Impacts of the Financial Crisis on the Residential Market Development in CEE

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Central European Residential Market Development Trends

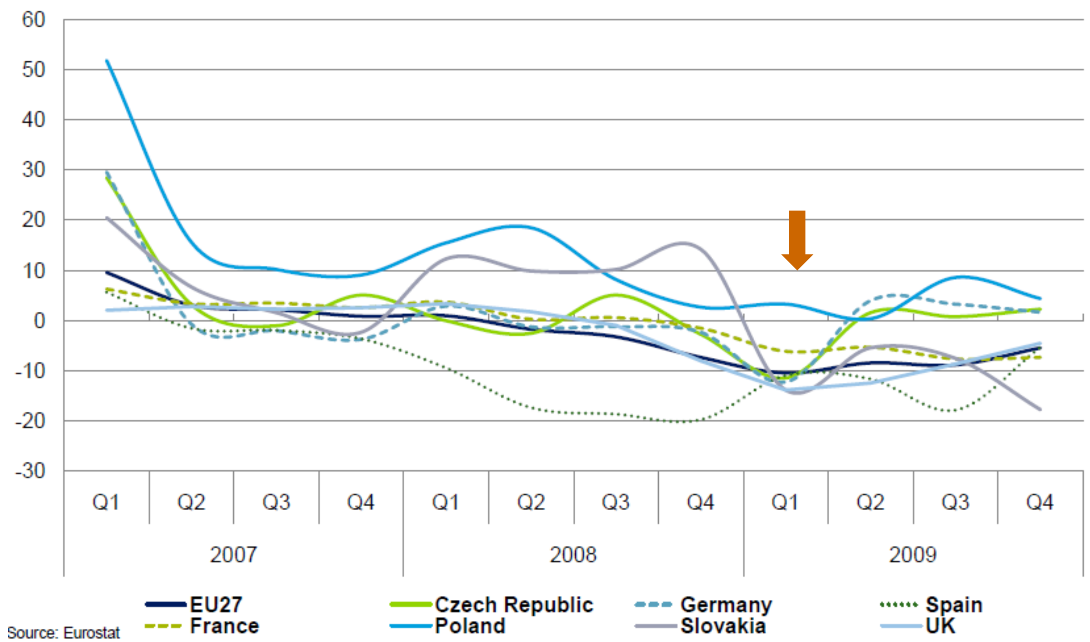
Residential Market Development

Residential Development Trends – EU: Construction Sector

- Construction Sector in EU – **strong impact of recent decline** in Residential Development
- **Sharp fall** in the EU construction industry from 2007-2008 **continued in 2009**. Although some markets started to recover at the end of last year, in many countries (Spain) recovery is more of a “statistical trap”
- In all EU countries with similar characteristics (fast economic & purchasing power growth, high proportion of residential development in construction industry, EU funds inflow), the decline in construction is driven by a **sharp decline in building construction**, where **residential construction** plays a significant role
- Current data on the development of almost all crisis-stricken economies show the **decline reached its lowest point as early as Q1 of 2009**

Construction Production in Selected EU Countries

Percentage Change, in Quarters (t/t-4)



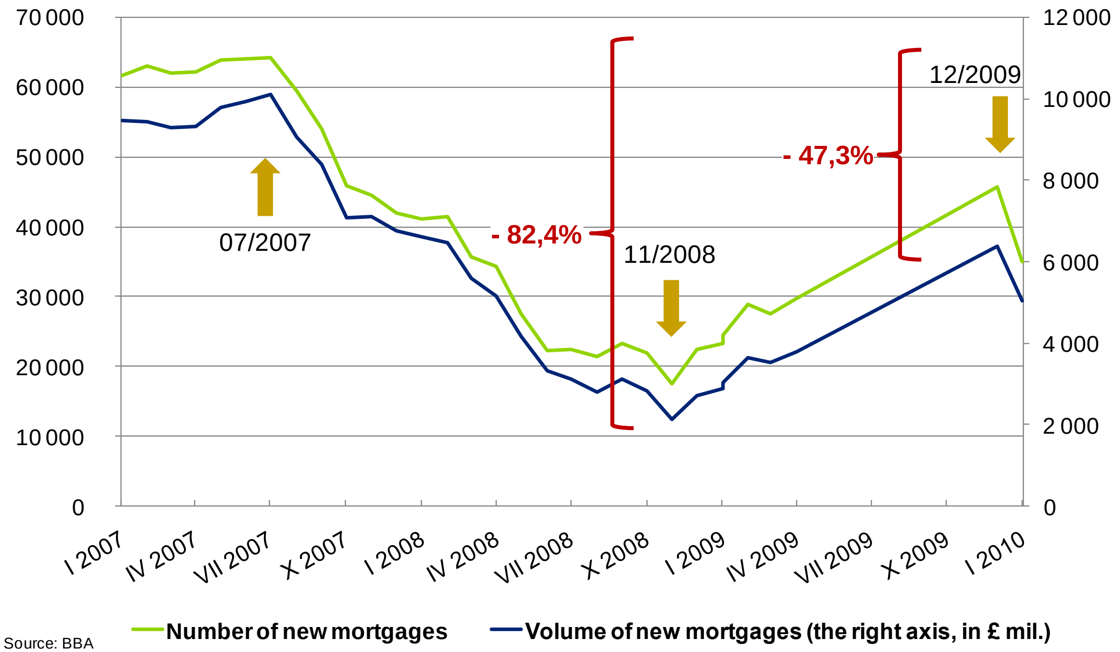
Source: Eurostat

Residential Market Development

Residential Development Trends – UK market

- During past decades, UK **residential property prices grew by approx. 36% per decade** (prices net of inflation) - an apartment/house represented one of the most stable investments
- Shift in peoples behaviour – the traditional enthusiasm in owning their own home has been **curbed** by the recession and change in credit availability, property prices **returned to a more reasonable level**
- Estimates indicate for 2010 a **further decline in residential property prices** all over the UK market **between 2 – 7%,** subject to the size of the property and region
- Share of **rental housing** is expected to **increase** - due to current market uncertainty and buyers' concern about their ability to repay mortgage loans
- From Nov 2006 (peak) until Nov 2008 the UK mortgage market **declined by 78% in terms of number and 82% in volume of new mortgage loans**
- By Dec 2009 mortgage market gained back **57% of its peak in Nov 2006** in terms of number of new housing mortgages and **53% in volume**
- January 2010, however, saw this positive development **lose strength**…

