

Banks Suspend Funding. What is the Key to Success in the Talks with the Lender?

Global financial crisis began in the third quarter of 2008 had an impact in terms of financing on Polish commercial properties market. Nowadays, due to the difficulties in raising money in the interbank market, and while awaiting the financial results for the IV quarter of 2008 some financial institutions have announced that their credit activity will be unfrozen after the second quarter of 2009 in the earliest. Other financial institutions significantly exacerbated lending criteria. The question arises what changes this limited credit activity will bring on the commercial property market. Do investors/developers have the chance to secure financing for their developments from banks, now? What terms of financing are required by the banks? In response to these questions it can be stated that banks currently use a more selective approach to projects and borrowers. The process of obtaining financing may be extended up to about 6 months, and the key to success is buying an under-rented property or in case of developments, with a high level of so-called pre-let, so the level of leased area before the start of a construction process.

Financing Terms – Prosperity Period vs Present Situation

urbulence in the financial markets have forced banks to tighten up lending criteria. At present, a higher level of equity is required, and thus a lower share of a loan in the total development costs (called LTC, Loan To Costs Index). It has also been raised the minimum required level of pre-let and margin, and reduced the maximum amortization period of the loan. In addition, due to the introduced by the banks rules of secured loan policy, it has also been increased the minimum required rate of debt service (called DSCR / ISCR, Debt Service Coverage Ratio, Interest Service Coverage Ratio), expressed as the ratio of cash flow from rental income to the installment of total amount of interest and principal or only interest. A more detailed comparison of current terms of the financing to those from prosperity period have been presented in the table below:

	<u>PROSPERITY</u>	<u>PRESENT</u>	
LTC	up to 85%	up to 65%	↓
MARGIN	1,5% - 2,0%	2,5% - 4,0%	↑
PRE-LET	5% - 10%	30% - 40%	↑
DSCR / ISCR	1,15	1,20 – 1,25	↑

Source: CPRF

Developments Desirable by Banks

In 2009 banks will use a more selective approach to projects and avoid investors/developers with no experience. Which transactions will be preferred by banks? Banks will finance mainly projects:

- fulfilling a condition of maximum level of LTC up to 65%;
- well-located, preferably in the city center;
- developed and prepared by experienced investors;
- safe through the high level of pre-let before construction begins;
- existing, new or renovated properties which generate income (DSCR > 1.20), undervalued, however with a substantial potential of value increase by:

- possible growth of rental income in the future; and/or
- possibility of renegotiating the lease agreements; and/or
- potential possibility of tenants exchange for those generating and ensuring higher and stable rental income; and/or
- possibility of introducing to the lease agreements a clause on rents indexation and other lease terms increasing the stability of income in time; and/or
- possibility of reducing operating costs including the costs of ownership, maintenance and use of property or the introduction of the full reconciliation of above mentioned costs; and/or
- possibility of introduction other tools stabilizing rental income.

Summary

In conclusion, the tightening of lending criteria will contribute significantly to changes in the real estate market in Poland. There will be probably observed, inter alia, the following trends:

- investors will alter the projects from residential schemes to office developments in short term;
- investors will postpone the commencement of projects;
- the emergence of new funds and real estate investors/developers debutants will be limited;
- the number of investment transactions will be reduced;
- the expansion of domestic and foreign companies will be limited, therefore the amount of potential tenants will be lower and prolonged decisions of companies as to the lease;

We are convinced that some financial institutions may limit the policy of credit up to the end of the first quarter of 2010. Fortunately, not all banks turned the tap with money. It should be noted that at the moment there are banks providing financing, although it is dependent on the fulfillment of more stringent criteria. We believe that banks will be forced in the near future to loosening of lending activity as it is their main source of income.

In conclusion, it should be stressed that the timing and process of finance raising for the time being is considerably prolonging, that is why we recommend an initiation of appropriate action at the stage of waiting for a building permit. In addition, a very important factor in the negotiations with the bank currently is, and will be a purchase of the undervalued property with a great potential for growth or high level of pre-let.

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