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PROPERTY IN PRAGUE

Market Conditions Report

RESIDENTIAL REAL ESTATE IN PRAGUE

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Economic and Social Trends in Prague's Residential Property Market

Gentrification

The introduction of the market economy caused a substantial differentiation in incomes and consequently demands for housing. Higher income persons are made up from successful local entrepreneurs, managers and other highly professional staff serving business community and also from foreign representatives of firms expanding to Central and East European countries. This group of people is likely to share values of contemporary urban life in western cities characterized by strong preferences for residency location in central and inner city neighbourhoods. As a result, there is a demand of higher income people for living in central parts of Prague. These changes are further facilitated by out-migration of central city residents of lower income groups, who are, due to the increase of living cost; seek cheaper locations for consumption of housing as well as daily goods.

In Prague, the market for new or renovated housing has developed in three major sectors:

1. suburban single-family housing purchased by newly wealthy Czechs;
2. new condominiums in the inner city targeted toward young Czech professionals;
3. renovated villas and apartments in well-established, affluent central and inner-city neighbourhoods and targeted nearly exclusively toward western foreigners and some wealthy Czechs.

Prague's city centre still lacks a truly innovatively designed residential community, set amidst public parks, with easy access to sports and recreation, surrounded by well designed "signature" styled apartments, offering families and professionals an active life-style in an urban environment, very attractive floor plans and high quality of equipment, fixtures and fittings.

Price Sectors

The residential market has become highly polarised even within areas of Prague with performance varying widely. The strong growth in house prices today is being driven by the lower and middle parts of the market where housing is still very affordable. The impetus for price growth is weaker higher up towards the luxury units where the price gaps between the mid-market housing units have widened in recent years.

The residential market in Prague can be divided into three price sectors. The first sector is characterized by the price range of CZK 22,000/m² – CZK 41,000/m². The highest percentage of transactions occurs in this sector.

The second sector is characterized by the price range of CZK 41,000/m² – CZK 85,000/m². The sector distinguishes among its developments by quality of the construction, their surroundings, and amenities. As a whole, however, the demand is higher than current supply offers, and continues to increase. Almost half of new developments are aimed at mid price sector, trying to keep pace with increasing demand. However, potential buyers are paying increasingly close attention to the

details, which separate this sector from the first sector, and many of the planned developments will not have the necessary increased quality.

Prices for New Apartment Developments on the Market: 2003

Internal Area CZK Price/m ²		% of Dev.	# Developments
from	to		
20,000	40,999	47%	115
41,000	84,999	47%	115
85,000	200,000	5%	13
Total Developments Surveyed		100%	243

Source: Erik Webb Dempsey, © January 2004 Property In Prague

The third sector is characterized by the price range of CZK 85,000/m² to upwards of CZK 200,000/m². Location is the most crucial factor in the higher price range. Most of these sites to date have been in the heart or in the vicinity of the historic centre, or in the prestigious “villa quarters” of Vinohrady and the 5th and 6th Districts of Prague. Due to the restrictions on construction in the centre and the mentioned attractive localities, demand continues to exceed supply.

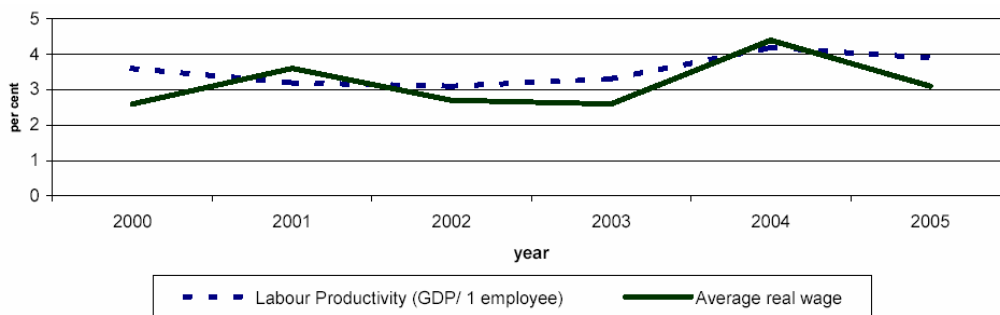
As the number of the newly permitting dwellings in Q3-2003 is the same as in Q3-2002, their 33.9% higher approximate value indicates a change in the market in favour of larger and better-equipped dwellings. The current supply of newly built apartments does not meet this demand.

