

Property Lending Barometer 2014

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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Dear Reader,

We are delighted to present the Property Lending Barometer 2014. In this 5th edition, the geographic orientation of the survey expanded in the CEE region and includes Russia for the first time. Additionally it includes Austria, Germany, United Kingdom and Sweden from Western Europe.

During 2013, most of the European economies experienced growth and this trend is forecasted to continue into late 2014 as well. However, this promising outlook can be threatened by the instability in the Middle East as well as the tensions between Russia and Ukraine, whose outcome is difficult to predict at the time this report was written.

Ever since the global financial crisis hit, European bank lending has seen tough times. As a consequence of the gradual economic recovery banks are becoming more open to financing and hence the overall lending sentiment has improved. Many banks are still focusing on repairing their balance sheets after the heavy losses experienced during the period of the credit crisis. A priority for banks, especially in some of the CEE countries, is to resolve their distressed debt portfolios either by selling or restructuring them.

It is important to stress that traditional bank lending has decreased since the onset of the financial crisis and alternative lenders, including insurance firms, pension funds, private equity and hedge funds, entered the market to fill the gap left by banks and more often compete with banks to provide financing. As a consequence of increased competition there is downward pressure on margins in most of the markets in Europe.

Furthermore, lenders are also slowly expanding their focus on secondary markets due to the limited number of quality products available in core markets and also the higher loan interest premium potential offered in non-core markets.

This report is an analysis of the findings of our survey of the leading banks active in the countries in scope. The purpose of our survey was to assess the prospects for bank financing in the real estate sector in Europe. The barometer includes input from more than 70 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. The following countries were included in the survey: Austria, the Baltics (Estonia, Latvia and Lithuania), Bulgaria, Croatia, the Czech Republic, Germany, Hungary, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Sweden and the United Kingdom.

There are significant differences among the participating countries; hence this year we provide a separate snapshot for each country to be able to emphasise their unique characteristics.

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 the banks, the proportion of impaired loans and banks' views on how to manage these loans. We also raise issues such as the potential effects of Basel III regulations and the banks' loan portfolio management strategies. Furthermore, the opportunity for new financing and banks' asset class preferences were also considered.

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

The survey provides insights for developers and investors alike, on the future prospects around real estate financing, and should enable banks to benchmark their practices based upon that of their peers.

Some highlights from the Property Lending Barometer 2014 include:

- The macroeconomic outlooks and the perceived risk profiles of each country, considering the impact and prospects for its real estate market.
- In terms of investment activity, the three largest European economies (UK, Germany and France) account for close to 70% of the transaction volume during H1 2014.
- Restructuring existing loans rather than seeking foreclosure is still the preferred way to handle problematic loans. Good quality projects with a potentially strong business model and additional equity have a better chance for successful restructuring.
- The strategic importance of real estate financing for banks is higher in those countries which have a more developed property market with more liquidity.
- In general, banks are still more interested in financing income-generating projects than development projects. Banks in Western European countries were more open to financing income-generating projects than those in less developed countries participating in the survey.
- A greater proportion of impaired loans was indicated by banks in the CEE region, as all the participating Western European countries had a higher than 90% ratio of fully compliant real estate loans.
- According to the surveyed banks, on average 60% of problematic real estate loans in all surveyed countries may be managed successfully through restructuring.
- Based on the average priority indicated by the surveyed banks, office and industrial are the most preferred asset classes, closely followed by the retail and residential sectors. The hotel sector remains the least preferred by banks in terms of financing, but good projects can obtain reasonable terms.
- Banks prefer to finance residential projects in more matured markets such as the UK, Germany, Austria and Sweden.
- There was a noticeable decrease in premiums in Hungary, Poland and Serbia, both in cases of development and income-generating projects, compared to the previous year's survey. In Romania there was a decrease in the premium applied for financing development projects.

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 approach of banks to real estate financing in Europe. The following countries are represented in the 2014 survey: Austria, the Baltics¹, Bulgaria, Croatia, the Czech Republic, Germany, Hungary, Poland, Romania, Russia, Serbia, Slovakia, Slovenia, Sweden and the United Kingdom.

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 70 banks, all of which were active in the real estate market in Europe. Data collection for this survey took place during the period May-July 2014.

Approximately 10% of survey participant banks were local banks, i.e. those operating predominantly in one country within Europe, whilst regional or multinational banks comprise the majority share of the respondent mix.

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.
- 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 2014

Geographic abbreviations

AUT – Austria; BAL – The Baltics; BUL – Bulgaria; CEE – Central and Eastern Europe;
CIS – Commonwealth of Independent States; CRO – Croatia; CZE – Czech Republic;
EMA – Europe, Middle East and Africa; GER – Germany; HUN – Hungary; POL – Poland; ROM – Romania;
RUS – Russia; SRB – Serbia; SVK – Slovakia; SLV – Slovenia; SWE – Sweden; GBR – United Kingdom

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



Overview of the European real estate market

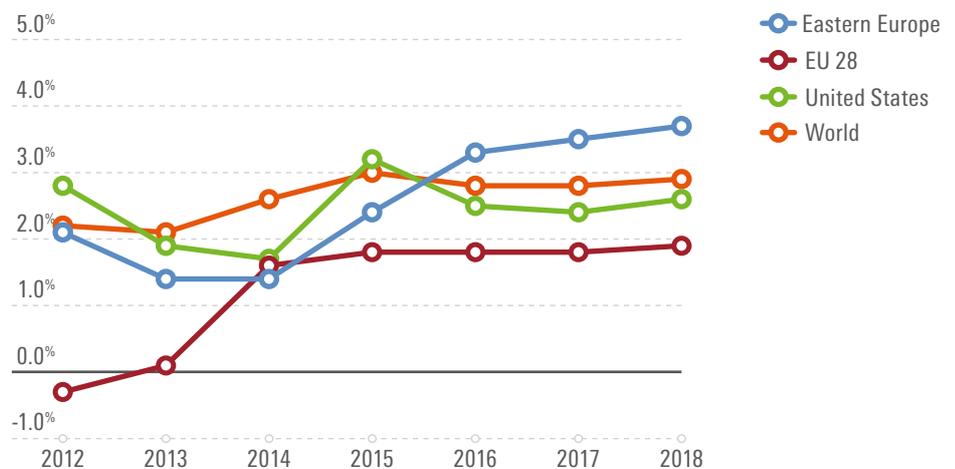
During 2013 most European economies experienced growth and the outlook is improving as this tendency is expected to continue into late 2014 as well. However, further growth remains conditional based on the commitment of certain countries to keep reforms on track. Additionally, the outcome of the current geopolitical crises, such as the increased tension between Russia and Ukraine, might jeopardise the growth outlook for the region as Russia is a significant export market to some of these countries. Conflicts in the Middle East are also affecting investors' confidence.

Based on current forecasts, real GDP is expected to exceed the 2008 level for the first time in the EU by the end of 2014. However, in some of the less developed countries, GDP will still remain far below the pre-crisis level. The improvement in the markets is mainly attributable to less fiscal tightening and some influence from private domestic demand for the first time since 2010.

Improved confidence and falling energy prices, at least for now, may partially fuel the growth in the short run. However, sustained consumption growth is a key factor, and this is largely dependent on improvements in the labour market situation. There have been encouraging increases in the employment rate, although only at a slow pace. The EU unemployment rate is expected to decrease slightly in 2014 to 10.5%, after reaching a historical peak of 10.8% in 2013. There is still a potential threat that high unemployment, high debt/GDP ratio, tight credit and indebtedness of households in the euro area might slow down the recovery process.

According to the forecast of the Economic Intelligence Unit (EIU) the average GDP growth in the European Union will be 1.8% on average for the period of 2014 to 2018. In the case of Eastern Europe growth will accelerate in 2014 and 2015, but overall an average 2.9% growth for the upcoming five years is forecasted.

GDP growth: Global Outlook



In this table Eastern Europe includes Azerbaijan, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Kazakhstan, Latvia, Lithuania, Poland, Romania, Russia, Serbia, Slovakia, Slovenia and Ukraine

Note: growth figures for 2014-18 are forecasted by EIU.

Source: Economist Intelligence Unit, 14 July 2014

Bank lending is recovering

The European Central Bank indicated its intention to keep policy rates low to facilitate investments until the economic recovery becomes more firm. The yield spreads in the euro area narrowed further as there has been increased interest from investors in the bonds of more vulnerable member states with higher return potential, due to the low interest environment in core markets.

Contrary to promising financial market developments, we are still seeing relatively weak bank lending activity compared to the pre-crisis years, although there are new players in the market who are providing alternative financing solutions. Overall the recovery in the euro area was less financed by the credit provided by the banks and more by firms financing their own investments internally or by issuing bonds. Lending conditions are now improving across Europe, starting with Western Europe, and this means more access to credit and more opportunity for investors to borrow.

The economic recovery will be backed by a European Central Bank initiative called the Asset Quality Review (AQR), a European stress test exercise, which raises issues such as collateral misvaluation. As a result of this exercise, analysts predict an improvement in lending volumes in the future. Due to the AQR the European banks remain under pressure to unload bad assets. It has provided a motivation for some banks to sell their bad assets faster in order to get better results during the review, as the final conclusion of the AQR is expected to be announced publicly in late 2014.

A successful AQR and stress test could be an important step in overcoming credit supply constraints, with positive impacts on growth of loans also in less developed countries.

According to business media, since the beginning of 2014 banks have started to predict an end to the tightening of credit standards on loans, which might also give a boost to the loans provided to households.



Real estate market in Europe

2013 was an exceptionally strong year in terms of property investment volume, as Europe experienced a growth of 22% since 2012 and it reached the highest transaction volume since 2007.

Thanks to the recovery of investor confidence and improved lending conditions, the first half of 2014 was strong with closing deals over €80 billion, which is approximately a 25% improvement compared to the same period in 2013.

Close to 70% of the transaction volume is accounted for by the three largest European economies, the UK, Germany and France, with the UK alone accounting for close to one third of the investment volume during H1 2014. The share of other Western European countries is approximately 14%, whereas the CEE region (excluding Russia) only represents 3.4% of the European investment transaction volume.

The strongest increases in volume were registered in the Czech Republic, Austria, France and Spain. The majority of the countries within the CEE managed to grow since last year as confidence is finally coming back to the region.

Cross-border investors are playing an important role in the recovery of the investment markets as they increased their share to 30% of the total investment volume, for instance in Spain the share of cross-border investment increased from 36% in 2012 to 78% in 2013, and in the case of Italy from 64% to 79%.

Demand for prime properties in core markets remains high, but according to recent market studies investors are continuously looking for higher returns and are prepared to take more risk. Furthermore the limited supply of quality prime assets and low yields in core markets drives investor focus to the secondary markets.

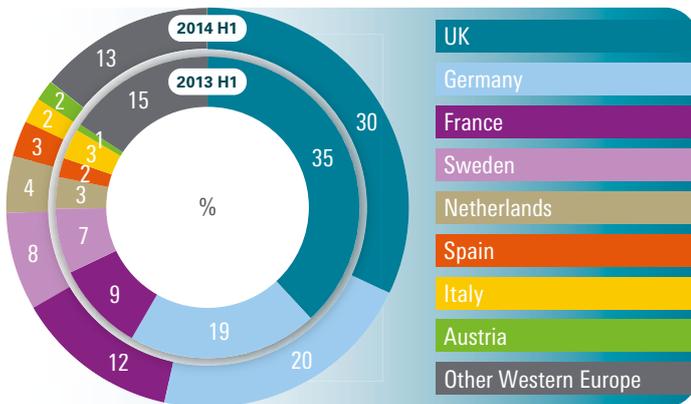
According to the CBRE European Investor Intentions survey conducted in 2014, interest in good secondary assets increased by 8%, partly at the expense of prime assets. 65% of the surveyed investors are looking for non prime assets, out of which approximately 5% are looking for distressed assets.

Among all asset classes, office space accounts for the majority of investment volume (47%), with retail (26%) and industrial (12%) space following. However, industrial has shown the strongest rise since 2012.

Due to increased demand, the prime yields are decreasing in the core markets and stabilising in the secondary markets. Prime yields in core markets have already reached a significantly low level, i.e. close to pre-crisis times.

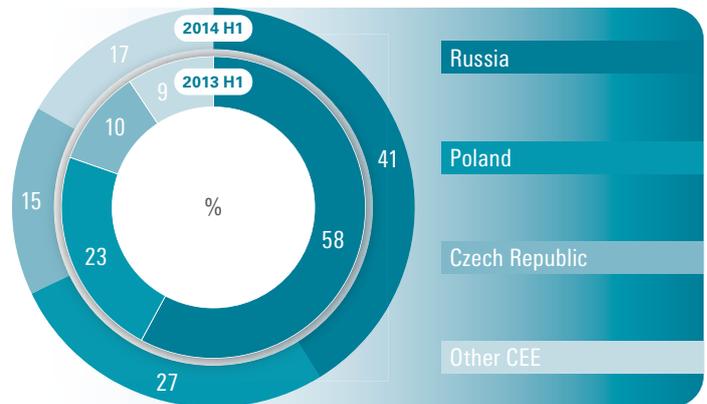
It is expected that during 2014 there will still be substantial demand for prime investment opportunities. According to market analysts' expectations, a more diverse group of buyers will look into the market and this trend will be accompanied by less strict lending conditions.

