Commercial Mortgages/Poland
Presale Report

DTC Real Estate Finance SP. z.o.o.

Expected Rating*

Class	Amount (PLNm)	Final Maturity	Rating
A	320.0	2011	BBB

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* Expected ratings do not reflect final ratings and are based on information provided by the issuer as of 17 June 2003.

■ Summary

This transaction is a securitisation of a portfolio of commercial properties in Poland owned by DTC Real Estate S.A. ("DTC RE"). Fitch Ratings has assigned an expected rating to the notes to be issued by DTC Real Estate Finance SP z.o.o., ("the Issuer") as indicated at left.

The expected rating reflects the positive and negative features of the underlying collateral and the integrity of the legal and financial structures and addresses the timely payment of interest and ultimate repayment of the principal by final legal maturity of July 2011.

The collateral consists of 12 commercial properties ("Real Properties"), as described in detail below. Payments due on the issued bonds will be funded from rents and other income received from tenants occupying units or space in these premises.

At closing, the Issuer will issue PLN320 million rated bonds ("Issuer bonds"), the proceeds from which will be used to purchase bonds issued by DTC RE ("DTC RE bonds"), the funds raised used for refinancing existing debt under a syndicated loan agreement. The Issuer is an insolvency remote, special purpose vehicle incorporated in Poland and established solely for the purpose of issuing the notes.

The Issuer bonds will be secured by a pledge on the DTC RE bonds, which will in turn be secured by, *inter alia*, mortgages over the Real Properties, an ordinary pledge on rent receivables from the Real Properties and registered pledges over the shares and enterprise of DTC RE.

■ Credit Committee Highlights

- This is the first commercial mortgage-backed securitisation to be rated in Poland.
- The structure is expected to create effective security over the Real Properties and associated receivables for the benefit of bondholders.
- Independent legal opinions will confirm that the structure of the transaction and bankruptcy remote nature of the Issuer will provide a level of security commensurate with the rating.
- The collateral comprises 12 retail complexes centrally-located in Poland's principal cities.
- The value of the portfolio is concentrated in central areas of Warsaw, with three buildings representing 60.1% of the total value.
- Some tenant concentration exists in that two tenants make up 47.9% of rental income, with five tenants accounting for 75.9%.
- The legal maturity of the bonds is 2011. However, the security package will remain in place after this date until the obligations under the notes have been fulfilled in accordance with the transaction documents. Therefore, security is available beyond 2011 in the event that the properties must be sold or transferred to meet the final interest payment.
- The Polish property market has changed significantly in recent years, and is expected to continue to do so in the future, particularly in the retail sector.

23 June 2003

Structure

The Issuer is a special purpose vehicle established exclusively for the purpose of this transaction. At closing, Issuer bonds to the maximum value of PLN320 million will be sold, the proceeds from which will be used to purchase the DTC RE bonds. The proceeds from the sale of the DTC RE bonds will be applied towards refinancing existing debt secured on the properties under a syndicated loan agreement.

The Issuer bonds will be secured by a pledge over the DTC RE bonds. The two sets of bonds will have substantially matching terms and conditions. DTC RE will provide security to the Issuer for its obligations to repay the DTC RE bonds that will include the following elements:

- Mortgages over the Real Properties owned (or held under a perpetual usufruct) by DTC RE;
- An ordinary pledge over rent receivables under lease agreements;
- Conditional assignment of receivables under insurance policies;
- Agreement to sell Real Properties to Issuer, if required;
- Voluntary submission of DTC RE to eviction from the properties, if required;
- Registered pledge over the Collection Account and other accounts of DTC RE;
- Registered pledge of DTC RE shares; and
- Registered pledge on the enterprise of DTC RE.

The security counsel will act on behalf of noteholders to oversee the security provided to the Issuer and keep noteholders informed of the performance of the collateral.

The mortgages over the properties will be registered prior to closing, but will rank junior to the mortgages currently securing the syndicated loan facility until the existing lenders release the properties from such security on the closing date. The total amount of the mortgage claim will be PLN450,000,000 to cover the recovery of the note principal balance, interest payments and associated costs.

