



Brussels, 10.2.2016
C(2016) 820 final

<p>In the published version of this decision, some information has been omitted, pursuant to articles 30 and 31 of Council Regulation (EU) 2015/1589 of 13 July 2015 laying down detailed rules for the application of Article 108 of the Treaty on the Functioning of the European Union, concerning non-disclosure of information covered by professional secrecy. The omissions are shown thus [...]</p>		<p style="text-align: center;">PUBLIC VERSION</p> <p>This document is made available for information purposes only.</p>
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Subject: State Aid SA.38843 (2015/N) – Hungary
Asset purchase programme by the Magyar Reorganizációs és Követeléskezelő Zrt., a Hungarian Asset Management Company

Sir,

The Commission wishes to inform Hungary that, having examined the information supplied by your authorities on the measure referred above, it has decided that it does not constitute State aid within the meaning of Article 107(1) of the Treaty on the Functioning of the European Union ("TFEU").

1. PROCEDURE

- (1) In November 2014, the Hungarian Central Bank (Magyar Nemzeti Bank, "MNB"), established an Asset Management Company ("AMC") named Magyar Reorganizációs és Követeléskezelő Zrt ("MARK") to buy at market prices non-performing loans ("NPLs") collateralised by commercial real estate ("CRE NPLs") from so-called Eligible Entities¹, as well as commercial real estate collateral ("CREs") that had already been repossessed².

¹ For a definition of Eligible Entities, see recital (6).

² If a borrower fails to comply with the agreed contractual terms and if real estate was given in collateral, then the lender has the right to seize or repossess that real estate.

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- (2) In order to get comfort that the portfolio selection methods and the pricing models to be used by MARK would indeed lead to market prices, in 2015 the Hungarian authorities entered into pre-notification contacts with the Commission. The first version of the valuation methodologies and valuation manual were submitted by the Hungarian authorities in June 2015. They subsequently refined those valuation methodologies several times to come to a final version in January 2016. Following those pre-notification contacts, the Hungarian authorities officially notified MARK's portfolio selection and pricing methodology for reasons of legal certainty on 19 January 2016, requesting the Commission to ascertain that the pricing models were in line with market conditions.
- (3) The Hungarian authorities have undertaken that MARK will not make any acquisition before the Commission's approval.
- (4) By letter dated 2 February 2016, Hungary agreed to waive its rights deriving from Article 342 of the Treaty on the Functioning of the European Union ("TFEU") in conjunction with Article 3 of Regulation 1/1958 and to have the present decision adopted and notified in English.

2. DESCRIPTION OF THE MEASURE

2.1. Description of MARK

- (5) The MNB established MARK in November 2014 with equity of HUF 21.7 billion³ and indicated that it would also fund MARK by providing a loan of HUF 300 billion⁴ on arm's length terms. At a later stage, MARK's equity might be opened up to private investors and its future funding might also come from third parties. MARK has a ten-year mandate which runs until end 2024.
- (6) MARK will purchase, at market prices, CRE NPLs and repossessed CREs from Eligible Entities. Eligible Entities are solvent financial institutions⁵ or their subsidiaries that are active in Hungary and that are either registered in Hungary or in the European Economic Area.
- (7) The binding arrangements for the asset purchases will be concluded in the 15 months following the adoption of this Decision. All the acquired NPLs will be collateralised and the underlying CREs can be subdivided in the following sub-classes of assets: offices, industrial, retail, hotels and land plots.
- (8) MARK is a voluntary scheme. Eligible Entities will decide autonomously whether or not to sell their assets. From preliminary contacts with Eligible Entities, MARK understands that some five to seven Eligible Entities would be interested. If an entity meets the definition of an Eligible Entity, MARK cannot reject an Eligible Entity's application for participation in MARK's asset purchasing programme.

³ Approximately EUR 69.7 million using the exchange rate of 311.3 HUF per EUR of 21 October 2015.

⁴ Approximately EUR 963.7 million using the exchange rate of 311.3 HUF per EUR of 21 October 2015.

⁵ As defined in Section 7 of Act CCXXXVII of 2013 on Credit Institutions and Financial Enterprises (<https://www.mnb.hu/en/supervision/regulation/supervisory-disclosure/rules-and-guidance>).

- (9) MARK aims to acquire approximately HUF 300 billion worth of assets (based on the purchase price). If the interest of Eligible Entities would exceed that amount, the MNB can approve additional funding.
- (10) When managing the acquired assets, MARK will maximise their value.
- (11) In relation to NPLs, MARK may:
 - (a) restructure the NPL;
 - (b) acquire the real estate collateral from the borrower through an agreement with the borrower (referred to as "enforcement") or;
 - (c) acquire the real estate asset through a liquidation process.
- (12) Sales of purchased NPLs are expected to start in 2017 and all purchased NPLs are expected to be sold by the end of 2024. If NPLs will be sold, MARK will do so via open, transparent and non-discriminatory processes with a view to maximise the sale price.
- (13) In relation to the repossessed CREs, in July 2015 MARK set up a wholly-owned subsidiary, MARK Ingatlan Zrt. ("MARK Ingatlan") to carry out the real estate management and trading activities. When selling CREs, MARK Ingatlan will use open, transparent and non-discriminatory processes with a view to maximise the sale price. MARK also intends to sell all the shares in MARK Ingatlan to private investors or float all the shares of MARK Ingatlan on a stock exchange by the end of 2024.
- (14) If by the end of 2024, MARK still holds any purchased assets and MARK is still owned by the MNB, MARK will within 12 months either sell all its remaining assets and be wound down, or be privatised⁶.