Real estate transactions broken down by country – Western Europe



Source: CBRE, BNP Paribas Real Estate

Real estate transactions broken down by country – Central and Eastern Europe



Source: CBRE

Investment by asset type in Europe



Source: Savills



Managing impaired loans

As a consequence of the economic and sovereign debt crisis in Europe, banks were facing an increased number of impaired loans, especially in the CEE region where the majority of property loans are denominated in a foreign currency. The combined effect of the weakening economic performance during the crisis and the depreciation of local currencies resulted in a high debt service liability that a significant number of borrowers could not endure. Hence a sizeable proportion of the loan portfolio became non-performing.

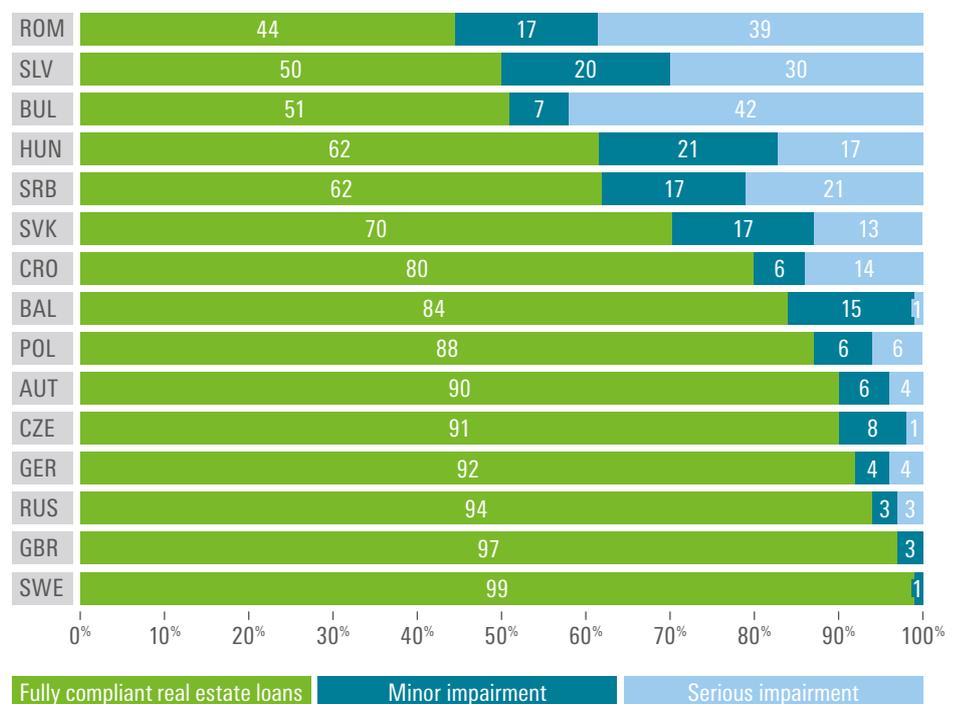
In this part of the survey we focus on banks' opportunities to manage real estate loans where debtors cannot pay their capital and/or interest on time, or where there is a technical breach of contract terms.

Current state of and future expectations for impaired loans

With the exception of the Czech Republic and Russia, the countries located in the CEE region tend to have a higher proportion of impaired loans compared to Western European countries.

The highest proportion of fully compliant loans is in Sweden, the UK and Russia with 99%, 97% and 94% respectively. Based on responses collected, the largest proportion of impaired real estate loans is in Romania (39% serious and 17% minor impairment). Approximately half of the loan portfolios either have minor or serious problems in Bulgaria and Slovenia. Bulgaria has the highest ratio of seriously impaired loans among all the surveyed countries at 42%.

Proportion of impaired real estate loans per country



Source: KPMG Property Lending Barometer 2014

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 loans.

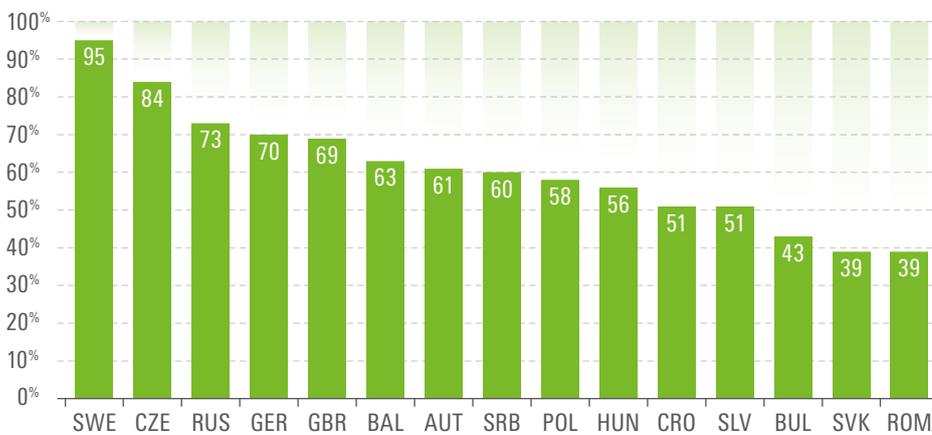
The highest percentage was indicated by Swedish and Czech banks. On average Swedish banks think that 95% of the loans with problems may be managed successfully through restructuring and the majority of respondents from Czech Republic indicated this ratio at around 83%.

Banks in Bulgaria, Slovakia and Romania are the least convinced regarding positive results of restructuring as they think that only around 40% or less can be resolved through restructuring.

It is clear that banks are more inclined to manage their impaired real estate portfolios through restructuring than by looking for immediate foreclosure. The rescheduling or restructuring of loans is thought to be a more favourable approach to manage problematic loans compared to other options.

Therefore, even though it has a relatively high cost, banks tend to keep non-performing loans on their balance sheets as long as there is a chance that the outstanding amount will be recovered.

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



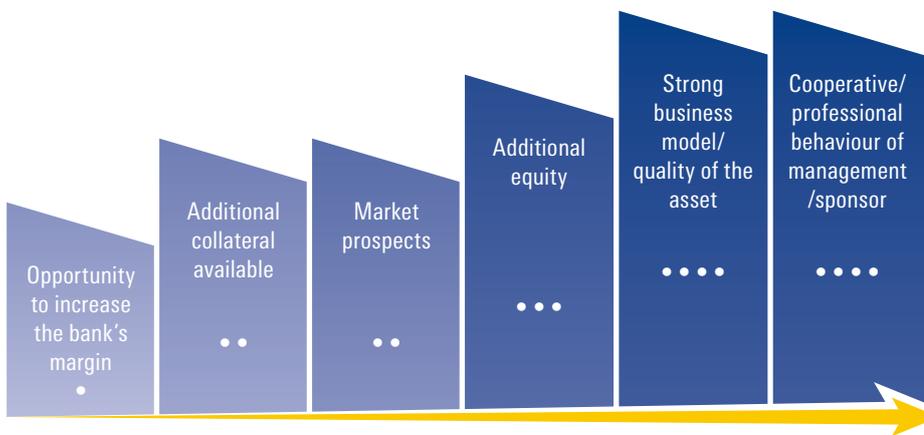
Source: KPMG Property Lending Barometer 2014

Most important criteria for successful restructuring

The primary precondition for any restructuring is co-operative behaviour on the part of the borrower. Once this condition has been met, banks indicated a strong business model and the quality of the asset as the most important criteria when restructuring. This shows that banks are putting the highest emphasis on business models/quality of the asset, as these continue to be key factors for successful restructuring.

According to banks, additional equity is the third most important factor to drive restructuring, followed by the market prospects and additional collateral available. The least important remains the opportunity to increase the bank's margin.

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



Source: KPMG Property Lending Barometer 2014





Prospects for real estate loan portfolios

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

Strategic importance of real estate financing

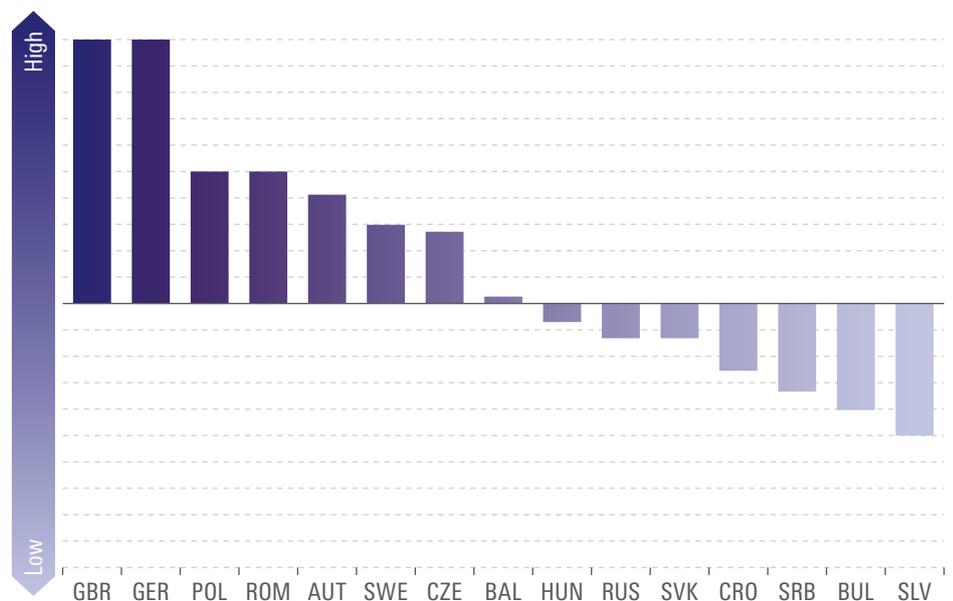
Overall, real estate financing remains strategically important to those European countries with a more developed real estate market. However banks in Poland and Romania also indicated a high strategic importance for real estate financing compared to other countries in the CEE region.

Respondents from the UK and Germany indicated that real estate financing is extremely important for them, contrary to Serbian, Bulgarian and Slovenian respondents who consider it the least important of all surveyed countries.

The results show that in those countries where the property market is more volatile and the economic development is not as firm, banks indicated a lower strategic importance of real estate financing. Furthermore, some CEE countries are relatively unexplored by international investors as these markets are less transparent and hence have a lower investment volume and liquidity compared with other more economically developed CEE countries.

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

Strategic importance of real estate financing for banks



Source: KPMG Property Lending Barometer 2014

Most important factors affecting real estate loan portfolios

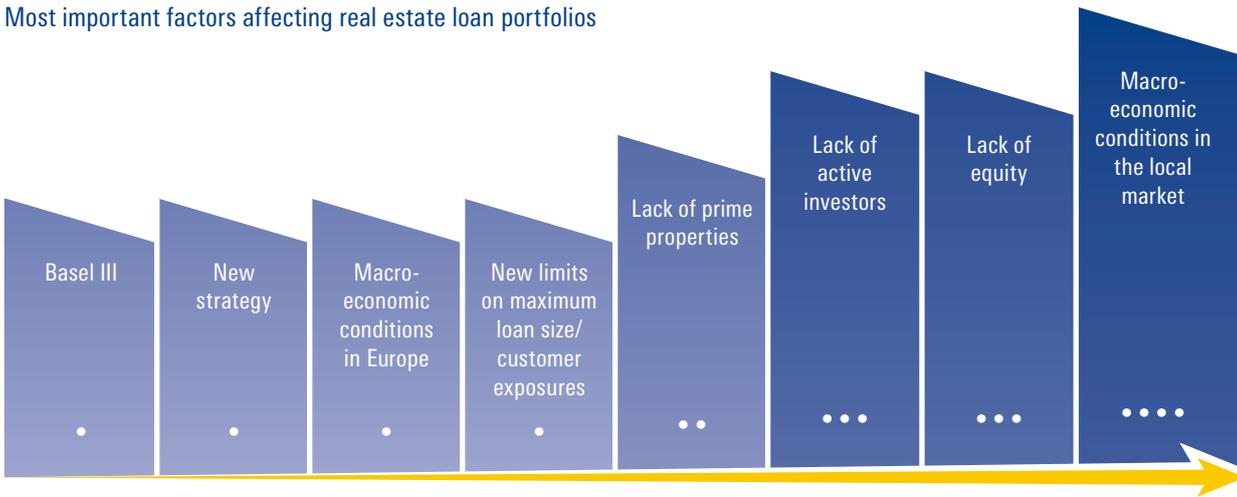
Banks were also asked to identify the key drivers affecting their real estate portfolios.

Based on the responses, the most significant factor identified was the local macroeconomic environment. A lack of equity or active investors was the second most significant factor for banks, and the lack of prime properties being a problematic factor as well. A combination of these factors is likely to have a negative impact on their loan portfolios.

New limits on the maximum loan size/customer exposure, macroeconomic conditions in Europe, new strategies and Basel III effects were not as important for banks.

Regarding the question as to where banks expect additional funds to come from if the overall size of their share in financing decreases, the majority of banks indicated that they expect additional equity from developers/investors, followed by private equity as the next most relevant source. Some banks indicated bonds and insurers as other potential sources. Furthermore, the willingness to invest in real estate by companies that do not have real estate as their core business was also mentioned as a potential source.

Most important factors affecting real estate loan portfolios



Source: KPMG Property Lending Barometer 2014



Disposing of loan portfolios

Less than one third of the banks surveyed are considering disposing of part of their commercial loan portfolios in the next 12-18 months. The highest proportion of surveyed banks who are considering to dispose of part of their commercial loan portfolio is in Bulgaria (60%), followed by Hungary (57%), Croatia and Slovenia (50%). Among those banks who are considering disposing of part of their loan portfolio, 80% have indicated a strategic exit as the main reason behind their decision. Other factors such as risk considerations and cleaning their distressed asset portfolio were also mentioned by banks.