Development of the Number and Volume of New Mortgages in the UK



Source: BBA

Residential Market Development

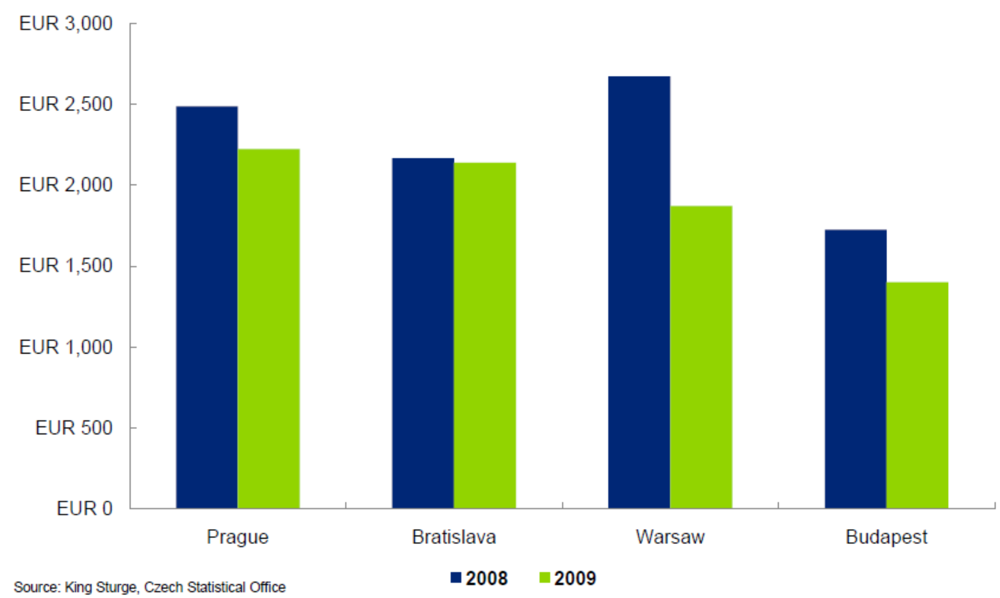
Apartment prices in CEE: Czech Republic, Slovakia, Poland, Hungary

- Price per m^2 of new **residential property in Prague** reached **EUR 2,200** in 2009, representing the highest value in the CEE countries benchmark. Sales of residential property markedly dropped and, consequently, the offer of new apartments exceeded demand in 2009.
- **In Bratislava**, average price of new **residential property** reached **EUR 2,100**/m^2 in 2009. Average price of residential property in Slovakia dropped 11% y-o-y. Offering prices of new apartments stagnated. Real selling prices in Bratislava were as much as 10% lower than the offering prices, primarily due to discounts.
- The 2009 price per m^2 in a new **Warsaw apartment** reached **EUR 1,900**, declining y-o-y by approximately 30%. The difference was due to a 10-15% y-o-y decline in real estate prices and exchange rate.
- **Budapes**t recorded the **lowest average prices** of new residential property, **EUR 1,400**/m^2. At the end of 2009, y-o-y decline in real estate prices of approx. 20% was recorded
- All benchmarked CEE capital cities recorded in 2009 a **price decline** (between 5-20%), as well as a **decline in the sales** of residential property (between 10-50%)…

  … and **increases in mortgage loan interest rates** (between 5-13%), and **reduced offer of new residential housing**

Prices of New Residential Real Estate in Selected European Cities

Price for m^2



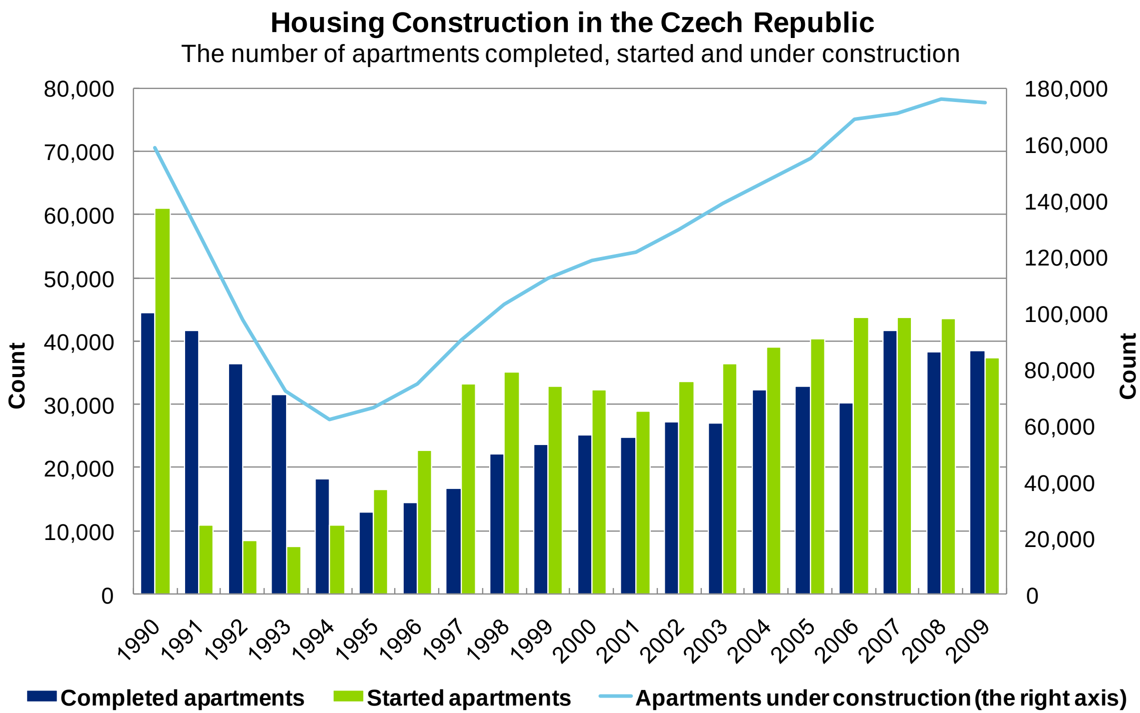
Source: King Sturge, Czech Statistical Office

