

Financial Crisis in Residential Development



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Foreword

We are pleased to provide you with a joint study conducted by Deloitte and Hyposervis entitled "Financial Crisis in Residential Development".

Over the past few months, financial markets have been undergoing a significant slowdown resulting from the spillover of the U.S. mortgage crisis to Europe and the subsequent ever-intensifying decline in demand in a major part of the world's economy. In many markets this development has dramatically affected the prices, liquidity and the financial situation of key market participants.

One of the sectors that has been impacted most severely by the crisis is residential development. After years of dynamic expansion, residential development experienced sudden, significant changes in its key market practices and general rules. The result is a situation where the possibilities, as well as expectations, of the individual market participants – developers, financing banks, real-estate brokers and clients – substantially differ from each other, which ultimately threatens not only the functioning of the market but also the capabilities of its players to cope with the new situation.

For the study, which was prepared between October 2008 and February 2009, we conducted a detailed analysis of both external and internal drivers affecting the development of the residential market in the Czech Republic. We also mapped the responses and attitudes of selected developers, construction companies and financial institutions regarding the development of the residential market as a result of the financial crisis and concerning potential scenarios of further development.

The study was prepared by a joint team of experts from Deloitte and Hyposervis who specialise in mortgage and real-estate market development. This approach not only contributed to a comprehensive coverage of the key market players but also to professional mapping of all aspects affecting the current and future development in this field.

The goal of this study was to offer independent, objective and comprehensive information on the current state of the business environment in residential development and on future expected developments including the possible impact on the general public:

- Developers will gain information on the current willingness and limitations of banks; under what conditions and to whom they will grant loans;
- Financial institutions will gain perspective on the current situation as well as information on developer and end client expectations; and
- Real-estate agents and construction companies will gain an overview of the key changes that substantially affect supply and demand in the residential development market.

We would like to thank all the companies that participated in the survey and in its preparation for their helpfulness and co-operation.

Together with future development scenarios, this study should enable companies active in the field to benchmark their current situation and practices with the prevailing opinions of market players and the current state of the residential market, thereby allowing them to more easily identify risks and opportunities to improve and strengthen their own market position.

Deloitte Advisory

Hyposervis

March 2009

1. Real Estate Markets in a Turbulent Time

- **Fluctuation of real estate prices is a periodically occurring phenomenon in developed countries.**
- **Real estate prices need several years to return to a sustainable level.**
- **The bursting of the real estate bubble has extraordinarily depressive effects on the confidence of businesses and small investors in the economy.**
- **Public stimulus is necessary to overcome the crisis.**
- **Inconsistent media reports and unprofessional commentaries fuel the crisis, causing chronic undermining of the public's confidence.**

The current situation in the world's markets, which is sometimes described as the deepest economic crisis since the 1930s, has been significantly affecting expert's discussions in recent months. For Czech society, this situation is even more serious because it is the first crisis of such size since the political and social transformation in the early 1990s with an impact on a large percentage of the population. The economic recession of 1997 and 1998 did not have such an extensive impact on the general public, partly thanks to the low indebtedness of households at that time. Today, however, the situation is different – households began to get into debt having faith in the continuous positive development of the country's economy, particularly in connection with purchasing homes.

Experience in the development of real estate markets in a number of countries in the last 30 years shows that periodic fluctuation of real estate prices is a natural phenomenon in developed countries. The current residential market slowdown has its precedent in the past crises, based on which it is possible to predict the expectations of the impact of the current crisis. Economic crises have much in common; they are often preceded by almost irrational faith in continuous growth and prosperity, for which rational reasons are sought. This was the case, for example, of the Internet bubble where the never-ending potential of technology was talked up. Japan's real estate boom in the 1980s was justified by the lack of land and the remarkable capability and strength of the economy.

A boom is usually reinforced by low interest rates and financial innovations, which multiply the returns on investments. For example the U.K. and the United States have recently seen exceptionally low interest rates combined with a growing supply of credit products available to increasingly broader segments of the population. Massive use of securitisation allowed banks to virtually free themselves from depositors and get long-term cheap re-financing on the inter-bank market. The creativity of the market in the form of complex financial derivatives based on, among others, repackaged mortgage loans has helped to transfer the risk from banks further to the market, which resulted in a lowering of the risk perception threshold in a number of financial institutions. This, in combination with the aim to maximise participation on the growth of the market, has ultimately led to a rapid increase in mortgage loans availability – but at the expense of a significant loosening of credit granting rules.

A real estate market boom usually leads to underestimation of risks and to a linear model of thinking where stable and permanent growth of prices and performance indicators such as revenues are expected. The mutually strengthening relationship between the growing real estate prices and ever more available loans is usually quickly reversed. Owners of overvalued properties (customers, developers or financial institutions) experience collapse of their balance sheets when the prices significantly drop. The decreased value of pledged real estate reduces the capacity of the private sector to incur new debt. Confidence significantly declines as soon as the price of the assets, particularly real estate, drops. Customers and companies are forced to de-leverage, which has led to forced divestments, which contribute to continued pressure on the reduction of the prices of assets, including real estate. One of the most valid lessons from the past crises says that even in highly liquid markets it is necessary to wait till the values return to their initial level; in the meantime the value of assets decrease.

Source: BCA Research, Deloitte Research study: Global Economic Outlook, 4th Q. 2008

	Finland 1991 - 94	Japan 1991 - 02	Norway 1987 - 93	Sweden 1991	USA – S&L crisis (small banks)	USA Current development
% change in real estate prices (net of inflation)						
Residential	-49%	-65%	-42%	-26%	+20%	-19%
Commercial		-81%		-59%	-44%	
% change of the value of assets						
Market	-70%	-66%	-45%	-46%	-18%	-23%
Financial	-92%	-71%	-83%	-80%	-44%	-44%
Total bank losses or fiscal/ recapitalisation costs (% GDP)	11%	24%	8%	4%	3%	4.3%, so far \$ 560 billion

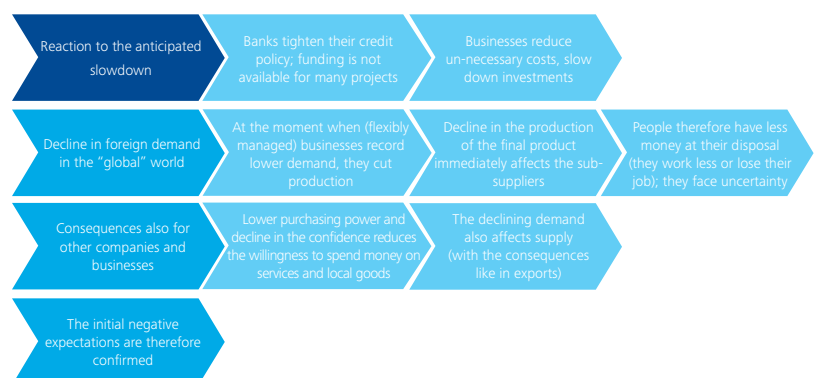
The financial crisis started more than one year ago with problems in the U.S. real estate market. The financial system was in acute jeopardy after the collapse of U.S. investment banks and AIG in September 2008. The fact that, in the case of Lehman Brothers, the ones who lost money were also debt owners has led to a fatal increase in distrust and threat to many institutions. In the course of several weeks the crisis spilled across the Atlantic Ocean and destabilised Europe’s banking sector. In retrospect, the strenuous adoption of the American government plan (in the pre-election period) seems more effective than the initial actions of EU politicians, although the massive (and gradually also more sophisticated) interventions stabilised the markets and eliminated the distrust to a certain extent. The problems, however, are not over because after the threat of financial crisis (which is not over yet) it is now time to combat the threat of global recession. In their efforts to mitigate its impact governments adopt additional costly packages, although these packages will not be able to compensate for the decline in private consumption and investments.

1.1 Economic Development in the European Context

The economic slowdown will affect virtually the entire industrialised world. Europe may even be more affected by the current negative development of the economies in connection with the effects of the “financial” crisis than the U.S. One of the reasons is the fact that the European Union’s financial sector is greatly exposed to risk assets. In general, European markets are less efficient and flexible. The political reality of the European Union complicates the decision-making process.

The robust and costly actions of the individual European countries’ governments will sooner or later stabilise the financial markets (there is no other option) but the key factor is the impact of the crisis on the real economy. Costly government actions cannot compensate for the effects of decreased private consumption on the economy.

The European Union is one of the largest export economies, on which the global slowdown will have a very significant impact. Domestic consumption is affected by consumer confidence – which has been low for a long time in the European Union. There is currently a risk of it further decreasing. Access to capital will be reduced on a global level, funding will be more expensive, risk-margins will grow significantly and only then will they return to the “standard level”.



The assumption that the Czech Republic would be little affected by the current crisis was wrong, primarily for the following reasons:

- Interconnection of the Czech economy with the economy of the European Union;
- Large percentage of exports in GDP, in a sensitive sector; and
- The general public is influenced by the negative information just as in other markets.

The Czech Republic's economy has already experienced a similar slowdown – at the end of 1990s. At that time, however, this slowdown was of a structural nature to a great extent. The current development is a new phenomenon for the Czech Republic, particularly due to the openness of its economy. In spite of the government's efforts to deal with the situation, only small effects can be achieved in small countries due to the global nature of the recession. An important element for overcoming the crisis is to maintain macro-economic stability and focus on "minimising the losses".

The Czech Republic's economy, just like the economy of the whole European Union, is undergoing a severe "growth slowdown". A significant slowdown in global growth will be reflected in a decline in demand for Czech exports (slowing down of investments). Another phenomenon that is now more prevalent is the more difficult access to bank loans (while the need for bank loans is growing) and the risk of a significant decline in consumer confidence. The situation is also complicated by last year's appreciation of the Czech crown and its current high volatility.

The financial crisis significantly affects the final consumption of households, which always grows relatively slowly in spite of rapid and balanced growth of the economy. In the following period, consumption may be encouraged by the decreasing prices of some commodities (e.g., crude oil), but in some commodities lower prices may also result in subsequent lower demand. The disposable income of the population may be affected not only by the decreasing employment rate but also by the growing cost of money (and decreasing competition).

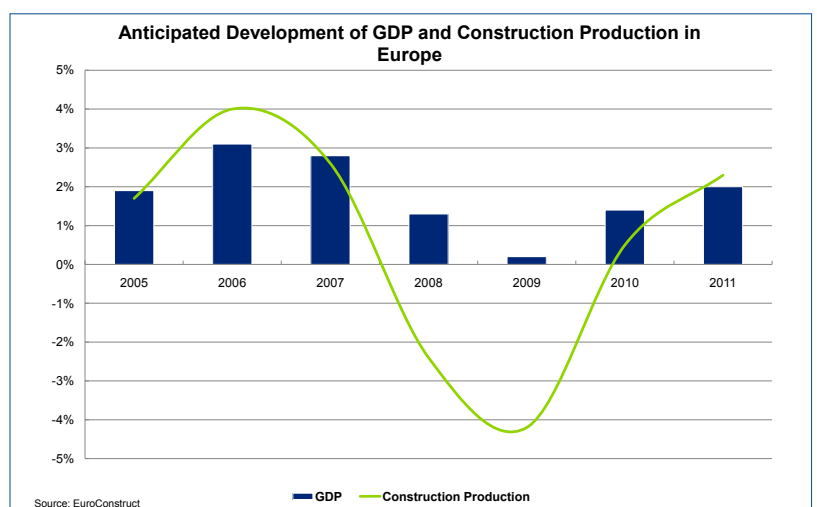
The result of the current situation, after the financial markets have stabilised, may be a significant slowdown of global growth, more difficult access to bank loans, the occurrence of similar problems in the capital market, and the risk of a substantial decline in consumer confidence.

1.2 Building Construction and the Residential Market in the Context of the Current Development

Building construction and capital construction projects are one of the pillars of the entire European economy with a significant multiplication effect to other industry sectors. They reflect the expectations of national economies development and are closely linked with the individual countries' GDP, but the amplitude of development in the event of a variation usually shows with greater force.

The unfavourable development of the recent months shows the impact of the global "financial" crisis on the construction segment, particularly on building construction. This trend is expected to continue for at least the first half of 2009.

Individual European countries try to mitigate the recession in the construction industry by investments from public funds, in particular investments in the development of infrastructure. Construction companies will therefore have to focus more on public contracts, which could ultimately lead to the reduction in prices of construction contracts, but secondarily it will lead to a decrease in the financial volume of construction production.



It is estimated that Europe's construction industry will start recovering in the period of 2010 and 2011. It is not expected, however, that all fields of the construction industry will develop in the same way; the first field to recover will probably be the area of renovations and non-residential buildings, and the last one the area of residential buildings.

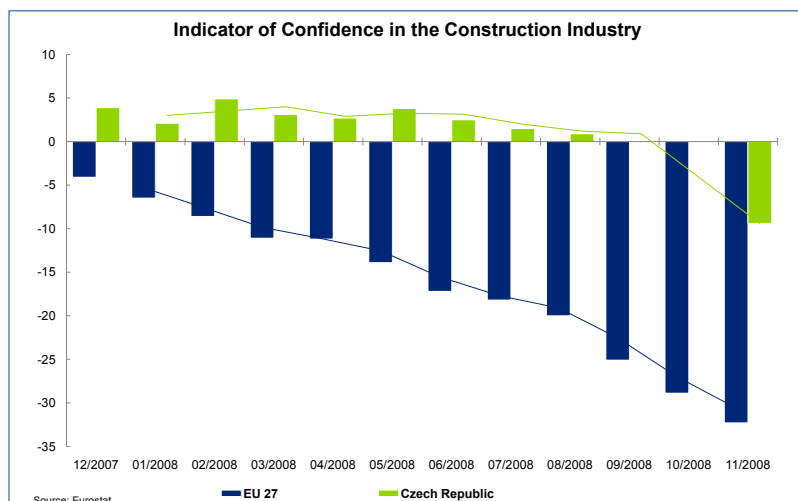
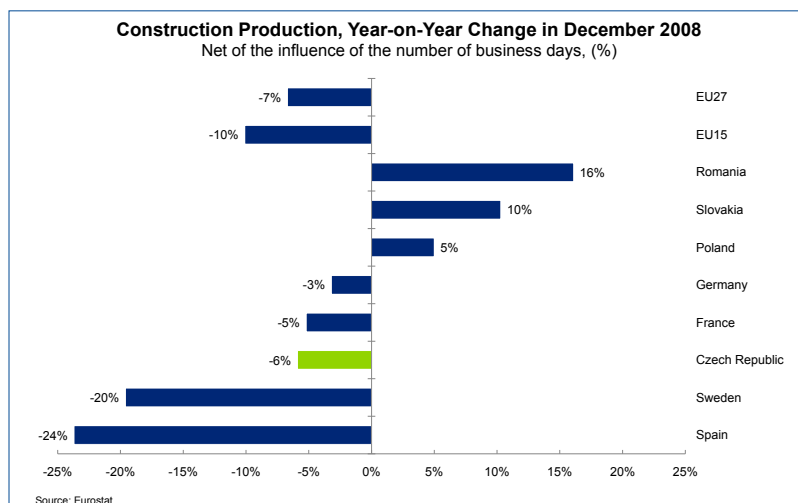
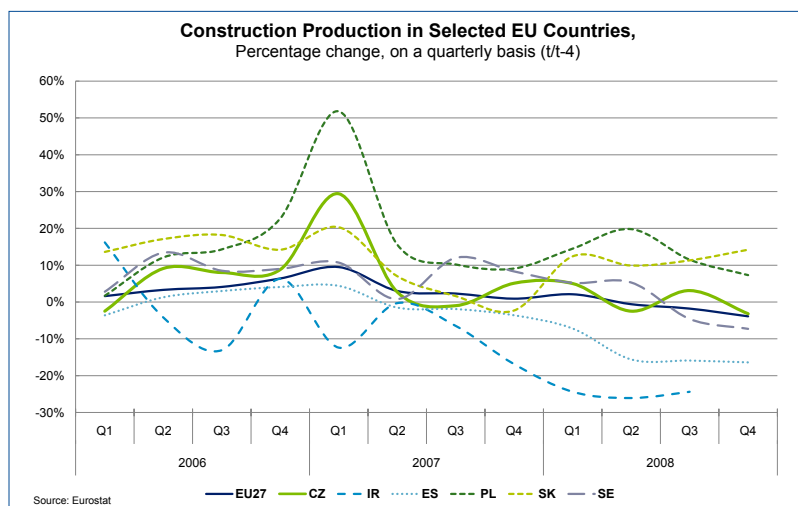
Toward the end of 2008, construction production in the countries of the European Union decreased by 4.2 percent on a year-on-year basis, of which building construction decreased by 4.6 percent and engineering construction decreased by 2.5 percent.

Of the European Union member states, the total value of construction production in 2008 increased the most in Slovakia (by 16.5 percent), in Romania (by 13.8 percent) and in Poland (by 7.0 percent). On the other hand, the greatest decline of construction production in 2008 was seen in Spain and Slovenia (by 9.7 percent and 8.2 percent, respectively).

Within the entire European Union the constant decline of the indicator of confidence in the construction industry has been almost linear since December 2007. In the Czech Republic, optimistic expectations in construction prevailed until May 2008 when the confidence indicator started dropping rapidly in connection with the occurring events, the negative expectations and international influence.

As a result of the impact of the "financial" crisis, the following is occurring in the field of building construction and capital construction projects on a global level:

- Limited availability of financing for construction and development projects;
- Freezing/ postponing of investment activities;
- Slowed down demand of consumers and businesses;
- Increased negative expectations regarding the future development both among clients and among entrepreneurial subjects;
- Speculative activities by clients (speculation concerning the drop in prices of real-estate or drop in interest rates of mortgage loans);
- Drop in prices of most residential properties;
- More restrictive conditions for granting loans;
- Increase in risk margins on loans; and
- Start of waiting tactics of the vendors of residential properties – decreased supply.



Macro-economic development, investment activity in the economy, contracts of construction companies, and building permits issued are important trends indicators in the demand for residential development and construction production.

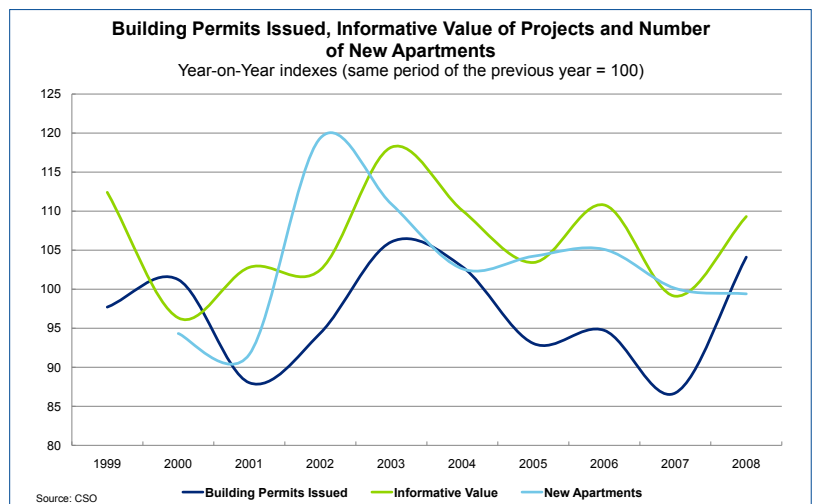
Development of the above-mentioned indicators in the last 10 years replicates the development of general construction production in the Czech Republic. Year-on-year fluctuation with a declining trend has been evident since 2004. In 2007 the index of building permits issued and informative values of properties reached its five-year minimum. This was caused mainly by the significant concentration of a majority of construction companies on the completion of residential properties in that year as a result of the planned increase in the VAT rate. More building permits were issued in 2008 on a year-on-year basis, and the informative value of the properties built increased as well. The number of new residential units stagnated in 2008.

The following occurred in 2008 after several years of mostly linear growth:

- A decline in residential development as a result of partial saturation of the demand for owned dwellings;
- A “freezing” of the development market as a result of changing the approach of the financing parties and stabilising the situation concerning the increased VAT rate;
- A general decline in building construction;
- A growth in engineering construction;
- Higher year-on-year growth of repairs and maintenance; and
- Severe deterioration of the payment morale.

The average headcount in the construction industry has been decreasing since 2005 while the average gross monthly wage continues to grow by 5-10 percent.

Prices of construction work, in spite of the impact of the “financial” crisis, grew constantly also in the last months of 2008 (they reached the maximum in summer 2008).



1.3 Impact of the Current Situation on European Residential Markets

Since the second half of 2008, most European residential and real-estate markets have started to experience the negative effects more significantly in the form of increased lack of demand by buyers, representing a substantial drop in the demand for owned dwellings, and particularly a substantial drop in the prices of most properties. The main negative effects on residential markets in the European Union, and thus the prices of properties, include, but are not limited to:

- The decrease in disposable income (particularly due to growing unemployment);
- Banks' unwillingness to lend money – decreased availability of loans;
- More restrictive and worse conditions for granting loans;
- Concerns about the future development of the residential and real-estate market;
- Fears of losing a job;
- Uncertainty regarding the ability to repay loans;
- Decreased demand for owned dwellings – lower interest in construction/development;
- Slowdown of the construction industry; and
- Slowdown of the national economy.

The European residential market is also significantly influenced by the development of the real-estate market in the United States where the greatest drop in sales of private homes ever was recorded in January 2009. Sales of homes dropped on a year-on-year basis by more than 10 percent, which represents a drop by 309 thousand dwellings in a year. Along with the constant drop in demand, the prices of properties also keep falling (currently at a five-year low). The average sales price of new homes fell by 13.5 percent on a year-on-year basis.

Like in the United States, negative expectations currently prevail in Europe. Although the prices of properties have fallen or starting gradually falling people are not willing to buy. A substantial factor affecting the residential market is also the waiting tactics of the buyers who expect an even greater drop in prices.

Residential markets have slowed down in almost all countries of the European Union. Prices of residential properties recorded a significant drop in 2008 and in early 2009 for example in Spain, the U.K., Ireland, Poland, and in Slovakia. In all these countries the construction industry and residential development saw a significant decline in 2008 and in early 2009.

The trend of negative development of the prices of residential properties, however, does not affect most European countries in the segment of luxury apartments and above-average apartments in the most attractive locations of the world's major cities. Unlike the other segments, this segment of dwellings saw an increase in prices in some locations in the 3rd quarter 2008 and in early 2009.

USA	
Current problem:	People's inability to repay mortgage loans
Previous problem:	Rapid increase in defaults of subprime mortgages due to re-setting of rates, subsequent drop in the prices of properties, stagnation of the mortgage market, liquidity crisis, bank failures
Initial problem:	Excess of supply – "forcing" mortgage loans on subprime clients, unsuitable products with zero equity, extreme loosening of loan credit granting policies and distribution practices
Ireland	
Current problem:	People's inability to repay mortgage loans
Previous problem:	Drop in the real-estate prices, stagnation of the mortgage market, liquidity crisis, bank failures
Initial problem:	Excess of supply – products with zero equity, negative balance of deposits vs. loans, overheated real-estate market
Spain	
Current problem:	People's inability to repay mortgage loans, decline in the construction industry
Previous problem:	Drop in the real-estate prices as a result of the departure of foreign investment clients, ceasing the 'buy to let' sales, stagnation of the mortgage market
Initial problem:	The market based not on domestic demand only but to a large extent on non-residents. Excess of supply – high percentage of investment purchases by non-residents – holiday (2nd property) clients from the U.K.
Czech Republic	
Current problem:	Disappearing signs of a liquidity crisis, speculative waiting for a drop in property prices and mortgage interest rates; falling demand for dwellings and the financing thereof
Previous problem:	Disproportional growth of supply and demand related to the date of increasing the VAT, jump-like increase in prices in 2007
Initial problem:	Administrative definition of a change in the market – VAT in 2007

2. Comparing the Current Situation in Europe with Similar Events in History

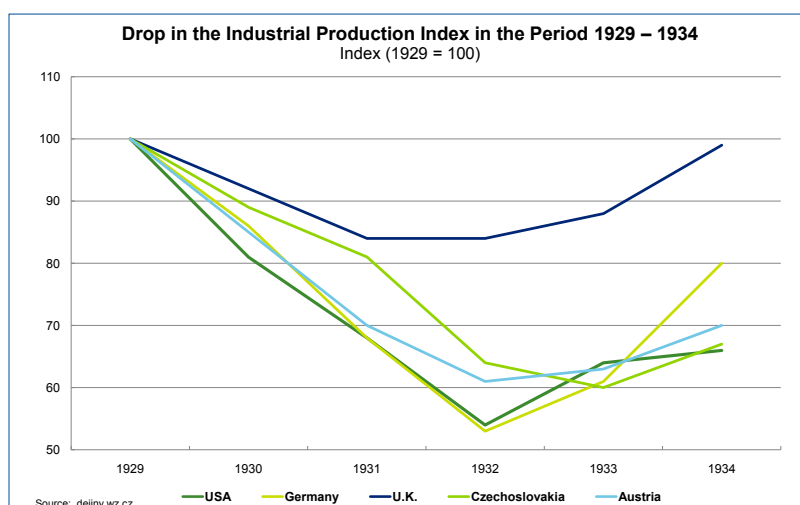
2.1 The Great Depression

The current “financial crisis” is sometimes compared to the Great Depression of 1929-1933, which foreshadowed important economic and political events throughout the world in the following decades. This situation provides room for comparison of the approach to solving the current crisis with that of the Great Depression of the 1930s.

