



# Property Lending Barometer 2022

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



It has been a turbulent 12 months since the last edition of the Property Lending Barometer. Following the gradual revival of the economy after several waves of the COVID-19 pandemic, war broke out in Ukraine, dramatically impacting Europe and the wider world. Record inflation, rising interest rates and pessimistic economic predictions are causing significant uncertainty and affecting market conditions.

As with previous reports, the latest edition of our annual survey of bank real estate financing, the 13th, gives an overview of general lending market conditions in this uncertain environment. The survey covers a range of countries in Central and Eastern Europe.

The conflict in Ukraine, combined with the spike in energy prices, is adding to the demands placed on companies regarding social responsibility and environmental sustainability (ESG, Environmental, Social and Governance). This year, our report notes that meeting a bank's minimum ESG requirements will soon be one of the basic requirements for real estate project loans. A special section devoted to ESG describes this trend.

Rising interest rates are signalling the gradual end of cheap credit, one of the key characteristics of recent years and another factor behind the runaway surge in real estate prices and the volume of transactions. The good news is the assumption that, as with previous years of the COVID-19 pandemic, banks have no plans to limit real estate financing significantly.

The objective of this report is to assess the prospects and sentiment for bank financing in the real estate sector in CEE, based on the answers of bank representatives from 10 countries.

The 2022 Barometer includes input from 41 banks, collected primarily via online questionnaires and in-depth interviews. Representatives of leading financial institutions have provided their views on the key issues influencing property lending.

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

Let me thank all of those who participated in this survey, as their co-operation was key to the success of this initiative. We hope you will find our report informative and enlightening in supporting your future business decisions related to real estate financing. If you would like to receive any clarification or discuss this year's survey results, please feel free to contact us.



**Pavel Kliment**

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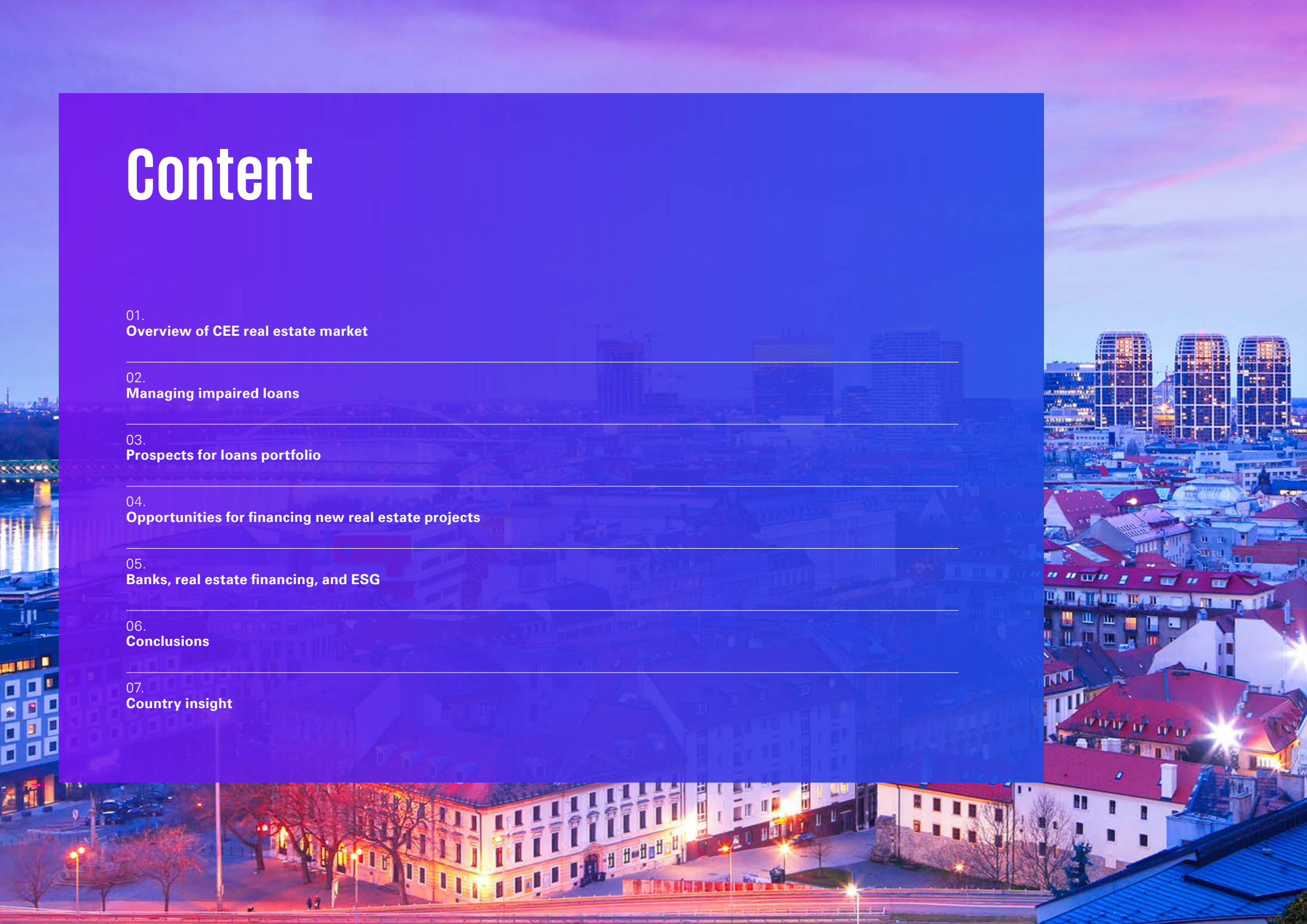
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# Methodology



## METHODOLOGY AND SAMPLE PROFILE

Our survey provides an analytical overview of banks' current approach to real estate financing in Central and Eastern Europe. The following countries are represented in the 2022 survey: Albania, Bulgaria, Croatia, the Czech Republic, Hungary, North Macedonia, Poland, Romania, Serbia and Slovakia. Survey data was primarily collected via online questionnaires and through in-depth interviews with bank representatives. Depending on the survey participants' organisational structure, interviewees were the heads of the 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 entailed 41 banks, all of which were active in the real estate market in Central and Eastern Europe over the last year.

Almost two thirds of the banks that participated in the survey were local, i.e. those operating predominantly within one European country, while the rest were mainly regional banks. Some multinational banks also participated.

Data collection for this survey took place in June-July 2022.

The survey also uses information obtained from public sources, which KPMG believe to be reliable. These market reports were published in 2021 and 2022 by Colliers, Cushman & Wakefield, the Economist Intelligence Unit, EurActiv.cz; the European Central Bank, the International Monetary Fund, the central banks of individual countries, tradingeconomics.com, the OECD, Real Capital Analytics.

## SURVEY LIMITATIONS

The following limiting factors should be noted:

- When the answers provided to specific questions were not sufficient to provide reliable information for a specific country, we have indicated this, or the country was omitted from that part of the analysis.
- Survey findings may be considered indicative but not representative.
- As in previous years, our assessment of the residential sector excluded residential projects whose construction costs were below EUR 10 million

### GEOGRAPHIC ABBREVIATIONS:

**ALB** – Albania;

**BUL** – Bulgaria;

**CEE** – Central and Eastern Europe;

**CRO** – Croatia;

**CZE** – Czech Republic;

**ECB** – European Central Bank;

**HUN** – Hungary;

**NM** – North Macedonia;

**POL** – Poland;

**ROM** – Romania;

**SRB** – Serbia;

**SVK** – Slovakia

01

# Overview of the CEE real estate market



## ECONOMIC OUTLOOK 2022

In light of the solid Eurozone economic rebound in 2021 (+ 5.7% GDP), the trend was expected to continue for 2022. Many businesses started to reopen after the pandemic with the help of recovery programs and monetary policies. However, two significant aspects have negatively shaped the predictions – supply chain disruptions due to continued lockdowns in Asia, and the Ukrainian – Russian war meddling in international trade and European continental relations.

The EU Commission estimated the forecasted growth at the beginning of the year at 4%, but it decreased below the base projection to 2.7% due to geopolitical obstacles. Economies are returning to pre-pandemic levels, as services are returning to operation and demand is rising. However, commodity and energy shortages and continued supply chain disruptions have adversely affected multiple industries and regions. The GDP in economies of the Central and Eastern European region surveyed in our report expanded on average by approximately 7%. Hungary, Poland, Slovenia, and Romania are expected to see faster real GDP growth above 3.5%, while the Czech Republic, Albania, and Slovakia are not likely to reach 3% in 2022. Whether those numbers will hold until the end of the year is subject to the developing situation in international trade.