2.2. Eligible Assets

- (15) MARK can only purchase assets ("Eligible Assets") that fulfil each of the following criteria:
 - (i) The asset must be owned by an Eligible Entity;
 - (ii) If the asset is a repossessed CRE:
 - (a) It must have been repossessed through commercial finance activities;
 - (b) its market value must be at least HUF 200 million⁷; and
 - (c) it must be located in Hungary;
 - (iii) If the asset is an NPL:

⁶ The MNB will sell all of its remaining shares in MARK to one or more private investors.

⁷ Approximately EUR 0.6 million using the exchange rate of 311.3 HUF/EUR of 21 October 2015.

- (a) At least 80% of the collateral value of the NPL must be derived from commercial real estate in Hungary and consist of either offices, hotels, retail projects, industrial projects or land plots for the commercial real estate development;
 - (b) The obligor must be in default within the meaning of Article 178 of Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms⁸;
 - (c) The total claim (gross outstanding amount) against a single debtor must be at least HUF 500 million⁹; and
 - (d) The debtor must be a company or a private entrepreneur, but it can be under liquidation or bankruptcy. If the debtor has more than one debt with the selling Eligible Entity and there is cross collateralisation among the debts or among the debts of the debtor and its related parties, then all the debts of the debtor group linked through that collateralization become eligible.
- (16) An asset will not be eligible for purchase by MARK if:
- (a) The asset is not (or in the case of a NPL, it is not collateralised by) an office, a hotel, a retail project, an industrial project or a land plot for commercial real estate development;¹⁰
 - (b) The debtor – in the case of an NPL – is a church or political party;
 - (c) The ownership of the real estate is related to any business activity of the selling Eligible Entity (such as its branch or head office building) (in the case of real estate and NPL purchases);
 - (d) The asset is a syndicated loan, in the sense that the Eligible Entity only has a joint or partial claim on the syndicated loan exposure.

2.3. Description of the asset purchase process by MARK

- (17) MARK will publicly announce the start of its asset purchasing programme through a press conference and in Hungarian newspapers, such that all Eligible Entities will be aware of the start of that programme¹¹. From that moment on, all Eligible Entities will be able to apply for participation on a voluntary basis. Each Eligible Entity will be allowed to offer its full list of Eligible Assets within three

⁸ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, p. 1.

⁹ Approximately EUR 1.6 million using the exchange rate of 311.3 HUF/EUR of 21 October 2015.

¹⁰ The asset or the collateral underlying an NPL should also not be agricultural land.

¹¹ MARK may also contact Eligible Entities directly to notify them of the publicly announced asset purchasing programme.

months of the start of MARK's asset purchasing programme, in accordance with the process outlined in section 2.3.1.

- (18) Each Eligible Entity¹² that applies for participation in the programme must provide MARK with a list of all of the Eligible Assets it holds at the date of the application ("Eligible Assets List"). The Eligible Entity may anonymise the borrower names in the list but the list must describe the type of asset (repossessed CRE or CRE NPL) and the current gross outstanding amount of each asset.

2.3.1. Portfolio selection process

- (19) Since MARK does not [...] conduct its pricing process for all Eligible Assets at exactly the same time, MARK has decided that it will divide the Eligible Asset Lists into smaller and more workable portfolios.
- (20) As soon as the Eligible Asset List has been finalised by the relevant Eligible Entity and offered to MARK, MARK will start to select - per participating Eligible Entity - a first portfolio from the Eligible Assets List in question.
- (21) Each participating Eligible Entity will be allowed to offer its first portfolio within three months after the start of MARK's asset purchasing programme.
- (22) Each Eligible Entity will only be allowed to offer its second selected portfolio once MARK has completed the pricing process for the first portfolios of all the participating Eligible Entities. In other words, the portfolio selection process will be organised in "rounds". The same approach will be followed for all subsequent portfolios. For example, each participating Eligible Entity will only be allowed to offer its third portfolio once MARK has completed the process for the second portfolios of all of the participating Eligible Entities and so on.
- (23) In each round, MARK will conduct the pricing process for the portfolios offered in that round in the order in which the portfolios were offered. In each round, MARK will conduct the pricing process in parallel for as many portfolios as possible, based on its operational capacity.
- (24) The criteria determining the size of each portfolio are:
- (i) A minimum accumulated gross outstanding amount of HUF 50 billion of Eligible Assets;
 - (ii) A minimum of 15 items of commercial real estate related to the Eligible Assets (in the case of NPLs, that requirement relates to the underlying real estate); and
 - (iii) The gross outstanding amount of a single Eligible Asset in the portfolio cannot be more than 50% of the gross outstanding amount of the portfolio.

¹² Each banking group that is prudentially supervised at holding level will be considered a single Eligible Entity and must thus offer its eligible portfolio for the initial selection process as a whole.

* [...] Covered by the obligation of professional secrecy

- (25) The composition of each portfolio will be determined by a random selection process based on the Eligible Assets List of each participating Eligible Entity. Each Eligible Asset on each Eligible Assets List will have a serial number and an Excel-based methodology will randomly generate serial numbers which will be included in the portfolio. That selection process will continue until the sum of the gross outstanding amount of the selected portfolio exceeds HUF 50 billion, the number of real estate assets related to the Eligible Assets in the portfolio exceeds 15 and the gross outstanding amount of any single Eligible Asset in the portfolio is not higher than 50% of the gross outstanding amount of the portfolio.
- (26) Once a portfolio has been selected, MARK will price that portfolio based on the methodology outlined in section 2.4. As it is a voluntary process, the price must be acceptable to the selling Eligible Entity. If the selling Eligible Entity does not wish to sell the selected portfolio, it is indeed not obliged to do so, but all the serial numbers of that portfolio will be excluded from any future portfolio selections. In other words, if a participating Eligible Entity has other Eligible Assets to be sold, the already offered serial numbers will be excluded from that Eligible Entity's Eligible Assets List from which the Excel-based methodology will select a new portfolio. No serial number can appear in more than one portfolio.
- (27) The portfolio selection process will be performed under the supervision of an independent auditor.

