is expected that it will become more complicated to execute amend-and-extend transactions.

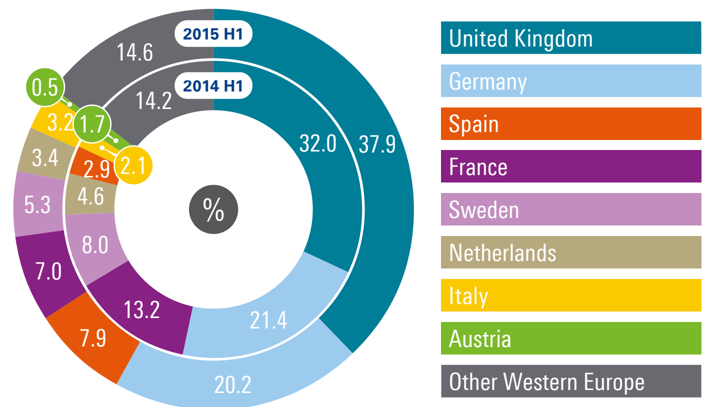
Real estate market in Europe

The investment market has remained active in 2015 and in terms of the total volume, the first half of the year was significantly stronger than the same period last year. Overall turnover exceeded EUR 110 billion, which represents close to a 35% increase compared to H1 2014.

Strong demand and further recovery on markets are forecasted, driven by more competitive return potential offered by property investments. The low interest rate environment across Europe with record low yields offered by government bonds turned investors' focus onto real estate markets.

As in 2014, almost two-thirds of the transaction volume in H1 2015 is accounted for by three countries. Compared to last year, France has lost its momentum and Spain has now become the third most active market, after the UK and Germany. The two largest economies in Europe, the UK and Germany remained as key players in the European investment market, with close to 38% and 20% shares in the investment volume, respectively. The share of Other Western Europe (indicated on the chart) remained at approximately 14%, whereas the CEE region (excluding Russia) only represents 3.4% of the aggregate European investment transaction volume.

Real estate transactions broken down by country – Western Europe

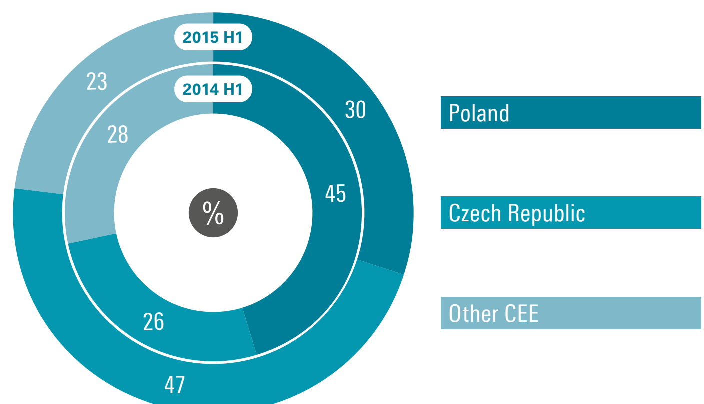


Source: *CBRE*

The most significant increase in volume was registered in Spain followed by Norway and Italy.

Overall investment activity and total turnover decreased by 7% in the CEE region. This negative change can be partly attributed to the geopolitical uncertainties in the region and the lack of a quality supply of retail and industrial/logistics properties suitable for investors. In the CEE region only the Czech Republic managed to increase their investment volume during the first half of the year compared to the same period in 2014. Poland and the other CEE countries could not attract as much investment as in H1 2014 and the Polish and the other CEE investment markets (indicated in the chart) fell by 38% and 25%, respectively. The Russian economy is struggling due to the sanctions of the EU and U.S., thus the investment market has become less active. The total transaction volume in Russia fell by 51% in H1 2015 compared to the same period in 2014.

Real estate transactions broken down by country – Central and Eastern Europe (excluding Russia)



Source: *CBRE*

2 DTZ

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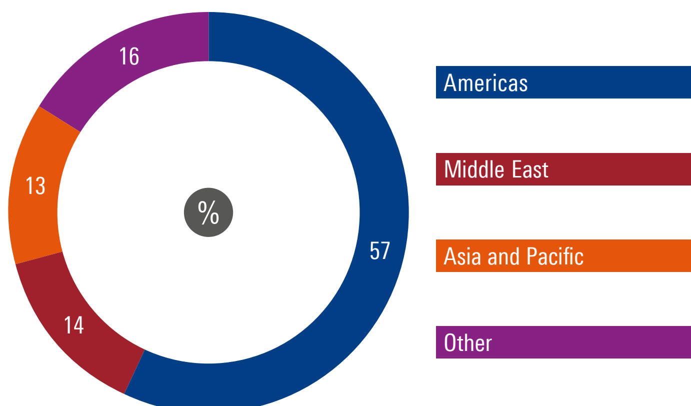
Cross-border investors are playing an important role in the recovery of the investment markets. Also as a result of the strengthening of the USD, the most notable cross-border investors in Europe are from the Americas region[3], although investors from Asia and Pacific markets such as China and South Korea are increasing their activity in the region as well[4]. The most attractive investment destinations in Europe for international investors are London, Milan, Luxembourg and Warsaw, where more than 50% of the investment volumes are being initiated by non-local investors. The largest proportion of domestic investors was registered in the Nordic[5], German and Spanish markets .

Demand for prime properties in core markets remains high, while the supply of prime assets suitable for investment is actually becoming weaker. Therefore, an increasing number of investors are prepared to take more risk and enter into markets with higher yield potential, as is being seen in Spain, Ireland and Italy.

There was no significant change in investors' asset class preference compared to last year with *office* being the most popular, (accounting for 44% of the total investment volume) followed by *retail* (23%), *industrial* (11%) and *hotel* (7%).

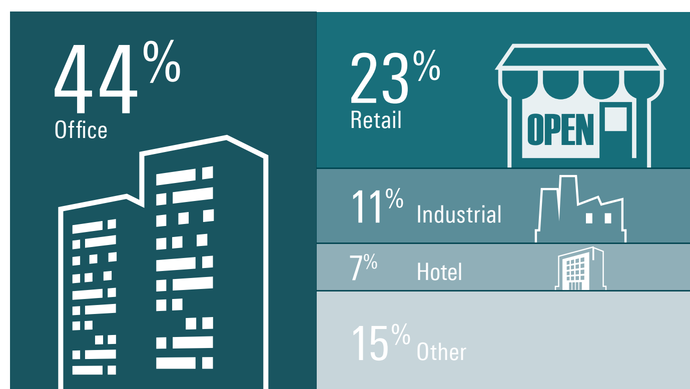
Prime yields experienced further decreases in the core markets since last year, almost reaching pre-crisis levels. However, rental fees remain at a low level, and this could attract both tenants and investors. Tenants can benefit from lower rental fees and could realize more favourable deals. For investors, the potential growth in rent levels could give an upside by improving their invested cash flow. According to analysts, the main issue for the further increase in the upcoming period will be the lack of prime products available to investors. As a consequence, it is expected that due to the increasing risk tolerance of investors and banks, quality assets in secondary locations could become the biggest winners in the property investment market this year.

Real Estate investment capital inflows to Europe by region (H1 2015)



Source: *JLL*

Investment by asset type in Europe (2014)



Source: *Colliers International*

3 Canada, USA, Partial coverage of Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Panama and Peru
4 DTZ
5 Norway and Sweden

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Managing impaired loans

The global economic crisis had a serious impact on the financing of the real estate sector. During the years of the crisis the proportion of impaired real estate loans were increasing in Europe especially in those less established peripheral markets where the majority of loans were denominated in foreign currency. The depreciation of local currency and declining economic conditions resulted in an increased proportion of impaired loans. Banks have different options when dealing with these loans, such as restructuring, foreclosing or selling these non-performing loan (NPL) portfolios. Due to the later improving market conditions, the gap between the price offered by investors for the NPL portfolios and banks' expectations narrowed, which led to more transactions. However, NPL portfolio transactions are more common in Western European countries, hence 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' opportunities 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

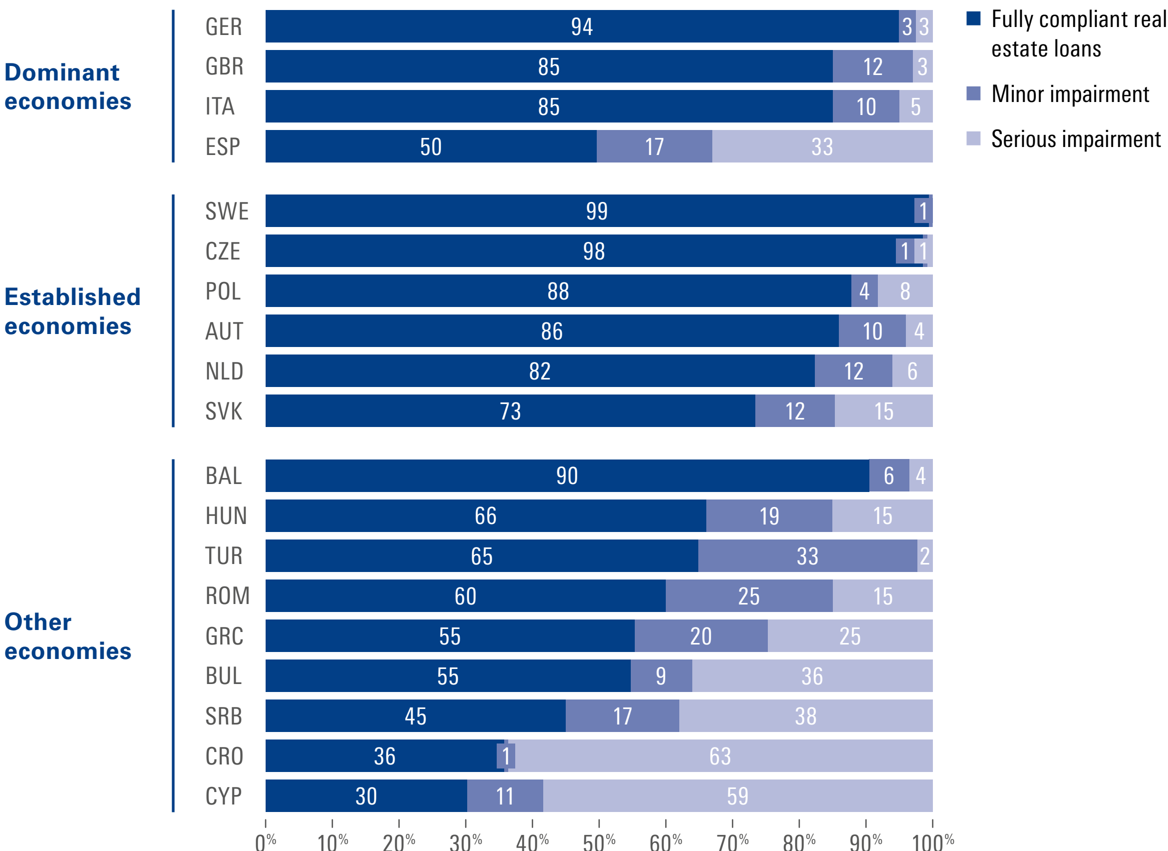
With the exception of Spain, banks operating in the dominant and established economies indicated a higher proportion of fully compliant loans (73-99%) compared to less established markets.

In the case of Spain, the long recession period and significant lost stimulus after the onset of the global financial crisis resulted in 50% of loans being impaired (33% serious and 17% minor impairment). As a result of the recent upturn and increasing activity in the real estate market the ratio of non-performing loans by banks is expected to decrease.

A high proportion of fully compliant loans is observable among the established economies, where the ratio of fully compliant loans currently ranges between 73% and 99%. The highest proportion is in Sweden with 99% followed by the Czech Republic with 98%, while the lowest is in Slovakia with 73%.

Based on responses collected, the highest proportion of impaired real estate loans among the less established other economies was in Cyprus with 70% of impaired loans (59% serious and 11% minor impairment). Banks in Croatia and Serbia also have a high proportion of impaired loans with 64% and 55% respectively.

Proportion of impaired real estate loans per country



Source: *KPMG Property Lending Barometer 2015*

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Restructuring as an opportunity to manage impaired loans

The majority of the bank representatives interviewed still think that through restructuring they can successfully manage the majority of their impaired real estate loans. On average banks indicated that approximately 60% of their impaired loans may be managed through restructuring. The answers suggest that rescheduling or restructuring of loans is still a preferred approach by banks to manage problematic loans.

On average, banks in the established economies indicated the highest ratio of impaired loans that may be managed through restructuring (72%), followed by those in the dominant economies with 61% and other markets with only 55%. The answers suggest that banks in more established countries believe that restructuring can be an appropriate solution for a greater share of their impaired loans compared to banks operating in other less established economies.

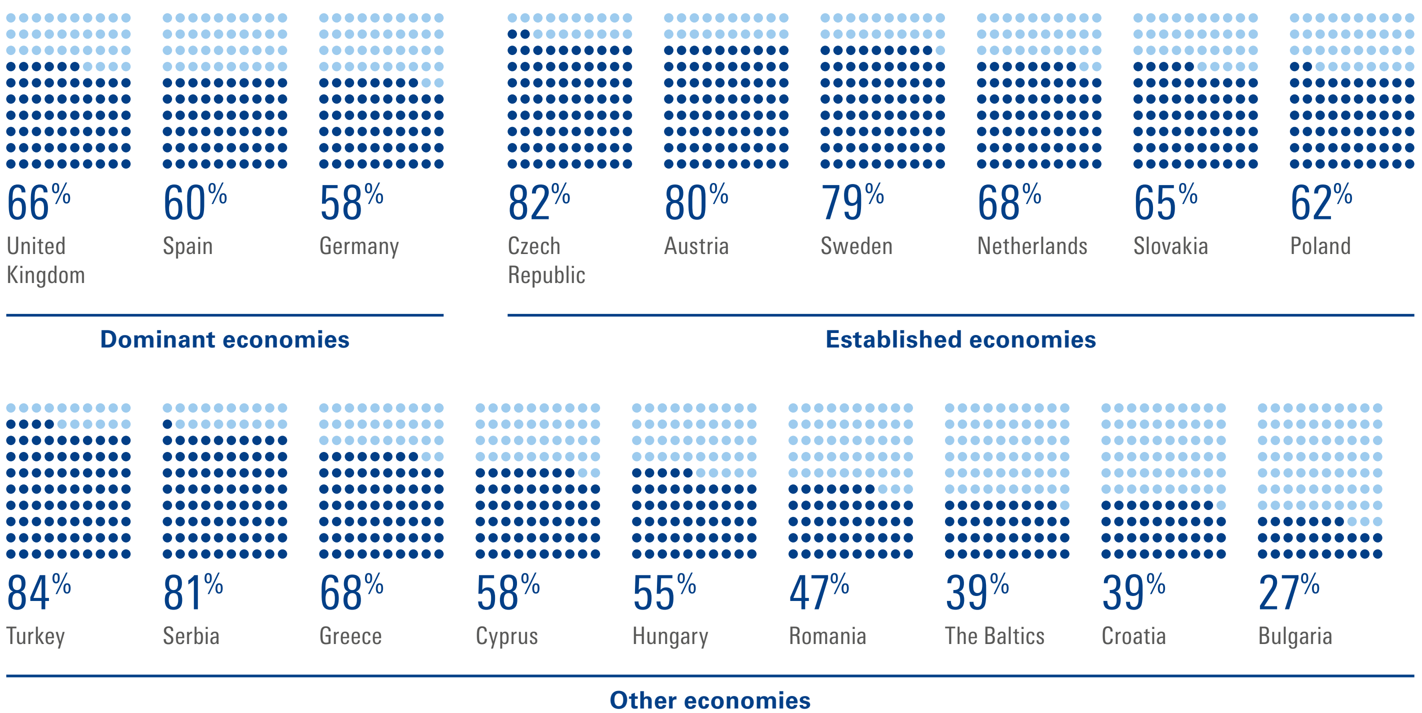
Banks from the UK were the most optimistic of the dominant economies in this regard, as based on their answers on average 66% of problematic loans may be managed successfully through restructuring. By contrast, German banks think that this proportion is below 60%.

Banks operating in the established economies indicated that between 62% and 82% of problematic loans may be managed through restructuring. Czech banks are the most optimistic in this regard with 82% and Polish banks the least optimistic with 62%.

From the less established other economies, the Turkish and Serbian banks considered that a large proportion of their impaired loans may be managed through restructuring, indicating on average 84% and 81% respectively. However, participants from Bulgaria, Romania and in the Baltic states indicated the lowest proportion, which suggest that banks in these countries do not think that restructuring can resolve the most problematic loans.

If banks neither prefer to reschedule or restructure the loans nor are looking for foreclosure, they can also consider selling their non-performing loan portfolios to specialized investors. These investors tend to achieve higher recovery from these problematic loans compared to banks, as it is their core competence to manage these distressed portfolios.

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



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Most important criteria for successful restructuring

Overall, banks' answers remained consistent with those of last year in the case of the most important criteria in terms of successful restructuring. The primary precondition for any restructuring is co-operative behaviour on the part of the borrower. If banks see that there is appropriate cooperation from the borrower then they consider the business model and the quality of the asset as the most important criteria when it comes to restructuring. The availability of additional equity remained the third most important factor during a restructuring.

Similarly to last year, the availability of additional collateral and the opportunity to increase the bank's margins were the least important for banks.

The answers show that banks have similar views on the criteria for successful restructuring regardless of the size and risk profile of the market in which they operate.

Most important criteria for successfully restructuring non-compliant real estate loans

Source: *KPMG Property Lending Barometer 2015*

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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.

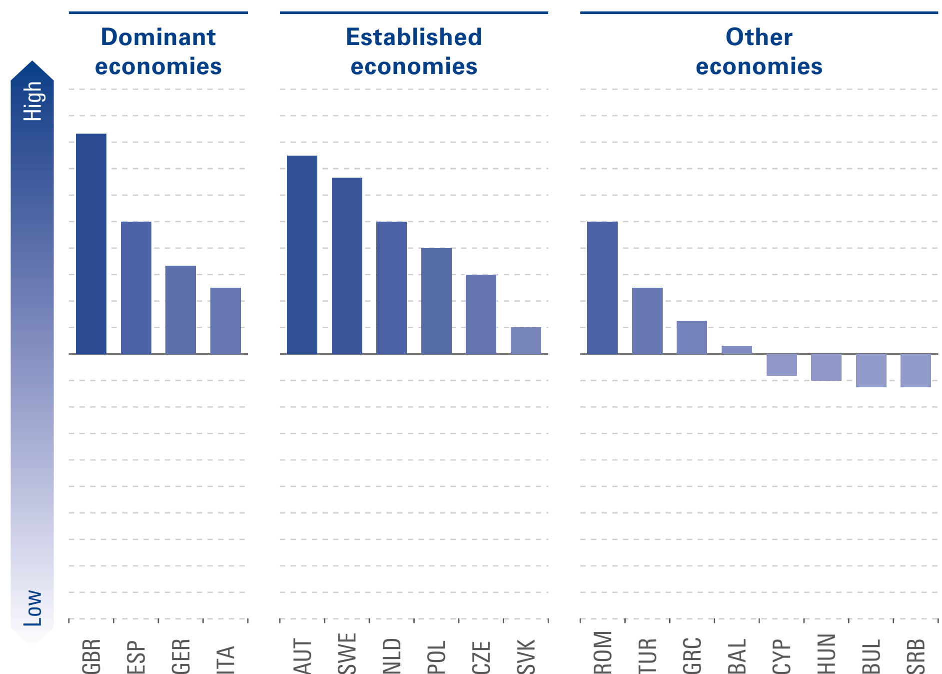
Strategic importance of real estate financing

Based on banks' feedback in general, real estate financing is now strategically more important in dominant and established economies. However, in some of the less established other economies such as Romania and Turkey, banks indicated a relatively high strategic importance for real estate financing compared to their peers.

