

ATTACHMENT #4

BBG/Bank Millennium Condo Loans Portfolio Analysis

(Based on Information received by CHF Consultant in May 2003)

Part I: Background and Major General Findings

Background

In Gdynia/Sopot area, three banks are currently providing financial services to condo associations: Bank Millennium (earlier Big Bank Gdanski or BBG), Bank Komunalny (primarily serving Gdynia area), and Bank Pocztowy. Bank Millennium enjoys by far the largest share of local financial services market, certainly with regard to services for condos associations. Based on available information, 80% of 672 registered Sopot condo associations are serviced by Millennium. This bank is also serving the City of Sopot. Operations of Bank Pocztowy are still very limited, but the city has been recently promoting this bank as another potential partner in condo lending. So far, one condo loan was issued by Bank Komunalny in 2003, with city of Sopot participating through an interest subsidy in a manner similar lending program with Millennium.

Getting a loan under the lending program requires close collaboration of the condo association with the bank and the city of Sopot. For the program to be successful, each partner has to know and understand its role. As far as condo associations are concerned, they are increasingly developing their skills in condo management, even though still struggling to be recognized as attractive prospective clients and market opportunity – by banks, municipal authorities as well as local property managers.

In order to facilitate the development, in 1999, CHF placed an international volunteer under the CDP-Poland program. Mr. James Glantz, then Vice President of National Cooperative Bank, Washington DC, worked with CDP-Poland team, with local AWIM, the city of Sopot and the Bank (then BBG) to conduct an assessment of the condo lending program and advise the bank and municipal authorities as to its further development. This very successful assignment resulted in a detailed loan portfolio analysis, and formulation of a series of recommendations directed at the bank, at municipal authorities, as well as local condo organizations and assisting NGOs.¹ Several workshops were held, in the course of which Mr. Glantz presented the situation of U.S. condo associations, advised Polish condo associations, and discussed and popularized the features of BBG-City of Sopot condo lending program.

¹ James E. Glantz, Condominium Development Project Volunteer Assignment 2: Assessment of Condo Loan Program, February 14-28, 1999, Big Bank Gdanski, S.A., City of Sopot, Poland. Volunteer Assignment Report. Internal CHF materials, May 1999.

In the course of this Case Study, CHF decided to conduct a second analysis to include information for years 2000-2003, in order to evaluate progress and assess the lending model's importance and potential.

Macroeconomic environment and BBG restructuring

As further background information we would like to provide brief context having impact on lending: the local environment, and issues specific to BBG. Between the year 1996 and 1999, BBG went through a process of mergers and acquisitions which coincided with rapid macroeconomic growth fueling the demand for credit services. However, by early 2001, the GDP growth had been reduced to 1.1% annually. At the same time, BBG had a significant Portuguese investment, and between 2001 and 2002 underwent a process of restructuring of all of its operations (it is currently operating under a new name, Bank Millennium). Some of the changes impacting lending were:

- Reorganization of the branch network and implementation of new market segmentation scheme,
- Centralization of credit decision making within a single center and developing centralized credit scoring and credit rating approaches,
- Reduction in staff of bank in order to improve efficiency.

Unfortunately, during the last two years, slower economic growth combined with significant changes within the Bank's lending and operational processes have had a negative effect on the bank's retail lending in general, and its condo association lending in particular.

Within the above context, CHF's study comparing the BBG/Millennium data and lending portfolio between 1999 and 2003 reflect significant progress and a positive tendency. For purposes of this study, the data is aggregated on an annual basis and as a result, the data sets for years 1999 and 2003 are incomplete and cannot be used to compare to other years. However, the data for year 2003 provide indications of the current state of Millennium's lending to condo associations.

Indicators Used

The following indicators were selected in order to assess importance of condo lending to the banking sector:

- Total number of loans
- Total and average renovation costs,
- Total and average loan size,
- Average Repayment term,
- Repeat borrowing by condo associations' members.

Detailed discussion is provided in Part II, below.

Major Findings of the Condo Portfolio Analysis

The analysis of the bank portfolio between 1996 and 2003 revealed three important positive trends:

- In 2003, the bank has refocused its lending toward the Revitalization Program loans, which are larger and have a longer term than the Small Improvement Program loans that characterized the portfolio until 2002. This shows that the bank is able and willing to take on more credit risk, having established that the condo loan program is profitable.
- Many condo associations have become repeat borrowers. They have either taken a second loan under the Small Improvement Program, or have utilized the larger Revitalization Program loans to make more significant improvements.
- Despite the economic difficulties and the significant internal restructuring in 2001 and 2002, BBG has continued its partnership with Gmina and the condo associations by providing loans to condo members.