DTC RE is registered as owning the perpetual usufruct of the land associated with the Real Properties and as the owner of the buildings on such land, an established form of property ownership in Poland.

A number of court proceedings are currently in progress to regularise the legal ownership of the Real Properties. Fitch has been informed that these will be resolved in favour of DTC RE although the timescale for their completion is uncertain.

Upon an event of default, the Issuer, following instructions from noteholders, has the right to have the Real Properties transferred to the Issuer to facilitate the repayment of the Issuer bonds. DTC RE will warrant that it has all the necessary authority required for the DTC RE bond issuance, and will not take steps to materially prejudice its enterprise.

Where possible, the pledges granted as security will be registered. The registration process can take several months as it requires court approval; however, once a pledge has been registered it can be enforced without requiring further court proceedings. Until the pledges have been registered they will be valid, but will require court proceedings to enforce upon them.

Based on the security available, Fitch expects that on an event of default, the Issuer would have effective control of the assets and liabilities of DTC RE, including the properties and the rights to all monies generated from them.

Events of Default

On the occurrence of the following events, the Security Counsel may serve notice that the Issuer bonds are immediately due and payable at their nominal value with accrued interest and default interest:

- The Issuer fails to pay the nominal value or any interest due on the Issuer's bonds on the due date; or
- Notice is received by DTC RE and/or the Issuer of specified events listed in the transaction documents, including:
    1. The warranties given by DTC RE under the transaction are untrue or have been breached;
    2. No valid security has been registered within 12 months of closing;
    3. Either DTC RE or the Issuer have failed to perform any of their obligations in the transaction documents;
    4. The Issuer has entered into legal agreements or undertaken corporate steps that prejudice the rights of the bondholders;
    5. Legal action, including bankruptcy proceedings, against either DTC RE or the Issuer;
    6. A material decrease in the value of the Real Properties resulting in the loan to value ratio exceeding 80%; and
    7. Financial deterioration of the transaction as evidenced by an unremedied breach of the coverage ratio of 1.3x or the security amounts falling below the required levels.

Legal

Fitch's final ratings are contingent upon receipt of satisfactory opinions from independent counsel regarding the bankruptcy remote nature of the Issuer, the tax neutrality of the structure, effective security over the assets and the legal, valid and binding nature of the obligations set out in the transaction documentation.

The Issuer will be a bankruptcy remote special purpose vehicle. The incorporation documentation limits its business activities exclusively to that which is in connection with the issue of the Issuer bonds. It may not incur any material liability or establish security interest other than in this connection. The security counsel, Baker & MacKenzie, attorneys at law, has effective control of the security. The majority shareholder in the Issuer will be the Polish Foundation for the Development of Education. TMF Poland will act as the nominee shareholder, and have effective control over the administration of the Issuer.

The bondholders are secured with a pledge over the DTC RE bonds, which are secured by, *inter alia*, the Real Properties. The structural features and security instruments of the transaction allow the Issuer to enforce the security without going through judicial enforcement procedures. In the event of a default, the Bondholders' Assembly will instruct the Security Counsel to notify the Issuer that the bonds are due and payable and the Issuer can enforce the security over the Real Properties. The Issuer will then realise the security by taking ownership of the collateral or, if appropriate, by instituting judicial enforcement. The proceeds of this action will be distributed to bondholders.

DTC Real Estate

The originator, DTC RE, is a property investment company operating exclusively in Poland. DTC RE owns a portfolio of 12 department stores located in central areas of the largest Polish cities including Warsaw, Krakow, Gdańsk, Szczecin, Poznań, Wrocław, Katowice and Lublin. The properties comprise 103,000m² of leaseable space, of which 77,000m² is retail and 26,000m² is secondary office space. Currently, the occupancy ratio is a relatively low 82%, although it has increased from 70% at YE01, suggesting that the current management team has been successful in improving the cashflow derived from the properties. The property pool is concentrated in the Warsaw market, where 40.9% of DTC RE's leased space generates 59.8% of the company's cashflow.