From the dominant and established economies, British and Austrian banks indicated the highest importance for real estate financing, while Italian and Slovakian banks indicated lesser importance. Elsewhere, banks operating in other less established economies such as Serbia and Bulgaria said 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



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

Banks were also asked how their focus has changed towards real estate financing as a part of the banks' lending activity compared to one year ago.

The majority (71%) of the respondents from the dominant economies indicated some extent of increase since last year, whereas in the case of the established markets 40% of the banks shared this opinion.

In the less established other economies the proportion of the banks who outlined that there was an increase in their focus on real estate financing was even lower compared to last year, as only approximately one fourth of the banks indicating an increased focus. The answers suggest that the recovery in real estate lending activity is more apparent across the dominant and established economies in Europe.

Most important factors affecting real estate loan portfolios

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

For banks in the dominant and established economies the most significant factor was the lack of prime properties. The responses show that in these more mature markets the increased investment activity is expected to result in a lack of quality properties that would eventually negatively impact loan portfolio prospects. However, it is still unknown how much additional risk investors and banks are willing to take when expanding their portfolios by investing in or financing more risky assets.

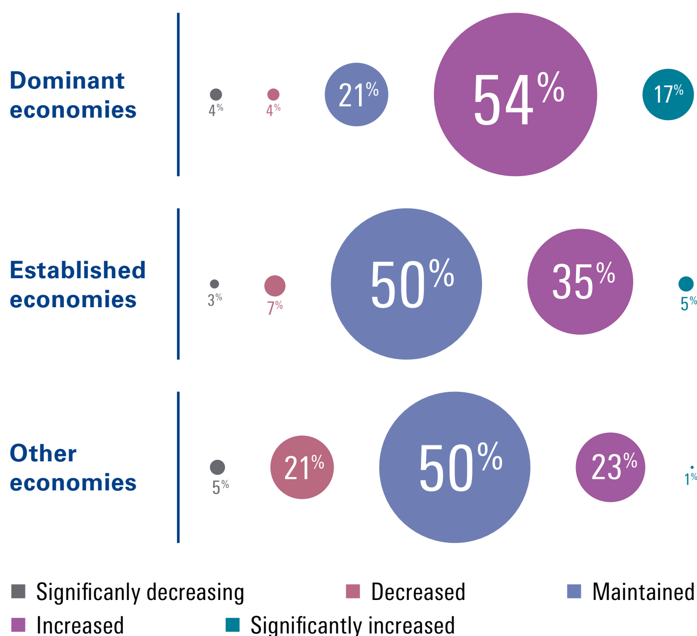
Macroeconomic conditions in Europe was the second most important factor in the dominant economies, while in the case of established economies local macroeconomic conditions were considered to have more importance.

In the other less established economies the local macroeconomic environment was identified as the most significant factor followed by the lack of active investors and lack of equity. 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 in the macroeconomic conditions in Europe has gained importance since last year among the participating banks. As the European economies are interconnected, a downturn in one market would eventually negatively affect the performance of the rest of the markets as well.

When banks 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 banks stated that additional funds may come from private equity followed by developers/investors. Bonds were also indicated as potential additional funds in Sweden, Poland and in the UK. Insurers were also mentioned by Hungarian and Polish banks.

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



Source: *KPMG Property Lending Barometer 2015*

Most important factors affecting real estate loan portfolios

	Dominant economies	Established economies	Other economies
Lack of prime properties	•••••	•••••	•
Macroeconomic conditions in Europe	••••	•	••
Lack of equity	•••	•	•••
Lack of active investors	••	•••	••••
New strategy	••	•	•
Macroeconomic conditions in the local market	•	••••	•••••
Basel III	•	••	•
New limits on maximum loan size/customer exposures	•	••	••

Source: *KPMG Property Lending Barometer 2015*

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Disposing of loan portfolios

In general, banks in less established economies are more inclined to dispose of part of their loan portfolios, as on average almost 60% 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 who are considering a disposal is significantly lower with only 28% and 14% respectively. According to market research data, even though banks in other less established economies are more willing to dispose of part of their loan portfolios, there are more closed transactions in the dominant and established economies.

All of the surveyed banks in Greece, Cyprus and Croatia stated that they are considering selling part of their commercial loan portfolios in the next 12-18 months. Furthermore, in Spain, Serbia and Hungary a large proportion of banks also responded similarly with 60%, 50% and 50% respectively. Whereas in Turkey, the Baltics, Sweden, Italy, Poland and the Czech Republic none of the banks participating in the survey 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 who are considering disposing of part of their loan portfolio, 65% 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 willingness to dispose of part of their loan portfolios, the complexity of these transactions reduces the demand for such investment opportunities. For investors it is complicated to manage loan portfolios due to often complex regulatory and tax structures. Despite the difficulties, investors' appetites for distressed real estate debts seem to have increased and the price gap between banks and investors narrowed since last year, especially in more mature markets. This is a positive trend as previously most of the banks resisted selling their impaired loan portfolios due to the fear of realizing heavy losses and rather chose to keep such items on their balance sheets.

Impact of Basel III

Bank representatives were also asked to comment on how Basel III regulations would impact their business. The implementation of Basel III was agreed by the members of the Basel Committee on Banking Supervision. It was designed to strengthen bank capital requirements by increasing bank liquidity and decreasing bank leverage. The regulation is scheduled to be introduced in various phases from 2013 until 2019. Banks have fairly similar opinions among the dominant, established and other economies regarding the effects Basel III.

Similarly to last year, only a small proportion of the surveyed banks thought that the new regulations would affect their current lending practice in the future.

Approximately two thirds of the banks predicted that their development portfolio would not change due to the Basel III regulations and only one fifth of the banks indicated that they would decrease.

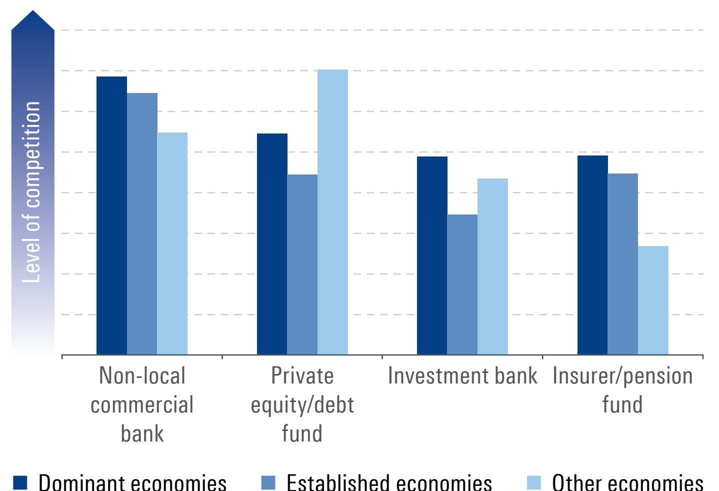
Slightly more than half of the respondents expect that their margins would not change and only one third indicated a potential increase due to the Basel III regulations. A larger proportion of banks are expecting a margin increase in the established and the dominant economies in comparison to the less established ones. The majority of respondents do not expect that their LTC/LTV requirements and loan terms would change due to the new regulations.

Alternative lenders

Bank representatives were asked which alternative lender they considered to be their biggest competitor in terms of banks' traditional real estate lending.

The responses show that banks in dominant and established economies consider non-local commercial banks as their key competitor, while in the other less established economies the private equity/debt funds are considered to be the main competitor for banks.

Competiton with alternative lenders



Source: *KPMG Property Lending Barometer 2015*

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Case study: Real Estate financing in Switzerland

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The Swiss real estate market can look back on a period of steady growth over the past 15 years and this growth has stimulated both the owner-occupier and investment markets. However, this unprecedented boom phase has given rise to concerns that the Swiss real estate market is overheating, which has encouraged the Swiss National Bank (SNB) and Swiss Bankers Association to restrict lending for residential property. This has not yet affected lending for investment properties.

Strict regulations for financing residential property

In spring 2013, the Swiss National Bank (SNB) introduced an anti-cyclical capital buffer in anticipation of a potential overheating of the real estate market. The anti-cyclical capital buffer is a macro-prudential measure, which requires banks to provide higher capital backing for loans granted. Initially, equity capital of 1% of the mortgage amount was required; however, in view of the continuous increase in the volume of mortgages issued and in house prices, the SNB decided to increase this capital requirement to 2% from 30th June 2014.

Along with this macro-prudential measure, Swiss banks had already opted to introduce voluntary self-regulation on lending. This means that a minimum of 10% of the mortgage lending value must be financed by so-called core capital in the case of new mortgage deals. Such capital includes own funds and liquidity not originating from collateral or from the early withdrawal of entitlements from the Second Pillar[6]. In addition to this regulation, it was also decided that two thirds of the mortgage lending value of the real estate in question must be repaid within a maximum period of 20 years. Stricter self-regulation was introduced as a second step in June 2014, reducing the repayment period from 20 to 15 years. Two further measures were also introduced: first, the lowest value principle in terms of the financing of real estate transactions was enforced, which means that the mortgage lending value is defined as the lower of the market value and purchase price and secondly, second incomes can only be considered if the second income earner is jointly held liable for the loan.

Despite historically low mortgage interest rates in Switzerland, this regulatory measure has led to a marked slowdown in demand for residential property. This self-regulation of banks in particular, and the associated stricter requirements relating to the capacity of the borrower to repay the debt in accordance with the terms of the loan, has led to a reduction in the number of loans granted to certain purchaser groups and to more conservative lending practices.

Investment properties pose slightly higher risks

In contrast to the lending market for residential property, the financing of investment properties has been relatively unaffected by regulatory interventions, despite the fact that these properties are experiencing a similar sharp rise in prices. There was a similar marked rise in prices of investment properties even last year, although there are considerable variations between the segments. It is the perceived stability of the values of residential real estate in particular which make this sector very popular with investors. The yield gap between the

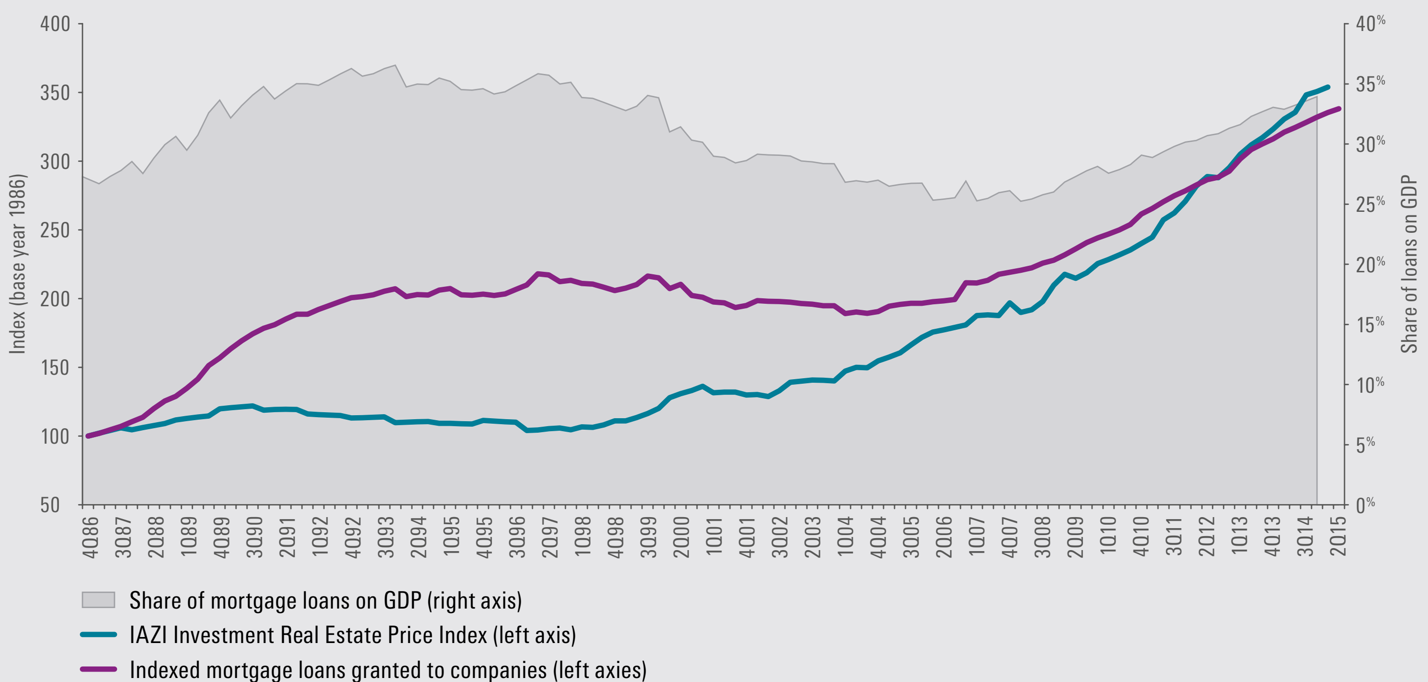
6 In Switzerland, provisions made for old age, death and complete loss of earnings are based on the Three Pillar Principle. The "Second Pillar" is defined as occupational pension schemes according to Occupational Pensions Act (BVG). This is augmented by statutory pay-as-you-earn (PAYE) pension schemes (First Pillar) and private pension schemes (Third Pillar).

returns from investment properties and risk-free investments increased again last year, improving the appeal of both direct and indirect property investments (real estate funds and listed real estate companies). Demand outstripped supply in the case of real estate investments, driving up prices, which led to a further decrease in initial yields for direct investments. Conversely, aggregate yields of indirect real estate investments on the stock exchange increased above the long-term average. In general, risks have increased slightly over the past year and in the case of investment properties, the risk of vacancy is significantly higher.

Differences in lending practices in the case of commercial loans

Banks adopt different approaches when granting loans on investment properties. The main parameters for all banks are the creditworthiness of the borrower, the equity and loan capital amounts, the type of property, additional collateral and, in part, the repayment. Levels of financing range from 40% (industrial buildings) to 70% (leased retail and office buildings, as well as private housing). Nonetheless, banks follow various strategies dependent upon market penetration plans, growth targets and risk assessment. Based on their experiences from the real estate crisis in the mid 1990’s, banks are demanding a pre-letting or presale quota of 60% as a precondition for the funding of commercial, industrial or retail real estate, in addition to yield-compliant acquisition and construction costs for land and buildings.

However, intense competition amongst banks has again led to more generous lending practices. A possible indicator of this is the rising volume of loans concluded with companies, which has increased more than threefold since 1986. A particularly sharp rise has been observed in the period since 2005. During this period, the volume of mortgage loans has increased from CHF 134 billion to CHF 224 billion. There is an almost direct correlation between the volume of loans granted and investment property price trends. The ratio of the volume of loans granted to the Gross Domestic Product is particularly interesting, reaching its highest level of 36.3% at the end of 1992, with this figure falling again as a result of the real estate crisis in the mid 1990’s and further until well after the turn of the Millennium. However, it has been rising again since 2007 and now stands at 33.9%, almost at its pre-1990’s crisis level. Our analysis suggests that a certain level of disparity has built up in the commercial lending market and therefore market participants with high volumes of loan capital could be threatened by strong price corrections.



Source: *SNB, Seco and KPMG*

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Lending on Real Estate in the Case of Swiss Real Estate Funds

Until now, there has been no regulation of investment real estate financing with the exception of Swiss real estate funds. The growth of such funds, together with the current identified overheating tendencies in some market sectors and liquidation of numerous real estate funds in Germany, has alerted regulators to the trends in this sector in Switzerland. This led to the introduction of the Collective Investment Schemes Act (KKV) in 2013, which stipulates that lending on individual properties for real estate funds may no longer exceed one third of the respective market value. The average debt-financing ratio is around 20%. This confirms that real estate funds are still not looking to increase their lending despite the attractive yield gap.

Opportunities for financing new real estate projects

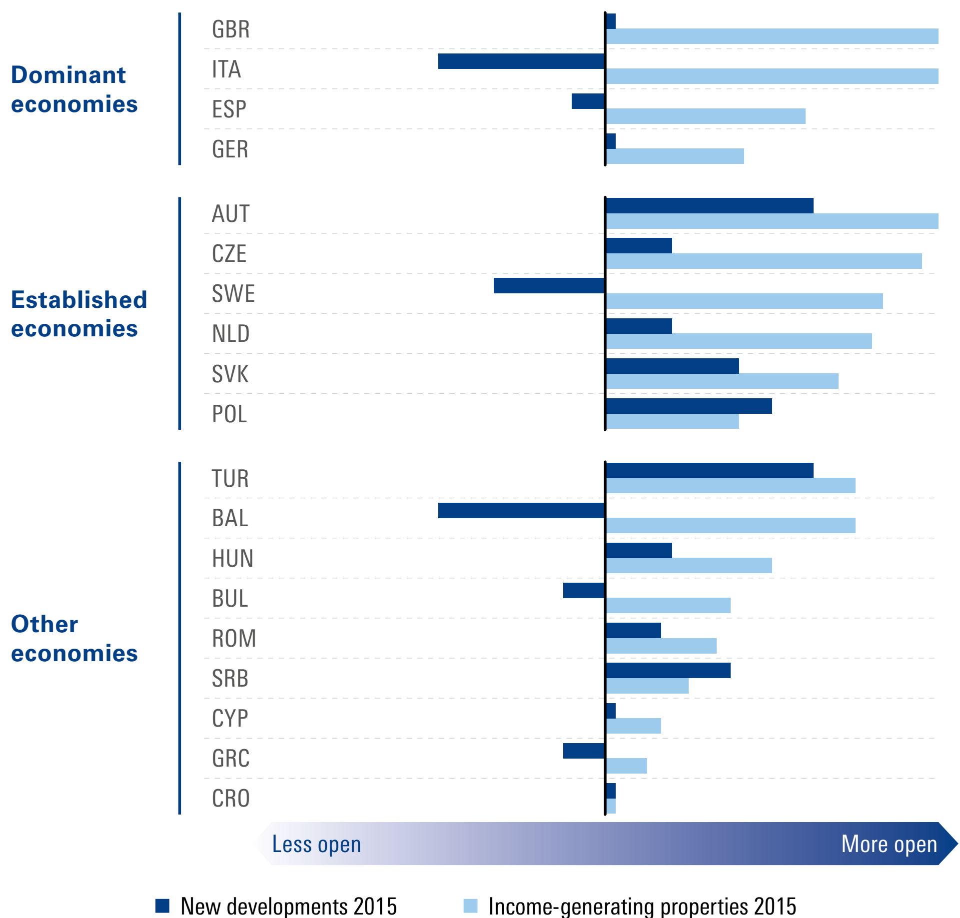
This section assesses the opportunities for developers in obtaining bank financing for real estate projects.