Residential Development Trends
Czech Republic

Czech Residential Market Development

Residential Development Trends – Period of the construction boom

- After the period of decline in residential development in the late 1980s and early 1990s a **substantial increase was recorded after 2000** when available **financial products intended to finance housing** were introduced (building savings loans and mortgage loans)
- Significant **growth** in residential construction was observed **during 2002 - 2007** due to three major factors:
  - Culmination of housing demand by the "baby-boomers"
  - Certainty of price increase as a result of the 2008 change of the VAT rate on residential projects
  - Availability of cheap funding & credit financing, growing household income and low unemployment
- All this was reflected in a **dynamic shift in development of residential real estate construction** and in 2007 in historically highest y-o-y increase in number of completed (+38%) and started apartments funded through a record volume of building savings and mortgage loans – **residential market "stocked up"**
- 2008 saw a significant change in the positive development of housing construction from previous years. A **material slump** in residential construction occurred (namely in Q4 2008) – when the **crisis** hit the region

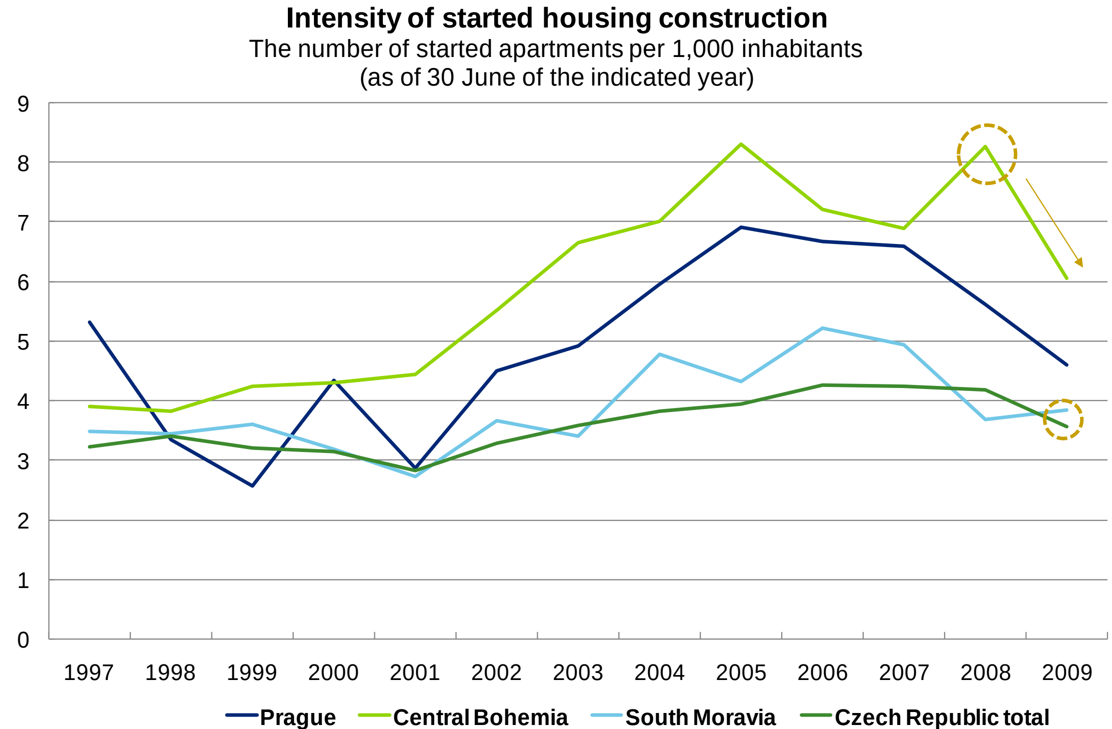


Source: Czech Statistical Office

Czech Residential Market Development

Residential Development Trends – Effects of the crisis

- The “financial” crisis of the second half of 2008 hit the Czech residential housing market in 2009 with full force when the **demand for residential real estate was reduced** by up to 30% on average, caused by:
  - overall economic recession in the Czech Republic
  - growing unemployment rate (from its low of 5,0% in Q2 2008 to 9,2% in Q4 2009, growing further)
  - uncertainty whether households and developers would be able to repay loans and complete projects
  - tightening of conditions for obtaining a mortgage, thus sudden limited availability of credit
- Households were **postponing housing purchases** as they expected a further **decrease in prices** and were distrustful of **projects being completed** by developers
- In 2009 a 14.3% decrease in number of started new apartments compared to 2008 (Q4 y-o-y: -21.2%) was recorded – **first drop in 15Y** below the number of **completed apartments**
- Despite impacts of the financial crisis in 2008, since mid 1990s there had been a **constant excess in number of started apartments over completed** ones through to 2009.
- In the years of the boom residential market created a **reserve** of apartments that would be completed in upcoming years



Source: Czech Statistical Office

Czech Residential Market Development

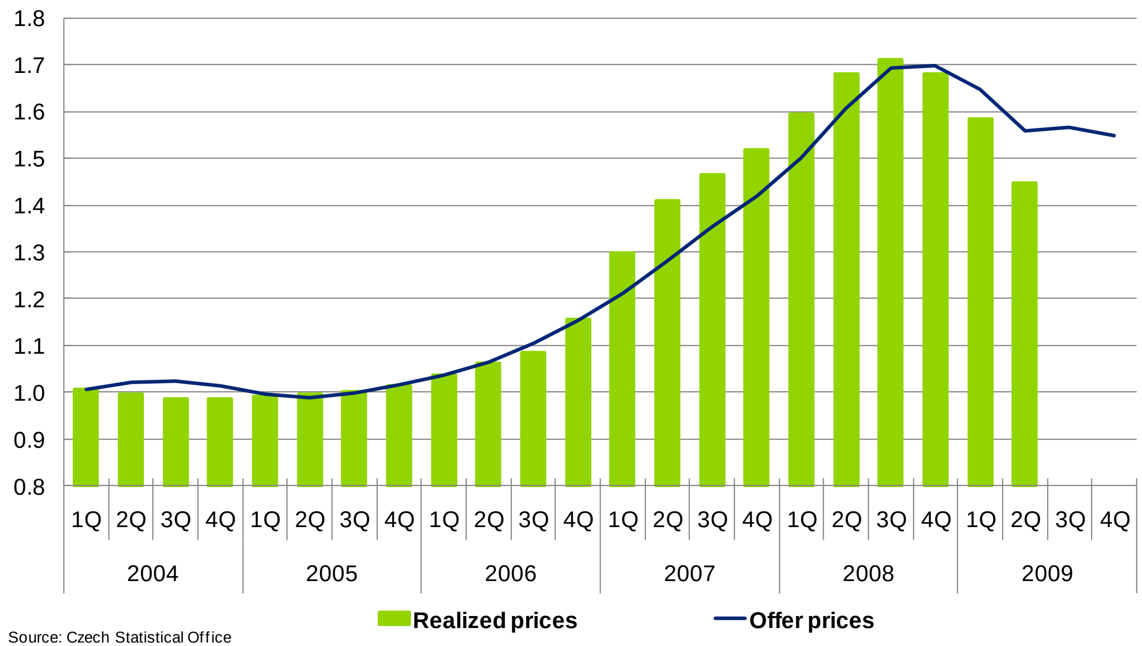
Apartment Price development – Period of continuous growth