History and Group Structure

Prior to 1994, the Real Properties were owned and operated by the Polish state. DTC SA was formed in 1998 by the privatisation of a state-owned entity, which held the Real Properties. In 1998, Eastbridge NV purchased from the Polish State Treasury a controlling stake in DTC SA.

DTC RE was established in July 2000 and in January 2001 the company's share capital was increased via an in-kind contribution of 12 properties from DTC SA. DTC RE is wholly-owned by DTC SA. The ultimate holding company of DTC SA is Eastbridge NV, which also owns the subsidiaries that control four of the largest tenants in the Real Properties.

Eastbridge NV is a Dutch company, majority (with a 68% stake) owned by Mr Yaron Bruckner. This company through some 30 subsidiaries has real estate, non-food retail and wholesale activities in Central and Eastern Europe, with its main focus on Poland (75% of the group's revenues). Since 2001, Eastbridge NV has reshaped its Polish retail interests by separating the legal ownership and management structures of the five retailers from those of the property business. The conclusion of this process prior to closing will mean that each of the business lines can operate separately without reliance upon the support of the other subsidiary companies or Eastbridge NV itself.

In the privatisation agreement, DTC SA was obliged to retain all of its employees for 3.5 years. In 2001, this social package expired and the headcount was reduced from 3,500 to 1,500.

Credit Analysis

Fitch used its tenant default model to simulate the impact of a range of stresses upon the cash flows that will be derived from the properties. This model defaults tenants according to their financial strength, as indicated by their rating. On the default of a tenant or the expiry of a lease, a period of vacancy is assumed, the length of which is determined by the quality of the property and therefore the attractiveness of the asset to potential occupiers. An amount of capital is assumed to be applied to the property to refurbish it for the next occupant. Following the void period, the property is assumed to be re-let at a rent determined by its current rental value, reduced by the Fitch rental value decline factors. Rental value declines have been determined for each European market using historical market information about the last significant property downturn and the impact that such a recession had on the rental values of similar properties. This rental stream is then projected forward to determine the

Tenants	Description	Number of Leases	Total Rent p.a. in PLNm	% of Rent p.a.
Galeria Centrum	Fashion and Beauty	7	15.94	32.2%
Empik	Press, Books, Music, Perfumery, Software Products And Language Schools	17	7.77	15.7%
Zara /Young Fashion	Fashion and Private Labels	3	4.70	9.5%
Smyk	Shoes, Baby Clothing, Toys, Stationery and Media Products;	5	4.84	9.8%
H&M	International fashion	1	4.33	8.7%
Ahold Polska	Supermarket chain; a subsidiary of Dutch-based Ahold	3	2.28	4.6%
Esprit / Ultimate Fashion	Fashion	2	0.83	1.7%
REMA 1000	Supermarket	1	0.64	1.3%
Other	Smaller tenants	102	8.21	16.6%
Total		**141**	**49.54**	**100**

potential sustainable cash flow from a particular property under such a stress scenario.

The five largest tenants account for 75.9% of the total income. Some 68.8% of income is received from tenants with a common holding parent company, although the agency understands that the default of any one subsidiary or the parent company would not cause the default of any of the other subsidiaries. These companies are not formally rated, and Fitch considers that their financial strength is inconsistent with investment grade credits. For this reason, the agency has assumed that the two largest tenants defaulted at the start of the transaction to simulate the impact of these companies collapsing simultaneously.

The portfolio is dominated by the largest and most valuable assets in Warsaw. All are in strong retail locations and therefore Fitch considers that the retail space would re-let readily if they were to become vacant.

■ Collateral

Properties

The 12 properties were valued at EUR128million by DTZ Polska, an independent real estate company, as at March 2003. A full list and description of the properties and rental receivables, which make up a portion of the security for this transaction, is attached as Annex 1, which also deals with the strengths and weaknesses of each property.