2.3.2. Pre-screening

- (28) Once the participating Eligible Entity has confirmed that it wishes to proceed with the selected portfolio, MARK and the participating Eligible Entity will enter into a confidentiality agreement. The participating Eligible Entity must then provide MARK with data about each Eligible Asset in the portfolio in the form requested by MARK ("Data Tape").
- (29) MARK will assess the data of the Data Tape and if it wishes to proceed, it will provide the participating Eligible Entity with written notice that it is willing to continue with the sale process in relation to the offered portfolio, and will request that the Eligible Entity establishes a data room. The participating Eligible Entity and MARK will then enter into a Cooperation Agreement outlining the terms and conditions of the purchase process.

2.3.3. Due diligence

- (30) Following the pre-screening process, the participating Eligible Entity will establish a data room that contains the portfolio documentation requested by MARK. After the opening of the data room, the participating Eligible Entity will be obliged under the Cooperation Agreement to inform MARK about any changes in relation to the portfolio and the content of the data room. MARK will commence due diligence on the portfolio after it receives notice from the participating Eligible Entity that the data room has opened. A sale or transfer by the Eligible Entity to a third party of any of the randomly selected assets after being notified by MARK will be deemed equivalent to a refusal to sell the portfolio. In such an event, MARK will move on to the next Eligible Entity in that round. Concretely, where MARK selects a portfolio through the random process in any round and an asset in that particular portfolio no longer exists in the

portfolio of the Eligible Entity because it has been sold or transferred, it will be equivalent to a refusal to sell and MARK will move on to the next Eligible Entity in that round.

2.3.4. Indicative and final offer

- (31) [...]
- (32) MARK and the participating Eligible Entity will then negotiate, and MARK may amend the indicative offer, provided the price for the portfolio does not exceed the maximum price determined in accordance with its pricing methodology (discussed in section 2.4).
- (33) If the indicative offer is accepted, MARK will carry out a second due diligence based on the information in the updated data room, to verify whether significant changes have taken place since the first due diligence that would cause deviation from MARK's indicative offer. Based on the result of that second due diligence, MARK will decide whether to purchase the portfolio in accordance with the previously accepted indicative offer or whether it is necessary to change any term or condition.
- (34) Once the transaction documents are signed and any conditions in the documents are fulfilled, MARK will acquire all Eligible Assets in the portfolio.

2.4. Description of MARK's pricing methodology

- (35) MARK has developed a detailed pricing methodology which allows the market value¹³ of a portfolio of Eligible Assets to be determined.
- (36) MARK will use its pricing methodology to determine a theoretical [...] price for each Eligible Asset in the selected portfolio. [...]
- (37) [...]
- (38) MARK's pricing methodology for the valuation of each Eligible Asset can in essence be subdivided in two stages:
 - (a) The first stage is the valuation of the CRE related to the Eligible Asset. In case of NPLs, the CRE is the underlying real estate collateral. In case of repossessed CRE, it is the CRE itself. The methodologies to value the CRE are briefly discussed in recitals (45) to (58).
 - (b) The CRE valuation is then used as input for the valuation of the Eligible Asset. The methodology mainly consists in applying discounts to the real estate valuation, depending on the characteristics of the Eligible Assets. That methodology is briefly discussed in recitals (59) to (65).

¹³ The amount that a willing buyer would pay to a willing seller in an arm's length transaction after proper marketing (where appropriate) and where both parties act knowledgeably, prudently and without compulsion.

2.4.1. Valuation of real estate

Process description

- (39) As already indicated in recital (38)(a), MARK's pricing methodology for an Eligible Asset is based on the valuation of the related CRE. The valuation of the CRE will be prepared in accordance with the process described in recitals (40) to (44), which has a number of robust "checks and balances" to ensure that the real estate valuations will be reliable, of a high professional quality and consistent.
- (40) As part of the due diligence process, the CRE related to each Eligible Asset in an offered selected portfolio will be individually valued by an "independent valuer" appointed by MARK from a panel of valuers, selected through a procurement process. The aim of the procurement process is to make sure that the valuers have the market knowledge and valuation competencies required to perform reliable and high quality valuations.
- (41) To ensure consistency and quality in the valuations, a number of controls have been put in place.
- (42) First, each valuation must be prepared in accordance with MARK's Property Valuation Principles and Manual ("Valuation Manual"), which is based on international valuation standards. The valuation manual sets out the procedures to be followed, the standards that valuers must comply with, the principles of valuation that must be applied and the requirements for a valuation report.
- (43) Secondly, each real estate valuation must be prepared in accordance with the valuation methodologies per asset class, described in recitals (45) to (58). Valuers have also at their disposal Excel valuation scorecards, aligned on the methodologies, to facilitate the valuation exercise.
- (44) Finally, each valuation will be reviewed during the due diligence process by a "validator" appointed by MARK. The validator must be a reputable company with an international background and the required market knowledge, expertise and property valuation experience. As part of the validation process, the validator will:
 - a. *Verify whether the valuation complies with the requirements on content and form described in the Valuation Manual:* the validator will assess whether the content is satisfactory, whether there are any chapters missing and whether the various investigations are documented to the appropriate level of detail;
 - b. *Verify whether the valuation complies with the international standards and regulations as set out in the Valuation Manual, with the valuation methodologies per asset class and with the available data for the property.* The validator will assess whether the property and the local market are described to the appropriate level of detail and at the appropriate standard of quality, whether the valuer has followed the international valuation standards formulated in the Valuation Manual, whether the parameters set in the valuation methodologies were properly applied and whether the information available over a certain property has been correctly reflected in the calculations.