- The **prices of apartments** in the Czech Republic were **continuously growing for nearly 15 years** and only showed slight fluctuations (e.g. in 2004)
- Due to the boom in the Czech economy, **increased demand for own housing** and the relative availability of funding, apartment prices grew intensely which resulted in a general increase in prices of residential real estate, especially between 2006 and 2008
- Growth in real wages, positive development on labour market, strengthening of Czech crown, availability of housing loans and optimistic expectations of households incited decisions to **buy own apartments**
- In Q1 and Q2 of 2007 the enormous increase in demand on the real estate market resulted in such **upwards pressure on prices** that people buying RE paid 12% and 9% higher prices on average compared to the same periods of 2006. Offer prices grew by 5.5%.
- Residential market expected this **trend to continue** - increased interest in own housing was beneficial for development and construction companies and, thanks to the multiplication effect, for the entire economy

Apartment Price Indexes

Offer versus realised prices - The Czech Republic total

(average in 2005 = 1)



Source: Czech Statistical Office

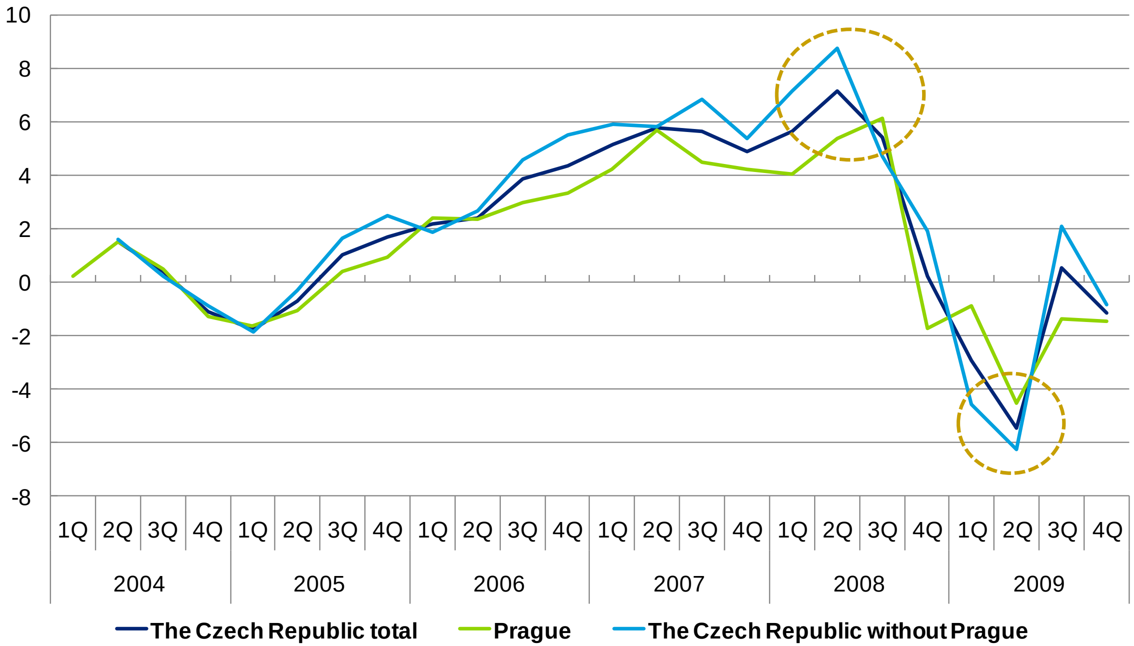
Czech Residential Market Development

Apartment Price development – Impacts of the crisis

- In Q3 and Q4 of 2008 and in the first half of 2009 the residential real estate **market reported a substantial reduction and a subsequent sudden y-o-y drop in the growth rates of offer prices** which was caused (apart from other reasons) by the financial crisis and restricted demand
- The **decrease in the demand** was noticeable in the second half of 2008 when the largest development companies reported a **10 – 20% y-o-y decline in the interest** in new apartments.
- Following the highest y-o-y growth in Q2 of 2008 when **prices of apartments** grew by 8.7%, in Q1 of 2009 fell by 4.6% y-o-y and in Q2 by 6.3%. This means that within 9 months the prices dropped by full 13.3% and **within a year the loss exceeded 15%**
- Real demand did not correspond with the offer prices, predominantly in the first half of 2009 - the **enormous drop in demand** resulted in people buying residential RE up to 7% cheaper on average compared to the same period of 2008, and offer prices decreased by 4.2% on average.
- **Revival** of the residential housing market now clearly depends on a positive macroeconomic development to be started and the **trust and stability of the middle class** segment to be returned

Apartment Price Indexes

Offer prices of residential real estate (QoQ change in %)