In Europe, the first fiscal quarter has already seen a rise in inflation by 2.4%, from 5 to 7.4%. The high value still reflects the lingering pandemic recession combined with the effects and uncertainty created by the energy war. In the first half of the year, Central and Eastern European countries have already passed the threshold of 10%. In July, the average inflation across the region was around 12%. Macedonia is experiencing the highest numbers, reaching 16%, and the lowest is currently in Albania, at 7.4%. The trend is predicted to continue, with the Czech Republic expecting inflation to be as high as 20% in October. Compared to the rest of Europe (not including the UK), the CEE region is also experiencing a much

higher consumer price index (+ 8.1%) due to the more significant and immediate dependency on fossil fuels and Russian imports. According to Reuters, the lowest dependence is in Romania, Serbia, Bulgaria, and Poland (30 - 35%), while the highest share is in Croatia and Slovakia. Countries such as Macedonia, Slovenia, or the Czech Republic can also experience sharper downfalls since imported gas exceeds 25% of primary energy consumption. In 2023, the European Central Bank estimates inflation to decrease to 3.6%. However, predictions for the rest of the 2022 fiscal year are uncertain, since the values rely heavily on the next geopolitical moves. There is the possibility that CEE economies might either fall into a recession or stagnate until 2023.

Macroeconomic factors causing the slowdown are, to some extent, mitigated by its robust labour force, as many businesses are reopening after the pandemic. As a result, the unemployment rate is currently the lowest since the Financial Crisis of 2007-08, both in the CEE region (6.9%) and the EU (6%). An exception is Romania, where the unemployment rate increased by 0.13%, but in other countries, it decreased by 1% or less.

As mentioned before, any predictions are uncertain and largely dependent on geopolitical factors. If inflation increases or the import of Russian gas halts, this could mean fatal trade gaps and even the destruction of whole industries. The effects of energy price shocks and supply bottlenecks will differ from country to country, depending on industry involvement. On the other hand, accelerated investments into renewable energy projects might help to sustain the European economy by supporting it in lowering its dependence on fossil fuels. However, this might not be a feasible solution for the CEE region, as its capital endowments remain below the EU average. Moreover, the region suffers from more significant investment gaps, and needs more robust financial sector diversification.

## BANK LENDING

The European Central Bank's primary goal, ensuring price stability, is now seriously challenged. Many economic factors have caused inflation to sharply accelerate in the first half of 2022, and most likely will continue to do so. The ECB has ended pandemic monetary measures in the form of Emergency and Asset bond purchase programs and put into effect quantitative tightening. The key bank interest rates increased from a planned 0.25% to 0.5% under the pressure of high inflation. Some national banks have followed and raised interest rates much faster than others, like the Czech Republic and Poland, to cool the market down. The bank lending rate in the Euro zone rose to 2.51% in October.

However, monetary policies will have to consider the additional burden of a more significant number of indebted businesses and households as a result of the pandemic crisis. Loans to households in the Euro zone have reached their highest since 2008, rising the year-to-year rate by 4.6%, while credit increased to 6.8%. The banking market continues tightening credit standards and loans for households and non-profit corporations.

Investor activity in certain asset classes has decreased, as has the demand for short-term loans, especially in the CEE countries. This is a result of increasing interest rates, falling savings, higher consumption expenditures and rising property prices. The ECB has not laid out a major strategic plan of measures. Instead, it continues to analyze the situation and takes further steps meeting-by-meeting depending on the latest data from the overheated market.

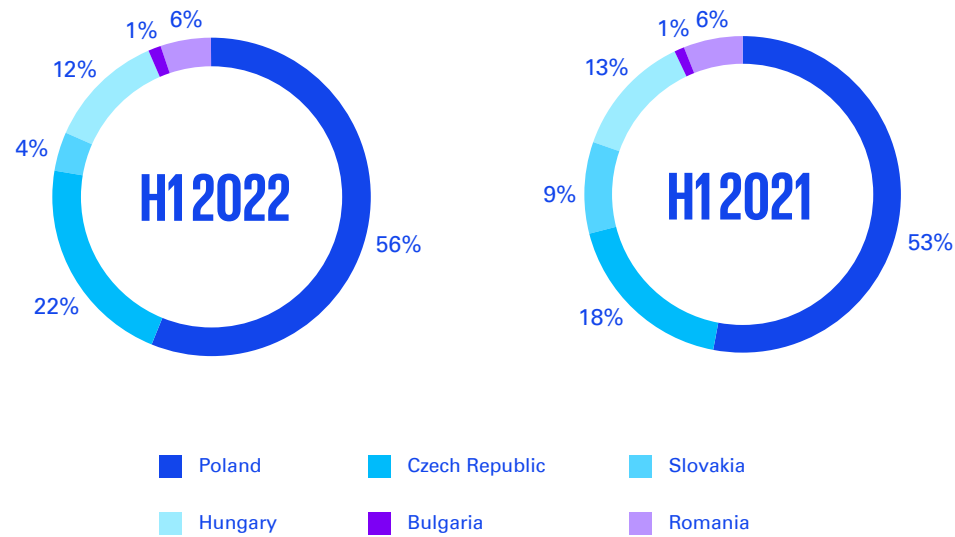
## REAL ESTATE MARKET IN CENTRAL AND EASTERN EUROPE

In the first half of 2022, the total investment volume in the CEE region was EUR 5.3 billion, showing an increase of 8.16% compared to the same period in 2021. Significant investment activities took place in the first quarter of 2022; however, investment slowed down again in the second quarter of 2022. In addition, a number of M&A transactions (through share acquisitions and transfers) were affected but are not included in the above investment volume.

In the first half of 2022, Poland showed the largest volume of investment in the CEE region with a share of 56%, followed by the Czech Republic (22%) and Hungary (12%). Despite the overall increase in investment in the region, investors remain cautious due to the geopolitical and economic situation as well as increasing financing costs, etc.

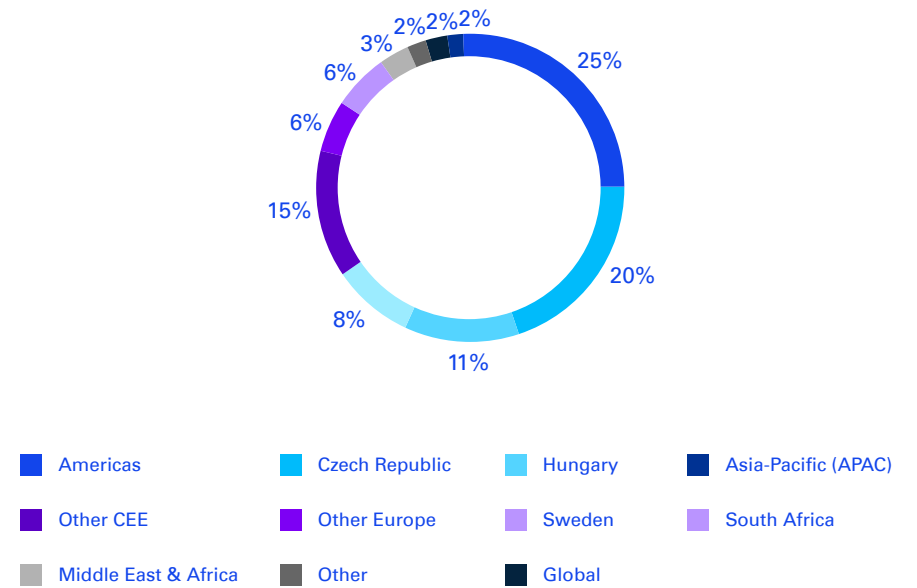


**BREAKDOWN OF REAL ESTATE TRANSACTION VOLUME  
CENTRAL AND EASTERN EUROPE**



Source: Colliers

**INVESTMENT IN CENTRAL AND EASTERN EUROPE  
BY ORIGIN OF INVESTORS, H1 2022**



Source: Colliers

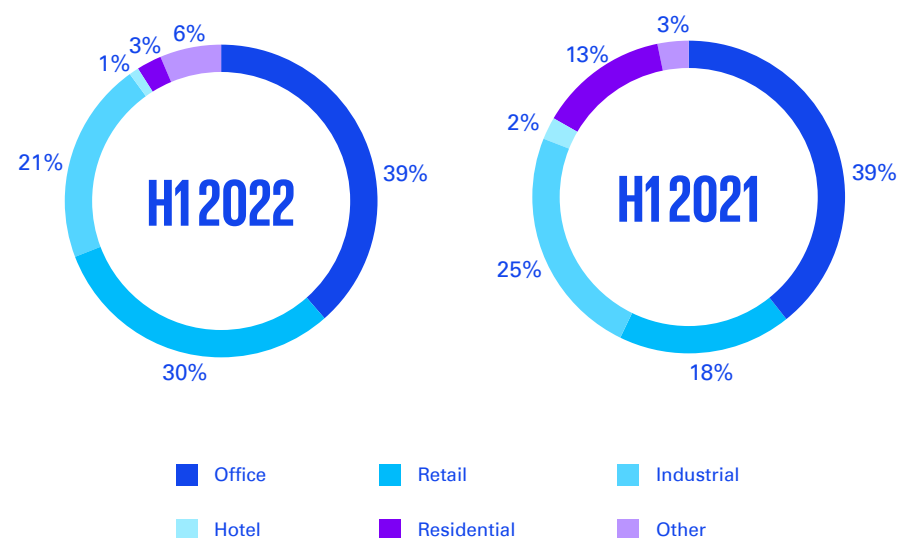
In the first half of 2022, the office property sector once again dominated, mainly due to particularly strong investment activity in Poland. This was followed by the retail sector with a share of 30%, a significant increase compared to the previous year. This increase in investment was mainly due to the full or partial sale of the Tesco and EPP portfolios.