Today, in result of the lending program, Sopot condominiums are:

- more often considering taking out renovation loans in order to augment available resources; out of a total number of 672 Sopot-based condos, 164 or 24.4% took one loan and 15 condos took two loans; number of borrowers is steadily growing;
- more inclined to lend again: 15 condos have taken a second loan after paying of the first one;
- more likely to share their positive experience in lending and the necessary know-how with other neighborhood condominiums. From the bank's perspective, making loans to condos turned out to be a good and safe business. As a result, the bank also gained confidence and developed a positive approach focused on serving bigger condos, which need more significant financing to carry out more extensive renovation projects.

Experience with Replication of the Condo Lending Project

Considering a number of positive findings, the question remains why the lending program has not been replicated beyond the city of Sopot. Apparently, at different points of time bank officers expressed interest in replicating this program across the country and this interest was confirmed to CHF consultant meeting with bank management in the course of this study in May 2003. However, so far replication has not happened. From bank officers' explanation it seemed apparent that the process of internal reorganization implemented between 2000 and 2002 was a major hindrance. There was no focused effort on the part of bank to assess conditions facilitating expansion and there was not enough manpower to provide necessary background research and study. Another explanation raised by bank representatives relates to the level of support received from local municipal authorities. Given that the program involves three partners: condo

associations, bank, an municipal authorities, lack of interest in the part of either of bank's partners is significantly weakening the chances of successful replication. In bank's preliminary assessment, local authorities in other Polish cities are not as inclined as Sopot city authorities to engage in similar lending partnership, even though this trend may be slowly changing as evidenced by recent publicly available information about creative revitalization programs enjoying support and participation of municipal authorities across the country.²

Part II: BBG/Millennium Condo Portfolio Analysis (1996 – 2003)

Since its inception in 1996, the BBG (now Millennium) condo lending program has been relatively successful from the point of view of the bank. The lending to condo associations grew rapidly in the late 1990s as a result of both deliberate bank policy and rapid macroeconomic growth. However, in 2001 and 2002, the loan program experienced a temporary decrease as a result of a macroeconomic slowdown and large-scale internal restructuring of the Bank's credit operations. The first several months of 2003 show increased willingness of Millennium's to provide credit services to condo associations.

The biggest obstacle that the condo loan program faces is that condo associations are not recognized as legal entities and thus lending is securitized by the assets of individual home owners. This makes the program fairly risky from the point of view of the bank. A big part of the bank's decision to continue with the condo lending program is the good relationship with Sopot Gmina which the bank has built over the years. From a credit standpoint, the relative security of all condo loans is due to the municipality's participation in the program. In addition, Millennium/BBG experience with disbursing and managing loans to condo owners is also important: after 6 years of continuous lending the bank is better able to judge the risk level relating to loans. Overall, the fact that condo lending did not discontinue even during the difficult years of 2001 and 2002 suggests that Millennium considers condo loans under this program to be a safe and profitable investment.

In order to make our conclusions clearer, we attach several illustrative Charts, to which we refer in the course of this report.

Total Renovation Cost, Total Loan Amount and Total Number of Loans

As a result of the real growth of the Polish economy and in per capita personal income in the late 1990s, the supply condo loans increased significantly with total renovation cost financed (Chart 1) and condo loans disbursed (Chart 3) peaking in 2000 at 2.5 million PNL and 43 loans per year respectively. In 2001 and 2002,

² A series of articles published in Polish periodical "Miasto," February 2003, presents new initiatives undertaken in the city of Poznan, Lublin, Szczecin, and Sopot.

the economic slowdown along with the internal restructuring of the bank's credit operations led to bank credit tightening and a decrease in demand for condo loans.

Year	2/1996	1997	1998	1999	2000	2001	2002	5/2003	Combined
Small Improvements Program Loans	1	39	18	27	43	28	23	5	184
Revitalization Program Loans	0	0	1	0	3	1	1	4	10
Total	1	39	19	27	46	29	24	9	194

Consequently, in 2001 and 2002, the number of loans disbursed and total amount loans disbursed to condo associations for both years decreased significantly: 28 and 23 (Chart 2), and 1.4 million PNL and 0.9 million PNL (Chart 4). However, the first five months of 2003 show a positive trend in all indicators and the year is on track to exceeding the total amount lent to condo associations for both of the previous years. The reason behind the healthy trend in 2003 is the number of larger, longer-term revitalization loans that the Bank disbursed in early 2003. By May 2003, the bank has disbursed 12,176,850 PNL³.