Tenant Base and Lease Maturities

The retail companies of the Eastbridge Group are the major tenants and represent 69% of annual rents. All these companies have nationally recognised brand names and some, in particular Empik, are large businesses. DTC RE’s exposure to the risk of default of these companies is limited to finding alternative occupiers for the vacated space. According to DTZ Polska’s valuation, the vacant possession value of the retail premises (i.e. the value of the premises vacated by the Eastbridge Group affiliated companies, taking into account 6-12 month periods to find replacement tenants) is less than 5% below their assessment of market value. All of the group companies are separate operational entities with separate management, marketing strategy and established leading retailers.

Rental contracts are usually signed for a fixed term of between five to 10 years, without early termination rights. The form of agreement concluded is an institutional standard on the Polish market: lease guarantees (bank, cash or rated parent companies) and civil liability insurance from the tenant, service charges’ requirement, rent indexation, premises under tenants’ responsibility and maintenance clauses. All retail companies from the Eastbridge Group leasing space from DTC RE have recently signed new long-term lease contracts (EUR-denominated in Polish Zloty with a CPI adjustment, paid in Polish Zloty (PLN), with a fixed term of 10 years, no termination clauses, and no sub-letting rights, with a six months’ bank guarantee provision).

Property Insurance

All DTC RE’s properties will be insured under an “all risks” policy including terrorism and two years loss of rent. The insurance policy will cover the total replacement of the properties, including buildings and electronic equipment therein.

The rights available under the insurance policies will be assigned to the Issuer. The Security Counsel will be able to inspect the policies entered into by DTC RE and confirm that they comply with DTC RE’s obligations to maintain proper insurance provisions.

Property Market in Poland

The property market in Poland developed in the early 1990s with the transition from a centrally-planned to a market-oriented economy. Economic growth was rapid, especially in the period 1995-2000 when average annual GDP growth exceeded 5%. Privatisation and significant foreign direct investment led to a marked increase in the demand for commercial space at a time when supply was limited, forcing rents up. Investment in office and retail space, hotels and warehouses, as well as at the higher end of the residential property market stepped up, as did the pace of development. With the growing availability of commercial space, rents fell, particularly for office space. According to Jones Lang LaSalle, an independent real estate advisory company, the office and warehouse markets in Poland are close to the bottom of the cycle, while shopping centres, although considered close to maturity in Warsaw, still have potential for growth. Thus, after years of overheating, the Polish property market, with the currently stabilising rates, more balanced completions and take-up of commercial space, has become less risky and more attractive to long-term investors, including property funds and insurance companies. In 2002, a number of foreign institutional investors such as investment funds including Deutsche Bank Real Estate entered the Polish market by acquiring several modern shopping centres from property developers. However, the Polish market continues to face challenges and is far less developed and transparent than Western European markets, which is reflected in higher yields of 10%-11%, both in prime office and shopping centre sites in Warsaw, compared with 5%-7% in major Western European cities.

The market for retail property in Poland is continuing to develop rapidly. Since the decentralisation and privatisation of the retail industry, the old established companies have continued to dominate the market. However, foreign retailers have become more interested in the opportunities available in Poland and have opened up new stores. Similarly, new shopping centres, based on modern best practice, have been constructed in peripheral, out-of-town and town centre locations. International supermarket operators have expanded rapidly and offer a wide range of goods in convenient out-of-town locations. All of these changes to the market will continue to alter the competition that the Real Properties face. The assets will require on going day-to-day and strategic management in order to derive rental income and capital values.

■ Performance Analytics

Fitch will monitor the transaction on a regular basis and as warranted by events. Its structured finance performance analytics team ensures that the assigned ratings remain, in the agency’s view, an appropriate reflection of the issued notes' credit risk.

Details of the transaction's performance will be available to subscribers at www.fitchresearch.com. Further information on this service is available at www.fitchratings.com.

Please call the Fitch analysts listed on the first page of this report for any queries regarding the initial analysis or the ongoing performance.