Source: Czech Statistical Office estimate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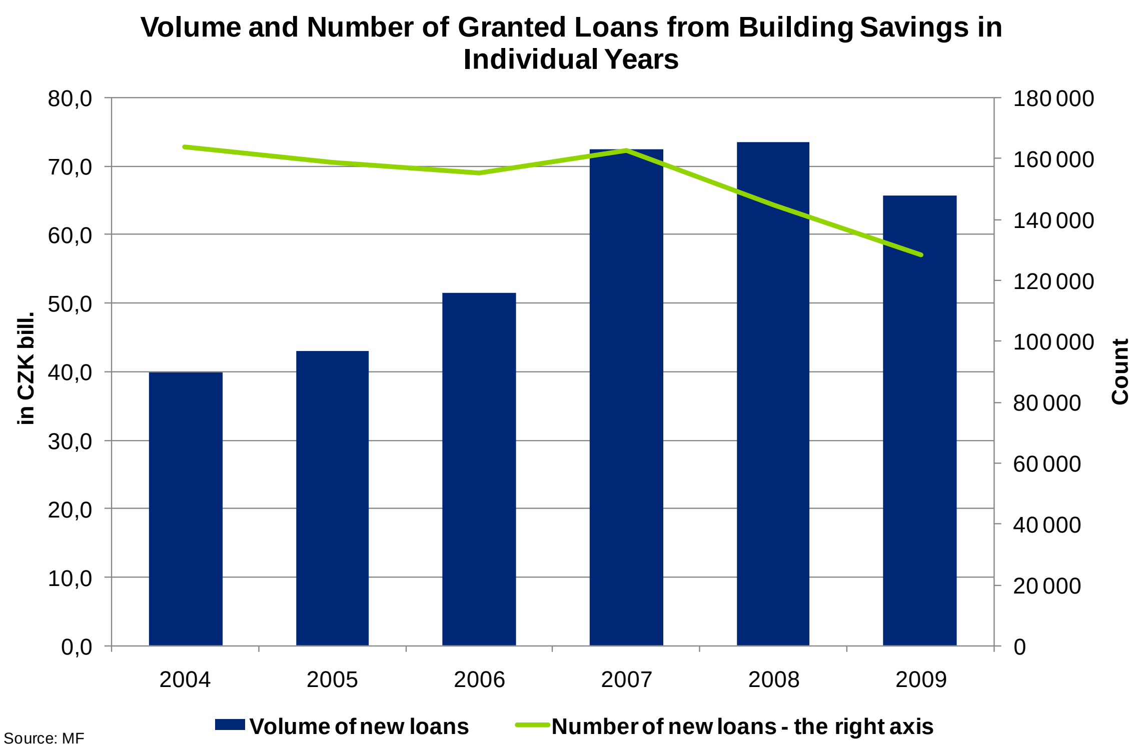
Building Savings and Mortgage Market in the Czech Republic

Czech Residential Market Development

Building savings loans market – Good performance, stability

- **Buildings savings** as a financial product was introduced to the Czech market by the Act on Buildings Savings with State Assistance (96/1993 Coll.) **in 1993**
- Construction loans were being **increasingly drawn up since 1997**. Similarly to the mortgage market, building savings loans (primarily "bridging loans") were **growing rapidly** and recorded a **peak in 2007-2008**
- After years of ongoing growth, in 2009 building savings banks also felt the **impacts of economic recession**, reflected in **first y-o-y decrease** of new savings contracts (-15%) and volume of new loans (-11%)
- In 2009, building savings banks granted 128,543 loans in volume of CZK 65.7 bn – approx. CZK 10 bn less only than loans provided by mortgage banks – *claiming a **48% market share in new housing loans***
- Structure of new building savings loans has not changed in the long term - most loans (43%) are used for modernisation and renovation…

  …**29% for purchasing apartments or family houses** and **13% for the construction of new houses or apartments**



Source: MF

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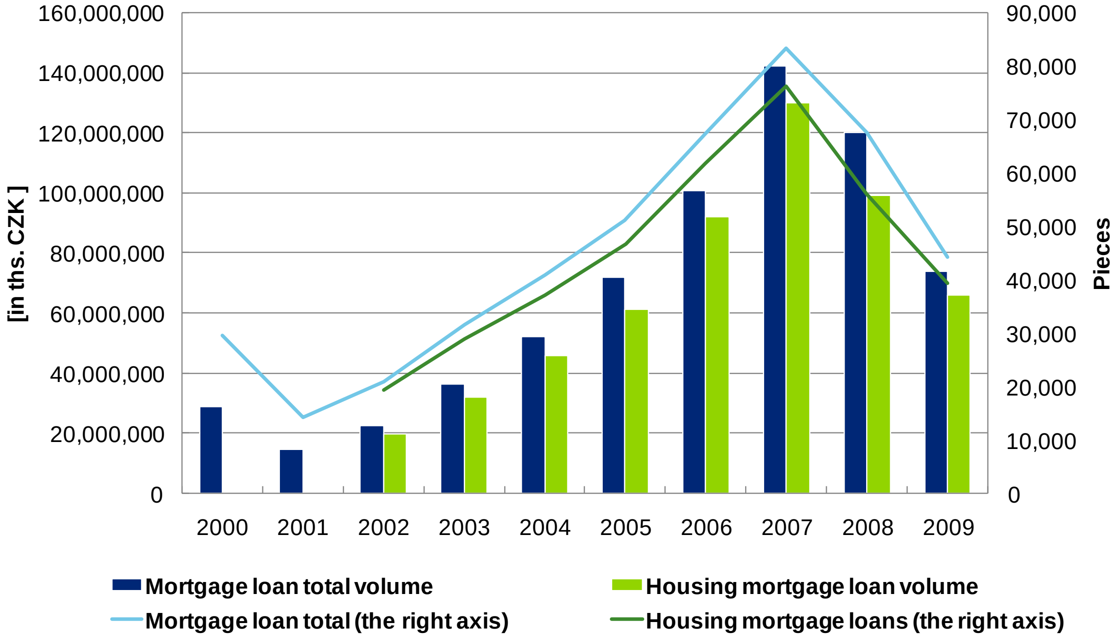
Mortgage loans market – Dynamic growth, unexpected decline

- History of **mortgage loans** in the Czech Republic **started in 1995**, whereby approx. until 2000 mortgage lending was **practically unknown**, in addition interest rates at the time oscillated **around 15% p.a.**
- After 2000 the situation changed and resulted in a **dynamic increase** of provided mortgage loans due to:
  - Refocusing of banks on retail lending, specifically mortgages
  - Steady decline of inflation and interest rates and strengthening of CZK
  - Continuous loosening of credit granting criteria and broad availability of loans
- The first hundred of billions CZK have been lent in 2003 and **peak was reached in 2007** (CZK 142.3 bn)
- In late 2008, after a long period of significant growth, the Czech mortgage **market fell sharply**, by **almost 20%** on y-o-y basis…

  …only to experience the **largest downward swing in its history in 2009 by almost 40%** y-o-y again
- Total number of new mortgage loans in 2009 amounted to 44,402 in total volume of CZK 74.3 bn. The number of new mortgage loans thus reached only **50% of the record year 2007**.
- *Mortgage banks secured a 52% market share in new housing loans*