- c. Carry out a professional review of the valuation by performing the valuation of the property with the validator's valuation software.
 - i. If the difference between the results of the valuations prepared by the valuer and the validator is less than 5%, the validator will suggest that the valuation should be accepted, provided the requirements regarding form, content and compliance are fulfilled;
 - ii. If the difference between the results of the valuations is between 5% and 10%, the validator will investigate whether the valuer used the parameters defined in the valuation methodologies. The validator will request explanation of any differences in opinion or other statement that is not fully clarified and supported. If the valuer is able to fully explain and provide support on those areas, the validator will suggest that the valuation should be accepted. If not, the valuation will be sent back for correction and the validator may request the modification or supplementation of the valuation.
 - iii. If the difference between the results of the valuations is more than 10%, in addition to the steps described in recital 44(c)(ii), the validator will also meet with the valuer to discuss the possible reason for the deviation. Normally such a difference will not be acceptable unless the valuer can fully explain the reason for the difference;
- d. After receiving the modified valuation, the validator will confirm whether it accepts it or request further modification;
- e. If the valuer fails to comply with any request by the validator and does not modify or amend the valuation, the validator will reject the valuation and MARK will assign another valuer to value the CRE.

Real Estate valuation methodologies

- (45) Each real estate valuation must be prepared in accordance with the real estate valuation methodologies¹⁴ developed by the external consultants¹⁵ hired by the Hungarian authorities, as is also described in recital (43).
- (46) The real estate valuation methodologies describe in details the models used and the extensive set of key parameters which have to be used during the valuation as well as how to determine the value of each property type. The Commission has verified in detail those models with the assistance of external experts.
- (47) **Offices in the Budapest area** will be valued by applying an income model, which discounts the cashflows and in particular the estimated rental values at an

¹⁴ The final version of the valuation methodologies were notified by the Hungarian authorities on 19 January 2016 ("Appendix 04 Property Valuation Principles and Manual – 19 January 2016 (Clean) – Confidential").

¹⁵ CBRE for commercial real estate valuation and KPMG for NPLs valuation.

appropriate "capitalisation rate". Valuers will be provided with a scorecard of parameters [...].

- (48) The parameters are in general objectively measurable and there is only limited room for interpretation by the valuers. The estimated rental values and capitalisation rates, deriving directly from the characteristics of the properties, were calibrated [...] on the basis of recent observed transactions¹⁶. Moreover, the capitalisation rate is floored at [6% - 12%]. [...]
- (49) Valuers also get guidance in the valuation methodology on the structure of future cash-flows¹⁷. For instance, for rental values, at the end of the running rental contract, the methodology asks for a void period (0 to 12 months), depending on the lettable¹⁸ profile of the property
- (50) **Offices outside the Budapest area** will be valued by applying a benchmark price per square meter. Due to the more limited number of observed office transactions outside the Budapest area, the benchmark price was calculated based on the average price of observed transactions. [...]
- (51) **Industrial projects** will be valued by applying an income model, which discounts the cashflows and in particular the estimated rental values at an appropriate "capitalisation rate". The cash-flows deriving from the current rental contract will be used until the end of the contract term and afterwards the estimated rental value will be automatically provided by a scorecard based on the technical condition and location of the property. Both the technical condition and the location are objective parameters. The capitalisation will also be automatically defined based on a list of mostly objectively measurable parameters¹⁹.
- (52) There is also guidance in the valuation methodology on direct parameters which will influence the structure of future cash-flows²⁰. The valuation methodology foresees amongst others a void period at the end of the rental contract, as well as incentive costs to attract new tenants.
- (53) **Land plots** will be valued using benchmark prices per square meter based on their location and zoning categories²¹. Benchmark prices to be applied by the valuers were established on the basis of around 20,000 transactions during the last three years. Benchmark prices were calculated by taking the median of transaction prices [...].

¹⁶ 30 transactions.

¹⁷ More specifically, on the future lease length, expiry void, incentives by landlords, landlord's service charge, capital expenditure and management fees.

¹⁸ Future lettable of the property will depend on the leasing track record of the building, the technical condition of the property, and vacancy observed in the submarket of the property.

¹⁹ Property is vacant or income generating, technical condition of the property, submarket, location, vacancy in the submarket, weighted average unexpired lease term, quality of tenancy, currency, occupancy, lettable.

²⁰ Future lease length, expiry void, incentives by landlords, landlord's service charge.

²¹ There are five types of locations (Budapest, Pest county, cities with more than 100,000 inhabitants, key regional cities and other cities) and three zoning categories (residential, city-centre, industrial).