According to industry insights, up until now most of the banks have resisted selling their impaired loan portfolios due to the fear of realising heavy losses. However the demand for these troubled assets has risen recently as demand from hedge funds and private equity investors are pushing up prices. Some investors have raised significant funds to buy distressed portfolios, often looking at buying debt positions that gives them significant control around restructuring. A potential increase in demand in Europe might be the consequence of decreased amounts of distressed debt in the U.S.

There are also investors who are specialised in purchasing debt in order to take control of companies, a strategy commonly known as "loan to own."

Impact of Basel III

Bank representatives were also asked to comment on how Basel III regulations would impact their business. The majority of the respondents think that the new regulations would not have a significant effect on them.

Approximately one third of the banks expect that, due to Basel III, their income-generating portfolios would gain and that their development loan portfolios would decrease. Close to 40% of the banks predict that due to Basel III banks' margins would increase and as a consequence associated financing would become more expensive.





Opportunities for financing new real estate projects

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

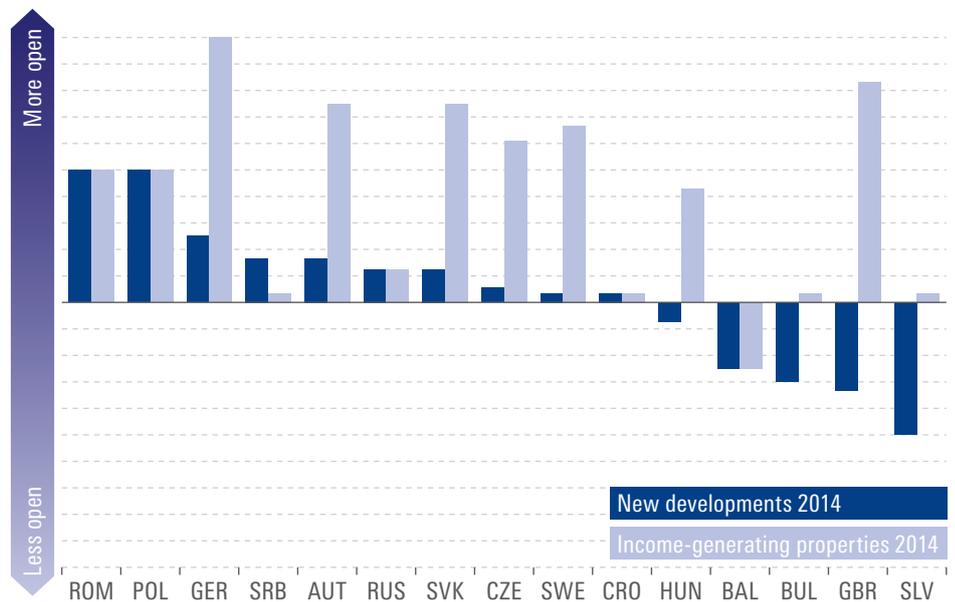
New financing

Unsurprisingly the majority of banks are more open to financing income-generating projects rather than developments, with Serbia being the only exception. In Russia and Croatia, banks are equally open for development and income-generating projects, albeit at a moderate level.

Polish and Romanian banks indicated the greatest openness to financing new developments followed by Germany. The least open were the Slovenian, British and Bulgarian banks.

Germany and the UK followed by Austrian and Slovakian banks were the most open to financing income-generating projects.

Openness of banks to finance development/income-generating projects



Source: KPMG Property Lending Barometer 2014

Asset class preferences

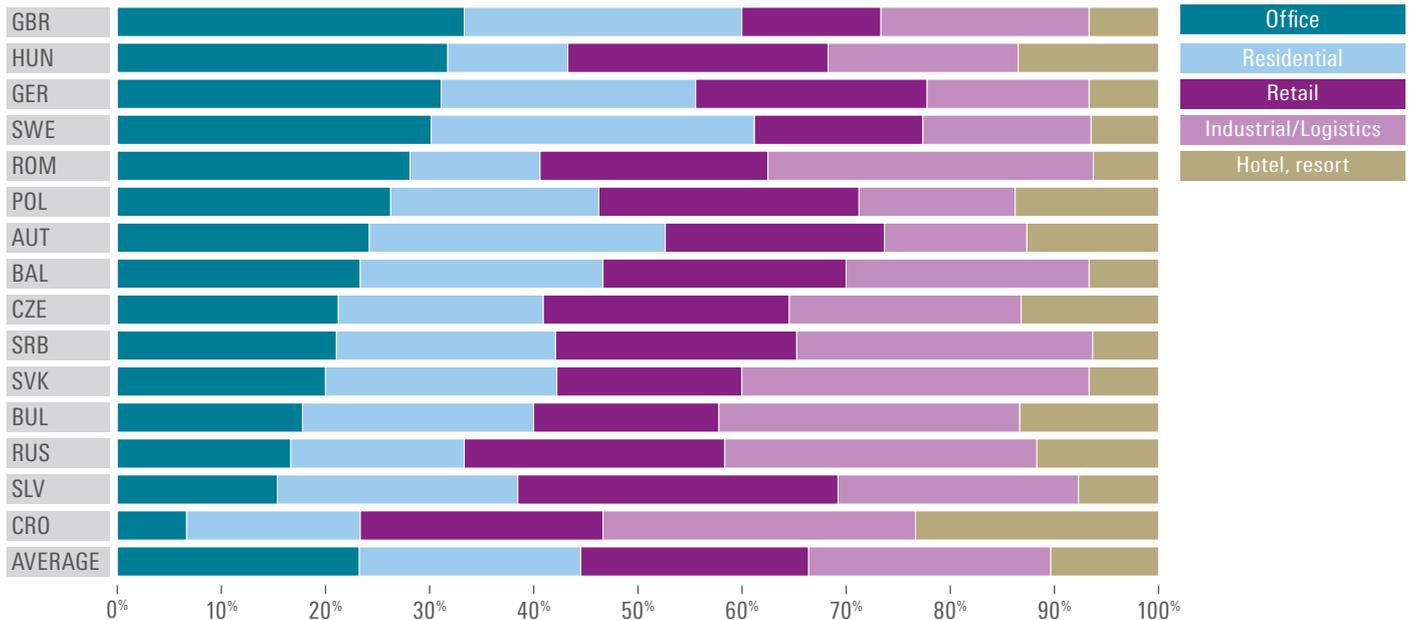
Banks were also asked about their preferred asset class in each country.

Taking the average of the indicated priorities of the surveyed banks, office and industrial are the most preferred asset classes, closely followed by retail and residential. Hotels were the least preferred asset class among the banks.

In general, residential projects received higher priority from banks operating in more mature markets such as the UK,

Germany, Austria and Sweden. Offices turned out to be the most favoured in the UK, Hungary and Germany. In Croatia, Romania, Slovakia, Serbia and Russia industrial was indicated as the most favoured, while in Slovenia and the Czech Republic banks prefer retail assets the most. Hotel investment was among the most favoured asset classes only in Croatia, most probably due to Croatia's traditionally strong tourism industry.

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 2014

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. In order to successfully obtain financing for a project, a strong business model and high quality of the asset were the most important considerations. Reputation and references of

the developer/operator and pre-letting/pre-sales level are seen as the second most important followed by the level of owner's equity. The significance of an independent feasibility study/valuation and size of the requested loan, when there is strong belief in the project, was the lowest criteria for banks.

Banks' most important criteria for considering real estate financing



Source: KPMG Property Lending Barometer 2014

Loan-to-cost ratios (LTC)

Banks were asked to comment on their technical criteria for financing. When questioned about LTC ratios, responses varied by country and asset type.

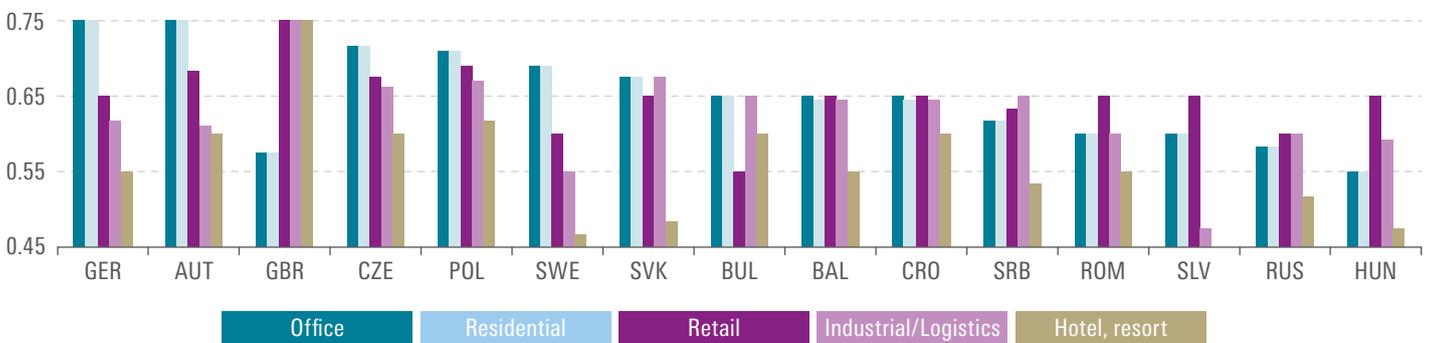
In the case of the more mature markets such as Germany, Austria and the UK, the loan-to-cost ratios for the office, residential, retail and industrial/logistics sectors were between 0.55 and 0.75 (i.e. reflecting a capital structure of 55-75% debt and 45-25% equity). In countries with less stable lending markets and higher risk profiles, primarily in Eastern Europe, the ratio is lower, ranging from 0.48 to 0.72 (i.e. reflecting a capital structure of 48-72% debt and 52-28% equity). Due to the higher perceived risk, the hotel sector currently requires a high equity ratio of 40-50%.

Loan-to-value ratios (LTV)

In more established markets, the LTV ratios for the office, residential, retail and industrial/logistics sectors exhibit a maximum loan-to-value ratio of 0.65 to 0.75 (i.e. reflecting a capital structure of 65-75% debt and 35-25% equity). However, among the more matured markets Sweden has the highest equity requirement with a loan-to-value ratio ranging from 0.57 to 0.65. Unsurprisingly, banks in countries with a higher perceived country risk profile, e.g. in Serbia and Slovenia, banks require a higher proportion of equity.

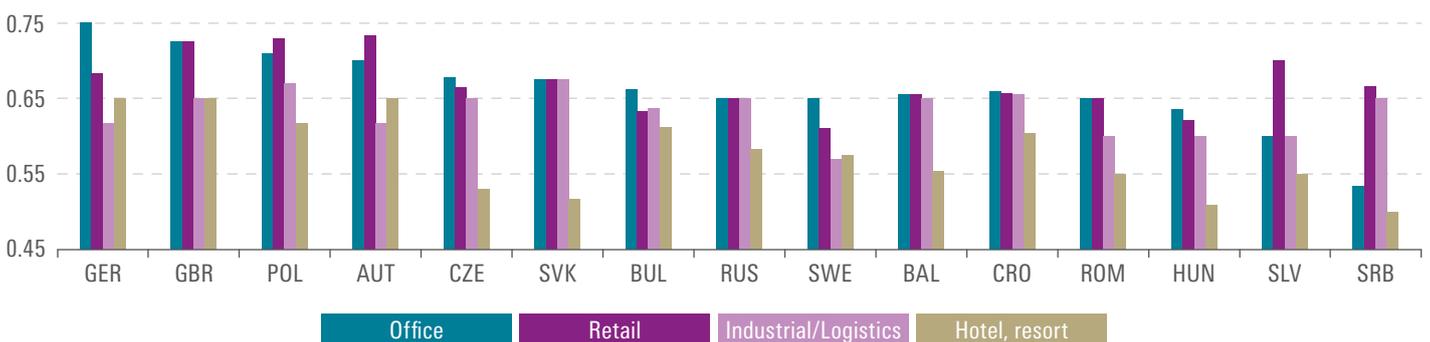
The equity required in the case of hotel properties is the highest of all the asset classes, close to an average of 40% and the lowest equity is required for the retail sector with an average of 33%, followed closely by the office and industrial sectors.

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



Source: KPMG Property Lending Barometer 2014

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



Source: KPMG Property Lending Barometer 2014

Pre-let ratios

Banks' demand for pre-let and pre-sale ratios also vary greatly across countries and sectors. Here Sweden and Croatia exhibit the highest ratios on average, followed by the Baltics and Slovakia. The pre-let ratios for the office and retail sectors are in general lower than for industrial, with an average of 53% and 54%. In the case of the industrial assets banks require on average a higher rate, around 64%. Usually the industrial and logistic projects are "built to suit" to fit the specific tenant requirements; hence the number of speculative developments in this asset class is lower compared to other asset types.