The highest volume of investment in the CEE region was attributable to domestic investors, with a 40% share of the total investment volume. European investors still dominate the market with a share of 61%. Significant investment activity continues to be seen from the Czech Republic (20%) and Hungary (11%), followed by North America (25%).

Over the recent months, capital investment in the CEE region has also been more active from South Africa, while the capital inflow from Asia, typically China and South Korea, dropped significantly.

The industrial and residential sectors remain attractive to investors, generating strong demand in both. However, investment slowed down in the sectors due to the lack of supply/availability of products.

**INVESTMENT BY ASSET TYPE  
CENTRAL AND EASTERN EUROPE, H1 2022**



Source: Colliers

## Q2 2022 PRIME YIELDS

At the end of Q2 2022, yields remained stable. However, current market conditions and sentiment are causing reduced investor demand but also greater caution on the part of credit institutions and rising funding costs due to increasing interest rates. These factors could impact significant valuation changes in the CEE region in the course of 2022.

COUNTRY	OFFICE PRIME YIELDS (%) / Q2 / 2022	INDUSTRIAL PRIME YIELDS (%) / Q2 / 2022
Czech Republic	4,00	4,00
Poland	4,35	4,35
Slovakia	5,00	5,50
Hungary	5,00	5,75

Sources: Real Capital Analytics, Colliers

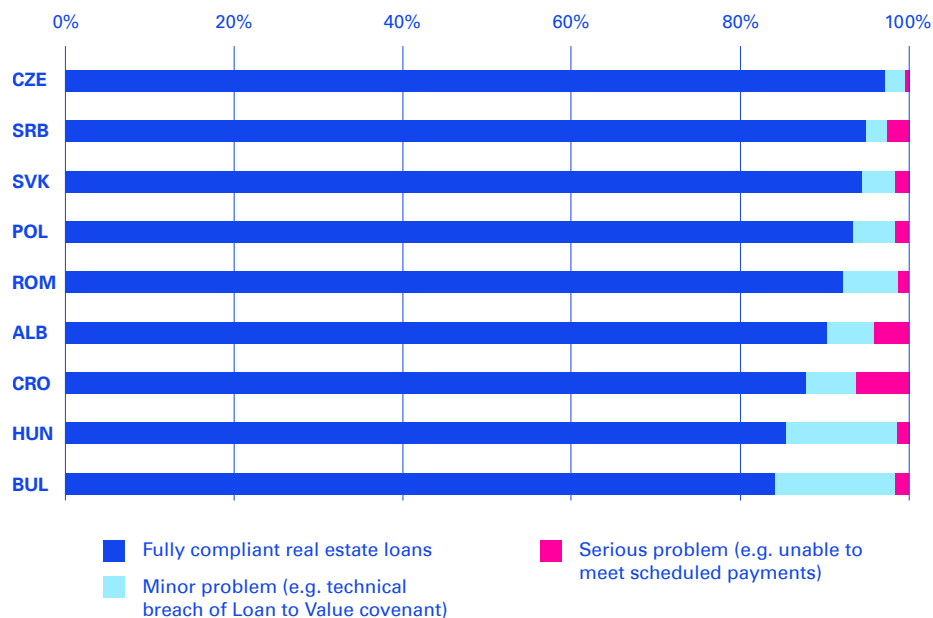
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# Managing impaired loans



The effect of the Covid-19 pandemic on the credit risk of banks in the CEE region was largely mitigated by comprehensive government support in most countries. This helped prevent the feared rapid decrease in quality of bank loans and, in most countries, led to a reduced percentage of impaired loans across the board. The biggest improvement (over 5% decrease of impaired loans) was observed in Bulgaria, Croatia, and Albania. On the other hand, these countries had and still have the highest percentage of impaired loans within the region. Czechia, Slovakia, Poland, and Serbia still boast the lowest percentage of impaired loans, just like in the previous years.

**PROPORTION OF IMPAIRED REAL ESTATE LOANS PER COUNTRY**



Over 59% of surveyed bankers expect no significant change in proportion of impaired real estate loans per country in the next 12 months, while 32% expect their number to increase slightly in their respective countries. Increased percentage of impaired loans is most expected in Romania, Hungary, Poland, and Slovakia.

Over 76% of surveyed bankers believe that the current level of the provisions in banking sector is sufficient, with 12% even considering them excessive. This represents a slight decrease compared to last year's numbers, 81% and 14% respectively, with more bankers now considering the level of provision as insufficient or extremely insufficient – sentiments that were most often seen in Poland and Hungary.

### DISPOSING OF LOAN PORTFOLIOS

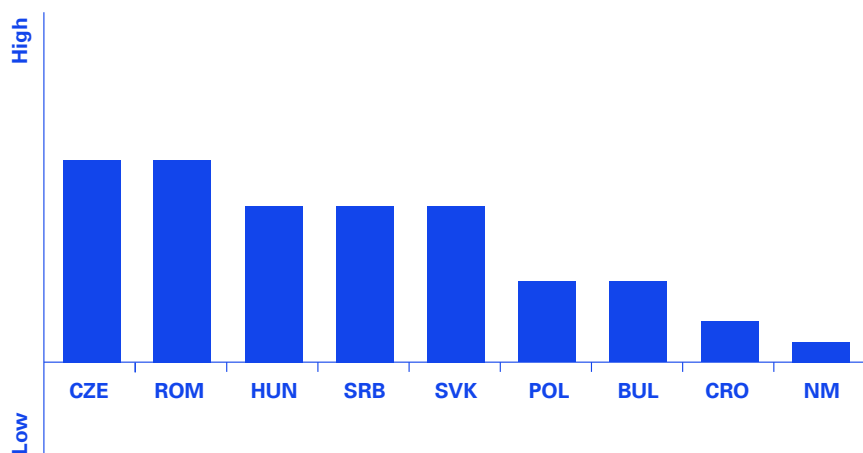
Similar to last year, some bankers from Slovakia, Bulgaria, and now Poland are considering selling their non-performing property loan portfolios within the next 12-18 months, mostly aiming at a strategic exit. In other countries, bankers have not expressed any such plans for the foreseeable future. Only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

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# Prospects for real estate loan portfolios

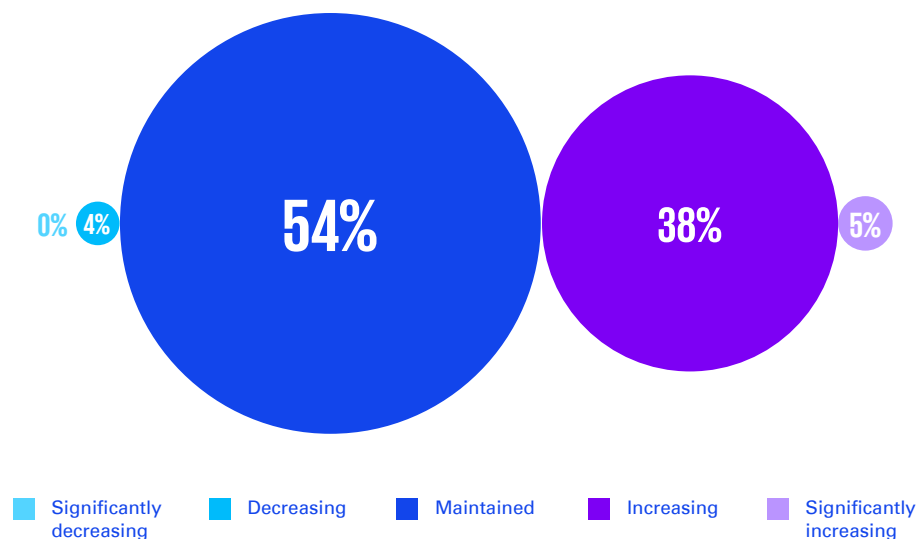


### STRATEGIC IMPORTANCE OF REAL ESTATE FINANCING FOR BANKS



Source: Property Lending Barometer, 2022

### FOCUS ON REAL ESTATE FINANCING WITHIN THE BANK'S LENDING ACTIVITY COMPARED TO ONE YEAR AGO



Source: Property Lending Barometer, 2022

The trend of banks becoming more interested in and focused on financing of commercial real estate continued in 2022, with a small drop in focus and interest aimed at this sector reported by some bankers in Poland. Similar trend can now be observed in some Czech bankers as well; however, the sector still maintains its strategic importance, with Czechia and Romania actually being at the top of the ladder in terms of sector's importance.