Purchasing Power of Prague Residents

Wages

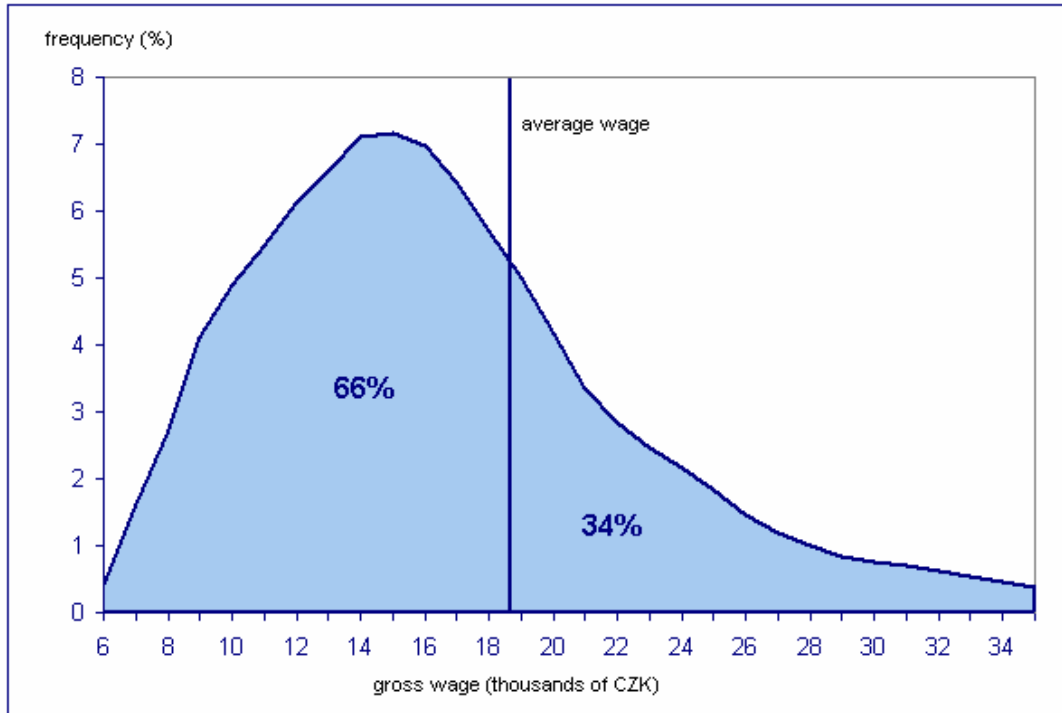
Wages in the Czech Republic are the second highest out of ten accession countries slated to join the European Union next year. The historically low interest rates, an ever strengthening currency and virtually non-existent inflation have stimulated higher consumer spending, which has helped to propel the Czech economy. These factors on top of ever increasing acceptance and accessibility to mortgage financing are the core factors driving real estate prices which we consider critical factors with regard to the domestic market’s ability to pay higher prices now and even higher in the future..

Real wages rose by 6.4 percent year-on-year in the third quarter of 2003. The Statistics Office said the average nominal wage grew 6.3 percent but consumer prices fell 0.1 percent, boosting the real wage gains. Government Council for Social and Economic Strategy predicts an average 3.16 % annual real wage growth until 2005.



Source: Government Council for Social and Economic Strategy, May 2002

According to the trade unions, wages should increase by six percent on average. Taking into account the projected GDP growth, changes in employment and inflation forecasts, this should be around a sustainable level. So, the gap between wages and productivity should close next year. Two thirds of Czech workers earn less than the national average and the gap between the best paid and least paid employees continues to widen.



Source: Czech Statistical Office 2003

Compared with countries like Slovakia, Hungary or Poland, Czech wages are increasing slightly faster, especially as compared to Poland and Slovakia, which are seen as the main competitors over FDI inflow.

According to our calculations, the average wage in the Czech Republic is around 47 percent of the EU average and the ratio is slightly increasing.

We expect that the process will follow growth in labour productivity. Most information sources are sceptical about the possibility of catching up with the rest of the EU quickly - it may take several decades.

As far as regional distribution is concerned, the highest wages remain in Prague. This is due to a different job market structure which requires many more people with high education. Prague, which represents only 11% of the Czech population, enjoys close to 40% of the total retail expenditures. Furthermore, although just 2% of the 5.2 million workforce earns over CZK 40,000 per month, approximately 65% of these high wage earners live and work in Prague. This equates to over 67,000 people. The second highest earning group, earning between CZK 23,000 – 40,000 per month, represents a further 20% of the population. This is the fastest growing section of the workforce nationwide, where salaries have grown by 40% in the last 4 years. The Prague segment of this group represents a further 184,000 people. This up-and-

coming, active social group demands home-ownership, of which there is an acknowledged shortage of supply.

- 251,000 people in Prague are in the top 22% of earners in the country
- The average monthly wage in Prague is 150% of the country average.
- Strong consumer spending with increased wages is driving economic growth.
- Prague represents 11% of the population but delivers 40% of the total retail expenditures.
- 65% of the high wage earners live and work in Prague.
- The second highest earning group representing 20% of the population is the fastest growing section of the workforce where salaries have grown by 40% in the last 4 years.