Average Renovation Costs

The average renovation cost followed the pattern discussed in the previous sections: the renovation cost grew in the late 1990s and then dropped during the economic slowdown and BBG restructuring in 2001 and 2002 (Chart 2). Due to the large amount of revitalization loans, the average has increased by 140% in the first months of 2003.

Year	2/1996	1997	1998	1999	2000	2001	2002	5/2003	Combined
Small Improvements Program Loans	27,242	41,472	59,655	84,114	59,084	63,209	54,084	36,501	58,296
Revitalization Program Loans	0	0	210,209	0	107,306	160,802	151,800	151,423	145,042
Total	27,242	41,472	67,579	84,114	62,229	66,575	58,155	87,577	62,767

³ All PNL amounts are in real 2003 PNL i.e. are adjusted for inflation.

Average Loan Size and Average Repayment Term

The average loan size grew considerably in the late 1990s and peaked at 64,901 PNL in 1999. Between 2000 and 2002, the average loan size was markedly lower due to macroeconomic and bank-specific factors. The variations in the average loan size were mainly due to the fact that revitalization program loans were between 150 and 300% of the average small improvement program loans. By early 2003, the large number of large revitalization loans had move the total average of the condo lending program to 62,745 PNL compared to 52,704 and 42,905 PNL in the course of previous 2 years. The maximum and minimum loan size amounts followed the same trends as the averages (More detailed information is available in CHF's source materials).

Year	2/1996	1997	1998	1999	2000	2001	2002	5/2003	Combined
Small Improvements Program Loans	24,435	33,681	41,622	64,901	46,382	50,141	39,187	29,597	45,039
Revitalization Program Loans			189,644		95,610	124,462	128,423	104,181	114,608
Total Average	24,435	33,681	49,413	64,901	49,593	52,704	42,905	62,745	48,625

The above data shows an interesting trend for the BBG condo portfolio. Throughout the period between 1996 and 2002, the large majority of the loans were made under the Small Improvement Program. However, by May 2003, the Revitalization Program had become the dominant program within the BBG condo lending program (Chart 4). Some of the key characteristics of the revitalization loans is its high average loan amounts (Table 3) and longer loan repayment periods (Table 4, Chart 5) compared to the SIP program. The increasing share of revitalization loans shows that BBG is more comfortable in disbursing larger loans to condo associations. In effect, the bank takes on more condo-owner credit risk. The profitability of the revitalization loans is presumably also higher, although the bank did not release information to show this conclusively.

Year	2/1996	1997	1998	1999	2000	2001	2002	5/2003	Combined
Small Improvements Program Loans			71		64	60	60	66	65
Revitalization Program Loans	24	31	35	33	31	27	29	25	31
Total Average	24	31	37	33	33	28	31	43	32

From the condo association point of view, the revitalization loans, although larger, are more convenient as they are also longer term, thus decreasing the monthly payments that the condo owners need to make. It is important to note that the revitalization loans are also use a more favorable interest rate subsidy which is an incentive to the owners to perform large condo repairs. The above tendency also shows that condo associations try to pay off their loans as soon as possible in order to get the benefit of the loan subsidy guaranteed by the City of Sopot (under the partnership program, interest is fully subsidized during the first year of loan and then decreases).

Above data confirms the tendency of increasing cost of investment projects undertaken by the condos. Condo owners feel more comfortable when financing the investment with a bank loan. On its part, the bank is also more likely to give a bigger loan, based on tract record developed and the good experience gained in dealing with condos that proved to be safe borrowers and good clients.