## KEY FACTORS AFFECTING REAL ESTATE LOAN PORTFOLIOS

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

The biggest factor affecting bank financing of commercial real estate is now the macroeconomic situation of individual countries, taking the top spot from pandemic situation, a factor that has lost its importance compared to last year. On the other hand, importance of steps taken by national banks and macroeconomic situation in Europe has grown. Results are similar across all countries, with the exception of Czechia, Croatia, and Serbia. Similarly to previous years and unlike other countries, lack of prime property plays an important role in Czechia. In Croatia, the lack of equity is more important than in other countries, while in Serbia, it's increasing property value.

Despite significant uncertainty about the future of individual nations' economies and the economy of the entire Europe, 41% of surveyed bankers expect the loan portfolios in their countries to grow in the next 12-18 months, with 56% expecting the growth of their bank's portfolio – both numbers significantly lower than they were last year. Portfolios are expected to stay roughly the same by 34% and 28% of bankers, respectively. Most optimism was expressed by bankers in Serbia, Slovakia, Albania and North Macedonia, while Bulgarian bankers are the least optimistic.

Macroeconomic conditions in the local market	★ ★ ★ ★ ★
Macroeconomic conditions in Europe	★ ★ ★ ★
Activities of European Central Bank / National Banks	★ ★ ★ ★
Increased property values	★ ★ ★
Lack of prime properties	★ ★
Lack of active investors	★ ★
Lack of equity	★
ESG	★
New strategy	★
Other	★

Source: Property Lending Barometer, 2022



## **DIRECT IMPACT OF THE WAR IN UKRAINE**

This year's survey included a new question focusing on the direct impact the war in Ukraine is having on bank financing of commercial real estate.

More than 59% of surveyed bankers believe that the ongoing war has had a direct impact on their bank's financing of commercial real estate, but none of them perceived it to be significant (i.e. leading to write-offs in the loan portfolio). Other surveyed bankers said the war had no effect on the sector as of the date of the survey (June 2022). Apart from direct impact on the sector, bankers expect the war to have a significant effect on the economic situation across all Europe.

## **ALTERNATIVE FINANCING**

Survey respondents maintained a negative view on providing other forms of financing apart from senior loans (i.e. mezzanine, whole loans, stretch senior) to finance real estate projects. Unlike in previous years, interest of Czech, Hungarian, and Slovak banks to potentially provide these types of loans has decreased significantly, with exceptions being very rare and very selective. Banks in Albania and North Macedonia, however, remain much more willing to provide these types of loans.

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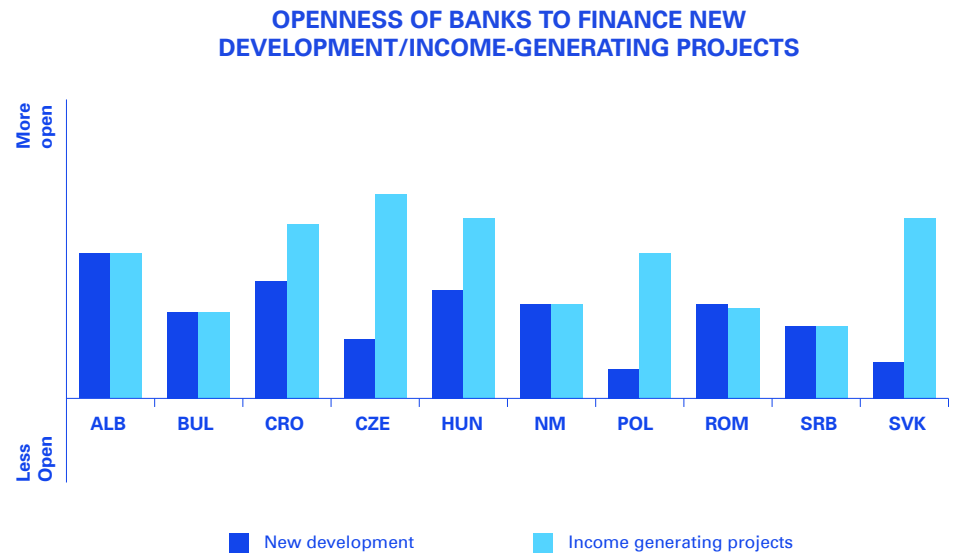
# Opportunities for financing new real estate projects



Survey participants revealed their attitude towards opportunities in terms of bank financing of real estate projects.

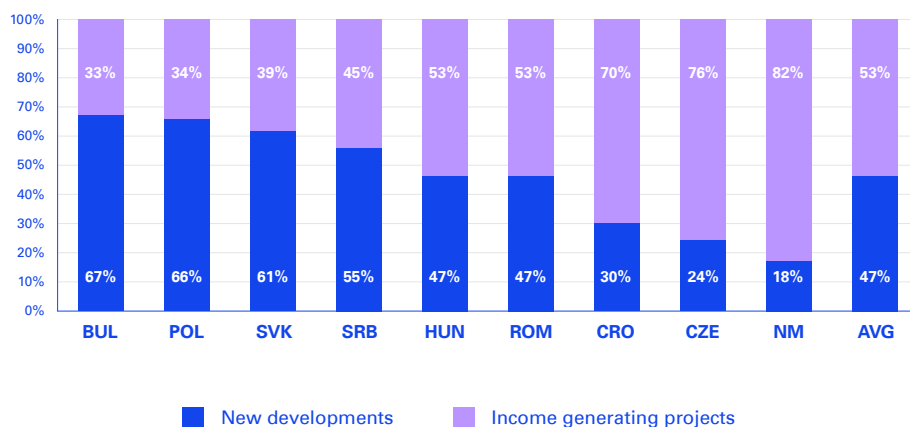
There was little difference in terms of respondents' willingness to finance income-generating projects, with a positive overall attitude expressed in all countries and the most positive attitude coming from Czechia, Hungary and Slovakia. Willingness expressed by banks in other surveyed CEE countries was more reserved, but still positive in this respect. When asked about banks' willingness to finance new developments, respondents also expressed a positive attitude. Banks from Albania were most open to the prospect, while bankers from Poland and Slovakia expressed a rather cautious attitude.

Responses have shown a significant increase in percentage of loans provided to fund new property development in Poland, with a reverse trend observed in Romania.



Source: Property Lending Barometer, 2022

### TOTAL VOLUME OF REAL ESTATE LOANS BANK



Source: KPMG Property Landing Barometer 2022

### CRITERIA FOR FINANCING

Representatives of those surveyed identified the most important criteria for selecting real estate projects to finance. Similarly to previous years, banks participating in our survey confirmed that in a majority of countries the most important criteria for obtaining financing for a real estate project are a strong business model and the quality of the asset. The reputation and references of the developer/operator, the financial background of the developer/investor, the pre-letting/pre-sale level, and the level of the owners' equity were also scored as quite important; this scoring also applies to the importance of sustainability which strengthened compared to last year.

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

Source: KPMG Property Landing Barometer 2022

## BANK LOANS IN OTHER THAN DOMESTIC CURRENCY

In the past 12 months, bankers in Croatia, Serbia, and Romania (more than 90% of the total volume) provided the largest share of bank loans for financing commercial real estate in a currency other than domestic currency, followed by bankers in the Czech Republic, Poland, and Hungary with a share of 70–80%. The biggest share of loans provided in a domestic currency rather than in a foreign currency was seen in Bulgaria. Significant growth in the share of loans in a foreign currency compared to the past was reported in Croatia, the Czech Republic, Hungary, and Romania. In contrast, this share showed no significant changes in Serbia, with some Bulgarian and Polish bankers reporting even a slight increase in the volume of domestic currency transactions.

The trend corresponds with the development of benchmarking rates in individual countries and their comparison with Euribor; in Croatia it is associated with the introduction of the euro effective from 1 January 2023.

Compared to previous years, there is an increase in interest in Euro financing even for projects with income denominated in the local currency (for example, residential projects, B-class real estate, etc.). This funding is done on a very selective basis and banks are aware of the systemic risk associated with this funding and have had negative experiences with providing CHF<sup>1</sup> mortgages to residents.

## BENCHMARK INTEREST RATE

CURRENCY AREA / COUNTRY	BENCHMARK RATE	DEC.,2021	VARIANCE TO EURIBOR	AUG., 2022	VARIANCE TO EURIBOR
Eurozone	3M EURIBOR	-0.58%		0.39%	
Poland	3M WIBOR	2.54%	3.12%	7.11%	6.72%
Czech Republic	3M PRIBOR	4.08%	4.66%	7.26%	6.87%
Romania	3M ROBOR	3.01%	3.59%	7.95%	7.56%
Hungary	3M BUBOR	4.21%	4.79%	12.76%	12.37%

Source: European Central Bank, European national banks

<sup>1</sup> In the first decade of the 21st century, loans (generally mortgages to households / customers) denominated in or indexed to foreign currencies, in particular the Swiss franc, became very popular in majority CEE countries (especially in Poland, Hungary). As a result of the global economic crisis and the Swiss National Bank's decision to unpeg the exchange rate in 2015, the rate of exchange between the Swiss franc and these national currencies (zlotys, forints, kunas, etc.) soared, consumers found themselves trapped. Often, they had to repay as much as twice the value of the loan taken, and could not escape the unfavourable contract by simply selling the property they had bought, as this would cover only a fraction of their debt.