Debt service coverage ratios

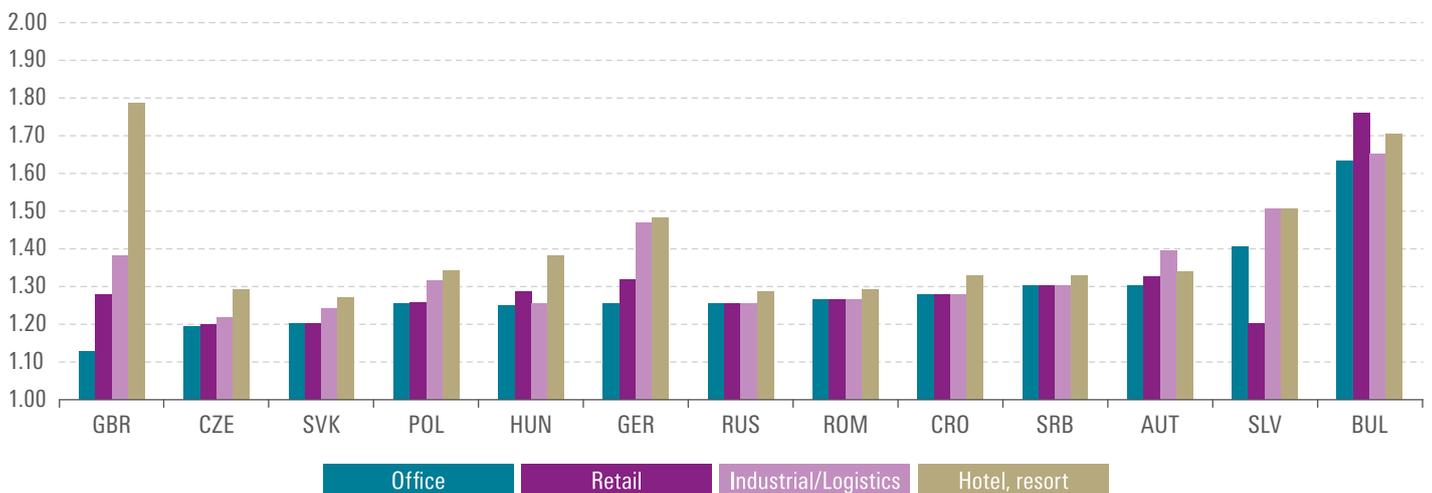
The debt service coverage ratios ('DSCR') expected for income-generating projects initiated by investors with excellent reputations and sound business plans were also examined. In almost all countries, the hotel sector ratios tended to be higher than those of any other asset class, approximately 1.45 on average, followed by the industrial sector with 1.42. Banks require the lowest DSCR ratio in the case of office and retail assets with an average of 1.34.

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 2014

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 2014

Interest premiums

In addition, participants 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 and with a solid business plan approached them. We herewith present only two asset classes, where the highest investment volume was realised in Europe: office and retail.

For new developments, the lowest loan interest premiums are in Sweden, Germany and Austria, due to the lower risk profile and well established real estate markets of these countries. Possibly more competition from banks and other types of lenders to provide debt financing to highly rated real estate projects is also driving down the margins in these markets. After these Western European countries, the more developed CEE markets of Czech Republic and Poland offer the most favourable financing conditions. The highest premiums were exhibited in Russia, Bulgaria and Croatia.

The premiums applied by banks for office and retail assets were very similar, with the exceptions being Slovenia, Serbia and Bulgaria. In Slovenia banks are willing to finance retail projects with even lower premiums than would be the case for office space (80 basis points). By contrast, Serbian and Bulgarian banks apply 100 and 110 basis points higher premiums on average than for office projects respectively.

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 remained similar when it came to financing income-generating projects.

The surveyed banks exhibited the highest premiums for the hotel asset class, which is often due to the more risky nature of these types of assets.

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



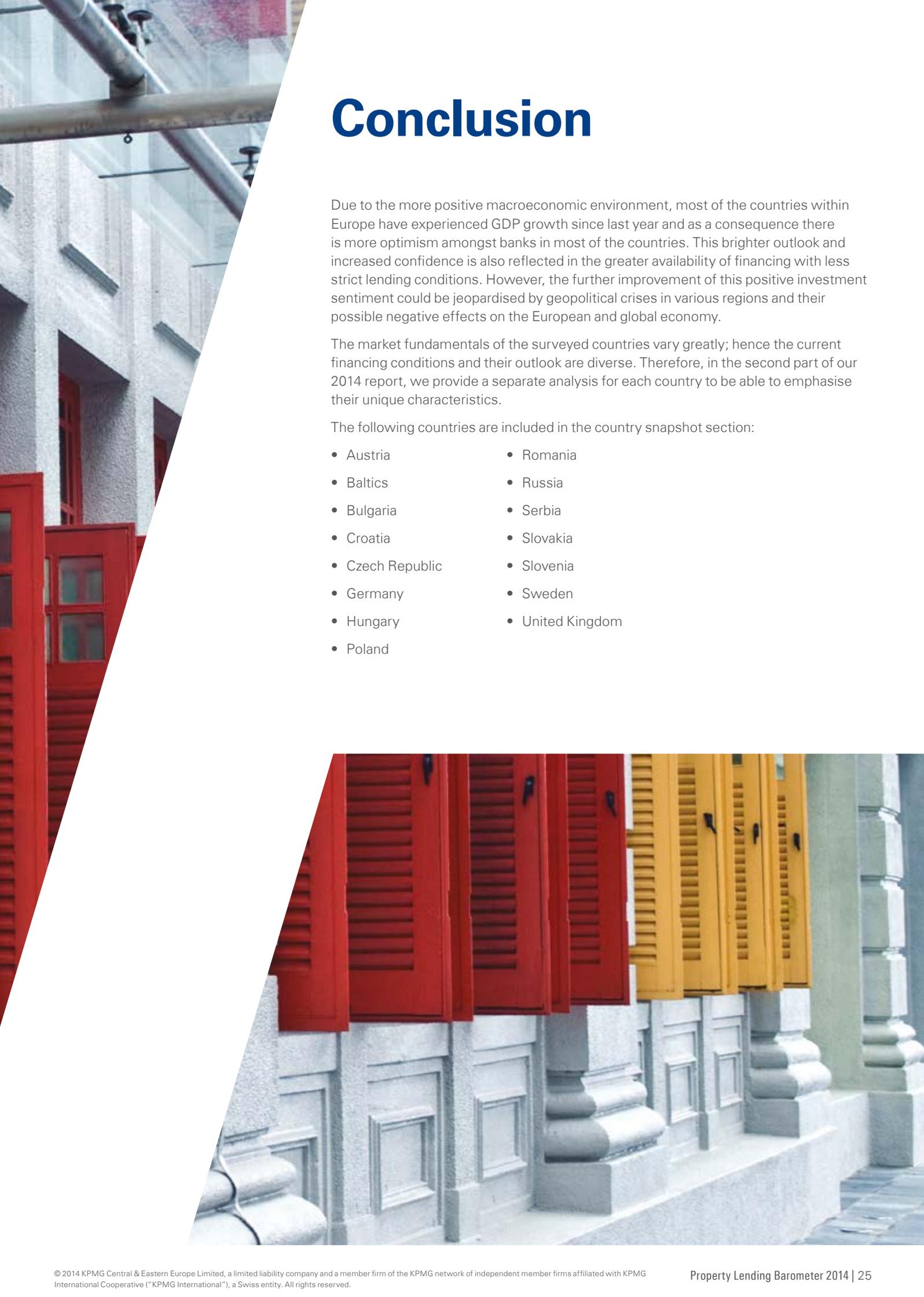
Source: KPMG Property Lending Barometer 2014

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



Source: KPMG Property Lending Barometer 2014





Conclusion

Due to the more positive macroeconomic environment, most of the countries within Europe have experienced GDP growth since last year and as a consequence there is more optimism amongst banks in most of the countries. This brighter outlook and increased confidence is also reflected in the greater availability of financing with less strict lending conditions. However, the further improvement of this positive investment sentiment could be jeopardised by geopolitical crises in various regions and their possible negative effects on the European and global economy.

The market fundamentals of the surveyed countries vary greatly; hence the current financing conditions and their outlook are diverse. Therefore, in the second part of our 2014 report, we provide a separate analysis for each country to be able to emphasise their unique characteristics.

The following countries are included in the country snapshot section:

- Austria
- Romania
- Baltics
- Russia
- Bulgaria
- Serbia
- Croatia
- Slovakia
- Czech Republic
- Slovenia
- Germany
- Sweden
- Hungary
- United Kingdom
- Poland



Country profiles



Austria

Overview

GDP growth was stagnant in 2012 and 2013, with 0.9% and 0.3% increases respectively, but it is expected to pick up from this year on, with a 1.4% rise forecasted for 2014 and 1.8% in 2015. Unemployment stood at a steady level of 7.6% in 2013, continuing the trend of the past few years. The economic recovery, driven by an increase in exports alongside subdued consumption and investments, and also increasing business confidence are forecasted to continue in late 2014. The government deficit decreased in 2013 to 1.5% of GDP compared to 2.6% in 2012. Overall, stagnation of the Eurozone and a weak fiscal outlook is having an adverse impact on Austrian economic growth.

Real estate investment activity grew in 2013 and is expected to grow further in 2014. The volume of transactions increased to EUR 1.7 billion in 2013 from EUR 1.65 billion in 2012 and the upturn is forecasted to continue in 2014. The most active market participants are Austrians and Germans with the highest volume of transactions in the office and retail sectors. Prime investment yields in Vienna somewhat declined in 2014, with 4.7% for offices, 3.95% for retail and 7.25% for logistics.

Lending market

The lending market in Austria is stable with a positive outlook. Most of the surveyed banks consider real estate lending to be strategically important and, thus, are open to financing real estate projects, especially the income-generating ones.

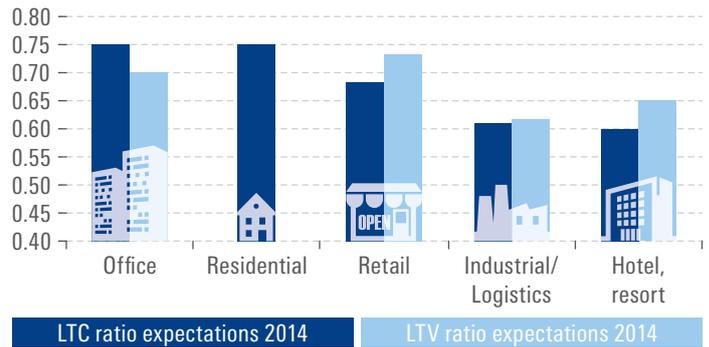
According to the survey, most of the respondents indicated that the level of provisions was adequate while some indicated it to be higher than necessary.

Future of real estate loan portfolios

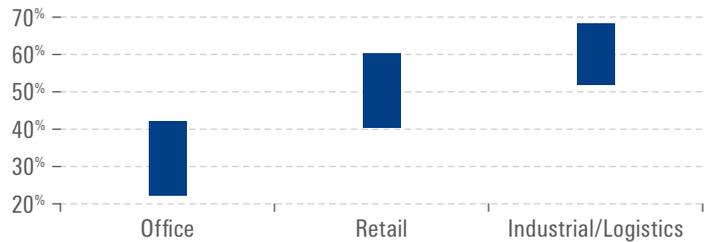
Banks were asked about their expectations regarding the loan portfolio sizes across the whole banking sector and of their own bank portfolio for the upcoming 12-18 months. The answers were split for both the whole banking sector and banks' own portfolio, indicating that most banks expect portfolio size increases and only a third of them do not anticipate any changes to the size of loan portfolios, and this suggests a potential expansion in 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 range 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 2014
Yield sources: CBRE



Baltics

Overview

The economic growth of the Baltic states was above the European average in 2013 due to strong domestic demand, high private consumption and recovering foreign demand. GDP growth in 2013 ranged from 0.8% in Estonia to 4.1% in Latvia. The Latvian economy is the fastest growing in the EU, with an outlook of 3.9% and 4.9% GDP growth in 2014 and 2015 respectively. The Estonian economy is expected to average 3.3% GDP growth in the short term and Lithuania is forecasted to reach 3.8% GDP growth by 2015. In line with the general trend in the EU, the unemployment rates are decreasing. The government deficit has been quite stable in the region, with forecasts for 2014 ranging between 0.5% of GDP for Estonia and 2.1% for Lithuania.

Real estate markets in the Baltics are active and mainly driven by institutional investors, with the office, retail and logistics property sectors having increased its investment volume by 60% in 2013 compared to 2012. The investment volume was over EUR 750 million, with approximately half of the transactions taking place in Latvia. The highest demand for real estate properties is coming from the Nordics market, CIS and local markets. Prime yields in these three countries were in the range of 7.5-8.0% for offices, between 7.5-7.75% for retail and 8.9-9.0% for logistics.

Lending market

The total loan portfolio of the banking sector fell by 6.5% in 2013. The volume of new loans has been increasing in 2014, but will not fully cover the continuing loan write-offs and amortisation.

Surveyed banks are less to moderately open to financing real estate projects and consider real estate financing as strategically not so important to them.

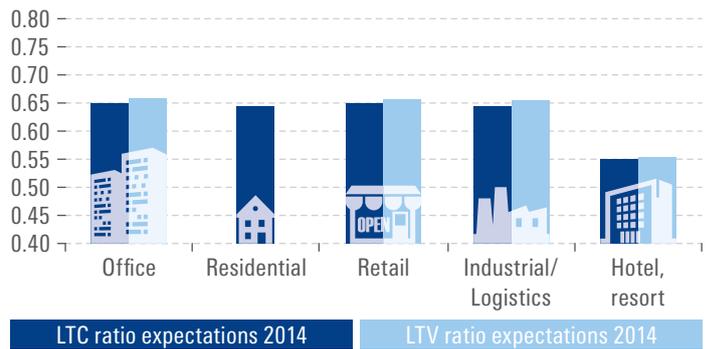
Similarly to the year before, the level of provisions was considered to be adequate in the region.

Future of real estate loan portfolios

Banks' answers were split in equal measure for the whole banking sector and also about their own portfolio size prospects for the next 12 to 18 months. Approximately half of the respondents expect loan portfolio sizes to grow and the rest expect it to remain at around the same level, which implies that there is no clear consensus among banks regarding market prospects. However, banks see less potential this year when considering how they could strengthen their own portfolios compared to last year.