New financing

This year, banks in most of the markets show some extent of openness for financing income-generating projects. Their answers suggest that banks in dominant and established economies are more open to financing real estate projects, especially income-generating projects.

Banks in Austria, the UK, Italy and the Czech Republic are the most open to financing income-generating projects.

Openness of banks to finance development/income-generating projects



Source: *KPMG European Property Lending Barometer 2015*

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

In the dominant economies surveyed, banks in general did not show a great degree of openness towards financing new developments, while among the established markets Austrian and Polish banks were quite open to financing such projects.

Among the less established other economies, banks in Turkey and the Baltics indicated the greatest openness towards financing income-generating projects. The least open were the Greek and Croatian banks. In terms of new developments, banks in Turkey and Serbia are currently the most open to financing such projects.

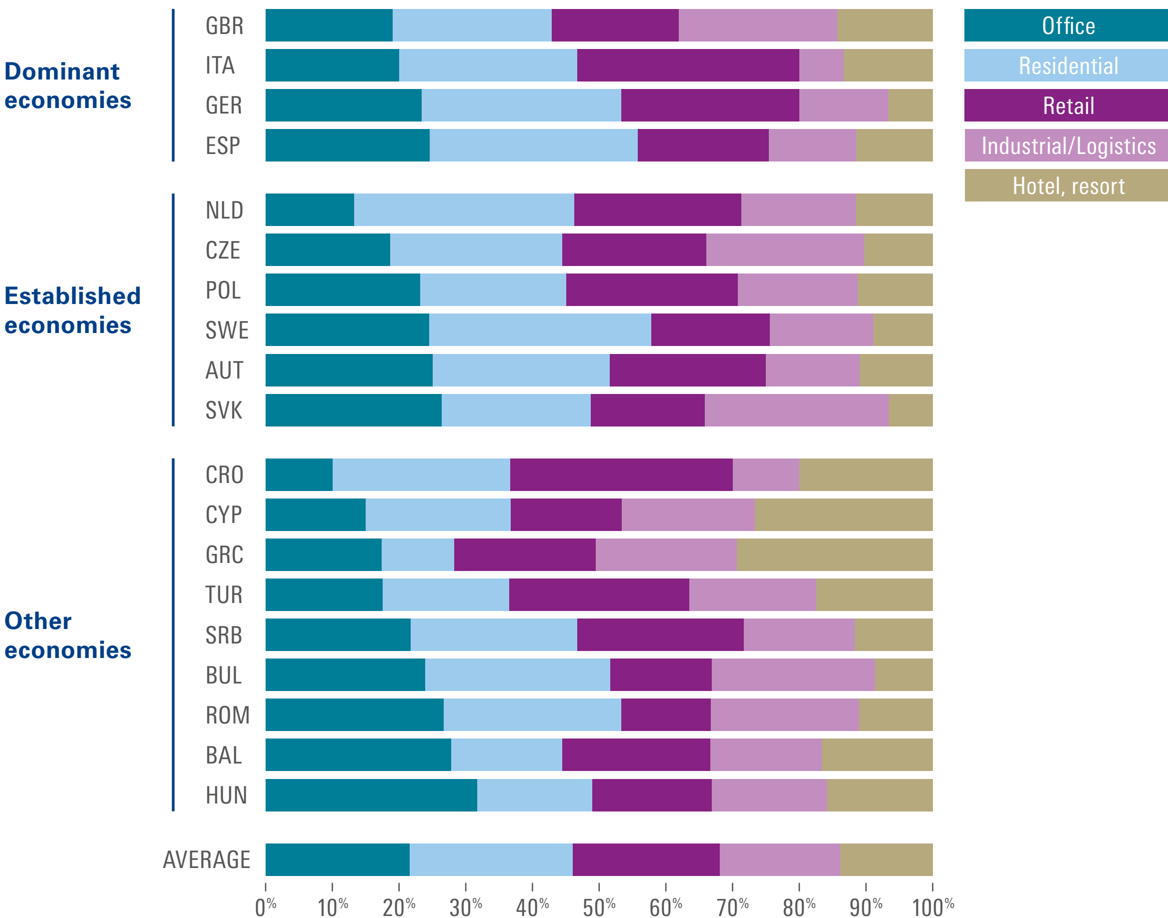
Asset class preferences

Banks were also asked about their preferred asset class for development financing in each country.

Taking the average of the indicated priorities, residential is the most preferred asset class among the surveyed banks both in the dominant and in the established economies. The second most preferred asset class is the retail sector followed by office space and industrial space in both market groups. The most favoured asset class among banks operating in less established economies is office space followed by the retail, residential and industrial sectors.

Similarly to previous years, the least preferred asset class on average in all three market groups was the hotel sector. The hotel asset class was the most favoured in those countries where tourism traditionally contributes to the economy to a large extent, i.e. in Cyprus and in Greece.

Banks' sector preferences in providing development financing by asset class



Note: *the longer the coloured bar, the more preferred the asset class is for the banks.*
Source: *KPMG Property Lending Barometer 2015;*

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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.

There is a consensus between the surveyed banks, regardless of the size and the risk profile of the market, that the most important criteria for obtaining financing for a project is a strong business model and the quality of the asset.

The second most important criteria across the dominant and established economies were the reputation and references of the developer/operator. In the case of the less established economies the level of the owner's equity is more important for banks, hence it stands in second place, while the reputation and references of the developer/operator is seen as the third most important factor.

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

Banks' most important criteria for considering real estate financing

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

Source: *KPMG Property Lending Barometer 2015*

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Loan-to-cost ratios (LTC)

Banks were asked to comment 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. Interestingly, 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 0.50 and 0.78 (i.e. reflecting a capital structure of 50-78% debt and 50-22% equity). On average, the residential sector has the highest LTC ratio with 68%, followed by retail and office with 63% and 62% respectively.

In the case of the established economies, the loan-to-cost ratios are between 0.50 and 0.76 (i.e. reflecting a capital structure of 50-76% debt and 50-24% equity). In these markets the residential sector also has the highest LTC ratio on average with 73%, followed by office with 70% and retail with 68%.

In general banks in other economies require more equity form developers, mainly due to the more risky nature of these markets, which resulted in more conservative lending policies followed by banks in these markets. The loan-to-cost ratios are in the range of 0.52 and 0.68 (i.e. reflecting a capital structure of 52-68% debt and 48-32% equity). In these markets the LTC ratios are the highest on average for office and the residential sector with 62%, followed by retail and industrial with 61%.

Unsurprisingly, the hotel sector requires the highest equity ratio in most of the countries with a range of 35-50%.

Loan-to-value ratios (LTV)

The ranking is similar between the country groups when taking the average LTV ratio of the asset classes per country group. In general, banks in less established economies are being more risk averse and require a higher proportion of equity when financing a 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 0.73 (i.e. reflecting a capital structure of 53-73% debt and 47-27% equity). The office and retail sectors, on average have the highest LTV ratios, both 66%, followed by industrial and hotel with 60% and 58% respectively.

The range is slightly wider in the case of the established economies with a ratio between 0.51 and 0.75 (reflecting a capital structure of 51-75% debt and 49-25% equity). The lowest average proportions of equity are required for the office sector (31%) and retail (32%), while the most equity is needed for hotel and resort projects (40%).

The loan-to-value ratios by banks in less established economies range from 0.53 to 0.78 (reflecting a capital structure of 53-78% debt and 47-22% equity). The least equity is required for the office and the retail (37%) projects, on average, while the most equity is required for hotel and resort projects (40%).

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 60%. 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. In general, the tendencies have remained similar to last year, which means that, on average, pre-let ratios for the office and retail sectors are lower in most of the markets compared to the industrial sector.

Interestingly, on average, 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 57% and 55% respectively, while for industrial it is 63%.

In the case of the established markets the average pre-let requirement for office developments is 58%, 63% for retail developments and 71% for industrial developments.

Among the less established markets the pre-lease requirements of banks for office developments on average is 49%, 53% for retail and 62% for industrial.

The answers suggest that banks are less open to speculative developments of industrial properties. Also it is more common in the industrial segment to develop properties according to a "built to suit" concept, which means that the property is pre-leased 100% to a single tenant. Accordingly, the property is developed based on the 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.

Banks indicated a wide range of DSCR expectations even within the country groups. Surprisingly, banks in Germany, the Netherlands and Sweden require higher DSCR ratios compared to their peers, especially in the case of industrial and hotel asset classes. Among the other less established economies surveyed, banks in Bulgaria, Cyprus and Greece indicated a significantly higher DSCR ratio compared to other countries within the group.

In general, the required DSCR ratios were the lowest in the office and retail sectors, followed by industrial and hotel.

In the dominant economies banks require the lowest DSCR ratio for the office asset class with an average of 1.38 followed by retail (1.45), industrial (1.68) and hotel (1.76).

Similarly to the dominant economies, banks operating in the established economies expect the lowest average ratio for offices (1.43) followed by retail (1.44), industrial (1.52) and hotel/resorts (1.55).

The lowest DSCR requirements of banks operating in less established markets is for office and retail with an average of 1.51 and 1.52 respectively. The required average for the industrial asset class is 1.55 and 1.61 for hotel/resort assets.

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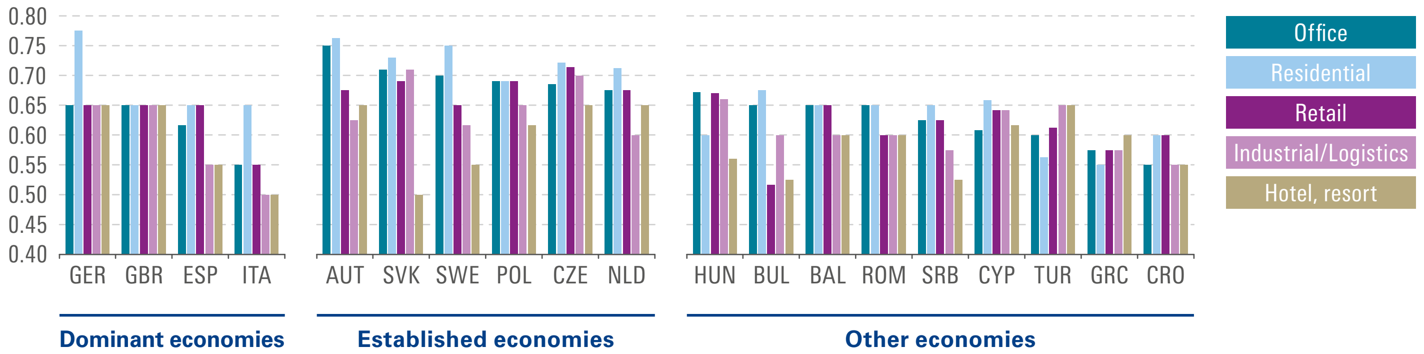
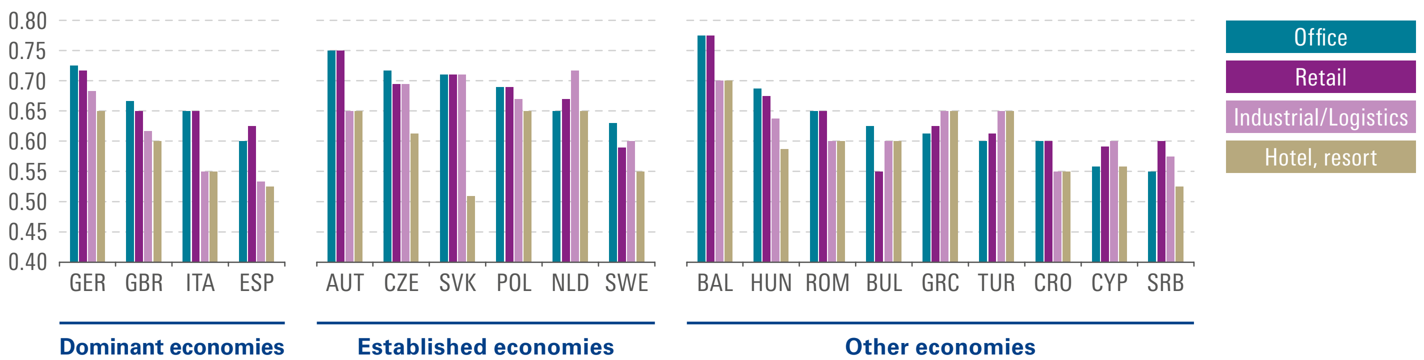
Loan-to-cost (LTC) ratio expectations for financing highly rated real estate development projects in the next 12-18 months



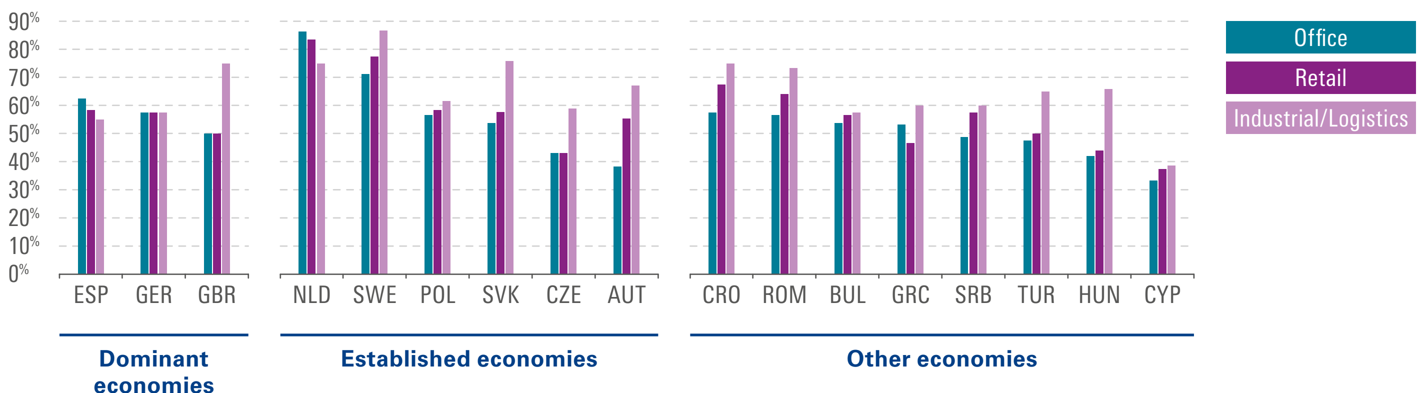
Source: *KPMG Property Lending Barometer 2015*

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



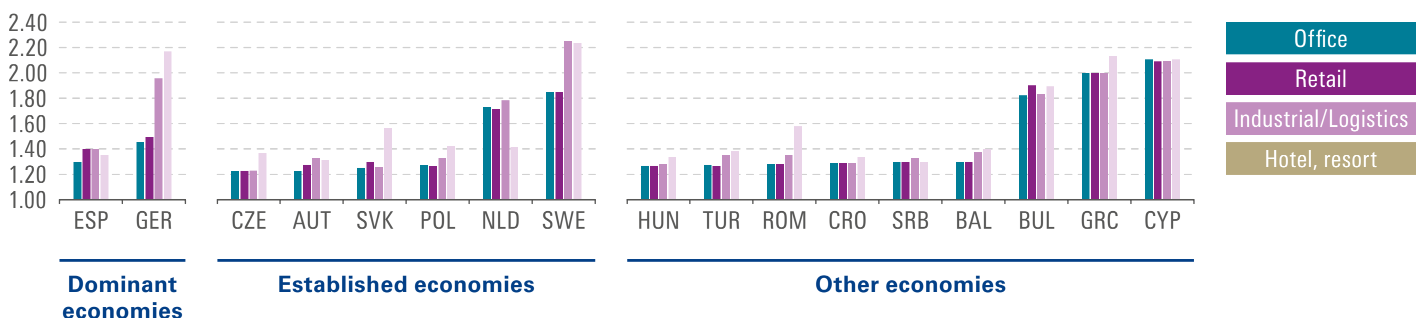
Source: *KPMG Property Lending Barometer 2015*

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 2015*

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 2015*

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Interest premiums

In addition, surveyed banks 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 2014. Premiums for all the asset classes in each country are presented in the country profile section of this report.

Similarly to previous years, the lowest loan interest premiums are seen in countries with low risk profiles and well established real estate markets. Increased recent competition among financing institutions in these economies has also contributed to more favourable conditions available to borrowers.

The improved economic environment across Europe has resulted in the easing of financing conditions among banks, hence they require lower interest premiums in most of the markets in comparison to last year. Other factors also contributed to this trend i.e. lower costs of fund available to banks and the increasing interest banks are showing in real estate financing.

According to the banks, the premium applied on new office developments in the dominant economies currently ranges from 2.0-4.0%, while for retail developments it is in the range of 2.0-4.6%. On average, German banks require the lowest premium and UK the highest.

In the case of the established economies the applied premium by banks for office developments is in the range of 1.6-3.8%, while for retail developments it ranges from 1.9-3.6%. Banks in Sweden require the lowest premiums, while the highest are required in the Netherlands.

Among the less established other economies the premiums required by banks both for office and retail developments is in the range of 3.2-7.5%, with Hungary being the lowest and Croatia the highest.

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 the new development projects. A lower premium is applied by most of the banks in the case of income-generating projects, as there is less risk associated with such projects. (i.e. a lack of development and leasing risk). The required risk premium because of these risks vary across the countries (i.e. banks in the Netherlands require 63-113 basis points lower premium for office and retail income-generating projects compared to new developments, whereas surveyed banks in Germany require 63-70 basis points lower premiums in the case of income-generating retail and office asset classes compared to new developments.)

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

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

Source: *KPMG Property Lending Barometer 2015*

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

Source: *KPMG Property Lending Barometer 2015*

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Conclusion

The macroeconomic outlooks and the perceived risk profiles of each country generally impact the prospects for its real estate market.

In general, financing conditions have become more favourable in comparison to previous years, and this can be attributed to several factors (i.e. lower cost of funds available to banks, increasing interest in real estate financing and more risk tolerance on the part of banks).

In terms of investment activity there was a significant increase (close to 35%) in the total investment volume in H1 2015 compared to the same period last year. The UK, Germany and Spain accounted for close to 70% of the transaction volume during H1 2015.

The recovery in real estate lending is more visible in the dominant and the established economies compared to the less established countries. The proportion of impaired loans is still high across most of the less established economies, therefore banks are still cautiously open to offering real estate financing.

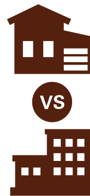
Restructuring existing loans rather than seeking foreclosure is still the preferred way to handle problematic loans. Quality projects with strong business models and projects with cooperative management have better chances in terms of successful restructuring.

With the exception of Spain, in all the participating Western European countries the proportion of fully compliant loans is higher than 80%. However, in Turkey, Hungary, Romania, Greece, Bulgaria and Cyprus the proportion of fully compliant loans is still below 65%.

Approximately 40% of the surveyed banks in 2015 indicted either high or very high reliance on valuations provided by external service providers, while less than 20% indicated either low or very low reliance.