## INTEREST RATE HEDGING

This year we queried individual banks about their requirements for clients to hedge interest rate risk associated with variable interest rates. Hedging this risk with a derivative instrument to more than 50% of the volume is requested by all bankers interviewed from Croatia, the Czech Republic, Hungary, Poland, and Romania. The most conservative are bankers in Croatia and Poland as significant number of them require the hedge for more than 80% of the loan volume.

Bankers in Albania, North Macedonia and Bulgaria do not require or are satisfied with hedge not exceeding 50% of the loan volume. The situation is rather inconsistent in Serbia – some banks require hedging for more than 80% of the loan volume, while some require no collateral against interest rate risk at all.

## INTEREST PREMIUMS

Banks provided responses for the interest premium range they would apply on a 3-month Euribor basis if a developer or investor of outstanding reputation with a solid business plan approached them.

A general trend prevails that interest premiums are the lowest in economies with lower risk profiles and well-established real estate markets, spurred by competition among financing institutions that have contributed to more favourable conditions available to borrowers.

Among the surveyed economies, Czech and Slovakian banks (similar to last year) apply the lowest premiums, while the highest are applied by Albanian and North Macedonia banks (similar to last year), which requiring also higher interest premium than last years. Czech, Slovakian and Croatian banks requiring then slightly higher interest premium compared to the last year), which is also in line with development in the western countries. Other countries surveyed generally showed a decrease in premiums (especially Hungary, Romania) or no significant changes (Poland) in the required premiums.

For individual assets, the largest decrease in premiums related to hotels, due to the gradual recovery of the tourism market, and to residential projects.

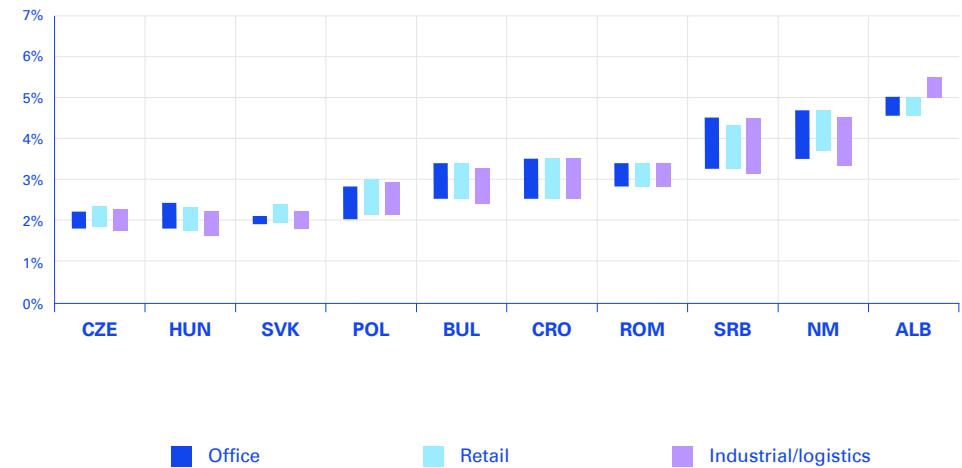
The trend of convergence among the required interest premiums for individual asset types continued this year, except for hotels.

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

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



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



Source: KPMG Property Landing Barometer 2022

In addition to loan interest premium, the total cost of loan is affected by the level of interest rate (EURIBOR), which is expected to growth due to the inflation and increased uncertainty in Europe. The growth of the interest premium is limited by the high competition among banks and also limited number of the prime assets projects.

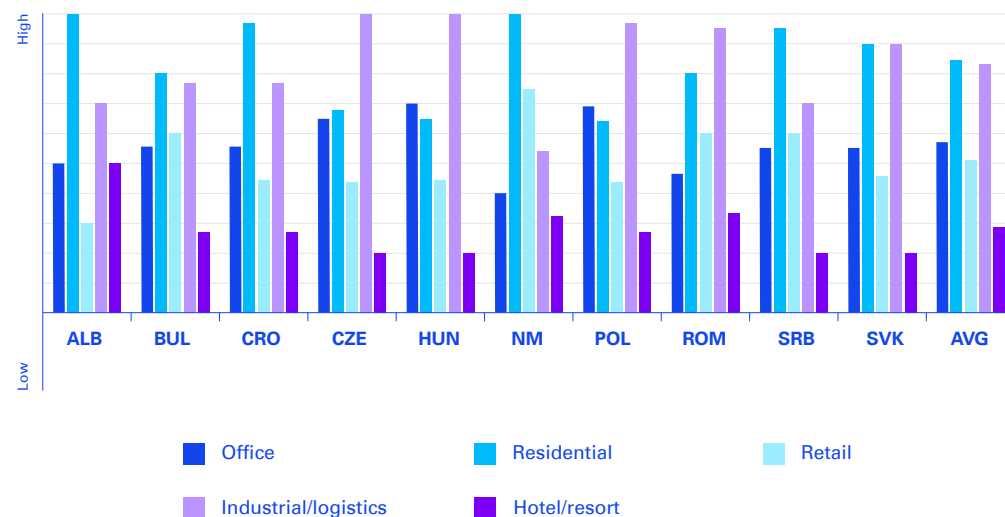
## ASSET CLASS PREFERENCES

Banks were also queried about their preferred asset class for development financing. Compared to responses from the previous year, the residential asset class kept the most popular position among banks surveyed, closely followed by the industrial/logistics asset class. No change can be observed regarding a trend of hotel & resorts being the least preferred asset class on average, especially in the Czech Republic, Hungary, Serbia, and Slovakia. Retail was also less preferred, with the exception of North Macedonia.

In spite of a gradual tourism recovery, 29% of all bankers surveyed throughout the region are currently unwilling to finance the development or investment in hotel/resort project. Most of these banks are in the Czech Republic, Poland, and Slovakia.

Compared to previous years, the banks surveyed mentioned their effort to diversify their loan portfolio and represent all asset classes.

### BANKS' SECTOR PREFERENCES IN PROVIDING DEVELOPMENT FINANCING BY ASSET CLASS



Source: KPMG Property Landing Barometer 2022



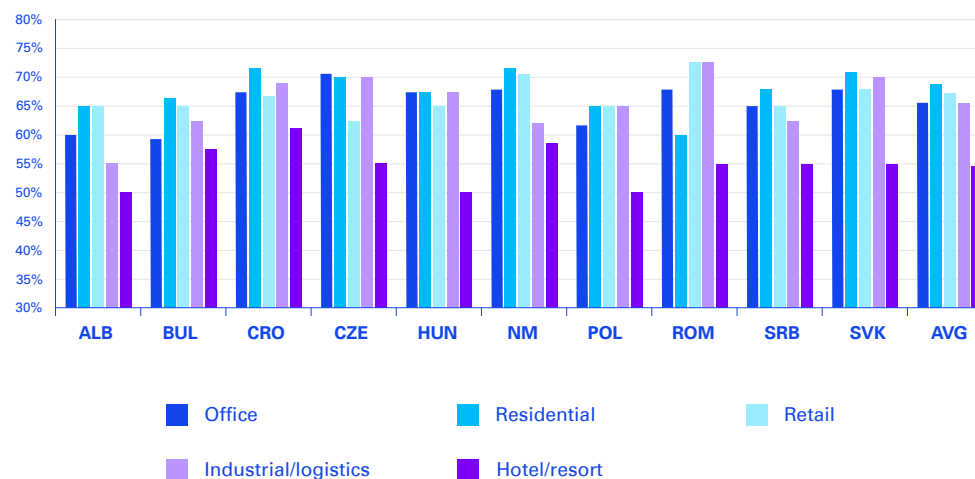
## LOAN-TO-COST RATIOS (LTC)

Bank representatives were also questioned regarding their technical criteria for financing. The loan-to-cost ratios they chose varied by country and asset type. Overall, average loan-to-cost ratios vary between 0.59 and 0.68 across countries, with a regional average of 0.64. In a country-by-country comparison, banks in Bulgaria require the highest level of equity. As of last year, Croatian and Czech banks were the least conservative.

Survey respondents in Central and Eastern Europe indicated loan-to-cost ratios for the office, residential, retail, industrial/logistics and hotel sectors in a range of 0.55 and 0.68 (i.e., reflecting a capital structure of 55–68% debt and 45–32% equity).