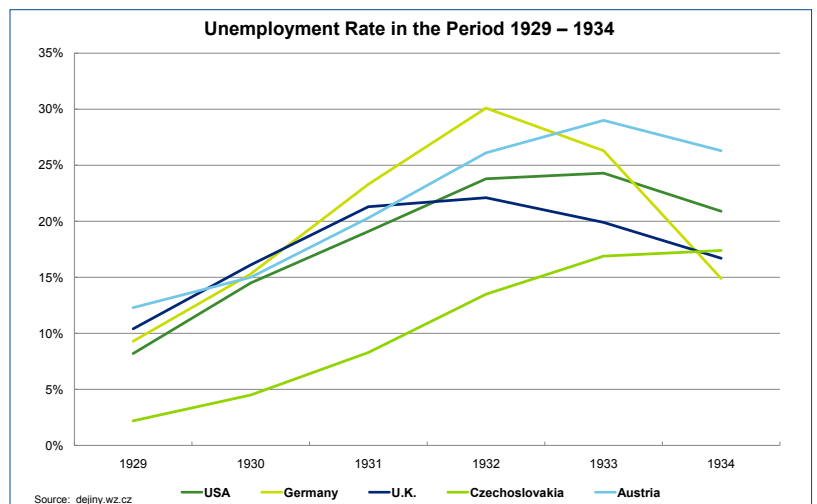
Common and Different Approaches to Solving the crisis today and in the 1930s		
	Approach in the 1930s	Approach today
Government’s approach	Waiting, relying on how the crisis will be dealt with abroad	Rather proactive approach, establishment of NERV and efforts to implement its proposals
Protectionism	Inclination to strong protectionism in the U.S. since mid 1930 and in the U.K. since 1932	Concerns about repeated global inclination to protectionism, which prevents the recovery of international trade and growth of prosperity
Exports	The Czech economy is strongly dependent on exports – in particular glass, textile, paper, and sugar	The Czech economy is strongly dependent on exports but in other segments – automobiles, electrical engineering
Banking sector	The banking sector saved by the government; the crisis came from Austria	Banks are healthy after the restructuring in the late 1990s, but risk aversion has increased
Currency	Devaluation of the Czech crown in 1934 and 1936	Some industries and the current opposition are demanding quick adoption of the Euro
Employment support	Massive, connected with electrification, residential development, arms production and construction of border defence fortification	The prevailing opinion is that mainly the market should deal with the crisis; although government intervention serves as a stabilisation factor

The significant decline of the real economy in the U.S. was preceded by the crash of the New York Stock Exchange. The crash was caused by the bursting of the great speculation bubble and excessively risky trading based on the so-called leverage effect, which was based on the confidence in the ever-growing market. The DJIA index grew by almost 300 percent in just five years, but then sharply fell. The return of the index to its maximum values of 1929 took an entire quarter of a century – until the mid-1950s.

The impact on the real U.S. economy was far-reaching, as documented by the GDP development chart – between 1929 and 1933 the drop in GDP was more than 40 percent. GDP in the U.S.A. only returned to the values of the late 1920s in the early 1940s.



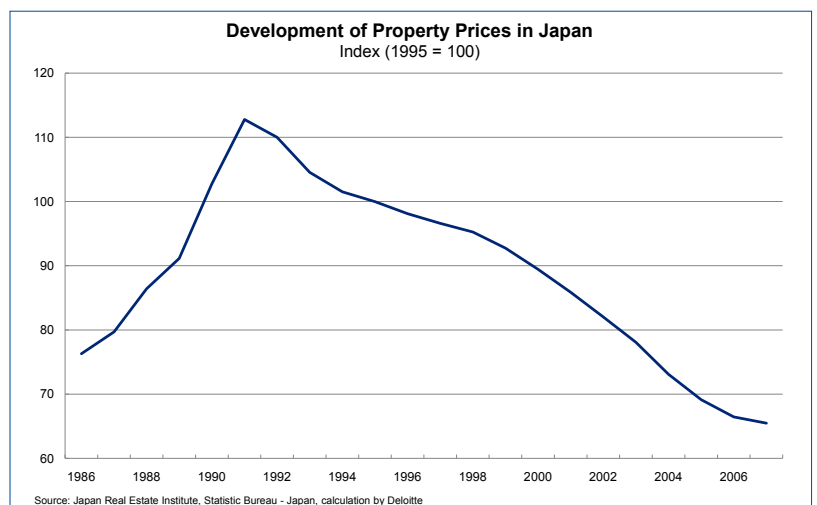
Although the markets were not very globalised, the impact of the Great Depression quickly spread across the Atlantic. The depression had the greatest impact in countries that were dependent on American capital. Many banks failed and currency systems collapsed. In Czechoslovakia, the industrial production fell rapidly – by 60 percent in the period between 1929 and 1933; unemployment rapidly grew to more than 17 percent in 1934. Global industrial production fell by 38 percent, international trade by 34 percent.



2.2 Japanese Real-Estate Crisis

An example of the impact of a market speculation bubble on the real economy can be seen in the “Japanese real-estate crisis”. Share prices and particularly real-estate prices sharply fell after rapid growth, which caused a slowdown of Japan’s economy for an entire decade (known as the “lost decade”). Bank shares fell by 78 percent in the period from 1990 to 2002, and banks got into trouble due to bad loans, which resulted in a dramatic reduction of the supply of loans.

In 1984 – 1990 real estate prices in Japan grew very rapidly. Inflated real estate prices caused the crowding-out of other expenses and contributed to the long-lasting recession in the 1990s.



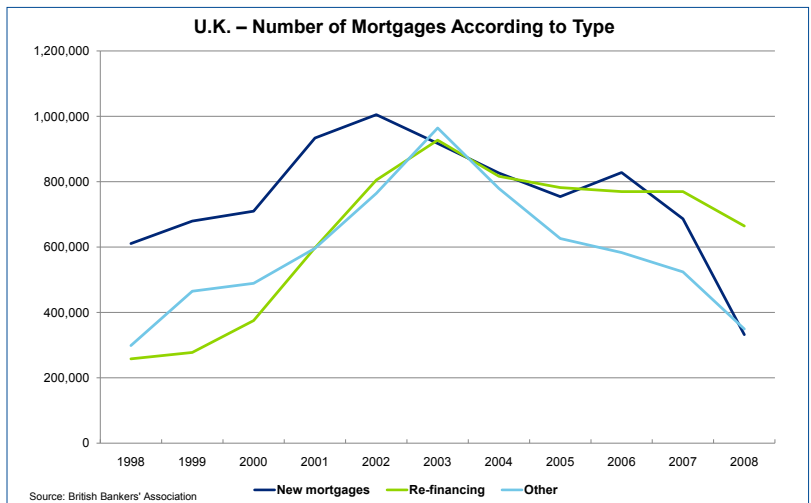
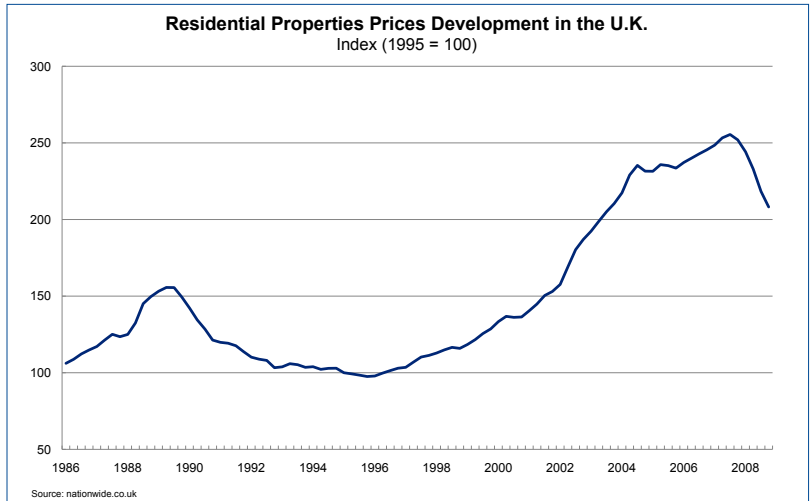
Prices of the most expensive properties in Tokyo’s Ginza quarter reached an incredible USD 1 million per square metre in 1989. The bursting of the bubble resulted in a dramatic drop in real estate prices. In 2004 properties in Tokyo’s financial district cost less than 1 percent of their maximum values, and residential properties cost less than 10 percent of their maximum values, although they still were among the most expensive in the world.

Huge state interventions during the 1990s did not lead to Japan’s economic recovery; they only resulted in rapid growth of the state debt.

2.3 The Real-Estate Crisis in the U.K.

The U.K. experienced a significant growth of real estate prices in the 1980s, in particular as a result of the Housing Act 80, which allowed privatisation of municipal dwellings by the tenants, and especially due to the collapse of the stock markets in 1987, which caused a number of investors to transfer their assets to properties as a safer alternative. At the end of 1980s the British government increased – amid fears of inflation (driven also by the growth of real-estate prices) – key interest rates from 7.5 percent (May 1988) to as much as 15 percent (October 1989). Interest rates of approximately 10 percent prevailed until 1992. Prices of properties fell sharply, in real prices by as much as 30 percent. Real estate prices stagnated until 1996; they only returned to the 1980s level in 2001. They continued growing due to the supply of cheap mortgages, and by the end of 2007 the real prices grew by more than 60 percent.

Prices of properties at the end of 2006 were 35 percent above the long-term (thirty-year) price trend. A significant aspect is the fact that the ratio between real-estate prices and the average income tends to be 3.5:1 in the long term, and in 2005 this ratio was 6:1, which suggests an approximately 40 percent overestimation of prices. A significant drop in prices is evident in 2008 and in early 2009, foreshadowing the return to real values. Knight Frank forecast a 30 percent drop in prices in 2009, a return of prices to the level of September 2003, and a drop in sales by 70 percent. A return to the 2007 price level is estimated on average in 2015, most quickly in London – in 2012. According to the above-mentioned estimate, prices of land for development around London decreased by one third of their value, and they are expected to fall by a further 15 percent in 2009. In January 2009 the British Banker’s Association recorded a year-on-year decrease in the number of new mortgages by 45 percent compared to January 2008; for the entire year 2008 the number of new mortgages dropped by 52.2 percent relative to 2007.



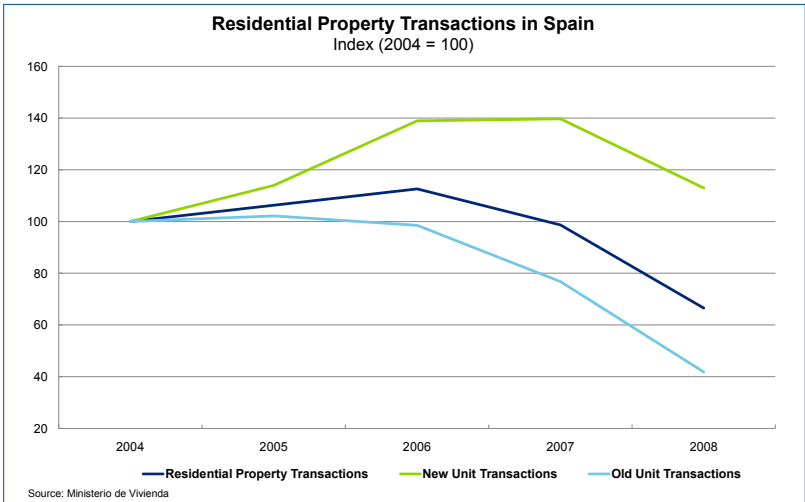
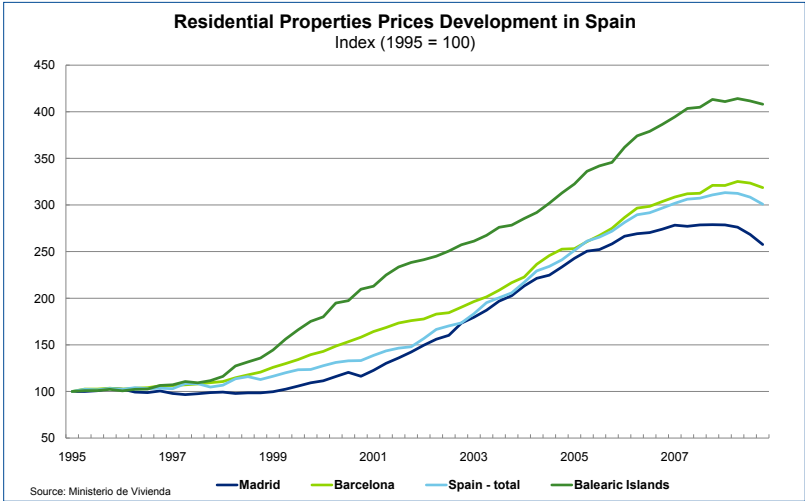
¹ Residential Market Forecast 2009, Knight Frank, 15 October 2008

2.4 The Real-Estate Crisis in Spain

Spain underwent a very similar development of the residential market as did the Czech Republic – rapid growth of the construction industry as a result of the inflow of money from EU funds, motivation of the economically active population to invest in owned dwellings, low interest rates as a result of the adoption of the Euro, and the country’s attractiveness for foreign investors resulted in rapid development of the residential market. In addition, Spain, unlike the Czech Republic, was characterised by high immigration and great interest by foreign buyers in vacation properties, which resulted in further growth of the demand for residential properties. The real-estate crisis in Spain started concurrently with the U.S. mortgage crisis, and the current situation in the housing market is therefore primarily a result of saturation of the domestic market and overheated prices. The global financial slowdown only had a secondary impact, at least at the beginning of the crisis.

A threat to Spain’s residential market is the risk of a debt trap for a large number of mortgage holders. According to a 2005 study by La Caixa, the average holder spends 55 percent of his/her salary on paying for the property (primary home or a vacation house/apartment). The current estimates are that approximately 10 percent of mortgage loan holders have a problem repaying the loan.

A large number of developers found themselves in a difficult financial situation. Sales fell by as much as 60 percent relative to 2005, most significantly in old apartments. The average time of selling a residential property has significantly increased. Discounts of 30 percent or even 50 percent on new apartments are often offered, but without significant impact on the sales.



3. Economic Situation in the Czech Republic

3.1 Macroeconomic Situation in the Czech Republic

Before the onset of the global financial and economic problems in September 2008, the Czech economy was in a good macroeconomic situation. The economic growth, which was naturally slowing down due to the effects of the economic cycle, was driven by foreign trade in spite of the disadvantageous exchange rate.

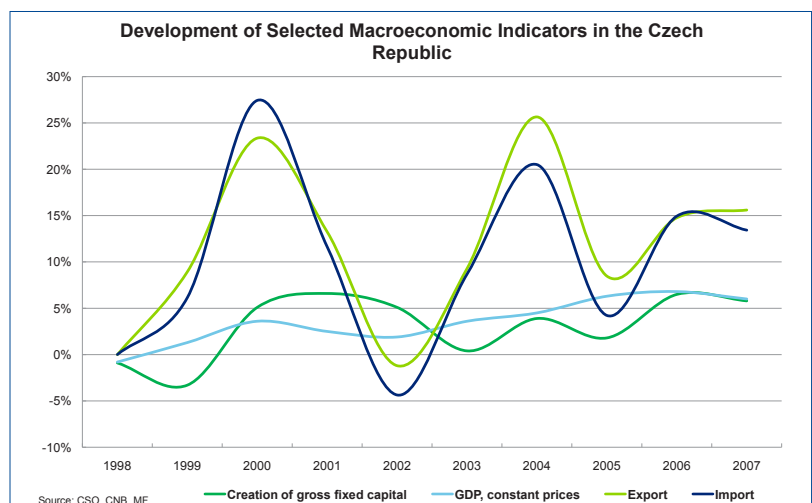
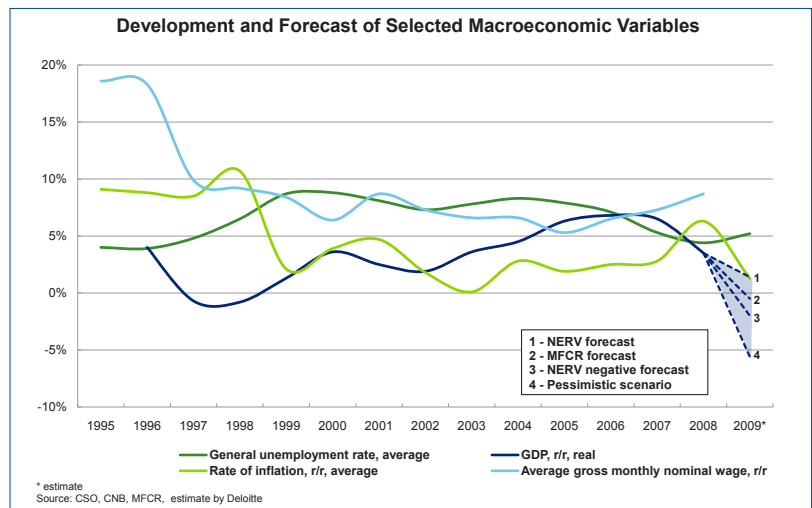
Specifics of the Czech economy prior to the impact of the “financial” crisis:

- From the beginning of the decade the growth of the economy was accelerating, even though the conditions were not always favourable;
- A wave of direct foreign investments helped to strengthen the growth and improve export performance;
- Household consumption (including the growth of their indebtedness) did not reach “unsustainable” levels;
- Economic growth of some 6 percent in the period 2005 – 2007 was “well balanced”;
- Acceleration of the inflation in 2008 was temporary;
- Development of the labour market showed positive results;
- The current account deficit was sustainable in comparison with other countries; and
- A substantial deficiency was the high commodity specialisation of exports in some engineering products, in particular automobiles and their accessories.

After having overcome the economic recession at the end of the last decade and after a substantial change of structure and politics, the Czech economy entered a period of economic growth. The key factor of this process was the changes made in the economy, support of foreign investments, and restructuring of the banking sector following privatisation.

The mainly export-oriented foreign investments significantly strengthened export performance of the Czech economy, with a logical delay, and also helped to improve its external stability (current account deficit), and since 2005 the Czech Republic has had a trade surplus. The subsequent accession of the Czech Republic to the EU served as a stimulus for additional investments.

The negative development in the labour market culminated in 2004. Since then the employment rate in the Czech economy has grown rapidly, even though wages have grown relatively moderately, it has affected the purchasing power of the population. Their purchasing power was also strengthened by the macroeconomic stability and low inflation. Interest rates reached levels similar to Western Europe, and banks restructured by their owners started offering loans aggressively to an ever broader group of the population.

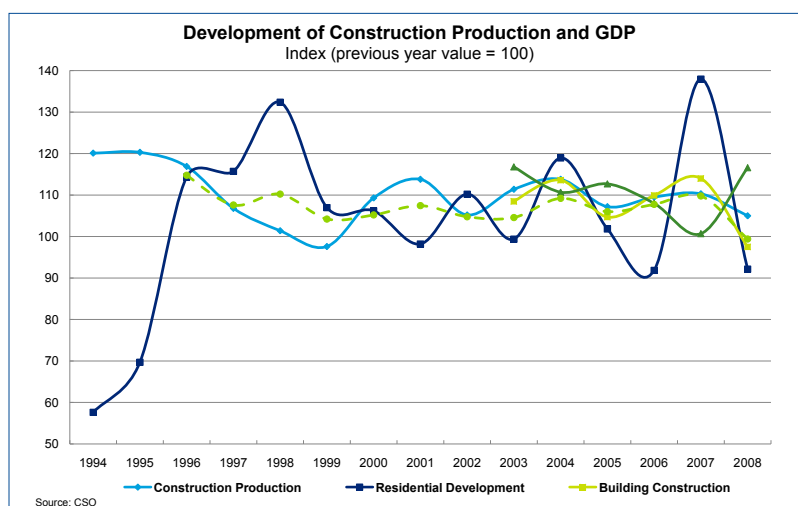


The global economic crisis reached the Czech Republic while it was still in the phase of rapid economic growth, with a stabilised financial system, but also weakened, to a certain extent, by the short-term rapid strengthening of the foreign exchange rate in the period between 2007 and 2008. The combination of almost 20 percent appreciation of the Czech crown against the Euro, and wages that were growing relatively quickly, which was also related to changes in taxes but also signs of overheating of the labour market, signalled a great slowdown of economic growth as early as the beginning of 2008. The economic crisis, which has gradually turned into a global recession, affected the Czech manufacturing industry basically without delay. Orders dropped by tens of percent, and the only improvement was seen in the automotive industry thanks to state aid in some countries (the so-called 'scrap' bonus), which, however, may only be temporary.

Another exposed sector which immediately responded to the deteriorating demand was the real estate sector. In other areas of the economy the delay will be longer and the impact more differentiated. It is also evident that due to the global surplus of capacities or supply the flow of private investments into the Czech Republic will be significantly cut in virtually all segments.

Under the conditions of an unprecedented increase in risk aversion, the Czech economy is helped to a certain extent by its visible macroeconomic stability. It, to a certain extent, compensates the great caution of investors regarding the region of Central and Eastern Europe. This caution is partly justified by the fact that some countries in the region (for example in the Baltics or Balkans) are in a very delicate situation.

A significant asset of the Czech economy is the stability of its financial system. Czech (or actually foreign banks active in the Czech Republic) suffered relatively small losses from investments in toxic assets. Even more valuable is the fact that banks have at their disposal large volumes of deposits of the local clients and, in addition, a vast majority of them are in the domestic currency. The low share of loans relative to primary deposits in combination with the elimination of the exchange rate risk in most transactions (also basically all loans, particularly loans granted to private persons, are denominated in CZK) make the banking sector not only quite resistant to the current developments but also capable of providing loans to clients, which is currently, when most businesses need operating capital, very important.



The growth of household consumption slowed down significantly in 2008. At the end of 2007 and in early 2008 the concurrent effects of several factors (growth of the global prices of crude oil and other raw materials, increase in indirect taxes) resulted in a one-time increase in the price level, which slowed down the growth of real income of households. The reduced household consumption ultimately also affects the residential and financial market in the form of a reduced demand for owned dwellings and a reduced number and volume of mortgage loans.

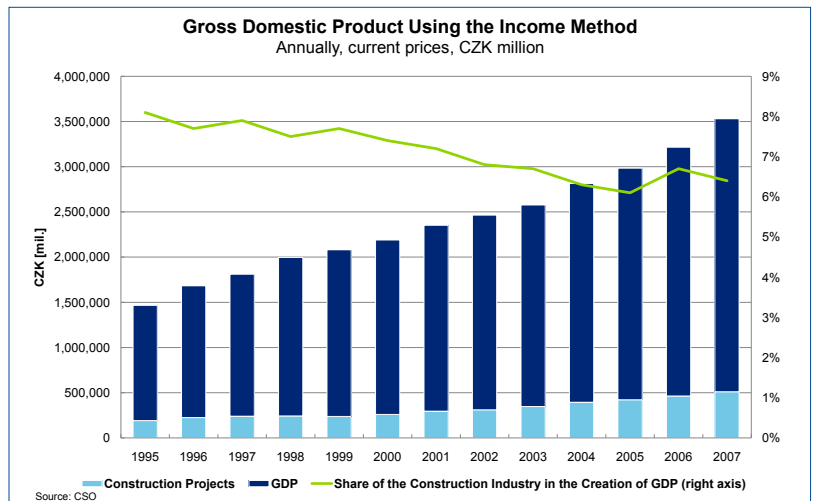
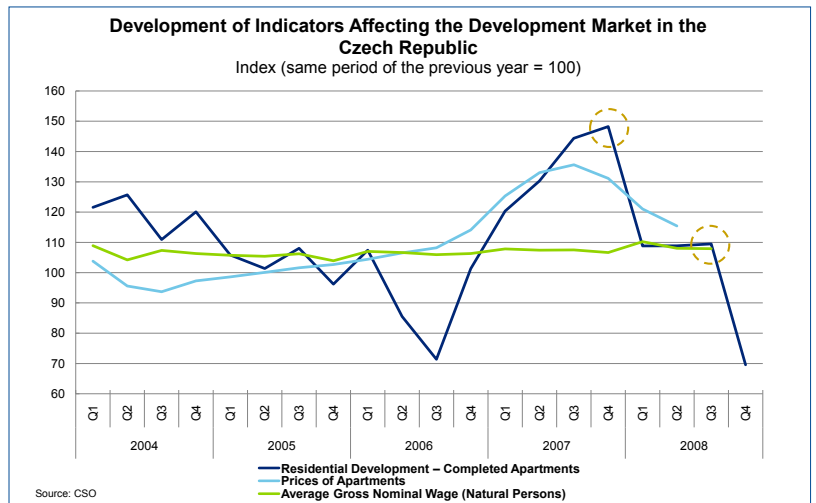
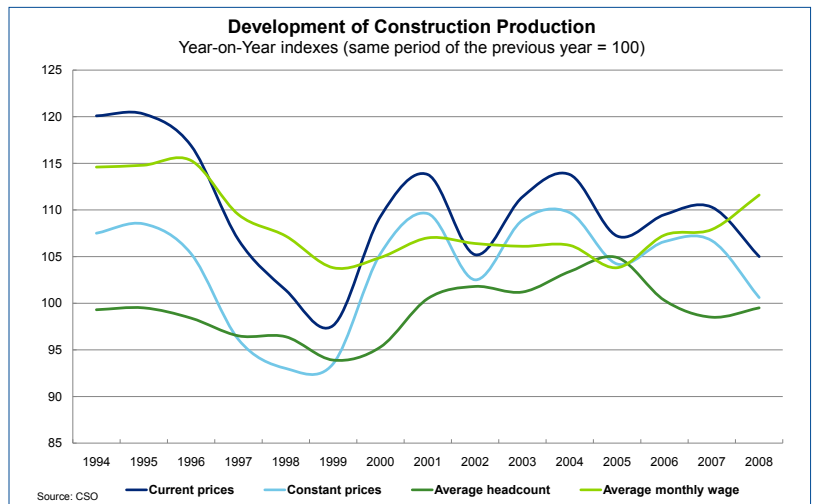
As a result of the economic growth in the past several years, the unemployment rate was dropping rapidly (also on a long-term basis – from 150 thousand to 110 thousand in the period between 2007 and 2008). Nevertheless, in the 3rd quarter of 2008 and in early 2009, when the labour market was affected by the first effects of the economic slowdown and companies started making excess employees redundant, the unemployment rate started growing quickly. Development in the upcoming years will depend on the development of the global economy.