The competition between banks and alternative lenders has increased. However, this is mostly in the more mature economies, and this supports recovery in the overall lending market. Surveyed banks in more established markets consider that among the alternative lenders non-local commercial banks followed by private equity/debt funds were their biggest competitors. In the less established markets, private equity/ debt funds were considered as the biggest competitor to banks.

According to our findings, banks still prefer income-generating projects compared to new developments, especially in the dominant and established economies.



Based on the average priority level indicated by the surveyed banks, the preferred asset class in the more established economies is residential followed by office and retail. Banks in less established markets prefer the office sector the most followed by retail and residential. The hotel sector remains the least preferred by banks in terms of financing.

Banks from established economies were the most open to participating in and leading club deals, as approximately 70% of the banks indicated some extent of openness for both. In the case of the dominant markets, close to 60% of the banks were either open or very much open both to participating in and leading club deals. By contrast, approximately 40% of the surveyed banks from other economies indicated some extent of openness to participate in and lead club deals.

The focus on real estate financing has either increased or stayed unchanged since last year among the surveyed countries except for in Slovakia, the Baltics, Cyprus and Greece, where banks indicated a decrease.

The market fundamentals of the surveyed countries vary greatly; hence the current financing conditions and their outlooks are diverse. Therefore, in the second part of our 2015 report, similarly to last year, we provide a separate analysis for each country, the aim of which is to emphasize their unique characteristics.

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Country profiles

Austria

"We expect that the currently favourable market development and financing situation will remain stable with a positive outlook and ongoing interest of investors in the Austrian real estate investment market for 2016."

Erich Thewanger

Overview

GDP growth was stagnant in the last three years due to slow recovery in most significant export partner countries of Austria. However, it is expected that from 2016 it will pick up and 1.4% annual growth could be achieved. The unemployment rate stood at 5.6 % in 2014, although it is expected that this will increase slightly as a result of slow economic growth and limited investment activity. Economic recovery is forecast in the long term, driven mainly by the increase in external demand, depreciation of the Euro and increasing consumer spending fuelled by the low inflation rate. Overall, Austrian economic growth has been affected by the stagnation of the Eurozone, thus consumer spending will remain the most important driving force of the economy.

Real estate investment activity grew in 2014 compared to the previous year. However, the volume of transactions in H1 2015 was EUR 880 million, a 34% decrease year-on-year. German and Austrian investors remained the key players in the Austrian investment market. The most active sectors were the retail, residential and hotel sectors in 2015. Prime investment yields in Vienna further declined in 2014, with 4.55-4.7% for offices, 3.9-4.1% for retail and 6.9-7.25% for logistics.

Lending market

Banks became more willing to finance real estate projects than last year and most of the surveyed banks indicated that real estate financing is strategically important to them. They are also open to financing new developments, as well as income-generating real estate projects, although they were less open towards new developments. According to their answers, 74% of the total loan volume was provided to income-generating projects and 26% to new developments in the last 12-18 months.

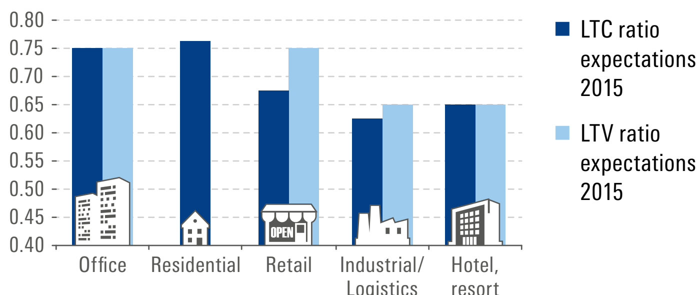
Based on their answers, banks would prefer higher loan/deal sizes compared to their current average. The indicated range of average loan/deal size is EUR 18-40 million, while the preferred level would be EUR 24-75 million. Banks outlined that among alternative lenders they consider insurers and pension funds followed by non-local commercial banks as their biggest competitors. Similarly to last year all respondents stated that the level of provisions was adequate.

Future of real estate loan portfolios

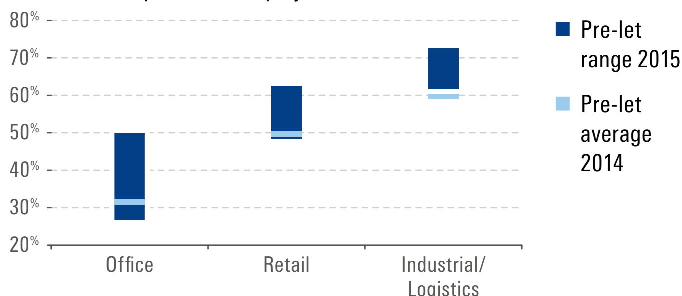
The majority of respondents agreed that the loan portfolio size of the whole banking sector, as well as their own bank's portfolios, would make gains over the next 12-18 months and only one quarter believed that it would remain unchanged. The answers imply a general optimism, as a large proportion of banks are expecting expansion potential across the lending market.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

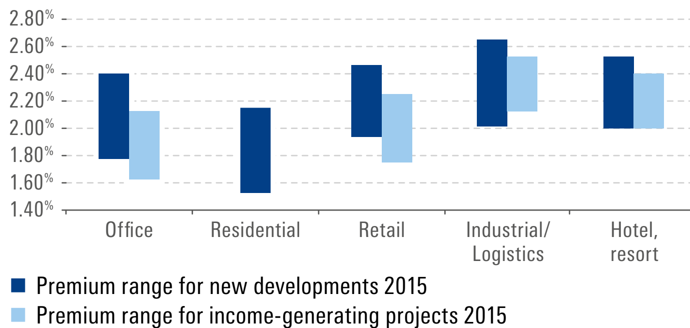
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



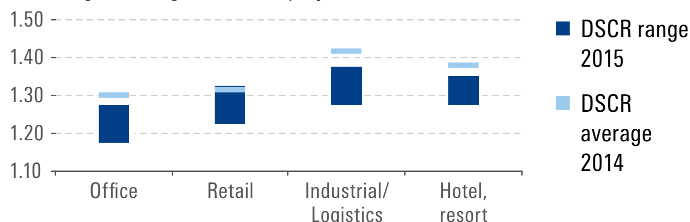
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



Sources: KPMG Property Lending Barometer 2015, CBRE (Yields)

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“Investor's appetite for yielding assets is increasing, especially in the retail sector”

Steve Austwick

Baltics

Overview

The economic growth of the Baltic states was above the European average in the last two years due to strong recovery in domestic demand. GDP growth in 2014 ranged from 2.1% in Estonia to Latvia (2.4%) to 3.0% in Lithuania. The Lithuanian economy is expected to be the fastest growing economy among the Baltic states with an outlook of 2.5% and 3.2% GDP growth in 2015 and 2016 respectively. This growth is also supported by Lithuania's integration into the Eurozone in early 2015 and continuing improvement in domestic consumption, which is the key driver of the economy across all three Baltics States. Lower external demand and geopolitical uncertainty has had a negative effect on the pace of the Baltics' economic growth. A positive sign is that the unemployment rates have further decreased in 2014 to 7.4% in Estonia, 10.7% in Lithuania and 10.8% in Latvia.

The real estate market in the Baltics has remained quite active with a total investment volume over EUR 850 million in 2014, up on the previous year's EUR 750 million. The preferred asset classes by investors remained office, retail and industrial. The highest demand for real estate properties came from the Nordics, CIS and local investors. As Lithuania joined the Eurozone, its market could attract more western European investors as well. Additionally, the Latvian investment market is expected to see more interest from investors, especially those who were previously focusing on the other two Baltic states. Prime yields fell slightly; 7.0-7.5% for offices and retail and 8.0-9.0% for logistics.

Lending market

In terms of the strategic importance of real estate financing there was no consensus among the surveyed banks. Some considered it important, while others considered it less so. In terms of the openness to financing real estate projects, banks indicated that they are open to financing income-generating projects, while they seem disinterested in the new developments.

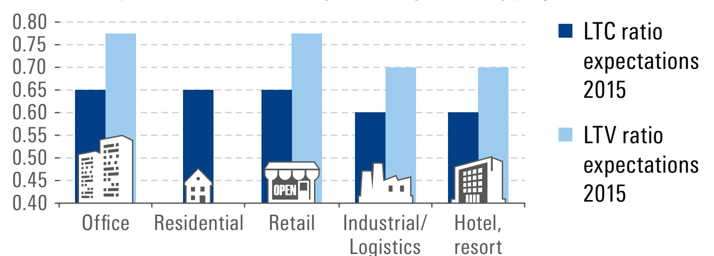
This is also supported by the distribution of the total loan volume, which was provided in the last 12-18 months, 83% went to income-generating projects and only 17% was provided for new developments. Based on the banks' answers, the preferred loan/deal size range is EUR 5-10 million, which is slightly higher than the actual average deal size range of EUR 3.45-6.45 million. Similarly to previous years, the level of provisions was considered to be adequate by all banks. Based on banks' answers private equity/debt funds followed by investment banks are the biggest competitors among the alternative lenders.

Future of real estate loan portfolios

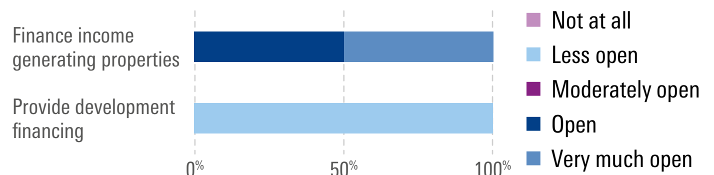
There is no clear consensus regarding the prospects of loan portfolio sizes among banks. Half of the respondents indicated that the sector's portfolio size would remain unchanged in the next 12-18 months, and the other half of the respondents assume that it will decrease. The answers suggest that the respondents are rather more optimistic about their own loan portfolios, where half of the respondents expect their loan portfolio size to grow and the rest expect them to remain unchanged.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

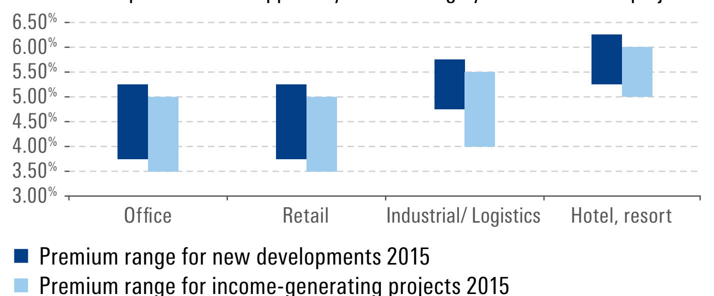
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



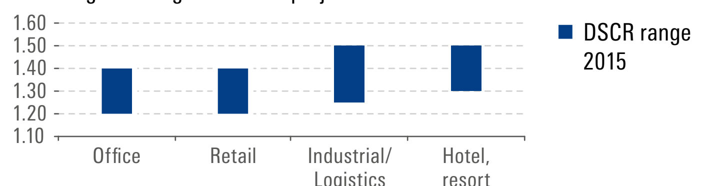
Openness of banks to finance development/income-generating projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



Sources: KPMG Property Lending Barometer 2015, CBRE (Yields)

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Bulgaria

"We have seen a modest volume of investment activity driven by opportunistic local investors during the last 12 months. We expect an increase in investment appetite from foreign investors due to a stable economic environment."

Nikola Kedov

Overview

GDP in Bulgaria grew at a rate of 1.7% in 2014, and it is forecast to remain at a similar level in 2015. Growth here is mainly supported by the strengthening domestic demand and better outlook within the Eurozone. Other factors such as increasing corporate profits due to lower energy prices and improving business confidence also contributed to the improved performance. However, investor demand is still weak due to awareness of Russian-Ukrainian tensions and the uncertainty in relation to the Greek debt crisis. The Bulgarian investment market remained quite inactive with only a few transactions closed in the last year. Some of the closed transactions were typically attributable to distressed assets in the office, development land and retail markets. Investment activity is expected to remain weaker compared to other more mature CEE countries, but slow recovery is expected in the long term. In the first half of 2015 the total investment volume reached EUR 90 million and it is expected that the annual investment volume will reach 2014 levels again. Prime yields in Sofia decreased slightly in 2015 with prime office yields standing currently at 9.0%, prime retail at 8.75% and prime logistics at 11.25%.

Lending market

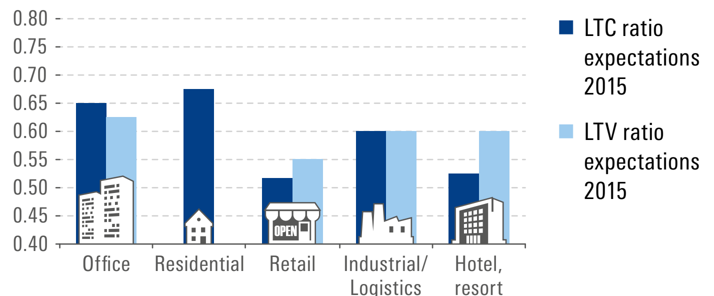
The slow economic recovery and relatively high non-performing loan ratio is keeping pressure on the banking sector. The bankruptcy of the Corporate Commercial Bank (KTB) has also caused concerns about the health of the Bulgarian banking system among European financial institutions. This case has not, however, affected the banking system overall, due to the adequate provision level for loans and liquidity support provided by the government. The strategic importance of real estate financing is considered by the banks as moderate, but a slight increase was noticed in comparison with last year's survey opinions. The openness of Bulgarian banks regarding real estate financing both for new development and income-generating projects is relatively modest. The distribution of the total volume of real estate loans provided by banks during the last 12-18 months between new development and income-generating projects was 17% and 83% respectively. Banks indicated non-local commercial banks followed by private equity/debt funds and investment banks as their biggest competitors among alternative lenders. The majority of respondents considered that the level of provisions is adequate in Bulgaria, while some consider, that it is slightly below adequate.

Future of real estate loan portfolios

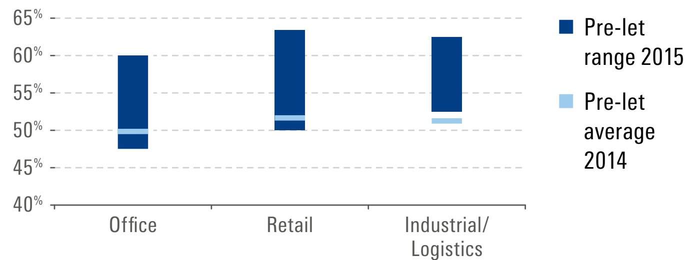
Approximately half of the respondents expect loan portfolio sizes across the whole banking sector to remain unchanged, one quarter expect it to decrease, and the rest expect increases. Banks were more optimistic about their own portfolios, where half of them indicated that their portfolio size would increase in the next 12-18 months, whilst the rest suggested that it would remain unchanged. Compared to the previous year, the answers suggest more positive expectations towards expansion in the lending market. When respondents considered that the portfolio size would decrease they expect that additional funds could come from private equity.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

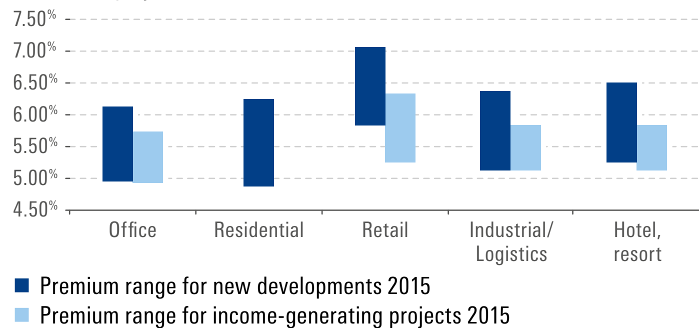
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



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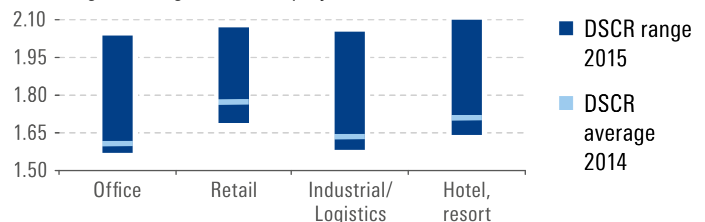

Sources: KPMG Property Lending Barometer 2015, Cushman & Wakefield (Yields)

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Croatia

"With record growth in tourist numbers expected for 2015, tourist and second home developments are in focus."

Paul Suchar

Overview

Croatia was heavily affected by the global financial crisis, with real GDP contracting for six consecutive years after 2009 and with a 0.4% decrease in 2014. However, the outlook is positive and it is forecast that GDP will increase by 0.4% in 2015 and by 1.4% in 2016. The unemployment rate has been increasing since the beginning of the economic crisis, peaking at 20.4% at the end of 2014. It is expected that the unemployment rate will have risen further by another 1.0% by the end of 2015. Despite a high unemployment rate, the contraction in private consumption is expected to come to an end in 2015, thanks to the positive impact of reforms to personal income taxation and lower oil prices. However, the recovery remains fragile as it is mostly supported by increased external demand. Key threats to recovery mainly relate to continuing fiscal imbalances and a less attractive investment climate due to high tax burdens and an inefficient judiciary in Croatia.

After years of downturn the commercial real estate sector experienced a slight recovery in 2014, primarily led by the capital Zagreb. Furthermore, due to the strong tourist industry, the hotel and hospitality market sector is very attractive among developers and investors alike in Croatia. There were several transactions closed in 2014 especially in the hospitality sector. It is expected that, with the ongoing EU recovery and the increasing availability of mortgage financing, the Croatian market is becoming more and more appealing for international investors, and this would then boost real estate market activity.

Prime yields in Zagreb decreased slightly since last year, currently standing at 8.05% for offices, 8.00% for retail and 9.25% for logistics.

Lending market

Banks' lending activity remained subdued due to the high proportion of non-performing loans within bank portfolios. Banks' high exposure to foreign currency loans also brings uncertainty to the market. As in 2014, surveyed banks consider real estate financing as strategically less important with moderate openness both for new developments and income-generating projects. According to their answers, among all the provided real estate loans in the last 12-18 months, 75% was provided for new developments and only 25% for income-generating projects. Banks' average loan sizes are in the range of EUR 3 to 37 million, while the preferred size would be between EUR 5 to 20 million.

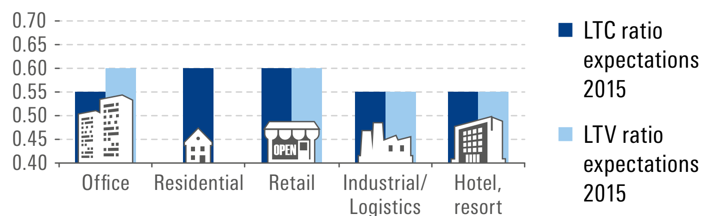
Among the alternative lenders, banks consider private equity followed by the non-local commercial banks as their key competitors. Half of the surveyed banks indicated that the level of provisions against real estate loans were at comfortable levels in the country's banking sector; while the other half think that it is slightly below adequate.