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

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



Source: KPMG Property Lending Barometer 2022

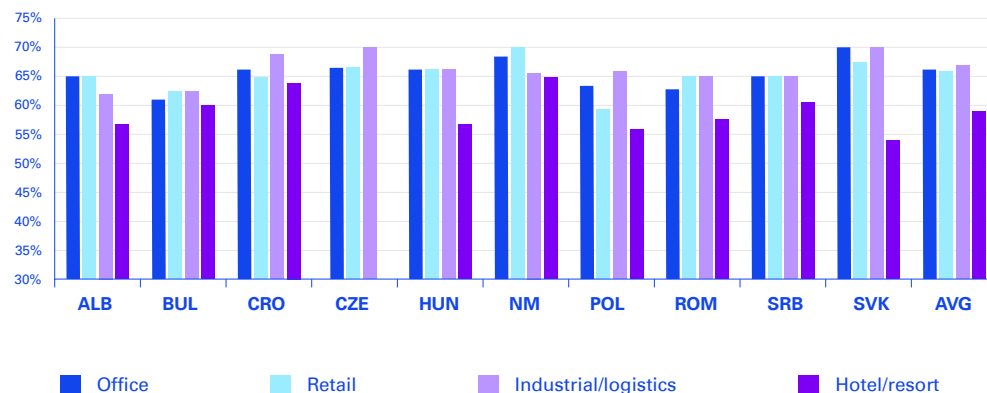
### LOAN-TO-VALUE RATIOS (LTV)

In those countries surveyed, the loan-to-value ratios for the office, retail and industrial/logistics range from 0.54 to 0.71 (i.e., reflecting a capital structure of 54–71% debt and 45–29% equity).

This year there was a continuing trend towards equalling LTV for individual asset classes except hotels and the average value of office, retail and industrial/logistics reached 66% for the region.

Hotel/resorts, on average, require the highest ratio of equity, with the average LTV ratio for countries included in the survey being 0.59. While banks in most countries in this group are quite restrictive, banks in Croatia and North Macedonia are willing to provide 64–65% credit in proportion to the total appraised real estate value for these types of assets.

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



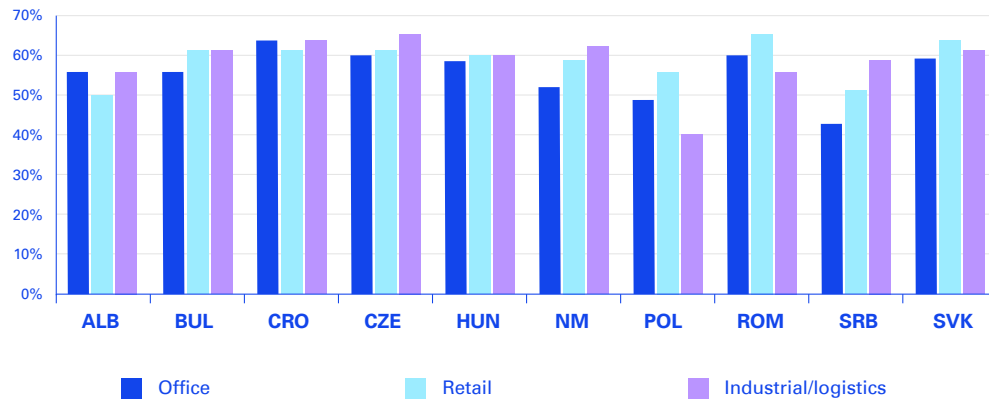
Source: KPMG Property Lending Barometer 2022

## PRE-LET RATIOS

As in the past, Polish banks request the lowest pre-let ratio on average, while Croatian banks have the most restrictive requirements. Polish banks also request the lowest pre-let ratio for office projects and logistics projects, while the lowest pre-let ratio for retail is requested by Albanian banks.

63% of the bankers surveyed responded that they did not change the requirements for pre-let ratios in respect of Industrial/logistics projects (55% for office and 52% for retail sectors).

### PRE-LET RATIO EXPECTATIONS FOR FINANCING HIGHLY RATED OFFICE, RETAIL, AND LOGISTICS REAL ESTATE DEVELOPMENT PROJECTS

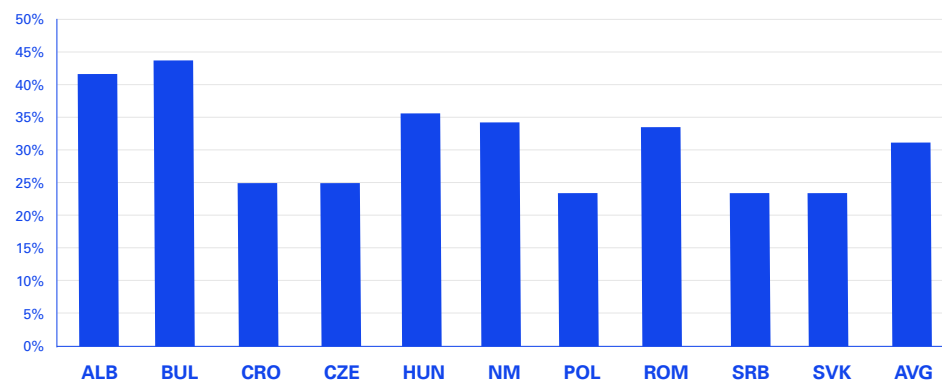


Source: KPMG Property Landing Barometer 2022

## PRE-SALES

57% of the bankers surveyed replied that they do not expect the requirements for pre-sales ratios in respect of residential projects to be changed compared to last year.

**PRE-SALES RATIO EXPECTATIONS FOR FINANCING HIGHLY RATED RESIDENTIAL DEVELOPMENT PROJECTS**

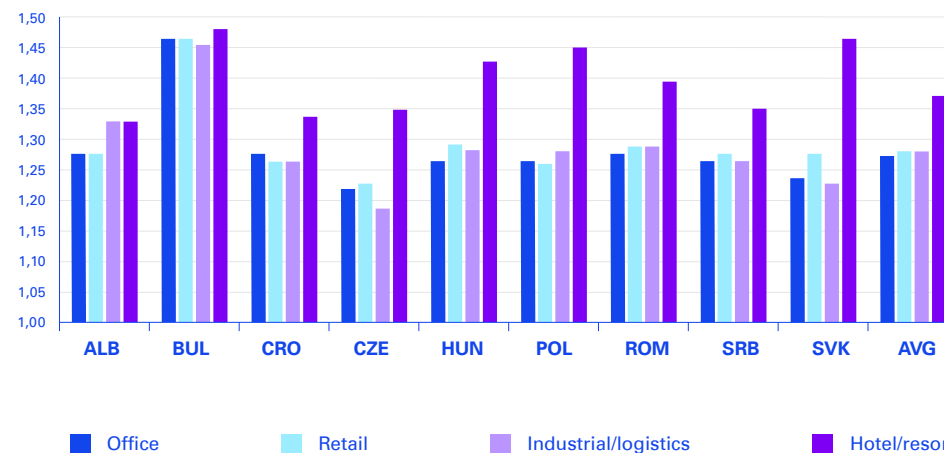


Source: KPMG Property Landing Barometer 2022

## DEBT SERVICE COVERAGE RATIOS

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

As in previous years, the requested value of DSCR for individual asset classes continued to converge, with the average value for individual countries approaching 1.28, with the exception of hotels/resorts reaching 1.38.



Source: KPMG Property Landing Barometer 2022

38% of the bankers surveyed confirmed that there had been no significant change in their requirements for DSCR compared to the previous year. As regards individual asset classes, no significant change occurred in respect of hotels (61%) and offices (55%), followed by industrial/logistics projects (50%) and retail (44%). The major tightening (reduction) of this ratio was requested for retail projects (29% of all bankers surveyed) and hotels (24%), whereas the major easing (increase) of this ratio was demanded for industrial/logistics projects (34%).

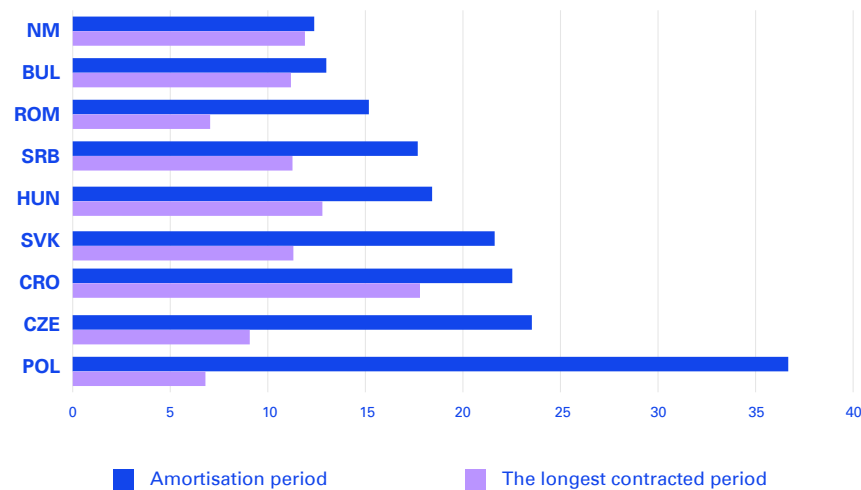
DSCR and LTV are the two most common banking covenants, and it is precisely in the event that the investor does not comply with the banking covenant that it is primarily a non-fulfillment of DSCR. The value of DSCR will be negatively affected next year by the growth of total interest costs.

## LENGTH OF LOAN

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

Even this year did not bring a significant change in the length of loans granted and the amortization rates. Investor pressure and high competition in Poland and other countries are the reasons for the maximum amortization period which is contrasted by internal requirements of banks for the length of the loan. The maximum difference between the amortization period and the length of the loan agreement is typical for many Western European countries, such as Germany or the Netherlands. As in the past, Croatia offers the longest loan agreements this year, and it has seen the most significant extension of the loan length and amortization period of the countries surveyed.