3.2 Construction Production Development

The period from 2005 until the end of 2007 was a period of almost concurrent growth of the GDP and construction production, which diverged only in the second half of 2008 as a result of the economic stagnation and the effects of the “financial” crisis.

Building construction saw a constant growth in the period in question, until mid 2008 when it fell for the first time since 2003. Engineering construction, due its specifics and high dependency on public funds, saw development with exactly opposite amplitudes to that of building construction and residential development in the period in question.

A significant deviation in the development of the construction industry and residential development is the year 2007 when – mainly due to the announced increase in VAT for residential development and months of uncertainty regarding the actual VAT rate – the number of completed dwellings significantly grew; in the 4th quarter the number of completed residential units was almost 40 percent higher than in the same period in 2006. Prices of dwellings also grew significantly on a year-on-year basis (locally by more than 35 percent). It is logical that such dynamics could not be maintained in the following year, i.e., in 2008, nevertheless, during the first two quarters of 2008 the number of completed dwellings was 10 percent higher than in 2007. The 3rd and 4th quarters saw the impact of two factors: the “financial” crisis and the extraordinary number of completed dwellings at the end of 2007, which was unsustainable in the midterm. It would therefore be misleading to attribute it to the effects of the financial crisis only.



3.3 Demographic Indicators Affecting the Residential Market in the Czech Republic

According to the data of the Czech Statistical Office, the total population of the Czech Republic in the 3rd quarter of 2008 was 10,446,157, of which the labour force amounted to 5,238,700 people.

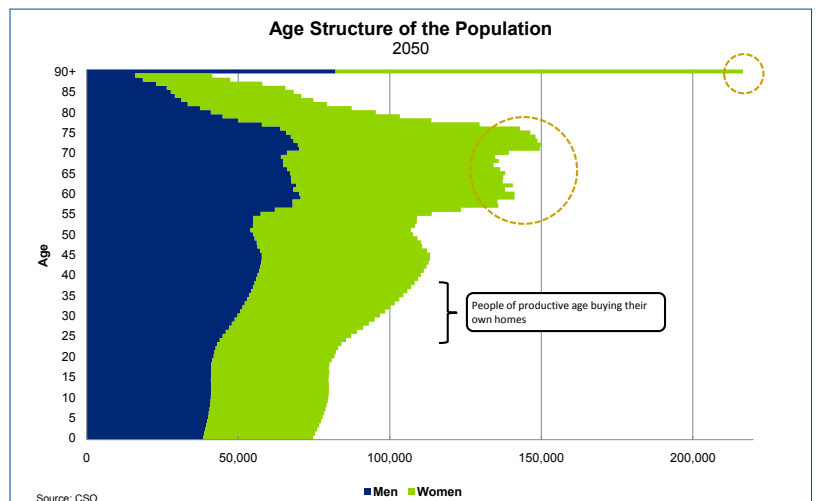
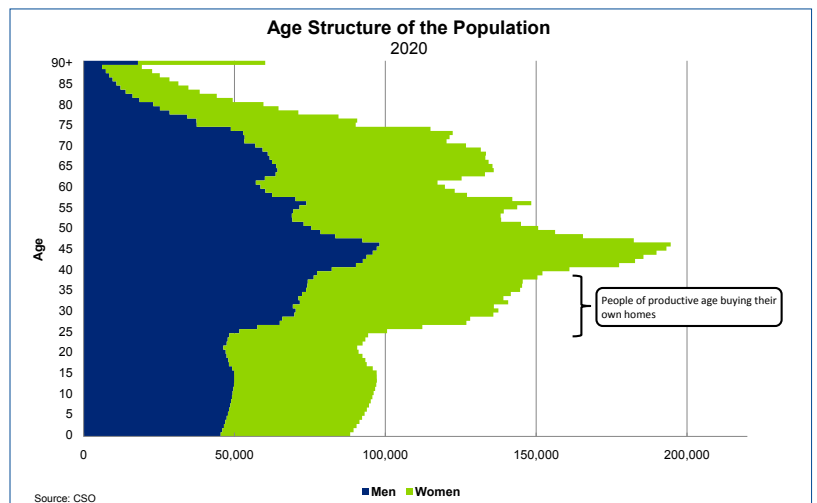
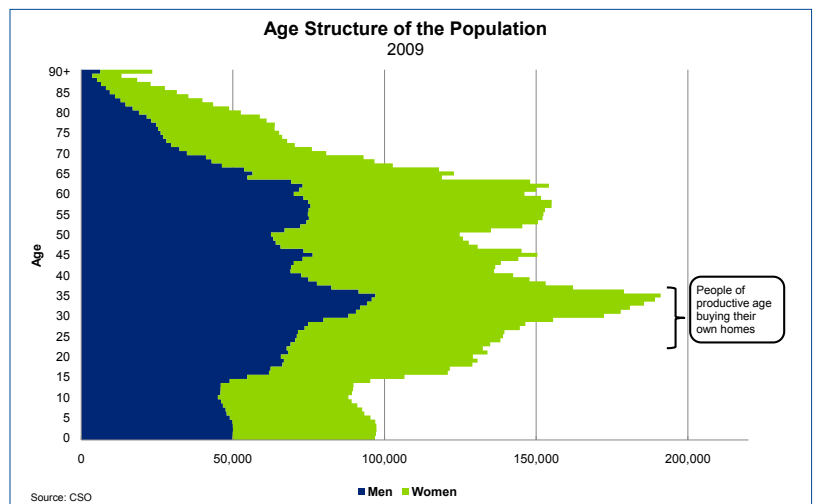
The most important group in respect of the development of the residential and real estate market in the long term is the population between 25 and 40 years of age. This economically active age group represents, in the vast majority, the side of demand for owned dwellings, and therefore becomes an important target group for most developers and financial institutions.

The age group in question, i.e., between 25 – 40 years of age, amounts to 2,606,609 people in 2009. This group, however, will gradually decrease in the upcoming years; in 2020 the Czech Republic will have 409,000 less people in the age group of 25 – 40, i.e., 2,197,609.

The trend of the gradual decline in the number of productive people in the above-mentioned age group will further deepen by 2050 when the age group of 25 – 40 will only have 1,601,148 people in the Czech Republic, i.e., more than 1 million less people than in 2009.

Demand for residential development and financial products focusing on housing in this important age group will therefore keep falling in the next 40 years.

With respect to demographic development, however, it is expected that the gradually shrinking population of the Czech Republic will be compensated by newly arriving foreign nationals with permanent or long-term residence. In 2008 there were more than 438 thousand foreign nationals with permanent or long-term residence permits in the Czech Republic.



3.4 Selected Sociological Indicators Affecting the Residential Market in the Czech Republic

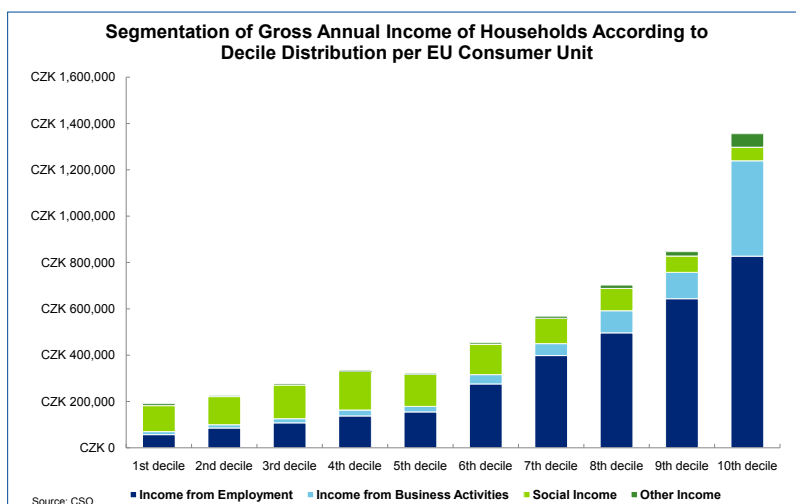
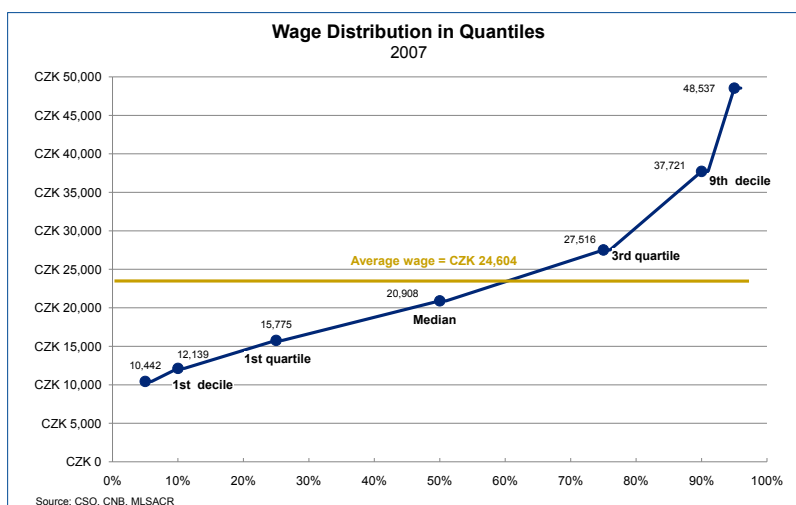
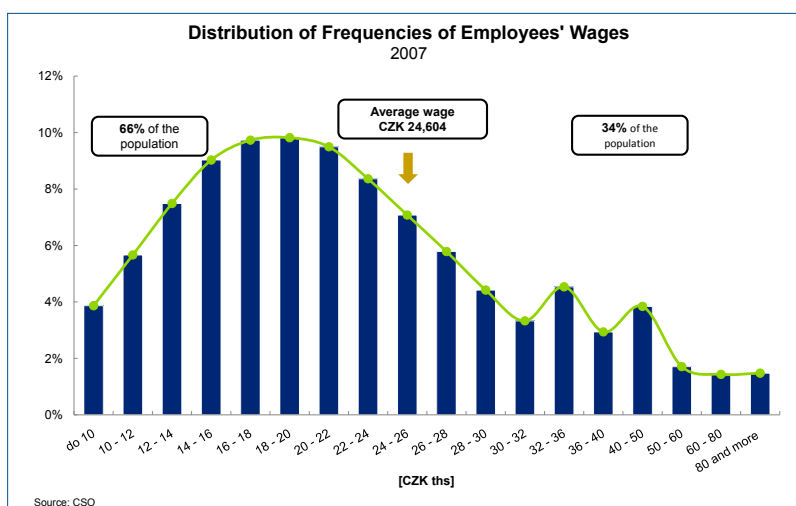
Distribution of the frequency of wages in the economically active population is characterised by asymmetry in the typical slope resulting from the effects of the minimum wage (CZK 8,000) at the beginning and the subsequent limitlessness. Most wages are in the first 8 wage groups, which, however, are lower than the average monthly wage (CZK 24,604).

The median, which divides the number of employees into two identical halves – is CZK 20,900 and is almost CZK 4,000 lower than the average wage. The maximum frequency – wage that most people earned – was almost CZK 20,000 in 2007.

It is possible to deduce that the percentage of employees out of the total number of employees receiving less than the average wage is approximately 66 percent.

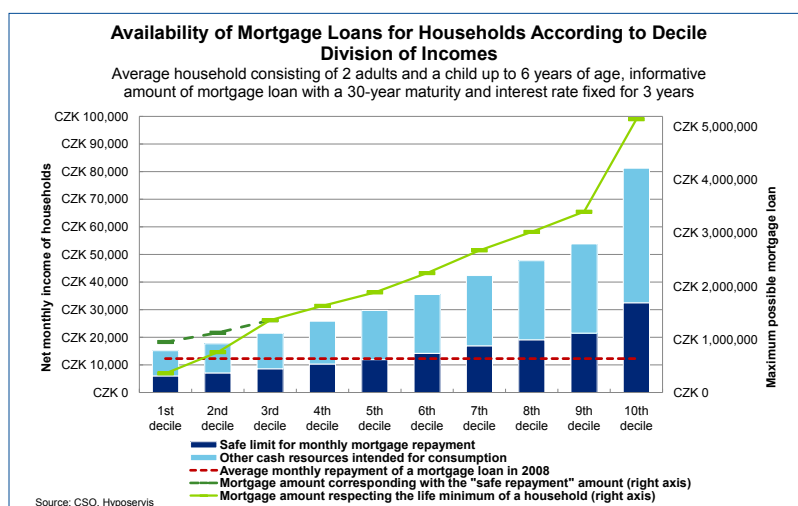
The possibility to receive a mortgage loan in the Czech Republic is therefore still the domain of the middle and upper-middle class of the population. With the average mortgage loan and the corresponding average monthly repayment, it is evident that the target group of residential development is the top four deciles of the population.

The above statement is better documented by the segmentation of the gross annual income according to decile division in EU consumer unit (statistical conversion of the weight of the household members, which takes into account the size and demographic structure of the household). It is evident that in the lower four deciles of households in the Czech Republic social benefit payments significantly prevail over income from employment. This fact shows significant dependency of 40 percent of households on direct aid from the state, also regarding housing. The situation starts to change only in the fifth and sixth decile, where, however, social income still represents a significant portion of the households' incomes. In the fifth decile of households we can see a decline in total income in comparison with the fourth decile. This might be caused by a higher percentage of household income from employment and business activities, which affects the entitlement to state benefits. The dependency of total gross incomes of households on social benefits differs significantly in the individual deciles.



While the percentage of social benefits in total gross income in the first decile is almost 59 percent, in the seventh decile of households this value amounts to 19 percent, and in the tenth decile only 4 percent. In the individual deciles could be also observed a significant difference in the number of working members of the households. While the lowest three deciles of households have the average of 0.49 working member, the top three deciles have an average of 1.84 working member.

It is important for the determination of the target group of the residential development market to take into account the limit for monthly repayment of a mortgage loan of a household. This safe limit of the repayment – using an expert estimate – is 40 percent of the net disposable income of a household. This represents the ideal percentage of monthly costs of acquiring an owned dwelling, a sustainable situation limiting the possibility of an unexpected fall into a debt trap, e.g., in the event of the loss of a job. The percentage of the safe limit for mortgage repayments is set at the same level for all households because the inclination to consumption grows proportionally with income. The safe limit for mortgage loan repayment in the 1st decile of households is CZK 6,000, in the 7th decile CZK 16,900, and in the 10th decile it exceeds CZK 22,000.



4. Comparison of the European and Czech Residential Markets

4.1 Characteristics of Residential Property in Europe

4.1.1 Residential Property

International comparison of the residential property situation suggests that the Czech Republic still slightly lags behind most European countries in terms of the number of dwellings relative to the population. There is therefore still space for new development in the Czech Republic. In addition, the Czech residential properties are characterised by their relatively high ages.

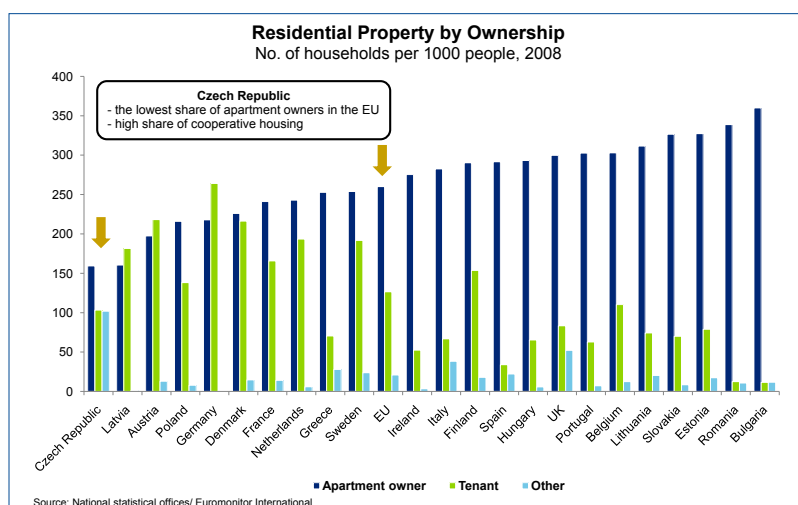
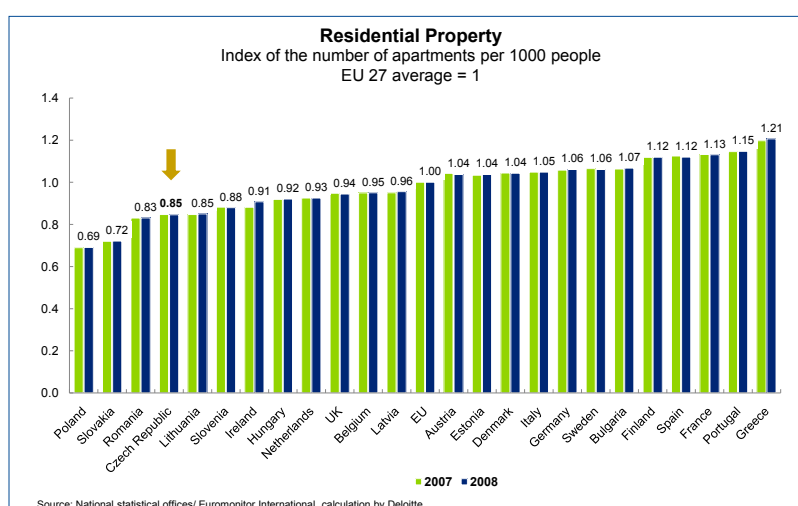
The residential property status includes all residential units intended for living, inhabited (in which at least one person has permanent or long-term residence) as well as vacant (units, in which no person with permanent or long-term residence is registered).

According to the indicator of the number of residential units per 1000 people, the Czech Republic is below average in European terms; the residential property amounts to 85 percent of the average of the European Union. This is in spite of the faster reproduction of residential properties resulting from the increased demand in the past several years. In general, primarily the former Eastern bloc countries are below the European average. The data on the total residential properties in the different European Union states differ as a result of the methodology used by the individual institutions that prepare the statistics both on the European and on a national level.

According to the data, there are more than 390 permanently inhabited residential units per 1000 people in the Czech Republic, the total number of all residential units, however, is estimated at 440 units per 1000 people according to the data of the Czech National Bank (ČNB). It is estimated that in absolute terms there were more than 4.6 million residential units in the Czech Republic in 2008 (in Belgium, which is comparable in terms of population: 4.9 million, and in the Netherlands: 6.9 million residential units).

4.1.2 Ownership Structure

In comparison with the rest of the European Union, the Czech Republic has the lowest share of privately owned apartments per 1000 people. The share of privately owned apartments in total residential properties in the Czech Republic is 15 percent lower than in Austria and 25 percent lower than in the Netherlands.



A significant factor in the issue of ownership structure in the Czech Republic is the type of property. The vast majority of family houses are privately owned by individuals (more than 96 percent), whereas apartments in apartment buildings are mostly rented. Primarily in the last 15 years, however, the percentage of privately owned apartments grew, in particular thanks to the strategy of developers who primarily built projects intended for direct sale. Residential development projects intended for lease contracts were only sporadically implemented in the past period.

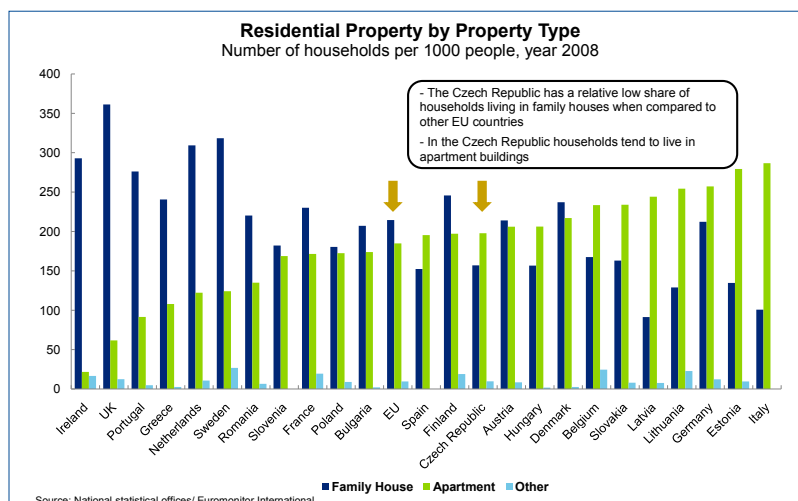
An important specific characteristic of the Czech residential market is “cooperative housing”, which does not exist as extensively in other EU countries (with the exception of the U.K. and Austria). Almost 102 households per 1000 people in the Czech Republic live in a cooperative apartment. In spite of the decline resulting from the sales of apartments to the individual members of housing cooperatives this type of residence represents approximately one seventh of all inhabited apartments in the Czech Republic.

4.1.3 Type of Real Estate

In the classification of the residential properties according to property type, people in the Czech Republic, unlike the European average, prefer living in an apartment building.

Almost 200 households per 1000 people in the Czech Republic live in an apartment and only 156 households per 1000 people live in family houses. This is also due to the relatively high degree of urbanisation comparable with the EU average. With 278 households per 1000 people, the Czech Republic approximates the European average within this urbanisation indicator, which amounts to 308 households per 1000 people. In recent years, however, the difference in the ratio between living in an apartment and living in a family house in the Czech Republic has been decreasing, in particular thanks to the departure of mainly young families to suburban areas. An example is the Region of Central Bohemia, which has for several years seen the construction of the largest number of family houses in comparison with other regions of the Czech Republic.

Inclination toward living in a privately owned house prevails in the countries of western and northern Europe. The largest number of households per 1000 people living in a family house was recorded in the U.K. in 2008 (more than 360), followed by Sweden (318), the Netherlands (309), and Ireland (292). In these countries, in comparison with other European countries, we can see the tendency to purchase or rent a dwelling with more rooms. The prevailing type of dwelling in the Czech Republic is a two-room and three-room apartment; in the above-mentioned countries (with the exception of Sweden) the tendency is to live in an apartment with five and more rooms.



4.1.4 Consumer Housing Expenditures

Total consumer housing expenditure in the Czech Republic in 2008 was 51 percent of the European Union average, and the Czech Republic therefore is one of the European countries with relatively low consumer housing expenditures, particularly in comparison with Western Europe.

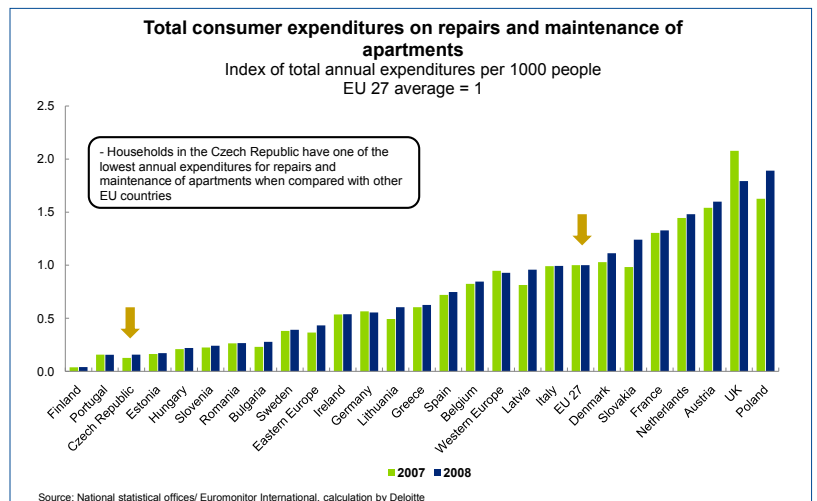
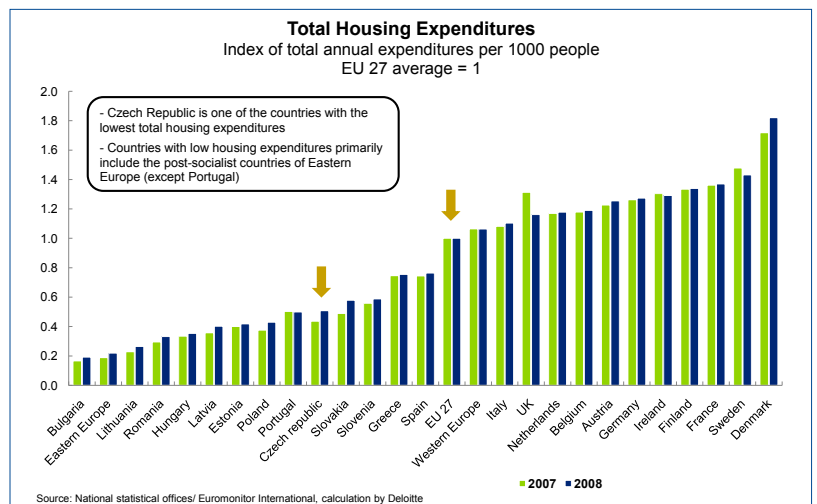
The average consumer housing expenditures in the European Union in 2008 amounted to EUR 3.2 million per 1000 people. The lowest housing expenditures of all European countries can be observed over the long term in Bulgaria and Lithuania where the percentage values are 19 percent and 26 percent of the pan-European average, respectively. Comparison of the average values of Eastern and Western Europe shows that Eastern Europe significantly lags behind the West because total housing expenditures are 22 percent of the pan-European average. Western Europe, on the other hand, exceeds this average by 6 percent.