Future of real estate loan portfolios

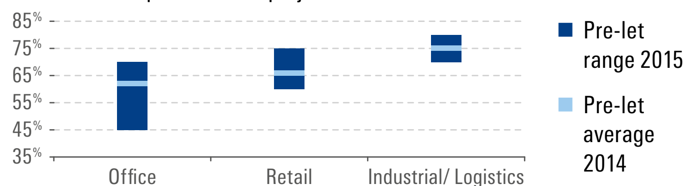
There was a consensus among surveyed banks on the prospects of the loan portfolio sizes of their own bank, which they think will remain unchanged. However, when it comes to the whole banking sector portfolio sizes, banks have a different view. Half of them indicated a future decrease while the other half think it will remain unchanged over the next 12-18 months. The answers imply that banks are still not optimistic about a potential recovery in real estate financing in the near future.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

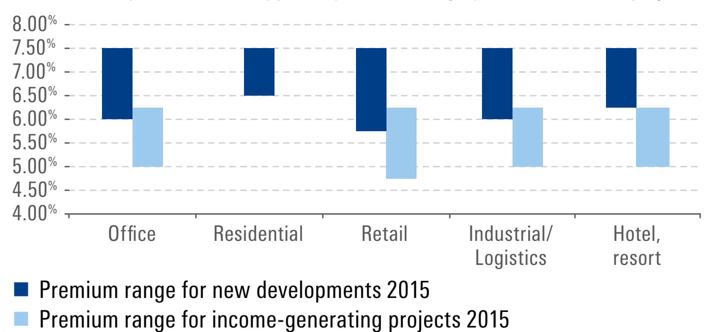
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects

Sources: KPMG Property Lending Barometer 2015, CBRE (Yields)

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"While high NPLs still encumber Banks' balance sheets, legislation changes coupled with recovery of economic indicators are expected to instigate funding of real estate opportunities."

Christophoros Anayiotos

Cyprus

Overview

Cyprus is in the third year of its economic adjustment programme, one which aims to manage the challenges of its economy. During Q1 2015, the Cypriot economy recorded growth for the first time since Q2 2011. According to the projections of the IMF, these include a GDP growth rate of 0.85% in 2015, reaching 1.86% in 2016 and then 2.35% in 2017. According to CyStat[7] the GDP growth in Q2 2015 was 0.9% (year-on-year). Cyprus' improved performance is mainly driven by strength in the tourism industry. The unemployment rate was 16.4% at the end of 2014 and, according to data from European Central Bank, the unemployment rate dropped to 16.2% in June 2015. As the rate will probably remain at a very high level together with decreasing real wages, it could have a negative effect on domestic demand. However, improved competitiveness as a result of the weaker Euro can boost the export market.

Despite stabilisation and a slow recovery, investment activity remains at a low level with no significant interest either from local or foreign investors in the short term. Furthermore, the de-leveraging process is holding back lending activity. The majority of investors are trying to access bank financing, but the banks' non-performing loan levels exceed 50% of total loans, therefore they are reluctant to finance real estate projects. Currently, residential properties dominate the market, but during the first quarter of 2015 the office sector performed relatively well too, compared to the previous quarter. Income-generating commercial projects are mainly attractive to foreign investors, while residential projects are of interest to local investors too. The average yields are stable at 4.4% for offices, 5.3% for retail and 4.3% for logistics.

Lending market

Banks in Cyprus are moderately active in terms of project financing, and currently most of the banks do not consider new real estate financing to be strategically important as they are overexposed and not looking to further expand their real estate portfolios.

Banks' answers suggest that the preferred loan/deal size is lower than the current average loan deal size. Banks' average loan sizes are in the range of EUR 1.7 to 2.7 million, while the preferred size would be between EUR 0.7 to 1.4 million. Banks are more open to financing income-generating projects than new developments, even though 67% of the total loan volume was provided for new developments and only 33% for income-generating projects. According to banks, their biggest competitors among alternative lenders are potentially private equity/ debt funds and investment banks. The majority of respondents indicated that the level of provisions was adequate in Cyprus.

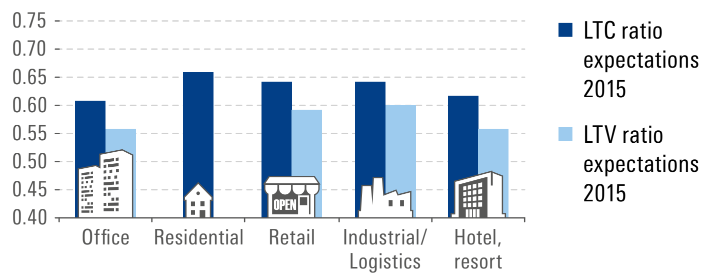
7 Statistical Service of the Republic of Cyprus

Future of real estate loan portfolios

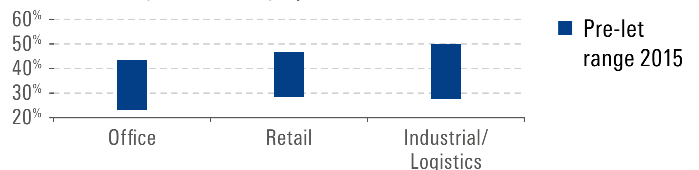
Both in terms of the prospects of the whole banking sector and banks' own portfolio size, the banks seem to be more conservative. Two-thirds of the banks surveyed expected that both their own and the whole sector's portfolio sizes would decrease and only one third of the respondents considered that they would remain unchanged in the next 12-18 months. Among those who considered that overall portfolio sizes would decrease, the majority indicated that additional funds may come from private equity and bonds.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

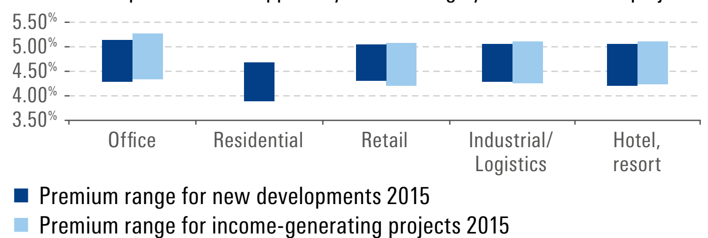
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



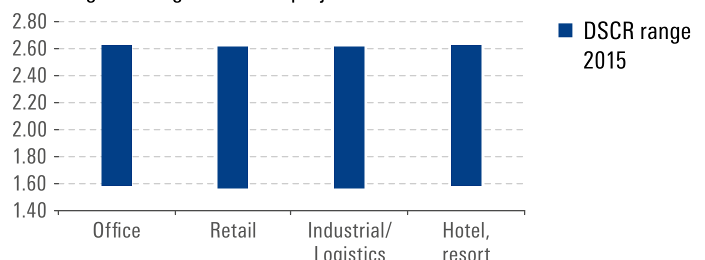
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



Sources: KPMG Property Lending Barometer 2015, RICS property price index (Yields)

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Czech Republic

"Record volume investment activity and solid GDP growth together with a well-capitalized banking sector is driving growth in the real estate market."

Pavel Kliment

Overview

The growth rate of the Czech economy accelerated in Q2 2015, and is expected to reach around 4.0% on an annual basis this year. GDP growth is forecast to reach 2.9% in 2016 and 2.6% in 2017. The growth is supported by better macroeconomic conditions in Europe and increasing consumer spending fuelled by low interest rates, a decrease in unemployment and low inflation. The export-oriented manufacturing sector is forecast to increase due to the weaker local currency and the recovery of the country's main export markets. Further improvement on the labour market is projected; decreasing unemployment, from 7.7% in 2014 to 6.9% in 2016. The well-capitalized bank system can reduce the dependence of the country on foreign capital, thus the vulnerability of the economy is considered to be low compared to other CEE countries.

Investment activity accelerated further with a total volume close to EUR 1.3 billion during the first half of 2015, this being 70% higher than for the same period last year. With this improvement the Czech Republic became the most active CEE investment market in the first half of the year. German institutional investors remain the most active in the market, but local and other Western European, Asian and American investors are also present. The retail sector is forecast to be the key target in the upcoming period, followed by industrial and office. Due to high demand, prime yields fell further in Prague, with 5.5% for offices, 7.0% for logistics and 5.5% for retail.

Lending market

Bank lending in the Czech Republic is expected to increase further due to improving investment activity, favourable loan terms and adequate bank funding. According to the surveyed banks, from a strategic point of view, real estate finance is becoming more important compared to last year. Banks are still focusing on the financing of income-generating projects as almost all of the respondents indicated that they were very much open to financing these projects. This is also supported by the total loan volume provided by banks, which shows that 76% of the total loan volume went to income-generating projects and only 14% went to new developments in the last 12-18 months. The answers suggest that the openness towards new developments has slightly increased compared to 2014.

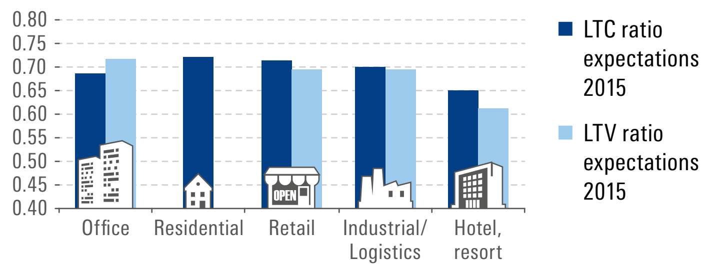
Banks indicated that their preferred loan/deal size is higher than the actual average loan size. The preferred range is EUR 40-75 million compared to the actual average range of EUR 16.5-25.5 million. The surveyed banks indicated that their biggest competitor among alternative lenders are the non-local commercial banks followed by private equity/debt funds. Most of the banks (70%) stated that the level of provisions is adequate or slightly high and only 30% of respondents indicated that the level is slightly below an adequate level.

Future of real estate loan portfolios

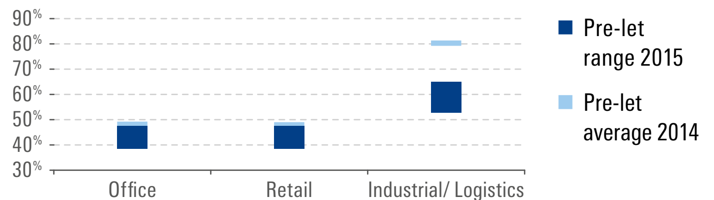
Compared to 2014, there was a positive shift among participating banks regarding the prospects of banks' own portfolios and those of the whole banking sector over the next 12-18 months. All of the respondents stated that the whole banking sector portfolio size would increase. In the case of their own bank's loan portfolio size, 90% of the respondents indicated that it would increase and only 10% anticipate that it would remain unchanged.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

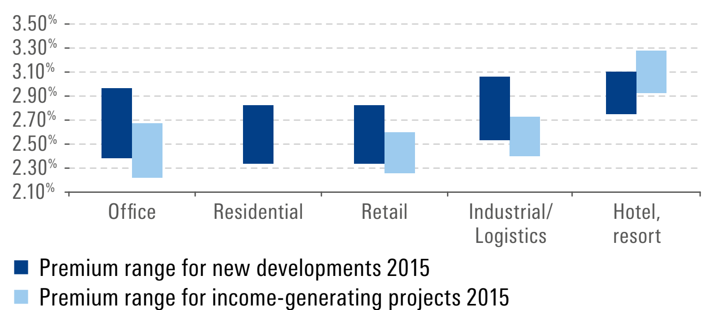
LTC ratio expectations for financing new developments and
LTV ratio expectations for financing income-generating projects



Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects

Sources: KPMG Property Lending Barometer 2015, CBRE (Yields)

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Germany

"Historically low interest rates, a relatively weak currency and a noticeable increase in international capital provide an uninterrupted rally on the German commercial real estate investment market."

Sven Andersen

Overview

GDP growth started to accelerate again in 2014, up 1.6% year-on-year and it is expected to increase further reaching 1.8% in 2015-2016. The key driver of economic growth is strong domestic demand, which is mainly caused by Germany's low inflation and stable employment. The unemployment rate was 6.7% in 2014 and is expected to decrease slightly in 2015. Industrial production and exports are expected to increase, due to growing demand in Europe and the U.S. as well. The weaker Euro is also helping the growth in exports.

The investment activity improved significantly in H1 2015 (by 28% year-on-year); however, it is forecast to slow down in the next 12 months. The most attractive asset class was offices, followed by retail. Although offices became less popular compared to last year, with a 16% decline in the overall share. The largest increase was recorded in the retail and hotel sectors, with 36% and 225% growth respectively, (though in the case of the hotel sector the significant shift was mainly due to the relatively low base). As a consequence of constant high demand there was a decrease in prime yields in key cities with 4.2-4.5% for offices, 3.9-4.0% for retail and 5.8% for logistics.

Lending market

Overall, there is a healthy and active lending market in Germany, which supports the property investment market. The majority of the surveyed banks indicated that real estate financing is of either medium or very high importance to them and only one third of the respondents considered it less important - this seems less hopeful compared to last year, when all the surveyed banks considered it to be of very high importance.

Banks are willing, though less than last year, to finance real estate projects with a preference for income-generating projects over new developments. Based on banks' answers, 92% of the total loan volume was provided to income-generating projects, whereas only 8% for new developments. The respondents stated that their biggest competitor among the alternative lenders was non-local commercial banks followed by private equity/debt funds and insurers/pension funds. Most of the respondents indicated that the level of provisions was adequate and one third of them believed that it might even be too high.

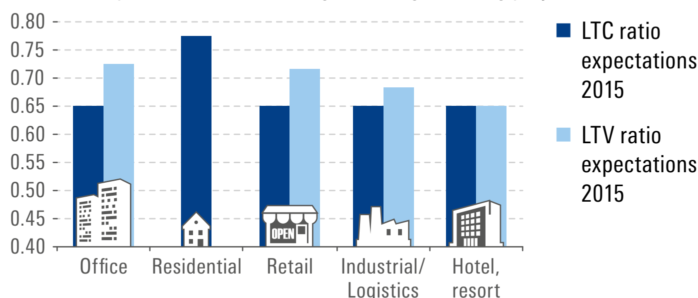
Future of real estate loan portfolios

Banks were asked to give their views on the prospects for the whole banking sector and their own real estate loan portfolios over the next 12-18 months. Half of respondents anticipated that the overall banking sector's portfolio sizes would not change and one third were of the opinion that it would increase. The rest of the respondents are forecasting a decrease.

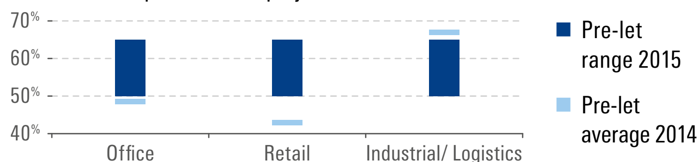
In terms of the prospects of their own loan portfolios, half of the respondents indicated that it would increase and only one third expect a decrease. The rest of the banks think it will not change. Those banks who thought that overall portfolio sizes would decrease expect that the additional funds could come from private equity and developers/investors.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

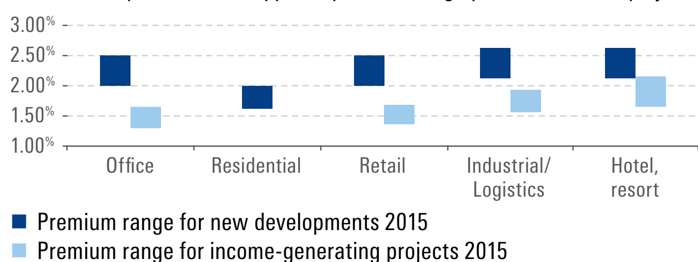
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



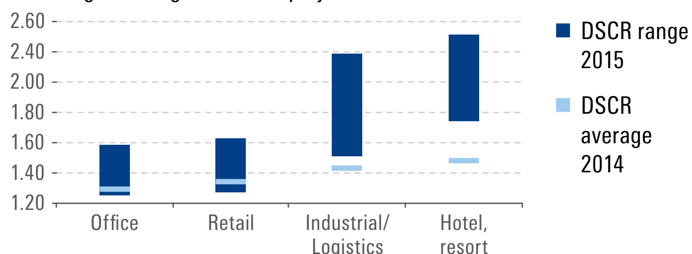
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



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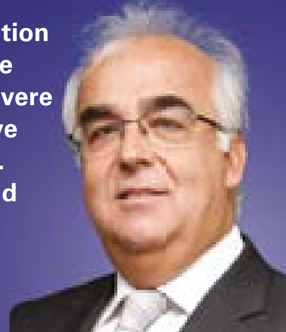
Greece



"The credit crisis, the reduction of disposable income and the sudden, never ending, and severe increase in property taxes have seriously impacted the market. Rationalization, stabilization and certainty will be key before we see any serious upturn"

Vangelis Apostolakis

Overview

After years of recession, in 2014 the Greek economy expanded by 0.8%, but according to projections and headline news in 2015, GDP will not see growth in 2015. Currently, there is high uncertainty regarding the economic prospects of the country due to their severe debt crisis. According to the latest developments, Greece and the EU came to an agreement about the third bailout programme which was prepared to prevent the Greek economy and the banking system from defaulting. Based on the new bailout programme the Greek government has to implement several austerity measures, which are likely to adversely affect the economic performance but which may enable Greece to manage some of its debt. There is a very high unemployment rate, e.g. 26.5% in 2014. Also, decreasing exports, low industrial production and weaker investment activity might lead to further recession here.

Due to the uncertainty about Greece leaving the Eurozone, investment activity in Greece has been subdued and only a few transactions were recorded during 2015, though Greek REIC's, Middle Eastern, European and US opportunistic funds have already started to enter the market and initiate transactions. Currently local investors are the key players in the real estate market. Prime yield expectations in Athens are expected to remain unchanged, with 8.5% for offices 6.5% for retail and 10.0% for logistics.

Lending market

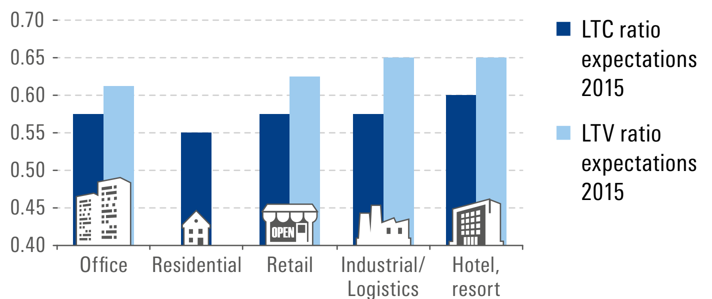
There is a new agreement between the government and the EU on the recapitalisation of the banking sector, but uncertainty is still very high across the market. According to banks' answers, real estate financing is moderately important to banks in Greece; only 25% of the respondents indicated that it is strategically important to them. Banks currently prefer to finance income-generating projects and they are showing less interest in new developments. Banks indicated that, on average, the new developments represent only 25% of the total volume of real estate loans provided in the last 12-18 months, while 75% was provided for income-generating projects. The average deal/loan size indicated by banks is in the range of EUR 17.6-25.6 million, which is broadly in line with the preferred size of EUR 15.6-25 million. According to banks, their biggest competitor among the alternative lenders are the private equity/debt funds followed by non-local commercial banks.