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

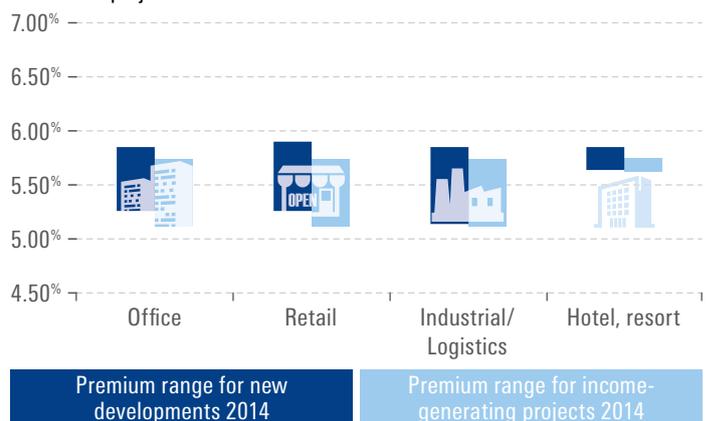
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



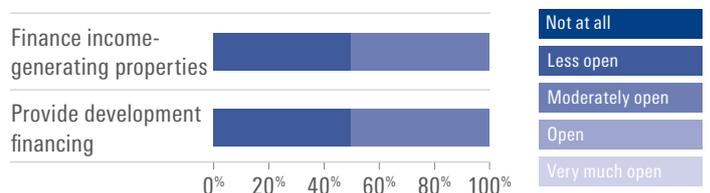
Pre-let ratio expectations for projects



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



Openness of banks to finance development/income-generating projects



Sources: KPMG Property Lending Barometer 2014
Yield sources: Colliers International

Bulgaria

Overview

GDP in Bulgaria increased by 0.9% in 2013 and is expected to grow further at a rate of 1.7% in 2014 and 2.7% in 2015. The sustainable growth of GDP is due to strengthening demand in the country and better outlook within the Eurozone, but this is offset by weak investor demand and political instability. Budget deficit widened in 2013 to 2% but is forecasted to shrink to 1.8% in 2014.

Few transactions took place in the last few years on the real estate market. Investment activity has been, and continues to be, sluggish, but it is forecasted to grow slowly in the next couple of years. Prime yields in Sofia did not change significantly in 2014 compared to 2013. Prime office yields are currently at 9.5%, prime retail at 9.25% and prime logistics at 11.5 - 11.75%.

The lending market

The continuing economic recession is keeping pressure on the banking sector in the country. The reduction in funds received from foreign parent banks may affect the liquidity of the whole banking sector, which is currently at a relatively high level compared to other CEE countries. Collateral for real estate loans has deteriorated over the past few years, creating a risk for bank capitalisation levels. The openness of Bulgarian banks regarding real estate financing is relatively modest, which is also supported by the fact that banks are now stating that real estate financing is not strategically important.

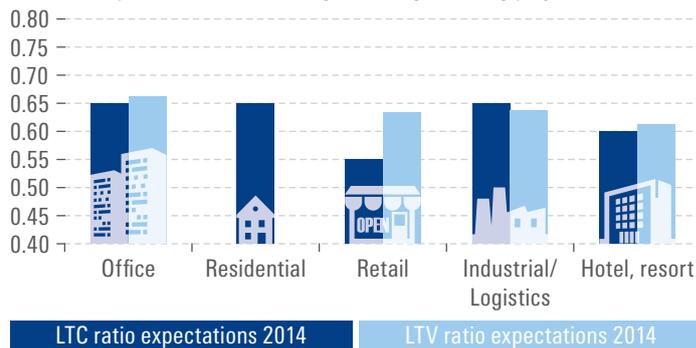
More than half of the respondents now consider that the level of provisions is close to adequate in Bulgaria, whereas, the rest answered that it was still low.

The future of real estate loan portfolios

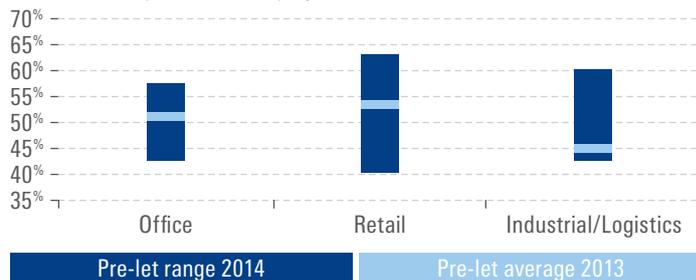
80% of respondents indicated that they could see the loan portfolio size of the whole banking sector remain unchanged for the next 12-18 months, whilst the rest suggested that it would decrease somewhat. Compared to the previous year, when a third of respondents expected a decrease of loan portfolio sizes, this year's result shows more positive expectations around the banking sector in Bulgaria. In respect of their own portfolio prospects, results are more diverse than a year ago, with slightly less than half of the respondents expecting the loan portfolio size to stay unchanged, and in almost equal proportions the rest expect portfolio sizes to increase, decrease or even significantly decrease over the next 12 to 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



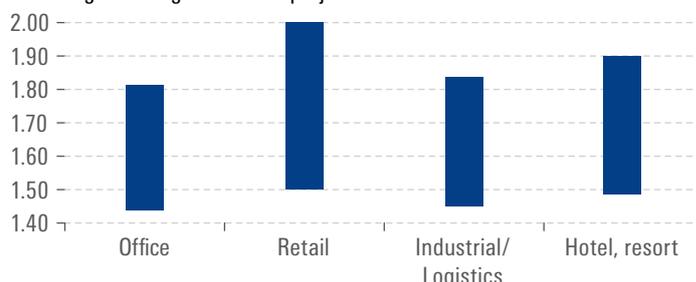
Pre-let ratio expectations for projects



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 2014
Yield sources: Eurobank Property Services



Croatia

Overview

The recession is expected to continue in Croatia during 2014 as well, which will be the sixth consecutive year without growth. It is forecasted that due to EU financed investments the country will be able to achieve modest growth in 2015 at the earliest. The rate of unemployment is forecasted to rise further as bank deleveraging continues and households remain focused on paying off debt. As a result, private spending is expected to remain at a low level with only a weak recovery potential. However, demand from most of the country's main trading partners is expected to improve in 2014. Due to the strong tourism season, the current account might record a surplus in 2014, albeit with a gradually expanding deficit, which is expected to be 2.8% of GDP on average during 2015-18.

Croatia's commercial real estate sector continues to struggle due to weak economic performance. 2014 will be rather a consolidation for the real estate market than growth, but it is expected that consequences of EU accession in July 2013 might further facilitate the property investment market, which was not active during the previous years.

Prime yields in Zagreb are expected to remain stable with 8.30% for offices, 9.50% for logistics and 8.25% for retail.

Lending market

Banks' business activities were constrained and their profitability remains depressed. It is expected that lending activity will remain weak through 2014, and there may be an additional risk associated with banks' high exposure to foreign currency lending. Surveyed banks are moderately open to financing real estate projects although many consider real estate financing to be of lower significance to them in 2014.

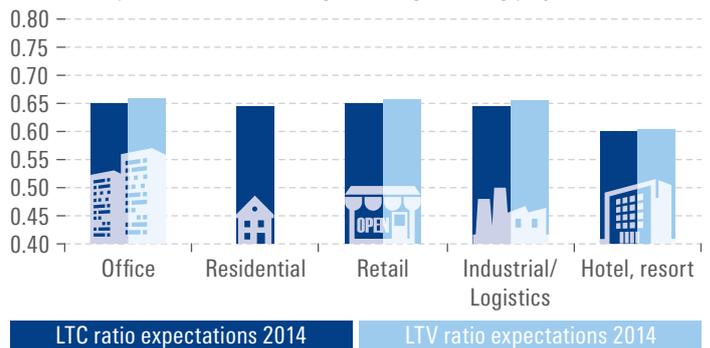
All of the surveyed banks indicated that the level of provisions against real estate loans were at comfortable levels in the country's banking sector; this is a positive sign that the banks feel prepared for any potential losses due to their real estate loan portfolios.

The 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 and for the whole banking sector. They expect that both will remain unchanged over the next 12-18 months. The banks' answers suggest that they still do not see the market experiencing 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



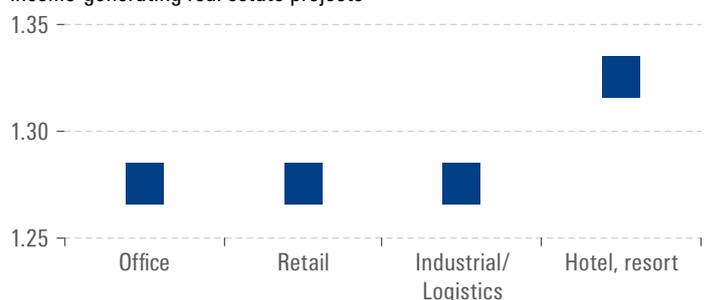
Pre-let ratio expectation range for projects



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 2014
Yield sources: CBRE



Czech Republic

Overview

GDP in the Czech Republic decreased by 0.9% in 2013, due to weak external demand and stagnating private consumption and low investment growth. However a strong recovery is forecasted with 2.4% and 2.5% GDP increases for 2014 and 2015. The growth is forecasted mainly as a consequence of the recovery of neighbouring Germany, which is the country's key export market. The labour market is expected to improve while the general government deficit is projected to increase; however this is forecasted to remain below 3% of GDP. After years of stagnation in consumer spending, it is expected that this area will start to contribute to growth due to an increase in real wages and improving labour market outlooks.

There was increased investors activity during the first half of 2014 as the investment volume exceeded the same period in 2013 by 50%. The majority of investments were performed in the office sector. Prime yields in Prague are showing a decreasing trend with (currently) 6.25% for offices, 7.75% for logistics and 6.25% for retail.

Lending market

Banks in the Czech Republic are operating in a stable environment with firm economic fundamentals in place. The banking sector remains self financed and relies on minimal funding from parent banks. Due to the stable economic and banking environment accompanied with growing investment activity it is expected that bank lending will increase.

Just as in 2013, more than 70% of our respondents indicated that the level of provisions was at adequate levels in the Czech Republic. Overall, there is confidence amongst banks that the level of provisions in the country's bank sector is satisfactory.

The future of real estate loan portfolios

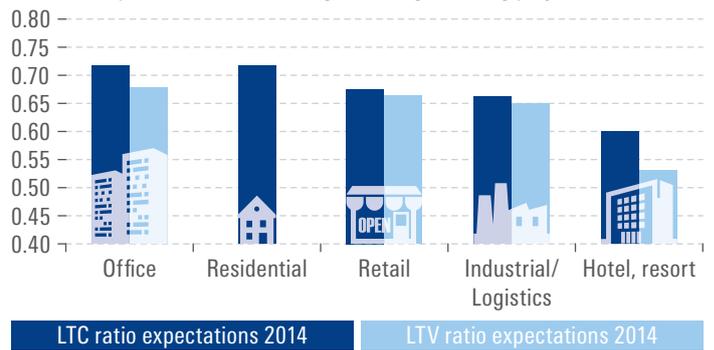
Compared to 2013, there has been a positive shift in the sector regarding the productive prospects of banks' own portfolios and those of the whole banking sector over the next 12-18 months. This year approximately 90% of respondents forecast an increase in the whole banking sector portfolio size and only 10% expected that it would stay unchanged.

In terms of their own portfolios, two thirds of the banks expected that they would increase in the next 12-18 months and some of the banks even predict a significant increase, the rest of the respondents predict that portfolios would remain unchanged. The answers this year also suggest a growth in lending activity in the next 12-18 months.

Among Czech banks who thought that overall portfolio sizes would decrease, the majority indicated that additional funds may be sourced through bonds or otherwise from private equity and insurers.

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



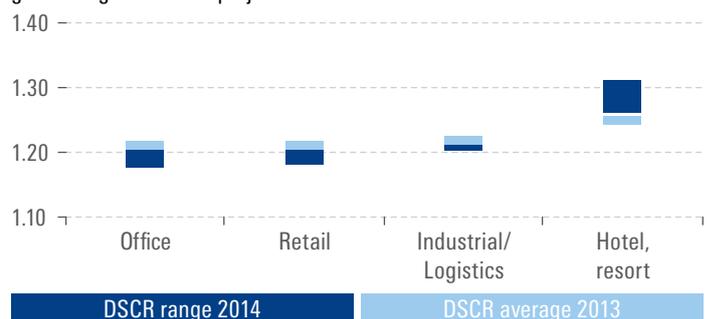
Pre-let ratio expectations for projects



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



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



Sources: KPMG Property Lending Barometer 2014
Yield sources: CBRE



Germany

Overview

GDP growth slowed down in 2013, standing at 0.5% as compared to 0.9% in 2012. GDP growth is expected to accelerate in 2014, reaching 2% mainly due to very strong domestic demand. Rising private consumption and housing investment are being led by low interest and unemployment rates. The unemployment level is stagnant, having changed by only a few percentage points as compared to 2012, standing at 5.3% in 2013 and is expected to remain at the same level in 2014. Analysts believe that export will rise dynamically due to increasing foreign industrial demand.

Since the beginning of the global financial crisis real estate investment activity in Germany peaked in 2013, marking a 20% increase year-on-year for that period. Offices were top of the list for investors, rising by more than 50%, demoting retail transactions to second place with a share of 33%. This positive dynamic trend is also expected in 2014. Prime yields in the key German cities, i.e. Berlin, Dusseldorf, Frankfurt, Hamburg and Munich, are expected to be slightly down compared to 2013, with 4.5% for offices, 4.2% for retail, and 6.3% for logistics.