Low total housing expenditures are typical primarily for post-socialist countries of Eastern Europe, which significantly lag behind the average of the entire European Union as well as the average of Western European countries. The average annual housing expenditures per 1000 people in the countries of the eastern bloc of the EU amount to approximately EUR 0.7 million, whereas the Western European average amounts to almost EUR 3.5 million.

The data for the Czech Republic is substantially distorted by the regulated rent. Total consumer housing expenditures in the Czech Republic have grown on a year-on-year basis in the last decades, which is caused particularly by the gradual growth in the rent of apartments (scheduled deregulation in 2011) and also due to growing expenses for the maintenance and repairs of apartments and houses (depending on the age of the residential property).

When comparing the total annual consumer spending of households on repairs and maintenance per 1000 people, the Czech Republic takes one of lowest places of all the countries compared. The amount of expenses for repairs and maintenance in the Czech Republic in 2008 was only 16 percent of the pan-European average (EUR 166,000 per 1000 people).

In international comparison, the lowest total consumer spending on repairs and maintenance of apartments



was in Finland (EUR 6.7 thousand per 1000 people), representing 4 percent of the pan-European average. The highest consumer spending on repairs and maintenance of apartments per 1000 people in 2008 was in Poland (89 percent above the all-European average) and the U.K., which shows one of the highest values of this indicator within the European Union (79 percent). The comparison of the average values of Eastern and Western Europe clearly shows that Eastern Europe lags behind the West by almost 50 percent.

It is estimated that the age of most apartments which are on the Czech residential market today is 25 – 45 years. One can therefore expect that in the course of the upcoming years the market will increasingly see more renovation and revitalisation projects (particularly in apartments in concrete-panel buildings).

4.1.5 Average Price of Apartments

When comparing the average prices of apartments in individual selected cities within the European Union, Prague is among the cities with rather higher price levels.

Of the selected European cities, the capital of the Czech Republic ranked third in the first half of 2008 in the price of an average-size apartment, and thus overcame even some Western European metropolitan areas comparable with Prague. The only more expensive cities were Warsaw and Rome. On the other hand, one of the least expensive cities was Berlin where an average-size apartment costs a little over EUR 100,000.

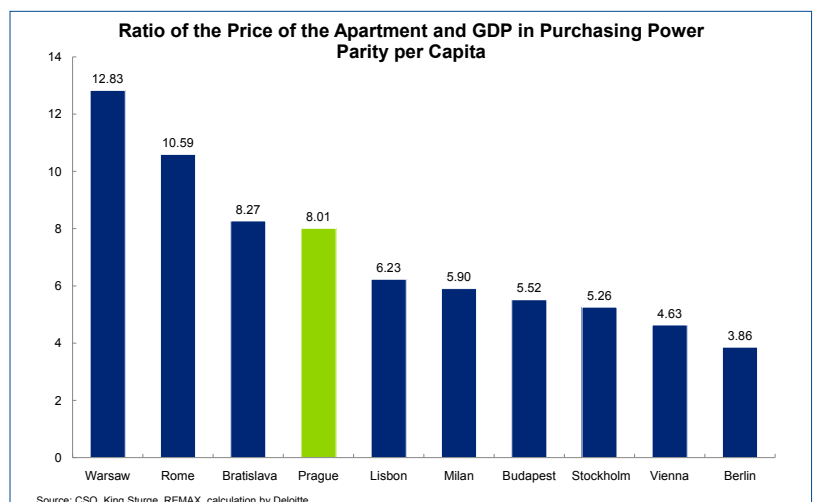
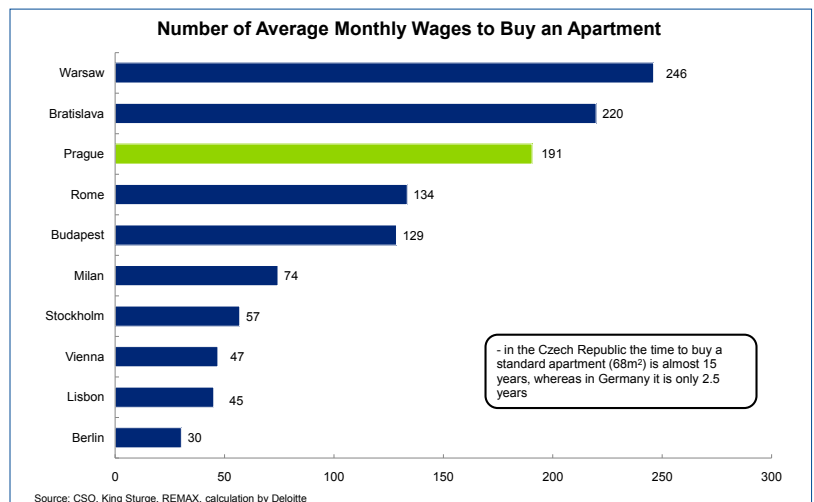
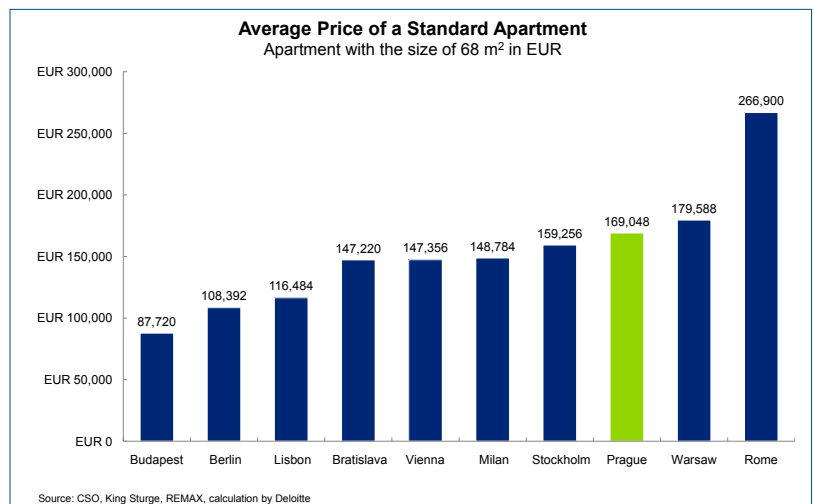
In proportion to the average monthly wage, Prague was also one of the relatively more expensive European cities in the first half of 2008. It took at least 191 average monthly salaries to buy a standard apartment of 68 m², whereas, for example, in Vienna only 47. The most expensive city of all the cities compared was Warsaw where it took 248 average monthly salaries.

In the Czech Republic the average time to purchase a standard apartment was almost 15 years whereas in Germany it was only 2.5 years. The highest number of average salaries to buy an apartment, and thus the longest time, was necessary in Poland's capital (more than 20 years). In Poland the prices of residential properties were overvalued and they grew until the 3rd quarter of 2008.

The price level in the countries of Central and Eastern Europe is substantially lower than in Western Europe. On the other hand, the prices of apartments in the cities of Central and Eastern Europe stated according to the percentage of the price of the apartment and GDP in purchasing power parity is substantially higher than in comparable cities of Western Europe.

The comparison of the percentage of the average price of an apartment and GDP in purchasing power parity per capita is a better representation of the real value of the apartment in the individual cities compared.

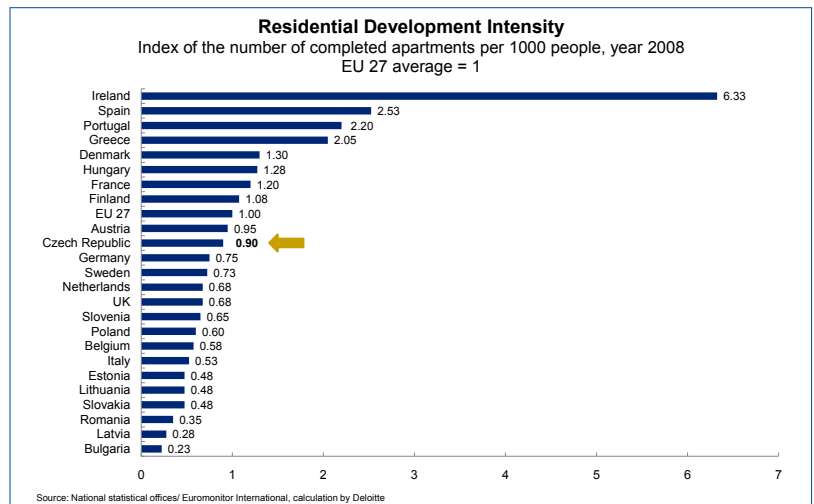
When stating the real value of an apartment using the percentage of the price of the apartment and GDP per capita in purchasing power parity it is evident that the real price level in Bratislava is higher than in Prague. The lowest price level of apartments was recorded in Vienna and Berlin.



4.1.6 Residential Development Intensity

The residential market in the Czech Republic in 2008 reached 90 percent of the European Union average in terms of the residential development intensity indicator, i.e., the number of completed apartments per 1000 people.

In the comparison between European countries in terms of this important indicator of the development of the residential market in 2008, the Czech Republic overtook for example Germany, Sweden, the Netherlands, and the U.K. In the Czech Republic the number of completed apartments was 3.68, in Germany 3, in the Netherlands and the U.K. 2.7 per 1000 people. The most apartments completed in 2008 were in Ireland: more than 25 apartments per 1000 people.



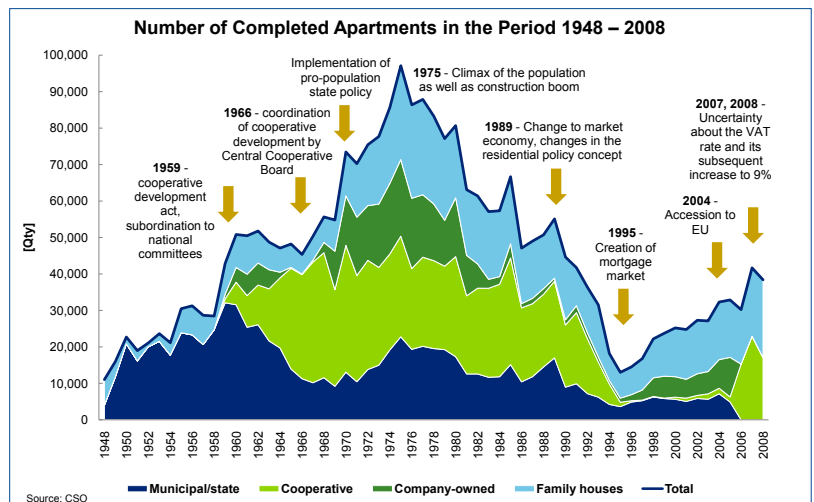
This fact may be a result primarily by the time delay of the onset of the effects of the “financial” crisis. While Western European countries felt the negative effects associated with the drop in demand for owned dwellings and the substantial drop in the property prices in the beginning of 2008 (in some countries with significant connections to American capital as early as in 2007), the Czech residential market was significantly affected by the above-mentioned effects only in the 4th quarter of 2008.

4.2 Construction of Residential Properties in the Czech Republic

4.2.1 Residential Development Trends

Residential development in the Czech Republic over the past sixty years developed virtually concurrently with the economic, political and demographic situation in the country.

Residential development reached its peak in the mid-1970s when its intensity was the highest ever – 10 completed apartments per 1000 people – almost 100,000 completed apartments per year.



After the period of decline in residential development in the late 1980s and early 1990s (due to the arrival of weaker demographic age groups, increased prices of goods, end of state subsidies for residential development and the resulting drop in the number of commenced projects) it started growing again gradually.

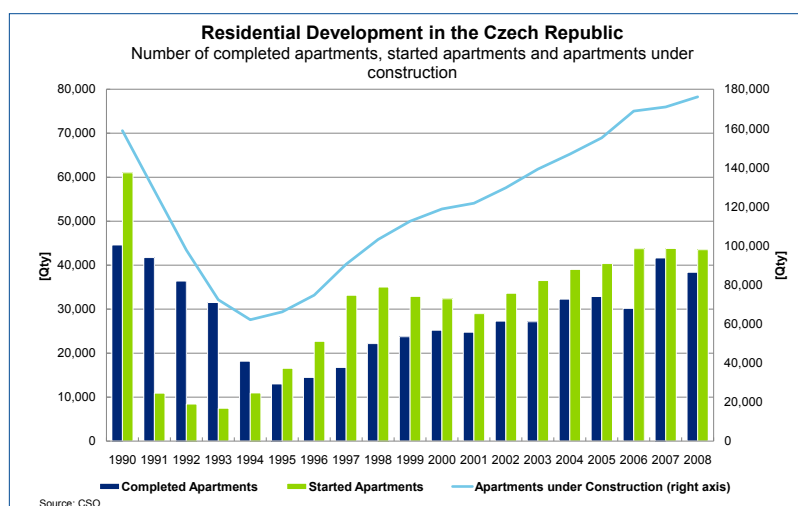
Development of the residential market in the Czech Republic is currently affected not only by the “financial” crisis, which has affected most markets in Western Europe, but also by other factors specific to the Czech Republic only. The current situation in the market is a result of the fact that a number of potential buyers reconsidered their plans to buy a dwelling in response to the announcement of the plan to increase the VAT rate (as at 1 January 2008), and the market prepared itself. The year 2007 therefore represented a dynamic shift in residential development. The number of completed apartments, commenced apartments and apartments in construction reached record-breaking values of year-on-year growth (completed apartments by a significant 38 percent).

Development of residential markets in Central and Eastern Europe was not linear in the past 18 years. A significant growth in the area of construction of new dwellings in the Czech Republic occurred only after 2000 when financial products intended for housing financing (mortgage loans and building savings loans) were introduced on the market to a more significant extent, and particularly after 2002 when interest rates fell substantially and also the maximum term for loan repayment was extended, and the 1970s baby-boomers started to buy dwellings more. The massive campaign in combination with the state housing aid (State Housing Development Fund - SFRB, deduction of mortgage interest from the basis of tax assessment, etc.) convinced the population that it is good to invest in a privately owned dwelling at any price; thanks to annual growth in prices residential properties have become a good investment also perceived as certain insurance for the retirement.

In particular, the year 2007 saw a significant growth of residential development resulting from two major factors:

- Culmination of demand by the “baby-boomers”; and
- Certainty of price increase as a result of the change of the VAT rate in residential projects.

In 2008 the previous years’ positive trend in residential development significantly changed, particularly due to the saturation of the market with residential properties in combination with the anticipation of the impact of the “financial” crisis residential development drops (particularly in the 4th quarter).



In 2008 was the first time since 2001 when the construction of the fewest apartments commenced on a year-on-year basis. It is expected that this fact will reflect on the intensity of residential development and the number of completed apartments in the following periods (years 2010 and 2011).

Since the mid-1990s there has been a constant excess of started apartments over completed apartments in the Czech Republic. A stock of unfinished apartments was created during the development “boom” in the residential market; these apartments will enter the market in their completed form in the following several years. The total number of unfinished apartments as of 31 December 2008 was 176,120. There are 3 percent more unfinished apartments on the market on a year-on-year basis. In 2007 there were 5,149 fewer unfinished apartments. The greatest share of unfinished projects in 2008 was seen in apartments in family houses (50.6 percent) and in apartment buildings (19 percent).

4.2.2 Residential Development Intensity

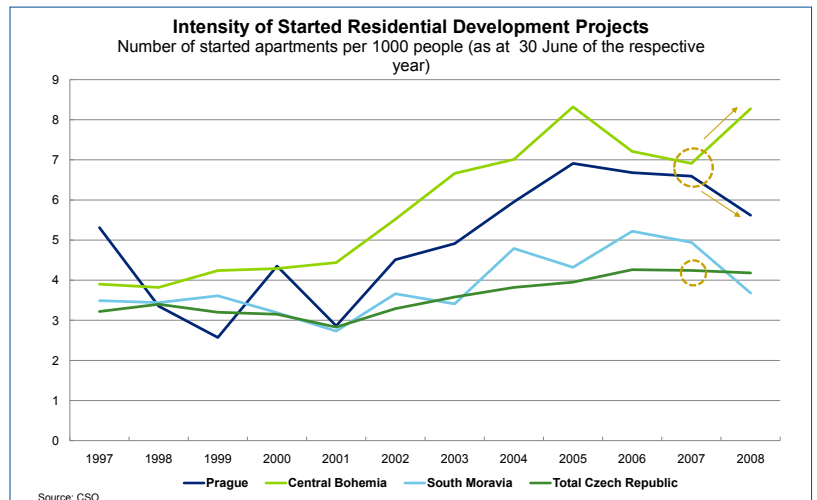
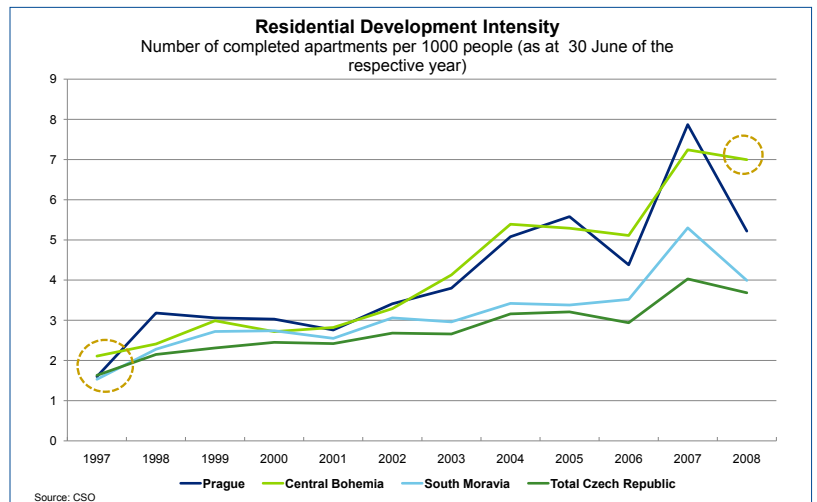
The growth of residential development intensity (the number of completed apartments per 1000 people) was almost linear from the second half of the 1990s until the 1st quarter of 2007. In 2007, however, the above-mentioned factors resulted in a significant change of the dynamics of residential development intensity. While in the period from 2000 to 2006 the average number of apartments completed annually in the Czech Republic per 1000 people was 2.7, in 2007 this indicator was 4 completed apartments per 1000 people. The subsequent drop in the residential development intensity in 2008 (3.6 completed apartments per 1000 people) may be understood as a natural return of the residential market to standard values, which are sustainable in the long term.

In the long term, the highest residential development intensity in the Czech Republic has been identified in the city of Prague and in Central Bohemia where it reached approximately 8 and 7 completed apartments per 1000 people, respectively, in 2007.

The intensity of started residential development projects (number of apartments, the construction of which started, per 1000 people) developing in the past almost identically to the number of completed apartments per 1000 people. A significant difference, however, can be seen in 2007 and 2008, when the number of completed apartments first significantly grew and then again significantly fell, whereas the segment of started apartments stagnated, and subsequently fell only slightly.

The average annual value of the residential development intensity indicator in the period from 2000 to 2008 in the Czech Republic is 3.7 started apartments per 1000 people.

The most important region in terms of growth of the residential market in the Czech Republic has been Central Bohemia for a long time; in this region, unlike other regions of the Czech Republic, the intensity of started residential development projects grew by more than 10 percent on a year-on-year basis in 2008.



4.2.3 Development of Prices of Residential Properties

Prices of apartments in the Czech Republic grew continuously, with slight fluctuation, for almost 15 years. The residential market was accustomed to this trend, and it was primarily developers and construction companies (and thanks to the multiplication effect also the building construction industry and manufacturers and vendors of construction material) who benefited from the increased demand for owned dwellings.

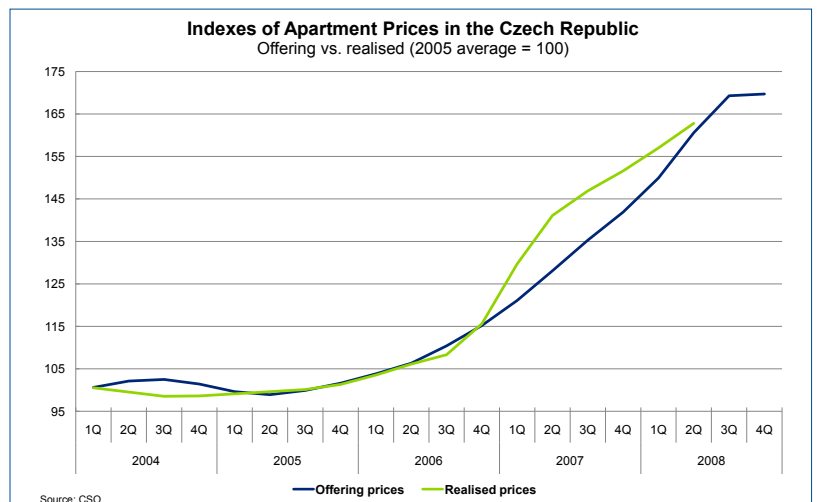
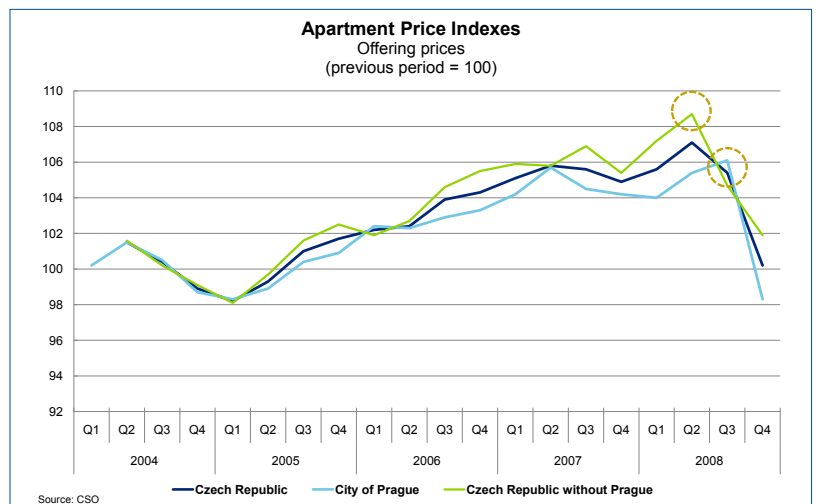
Primarily due to the increased demand for owned homes and the relatively easy availability of financing the prices of apartments grew very intensively in the past few years (particularly since 2000), which resulted in a broad increase in prices of residential properties in the Czech Republic.

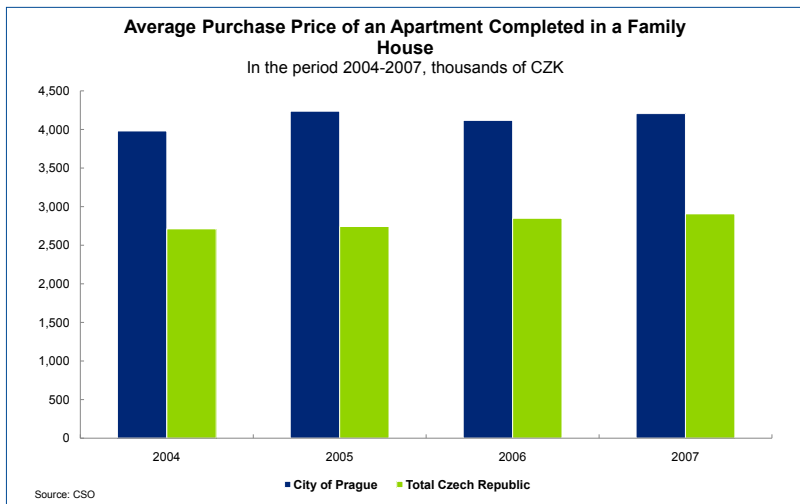
According to a survey of the Center for Economic Research and Graduate Education (CERGE), property prices in the Czech Republic grew significantly mainly in 2007. The price of a standard apartment with the size of 68 square metres outside of Prague grew by 34 percent, in Prague by 22 percent relative to 2006.

The growth of prices of apartments has currently almost stopped in the whole Czech Republic, with the exception of the segment of luxury, above-average apartments in “prime” locations, where the growth in prices slowed down, or where the growth was slower in the recent years.

The prices of apartments offered started to fall in the last three months in 2008. The growth of the offering prices of apartments in the 3rd quarter of 2008 significantly slowed down for the first time since 2005. The change of the index of growth of offering prices between the 3rd and 4th quarters of 2008 was only 0.4 percent. When compared with the third quarter 2007, the prices in Prague were lower by 1.7 percent.

In the second half of 2008 the prices of apartments started being affected by the negative factors of saturation of the residential market and the “financial” crisis.