Future of real estate loan portfolios

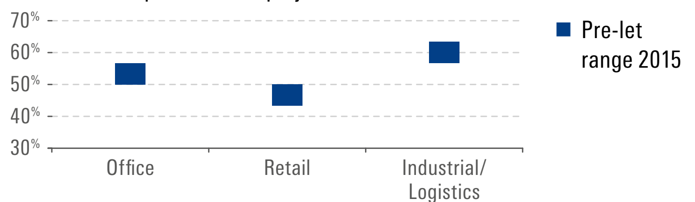
Banks anticipate similar prospects for their own and the whole banking sector loan portfolio sizes. Half of the respondents expect that these will decrease, while the other half equally believe that they may remain unchanged or slightly increase over the next 12-18 months. Those banks who stated that their overall portfolio would decrease expect that additional funds could come from private equity. The answers suggest that the majority of banks do not expect that the market will experience an upturn in the near future.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

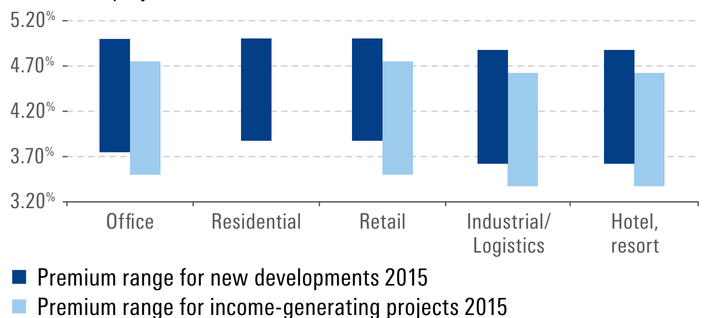
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



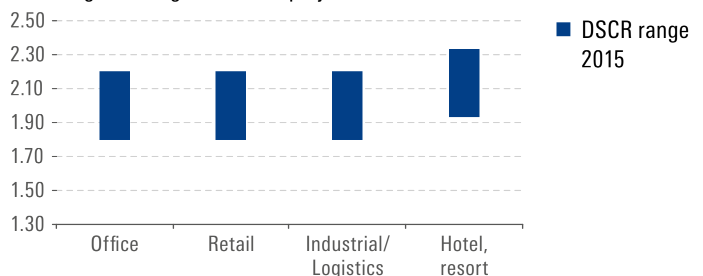
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



Sources: KPMG Property Lending Barometer 2015, CBRE (Yields)

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Hungary

> "Increasing activity in the real estate market has positively influenced banks willingness to finance projects."
>
> Andrea Sartori

Overview

In 2014, the Hungarian economy grew by 3.6%, which was the strongest growth since 2006. Analysts predict that the intensity of the growth will slow down this year to 2.9% GDP growth. The boost in economic performance was fuelled by the increase in both public and private investments, which were bolstered by the accelerated absorption of EU funds and the central bank's funding for subsidised loan funded growth schemes. It is expected that private consumption growth will strengthen, however from a low base, becoming the main driver of economic growth in 2015.

In 2014, the total investment volume in Hungary was at its highest level since 2006 at EUR 580 million, out of which almost 80% was in income-generating assets. The total transaction volume in H1 2015 reached EUR 280 million, which is similar to the volume reached during the same period in 2014. However, the 2015 annual investment volume is expected to outperform last year by approximately 20-30%. Improving economic conditions and attractive yields for prime properties resulted in increasing demand both from local and international investors as well. Due to this increased interest, there was a yield compression in the prime segment. Currently, yields in Budapest are 7.25-7.75% for prime office, prime retail stands at 6.75-7.25% and at 9.00% for prime logistics.

Lending market

The lending market in Hungary has become more active since last year as a consequence of the better economic outlook, low interest rates and easing financing conditions. Similarly to last year, banks consider real estate financing to be moderately important to them from a strategic point of view. Close to 80% of respondents indicated that the level of provisions is adequate or even higher than adequate in Hungary and only about one fifth of the respondents think it is below adequate, which shows a positive tendency since last year.

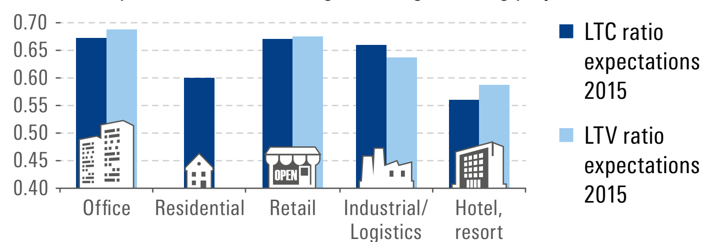
There was an increase in banks' willingness to finance development projects, as this year half of the surveyed banks indicated greater than moderate willingness to finance such projects. However, income-generating projects are still more favourable for banks with two thirds of respondents indicating an openness to financing these projects. The distribution of total volume of real estate loans provided by banks during the last 12-18 months between these two categories were 39% for new developments and 61% for income-generating projects. The average loan deal size provided by banks is in the range of EUR 7-18 million, while the preferred size would be between EUR 11-23 million. Among alternative lenders banks consider non-local commercial banks and private equity/debt funds as their biggest competitors followed by insurer/pension funds and investment banks.

Future of real estate loan portfolios

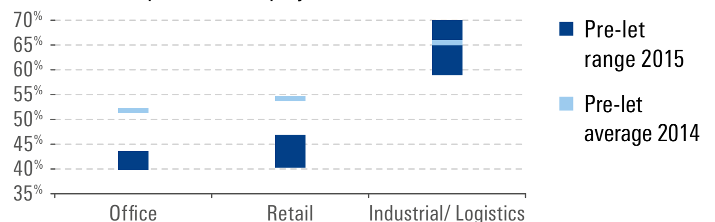
Half of the respondents indicated that they think that the whole banking sector's real estate loan portfolio size in the next 12-18 months would increase. It is a significant improvement considering that last year only about 14% had this opinion. Similarly to last year banks are not so optimistic regarding their own portfolios and 60% think it will remain unchanged, with 30% feeling that some increase would occur soon.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

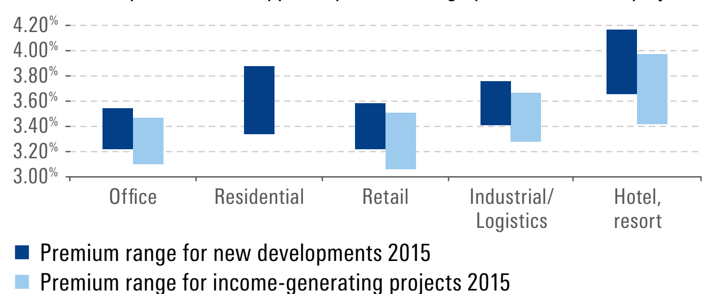
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



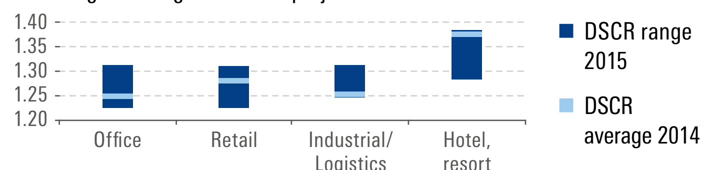
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



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Italy

> "Recovering transaction volumes and low interest rates are starting to renovate banks' interest in real estate, although with a very selective approach."
>
> Maurizio Nitrati

Overview

As a consequence of the positive external factors economic growth in Italy is expected to return in 2015 after a slight contraction (-0.4%) in 2014. The GDP growth rate is forecast to reach a modest 0.5% this year and accelerate to about 1% per year in 2016-19. The key factors supporting the expansion of the economy are lower international oil prices, the quantitative easing programme by the European Central Bank and the more competitive euro exchange rate bolstering exports and also improving conditions in the Eurozone.

Meanwhile the country is still faced with a high unemployment rate (12.6% in 2014) and only a slow gradual decrease is expected up to 2016 (just below 12%). An increase in domestic demand is not expected as the growth in average real wages is projected to slow down in the upcoming years. However, a positive sign is that the government's deficit is improving due to its strict fiscal policies and this deficit is forecast to decline in the upcoming period, reaching 2% in 2016. At the same time, public debt is projected to peak in 2015 at 133% of GDP.

The recovery of the Italian real estate sector started in 2013, continuing into 2014. Fortunately, there is strong interest both from local and international investors in Italian investment opportunities. In terms of the annual investment volume, 2014 outperformed 2013 by 10% and this trend is projected to continue in 2015. In H1 2015 the total transactions volume reached EUR 3.4 billion, which is approximately double the amount seen in H1 2014.

The majority of investments performed in 2014 were in the retail (48%) sector followed by the office (29%) and the hotel (11%) sectors. Prime yields in Rome and Milan are falling, currently standing at 4.75-6.50% for offices, 4.0-4.6% for retail and 7.5-8.0% for logistics.

Lending market

The completion of the AQR in the autumn of 2014 positively affected bank lending in Italy. The credit supply tightness eased and the lending market started to expand. Also the cost of financing fell further for both households and firms, mainly driven by lower base rates. The debt market improvement led to an ease in real estate financing conditions, where margins decreased both for prime and secondary assets. Currently the risk premium applied by banks is approximately 250 basis points.[7]

When banks were asked about the strategic importance of real estate financing, half of the respondents indicated that it was important to them, while for the other half it ranks as medium importance. In terms of the level of provisions, banks did not have a unified view. Some thinks it is adequate while others think it is too low. Interviewed banks indicated that among alternative lenders they consider non-local commercial banks, investment banks and insurers/pension funds as their key competitors.

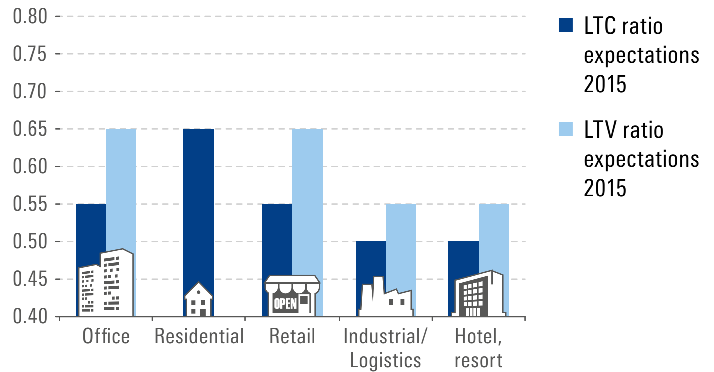
Banks also outlined that they were very much open to financing income-generating projects, but less inclined to finance new developments. From the total volume of new real estate loans provided in the last 12-18 months, only 5% were provided for new developments and the other 95% for income-generating projects. According to the respondents, the average size of a loan/deal was in the range of EUR 40-75 million, while the preferred size would be EUR 45-90 million.

Future of real estate loan portfolios

Regarding the prospects of the whole banking sector over the next 12-18 months, all of the respondents forecast an increase in the whole banking sector's portfolio size. Their answers suggest growth in lending activity in the next 12-18 months.

However, in terms of their own portfolio, the banks' answers were not as unified, half of the banks expected that it would increase in the next 12-18 months and the other half predict that it would remain unchanged.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months



Sources: KPMG Property Lending Barometer 2015, CBRE (Yields)

7 CBRE Marketview

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Netherlands

> "There is increased real estate lending due to growth in investment volume in combination with well capitalized banks and availability of alternative funding sources."
>
> Frank Mulders

Overview

After a year of moderate recession in 2013, the Dutch economy expanded by approximately 1.0% in 2014 and an even stronger growth of 2.1% is projected for 2015. The underlying conditions of the economy have improved over the last year, due to strong consumption growth, a recovery in investment activity and positive net exports. Further growth in exports is expected due to the weaker Euro compared to the previous years. Labour market conditions have improved since last year and the unemployment rate is steadily decreasing.

The total commercial Real Estate investment volume in 2014 outperformed the previous year and H1 2015 investment volume is 1.7% higher than the same period in 2014. The proportion of international investors has increased, due to good transparency in the Dutch market and the expected capital value increase in the property market during the upcoming period. During the crisis years the share of foreign investment was between 17-31%, but in 2014 it increased to 65%.The most attractive asset class was office space followed by retail and industrial. Prime yields decreased in 2014 compared to the previous years and further downward pressure is expected throughout 2015. Prime office yields stood at 5.2-6.0% prime retail at 3.9-4.4% and prime logistics at 6.0-9.0%.

Lending market

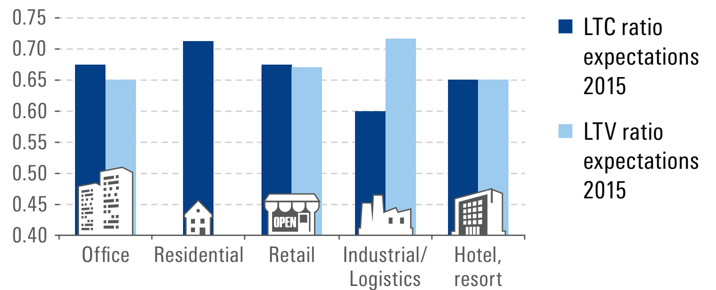
There is good availability of financing especially for prime properties and the increasing credit supply resulted in more open financing conditions. The number of alternative lenders is also increasing in the market, creating a more competitive lending environment. According to the banks' responses, among the alternative lenders they consider non-local commercial banks as their biggest competitor, followed by private equity/debt funds and insurers/pension funds. The majority of Dutch banks (80%) indicated that real estate financing is either important or extremely important to them from a strategic point of view, while only 20% said that it is not particularly important to them. All of the banks are confident that the level of provisions against real estate loans in the sector is adequate. Furthermore, the majority of the banks indicated that they are open to financing real estate projects, especially income-generating projects, where 80% of the respondents were very much open. In the case of new developments, 60% of the banks indicated greater openness. According to the banks, 18% of their total loan volume was provided for new developments in the last 12-18 months, while 82% was for income-generating projects. In terms of loan deal sizes, banks indicated an average range of EUR 11-28 million, while the preferred loan deal size was set in the range of EUR 13-49 million.

Future of real estate loan portfolios

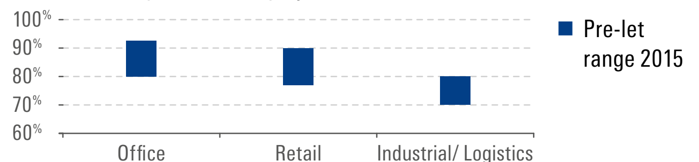
60% of the respondents considered that loan portfolio sizes across the overall banking sector would increase over the next 12 to 18 months, while the rest of the respondents were expecting no change or a slight decrease. When banks were asked about their own portfolios, 40% expected slight decreases and 60% thought that they would strengthen in the next 12-18 months.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

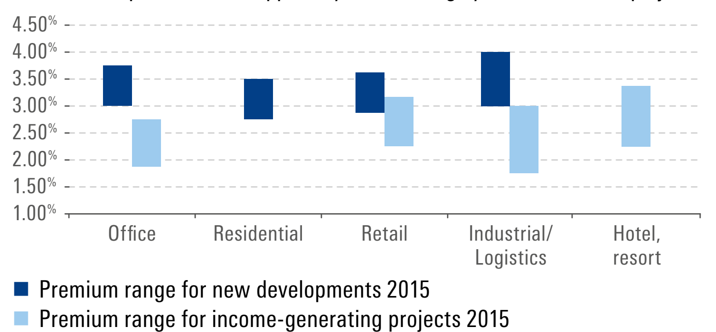
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



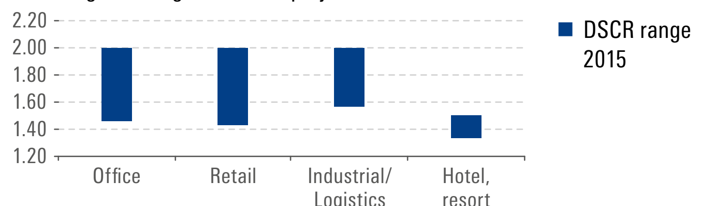
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



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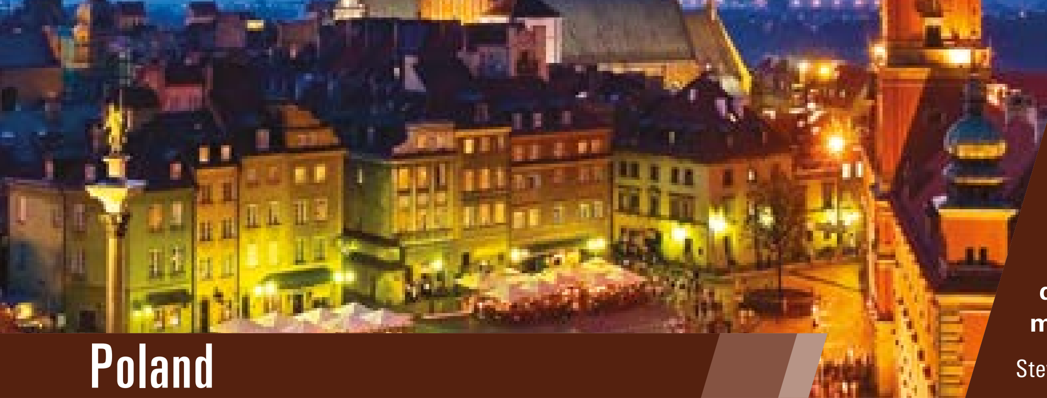


Poland

"Retail overtook Office as the preferred asset class for development financing, due to the large quantity of new office space being delivered to the market in Poland."

Steven Baxted

Overview

In 2014 Poland recovered relatively strongly from the temporary slowdown seen in 2012-2013. GDP grew by almost 3.5% in 2014, mainly fuelled by strong domestic demand backed by the improving labour market conditions and increasing disposable household income. Besides this, the corporate sector increased their investments thanks to favourable financing conditions and, as a result of production capacity improvements. It is expected that economic activity will continue to grow due to further improvement in private consumption. The general government deficit decreased to 3.2% of GDP in 2014, down from 4.0% in 2013, and this trend is projected to continue.

Similarly to previous years, Poland remained one of the most attractive investment destinations in the CEE region during H1 2015 with a total investment volume of EUR 807 million, representing approximately 30% of the total CEE volume. Even though there was intense activity, volumes are significantly lower (-38%) in comparison to H1 2014. However, it should be noted that there are a number of large ongoing deals, which indicate a potentially strong year in 2015. The prime yields in Warsaw are expected to hold firm with constant high demand, staying at 6.00-6.25% for offices, 5.50-5.90% for retail and 7.00% for logistics. In secondary locations, some yield compression is expected due to increasing demand.

Lending market

In general, banks in Poland remained active in real estate lending and are constantly looking for opportunities with credit terms easing gradually. Additionally, there is increasing pressure from alternative lenders, who are becoming more active in the market. Most banks consider non-local commercial banks as their biggest competitors followed by private equity and debt funds. For the majority of the interviewed banks (60%), real estate financing is either important or extremely important, the rest of the respondents considered it as of medium importance. The majority of the banks are interested in financing both income-generating and new developments, but based on their answers this year they marginally prefer new developments to income-generating projects. This answer is also supported by the distribution of the lending volume provided by the banks in the last 12-18 months. On average they provided 54% of their loans to new developments and 46% to income-generating projects. Based on the banks' answers, the average loan deal size is in the range of EUR 15-22 million and the preferred size is between 26-52 million.