Development of Mortgage Numbers and Volume in Individual Years



Source: MMR

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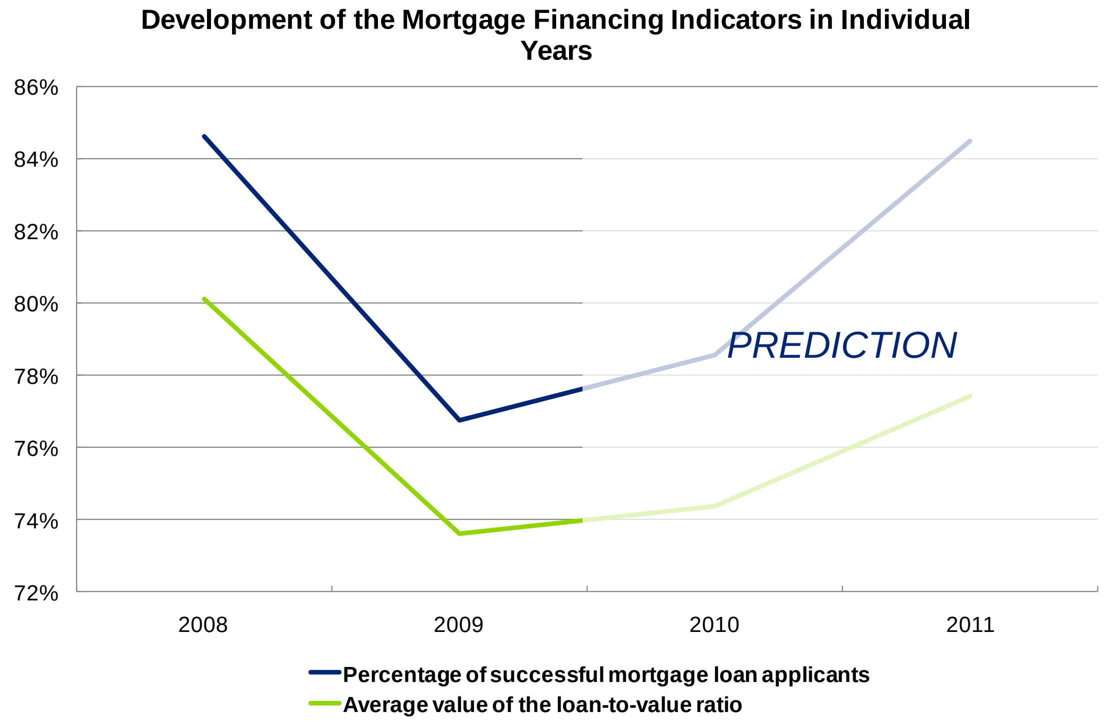
Mortgage loans market – Resetting of rules

- Q1 of 2009 was characterised by a **substantial change in banks' behaviour** but clients did not materially change their expectations developed over the last 3 years relating to mortgage loan availability.
- Q2 and Q3 were markedly impacted by the **waiting strategy** on the demand side and expected decrease in real estate prices and interest rates.
- In Q4, the view of the situation by banks and clients **reversed.** Banks have started to reduce their restrictions - conversely, **clients' fear of drawing loans** materially increased which substantially **reduced demand** for mortgage loans compared to early 2009.
- Substantial **change occurred in the banks mortgage loan product offer**. Towards the end of 2008 and in Q1 of 2009, banks were **eliminating more risky products** like 100% LTV mortgages, no docs mortgages and in general reduced max. acceptable LTV to approx. 70%.
- Stricter granting conditions were imposed. In late 2009 some banks already **softened** LTV limits again.
- **Non-performing** mortgage loans exceeded 2% in mid 2009 and continued to grow **to reach 2.25%** in Q3 of 2009. Building savings banks reported on average only 1.8% NPL share in 2009.



Prediction of Czech Residential Market Development for 2010+

Czech Residential Market Development

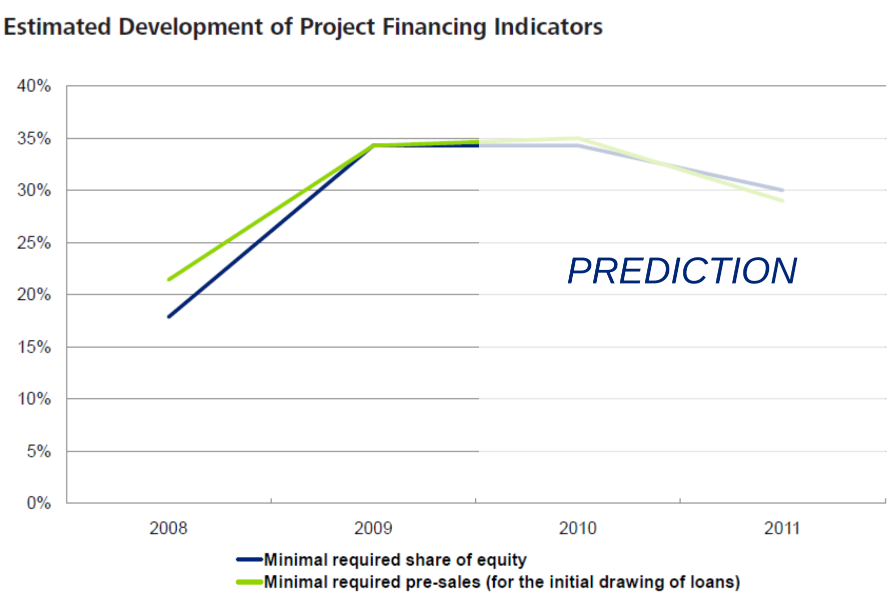
Prediction of the residential market – Facts and Outlook