Repeat Borrowing by Condo Owners

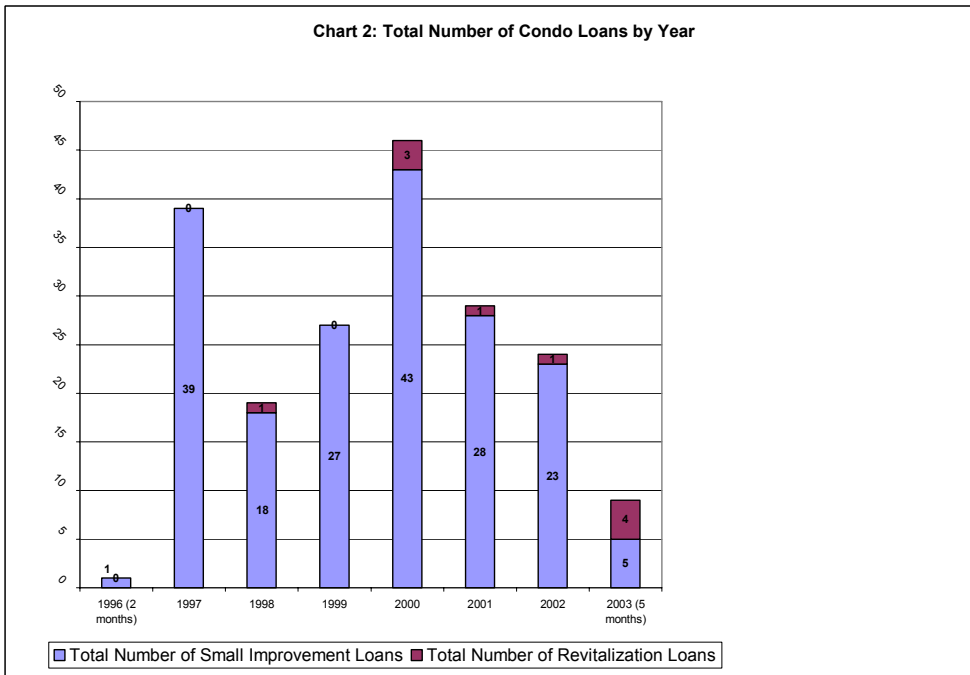
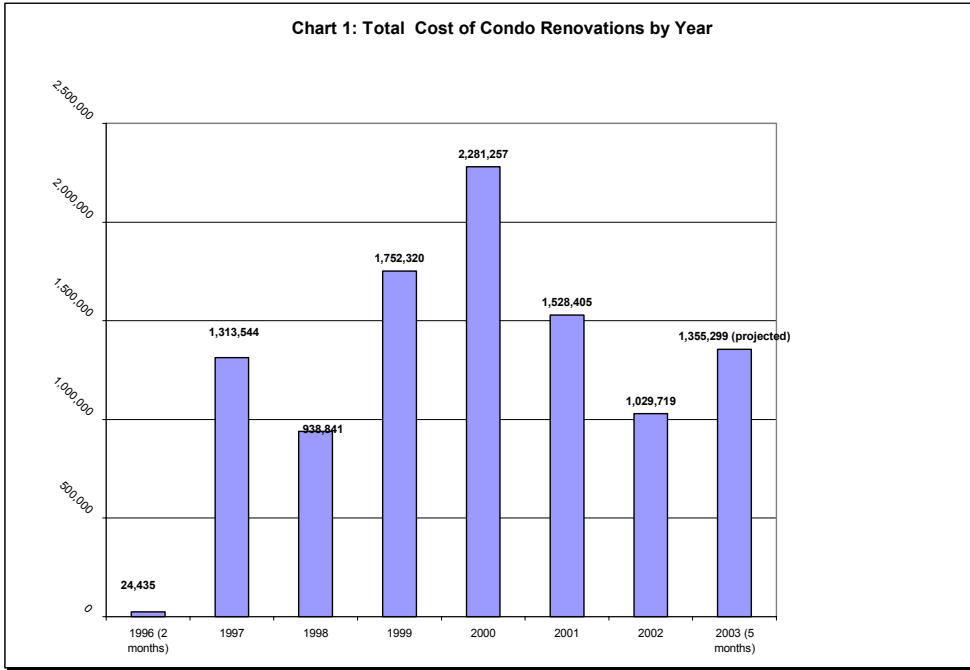
By May 2003, 164 condo associations or 24.4% of the 672 condo associations in Sopot had taken out a loan with BBG. In addition, 15 condo associations were able to repay their initial loans and become repeat borrowers to continue the improvement of their housing. This process also allows the bank to build its experience with lending to condo owners, although the loans are still collateralized by the individual condo owners rather than the condominium association as a separate entity.

Condo Association Size

Number of housing units affected by renovation lending stands at 1,487. The majority (80%) of Sopot condominiums consist of no more than 7 units per building. For this reason they can be categorized as “small” and an average number of units that take a loan, per condo, equals 7.7. The numbers show a slowly increasing tendency, which corresponds to the practice of serving slightly bigger condos which successfully participated in the lending program co-sponsored by partner bank and the City of Sopot.

Condo Ownership

On average, the condo association had 30% Gmina ownership and 70% condo member ownership. Interviews with bank officials revealed that BBG considers Gmina high percentage of Gmina ownership to be a better credit risk than condo associations where there is no Gmina ownership. This fact is the consequence of lack of legal recognition of a condo association as a separate business entity and the resulting individual lending approach that the bank takes towards condo association loan. Due to lack of adequate data, the analysis failed to reveal a connection between higher Gmina ownership and larger bank credit.