- (54) **Retail properties** will be valued based on an income model if the property is a modern retail building (built or refurbished in the last 25 years) that has been built or rebuilt specifically for retail tenants or for single retailer occupancy, and at least 50% of the gross lettable area is leased to qualified retailers.²² For each property to be valued, the independent valuers will select rental values, based on the tenant, and capitalisation rates, based on the characteristics of the properties²³. Rental values and capitalisation rates were calibrated in a conservative manner on the basis of recently observed transactions.
- (55) If the property does not meet the criteria to qualify for the income model, the market value will be calculated based on benchmark prices per square meter derived from the database containing the transactions in Hungary in the last three years. The benchmark prices per square meter were calculated by taking the average of transaction prices or alternatively the median of transaction prices when it was lower than average prices due to some outliers. Such an approach can be assessed as prudent. The valuation methodology provides detailed guidance about the retail space average prices for vacant retail premises and retail premises leased in majority to non-qualified retailers.
- (56) Retail properties over 25,000 square metres of gross lettable area and/or with over 50 retail tenants can be valued on a case-by-case basis. For those specific retail properties, two calculations will be made in parallel. One calculation would be made according to the standard income model for retail properties. The other calculation would be ad hoc, with more parameters than in the standard income model. In any case, the final valuation will not be higher than the standard income model valuation.
- (57) **Hotels located in Budapest** will be valued based on an income model approach with capitalisation rates derived from recent transactions. Prudent guidance is provided in the methodology on how to estimate the future cash-flows. The methodology also requires the valuer to calculate the EBITDA²⁴ multiple implied by the valuation [...].
- (58) **Hotels located outside Budapest** will be valued applying a simplified income approach, based on EBITDA multiple. Capitalisation rates are the ones used for hotels located in Budapest, but with the application of additional discounts depending on the hotel contract type and the hotel location. Those additional discounts reflect the limited number of transactions for that category of properties. The methodology also requires the valuer to calculate the EBITDA multiple implied by the valuation. It should be in the range [1 – 9] times.

²² Qualified retailers should meet the following characteristics:

- Being a true international retailer. All Hungarian stores should be owned and managed by the foreign mother company. Hungarian stores managed under a franchise or owned by investors / funds, should not be on the list. Local retail chains should be excluded from the list.
- The retailer should have at least 20 stores in Hungary, to confirm that Hungary is a strategic investment for the mother company.
- Generic categories of retailers like "Municipality offices" or "Customer offices" should not be on the list.

²³ Retailer profile, length of the lease term, size of the city where it is located.

²⁴ Earnings before Interest, Taxes, Depreciation and Amortisation.

2.4.2. Valuation of the Eligible Asset

- (59) Once the valuation of the CRE has been determined as described in section 2.4.1, that value will be used as an input in MARK's pricing model to calculate the theoretical maximum price of the Eligible Asset. The methodology to calculate the maximum value of repossessed real estate and NPLs²⁵ on the basis of the Real Estate value can be summarized as follows:
- (60) If the Eligible Asset is **repossessed CRE**, the theoretical maximum price will be calculated by:
- (a) Deducting a [1% – 8%]²⁶ operational and risk cost from the validated valuation of the Real Estate; and
 - (b) Discounting the resulting amount with a weighted cost of capital ("WACC") of [7% – 15%]²⁷ over the appropriate time to sale (which will depend on the property type and location).
- (61) If the Eligible Asset is an **NPL**, MARK must assess whether the NPL can be restructured. To do so, MARK will first assess whether the NPL meets any of the criteria that would exclude it from being restructurable. An NPL cannot be classified as restructurable if it is a plot, it is already undergoing a liquidation or bankruptcy procedure, or the borrower's behaviour is assessed as "hostile" according to a scorecard developed by MARK²⁸. If the NPL is not excluded for one of those reasons, MARK will perform several checks to see whether the loan is restructurable. Those checks are meant to verify the repayment capacity of the borrower after the loan restructuring.
- (62) If MARK concludes that the NPL is restructurable, the theoretical maximum price will be calculated by:
- i. Deducting a [1% – 8%] operational and risk cost from the validated valuation of the Real Estate, and then deducting a [4% – 10%] restructuring cost from that amount to arrive at the theoretical amount of a restructured loan; and
 - ii. Discounting the resulting amount with a WACC of [7% – 15%] over the restructuring time [...].

²⁵ The final version of the methodology to calculate the maximum value of repossessed real estate and NPLs was notified by the Hungarian authorities on 27 January 2016 ("Appendix 02 MARK_s NPL and real estate pricing methodology - 19 January ...").

²⁶ That discount was calculated to cover MARK's operational and risk costs.

²⁷ MARK's internal expected rate of return.

²⁸ MARK developed a scorecard to assess whether an asset should be enforced or liquidated. The criteria of the scorecard are: behaviour of the client (hostile, neutral or cooperative), repayment capacity of the deal related to the occupancy, lettability profile of the property.

- (63) If the NPL is not restructurable, MARK must assess whether the NPL should be enforced or liquidated²⁹ using a score card³⁰ that considers the expected level of cooperation of the borrower, the potential cash flow production capability of the Real Estate, and the marketability of the CRE in its technical condition.
- (64) If the NPL is to be enforced, the theoretical maximum price will be calculated by:
- i. Deducting a [1% – 8%] operational and risk cost from the validated valuation of the CRE, and then deducting the enforcement cost from this amount. If the borrower has been assessed to be cooperative, the enforcement cost is [6% – 11%]; otherwise, the enforcement cost is [8% – 13%]³¹; and
 - ii. Discounting the resulting amount with a WACC of [7% – 15%] over the enforcement time [...] and the appropriate time to sale (which will depend on the property type and location).
- (65) If the NPL is to be liquidated, the theoretical maximum price will be calculated by:
- i. Deducting a [1% – 8%] operational and risk cost from the validated valuation of the CRE, and then deducting the liquidation cost from this amount. The liquidation cost is [9% – 15%] for plots and [11% – 18%]³² for all other types of CRE; and
 - ii. Discounting the resulting amount with a WACC of [7% – 15%] over the liquidation time [...] and the appropriate time to sale (which will depend on the property type and location).
- (66) In order to verify that the discounts described in recitals (62) to (65) that are to be applied in the three scenarios (restructuring, enforcement and liquidation) were in line with market practices, the Hungarian authorities analysed recent NPL transactions that took place in Hungary during the last three years. The Hungarian authorities asked to the banks involved in those transactions to provide the sales prices, the market value of the underlying collaterals, as well as all data necessary to re-price the transactions with MARK's valuation methodologies.
- (67) MARK re-priced those transactions, including the value of the underlying collaterals, with its own valuation methodologies. [...]. That analysis confirmed

²⁹ Enforcement is the process to take over the ownership of collateralised real estate in a friendly way, while liquidation is the process to take over the ownership of the mortgaged real estate through legal procedures. See also recital (10).