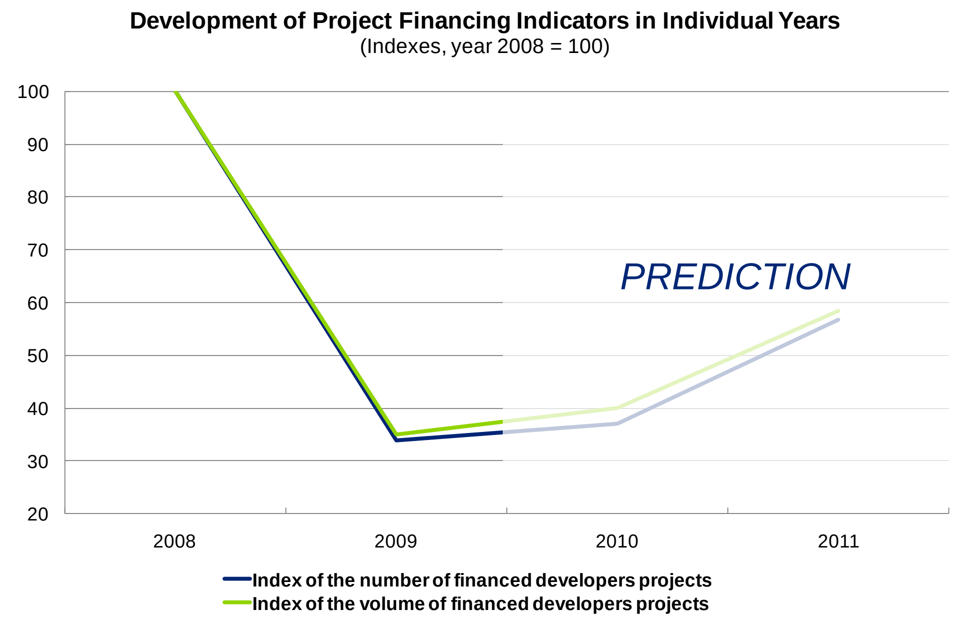
- Indicator of volume of available housing in CR expressed as a percentage of **available housing per 1,000 inhabitants has neared the EU27** average, its level is comparable to Belgium, exceeds NL and UK
- Further growth is expected only with respect to **population growth** and **renewal of available housing**
- While CR neared comparable Western EU countries in terms of volume of available housing, **it lags behind in its quality and age** – room for **increased spend on repairing and maintaining apartments**
- Compared to most Western EU countries, **share of rental housing is relatively low and decreasing,** reaching only 37% of the level in Germany or 64% of Austria – opportunity for developers
- In 2009 **sales of completed and almost completed apartments largely outweighed** sales of apartments under construction – as only a short term anomaly
- **Supply and demand are expected to come into balance**; at the same time, supply of apartments under construction or the supply of completed apartments will decrease substantially; and the share of the sales of apartments under preparation and under construction will start growing
- Panic from market development from late 2008 **calmed** and participants have **started to behave rationally**
- Market has established **new rules,** most of the developers have "learnt" to live under the new conditions
- Residential market seems to have stabilised at a **new price level, nevertheless** people interested in purchasing homes continue to **speculate** about further market decline
- Banks and developers as well as the public are **more optimistic** than a year ago

- In the years to come, **demographic development** will offer a new segment in residential market to developers, such as **homes for seniors** in specialised housing facilities or rental care apartments

Czech Residential Market Development
Prediction of the residential market – Project financing

- In 2009, compared to 2008, **financial institutions increased the minimum required equity** on average from 18% to **34%.** This parameter is expected to stagnate over 2010, declining to 30% on average in 2011
- Similarly, the **minimal required pre-sales** (for first drawing of loans) grew abruptly y-o-y from 21% to **34%** on average. Banks expect this figure to slightly grow further in 2010, falling to 29% on average in 2011.
- In 2010, development projects financed are **expected to grow** gradually; in 2011, the growth is expected to accelerate, to the **value of 57% in terms of the number of or to 58% in terms of the volume** of financed development projects in 2008



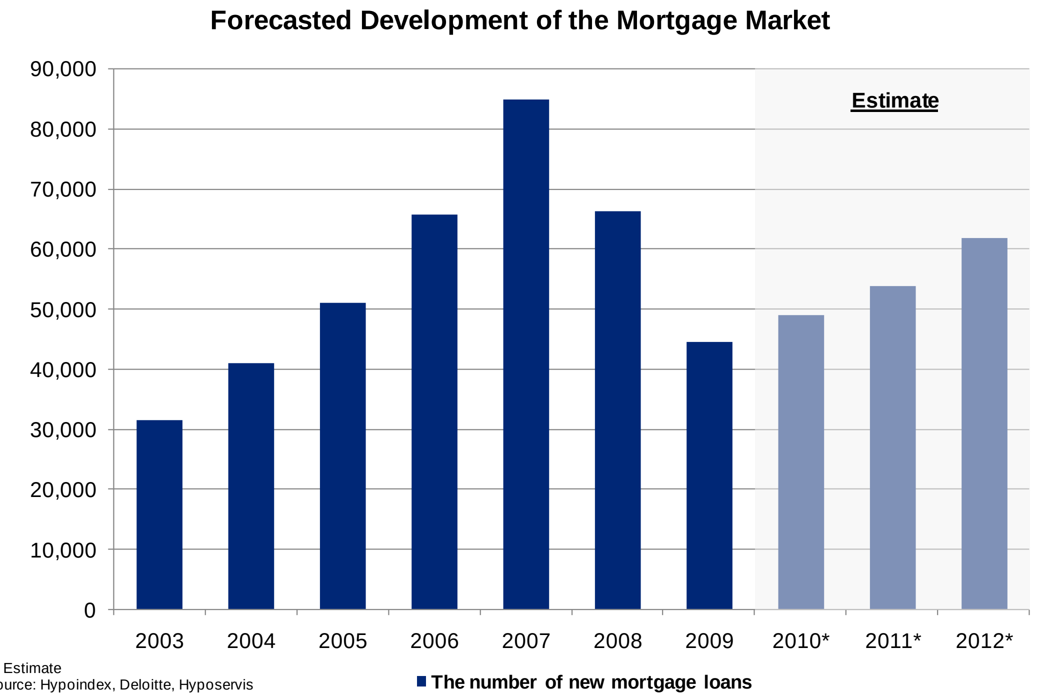


Czech Residential Market Development

Prediction of the residential market – Mortgage Market Development

- Gradual alignment of perceptions of the situation on the market by developers, banks and clients is expected, resulting in a more **balanced market supply and demand** in 2010+
- Prevailing opinion is that **interest rates** on standard products with longer-term fixation **will not decline** in the near future. Banks continue to take seriously unemployment trends and the inherent risks of default
- **New anticipated trends** include **launching alternative mortgage** products based on variable (floating) interest rates intended mainly for more sophisticated clients of banks
- Mortgage market as a whole will continue to be affected by the **fear of people to draw new loans**, directly dependent on the overall economic development of the Czech Republic and the labour market.

- 2010 is not likely to see changes in trend of client migration among banks for **refinancing** - share of refinancing on the total number of mortgage transactions is expected max. at 10%; similarly to 2009
- Banks expect the **approval rate** to grow again over the next two years, reaching the 2008 value of approx. 85% in 2011
- Average **loan-to-value** (LTV) ratio is expected to grow gradually to 77% in 2011, remaining on more conservative levels than before the crisis
- In 2010 **86% of the mortgage volumes achieved in 2008** shall be reached.