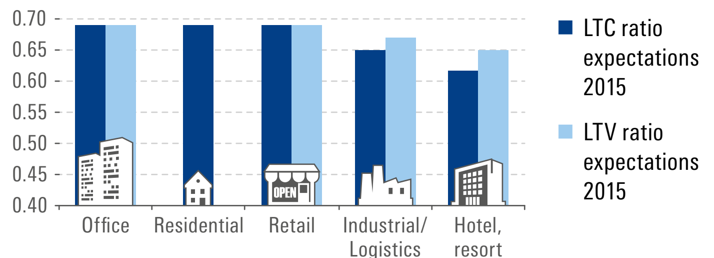
Most of the banks (80%) think that the level of provisions in the banking sector is adequate, and only 20% think it is slightly below adequate levels.

Future of real estate loan portfolios

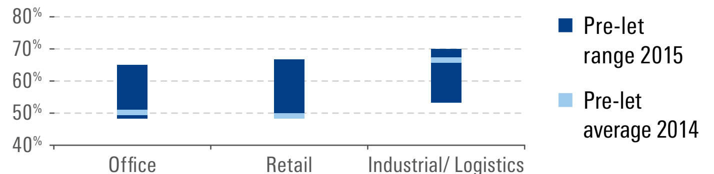
According to this year's answers, there is no clear consensus among banks on the prospects of their own or the whole banking sector portfolio sizes in the upcoming period. For both cases some of the banks anticipate an increase, while the others are forecasting that it will either remain unchanged or decrease.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

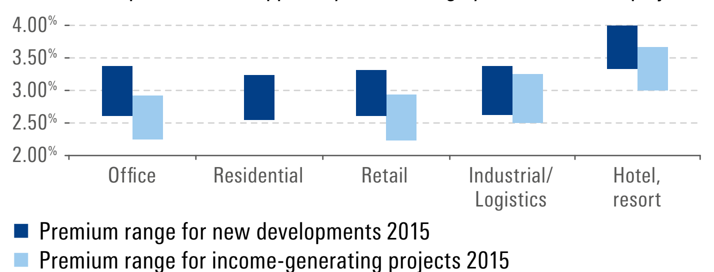
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



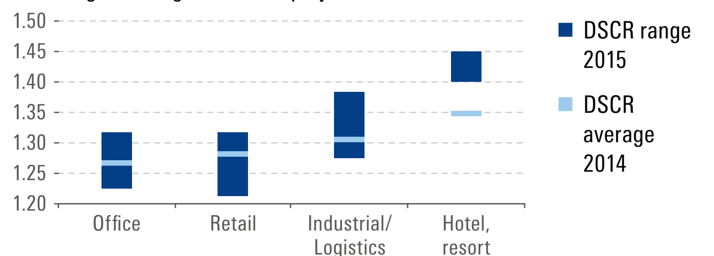
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



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Romania

"Tax cuts and a favourable labour market outlook enhance positive consumer sentiment, while banks show confidence in expansion in the near future."

Ori Efraim

Overview

After years of modest recovery following the recession, growth picked up in Romania in 2013 and 2014 with 3.4% and 2.8% growth in those years respectively. It appears that growth also continues in 2015 with an expected 4% annual growth rate by year end. The rise in GDP is forecast to continue in the upcoming years at a rate of 3-4%. Growth in Romania is mainly fuelled by private consumption and growing investments. Tax cuts accompanied by a favourable labour market outlook and low inflation enhanced consumer sentiment. The growth in investments is also being bolstered by lower borrowing costs, tax exemptions on reinvested profits and a positive macroeconomic environment. However, there are certain negative influences such as the Russia-Ukraine conflict, and the risk in relation to the Greek debt crisis which might threaten growth and undermine investment and exports. In 2014 Romania was the third most active market within the CEE with EUR 1.3 billion total investment volume. This figure represents nearly three times the volume realized in 2013. This significant growth is mainly attributable to the fact that international investors are becoming active again. After the record year of 2014, property investment volume in the first half of the year is estimated at approximately EUR 190 million, which is a significant decrease when compared with the same period of 2014. However, a strong second half is expected as there are a number of ongoing deals which are set to be closed during this period. An important trend is that more banks started to sell large non-performing loan portfolios, which means that many of the underlying assets will continue to come onto the market in the upcoming period. Prime yields in Bucharest decreased since last year (by approximately 25-75 basis points). Currently, the yield expectation for offices is 7.75%, for retail: 7.75-8.00% and for logistics: 9.25-9.75%.

Lending market

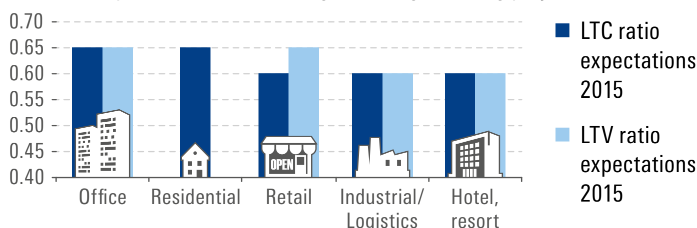
Bank lending is recovering gradually in Romania with lower borrowing costs and better availability of financing. Both the improvement in banks' capital positions (by selling their non-performing loan portfolios) and an improved economic climate have contributed to this trend, which is expected to continue in the near future as well. Among the alternative lenders, banks consider private equity as their biggest competitor followed by non-local commercial banks and investment banks. All of the surveyed banks indicated that real estate financing is strategically important to them. Two thirds of the banks indicated openness towards financing both new developments and income-generating projects, the rest indicated only minor interest. The distribution of total loan volumes provided by the banks in the last 12-18 months between new developments and income-generating projects was 23% and 77%, respectively. Banks indicated that the average loan deal size was in the range of EUR 7-17 million, while the preferred size is slightly higher at EUR 8-20 million. This year all of the surveyed banks indicated that the level of provisions in the bank sector is adequate or even slightly high, which is a positive shift since last year, when some banks deemed it too low.

Future of real estate loan portfolios

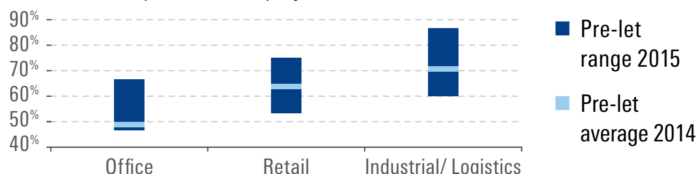
Banks have differing views regarding the prospects of their own and of the whole banking sector's loan portfolio sizes over the next 12-18 months. The majority of respondents forecast an increase both in their own and the whole banking sector's portfolio sizes, while some banks think that these would decrease slightly. The answers suggest that most of the banks are confident about the expansion of loan portfolios in the near future.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

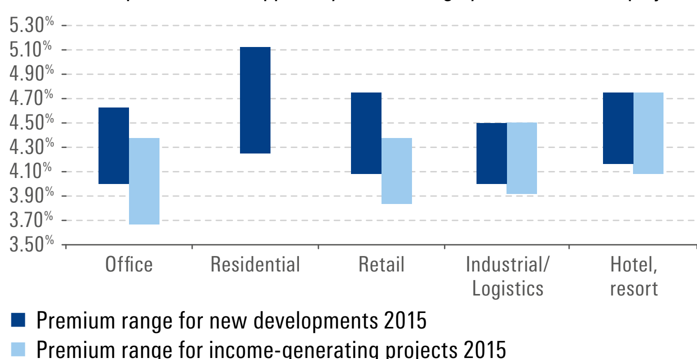
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



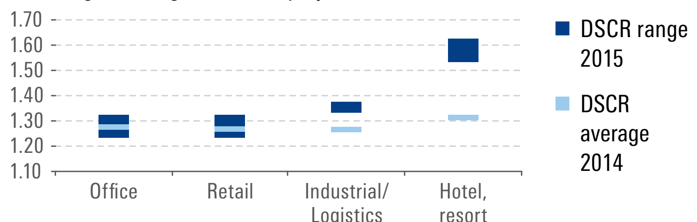
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



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Serbia

"It is expected that progress with EU membership negotiations will bring more confidence to the market, eventually leading to an increase in investment activity."

James Thornley

Overview

The economy was in recession in 2014 and GDP contracted by 1.8%, mainly due to weak domestic demand and the severe flood crisis that year. It is expected that the economy will recover from the recession and achieve 0.5% growth in 2015, followed by growth of 2.5% in 2016. The positive effects of lower oil prices, increased confidence and the recently accepted IMF agreement are expected to contribute to the recovery. The labour market showed signs of improvement; however, the changes in government public employment policy are expected to affect the unemployment rate negatively in the upcoming period. The budget deficit is also expected to come down from 6.7% of GDP in 2014, due to the recently introduced austerity measures affecting the pensions, public sector wages and state subsidies. Despite strong consolidation efforts, government debt is expected to further increase and to exceed 80% of GDP in 2015.

The Belgrade Waterfront Development was the only significant real estate investment deal (EUR 3.5 billion) which was closed recently in Serbia. The project will be delivered to a plot of approximately 90 hectares. It will comprise of residential buildings, offices, a shopping mall, luxury hotels and a 200 meter high tower. It is a joint venture project of the Serbian government and a real estate developer from the United Arab Emirates. Going forward it is expected that progress with EU membership negotiations will bring more confidence to the market, eventually leading to an increase in investment activity. Prime yields in Belgrade have largely remained stable over the recent period with 9.50% for office space, 8.25% for retail and 12.00% for logistics.

Lending market

Banks in Serbia are facing a problem with non-performing loans, which is reflected in banks' more conservative approach to financing new projects, hence lending activity remains weak. As in previous years, surveyed banks in Serbia consider real estate financing to be not so important to them from a strategic point of view. Based on the responses, the majority of the banks (75%) were open to financing new developments, while only half of them indicated interest in financing income-generating projects. Banks consider private equity/ debt funds as their key competitor followed by non-local commercial and investment banks. Respondents indicated that their preferred loan deal size was lower compared to the actual size of loans. Answers show that the actual loan deal size is in the range of EUR 10-20 million, while the preferred size is between EUR 7-19 million.

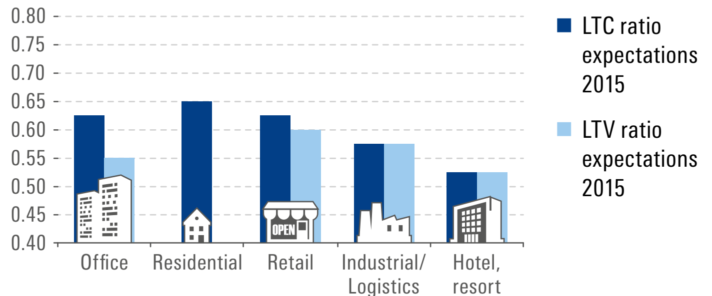
Half of the interviewed banks thought that the level of provisions was adequate in the country's bank sector, while the other half of banks consider it slightly below adequate.

Future of real estate loan portfolios

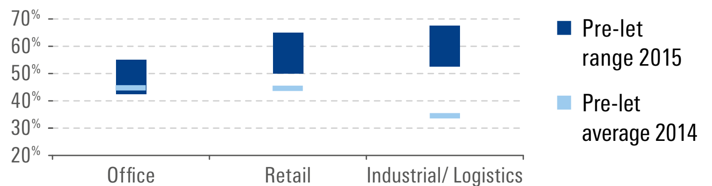
Half of the surveyed banks saw signs of potential expansion in lending volume and they expect that both their own and the overall banking loan portfolio sizes will increase over the next 12-18 months. Half of the banks think that their own portfolio will remain unchanged, but when it comes to the prospects of the portfolios of the whole banking sector, some banks even expect a decrease. Those banks who think that overall portfolio sizes of the banking sector would decrease, expect that the additional funds could come from private equity and developers/investors.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

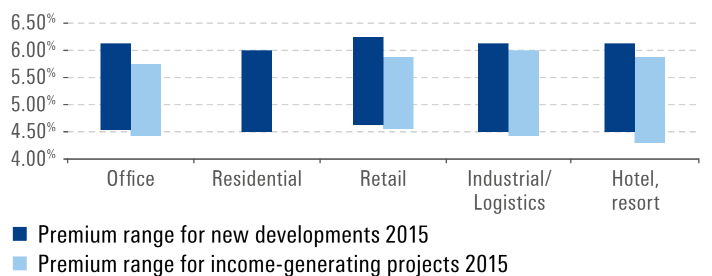
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



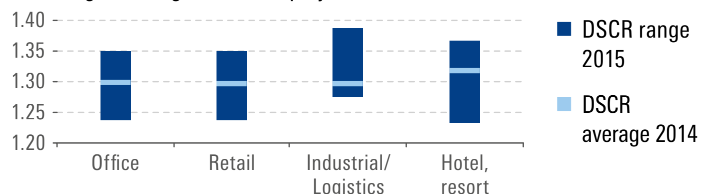
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



Sources: KPMG Property Lending Barometer 2015, CBRE (Yields)

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Slovakia

"Financing conditions of banks have become more favourable since last year, supporting growth in the real estate investment market."

Rastislav Nemec

Overview

Slovakia experienced stronger economic growth in 2014 compared to 2013. GDP grew by 2.4% in 2014 and the growth rate is expected to reach 2.9% in 2015. Even though there are positive signs it is not expected that growth will return to pre-crisis levels soon. Slovak economic expansion mostly relies on the recovery of domestic demand and investments. Labour market conditions such as unemployment rates and average real wages are expected to improve, however at a pace lower than was hoped for. In 2014, the government deficit increased to 2.9% of GDP from 2.6% in 2013, but it is expected that the deficit will decline to 2.7% in 2015.

The improved economic environment has positively affected the real estate investment market as well. As a consequence, investment volume in 2014 reached EUR 610 million, the highest level since 2005. Slovakia saw 8% of the total transaction volume within the CEE region in 2014.

In H1 2015, the investment volumes appear to be lower compared to the same period last year, but activity is expected to accelerate, as the majority of deals are set to be closed in the second half of 2015. However, it is not expected that 2015 will outperform the record year of 2014. Domestic and the international investors both increased their interest in higher yielding properties in regional cities, hence secondary locations are becoming more liquid.

Property yields in Slovakia are expected to fall due to increasing demand. Prime yields in Bratislava stand at 7.00% for offices, 6.75-6.90% for retail and 7.90-8.25% for logistics.

Lending market

In Slovakia the banking sector is well capitalized in general, with good asset quality. There is greater demand for loans from all sectors with good availability of financing. According to this year's survey answers, banks consider real estate financing strategically more important compared to last year. All of the respondents were satisfied with the level of provisions against real estate loans in the banking sector.

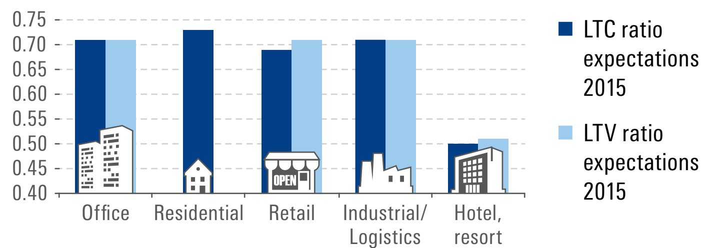
Banks are showing increasing interest in financing new developments compared to last year, but they still prefer income-generating projects. However, based on the banks' answers, the volume of real estate loans provided in the last 12-18 months is equally distributed between new developments and income-generating projects. The average size of the indicated loan deal is in the range EUR 9-20 million, while the preferred size would be between EUR 12-28 million according to the participating banks. There is a clear consensus that among the alternative lenders their main competitors are non-local commercial banks, followed by private equity, debt funds and investment banks.

Future of real estate loan portfolios

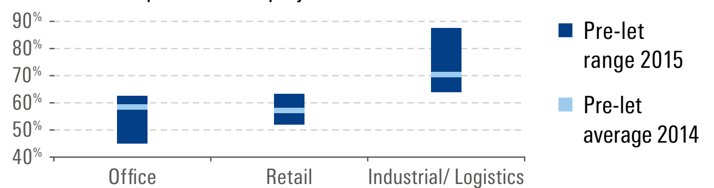
There is a clear, positive shift among the respondents since last year when they were also asked about the whole banking sector's and their own loan portfolio size. 60% of the respondents now think that both their own and the whole sector's portfolio sizes will increase in the following 12-18 months and only 40% think that they will remain unchanged. The answers suggest that bank lending for real estate purposes might expand in the upcoming 12-18 months in Slovakia.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

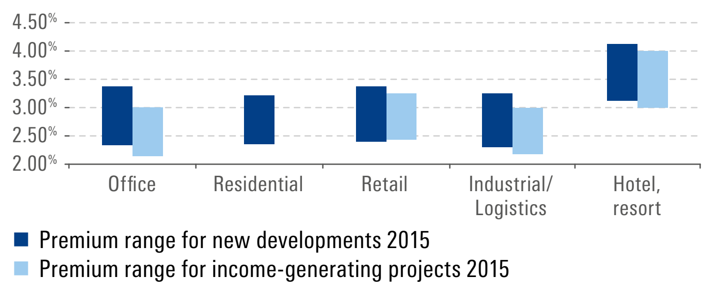
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



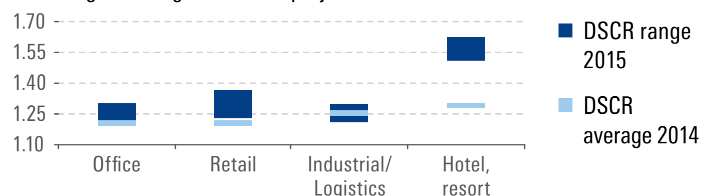
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



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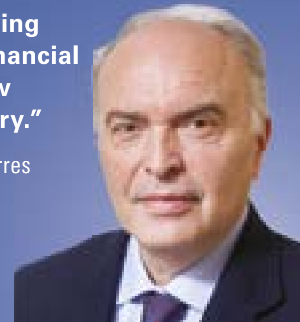


"Banks are playing operative and financial roles to drive new real estate recovery."

Francisco Javier Lopez Torres

Spain

Overview

After a long period of recession, Spain experienced GDP growth of 1.4% in 2014. The improved labour market prospects, eased financing conditions and renewed confidence is expected to further boost this growth momentum. Analysts project that the GDP growth in 2015 will outperform the previous year and will achieve 3%. Favourable external developments and less restrictive fiscal policy also helped the country to move forward in its recovery phase. The rate of unemployment decreased from 26.1% in 2013 to 24.5% in 2014 and further decreases are expected in the upcoming years to a level of 20.4% by 2017. In 2014, real estate investment volume significantly outperformed the previous year. Based on the data available for H1 2015, this year will be even stronger; in the first half of the year investment volume in Spain exceeded EUR 8.4 billion, which means that investment activity has almost tripled compared to in the same period last year. Many new buyers mainly from Europe and the U.S. entered into the Spanish real estate market, primarily focussing on core products, putting downward pressure on prime yields. Currently, prime yields are 4.75-4.90% for offices, 4.50% for retail and 7.00-7.25% for logistics.

