

Is This Thaw on the Commercial Real Estate Financing Market? Characteristics of the Main Conditions and Collaterals Required by the Banks.

As a result of turbulences in world financial markets, deteriorating macroeconomic indicators and a slowdown on the commercial property leasing market in Poland, the vast majority of financial institutions decided to suspend their credit policy, even till the end of 2009. Fortunately, not all banks turned the tap with money. Since the beginning of the year we have had a chance to observe commercial real estate financing transactions, which can be a sign of slow stabilization of the market. The banks prefer existing developments generating income, while financing new projects to a small extent, the so-called speculative, without an appropriate level of leased area prior to the first drawdown of a credit. The question arises as to what chances do investors / developers have to obtain finance for the construction? What collaterals and conditions have to be fulfilled prior to the first tranche of a loan? In response to these questions it can be stated that the banks now require the involvement of equity at a minimum of 35% and signed lease agreements for a minimum of 50% of a building leasing area. In addition, before releasing the first tranche of a loan the borrower should obtain a positive opinion in the due diligence reports (legal, technical) and to establish certain collaterals for a financial institution.

Transaction of Finance Raised by the Developers / Investors in Poland in the First Half of 2009.

During the first half of this year we observed transactions of funds raised by experienced developers for large and medium-sized developments, a well-prepared and safe through the high level of pre-lease.

The most important transactions of obtaining loans from financial institutions are shown below:

PROJECT NAME	DEVELOPER / INVESTOR	AMOUNT OF LOAN	PURPOSE
Galeria Jastrzębie	Polimeni International	18 mln EUR	Construction Loan
Saski Crescent	Europolis	80 mln EUR	Refinancing Loans
Europolis Park Błonie, Phase I			
Platinum Business Park – Phase III	Globe Trade Center	20 mln EUR	Construction Loan
Park Postępu	Echo Investment	50 mln EUR	Refinancing Loan
Malta Office Park	Echo Investment	32 mln EUR	Refinancing and Construction Loan
Crown Square	Ghelamco	60 mln EUR	Construction Loans
Katowice Business Point			

Source: CPRF

Financing Conditions

Due to market changes some financial institutions have been providing loans for construction, however they are dependent on a fulfillment of more stringent criteria. Currently it is required equity at a minimum level of 35%, and thus the share of credit in the total cost of a development (called LTC index, Loan To Costs) may reach a level of no higher than 65%. It was also raised the minimum required level of pre-let and margin. In addition, due to the introduced by the banks rules of secured loan policy, it was increased the minimum required rate of a debt

service index (called DSCR / ISCR, Debt Service Coverage Ratio, Interest Service Coverage Ratio), expressed as the ratio of a cash flow from a rental income to the installment of total amount of interest and principal or only interest.

A more detailed comparison of current conditions of the financing to the period of property market prosperity is show below:

	PROPERTY MARKET PROSPERITY TERM	PRESENT TIME	
LTC	up to 85%	up to 65%	↓
MARGIN	1,5% - 2,0%	3,75% - 5,0%	↑
PRE-LET	5% - 10%	50% - 60%	↑
DSCR / ISCR	1,15	1,25	↑

Source: CPRF

Positive Opinion in Due Diligence Reports and Collaterals for the Financing Institutions.

Before signing the loan agreement and meeting conditions required for the equity, debt coverage and the leased space the developer / investor is required to obtain a favorable opinion in due diligence reports. In the legal and technical report, which are prepared by independent third parties, there are verified issues, inter alia:

- Land purchase agreement and property titles;
- SPV structure with particular focus on management agreement concluded between SPV shareholders;
- Borrower Equity;
- Financial statements / information about borrower's financial situation and its shareholders;
- Shareholder loan agreement of and their subordination;
- Legal state of the property, issued decisions, permits;
- Property valuation prepared according to TEGoVA / RICS standards by independent property appraiser,
- Loan to property market value index (called LTV, loan to value);
- Loan to the total development costs index (called LTC, Loan To Costs);
- Debt service coverage index (DSCR, Debt Service Coverage Ratio);
- Total cost of the development reviewed by banking inspector;
- Agreements with general contractor and subcontractors;
- Financial statements and track records of general contractor and subcontractors;
- History and current status of borrower's settlement with tax and social security offices;
- Environmental reports - if applicable;
- Signed lease agreements and lease agreement template;
- Financial situation of tenants leasing more than 20% of building leasing area or generating more than 20% of development's revenue;
- Projected budget of property operating costs involving non-reconciled costs;
- Property management contract and property manager experience;
- Contracts relating to the SPV and other which the borrower is a party in.

In addition, the financial institutions require from borrowers establishing, inter alia, the following collaterals:

- The first mortgage on the property (e.g. in the amount of twice of VAT credit and loan);
- The pledge over shares registered in the borrower SPV;

- The pledge of bank accounts registered to the borrower (all accounts will be carried out in the bank of the lender);
- Transfer of receivables in respect of the lease agreements, management contracts as well as general contractor agreement, insurance, and any revenue generated by the property;
- Bank guarantee in the event of cost overruns amounting to 5% of the total cost of the development, in content and form acceptable to a lender;
- Bank guarantee servicing of interest (amounting to twice of annual interest handling). The guarantee will be released by providing - on the basis of a signed lease agreement - the DSCR of not less than for instance of 1.25;
- Lock on the borrower's bank accounts;
- Proxy to all bank accounts of the borrower;
- Subordination agreement concluded with shareholder of the borrower;
- A statement to submit to execution.

Conclusions

Due to the turbulence on the financial markets, banks have changed their financing policy substantially. Nowadays they require much higher level of equity and in case of construction loans, pre-lease at the level of 50% of the total leasing area. As a result of the introduction of more stringent criteria the commencement of a great number of commercial developments has been suspended. A significant number of the developments is likely to be redesigned and divided into more phases. In addition, due to the high cost of financing it is expected that a number of developments will be carried out by investors' equity and then refinanced during a building operation.

We believe that given the favorable macro-economic signals concerning Polish economy, among others increasing the GDP rate and a retail sale level, will make banks be more willing to loosening of their lending activity this and in subsequent years.

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