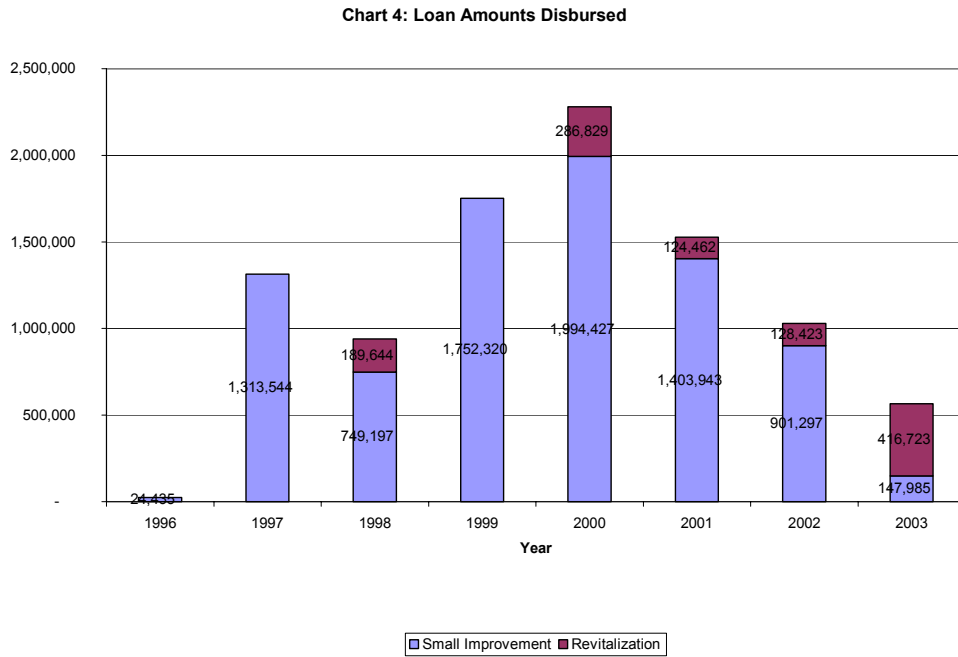
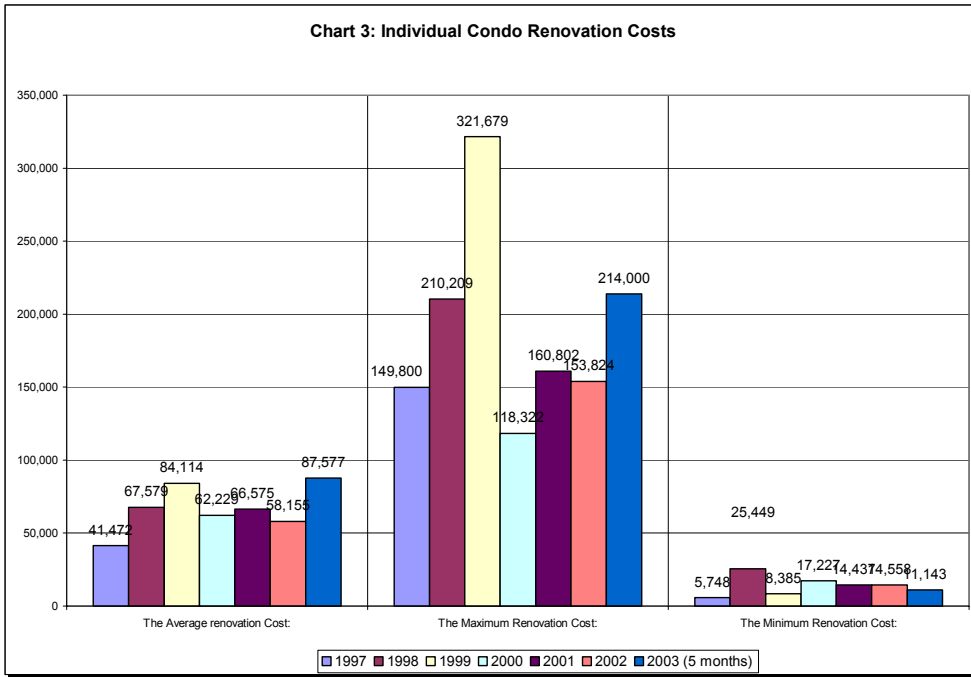


Chart 5: Average Loan Term