³⁰ See footnote 28.

³¹ Enforcement costs were estimated by the external expert hired by the Hungarian authorities, based on information gathered from previous engagements, relevant information sources and interviews with relevant parties.

³² Liquidation costs were estimated by the external expert hired by the Hungarian authorities, based on information gathered from previous engagements, relevant information sources and interviews with relevant parties.

that MARK's proposed discounts to get from collateral value to NPL value were at least equivalent to recent observed market discounts.³³

2.4.3. *Cap on maximum price for each portfolio*

- (68) MARK will also calculate a "Cap Price" for each portfolio, which will be [...] % of the sum of:
- i. the gross outstanding amount for each NPL in the portfolio; and
 - ii. the gross outstanding amount of the original NPL at the time of repossession for each reposessed real estate in the portfolio.
- (69) If the maximum price for a portfolio determined in accordance with MARK's pricing methodology exceeds the Cap Price, then the maximum price for the portfolio will be reduced to the Cap Price.³⁴
- (70) Finally, if a CRE asset is part of the collateral of a NPL but does not belong to any of the five validated real estate asset classes in the valuation methodologies, then it will be valued at zero.

2.5. Reporting and monitoring

- (71) In order to allow the Commission to verify whether the pricing models as described in recitals (45) to (70) have been properly applied, the Hungarian authorities undertake to submit to the Commission a number of portfolio and asset specific items subsequent to each portfolio purchase as outlined in Appendix 1 within 15 working days following the signature of the transaction documents.
- (72) The Hungarian authorities will be available to the Commission to answer any questions about such reports.
- (73) The Hungarian authorities undertook to adequately inform Eligible Entities participating in MARK's asset purchase programme that any divergence from MARK's pricing model that conveys an advantage to the Eligible Entities may be considered illegal State aid.

3. POSITION OF HUNGARY

- (74) According to the Hungarian authorities, the objective of the measure is to encourage the Eligible Entities to reduce their NPLs. As a result, Eligible Entities could free up significant amounts of capital and liquidity, which would allow them to increase lending to creditworthy borrowers.
- (75) During the past seven years of crisis, Eligible Entities have been slow to remove NPLs – and in particular CRE NPLs – from their balance sheets. At the end of June 2015, corporate NPLs³⁵ – as a proportion of total corporate loans – stood at

³³ That analysis was sent on 10 September 2015 by e-mail by the Hungarian authorities to the Commission.

³⁴ In the event that MARK considers the particular characteristics of a particular portfolio justifies an adjustment to the pricing methodology outlined above, the Hungarian authorities will engage in a separate dialogue with DG Competition.

³⁵ For the purpose of those statistics, NPLs are defined as loans which are more than 90 days delinquent.

14.1% with CRE NPLs accounting for a significant and growing proportion. Project financing NPLs (which are predominantly CRE NPLs) account for more than half of total corporate NPLs (as of the second half of 2015). At the end of June 2015, project loan NPLs - as a proportion of total project loans – amounted to 27.3% and did not materially decrease in the past seven years.

- (76) However, despite those high NPL levels, Eligible Entities are generally solvent and – at the end of June 2015 - the sector's capital adequacy ratio reached a historic high of 20.9%. According to the Hungarian authorities NPLs were also well provisioned with for instance a loan loss coverage ratio for CRE NPLs at 71% as at the end of June 2015.
- (77) As regards the portfolio selection process, Hungary submits that the process is designed in such a way that it avoids adverse selection because:
- (a) an Eligible Entity either has to offer for sale all of its Eligible Assets or the Eligible Assets in each portfolio are randomly selected in a process that is beyond the control of the Eligible Entity; and
 - (b) each Eligible Asset can only be offered once. If an Eligible Entity chooses not to sell a randomly selected portfolio, then none of those assets can be included in any subsequent portfolio.
- (78) As regards the potential interaction with the supervisory policy of the MNB and in particular the Systemic Risk Buffer³⁶, the Hungarian authorities reassured the Commission that there would be no level playing field issues. First, the Systemic Risk Buffer will be imposed only in January 2017, by which time the first round will be concluded. Second the Systemic Risk Buffer will be flexible so that, other than annual revisions, banks can submit anytime a request for revision if they have a significant decrease in distressed CRE portfolio in the meantime.
- (79) According to the Hungarian authorities, participating Eligible Entities do not benefit from State aid pursuant to Article 107(1) TFEU because MARK will buy Eligible Assets at market prices. As a result, the participating Eligible Entities will not receive any economic advantage in comparison to other commercial market participants. However, the Hungarian authorities wished to notify the proposals for reasons of legal certainty.