**MAXIMUM AMORTIZATION PERIOD\* AND LONGEST CONTRACTED TERM AVAILABLE (IN YEARS)**



Source: KPMG Property Landing Barometer 2022

There are differences between the amortization rates applied for different asset classes as well. Taking the average of all surveyed countries, the office projects receive the most favourable terms, which is similar to prior years.

Compared to last year, the difference in the amortization rate and the maximum length of the loan agreement among individual asset classes decreased, which is, among other things, attributable to the provision of more favourable conditions for financing logistics projects.

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

**05**

# **Banks, real estate financing, and ESG - from commitment to action**

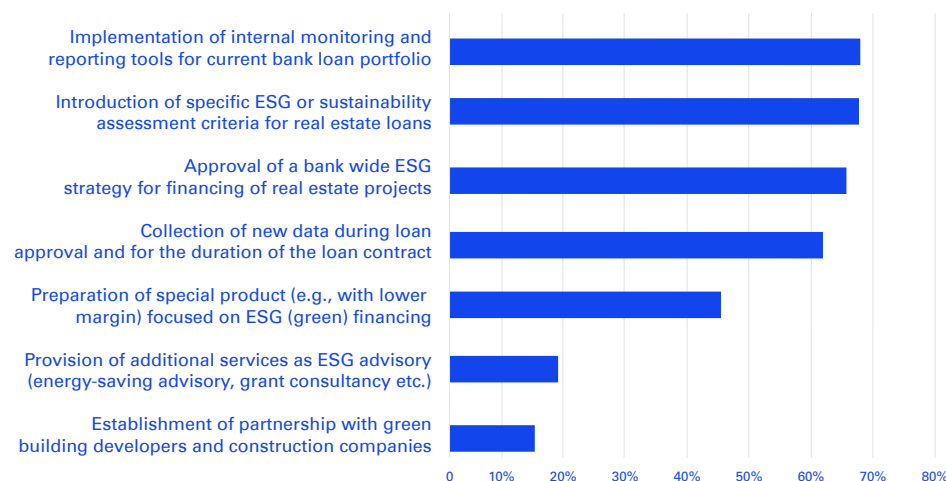


An increasing incidence of material climate risks, the COVID-19 pandemic, and the current conflict in Ukraine have shown the real importance of environmental, social, and governance (ESG) requirements. As ESG has had a significant impact on the real estate market, we focused on this area during our survey.

The growing importance of ESG in the financing of commercial real estate compared to the previous 12 months was confirmed by the most surveyed bankers. Bankers from Hungary and Croatia confirmed the greatest increase in focus on ESG.

The focus on ESG has mainly been driven by a change in the approach of financial institutions with a global impact<sup>2</sup> and new legislation (local and EU taxonomy), which is also reflected in the strategies of parent companies and subsequently individual banks. Other significant factors are the requirements and approaches of the central banks. An example is the Hungarian Central Bank, considered a leader in sustainable finance in the CEE region. In 2019, the bank activated its Green Programme, while in 2021 it issued several measures to promote green financing for credit institutions and real estate projects. Whether a country is part of the Eurozone and thus falls under the jurisdiction of the European Central Bank also makes a big difference. An important impulse is also the growing interest of clients in whether their bank considers ESG when providing financing.

### CURRENT STATUS OF ESG IMPLEMENTATION IN REAL ESTATE FINANCING



Source: KPMG Property Landing Barometer 2022

<sup>2</sup> A significant step forward was taken during last year's COP 26 climate summit in Glasgow, when financial institutions managing approx. \$130 trillion in assets formed the Glasgow Financial Alliance for Net Zero ("GFANZ").



The introduction of specific ESG and sustainability criteria for evaluating loans intended to finance real estate as well as the collection of new data and the introduction of internal monitoring and reporting for this area was confirmed by more than 68 percent of the bankers. According to the bankers interviewed, the implementation pace for measures in this area is lower in Bulgaria, Romania, and Serbia. These activities are also accelerated by new European legislation for credit institutions explicitly requiring the inclusion of ESG elements in lending.

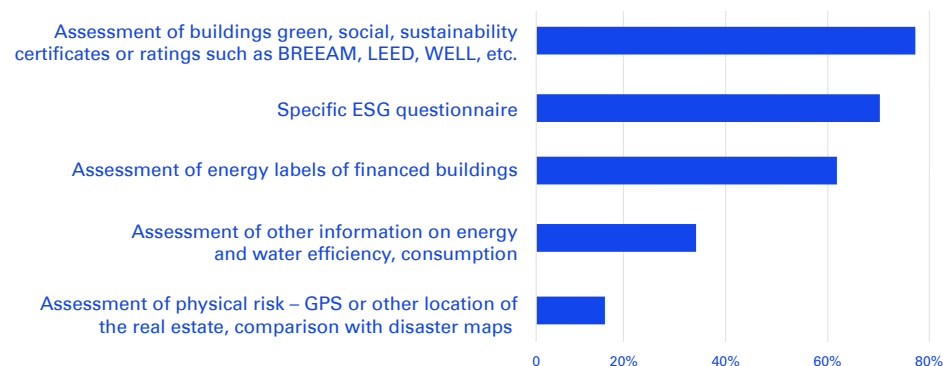
Among the surveyed bankers, 65 percent approved their bank's ESG strategy for real estate. Czech, Hungarian, and Polish bankers are above this average, while in Croatia and Romania more than half of the banks surveyed do not have any approved ESG strategies for this financing area.

Our survey also shows that the provision of additional ESG services (including subsidy consulting, energy saving consulting, etc.) is very limited, except in the Czech Republic where most of the banks offer these additional services. Similarly, this also applies to banks establishing partnerships with developers and construction companies that focus on sustainability. Czech and Romanian bankers are the most active in this area (more than a third of the respondents answered positively), followed by their Hungarian and Croatian colleagues.

## SPECIFIC EVALUATION CRITERIA FOR LOAN ASSESSMENT

More than three fourths of the banks surveyed that have already implemented specific evaluation criteria for loan assessment work with external ratings or certificates such as BREEAM, LEED, WELL, GRESB etc. A similar share of banks has a specific ESG questionnaire. The use of energy labels is most common in Croatia and the Czech Republic. In general, the banks interviewed do not rely on just one tool or criterion to evaluate a loan in terms of ESG and sustainability.

### INTRODUCTION OF SPECIFIC EVALUATION CRITERIA FOR LOAN LOANS CONSIDERING ESG



Source: KPMG Property Landing Barometer 2022

As regards the existence of internal ESG assessment criteria, 7 percent of the bankers interviewed have already experienced their bank not approving a loan because of unmet criteria. A further 26 percent confirm that they have experienced non-approval of a loan due to the failure to meet a combination of several types of conditions, among them ESG criteria. In the last 12 months, the remaining percentage of bankers did not experience the failure to meet the bank's ESG criteria leading to a loan's disapproval, either alone or in combination.

#### **SPECIAL PRODUCT FOCUSED ON ESG (GREEN) FINANCING – LIMITED PRACTICAL EXPERIENCE**

The preparation or launch of a special product focused on ESG (green) financing was confirmed by almost half of the bankers surveyed. Most often such an offered or planned product consists of a loan with a lower interest margin or, significantly less often, a loan with extended maturity or lower amortisation. Nonetheless, to date there is very little practical experience with providing these special products. Majority of the bankers interviewed in Poland, Slovakia and Czech Republic is not yet considering the launch of the special product focused on ESG and see the fulfilment of ESG criteria to be one of the basis conditions for granting a loan at all.

06

# Conclusion



- Despite the overall increase in investment in the CEE region compared to H1 2021, investors remain cautious because of the geopolitical and economic situation, the increase in financing costs and other factors. H2 2022 will likely mean significant decrease in investment, if long or short, this is to be found out.
- At the end of Q2 2022, yields remained stable. However, current market conditions and sentiment are leading to reduced investor demand and greater precaution of credit institutions and increasing funding costs because of rising interest rates.
- Most bankers interviewed requested the hedging of the interest rate risk associated with variable interest rates with a derivative instrument to more than 50% of the bank loan volume. The expectation represents the bankers from Albania, Bulgaria and North Macedonia do not require or are satisfied with a hedge not exceeding 50% of the loan volume.
- Most bankers from non-EUR countries reported over 70% loan in the foreign currency (EUR), except Bulgaria. The growth in the share of foreign currency corresponds to the development of benchmarking rates in individual countries and the comparison of such rates with EURIBOR.
- Although the share of bank loans for financing new developments has increased compared to the previous year, banks are now less open to funding new development. In addition, there is a greater preference among banks for financing income-generating projects.
- There was generally reduction of the percentage of impaired loans considering recovery after COVID-19. The most significant improvement (the number of impaired loans decreased by more than 5%) was observed in Bulgaria, Croatia, and Albania. Conversely, these countries had and still have the highest percentage of impaired loans within the region. Czechia, Slovakia, Poland, and Serbia still boast the lowest percentage of impaired loans, as in previous years.
- More than 59% of the bankers questioned believe that the ongoing war in Ukraine has had a direct impact on their bank's financing of commercial real estate. However, none of them perceived it to be significant (i.e. leading to write-offs in the loan portfolio). Other bankers stated the war did not affect their business as at the date of the survey (June 2022). Apart from the direct impact on the sector, bankers expect the war to have a significantly impact the economic situation across Europe.
- The general trend is that interest premiums are the lowest in economies with lower risk profiles and well-established real estate markets. This development is spurred by competition among financing institutions that have contributed to more favourable conditions for borrowers.
- Like last year, most banks surveyed require higher interest premiums for development projects than for income-generating projects. The Czech and Hungarian banks reported the greatest such variance.