4.3 Development of the Mortgage Market

Although the mortgage lending market in the Czech Republic continuously grew in the period from 2000 to 2008, when compared to the old EU countries and also the EU average, it is still a market that is only in its development phase – both in terms of the number and volume of mortgage loans per capita and in terms of the volume of mortgage loans relative to GDP. Even in comparison with Austria, which is very conservative in terms of mortgages and has always shown the lowest mortgage market indicators of all the old EU countries, the Czech mortgage market amounts to one third to one half thereof.

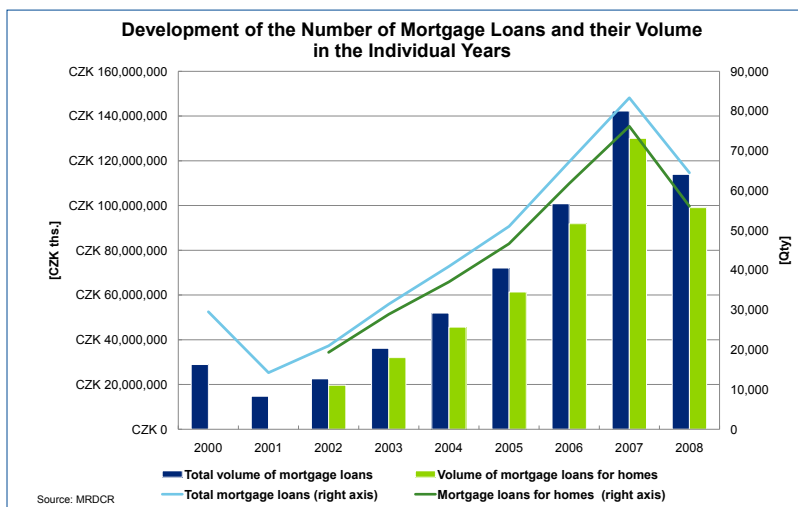
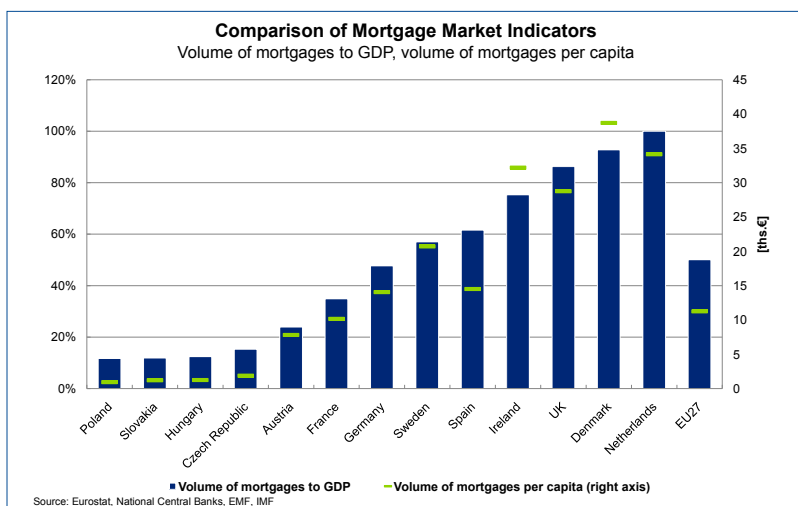
In 2008, after a period of significant growth, the Czech mortgage market fell sharply, by almost 20 percent on a year-on-year basis when compared to 2007.

A total of 64,497 mortgage loans with a volume of CZK 113.9 billion were granted in 2008, whereas in 2007 it was 83,340 mortgage loans with a volume of CZK 142.3 billion. In terms of number of mortgage loans, the year 2008 equalled the market levels of 2005 and 2006.

In spite of the decline of the mortgage market, the average amount of a mortgage loan is still growing on a year-on-year basis (in 2008 it was CZK 1.76 million). Due to the growth of the average mortgage loan, the decline in 2008 was more significant in terms of the number of mortgages than the volume thereof.

A significant year-on-year decrease in the number of mortgages was recorded in January 2009, by 44 percent, and the mortgage loan volume by 43 percent (in January 2008 the total number of mortgage loans granted was 4,817 with a volume of CZK 8.2 billion, whereas in January 2009 only 2,675 with a volume of CZK 4.6 billion), which might indicate a similar decline in the volume of the residential market.

The growth of prices of new apartments drove up the prices of older apartments as well, and thus of the average mortgage loan. Because of this, the average amount of mortgage loan grew even after the rapid slowdown of demand for new apartments in the 1st half of 2008.

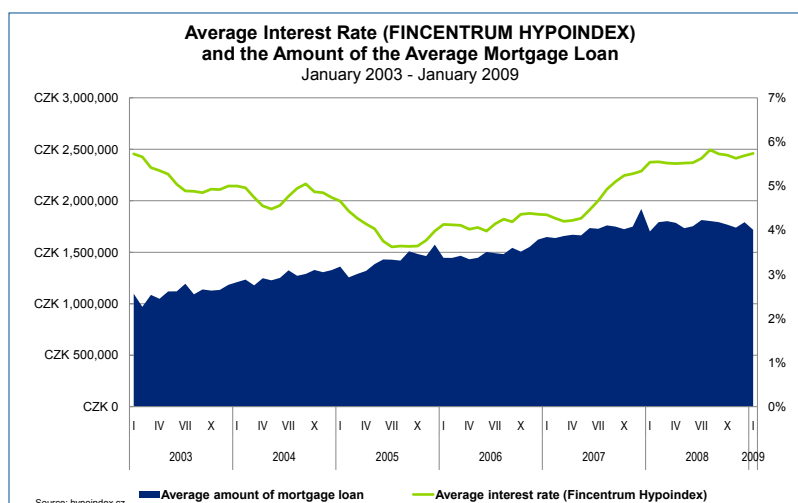
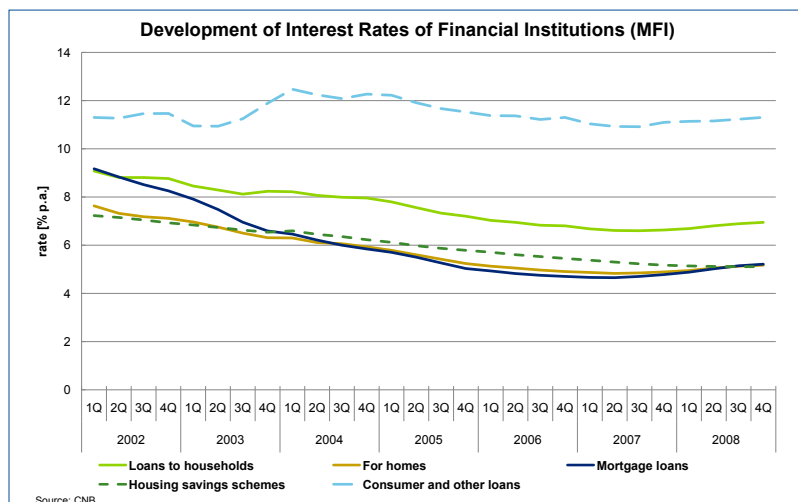
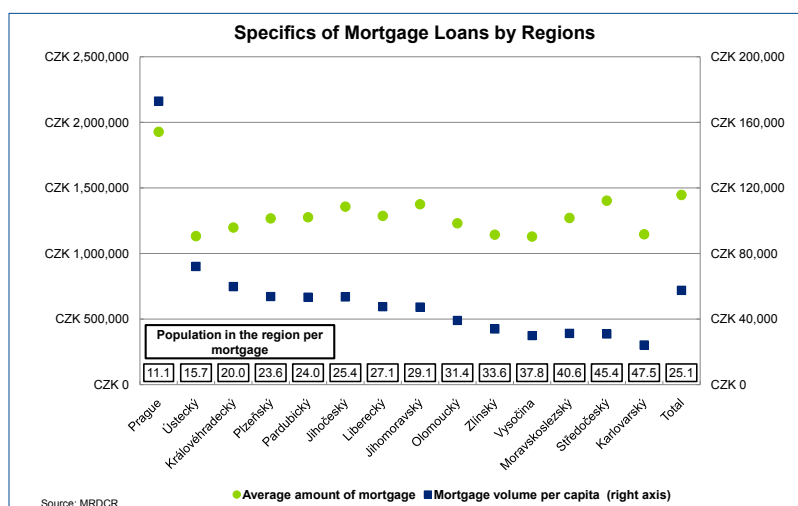


The greatest number of people per mortgage loan was recorded in Prague (11) and in the region of Ústí nad Labem (16). When calculating according to the average size of a family in the Czech Republic (provided that the average family has 3 members) we can deduce that in Prague every fourth family has a mortgage loan, and in the region of Ústí nad Labem every fifth family has one. In the Czech Republic as a whole every eighth household on average has a mortgage loan.

Prague (also due to the high prices of apartments and higher market rent) is on the top position when compared with all regions in the country, both in terms of the average amount of mortgage loans (almost CZK 2 million) and in terms of the average indebtedness by mortgage per capita (more than CZK 170,000). The region of Ústí nad Labem is in the second position in the overall rating, particularly thanks to the lowest prices of properties in the Czech Republic, which, however, are growing quickly.

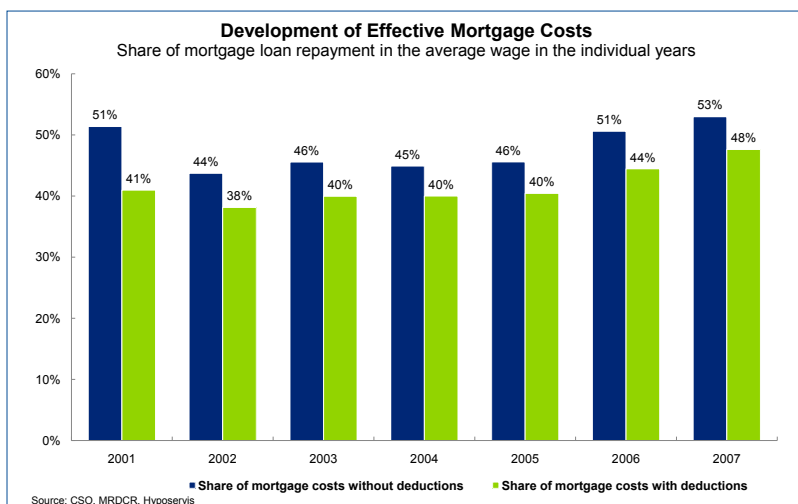
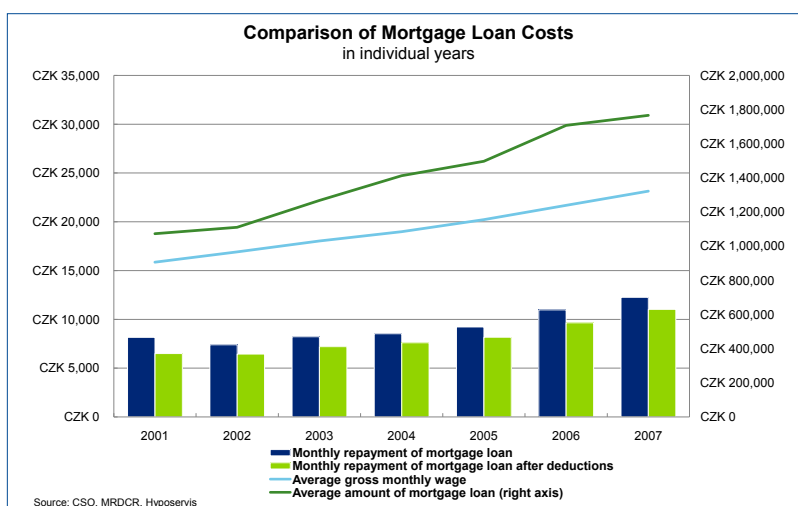
The interest rates of all types of loans saw similar development in the period in question, according to the data of the Czech National Bank (ČNB): they reached its minimum level in the second quarter of 2007 and then started growing again. On the other hand, the interest rates intended for new clients, compared using the Hypoindex – by means of the weighted average interest rate, for which new mortgage loans are granted to individuals, reached its lowest level in the second half of 2005; they slightly fluctuated in 2006, and since mid 2007 they have been growing continuously.

Interest rates of commercial loans are derived from the key interest rates set by the Czech National Bank. Although the Czech National Bank decreased its key interest rate in February 2009 to 1.75 percent p.a., which is a historic minimum, it will have minimum impact on mortgage interest rates and thus the residential market. It is expected that the banks' responses – due to the increased sensitivity to risk – will not be direct in terms of reducing the rates.



In the period from 2002 to 2008 the instalment of an average mortgage grew slightly faster than the average wage. As a result of the reduction of the state subsidy for mortgages for new apartments (it had an impact mainly in the period from 2000 to 2003) and the changes in tax deductions, the effective cost for mortgage clients has been increasing since 2003.

Interest rates have been gradually falling since the Czech local financial crisis of 1997. Thanks to the introduction of state financial subsidy for mortgages for new dwellings and its impact, delayed by one year, the effective cost of an average mortgage stabilised in the period of 2000 to 2003 at approximately 40 percent of the average wage. In the period from 2004 to 2006 it stayed on the 40 percent level thanks to the extremely low interest rates, but it has been growing continuously since 2006, up to 50 percent of the average wage.



5. Survey Results

5.1 Survey Methodology

The survey concerning the impact of the financial crisis on residential development market was performed in the form of a questionnaire and was divided into three parts – survey among developers, financial institutions, and the general public.

5.1.1 Banks and Developers

The survey among developers and financial institutions was conducted between November 2008 and January 2009.

The companies that participated in the survey included universal banks, mortgage banks and building savings banks providing the services of project and mortgage financing, and major developers active in the Czech Republic. Because of the generally low number of companies in respect of statistical processing the questionnaires were filled out during a personal interview of Deloitte consultants with the representatives of banks and developers, and so it was possible to add to the individual questions details and specific information, which the companies provided to the individual questions.

The questionnaires included questions on the impact of the financial crisis on residential development market and on the banking sector and have been structured in order to be able to mutually compare the results. The questionnaire for banks included 83 questions; the questionnaire for developers included 104 questions. In addition to relative frequencies, we performed tests of the individual questions, which verified the dependency of the answers on the type of company. The results from the banks and developers were subsequently compared and statistically significant deviations between the individual answers of these two groups were identified.

5.1.2 General Public

Another part of the survey was performed in February and March 2009 among the qualified public, who were looking for dwellings in new residential projects over the past several years. The questionnaire was distributed over the Internet and included mainly closed questions. The questions were about the people's concerns related to the "financial" crisis, anticipation of changes in the real estate market, influence of media information on their decisions, and preferences of the incentives and bonuses that developers currently offer.

The answers were analyzed from 324 valid questionnaires.

2.2.2 Vliv na přístup a podmínky financování

	Negativní	1	2	3	4	5	Pozitívni
Počítáte vyšší přínos/nároky bank při získání projektového financování?	Ano, velmi						Ne, vůbec
Zhoršila se v důsledku finanční krize dostupnost bankovních úvěrů pro provázení financování?	Ano, velmi						Ne, vůbec
Počítáte rozdíl v důsledcích finanční krize na stav projektů u projektů v různých stádiích realizace?	Znatelný						Zanedbatelný
Když ano, jaký u startovní fáze projektu?							
Když ano, jaký u realizační fáze projektu?							
Když ano, jaký u konečné fáze projektu?							
Očekáváte, že se dostupnost úvěrového financování v následujícím časovém horizontu 1 rok	Zhorší						Zlepší
Zvyšuje se požadavek na vlastní kapitál?	Ano, velmi						Ne, vůbec

2.2.2.1 Projektové financování

Jak se změnil nároky na minimální podíl vlastních zdrojů za poslední rok?
 Před rokem%
 Nyní%

Jak se změnila úroková marže za poslední rok?
 Před rokem%
 Nyní%

Jak se změnil nároky na minimální výši předprodeji (pro první čerpání úvěru) za poslední rok?
 Před rokem%
 Nyní%

	Negativní	1	2	3	4	5	Pozitívni
Bude vaše společnost omezoval množit developerstých projektů, které budete chtít financovat bankami?	Ano, určitě						Ne, vůbec
Když ano, jakým způsobem?							

Kterých z následujících situací se v souvislosti s vzrůstající finanční krizí V osobně obáváte? V osobně obáváte?

	velmi se obávám	spíše se obávám	spíše se neobávám	vůbec se neobávám	nevím
Ztráta zaměstnání (u mě nebo jiného členu domácnosti)	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Snižování příjmu domácnosti	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Neschopnost splácet hypoteční úvěr	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Neschopnost splácet osobní půjčky	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Nízká dostupnost hypotečních úvěrů	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Snižování ceny bytu pod úroveň výše hypotéky	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Jaký vliv na Vaše případné rozhodování o pořízení bytu/ hypotéky by měly současné mediální informace o finanční krizi?

Byt/ hypotéku bych si nyní spíše pořítil/a

Byt/ hypotéku bych si nyní spíše nepořítil/a

Mediální informace by na mě neměly žádný vliv

Koupil bytu/ pořízení hypotéky bych odložil/a na později

Nevím

5.2 Results from the Questionnaires for Banks and Developers

5.2.1 Banks

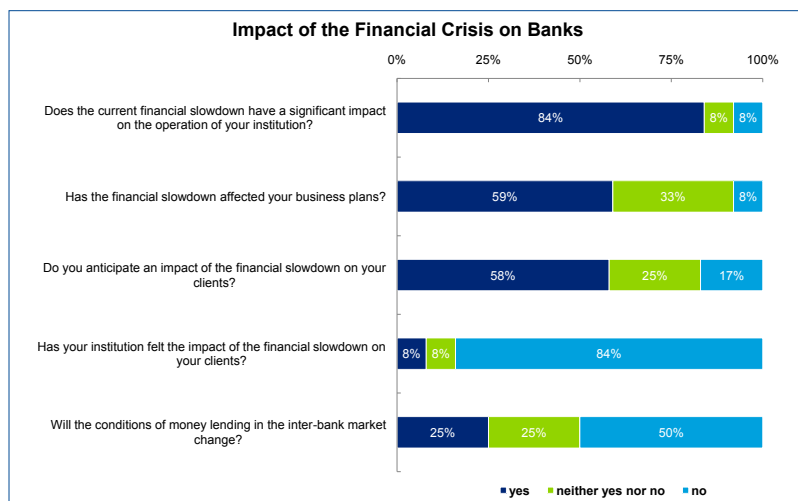
The banks that participated in the survey were universal banks providing the services of project (developer) and/or retail mortgage financing, specialised mortgage banks and building savings banks. Data collection in the financial institutions took place in the period from November to December 2008.

Impact of the Financial Crisis on Banks

According to the vast majority of banks (84 percent), the current financial slowdown has had a significant impact on their operations. More than one half of the banks stated that the financial crisis palpably affected their business plans on the asset side – the volume of loans granted declined or even new transactions were stopped entirely (due to more careful risk approach and/or liquidity constraints) and they started focusing more on deposits collection. The banks also reconsidered their business strategy for individual segments. Decline was seen also in the building savings sector.

More than one half of the banks anticipate impact of the financial crisis on their clients (mainly building savings banks do not expect a significant impact). Most banks (84 percent) have not yet experienced any direct impact ; if so, then only in isolated cases of development projects and in the corporate segment, not in the retail mortgage segment. In case of mortgage loans banks anticipate a delayed onset of defaults in the first half of 2009.

In the area of re-financing, one half of the banks believe that in the near future the conditions for money lending in the inter-bank market will not change substantially; some believe that the higher rates will remain even after the crisis has ended.



Impact on the Availability and Conditions of Financing

Project financing (development projects)

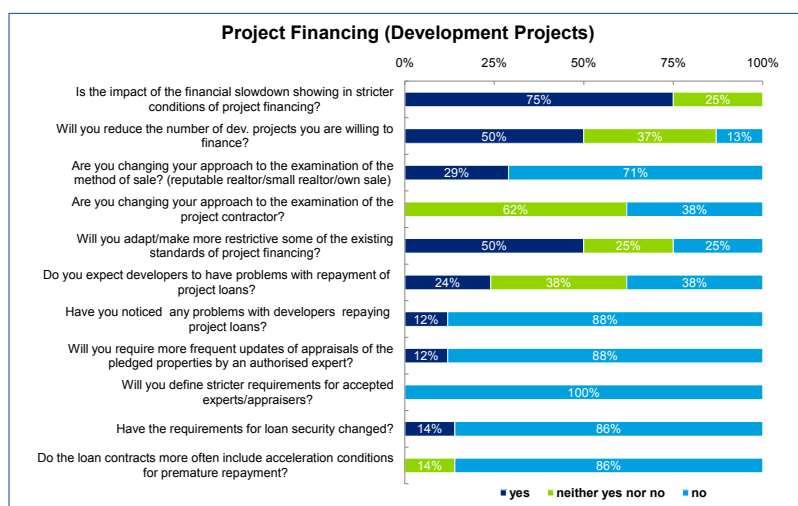
According to most banks (75 percent), the impact of the financial crisis has shown in more restrictive conditions for project financing. One half of the banks plan to limit the quantity of development projects they will be willing to finance, or, as the case may be, to put greater emphasis on the quality of the projects financed, and they will also watch more carefully the number of opened projects of the particular developer.

Most banks will not change their approach to the examination of the method of sale of residential units by the developer (whether by a reputable realtor or selling on their own or by a small realtor). One third of the banks will not change their approach to the examination of the project contractor; two thirds are not decided on this issue or they are considering a slightly more restrictive approach.

One half of the banks will modify (or tighten) in connection with the slowdown some of the existing standards of project financing, others have already recently modified their standards – typically by introducing more restrictive requirements for equity and the volume of pre-sales. There was recorded a year-on-year increase in the requirement for:

- Minimum equity by 0² – 15 percentage points (average 9 percentage points);
- Minimum volume of pre-sales (for 1st drawing) by 0 – 18 percentage points (average 8 percentage points).

The average interest margin grew on a year-on-year basis by 75 – 155 bps (average 103 bps).



The banks anticipate – to different degrees – developers' difficulties with repayment of project loans (24 percent anticipate difficulties / 38 percent cannot tell / 38 percent do not expect complications). The vast majority of banks have not yet experienced developers' problems with the repayment of project loans, although there have been already recorded a few initial defaults.

Almost none of the banks will introduce more frequent valuation of the pledged properties by an authorised expert; the current frequency is considered sufficient. Stricter monitoring during the construction phase is partially being considered. None of the banks plan to define stricter requirements for the accepted authorised experts/appraisers.

Almost all the banks (86 percent) stated that they did not change their requirements for loan securing, with the exception of the above-mentioned higher requirements for equity, and that they do not use acceleration conditions for premature repayment depending on the development of the market value of the pledged property in their loan contracts more often because they used this covenant as a standard before.

² The value includes a change of the requirement for minimum equity of the universal banks and building savings banks. In universal banks the minimum increase was approximately 10 percent.

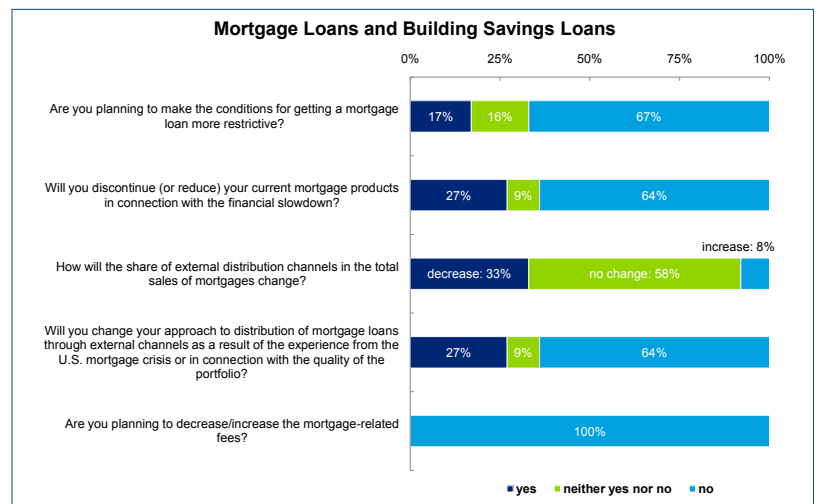
Mortgage loans and building savings loans

Two thirds of the banks (67 percent) do not plan to tighten their requirements for granting mortgage loans – because they either recently did this or have already partly implemented it (63 percent of these banks). The more restrictive requirements mostly pertain to marginal segments with average creditworthiness.

Approximately two thirds of the banks do not plan to discontinue (or reduce) their current mortgage products in connection with the financial crisis. If, however, the banks plan or have already introduced certain limitations, it is typically a limitation of mortgage loans with 100 percent LTV, “Buy to Let” mortgage loans, and virtual discontinuation of the mortgage loan without the requirement to prove income.

One third of the banks believe that in the near future the share of external distribution channels on the total sales of mortgages will decrease; more than one half of the banks do not expect any changes in this respect. At the same time, almost two thirds of the banks (64 percent) claim that they will not change their approach to distribution of mortgage loans through external channels as a result of the experience from the U.S. mortgage crisis or in connection with the quality of the portfolio, and if so (27 percent), they will introduce stricter credit checks in the external channels (or they have already introduced this limitation in 2008) and put greater emphasis on client retention (i.e., profitability).

None of the banks plan to reduce/increase fees associated with mortgages.