4. ASSESSMENT OF THE PRESENCE OF AID

- (80) The present decision only looks at possible aid in relation to the sellers of assets to MARK and is without prejudice to the examination of State aid to any other beneficiary. The present decision does also not pronounce itself on the set-up and governance of MARK.
- (81) By virtue of Article 107(1) TFEU "*any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods*

³⁶ The purpose of the Systemic Risk Buffer is to manage risks related to project financing loans and real estate exposures deemed problematic. Its size will depend on the ratio of the gross stock of problem exposures to the domestic Pillar I capital requirement.

shall, in so far as it affects trade between Member States, be incompatible with the internal market."

- (82) To constitute State aid within the meaning of Article 107(1) TFEU, a measure has to fulfil four conditions. First, the aid is granted by a Member State or through State resources. Second, the measure confers a selective advantage to certain undertakings or the production of certain goods. Third, the measure must be liable to affect trade between Member States. Fourth, the measure must distort or threaten to distort competition in the internal market. Those four criteria are cumulative, which implies that if one of the four criteria is not met, a measure does not represent State aid.
- (83) The Hungarian authorities argue that MARK's asset purchase programme would not constitute State aid to the participating Eligible Entities because it does not fulfil all the four State aid conditions of Article 107(1) TFEU. In particular, Hungary argues that the MARK asset purchase programme would buy Eligible Assets at market prices and therefore would not confer a selective economic advantage on participating Eligible Entities.
- (84) Against that background, the Commission has thoroughly assessed MARK's pricing methodology – with the assistance of external experts as described in recital (46) –to ascertain whether that methodology would indeed lead to asset purchase prices that are in line with market conditions, so that the measure would indeed not confer State aid within the meaning of Article 107(1) TFEU on the participating Eligible Entities.
- (85) The Commission observes that in order to value the Eligible Assets the Hungarian authorities have developed a two-stage process as described in recital (38). First the CRE related to the Eligible Asset is valued and then – in a second stage – that value is used to calculate the market price of the Eligible Asset.
- (86) As regards the first stage – i.e. the calculation of the market value of the CRE – the Commission observes that the Hungarian authorities have developed detailed models for all sub-classes of assets in the Eligible Asset Lists. There are detailed separate models for Budapest offices, non-Budapest offices, land plots, retail projects, industrial projects and hotels, which allows MARK to calculate market prices for portfolios irrespective of the precise proportion of a certain sub- class of assets in a portfolio.
- (87) As regards the models used, the Commission notes positively that MARK uses generally accepted valuation techniques such as the "income approach" (which discounts cashflows (such as the rents received) at a capitalisation rate and the "market approach" (which is based on the analysis of comparable transactions observed in the market).
- (88) The Commission takes positive note of the fact that all MARK's models for sub-classes of assets are calibrated on market prices and/or directly based on market comparables. As regards four models (those for Budapest offices, industrial projects, retail and hotels located in Budapest), the rental and capitalisation rate are modelled based on a large number of relevant valuation parameters and those models are calibrated to recent market transactions. As regards the market approach models (offices outside Budapest, land), they start from directly observable market transactions (i.e. 31 in the case of non-Budapest offices,

around 20,000 for land plots), to which a number of corrections are applied to make the models sufficiently conservative.

- (89) The Commission also takes notes that the models are designed in a prudent and conservative manner. For instance, for Budapest offices and Industrial projects, if a contract provides for a certain rental fee, the amount is not indexed and if a rental contract needs to be renewed, a conservative void period is built in to reflect the possibility that it might take some time to find a new tenant. As regards offices outside Budapest, buildings with technical conditions above average were excluded from the peer group, thereby making the peer group more conservative. For land plots and retail, the model was made more conservative by using the median instead of the average, to avoid the impact of material outliers. For hotels, the valuers must verify that the final valuation is not higher than pre-defined EBITDA multiples.
- (90) The diligent valuation process gives the Commission further comfort that the CRE valuations for the different sub-classes of assets will indeed not exceed the market prices. In that regard, the Commission positively notes that MARK will use independent valuers to make valuations for CRE lines, which will be selected by an independent tender. The independent valuers and the professional expert will be bound by the detailed models which are laid down in the real estate valuation methodologies. A validator will double-check the valuation as described in recital (44), which is also an element of comfort.
- (91) When – in a second stage – the CRE values are used to calculate the market values of the Eligible Assets, additional elements of prudence are introduced. As regards the valuation of NPLs, the Hungarian authorities have used conservative assumptions as to when a loan is still restructurable and appropriate discounts have been applied to assume that the seizing of collateral and the time to sale will lead to certain costs. The Commission has also been able to observe that for NPLs the sum of discounts applied to the CRE value to get the NPL value was at least equivalent to the discounts applied in recent NPL transactions, as described in recitals (66) and (67).
- (92) As regards the valuation of repossessed real estate, the valuation methodologies described in recitals (45) to (58) already provide prices in line with market conditions. Discounts for time to sale and operational costs bring prices even lower, which provides additional comfort that transaction prices for repossessed real estate will not exceed market prices.
- (93) In addition, an overall cap price at [...] %³⁷ of the gross book value of the portfolio mitigates the risk of overvaluation, thereby providing additional comfort that the prices resulting from the pricing models will not lead to prices that are not in line with those in the market.

³⁷ Even though the Commission acknowledges that NPL markets can vary from one country to another, the Commission observes that this cap price is broadly comparable with actual market prices in other sector-wide Asset Management Companies like for instance in Ireland (Establishment of a National Asset Management Agency (NAMA): Asset relief scheme for banks in Ireland, OJ C 94, 14.04.2010, p. 10), Slovenia (Restructuring of NLB, OJ L 246, 21.8.2014, p. 28), and Spain (Restructuring and recapitalisation of the BFA/Bankia Group, OJ C 77, 15.3.2013, p. 1).