- Bankers in several countries reported an increase in interest premiums, which was exceptional in the past because of high competition. In addition to the loan interest premium, the total cost of the credit is significantly affected by the interest rate level (EURIBOR), which is expected to grow because of inflation and increased uncertainty in Europe.
- The residential asset class became the most popular sector among the banks surveyed, closely followed by the industrial/logistics asset class.
- Bankers from all participating countries confirmed the growing importance of sustainable financing. A key driver of this trend was the alignment of EU legislation (including taxonomy) with company strategy, among parent companies and then individual banks.
- Over 68% of the bankers surveyed said that their institution has incorporated ESG criteria into real estate loan evaluations, with roughly the same number of bankers mentioning the collection of new data and the introduction of related internal reporting and monitoring.
- 65% of bankers confirmed having a bank-wide ESG strategy for real estate financing, with Czech, Hungarian, and Polish banks ranking above this figure. However, more than half of banks in Croatia and Romania surveyed have no ESG strategy for the sector.
- Over 75% of the banks surveyed that already have ESG evaluation criteria in place use external certificates such as BREEAM, LEED, WELL or GRESB to assess a building's sustainability, with a similar number of banks using their own special ESG questionnaire.
- Failure to meet ESG criteria requirements can be a reason for loan rejection – 7% of respondents from banks with existing internal ESG criteria confirmed that they had observed such cases, with a further 26% having seen loans refused because of failure to meet several different conditions, with ESG criteria being among them.
- More than half of the bankers surveyed confirmed their banks have either created or are working on introducing special products aimed at sustainable financing. Doing so allows them to offer lower interest margins, longer maturity, or lower amortization to projects that meet ESG criteria. However, there is limited practical experience in terms of actually providing these products.

07

# Country Insights & Contacts



The real estate market in Albania has been steadily growing over the past decade and is perceived as a safe haven by conservative local investors. The redevelopment plan after the 2019 earthquake is still ongoing with many projects still in construction phase due to COVID-19 market shocks and delays.

The conflict in Ukraine appears to have a less severe effect on the Albanian economy due to low gas dependency. The inflation rate in Albania is increasing although lagging behind the European average, which could further fuel the bullish mood on the real estate market and even attract foreign investments to the sector. Meanwhile, banks remain open to finance real estate projects and maintain their focus on residential property financing.



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In 2021, the post-COVID recovery of the market in Bulgaria was highlighted by increasing prices of building materials, increasing purchasing power, and availability of banking financing. In 2022, with the inflation rate well into double digits and increasing interest rates, the same factors are changing banks' openness to provide financing, as increasing construction material prices may impede investors' ability to complete their pipeline of construction projects, while decreasing purchasing power and increasing interest rates are hindering the potential sale of the finished stock of properties.

The upward trends in the logistics, energy, and technology sectors seem to be providing stability to office and commercial property prices, while residential property prices could experience a downward correction in the short- to mid-term. With ESG being embedded more deeply into the operations of the major international banks present in Bulgaria, it is expected that its influence will continue to shape the agenda on the real estate market and developments.



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With Croatia joining the Euro zone as well as the Schengen area from 1 January 2023, investors are expected to foster interest in Croatian real estate, with the price of commercial and residential real estate expected to (further) increase. Albeit, other developments, including interest rates, purchasing power, and certain political risks at the EU level will also impact the demand for real estate i.e., transaction volume.



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While Q1-Q2 2022 showed strong investment volumes, in Q3 2022 there was a significant decline and investors are waiting for further development.

The overall current economic situation associated with double-digit inflation, the growth of interest costs, the decline in the performance of the economy and, above all, significant uncertainty has the greatest impact on new development projects and, with the exception of logistics projects, very often their start or realisation is postponed. Uncertainty is primarily connected to the question of the duration of the current conflict in Ukraine. The interest of domestic banks in financing projects with real estate is still very strong, with the fact that the current situation forces them to increase interest margins and work more on a selective basis when providing new loans. The majority of Czech bankers interviewed are not considering the introduction of a special product aimed at sustainable financing (for example, associated with a lower interest margin) and consider the fulfillment of ESG criteria to be one of the basic conditions for granting a loan at all.



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The Hungarian market has been characterized by a strong boom in residential developments up to Q2 2022. Due to a special allowance of only 5% VAT instead of the regular 27%, developers could cope with the radical increase of construction costs, while bank finance was available for them and mortgage financing for the buyers as well. The average unit price of new stock showed a 14.5% increase compared to Q1 of the previous year. Global and regional economic changes have dramatically influenced market supply and demand since Q3 2022. Considering all current trends and the constraints in the global supply-chain and exploding energy prices makes the prospects for real estate financing and property lending currently unpredictable.

Hungarian banks are keen to comply with the relevant ESG EU regulations and Taxonomy. The Hungarian National Bank introduced new regulations and financial instruments to help green financing. The main driver for banks today is still the availability of low-cost financing opportunities for ESG compliant green projects and the green rehabilitation of existing housing stock. According to our recent survey, ESG – in relation to real estate finance – is understood mainly as a green building compliance issue with less attention paid to the letters “S” or “G”. Due to recent changes, we may assume that the letter “E” is not an abbreviation for environment but rather for ENERGY.



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The post-COVID real estate market in North Macedonia has experienced growth in development activity, resulting mainly from the expectations for a positive economic outlook and an increase in demand. The investment market shows positive signals for the upcoming period, with more dynamic development activity in the office market expected in Skopje, the capital of the country. Residential remains a preferred asset class of both banks and developers. Residential prices increased by more than 15% over the last 12 months, directly affected by the increase in the prices of construction materials, as well as the increase in the cost of labor. However, the demand for residential premises remains strong, supported by housing loans.

Limited ESG initiatives have been implemented by the local banks regarding real estate financing, though changes are expected to be introduced in the near future.



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The real estate market in Poland is currently focused mostly on logistic assets. Investors are also interested in office and PRS (Private Rented Sector) projects. Although the current market turbulences have caused the real estate sector in Poland to slow down a bit in respect to the number of transactions, the Polish real estate sector remains a strong and stable place for investment.

Following our discussions, the major focus of banks appears to be on the financing of logistic and office projects. We also understand that banks are cautious in terms of the granting of financing due to the macroeconomic situation and believe that ESG importance is bound to grow over the coming years.



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Romanian real-estate is expected to continue its growth in 2023, despite growing inflation and limitations on the applicability of the reduced VAT rate in the residential area, predicted to impact the market next year. Ongoing projects and a declining vacancy rate, especially in the large cities, offset rising development costs, and trust is reinforced by the growth rates for the Romanian economy projected by the European Commission at 4.5% in 2023.

The local real estate market is expected to adapt to the "new reality", with a focus on flexible and mixed office and residential spaces, in-city logistics and a more prominent build-to-rent niche. One of the challenges in real-estate is the integration of ESG in projects at all stages, as clear strategies and implementation plans for these objective become both a legal requirement and a priority for clients, especially for institutional entities.



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Despite the current inflationary environment, the retail real estate sector in Serbia is picking up and reaching the pre-covid level. Office demand is increasing mainly due to the expansion of the IT sector resulting in the very low vacancy rates. Prices in residential real estate continue to go up.

In the future development in the real estate sector will be achieved with greater emphases on sustainability and ESG indicators. ESG has gained increasing significance for banks over the years as they need to show their commitment to sustainable business. With the increased attention from regulators and the community, banks in Serbia continue to include and prioritize ESG considerations in their strategy.



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The market has been slightly cautious in recent years when it comes to office premises. Uncertainties caused by the Covid-19 pandemic have somewhat passed. It seems that "full scope" home office work is not suitable for all businesses and high quality offices will have their place on the market. On the other hand, the dynamics on the Bratislava market is slightly different than on other neighbouring markets due to a lower proportion of "headquarters" tenants and is more at risk.

Due to market conditions, it can be expected that margins will increase. The banks will also focus more on project risks and cash flows, including how the developers are hedged. Another increasing focus is ESG. Once their contracts expire, large-scale tenants are looking for premises that also meet high sustainability standards. Increasing energy prices also underline the demand for energy efficient buildings. The same focus on sustainability, however, still cannot be observed on the residential buildings market, which is significantly driven by demand that is higher than supply.



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