* - Estimate
Source: Hypoindex, Deloitte, Hyposervis

Czech Residential Market Development

Prediction of the residential market – Price development

- Generally, Czech residential real estate prices are **expected to stagnate in 2010**
- In 2010+, the **quality and location** of the specific apartment **will drive the prices** to a greater extent.
- We gradually expect more significant **differences in the prices of new apartments and old non-refurbished** apartments mostly in prefabricated blocks of flats whose prices grew unrealistically in the past years but also declined most dramatically of all types of apartments in 2009
- Price level of the residential market is expected to **stabilise approx. at the level of year 2006**
- Individual **categories of apartments** are expected to be differentiated to a greater extent based on their **standards** in terms of the size of the apartment and used materials, **location, public facilities and the available transportation infrastructure**

Benchmarking of the Expected and Actual Development of Prices for Individual Types of Real Estate in 2009:

Old apartments in brick-built blocks of flats	Apartments in prefabricated blocks of flats	New apartments
Price declines expected in 2009 compared to 2008		
0 – 20 %	20 – 30 %	5 – 15 %
Price declines actually reported in 2009		
do 10 %	do 25 %	do 9 %

Expected Price Development for Individual Types of Real Estate for 2010 Compared to 2009:

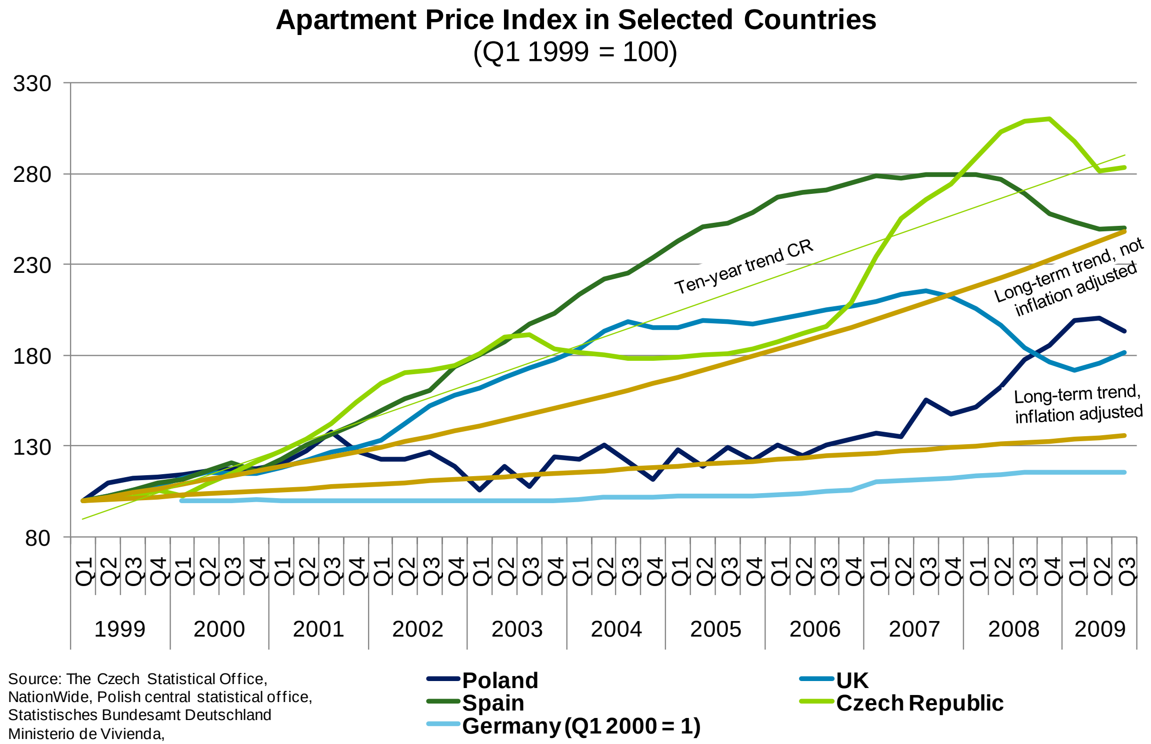
Old apartments in brick-built blocks of flats	Apartments in prefabricated blocks of flats	New apartments
Estatimated price development in 2010		
0% to +3%	-5 % to 0 %	-2% to +2% *

* - depending on the size, quality and location

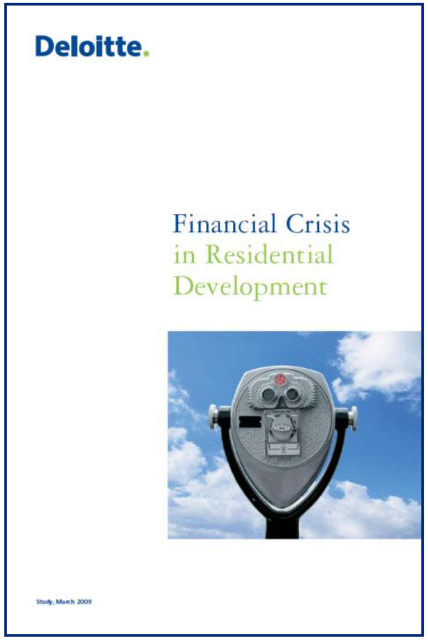
Czech Residential Market Development

Prediction of the residential market – Long-term price development outlook

- Residential property prices are **not likely to grow as dynamically as before 2008** in the upcoming years
- According to EU benchmarks, as in the previous year, annual growth of apartment prices of **2 – 3% above the inflation** rate is considered sustainable in the long term
- European experience shows that residential property is a **good long-term investment** for its **price stability and anti-inflation effect** in the long term



Source: The Czech Statistical Office, NationWide, Polish central statistical office, Statistisches Bundesamt Deutschland Ministerio de Vivienda,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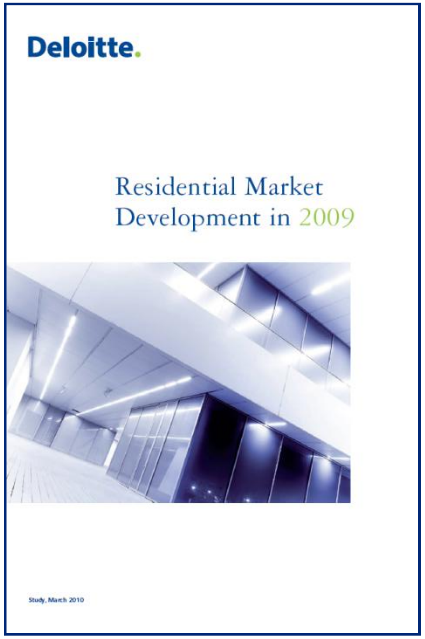
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