- (94) As regards the risk of adverse selection (i.e. clients only selling bad assets and keeping good assets), the Commission observes that the Hungarian authorities have taken sufficient procedural safeguards to eliminate that risk. The composition of the portfolios as described in section 2.3.1 implies that the portfolios should in principle not be biased one way or the other in terms of asset quality. Moreover, the portfolio selection is based on a randomised methodology which is conducted by MARK under the supervision of an independent auditor. Finally, every Eligible Entity will have to participate as a consolidated entity, thereby making it unattractive to create subsidiaries with assets with asset quality below or above average.
- (95) Finally, the Commission also takes note of the fact that the Hungarian authorities will ensure that MARK concludes binding agreements on all its transactions with the Eligible Entities in the next fifteen months, which seems an appropriate period in which the pricing produced by the models can be expected to remain accurate.
- (96) As regards, the monitoring of the transactions, the Commission takes positive note of the arrangements set out in recitals (71) to (73).

5. CONCLUSION

The Commission has accordingly decided that, based on the information provided by the Hungarian authorities, the measure does not constitute aid within the meaning of Article 107(1) TFEU to Eligible Entities.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: <http://ec.europa.eu/competition/elojade/isef/index.cfm>.

Your request should be sent electronically to the following address:

European Commission,
Directorate-General Competition
State Aid Greffe
B-1049 Brussels
Stateaidgreffe@ec.europa.eu

Yours faithfully
For the Commission

Margrethe VESTAGER
Member of the Commission



Appendix 1: Reporting arrangements

The Hungarian authorities commit to provide the following reports to the European Commission.

1. Portfolio purchase summary

Frequency: after each purchase

1.1 Information provided by MNB on the purchased portfolio based on the data provided by the Eligible Entity to MNB:

- Number of NPL exposures, total gross book value and total net book value
- Number of repossessed real estate exposures and net book value
- Portfolio transfer price

NPL's			Real Estate		Portfolio Transfer Price
Number of NPL exposures	Total Gross Book Value	Total Net Book Value	Number of REO's	Net Book Value	

1.2 Information provided by MARK on the purchased portfolio:

- Information is to be provided by 5 asset classes for both NPLs (regarding collaterals) and for repossessed real estates (Retail, Landplot, Hotel, Industrial, Office)
- For NPLs the following aggregate information will be provided for the purchased portfolio: (i) total number of collaterals per real estate classes, (ii) total market value of collaterals per real estate classes, (iii) total gross book value per real estate classes
- For repossessed real estates the following aggregate information will be provided for the purchased portfolio: (i) total number of purchased real estate per real estate classes, (ii) book value (i.e. purchase price) of real estate per real estate classes

	NPL's			REO's	
	Number of collaterals	MV of collaterals	NPL's GBV (prorata weighted by MV of collaterals)	Number of collaterals	book Value
In Bio HUF					
Retail					
Landplots					
Hotels					
Industrials					
Offices					
Total					

1.3 Collateral and repossessed real estate parameters

On the top of the above information, MARK will provide a detailed table on the real estate parameters for both the underlying real estate collateral in the case of NPLs and for the repossessed real estate purchased in the portfolio. The table will show each collateral and purchased real estate in different lines. The columns of the table will show the following information: (i) property type, (ii) location, (iii) sqm and (iv) market value

derived from the methodology. Depending on the property type, the following additional information will be provided:

- Office
 - Current ERV,
 - Occupancy,
 - WAULT,
 - BRF technical scorecard rating, if available,
 - BRF location scorecard rating, if available,
 - Quality of tenancy,
 - Currency.
- Retail
 - Occupancy, specifying the split "Qualified retailers"/"Non-qualified retailers",
 - If the income model is used,
 - Current ERV,
 - WAULT.
- Industrial projects
 - Current ERV,
 - Occupancy
 - WAULT,
 - Technical condition,
 - Submarket → specify the category,
 - Quality of tenancy,
 - Currency.
- Landplots
 - Location → specify the category,
 - Function (residential, city-centre, industrial).
- Hotels
 - Average room rate last three years,
 - Occupancy rate last three years,
 - EBITDA last three years.

2. Annual portfolio performance report

Frequency: until 28 February each year

Content: MARK will provide an annual summary report on each purchased portfolio. In that report DG COMP can check

- a. whether the original function of the property has been changed to a new best use
- b. whether the restructuring / enforcement / liquidation choice has been realized in case of NPL

Market value calculation of collateral property				NPL and repossessed property transfer price calculation			
	Original function	Current best use	Original market value	Original NPL type (restructuring / enforcement / liquidation)	Original NPL situation (restructuring / enforcement / liquidation)	Transfer price	Interim expenditure and revenue
NPL	1						
	2						
	3						
	4						
	SUM				sum	only sum	
Repossessed properties	1						
	2						
	3						
	4						
	SUM				sum	only sum	

3. Annual corporate reports

Frequency: until 31 May each year

Content: MARK will provide annually the audited balance sheet and income statement.

The auditor will be an internationally recognized auditor

firm. MARK will provide the income statement by each planned business line, such as

- a. Own NPL portfolio management
- b. Own property portfolio management
- c. Debt service

Therefore the overall performance of the portfolio purchase programme can be assessed.

4. Loan loss provision report by the National Bank

Frequency: annually, in the first and second year after the portfolio purchase

Content: Finally the National Bank of Hungary will provide in the upcoming years the amount of released loan loss provision for each bank and

the transfer price and amount of each purchased portfolio. That report will show how

MARK's purchase programme affects the balance sheets of the banks.