The lending market

The lending market in Germany is strong and growing dynamically. Terms and conditions for loan or credit lines approval to companies as well as to households eased in 2013 as compared to previous years and are expected to stay at that level through 2014. German mortgage banks will increase lending activity in line with growing demand. In 2013, bank lending rates in Germany reached their lowest level since the beginning of 2007. Surveyed banks indicated that real estate financing is still of high importance to them strategically and that they are willing to finance real estate projects, especially income-generating ones.

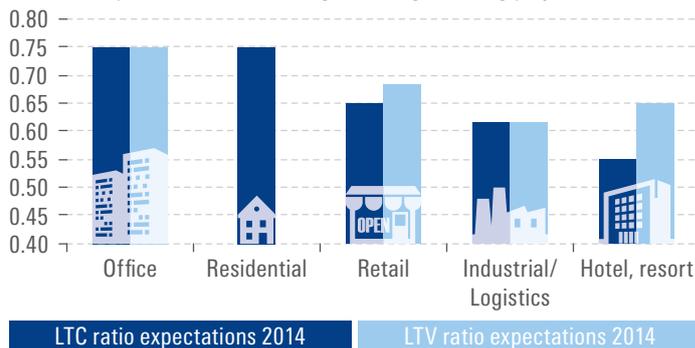
All respondents indicated that the provision levels are adequate in Germany.

The future of real estate loan portfolios

Expectations regarding the loan portfolio size of the whole banking sector remain positive. Whereas none of the respondents consider a decrease in lending volumes over the next 12-18 months, the vast majority of all survey participants believe in a significant increase in volumes. One quarter of all respondents expect volumes to remain unchanged. Besides this, half of our respondents are anticipating that their own loan portfolio size would significantly increase in the next 12-18 months, overall suggesting a positive trend in the banking sector.

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



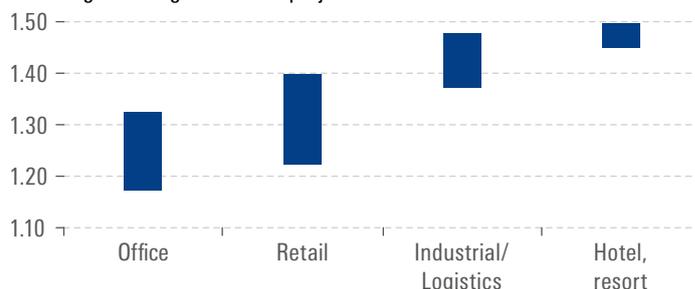
Pre-let ratio expectation range for projects



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 2014
Yield sources: CBRE



Hungary

Overview

After GDP growth of 1.1% in 2013, Hungary's economy is expected to grow by approximately 2.5% in 2014 and 2.3% in 2015. The government deficit remained stable at 2.2% of GDP in 2013, but it is expected to stay close to the 3% limit in 2014. There are still uncertainties associated with the resolution of foreign currency denominated mortgages and this may lead to high external vulnerability.

Real estate investment activity is finally picking up in Hungary. The investment market in Hungary is getting more appealing to international investors due to the improving macroeconomic environment and the high yield offered in the market. Prime yields in Budapest did not change significantly in the previous year with 7.5 to 7.75% for prime office, prime retail at 7.25-7.5% and 9.25-9.5% for prime logistics.

Lending market

Overall, the lending market in Hungary has improved slightly since last year due to improving macroeconomic conditions; however it still remains highly volatile. Recent decision by the Curia of Hungary could dampen the positive trend as it plan to force banks to repay charges deemed to be "unfair" on foreign-currency mortgages, which may result in significant financial liabilities for banks. Surveyed banks were moderately open to financing real estate development projects, but they showed more openness to financing income-generating ones. Strategically, banks consider real estate financing to be moderately important.

Similarly to last year, more than 70% of respondents indicated that the level of provisions is adequate in Hungary. Another positive sign is that none of the interviewed banks in Hungary indicated that the level of provisions could be considered to be too low, which suggests that banks are already prepared for the losses associated with the potential loan defaults.

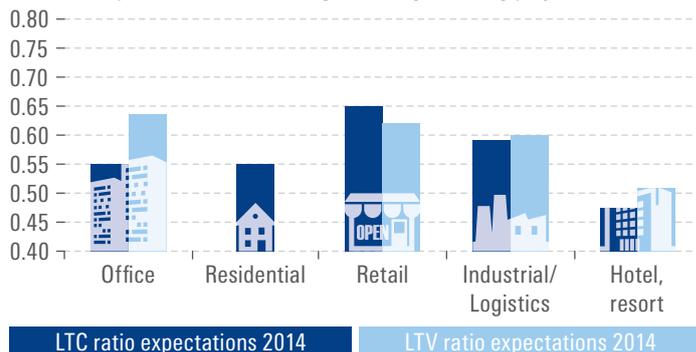
Future of real estate loan portfolios

More than half of the respondents answered that the loan portfolio size of the whole banking sector would remain unchanged in the upcoming 12-18 months. This is a significant improvement since last year when all respondents expected either a decrease or a significant decrease in portfolio sizes. This year only one third of the banks surveyed were expecting further shrinkage of loan portfolio sizes. Most of the respondents thought that the additional funds would come either from private equity or from developers/investors.

In terms of the prospects of their own portfolios, the banks seem to be more pessimistic, as nearly half of the respondents expect that their own portfolios would decrease and the other half expects that they would remain unchanged.

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

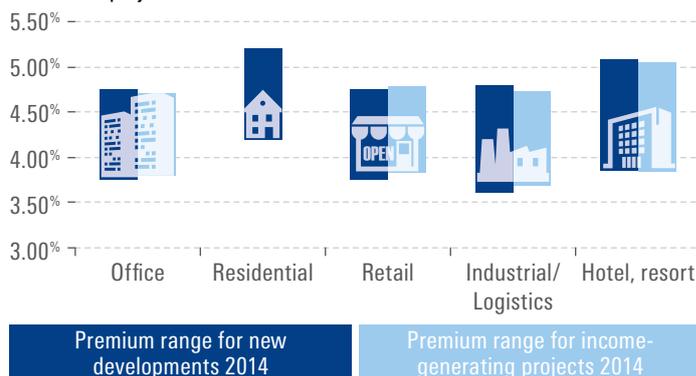
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



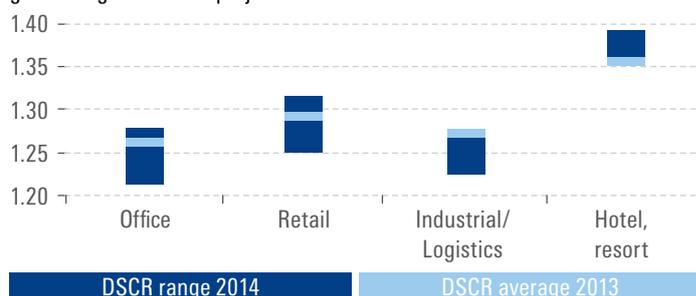
Pre-let ratio expectations for projects



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



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



Sources: KPMG Property Lending Barometer 2014
Yield sources: CBRE & Jones Lang LaSalle



Poland

Overview

The recovery slowed down from 2.0% in 2012 to 1.6% during 2013, but is expected to pick up again and achieve approximately 3.5% growth in 2014. The reason for the temporary hold back was mainly due to weak external demand and falling fixed investments. The growth in the upcoming period is expected to be fuelled by recovering domestic demand. The unemployment rate is expected to decrease gradually. The structural deficit is also expected to improve in the long term with a simultaneous decrease in the government debt to GDP ratio.

Real estate transaction volume during the first half of 2014 was over 20% above the respective period in 2013. Poland remained the leading regional market in terms of investment volume with a share of circa 50% of CEE transactions. It is forecasted that 2014 will be a strong year again and might even exceed the already high volume of 2013. Prime yields in Warsaw are expected to remain stable with 6.00% for offices, 5.90% for retail and 7.25% for logistics.

Lending market

Overall the lending market in Poland is healthy, especially compared to the majority of CEE countries. Banks typically have a balanced business model and as a result they have good asset quality and high profitability. For most of the interviewed banks, real estate financing is strategically important and they are open to financing new developments and income-generating projects as well. There is a positive outlook about further growth in bank lending in 2014 backed by growing investments and a promising economic environment.

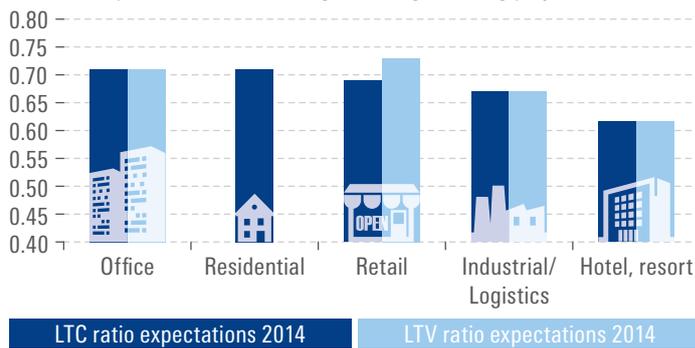
Similarly to last year there was a clear consensus among the interviewed banks, as they all think that the level of provisions in the country's bank sector is adequate.

Future of real estate loan portfolios

Considering the banks interviewed, 60% expect that the loan portfolio size of the whole banking sector would remain unchanged and 40% forecast an increase in the upcoming 12-18 months, which is a significant improvement compared with the last two years when more than half of our respondents expected a decrease in the portfolio size and only 40% thought it would remain unchanged. When it comes to the prospects of their own portfolios, banks have become more optimistic since last year with 80% now expecting that their own portfolio would increase and only 20% expecting it would remain unchanged in the upcoming 12-18 months. This is a significant improvement in banks' sentiments compared to last year, when only 40% of the respondents forecasted an increase and the rest either expected that it would remain unchanged or decrease. The answers suggest that the majority of the banks are confident that the lending market would further expand in Poland 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



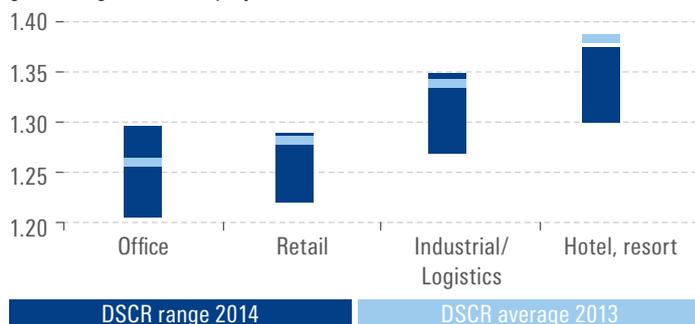
Pre-let ratio expectations for projects



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



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



Sources: KPMG Property Lending Barometer 2014
Yield sources: CBRE



Romania

Overview

Recovery from recession in Romania has been modest, but in 2013 there was a strong 3.5% growth. The real GDP growth is expected to remain over 3% in 2014 and 2015. The main driver of growth was an increase in exports in the industrial and agricultural industries. The fiscal adjustment is forecasted to continue and domestic demand is expected to gradually overtake net exports as the main driver of growth. Despite robust growth, recovery of the labour market remained weak with an increased unemployment rate during 2013, although it is forecasted that this will now decrease gradually. The budget deficit is forecasted to be 2.2% of GDP in 2014, which is similar to the 2013 level.

The property investment volume recorded in the first half of 2014 has already exceeded the total investment volume in 2013. Such growth is a sign that Romania is again considered a promising investment destination by international investors. Also the diversity of investors is increasing, and as a consequence there was a sharp growth in market liquidity. Prime yields in Bucharest did not change significantly since last year with 8.25% for offices, 8.25% for retail and 10.00% for logistics.

The lending market

Bank lending conditions have improved in Romania since last year. There is high investor demand, which is facilitated by an increasing willingness amongst banks to provide debt financing. Surveyed banks indicated that they are open to financing both new developments and income-generating real estate projects. However, the conditions offered in Romania still reflect a higher perceived country risk compared to more mature CEE markets.

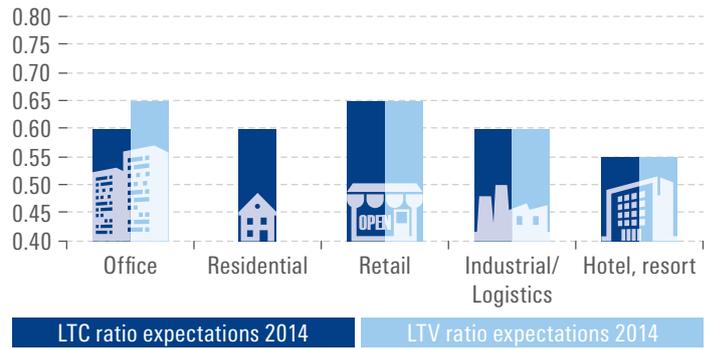
Banks have differing views regarding the level of provisions in the country's bank sector. Some of the respondents indicated that the level was adequate and others deemed it too low.

The future of real estate loan portfolios

There was a noticeably positive shift among banks regarding the prospects of their own and the whole banking sector's loan portfolio sizes over the next 12-18 months. This year, roughly half of the respondents forecast an increase both in their own and the whole banking sector portfolio sizes, while the other half think that these would remain unchanged. Last year there was a clear consensus among the banks that no growth was expected. Based on the results this year, banks forecast an increase in lending volume in the upcoming period.