Risk Management

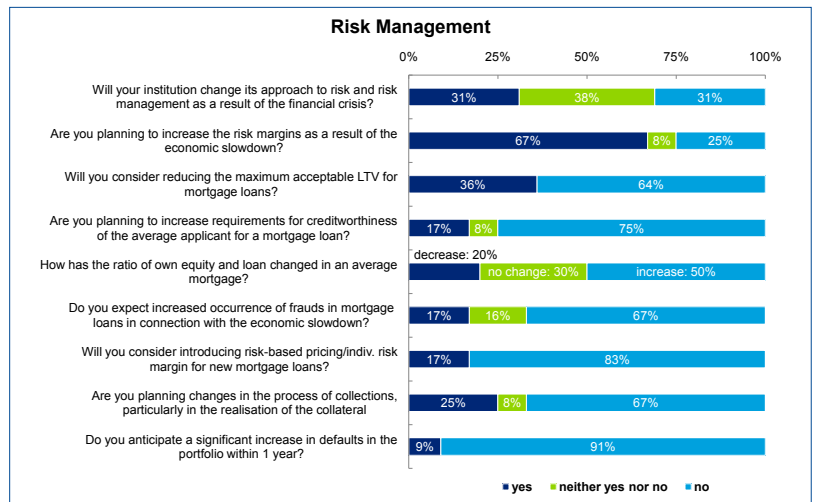
Most of the banks do not plan any major changes to their general approach to risk and risk management system as a result of the financial crisis (31 percent yes / 38 percent not decided / 31 percent no), partly because they have already implemented changes – primarily in the approach to individual client segments.

Two thirds of the banks plan to increase the risk margin in connection with the crisis (some banks only for selected products, or they have already increased the margins).

Almost two thirds of the banks (64 percent) will not consider reducing the maximum acceptable LTV for mortgage loans; approximately one third of the banks will, to the standard maximum LTV of 70 – 85 percent. Most of the banks still offer to creditworthy clients mortgage loans with LTV of up to 100 – 120 percent, American mortgages with LTV 50 – 70 percent, and exceptionally mortgages without the requirement to prove income with a maximum of 50 percent LTV – all this selectively after a more thorough credit review. Some banks newly limit the maximum LTV according to the region and type of real estate (e.g., for concrete-panel buildings). In general, all banks are making the conditions for granting a mortgage loan more restrictive.

Most of the banks do not plan to increase (or they recently increased) the requirements for creditworthiness of the average applicant for a mortgage loan (e.g., income stability and minimum disposable income). One third of the banks increased the ratio of own equity and loan in the average mortgage; one third of the banks did not change this ratio.

Two thirds of the banks do not expect increased fraud occurrence in mortgage portfolios in connection with the economic slowdown. Most of the banks, however, add that if frauds occur they will be so-called “soft-frauds” in the form of forging documents proving one’s income or manipulation of documents required for getting a mortgage loan. In some cases it may be supported by the external mortgage loan sales agents thanks to their prevailing primary motivation by the volume of production.



Most of the banks will not consider introducing risk-based pricing for new mortgage loans (individual risk margins) – almost 50 percent of them, however, because they have already implemented it.

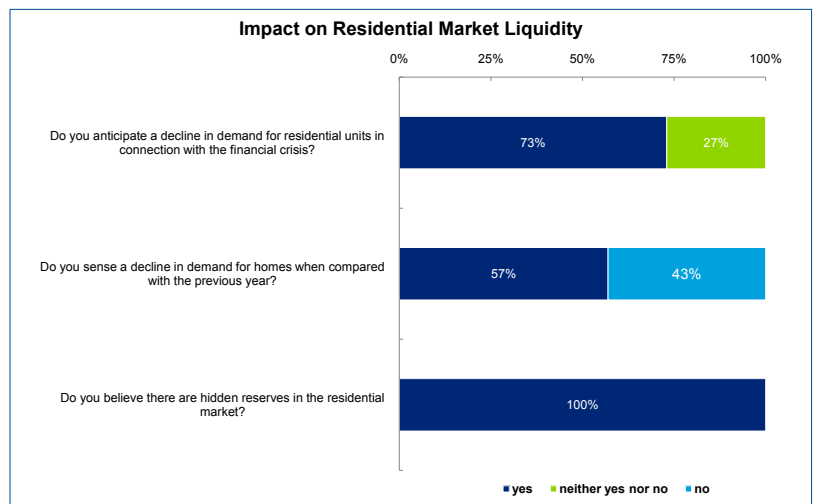
Two thirds of the banks (67 percent) do not plan any changes in the area of collections, in some cases because they have already enhanced the process. Some institutions plan to modify the processes and scripts for early collections, in some exceptional cases they plan to introduce predictive behavioural scoring for portfolio segmentation and more effective collections. In general, there are efforts to be more proactive in the initial phase of loan default. Another planned change is acceleration of forced sales.

The banks now evaluate their portfolio more frequently. Almost none of the banks, however, expect a substantial increase in defaults in the portfolio within one year.

Impact of the Crisis on Residential Market Liquidity

Most of the banks (73 percent) expect a noticeable decline in demand for residential units (a short-term palpable decline, e.g. some projects in the Prague suburban area are perceived rather sceptically) in connection with the crisis. Some mortgage banks also anticipate stronger negative demographic factors. More than one half of the banks have already experienced a year-on-year decline in the demand for housing in the volume of 10 – 33 percent; the other half has not (yet) registered the decline. Some of the banks pointed to the “distorted” reference base of 2007 with respect to the VAT effect.

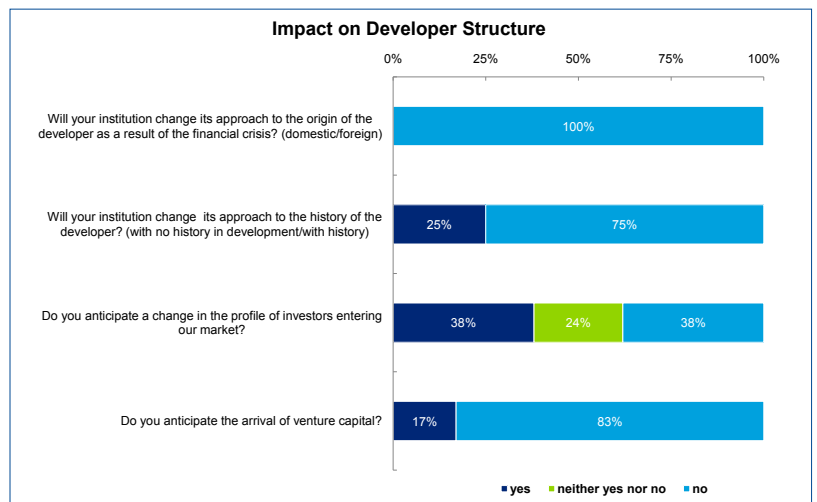
Some of the banks expressed the opinion that there are hidden reserves in the residential market because developers often artificially inflate pre-sale figures in their statistics.



Impact on Developers Structure

None of the banks will change its approach to the origin of the developer (domestic vs. foreign) as a result of the financial crisis, and most of the banks (75 percent) do not even plan to change their attitude to the history of the developer (without history in development, with history) – mainly because they have already taken this criterion into account. It is very likely, however, that projects of start-up companies without history will no longer be financed.

Some of the banks (38 percent) believe that the profile of investors entering the market will change (growth of the share of domestic investors or investors from the East), some do not (38 percent); most of the banks do not expect the arrival of venture capital.



Investment Climate and Impact on the Expectations of Consolidation of the Developer Market

Almost all of the banks (91 percent) rate the current investment climate and conditions for the development business as poor; but they simultaneously say that such development will help to clean up the market, which is desirable.

All of the banks expect that the investment climate will get worse in the next period (1 year), that the volume of investment transactions will decrease, and that transaction activity in the market will deteriorate. All of the banks expect that investors' activities will decline and that the financial slowdown will negatively affect the development market in the Czech Republic.

The banks expect that the development market will recover to the 2007 level in approximately 2 – 4 years (and that perhaps not even the 2007 level will be achieved).

The banks differ in their opinion on the probability of mergers of developer groups in relation to the crisis (probably 18 percent, probably not 36 percent); one half of the banks anticipate failures of developer groups, one third of the banks do not.

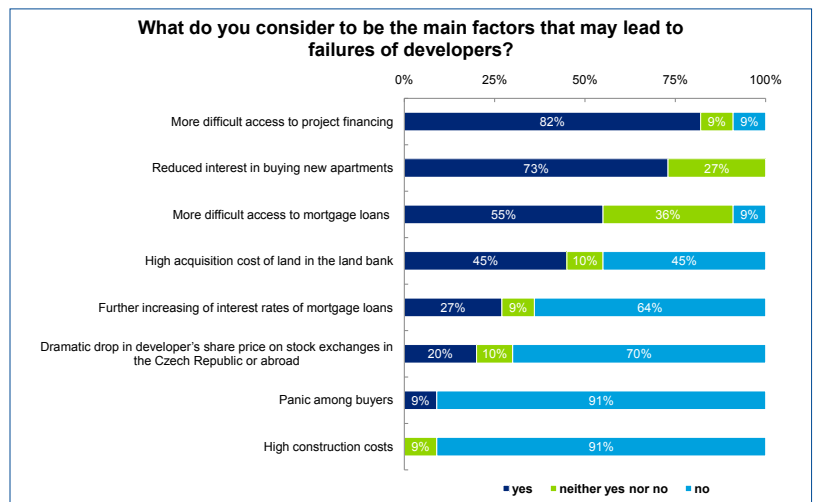
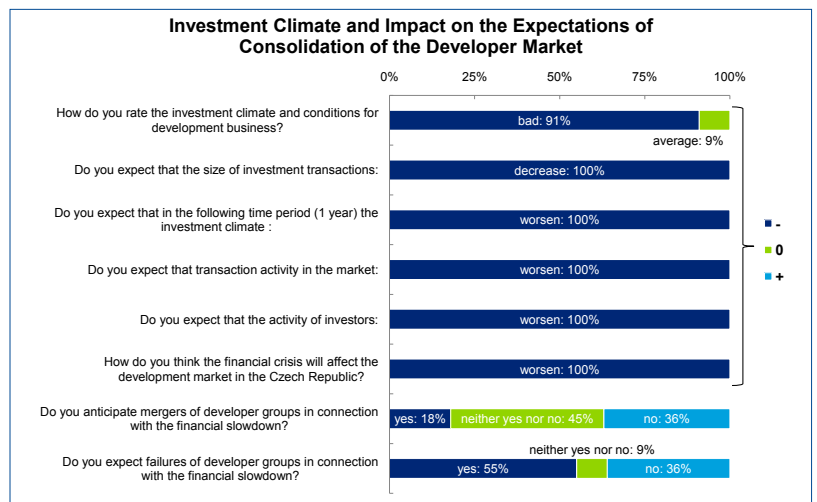
Main factors which may lead to failures of developers, in the banks' opinion, include:

- More difficult access to project financing – most of the banks;
- Slowed down interest in buying new apartments – most of the banks; and
- More difficult access to mortgage loans – half of the banks.

Factors which will not lead to failures of developers, in the banks' opinion, include:

- Further growth of interest rates in mortgage loans – more than one half of the banks;
- High construction costs – almost all of the banks; and
- Dramatic drop in the developer's share price on stock exchanges in the Czech Republic or abroad – most of the banks.

The banks did not have the same opinion on whether the high acquisition cost of land in land banks (45 percent probably / 45 percent probably not) may lead to failures of developers.



5.2.2 Developers

Other parties participating in the survey were developers representing all segments of residential development focusing on the construction of new residential projects. They included Czech companies, international companies, independent developers, investment groups, and companies that combine development and construction activities. Data collection among developers took place in the period from November 2008 to January 2009.

Impact of the Financial Crisis on Developers

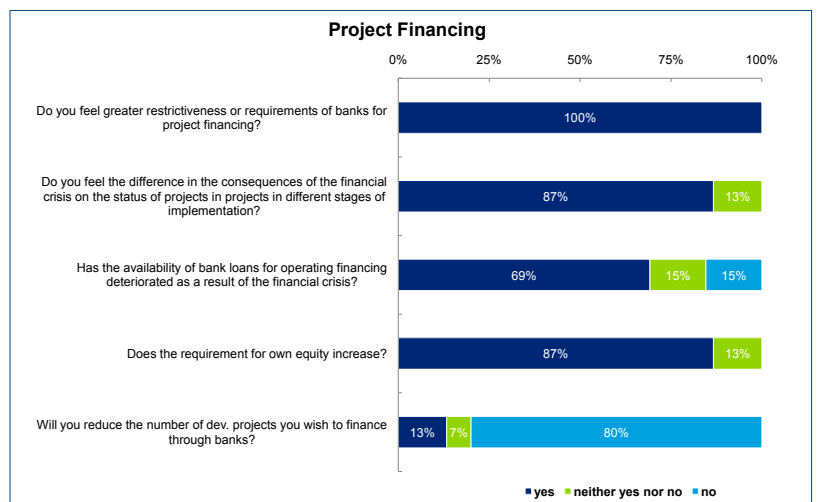
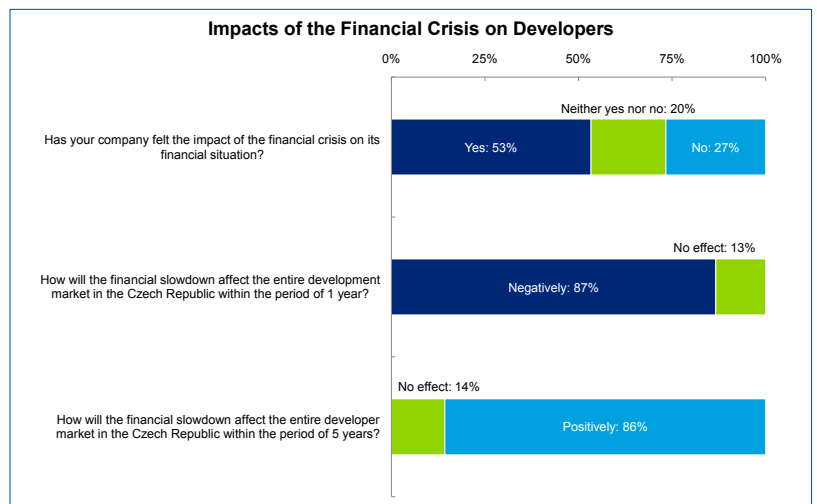
According to the vast majority of companies, the current financial slowdown has significant impact on their business. Most often, the companies felt the impact in the area of project financing and reduced demand by clients. Almost all of the companies (87 percent) believe that the financial slowdown will affect the entire development market in the Czech Republic within the period of 1 year, whereas none of the companies participating in the survey expect negative impact in the 5 years horizon. The companies specify that there will be increased pressure on the quality of projects and the market will be cleaned up.

Impact on the Availability and Conditions of Financing

Project financing (development projects)

All companies (100 percent) feel greater restrictiveness or stricter requirements of banks for project financing. Almost all of the companies (87 percent) feel the difference in the consequences of the financial crisis on the status of projects in projects in different stages of implementation. Developers see the most difficulties in the starting phase of a project (problems with financing, pre-sales, equity). Almost all of the companies (87 percent) claim that the requirements for own equity are increasing.

The requirements for the minimum own equity have increased on average by 12 percentage points, from 10 percent to up to 40 percent. A similar situation is seen in the requirement for pre-sales, where the requirement of minimum pre-sales increased on a year-on-year basis by 17 percentage points (from the average 15 percent up to 40 – 50 percent). Interest margins grew on a year-on-year basis by an average of 78 bps (0-200 bps). Despite of these changes, most of the companies (80 percent) do not plan to reduce the number of development projects financed by banks.



Mortgage loans and building savings loans

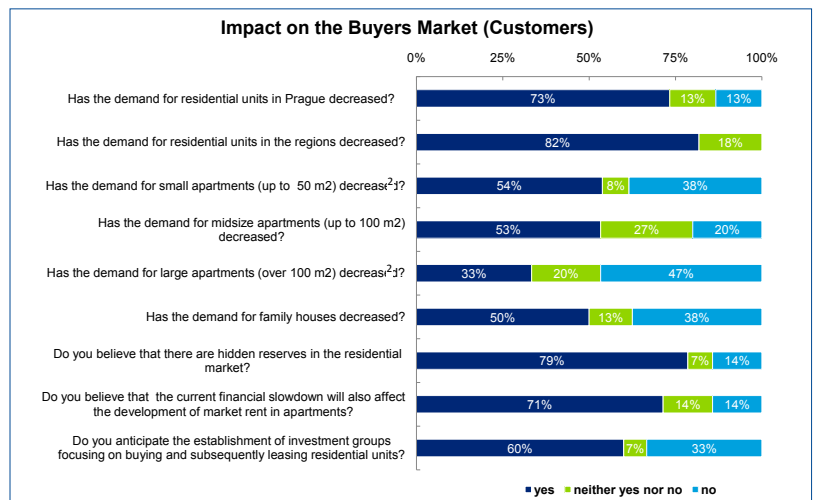
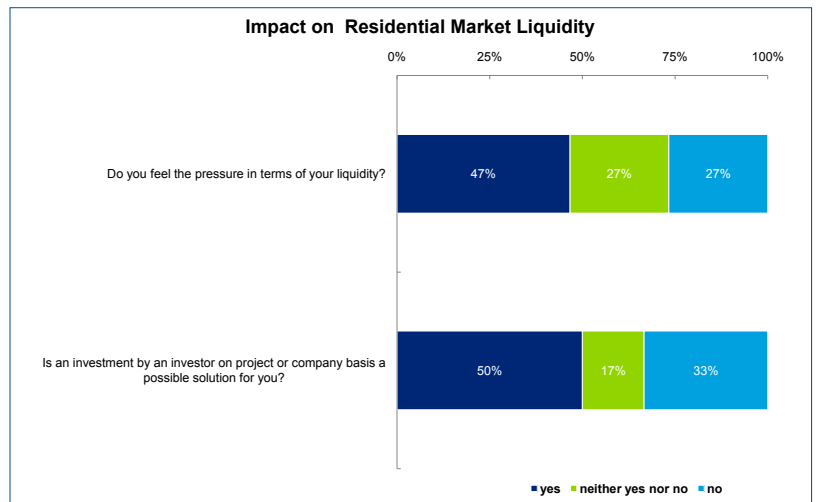
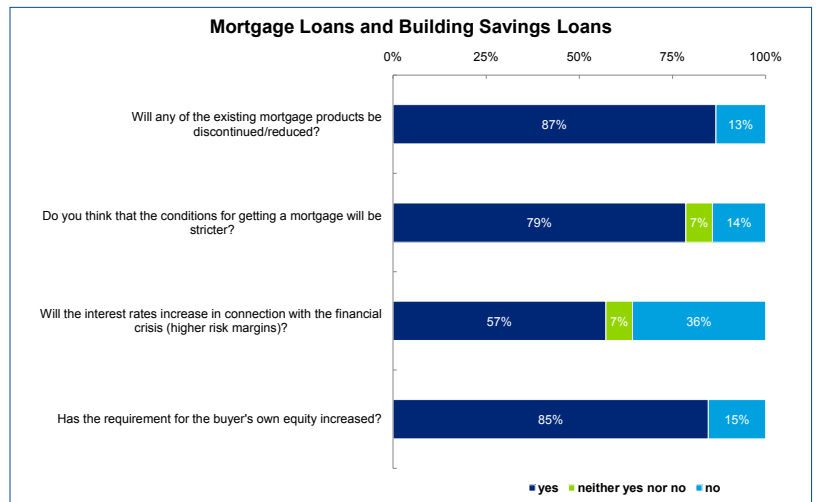
Almost all of the companies (87 percent) believe that in connection with the economic slowdown banks will discontinue (or reduce) some of the existing mortgage products. Most of the companies (79 percent) believe that the requirements for obtaining a mortgage will be stricter. More than half of the companies (57 percent) believe that in connection with the financial slowdown the interest rates will grow (e.g., higher risk margins), in short term horizon. Most of the companies (85 percent) claim that the requirements for the buyer's own equity have been increased.

Impact on the Residential Market Liquidity

The companies perceive differently the impact of the crisis on the liquidity of the residential market, particularly depending on whether they are implementing development projects, they are starting development projects, or they are about to finish them. Depending on the project phase they feel the liquidity pressure. Half of the companies feel the pressure on liquidity – these companies have introduced cost saving measures and are reducing (operating) costs; they seek to retain the current projects or they reduce headcount. Some of the companies cannot tell (27 percent), others do not feel the pressure (27 percent) – mostly small companies. For one half of the companies (50 percent) representing the construction companies segment, or companies focusing on the lower price segments, the possible solution would be entry of an investor on a project or company basis; for one third of the companies (33 percent), particularly companies of an investment nature, it is not the solution.

Impact on the Buyer's Market (Customers)

Most of the companies receive information from their sales agents on the decline of customers as a result of speculative waiting (waiting for the response of the real estate market). The customers' bargaining position is strengthening when negotiating the price of a property, and most customers expect a discount. At the same time, there is a factor of speculative waiting for the reduction of interest rates of mortgage and other loans. According to most companies, the demand for residential units has noticeably decreased, in connection with the financial slowdown, in Prague (73 percent) as well as in other regions (82 percent). The decline in demand mainly pertains to small and medium-sized apartments; as for larger and luxury apartments it depends more on the type of the specific project. Most of the companies (79 percent) believe that there are hidden reserves in the market of apartment sales, in the amount of 14-18 percent.



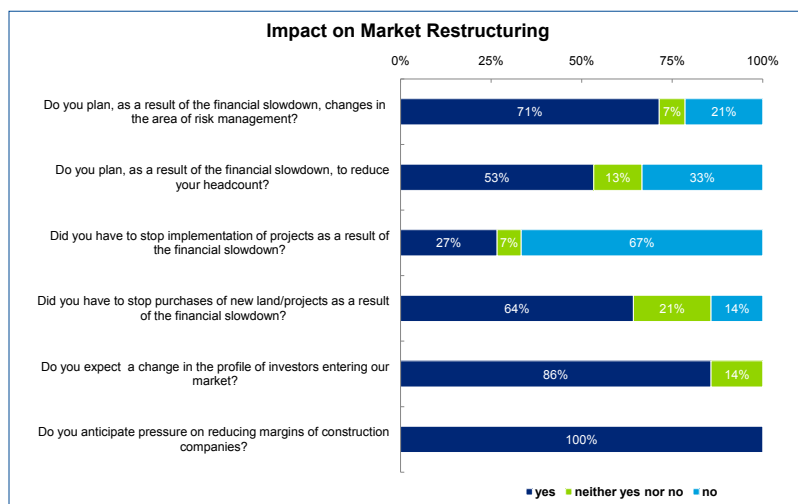
The dominant part of the buyer structure in the Czech Republic are Czech citizens who buy apartments for their own housing needs. In the minority part are foreign buyers, who buy apartments as an investment. The structure of buyers significantly changed in terms of the country of origin of the investor, particularly as a result of the significant economic depression in their home countries.

Most of the companies (71 percent) believe that the current financial slowdown will also have an impact on the development of the market rent for apartments. More than half of the companies (60 percent) anticipate establishment of investment groups focusing on buying and subsequently renting residential units.

The companies were not very willing to estimate exactly the impact of the crisis on their business, particularly not the possible price decreases; half of the companies expect a decrease in sales prices of new apartments by 10 up to 20 percent; a number of companies do not expect prices to fall.

Impact on Market Restructuring

Most of the companies (71 percent) plan changes in the area of risk management as a result of the financial slowdown. Half of the companies (53 percent) plan to reduce their headcount. The companies are considering looking for savings particularly in the area of reorganization and restructuring as a result of the crisis (64 percent yes); small companies are not considering savings in this area. The companies are also looking for improvements in the changes of the configuration of project controlling and reporting (60 percent yes). On the other hand, the companies are not considering looking for savings in the area of implementation / re-implementation of IS/ICT (80 percent no), or in the changes of their own motivation systems (60 percent no).



The positive point is that the current situation does not deter two thirds of the companies from developing further projects in the Czech Republic, but more than half of the companies (64 percent) were forced to discontinue purchases of new properties (land)/projects as a result of the financial crisis. In the future, however, they plan to prepare projects only under the condition of project profitability. In the event of the decline of prices in the real estate market they would rather not start new projects at all. With respect to the fact that most of the supply in new residential projects in the past five years was directed at the end of 2007 due to the anticipated change of VAT, most of the companies believe that non-commencement of already prepared new projects would result in a substantial reduction of the supply, and thus future forced dramatic increases in demand for new apartments.

Almost all of the companies (86 percent) anticipate a noticeable change in the profile of investors entering our market. In the opinion of most of the companies, the speculation-oriented segment will disappear.