Lending market

Bank lending in Spain is becoming less restrictive, mainly due to the recovery in the economy. Two thirds of the responding banks considered real estate financing either important or extremely important to them and for the rest it is moderately important. The majority of the respondents thought that the level of provisions against real estate loans is adequate and 40% think that it is slightly lower than adequate.

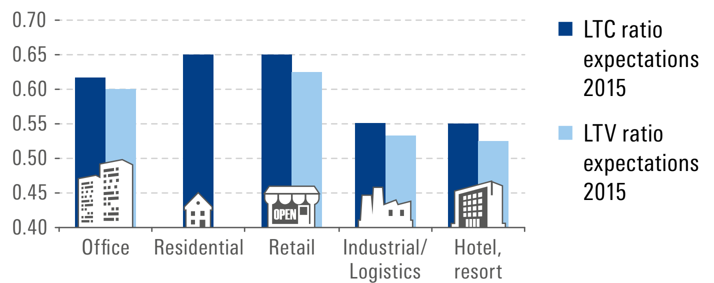
Banks consider that among alternative lenders, private equity and debt funds are their biggest competitors followed by non-local commercial banks. The majority of the banks indicated that they are open to financing income-generating projects, but only 20% indicated openness towards financing new developments. This sentiment is also supported by the distribution of the loan volume provided by the banks across these two categories in the last 12-18 months. Of the total volume, banks provided 21% for new developments and 79% for income-generating projects. In terms of the average deal size, banks indicated an average range of EUR 17-23 million per deal, while the preferred range was given as EUR 23-31 million.

Future of real estate loan portfolios

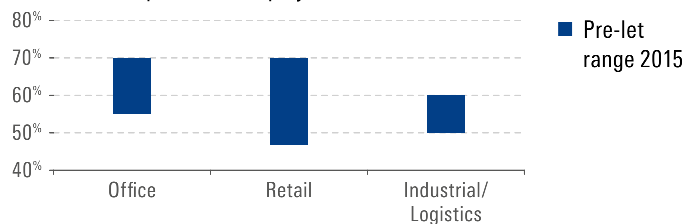
When asked about the prospects of portfolio sizes across the whole market over the next 12 to 18 months, banks were divided. 50% of them expect a decrease while the other half expect an increase. They were similarly divided when they were asked about the prospects of their own portfolios. The answers suggest that some of the banks are not convinced that they will be able to expand their portfolio in the next 12-18 months.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

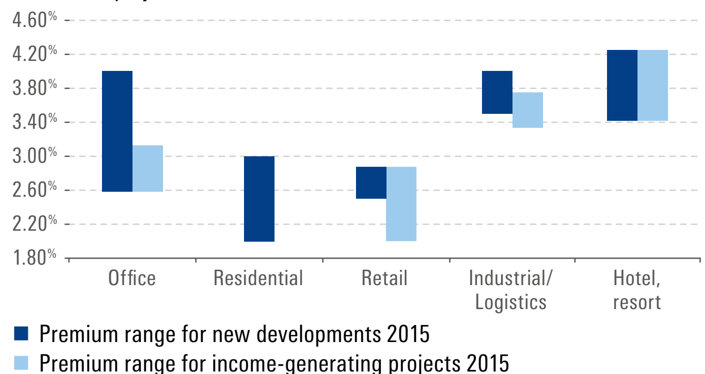
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



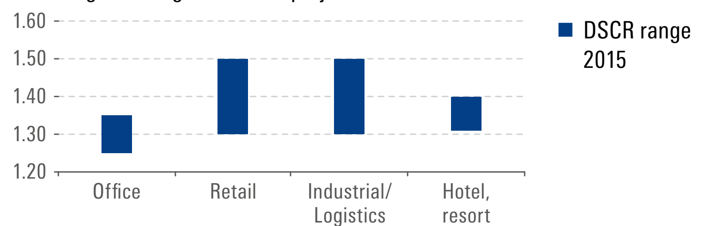
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



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"Stability, growth and transparency are fuelling real estate markets as alternatives looks relatively riskier."

Björn Flink

Sweden

Overview

Sweden's GDP increased by 2.4% in 2014, which is a significant improvement compared to the 1.3% in 2013. Due to strong domestic demand and an improved export outlook, the momentum of growth is expected to continue and to reach 2.6% in 2015. The growth in exports is mainly fuelled by stronger economic growth in Europe and a slightly weaker local currency. The level of investments decreased by 0.4% in 2013, followed by an expansion of 6.5% in 2014, which was the highest rate since 2007. The main reason for this growth was the significant increase in housing investments, construction and a large research and development investment; however, it is expected that construction activity will slow in the coming years.

The total real estate investment volume in 2014 outperformed 2013 by approximately 60% and it even exceeded the record years of 2006 and 2007. However, a moderate decrease (-9.7%) was observed on the market in H1 2015, compared to the same period in 2014. The most active cities in terms of property investments are Stockholm, followed by Götheborg and Malmö. Due to good market transparency and a favourable business climate accompanied by weaker local currency compared to last year, the proportion of international investors is gradually increasing in Sweden. Prime yields have decreased since last year, by 25-75 basis points, with the current levels at 4.25-4.5% for offices, 4.25% for retail and 5.75% logistics. As prime yields are moving even lower due to a lack of available prime products, buyers are increasingly focusing on secondary locations with higher yield potential.

Lending market

This year, two thirds of the interviewed Swedish banks considered real estate financing to be strategically very important for them, which is a significant improvement compared to last year's figure of 20%. All of the respondents were confident that the level of provisions against real estate loans was adequate in the banking sector. Due to the abundance of capital available in the capital markets developers are issuing bonds or equity instruments through the stock exchange. In this way they can acquire capital directly from investors without using traditional bank lending. Other alternative sources of financing such as non-local commercial banks or insurers/pension funds are also considered to be significant competitors to banks.

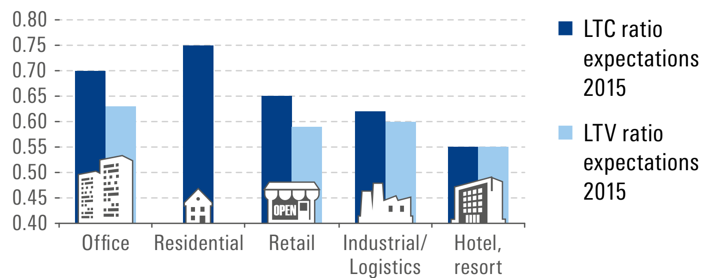
Banks also indicated that they were open to financing income-generating projects, but they are less willing to participate in development projects. Their willingness to finance development projects has decreased since last year. Based on the banks' answers, new developments represent 9% of the total volume of real estate loans provided in the last 12-18 months compared to 91% of the total volume provided for income-generating projects. The average deal/loan size indicated by banks was in the range of EUR 32-55 million, while the preferred size would be EUR 40-87 million.

Future of real estate loan portfolios

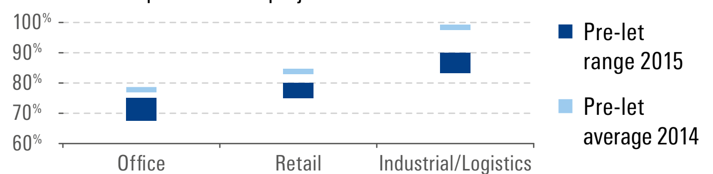
As with last year, the majority of the banks thought that both their own and the whole sector's loan portfolio sizes would make gains over the next 12-18 months. Only one third considered that they would remain unchanged or slightly decrease. The answers suggest continuous optimism among the banks that there is still an expansion potential across the lending market.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

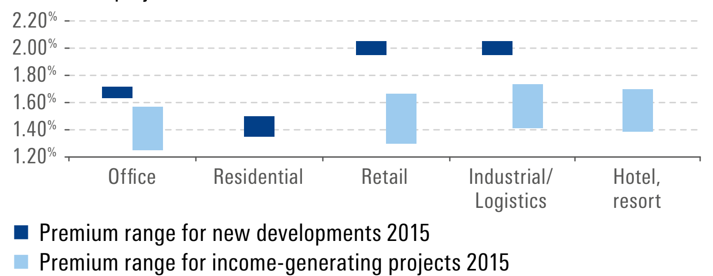
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



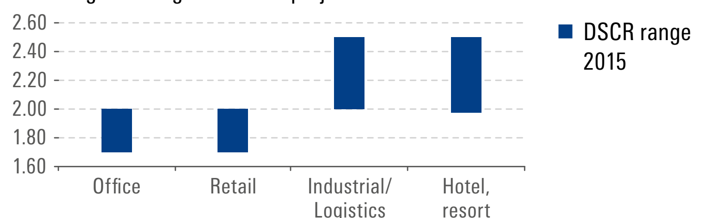
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



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Turkey

"Despite the slowdown of certain economic indicators amid political uncertainty, a major portion of the banks expect continued growth in lending volumes thanks to the well capitalized banking sector and an expanding economy alongside continuing investor interest."

Tayfun Pisirir

Overview

In 2014 GDP growth slowed to 2.9% as compared to 4.2% in 2013. This setback reflects the impact of stricter monetary policies, which have negatively affected domestic demand. Growth is expected to increase slightly in 2015, reaching 3.0% and about 3.3-3.5% annually in 2016-2017, bolstered by lower energy prices, a better macroeconomic environment across the European export markets and better political stability. However, unemployment remains high, at about 10%. Consumer and business sentiment has deteriorated in the run-up to the general election and political uncertainty has increased. Despite Turkey's temporary slowdown, the property market is rising and foreign investors were active in the market during 2014. The expanding economy suggests further growth in the real estate market in 2015, which is also supported by the strong tourist sector. The retail and office asset classes were of greatest interest, with shopping centres experiencing particularly rapid development. The lack of available prime income-generating products has been leading investor's towards new developments and refurbishments. However, investors are acting with caution given the geopolitical tension in the region. Prime yields in Istanbul are slightly down compared to 2014, with 6.5-6.8% for offices, 5.8-6.6% for retail and 7.5-9.0% for logistics.

Lending market

The lending market in Turkey has recently been showing gradual improvement. The volume of mortgage loans showed a year-on-year rise of 3% in 2014. Financing conditions eased in the previous year and the availability of financing is expected to improve further. Surveyed banks had a diverse view of the strategic importance of real estate financing to them. For 50% of the respondents it was either important or extremely important, while the other 50% suggested either medium or low importance. Among alternative lenders, banks consider non-local commercial banks and investment banks as their biggest competitors followed by private equity/debt funds. 75% of the interviewed banks indicated that the provision levels were adequate and only 25% thought that they were slightly below adequate.

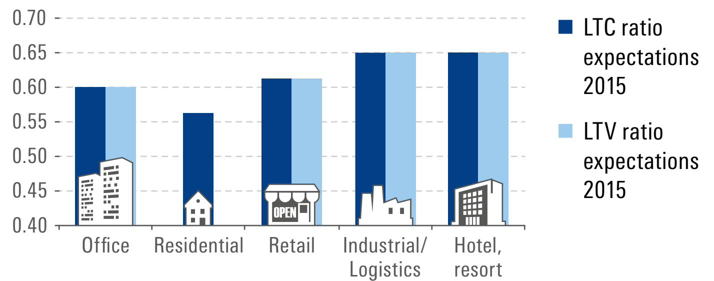
Banks indicated that they were open to financing both new developments and income-generating projects. According to the total loan volume provided, 73% was allocated for new developments and 27% for income-generating projects. The average deal size based on the banks' answers was in the range EUR 5-21 million, while the preferred loan deal size was EUR 7-27 million.

Future of real estate loan portfolios

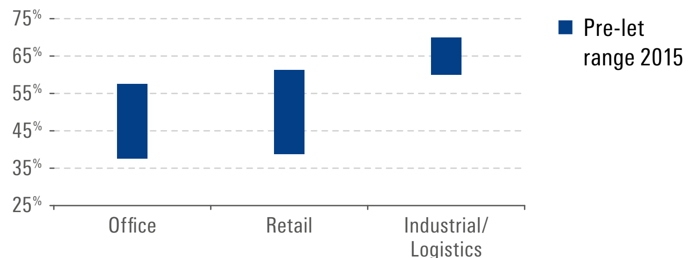
Expectations regarding their own and the whole lending sector's loan portfolio sizes were positive, as none of the respondents foresaw a decrease in lending volumes over the next 12-18 months. The vast majority of the survey participants believed that portfolio sizes would increase and only one quarter of all respondents expected that it would remain unchanged both for their own and the whole banking sector's portfolios. The answers suggest positive sentiments in the banking sector for potential further growth.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

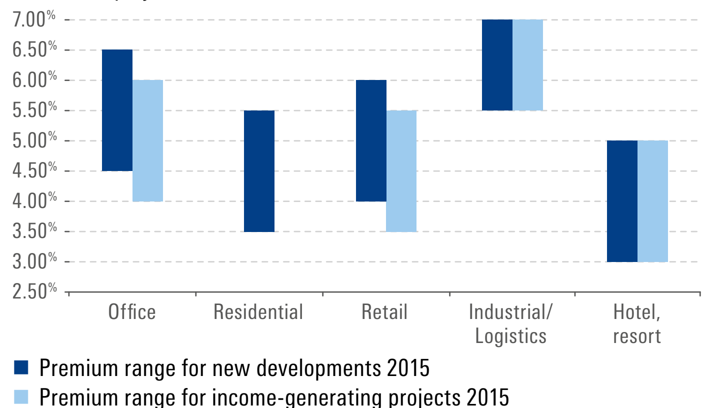
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



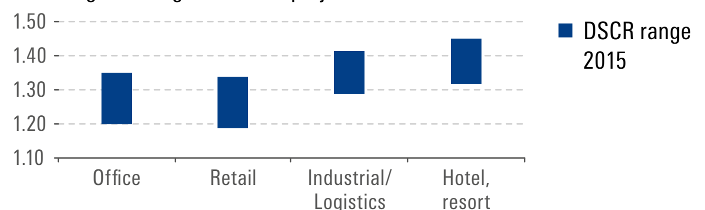
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Debt service coverage ratio expectation range for financing income-generating real estate projects



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United Kingdom

"The UK continues to demonstrate signs of strong economic recovery, boosted by continued investor and consumer confidence in the property market."

Andrew Jenke

Overview

The UK economy grew by 2.8% in 2014, and this growth momentum is expected to continue during 2015 due to strong domestic demand. Growth here is being bolstered by other factors such as low oil prices, a decrease in the unemployment rate, lower borrowing costs and the gradual increase in households' disposable income. The positive shift in the labour market is expected to continue during 2015 and the unemployment rate is expected to fall below 5% in 2016. Inflation is forecast to fall again in 2015 with some increase expected only in 2016. A positive sign is that the budget deficit continues to fall; however, the government debt ratio is close to its peak.

2014 was again a strong year in the UK real estate investment market. In terms of investment volume, 2014 was similar to the previous year, but there was a clear geographic shift of investors' activity away from London to other parts of the country. This was due to the limited availability of prime products in London, which resulted in a very low yield environment in the capital city. Considering the H1 2015 activity, this year is also expected to be promising, as the total volume is outperforming the same period of last year by approximately 60%. Prime investment yields in London experienced downward movement since last year, currently standing at 3.5-4.25% for prime office, 2.25-4.75% for prime retail and 4.6-5.25% for prime logistics.

Lending market

The UK debt market remains active and lending to property companies increased significantly and investment activity is approaching the pre-crisis level. The market is characterized by good availability of financing with favourable conditions. However, there is uncertainty about the evolution of interest rates in 2015. The proportion of bank lending from the total lending volume remains below the pre-crisis level, while financing from alternative lenders hits record high levels. Surveyed banks indicated that among alternative lenders they consider non-local commercial banks as their biggest competitor followed by investment banks and private equity/debt funds.

Real estate financing remains at a very high importance for surveyed banks and they also indicated that they were very much open to financing income-generating real estate projects. However, new developments are still less preferred by the banks with two thirds indicating moderate and one third great openness to financing these projects. Based on their answers, only 7% of the total loan volume provided in the last 12-18 months was associated with development projects and the other 93% was granted to income-generating projects. The average loan deal size indicated by the banks is in the range of EUR 48-56 million, while the preferred range would be between EUR 35-100 million.

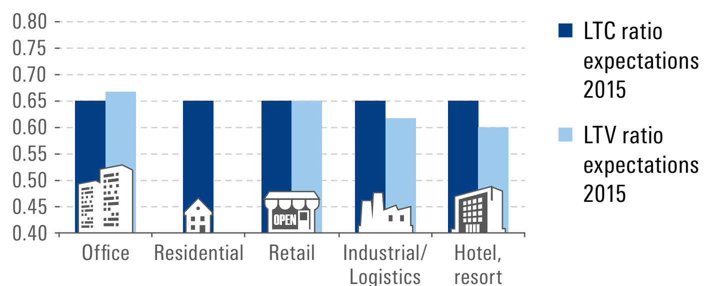
Most of the respondents indicated that the level of provisions was adequate and only some believed that it might be too low.

Future of real estate loan portfolios

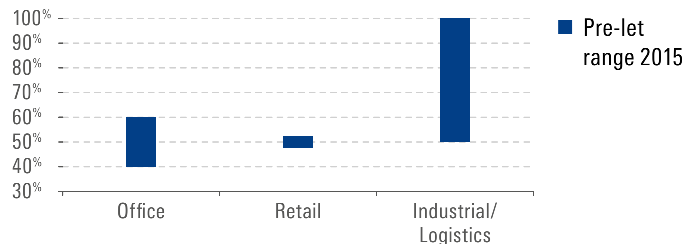
As in last year, the majority of respondents thought that overall banking sector portfolio sizes would increase and only a few were of the opinion that they would remain unchanged. In terms of the prospects of their own loan portfolios, banks were more optimistic and all of the respondents forecast an increase. Overall, based on the answers, banks are confident that there is room to further expand their portfolios in line with improving market conditions.

Financing expectations of highly rated development and income-generating projects in the next 12-18 months

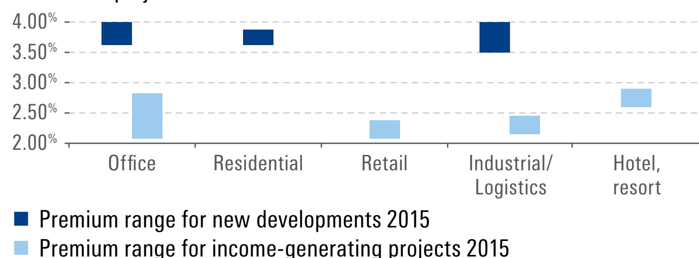
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



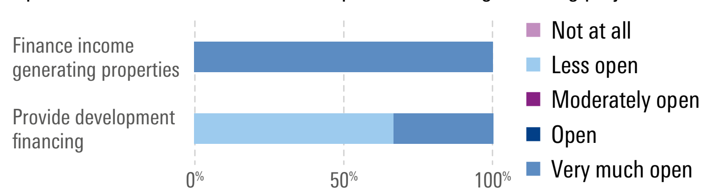
Pre-let ratio expectation for projects



Loan interest premium to be applied by banks for highly rated real estate projects



Openness of banks to finance development/income-generating projects



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