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

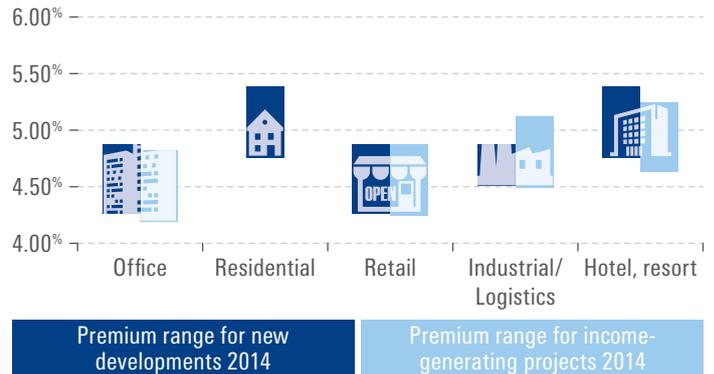
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



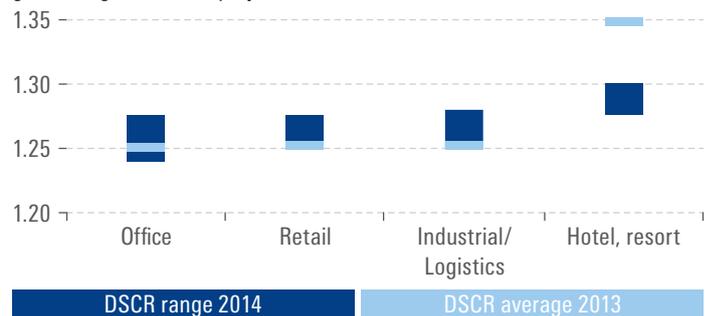
Pre-let ratio expectation range for projects



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



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



Sources: KPMG Property Lending Barometer 2014
Yield sources: CBRE

Russia

Overview

Over the last four years, a decline in GDP growth could be observed in the Russian economy and this is expected to continue in 2014 as well. GDP will grow by only 0.5% in 2014 compared to 1.3% growth in 2013. There is a GDP growth projection of 1.3% for 2015, however short term forecasts are unreliable considering the recent instability, brought by the Ukrainian crisis. Russia's expected slower short-term growth is a consequence of the current higher risk environment. Possible foreign capital outflow, a decrease in investment volume and increased financing costs all jeopardise the growth outlook. Regarding consumption growth, this is expected to weaken as real income growth slows down and consumer credit becomes more expensive. The country's long-term economic outlook will be based on a sustainable upward shift in investors' and consumers' confidence as well as the implementation of more broad structural reforms. The government deficit is fixed at 0.5% of GDP for 2014 and is expected to rise to 1% of GDP in 2015. Debt-to-GDP ratio is set to stand at around 15% of GDP.

Real estate investments peaked at USD 8.2 billion in volume in 2013. Property transaction turnover was at its highest (since the pre-crisis times) in 2013, marking almost a 30% increase year-on-year. Prime yields in the two main Russian cities of Moscow and St. Petersburg have remained stable since 2013, with prime offices at 8.5-11.0%, prime retail at 9.0-11.0% and prime logistics at 11.0-12.5%.

The lending market

Bank lending in Russia is facing difficulties caused by the political situation in the region. Western banks have cut lending in Russia to the lowest level since 2009 as new sanctions are being introduced by Europe and the US. Despite this, lending from Chinese banks is expected to grow in volume in response to this situation. The surveyed banks indicated modest openness to finance real estate projects and consider real estate financing as not so important strategically.

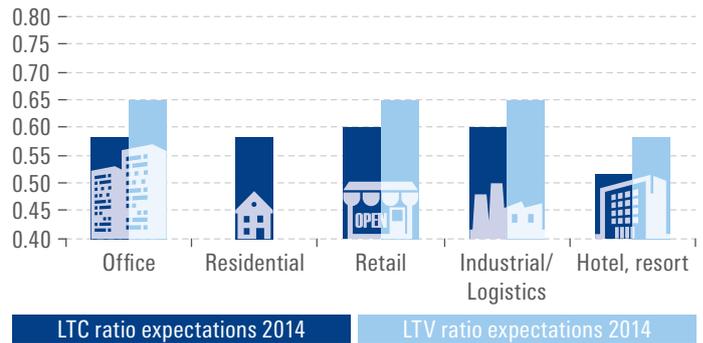
According to the survey, all of the respondents indicated that the level of provisions in Russia was at an adequate level.

The future of real estate loan portfolios

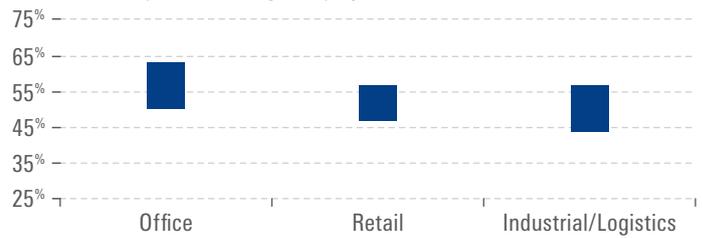
When asked about the prospects of the portfolio size of the whole market over the next 12 to 18 months, all of the surveyed banks suggested that it would increase. But when asked about their own portfolio size, three quarters of respondents expected it to increase and the rest believed it would remain unchanged. Based on the answers, banks expect that the lending market will expand 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 range 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 2014
Yield sources: CBRE



Serbia

Overview

After the economy contracted by 1.5% in 2012, real GDP grew by 2.5% in 2013 mainly as a consequence of a strong year in the agricultural sector. According to analysts the economy will fall into recession again in 2014. It is expected that due to lack of consolidation measures by the government the GDP/debt ratio might exceed 70% in 2014. Growth is forecasted to remain slow, due to weak domestic consumption. Recovery is largely dependent on the country's ability to increase their export base especially in the automotive industry. Private consumption dropped significantly in 2012 and showed only a slight rise in 2013. High unemployment remains a key problem for the economy.

There was no significant property investment recorded during the first half of 2014. Serbia started formal EU accession negotiations, which will involve regulatory reforms. These new regulatory changes may provide increased confidence for institutional investors to consider Serbia and take advantage of the opportunities that can be found in this largely unexplored market. Prime yields in Belgrade are expected to remain stable with 9.50% for offices, 8.50% for retail and 12.00% for logistics.

The lending market

The property lending market in Serbia is weaker compared with the majority of the countries in the CEE region. Total bank lending to companies and to households declined in Q1 2014 for the sixth quarter in a row. For most surveyed banks in Serbia real estate financing is strategically less important. However, there is a strong growth potential in the market if EU accession proceeds and the market gradually becomes more transparent to international investors.

There has been improvement since 2013 in how banks consider the level of provisions. This year the majority of the interviewed banks thought that the level of provision is adequate in the country's bank sector and only a minority of banks consider it below adequate.

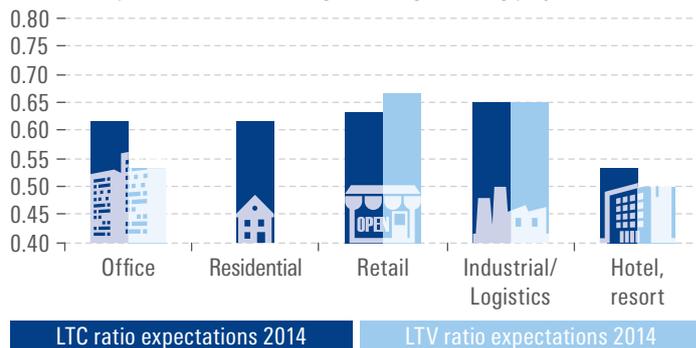
The future of real estate loan portfolios

As in the previous year, the surveyed banks do not see signs of potential expansion in lending volume and expect that both their own and the overall banking loan portfolio sizes will remain unchanged over the next 12-18 months.

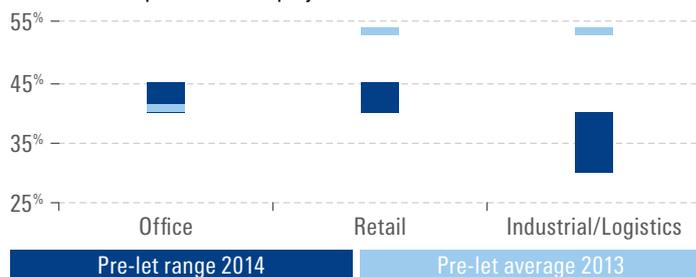
Those banks who think that overall portfolio size would decrease expect that the additional funds could come from developers/ investors.

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



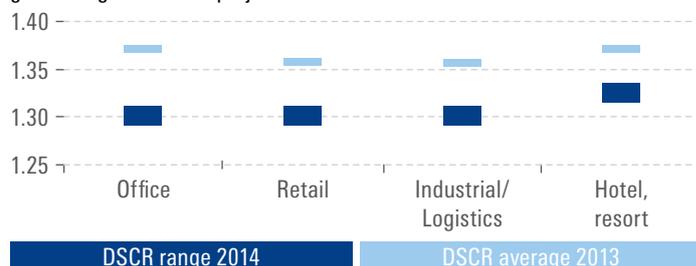
Pre-let ratio expectations for projects



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



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



Sources: KPMG Property Lending Barometer 2014

Yield sources: CBRE

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Slovakia

Overview

The growth of the Slovak economy slowed down in 2013, but is expected to accelerate to 2.6% in 2014 and to 2.7% in 2015. Domestic demand has become a more dominant factor of growth compared to exports, which makes the composition of current growth more balanced. After a slight increase in unemployment in 2013, a decreasing tendency is expected for the upcoming years with simultaneous private consumption increases. The government deficit is projected to remain close to 3% of GDP, but it is expected that it will remain below 3% in coming years.

The property investment volume in 2014 is expected to be similar to that of 2013. However, during the first half of 2014 only one significant property transaction was closed. The lack of prime properties available on the market remains a serious barrier for a significant upturn in investment volume. However, there is increasing interest from smaller local investors for non-prime products and, as a result, secondary markets are gaining liquidity.

Prime yields in Bratislava have remained largely stable since last year with 7.00% for offices, 7.00% for retail and 8.50% for logistics.

The lending market

The lending market in Slovakia is stable as the banks are well capitalised and more self-financed than other CEE countries' banks. The asset quality of banks is good and the positive macroeconomic outlook might further facilitate increasing lending activity with favourable conditions. Surveyed banks were open to backing real estate projects, especially income-generating ones. However, they consider real estate financing moderately important at the moment.

The majority of the interviewed banks thought that the level of provisions is adequate in the country's banking sector and only some banks thought that provisions were below an adequate level, although this shows a slight fall compared with last year when all Slovakian banks in scope considered the level of provisions adequate.

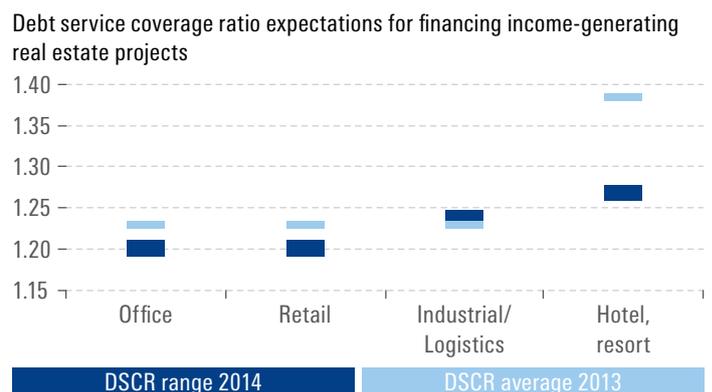
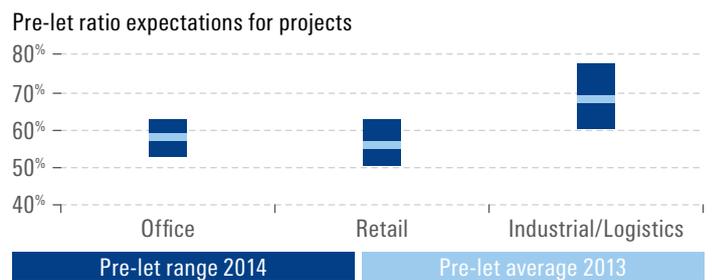
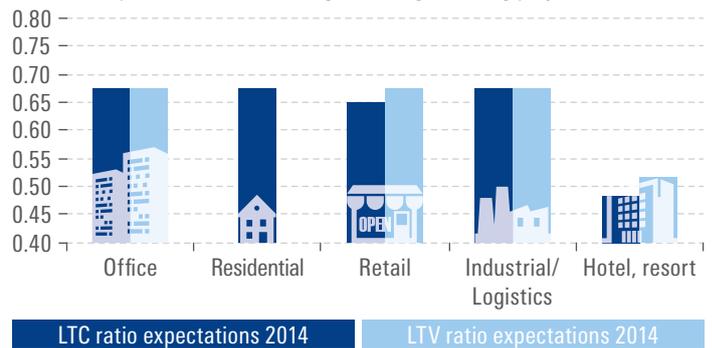
The future of real estate loan portfolios

The majority of the surveyed banks expect that both their own and the whole banking sector loan portfolio sizes would remain unchanged and only a quarter of the banks forecast a decrease in the next 12-18 months. However, almost all banks stated that their own portfolio prospects would be slightly down from 2013.