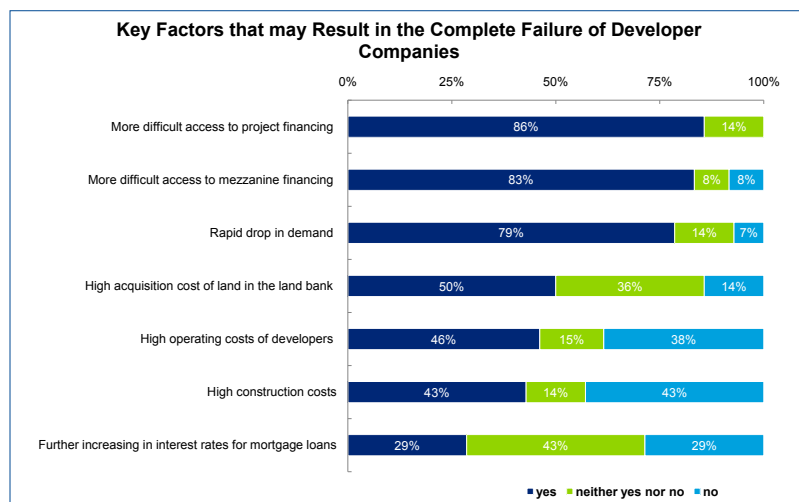
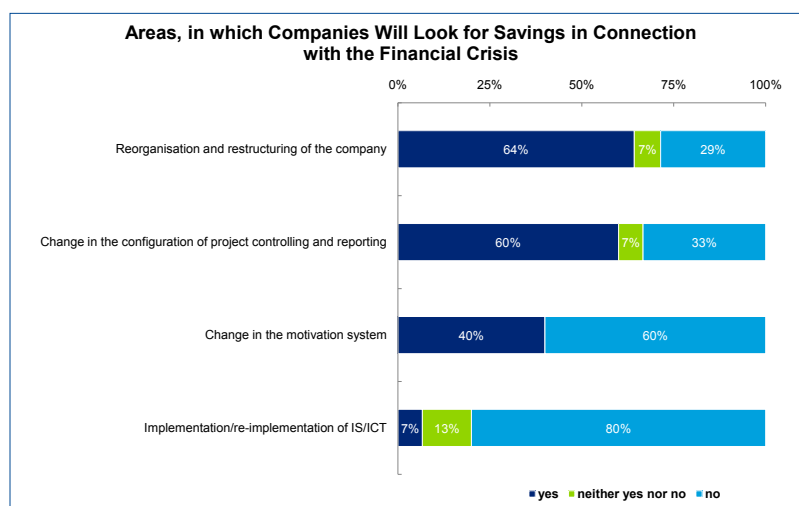
All of the companies expect pressure on reducing the margins of the construction companies, approximately 5 – 15 percent (for construction works). They believe that the main factors that may lead to failures of developers include particularly unavailability of external financing and poor liquidity.

The main factors which may lead to failures of developers include:

- More difficult access to project financing – most of the companies;
- More difficult access to mezzanine financing – most of the companies;
- Rapid drop in demand – most of the companies;
- High acquisition cost of land in the land bank – half of the companies; and
- High operating costs of developers – almost half of the companies.

Factors in which the companies did not have the same opinion as to whether they will lead to failures of developers include:

- High construction costs; and
- Further increase in interest rates of mortgage loans.



5.2.3 Comparison of the Results of Banks and Developers

As some of the groups of questions in the survey were the same or similar for both banks and developers it was possible to compare their answers, how they differed or when they were identical.

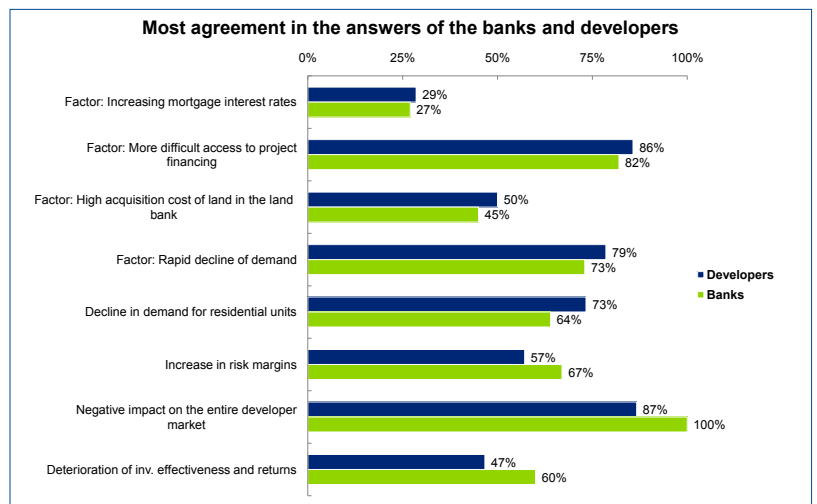
The most agreement was in the opinions on the factors that may potentially lead to failures or problems of developers. Both banks and developers almost completely agreed that these factors are particularly more difficult access to project financing (supported by the increase in cost of funds), rapid decline of the market demand, high acquisition cost of land in the land bank, and also further potential growth of the mortgage interest rates.

Banks and developers are also in agreement on the fact that in connection with the financial crisis the demand for residential units palpably fell and that the crisis will negatively affect the entire development market, and investment effectiveness and returns on investments will deteriorate.

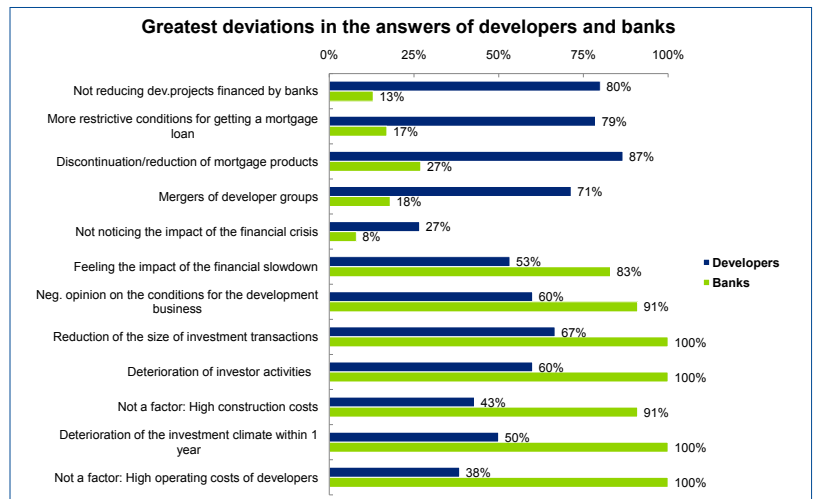
The study, however, clearly showed that banks and developers have a different opinion on some areas or they have different expectations, and at times they even have opposing views. The chart shows the statements in which a statistically significant deviation was found in the answers of banks and developers.

The first is the general perception of the impact of the crisis on their business – developers are substantially more optimistic in their expectations – also concerning the future development of the conditions for development business and the appetite of investors in the development segment in general.

Developers more often said that they will not reduce the number of projects that they want to finance through banks. On the other hand, banks will reduce the number of development projects they are willing to finance. In a similar way, developers believe that the requirements and conditions for getting a mortgage will be stricter, that mortgage products will be discontinued (or reduced, as the case may be), but banks are not planning any further significant tightening of the conditions for mortgage loans or reduction of mortgage products. Unlike the banks, developers believe that developer groups will merge more often.



The statements are listed in the order from the most agreement in the answers of the banks and developers.



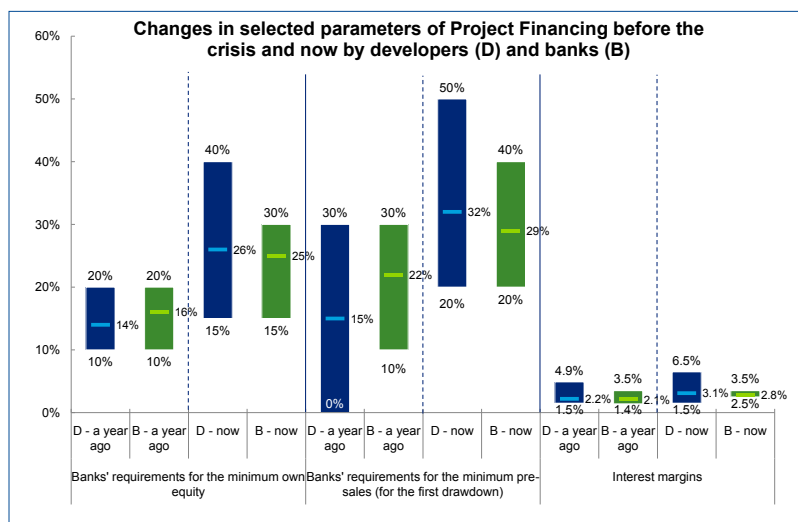
On the other hand, banks – unlike developers – believe that high operating costs of developers or construction costs are not factors that will lead to failures among developers. Banks expect, more often than developers, that the investment climate, transaction activity in the market, and investors' activities will deteriorate and that the volume of investment transactions will decrease. Unlike developers, banks do not expect the arrival of venture capital.

The comparison also illustrates year-on-year (12/2007 vs. 12/2008) market changes of selected parameters of development project financing registered by developers and banks.

Without exception, minimum requirements for own equity (on average by 9 – 12 percentage points) and for pre-sales (in average by 8 – 17 percentage points) have increased.

At the same time, interest margins grew on average by 79 – 103 bps.

In all the above-mentioned categories, developers stated higher year-on-year increases on average (the top limits of the said ranges apply to them) i.e., in general more severe tightening of access and more expensive financing than the financing banks.

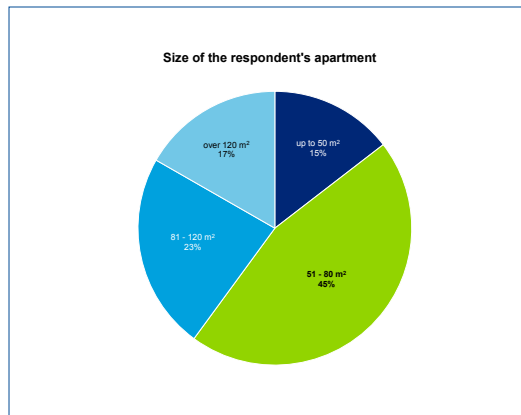
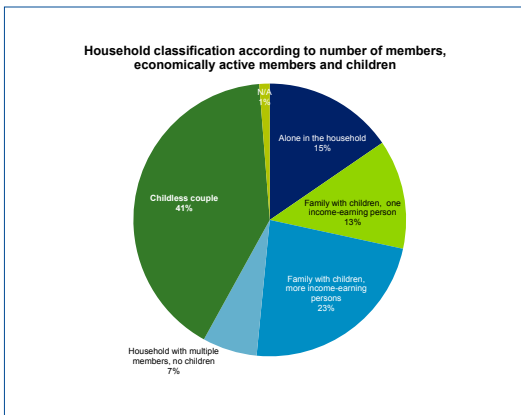
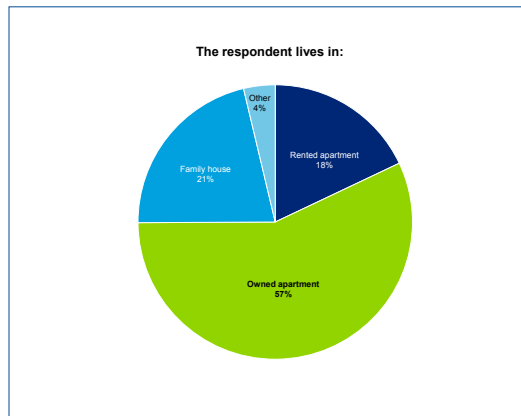
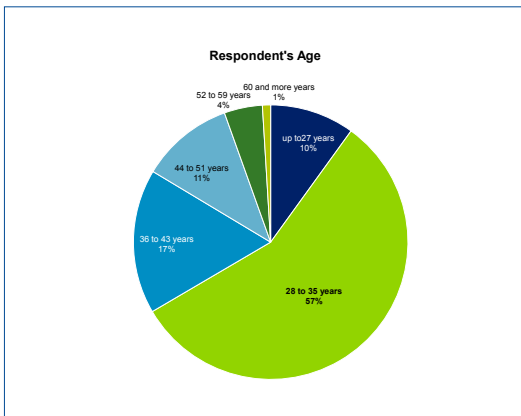


5.3 Results of the Questionnaires for the Public

5.3.1 Sample Structure

A total of 324 respondents were included in the different groups as follows:

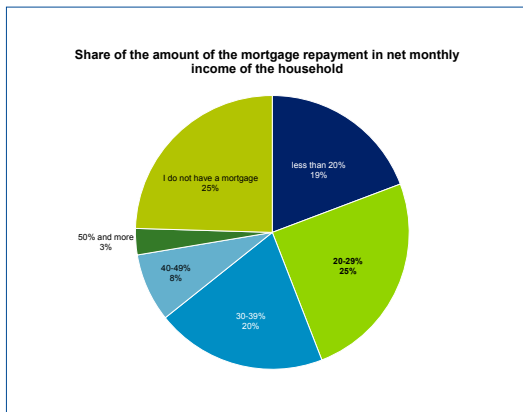
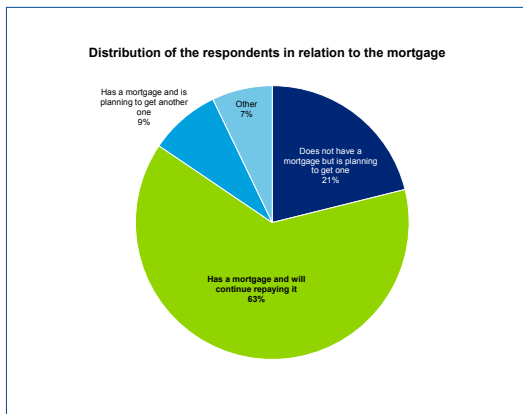
Most of the respondents (more than half) were aged 28 - 35 and also 36 - 43, i.e., in the age when most people start families and buy their first, or second (in the higher age group), home. As for the household structure, most represented were households with two adults without children followed by families with children with more than one income-earning person.



More than one half of the respondents live in their own apartment. The most frequent size of the respondent's apartment is 51 – 80 m², which corresponds approximately with the layout of a two- to three-room apartment.

The largest group of respondents, almost two thirds, currently has a mortgage loan and will continue repaying it. Another group, 21 percent of respondents, does not have a mortgage loan but is planning to get one. The amount of repayment of the mortgage loan constitutes mostly 20 – 29 percent of the monthly net income of a household; the least represented are those in which the percentage of the income exceeds 40 percent.

In all questions related to the respondents' opinion we identified statistically significant deviations for the above-mentioned groups.



5.3.2 Respondents' Opinions – Analysis of the Individual Questions

Respondents' concerns related to the financial crisis

To the question what situations they fear in connection with the financial crisis, most respondents said that they fear a decrease in the household's income (every other respondent fears this). Of all respondents, those who live in a rented apartment fear this situation more frequently.

On the other hand, primarily those whose mortgage repayment is less than 20 percent of the household net income, older respondents aged 52-59 years, people living in their own apartment, and those who have a mortgage and plan to apply for another do not fear a decrease in income.

Lower availability of mortgage loans is feared more frequently by people who do not have a mortgage yet but plan to get one. Loss of a job, which came out as the third most feared situation, is primarily quoted by respondents who live in small apartments (up to 50 m²). Respondents living in large apartments (over 120 m²) fear much less than others that the price of the apartment will fall below the amount of the mortgage.



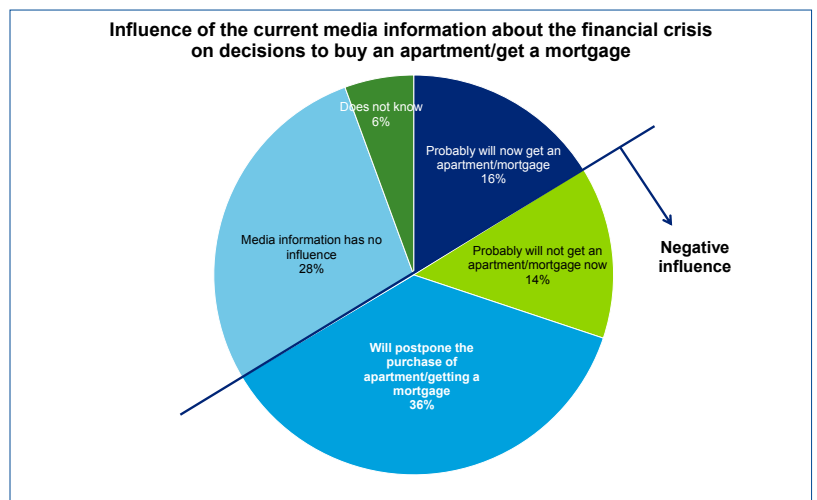
The respondents stated that they are more afraid that they will not be able to repay the mortgage loan than other loans. Inability to repay a mortgage is feared more frequently by people living in small apartments (up to 50 m²); this situation, on the other hand, is not feared by the respondents whose mortgage repayment is less than 20 percent of the household income.

Influence of Current Media Information on the Financial Crisis on Decisions to Buy an Apartment or Get a Mortgage

The current media information on the financial crisis negatively influences one half of the respondents in terms of their interest in getting a mortgage – most often they have postponed their decision to apply for a mortgage.

Media information does not influence more than one fourth of the people, in particular respondents who live in a family house or who have a mortgage and are planning to get another one.

There is also a group of people on which the media information has a positive influence – primarily those whose mortgage repayment is less than 20 percent of the household income – tend to be encouraged to buy an apartment.



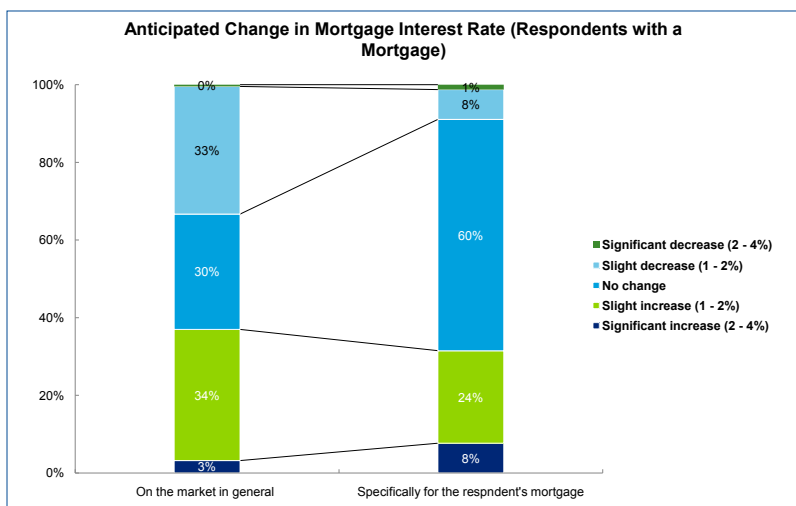
Developer's Incentives to Buy an Apartment

Order	Developer's incentives that motivate to buy an apartment
1	Discount on the purchase price of the apartment (5 – 10%)
2	Reimbursement of mortgage payments up to the set limit/ payment of interest on the mortgage loan for 1 year
3	Insurance guarantee – payment of insurance against inability to repay a mortgage (PPI)
4	Free furnishing for a part of the apartment (e.g., kitchen furniture)
5	A free car

The respondents were asked which incentives of a developer would motivate them most to buy an apartment. Of the incentives listed, the following are ordered from the most preferred to the least preferred. The table shows that the respondents more frequently prefer a financial benefit to a material bonus.

A discount on the purchase price of the apartment would be most welcome by those who do not have a mortgage and are planning to get one, and also respondents living in a rented apartment. Reimbursement of mortgage payments or interest would be appreciated by young people up to the age of 27 years and respondents without children. Insurance guarantee is preferred primarily by people in the age range of 44 – 51 years and families with children; on the other hand, it less motivates the respondents who live alone and have no children. Free apartment furnishings are somewhat less preferred (as opposed to other people) by people living in larger apartments (size 81 – 120 m²). The least preferred incentive of the above list – a free car – is preferred much more frequently by respondents aged 52 – 59, and less preferred by those whose mortgage repayment is a large percentage of the household income (more than 40 percent).

Anticipated Change of Mortgage Interest Rates



The respondents were first asked how they think mortgage interest rates will change before the end of 2009 in general, and then, if they have a mortgage and if their interest rate will be reset in the next 12 months, how they believe the interest rate on their mortgage will change.

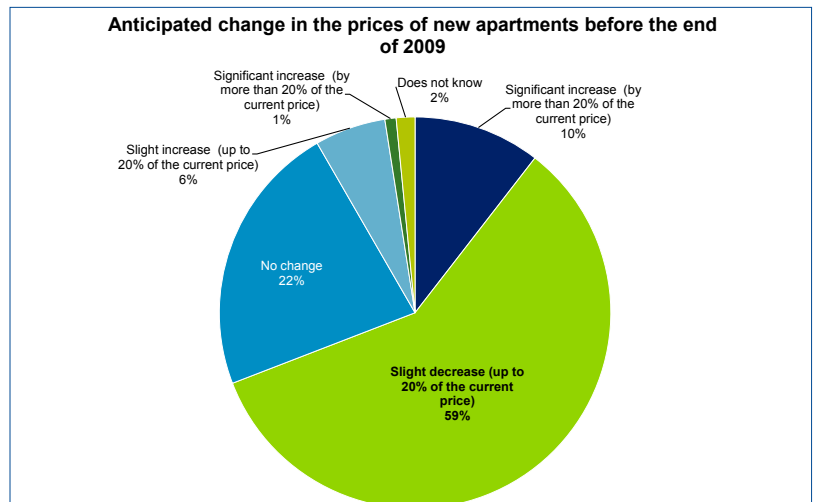
The following chart shows the comparison of these answers, only in the respondents who have a mortgage.

It was difficult for the respondents to estimate the change of the mortgage interest rates on the market in general – slightly more than one third of the respondents expect an increase (primarily those whose mortgage repayment is less than 20 percent of the household income), one third expects a decrease (primarily those living in a rented apartment), and the remaining almost one third expects that mortgage interest rates will not change before the end of 2009. On the other hand, re-setting of the mortgage interest rate will not occur in 60 percent of respondents (primarily in people with mortgage repayment less than 39 percent of the household income); it will decrease only in 9 percent of respondents and increase in one third of the respondents (mainly those who have a mortgage and will continue repaying it or even get another mortgage).

Anticipated Change of the Prices of New Apartments

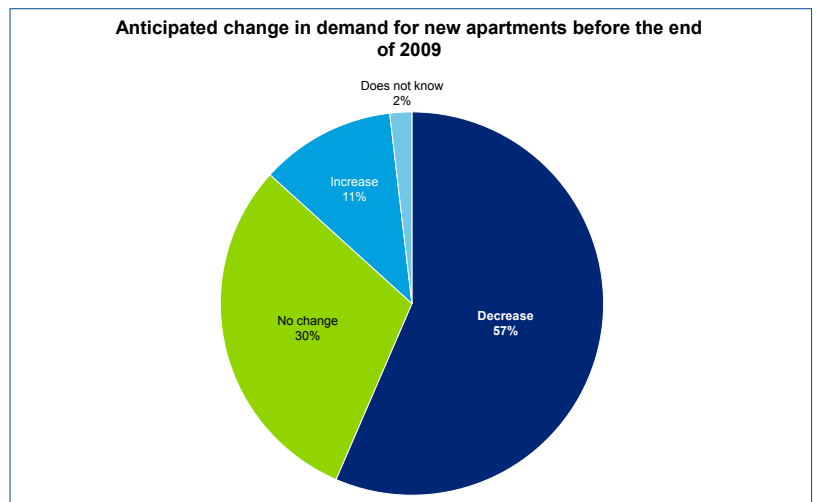
More than two thirds of the respondents expect that the prices of new apartments will fall before the end of 2009, most frequently up to 20 percent of the current price. According to 22 percent of respondents, the prices will not change.

Future price reduction is more significantly expected by people without a mortgage.



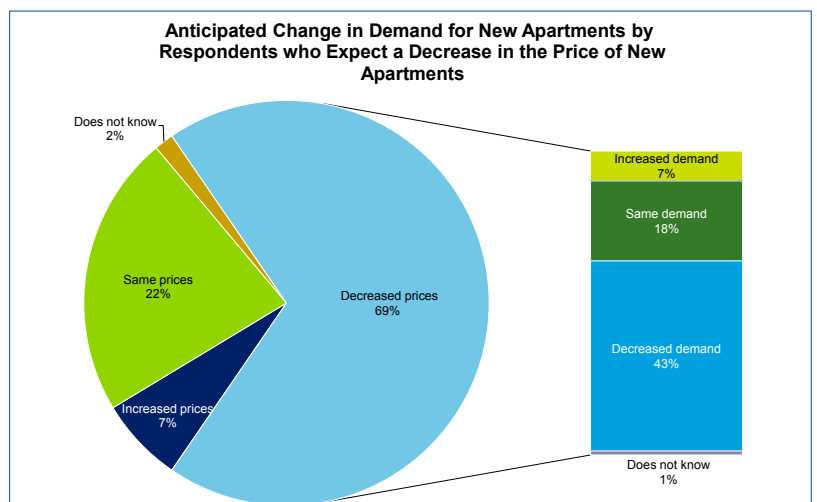
Anticipated Change of the Demand for New Apartments

According to more than one half of the respondents, demand for new apartments will fall by the end of 2009. Increased demand is expected by a mere 11 percent of respondents, mostly those whose mortgage repayment is less than 20 percent of their net income.



Respondents who expect that the prices of new apartments will fall also expect more frequently lower demand for new apartments. According to the respondents, the decrease in prices of new apartments therefore does not lead to increased demand for new apartments.

The opinion that the demand for new apartments will fall is shared (as opposed to others) more frequently by the respondents who also believe that interest rates in the market will grow and also those who fear a loss of job and inability to repay the mortgage loan.



6. Study Conclusions

6.1 Summary

The study has shown that the current slowdown in the residential market can be described primarily as a crisis of demand – it is primarily the result of absorbing part of the demand from subsequent years in 2007 and satisfying the housing needs of baby-boomers. The impact of the global crisis is more likely secondary and is shown in the departure of speculative investors (domestic and foreign) and also in the waiting of buyers for an expected drop in apartment prices, and in the fear of reduced household income, for example resulting from the loss of a job.

The Czech mortgage market, unlike in e.g. Hungary, Iceland or the Balkans, is based on the domestic currency, and has been therefore protected from the exchange rate shocks and the associated negative impact on the borrowers' ability to repay mortgage loans. The residential market consisted of 90 percent domestic demand for dwellings; secondary housing, foreign and speculative investors were a minority. It is therefore possible to expect that, due to the above-mentioned factors, the impact of the global crisis on the residential market will be less severe than in other countries. Nevertheless, it is still necessary to seriously anticipate the negative symptoms of the crisis as without state intervention they may have a critical impact on the entire construction industry and capital construction industry with far-reaching social implications.

In addition, the domestic mortgage market is not unhealthy, it did not have time to become "infected" according to the model of the U.S., Ireland, the U.K. or Spain, and it is possible to claim that it has stabilised on a safe level. No subprime products were introduced to the Czech market; banks' excessive benevolence towards mortgage applicants was only seen in the period of approximately 18 months in 2007 and 2008. The majority of mortgage loans are granted with a significant share of client's own equity; the market has not inclined towards 100 percent LTV. A longer lasting reduction in the banks' willingness to grant mortgage loans, however, may potentially support the shift of part of the demand to less transparent non-banking credit providers. The Czech banking market and the vast majority of its players have the advantage of a sufficient volume of primary deposits, i.e., have sufficient liquidity; the market is largely based on domestic clients' deposits in the domestic currency.

There was no primary infection by toxic assets, and even the secondary influence of the parent banks was not substantial, the market is currently fully clear of these assets.

The changes seen in the banks' approach to the financing of residential development projects represented particularly in the increased requirements for the developer's own equity and substantially increased requirements for pre-sales may have a stabilising effect on the residential market as the slowdown resulted primarily from lower demand and not from a short-term freezing of the supply as a result of the financial crisis. It is therefore being perceived as a rather desired correction of the market rules of project financing.

Fluctuations in the demand for homes, as well as in the home prices, are common in the developed world, and both the buyers and developers in the Czech Republic must get used to this. International experience shows that in the long term, residential properties are a good investment, in spite of the occasional price fluctuations; in the longer term they show price stability and anti-inflation effects. The insufficiently resolved issue of retirement pensions of today's productive generation in Central Europe therefore predestines investments in real estate as an advantageous form of a "supplementary pension insurance".

Based on the experience from past economic crises with specific impacts on the housing segment, we can formulate the following conclusions:

- Government corrective interventions in the economy tend to be one of the triggers of fluctuations in the real estate market, and therefore a well considered government action should also constitute a stabilising mechanism. A successful remedial program usually has several common denominators:
 - Strong political background;
 - High degree of explanation and transparency;
 - Rational approach (populist solutions only lead to intensification of the negative impact of the crisis); and
 - Good quality insolvency legislation.
- A return to a balanced situation in the real estate market takes several years, particularly due to the significant depressive effect of the drop in property prices on the confidence and expectations of a large part of the population;
- Deflation of the real estate prices affects the entire economy and substantially prevents quick recovery of the economy;
- Economic crises of the past decades were significantly fuelled by negative media reports.

Based on international experience, it is recommended to implement government measures that will lead to correction of the discrepancies in the residential market. If the residential market slump is not prevented it will negatively affect the entire economy and all its players. Uncertainty and distrust of the population in the area of buying their own home will grow, and other ways to deal with the housing issue will be sought (e.g., rental, municipal and social housing, social benefits and aid). A separate issue is the risk of a debt trap for the holders of mortgage loans and the related higher borrower delinquency. Forced sales of pledged properties would result in negative multiplication of the impact on the property prices and also significant social implications, which would probably have to be covered by public budgets. In order to ensure a quick recovery of the residential market and the related industries it is desirable that the government and the affected parties ensure:

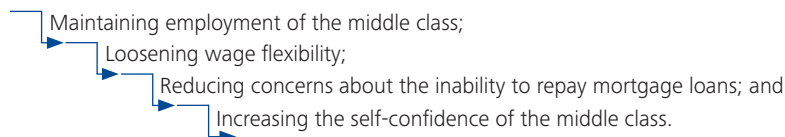
- Fulfilment of the expected reduction of property prices;
- Change of the developers' approach – from the profit maximisation to loss minimisation mode;
- Support of the middle class, which has been the main driver of growth of the entire industry;
- Prevention of forced sales of apartments as a result of the impact of the crisis on the holders of mortgage loans; and
- Revitalisation of demand in the residential market.

6.2 Measures

6.2.1 Support of the Middle Class

The residential market in the Czech Republic is primarily the domain of the middle and upper-middle class of the population, which has been active in the previous years in buying their own homes or in improving their homes on their own account, without expecting any aid from the state. Thanks to the demand of this group of people the residential market significantly developed in the past 10 years, and construction production in the area of residential development, which declined to the minimum in the early 1990s, was able to grow. If the residential development market is to be revived the government measures related to the support and revival of the economy should be aimed at eliminating the negative expectations of this segment of the population.

The government measures should primarily be directed at:



6.2.2 Prevention of Forced Sales of Apartments Due to Inability to Repay Mortgage Loans

Approximately 10 percent of mortgage holders in Spain have problems repaying their mortgage, in the U.S. up to 12 percent. In the Czech Republic the situation could be similar if the crisis intensifies. Under the pessimistic scenario, if the problem with repayment affected 10 percent of mortgage loan holders, forced sales could put as many as 40,000 apartments pledged as security to banks on the market, which would ultimately:

- Intensify the current negative situation of the residential market;
- Result in a significant drop in prices, in some locations below the level of developer costs;
- Result in social problems in the form of the loss of homes; and
- Cause significant losses for the financing institutions.

6.2.3 Reviving the Residential Market

Investment development has a significant multiplication effect on other industries, in particular building construction and the industries related to housing such as manufacturers and vendors of construction material and equipment, design and architectural studios, manufacturers and vendors of apartment furnishings, and the entire associated segment of commerce and services. There are also significant effects on the banking sector; problems are expected with the deflation of assets, the necessity to revalue assets and the related losses and adjustments impairing the banks' financial statements. Even a relatively small revival of the segment and sales with zero margins will help the companies in the field survive.

6.3 Possible Instruments for Reviving the Residential Market

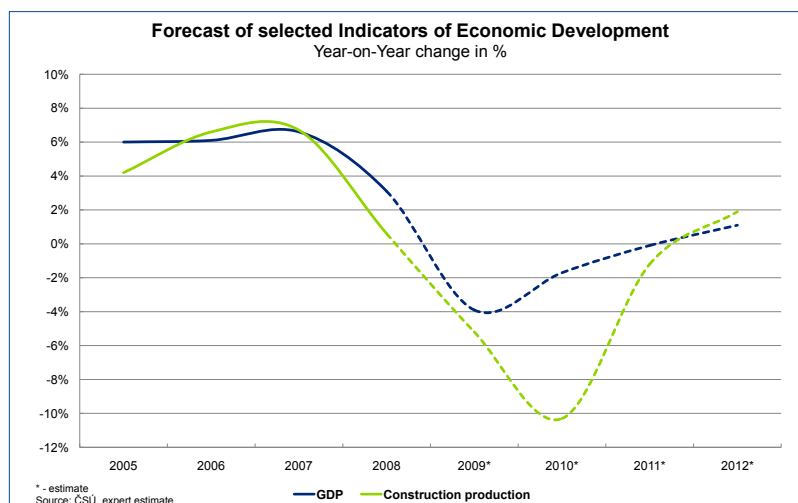
Instrument	Description
Payment protection insurance of the client against the inability to repay a mortgage loan	Commercial insurance product (with the involvement of the bank, insurer, developer) – based on the payment protection insurance against inability to repay a home loan as a result of job loss, but for a significantly longer period than the current products. Ideally for the period of the expected duration of the crisis. Optimally designed as a marketing bonus, where the developer pays the said insurance premium for the client instead of paying for a car. The clients would therefore have security that for the time when the impact of the crisis can be expected they will be protected in the event of a job loss. The product is directed at the lucrative client segment and at a limited segment in terms of the number of participants – for purchases in new development projects (secondarily also banks) to create a new environment that will put emphasis on elimination of the risk of loss of income of the client.
Aid in the event of inability to repay mortgage loans	A state guarantee agency which would take over the obligation to repay the interest on mortgage loans in the event of a job loss or reduction of income, which would be transformed into a commercial loan after the crisis has passed away. The above-mentioned approach should optimally be combined with a postponement of the payments of the principal granted by the financing bank. A significant risk of this measure may be the setting of the upper limit, which might exclude the target middle class from this measure. The said measure would represent additional expenditures of the state in the estimated amount of CZK 1.1 billion in the first year, and CZK 5.5 billion for the entire duration of the crisis (estimated 2-3 years).
Support of the creation of new types of rental housing	More than 60 percent of respondents among developers anticipate creation of investment groups focusing on purchases and subsequent lease of residential units based on the market principle. The stated “rental apartment supply” may help to kick-start the residential market and building construction industry, and maintain the price level of rents.
Temporary reduction of VAT on apartments	An initiative of the Association of Building Entrepreneurs to reduce the VAT rate for residential development to 5 percent for a limited period of 2, maximally 3 years in order to encourage the commencement of the construction of postponed projects and thus improve the performance of the building construction industry. The reduction of the VAT rate to 0 percent would currently be contrary to the EU rules and would have to be approved by the EU authorities. The said measure may presently even worsen the situation of residential development because the market may slow down significantly due to the anticipation of the change in the time before the reduced VAT comes into effect. The end of the validity of this measure will probably result (similarly to the increase in the VAT rate in 2007) in a situation where a number of potential buyers will reconsider the timing of their plans to buy a dwelling, and the measure will partly absorb the demand from 2012 and the following years. The said measure could therefore eliminate any imbalances between the supply and demand after the crisis has faded away. The critical success factor is the speed of putting this measure into effect and the pre-defined termination thereof.
Restoration of tax benefits for mortgage bonds	The provision which made it possible to exempt interest income from mortgage bonds from the withholding tax was added to the income tax act in 1994 in order to support this banking product designed for re-financing mortgage loans for residential development. With the gradual development of the capital market the Ministry of Finance of the Czech Republic concluded that the importance of this exemption gradually decreased, and starting 1 January 2008 this exemption was cancelled for mortgage bonds issued after 1 January 2008. The estimated impact of this measure on the state budget was approximately CZK 2 billion. Even at the time of passing this amendment there were speculations on whether this additional income for the state budget would not be compensated by substantially higher indirect losses resulting from the decline in the real estate market. With respect to the current developments the restoration of the tax benefits could be one of the stimuli for increasing the demand for mortgage bonds.

6.3 Possible Instruments for Reviving the Residential Market - continued

Instrument	Description
Support for the construction of municipal rental apartments in smaller municipalities	Construction of municipal rental apartments in smaller municipalities in cooperation with investors, for example in the form of PPP projects or external project management services in order to utilise the free capacities of developers and support building construction in regions which have not been developers' primary focus. The said measure requires changes to the respective laws, in particular regulated rent.
Possibility to deduct the cost of an apartment bought as a home from the tax base	The possibility to deduct the amortisation of an apartment purchased as a home (i.e., 2 percent) from the tax base will cost the state some CZK 1.7 billion from income tax revenues, which will be retained by the holders of mortgage loans. This measure should make investments in owned dwellings more attractive.
Possibility to deduct the loss from apartment rental income	Changes in the residential market may lead to the necessity to lease apartments for a price that is below the costs, particularly in more expensive apartments. It is currently not possible to deduct the said costs from the basis of assessment of income tax from employment income. The above-described motivation is supposed to correct the situation for small apartment lessors and to eliminate any non-official leases.
Cancelling the property transfer tax	The Ministry of Finance plans to cancel, effective from 1 January 2010, property transfer tax which currently amounts to 3 percent. This measure is supposed to reduce the transaction costs related to sales of apartments and to help the residential market. The measure, however, will mainly have an impact on the market of older apartments; new apartments are exempted from the property transfer tax. The impact on residential development and thus the building construction industry will therefore be rather negative. Cancellation of the property transfer tax will result in reduced collections for the state budget in an estimated amount of CZK 7 billion.
Change of the state financial support for mortgages	Recommendation to change the government regulation on state financial support of mortgages for new dwellings in the form of time harmonisation of the methodology in order to provide the state financial support according to the specific interest rate of the particular mortgage loan and not according to the average interest rate of all mortgages granted in the previous year, as is the current practice. At the same time, it is desirable to harmonise the methodology of applying for the state financial support in such a manner that it will be "automatic", because in the previous years a number of mortgage loan holders lost the chance to enjoy the future state financial support just because they did not file the application for the state financial support believing that state financial support was currently not effective.

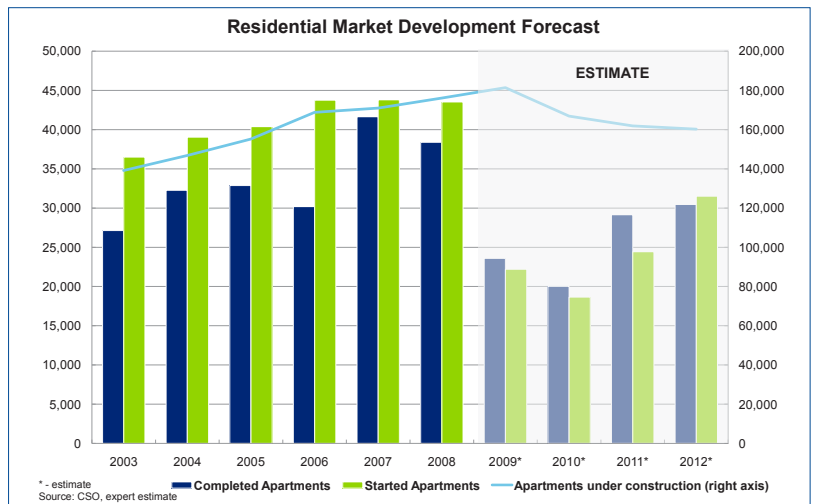
6.4 Market Development Forecast

Because of the strong orientation of the Czech economy on exports, in particular to countries significantly hit by the financial crisis, it is possible to expect a significant impact on the GDP growth and on important indicators of confidence in the Czech economy. The forecasts of the development of the Czech economy significantly differ yet frequently indicate the more negative scenarios. The estimates range between growth of 3.7 percent (the original estimate of the Ministry of Finance in 2008) and recession of up to 3.9 percent (the pessimistic estimate of the authors of this study), but the most frequent estimate in respect of the current turbulent development is "negative zero". The recession may be positively corrected by systemic state intervention.



6.4.1 Residential Market Development Forecast

After eight years of continuous growth, the residential market will slow down and there will be a certain correction of prices as well as of preferred concepts – for developers, the time when everything that was built was quickly sold, is over. It is possible to expect more significant market segmentation from the customers' perspective, market differentiation based on quality and modern design. Support of environment-friendly dwellings and implementation of energy certificates of buildings may have a positive impact on clients' preferences and the choice of development projects based on the environmental aspects and the TCO (Total Cost of Ownership) concept, which may result in the choice of different materials and technologies from today.



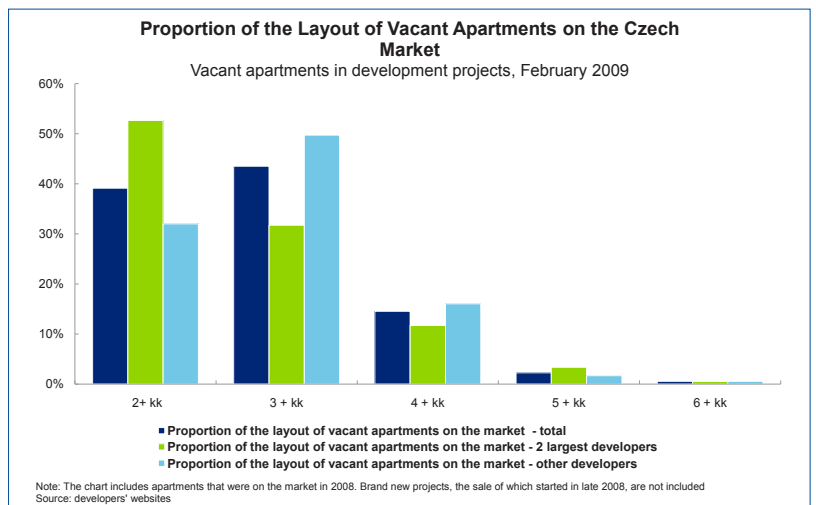
Demand Trends

Demand for residential properties is expected to fall in 2009 by as much as 45 percent, and return to the 2006 levels, which may result in a medium-term reduction in the supply of apartments in the following years with an impact on the stimulation of demand and the subsequent repeated growth in prices.

It is expected that sales of apartments in the phase of zoning/planning decisions, or prior to the commencement of the construction work will be less preferred. On the other hand, the sales of completed apartments are expected to grow. A decrease in demand for owned apartments represents a stimulus for the rental market.

Price Development

In general, prices of residential properties are expected to fall in 2009. While the growth of prices of residential properties has been more or less universal, the drop will certainly not be universal. It will depend on the quality of the particular apartment and the location. Prices are currently expected to fall primarily in older, particularly non-renovated apartments in concrete panel buildings (in which the prices grew almost unrealistically in the previous years) and apartments and projects in locations that are not well accessible in terms of transport and that are insufficiently socially equipped. The price level of the residential market is expected to return to the 2006 levels as a result of the current events. It is not possible to expect significant growth in the prices of residential properties in the following years. Long-term sustainable growth is probably an annual increase in apartment prices by 2-3 percent above the inflation.



Anticipated drop in prices in the individual types of properties relative to 2008:

Old apartments in compact buildings	Apartments in concrete panel buildings	New apartments
0 – 20%	20 – 30%	5 – 15%

At the same time, greater differentiation of the individual classes of apartments depending on the standards (size as well as materials), location and civic amenities and available transport services is expected. Until now almost all apartments were described as luxury and above-average. At the same time, greater price differentiation of the different parts of towns and cities can be expected.

There may also be a significant impact on the amount of rent, particularly in more expensive apartments, where annual return may decrease to 1-2 percent, similar to the current situation in Ireland. On the other hand, the less expensive segment will retain annual returns of approximately 4-5 percent.

6.4.2 Developers Situation Forecast

The impact of the current situation in the residential market on developers may be significant due to the combination of two important negative factors: the global financial crisis and the natural decline in demand. The residential market will take longer to recover from the crisis than the commercial property market because of the depressive effects of the market decline on small investors. The market slowdown will clean up the entire residential market. Particularly developers who use significant leverage and who have a significant pool of land with liens for project loans may get into serious trouble. 87 percent of the developers inquired anticipate insolvency of developer groups in connection with the financial crisis. As a result of the above-mentioned situation, individual developers will probably merge into larger groups; this possibility was admitted also by a majority of the developers' representatives inquired (71 percent). It is expected that new entities will enter the residential development market, particularly from among major industrial and investment groups.

There will be a significant impact on the employees in the area of development; 53 percent of developers plan to reduce staff headcount. A significant correction of the salary level and the compensation packages of the respective specialists can be expected.

6.4.3 Real Estate Companies Development Forecast

A significantly negative impact can be expected in the segment of real estate brokers specializing in sales and leases of residential properties. The number of real estate agencies is much higher than in other countries, in terms of the indicator of number of real estate agencies per capita. It is possible to expect a reduction of up to 50 percent, perhaps even a two-thirds reduction of the number of real estate companies, primarily small "garage companies". On the other hand, the position of large, well-established and successful real estate companies capable of financing operating costs in the period of a temporary market freeze will likely be strengthened. The threat of the sellers' financial

instability may result in an increased share of standardised transactions, i.e., transactions effected through specialised parties. In the real estate field we can expect different forms of "clustering" of real estate agencies, for example in the form of franchise-based chains. Another expected trend is greater preference of brokering leases, providing services related to apartment leases for those who had bought the apartment as an investment, and, if applicable, of services associated with forced sales of properties.

6.4.4 Mortgage Market Development Forecast

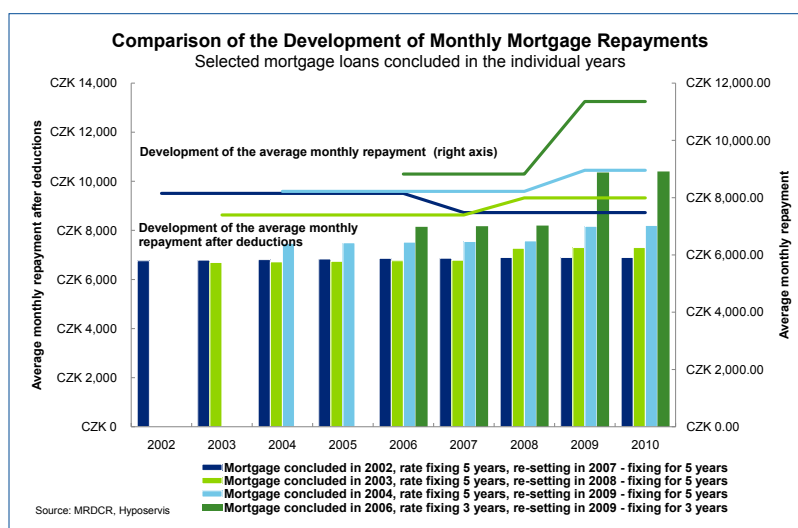
The impact of the global financial crisis found the mortgage market in a growth phase; the segment of creditworthy middle-class clients has not yet been fully exploited, and so a quick market recovery is likely. The current conditions for getting a mortgage (after the recent partial correction) can work successfully and will satisfy the absolute majority of the demand. A risk can be expected in clients who were buying at the time of the rapid growth of prices in 2007.

According to the prevailing opinion, mortgage interest rates will not decrease in the near future. The reason for this assumption is the fact that the global inter-bank market still lacks medium-term and long-term liquidity. At the same time, the mutual banks' distrust regarding money lending in the inter-bank market persists, and so the risk and liquidity margins are not decreasing. Mortgage rates are now on a level comparable with early 2003. From the perspective of that time the rates were low and have become an impulse to a very positive development of the mortgage and residential markets in the following years.



The mortgage market as a whole will probably not see the same fluctuation as new residential development. It is more differentiated, and financing of new dwellings constitutes only a small part of the entire mortgage market. Financing of other segments such as privatisation of apartments, renovations of apartment buildings, individual construction projects, or reconstructions of family houses will probably not be significantly affected. In addition, there will probably be a natural migration of clients between banks through re-financing of loans because for some of their holders it will be necessary to set up mortgages differently. No accurate data on refinancing transactions is available; however, we can assume that – as opposed to the past three years – a substantially greater portion of new transactions will probably be replaced by refinancing of already granted mortgages.

According to estimates, the rate fixing period will expire in 2009 for approximately 70 thousand mortgage clients. In 2004, the prevailing rate fixing period was five years, in 2006 three years and one year. Together with the mortgages provided with one-year rate fixing in the period from 2006 to 2008, this group represents approximately 20 percent of all mortgage clients. The current economic development may result in a significant increase of effective mortgage repayment costs for a substantial portion of these clients. The highest risk of such dramatic increases is in clients who got their mortgage with three-year (or shorter) rate fixing in 2006 (or in 2007) and with five-year rate fixing in 2004. For these clients (the estimated number is 40 to 45 thousand mortgage loans) the effective increase in interest rates will be by 2 to 4 percentage points. One reason is that mortgage interest rates have been continuously growing since 2006, and another reason is that some banks offer higher interest rates to existing clients upon the rate re-setting than the introductory rates offered to new clients. The result of the combination of these two factors is that for the average mortgage loan of such clients the effective mortgage costs will increase by 25 - 30 percent relative to their previous mortgage costs, and we can assume that some of these clients will be forced to reconsider the terms of their mortgage with respect to the current situation of their income and expenditures.



Inability or unwillingness of the mortgage market as the current main provider of financing of purchases of new properties to accept the potential risk of debt trap of a portion of mortgage clients and to actively seek solutions that would prevent this situation could ultimately result in some secondary risks, which could negatively affect the entire residential and mortgage market.

A significant risk could be the arrival of subprime non-banking providers that would lend money to people who are under disproportionate pressure and have problems repaying their mortgages in order to solve their mortgage problems, with much higher interest rates, which would then result in the “robbing Peter to pay Paul” effect. Ultimately, this could lead to much faster “non-banking” sales of the pledged properties, probably for much lower prices. This would only intensify the possible problem related to the drop in prices of residential properties.

- The Czech residential and mortgage market is relatively healthy, is based on domestic demand and domestic currency, and is not endangered by exchange rate shocks.
- The global crisis has already fully affected the Czech Republic, its effect on the situation in the residential market, however, is only a secondary factor; the primary factor is the balancing of the unnatural growth of 2007 and departure of speculative investors.
- The current situation is not a reason to panic; fluctuations in demand for dwellings and in the prices of dwellings are a common phenomenon in the developed world.
- Potential buyers are still relatively optimistic, they only speculate on falling prices.
- The residential market has been driven by the middle class who has been independent of state aid, bought dwellings on their account and has a large share in the production of GDP and revenues of the state budget.
- The impact of the depression due to the decline of the residential market on the middle class may be worse without system interventions, with more time necessary for recovery. The market is currently in the phase where problems can be actively prevented.
- The key factor of quick recovery of the residential market and the related industries is directing support at the middle class and preventing extensive forced sales of pledged apartments of those who find themselves in a debt trap. State aid is desirable in this case.

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