Those banks who thought that the overall portfolio size would decrease also expected that the additional funds may have to come from bonds followed by developers/investors and 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



Sources: KPMG Property Lending Barometer 2014
Yield sources: CBRE



Slovenia

Overview

Slovenia exited economic recession at the end of 2013, with GDP contraction decreased from -2.9% (minus) in 2012 to -0.9% in 2013. Growth drivers include an increase in domestic demand, a rise in exports and increased governmental investments through EU-funded projects. The economic outlook is positive, with 0.8% GDP growth expected in 2014 and 1.4% in 2015. The government deficit increased by 10.7% in 2013 (4.0% in 2012) mainly due to recapitalisation in the banking sector. The budget deficit also increased in 2013 and is expected to grow to 4.3% in 2014.

The real estate market in Slovenia remains depressed due to economic and political difficulties in the country and a lack of bank financing. On the other hand, the real estate taxes imposed starting from 2014 were repealed by the constitutional court. Prime yields have decreased in 2014 compared to the previous year, with 8.5% for prime offices, 7.0% for prime retail and 10% for prime logistics.

The lending market

As of 2014, the banking sector in Slovenia was recapitalized; hence the banks partly regained their capability to service the domestic credit demand. Compared to other surveyed countries, Slovenian banks were the least open to financing real estate projects and also indicated that real estate financing was not particularly important to them strategically.

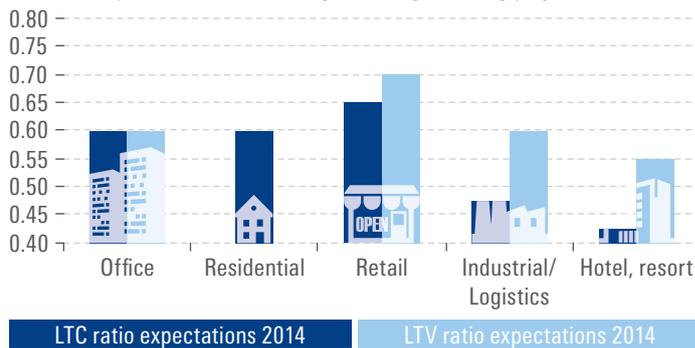
In comparison to last year when all of the respondents considered the provision levels in Slovenia as being too low, this year's survey showed an upward trend, with overall expectations of the provision levels in the country's banking sector approximating an adequate level. This tendency is in line with a positive economic outlook for 2015 and the government initiatives to recapitalise the banking sector.

The future of real estate loan portfolios

Consistent with last year, the majority of the respondents considered that the loan portfolio size of both the overall banking sector and their own portfolios would decrease over the next 12 to 18 months, which suggests that according to banks the tightening of credit markets is still not over yet. Nevertheless, an improving tendency is anticipated in the upcoming years given the positive economic outlook and recovering local banking sector.

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

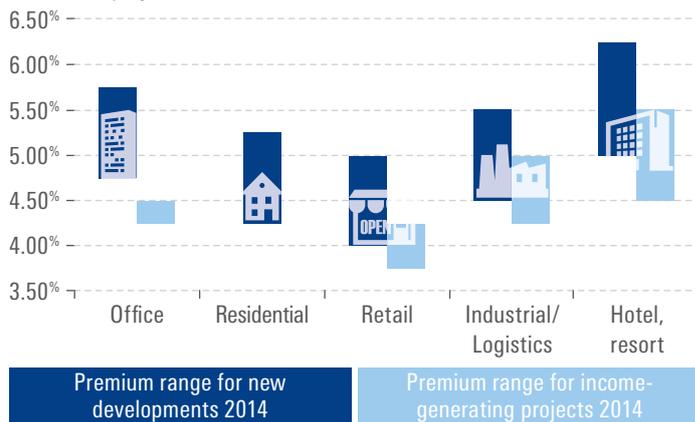
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



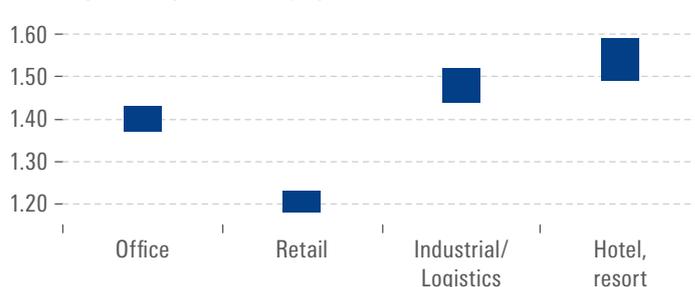
Pre-let ratio expectation range for projects



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 2014
Yield sources: Cushman & Wakefield



Sweden

Overview

GDP growth exceeded the forecasts and reached 1.5% in 2013. The expected GDP growth for 2014 is 2.2% and should reach 2.4% in 2015. Because of the expansionary fiscal course taken by the government, the governmental deficit is expected to increase from 1.1% in 2013 to 1.8% in 2014. Private consumption, growing investment volume, increasing construction investment and improving exports will be drivers for economic growth in the near future.

Real estate investment activity decreased by 8% in 2013 as compared to 2012, but the number of transactions increased 13% year-on-year. Domestic investors dominate the real estate market due to higher barriers to competition for foreigners. The most significant barriers are the ever increasing complexity in the tax regime and the strong Swedish krona. However, the local currency has started to depreciate recently. Prime yields remained the same compared to 2013, with offices at 4.5%, retail at 4.5% and logistics at 6.5%. As prime yields hit historical lows, more buyers are focusing on secondary assets, which offer higher return potential.

The lending market

Banks are becoming more willing to finance real estate projects. However, due to a limited supply of prime properties, banks are becoming more open to financing secondary assets. Despite their openness, the banks' exposure to the real estate sector is limited and, thus, creates challenges for investors when seeking to obtain funds.

Most of the surveyed banks indicated that real estate financing is strategically important to them and that they are open to financing income-generating real estate projects. They showed less openness toward development projects.

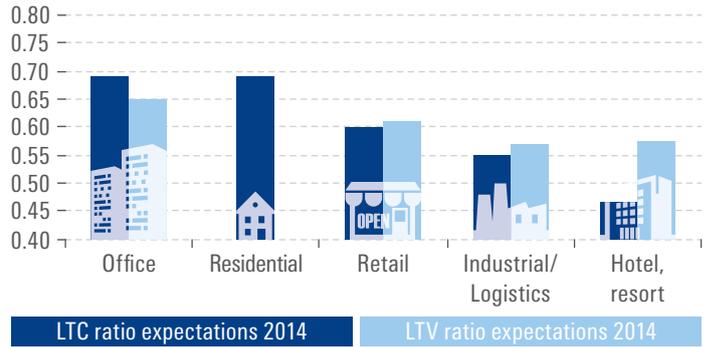
All respondents indicated that the level of provisions in Sweden was adequate.

The future of real estate loan portfolios

Consensually, a majority of respondents consider 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. One third considered that their own bank's portfolio size would remain unchanged over the mentioned period and only a few have the same opinion regarding the whole sector. The answers imply a general optimism, as a large proportion of banks expected expansion potential across the lending market.

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

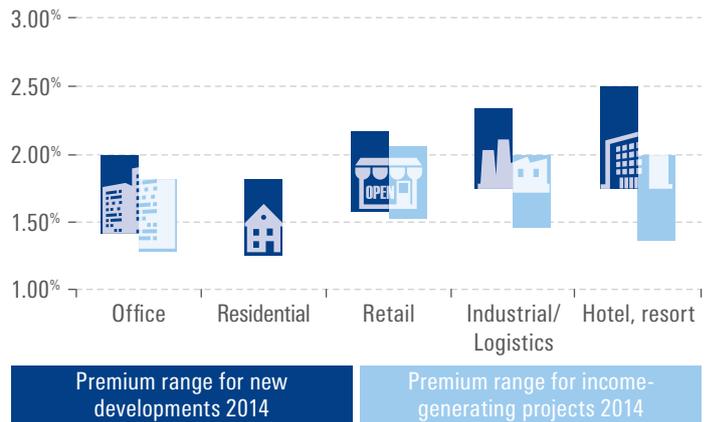
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



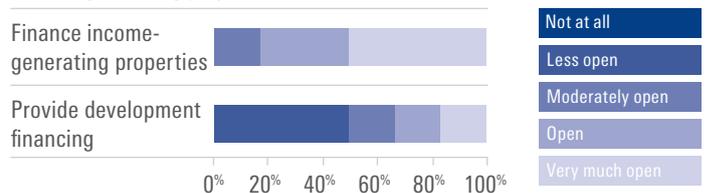
Pre-let ratio expectation range for projects



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



Openness of banks to finance development/income-generating projects



Sources: KPMG Property Lending Barometer 2014
Yield sources: CBRE



United Kingdom

Overview

The GDP of the United Kingdom increased by 1.7% in 2013. Economic growth has accelerated; it is expected to exceed 3% in 2014, easing back to 2.5% in 2015. Robust employment growth is expected to continue, while inflation is projected to remain close to the target of 2%. The budget deficit continued to fall slightly, although the government debt to GDP ratio is expected to rise. The economic prospects remain highly dependent on household spending and, as households are generally in debt and have decreasing savings, this may become a risk to the overall growth of the economy.

Investment volume in the UK is the highest in Europe with London being the most sought after destination for investors. There was an increase of 15% in total investment volume in H1 2014 compared with the same period in 2013. Investors are looking for opportunities in the face of decreasing numbers of actual investment products in London. There are also some major regional UK cities gaining attractiveness on the investment map, such as Manchester and Edinburgh. Prime investment yields in London continued to decrease throughout 2013 with 4.0-4.75% for prime office, prime retail at 3.00-5.25% and prime logistics at 6.25%.

The lending market

Overall there is a healthy and active lending market in the United Kingdom, and this has helped the property industry to continue 2013's trend for expansion. Although traditional bank lending has decreased since the crisis, according to recent business reports, nearly a quarter of new UK commercial property loans originated from non-bank lenders in 2013. The new players in the lending market are insurance firms, pension funds, private equity and hedge funds, all of which entered the market to fill the gap left by banks due to their more risk averse approach to property financing. Surveyed banks indicated that real estate financing was of very high importance to them and that they were willing to finance real estate projects. However, they still prefer to finance income-generating projects rather than developments.

Most of the respondents indicated that the level of provisions was adequate and some of them believed that it might even be too high.

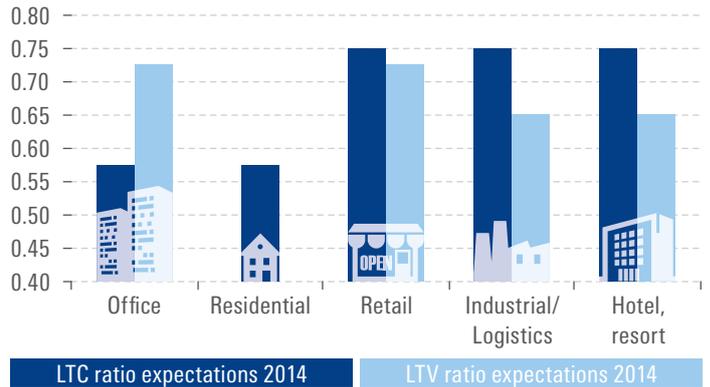
The future of real estate loan portfolios

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. The majority of respondents thought that the overall banking sector portfolio size would increase and a few were of the opinion that it would remain unchanged.

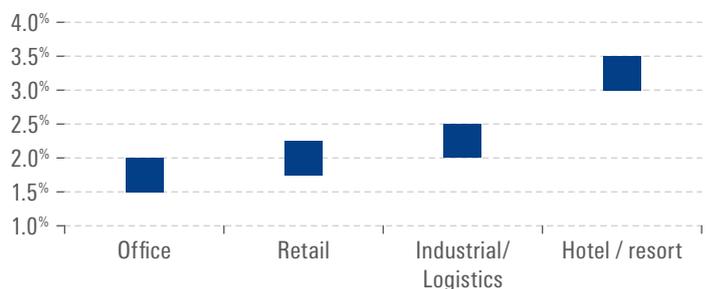
When it came to the prospects of their own loan portfolios, all of the participating banks forecasted an increase. The answers imply broad optimism, banks feeling that the period of growth will continue.

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

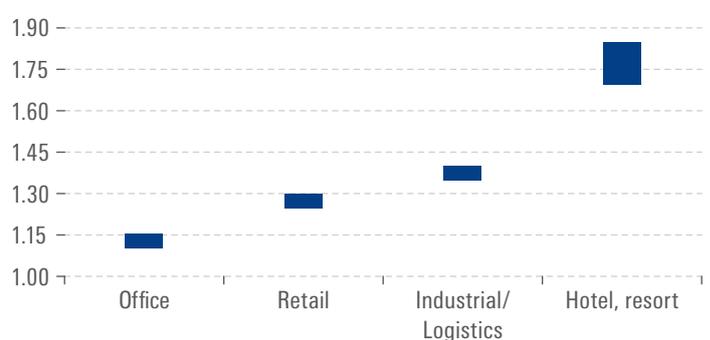
LTC ratio expectations for financing new developments and LTV ratio expectations for financing income-generating projects



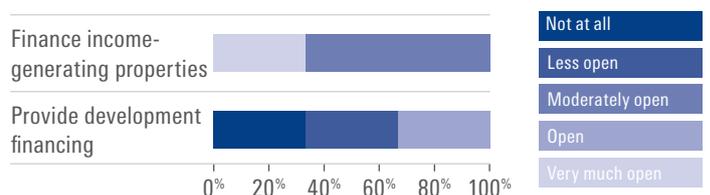
Loan interest premium to be applied by banks for highly rated income-generating real estate projects



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



Openness of banks to finance development/income-generating projects



Sources: KPMG Property Lending Barometer 2014
Yield sources: CBRE

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