2003 Wages

Average Czech Rep. Wage	18,697 CZK/month	=	580 EUR/month
Average Prague Wage	29,281 CZK/month	=	920 EUR/month
Average Manager Wage	55,000 CZK/month	=	1,700 EUR/month
Average Executive Wage	93,340 CZK/month	=	2,900 EUR/month

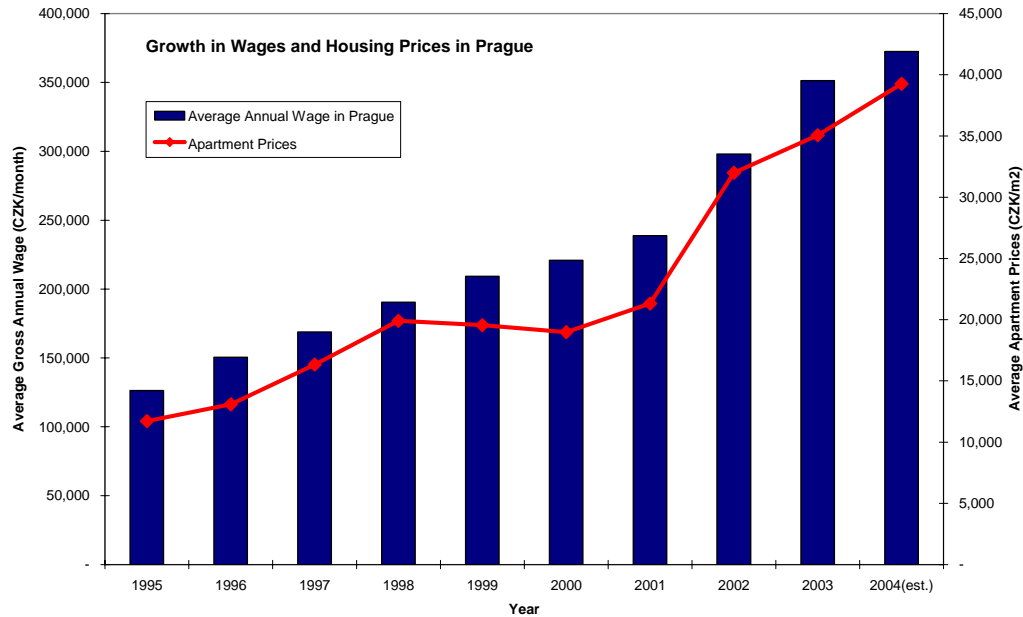
Despite indications given by officially published averages, there is a large and growing population of young upper-middle-class managers that have since replaced their ultra-salaried western counterparts. Higher income persons are made up from successful local entrepreneurs, managers and other highly professional staff serving business community and also from foreign representatives of firms expanding to Central and East European countries. A recent survey shows typical monthly salaries for positions within mid-to-large sized companies:

Position	AVERAGE GROSS MONTHLY SALARIES IN PRAGUE (CZK)				AFFORDABILITY			
	Mid-Size Companies		Large Firms and Director Titles		Price Range for Flats (CZK) (1)		Monthly Mortgage Payment (CZK) (2)	
	Between	And	Between	And	From	To	From	To
Advertising manager	40,000	60,000	62,000	77,000	4,104,000	5,266,800	18,881	24,230
PR manager	40,000	59,000	76,000	105,000	4,035,600	7,182,000	18,566	33,041
Marketing manager/director	33,000	56,000	57,000	128,000	3,830,400	8,755,200	17,622	40,278
Key account manager	31,000	45,000	53,000	72,000	3,078,000	4,924,800	14,160	22,657
Product manager	30,000	45,000	50,000	78,000	3,078,000	5,335,200	14,160	24,545
Sales manager/director	33,000	55,000	62,000	150,000	3,762,000	10,260,000	17,307	47,201
Area sales manager	37,000	61,000	40,700	67,100	4,172,400	4,589,640	19,195	21,115
Sales representative	17,000	32,000	26,000	46,000	2,188,800	3,146,400	10,070	14,475
Financial manager	50,000	78,000	98,000	172,000	5,335,200	11,764,800	24,545	54,124
HR manager	33,000	53,000	62,000	116,000	3,625,200	7,934,400	16,678	36,502
Chief accountant	38,000	65,000	41,800	71,500	4,446,000	4,890,600	20,454	22,499
Sourcing/Purchasing manager	31,000	46,000	56,000	89,000	3,146,400	6,087,600	14,475	28,006
In-house lawyer	33,000	58,000	60,000	108,000	3,967,200	7,387,200	18,251	33,985
Office manager	23,000	38,000	25,300	41,800	2,599,200	2,859,120	11,958	13,153
IT manager	40,000	53,000	80,000	140,000	3,625,200	9,576,000	16,678	44,055
AVERAGE	33,933	53,600	56,653	97,427	3,666,240	6,663,984	16,867	30,658
Min	17,000	32,000	25,300	41,800	2,188,800	2,859,120	10,070	13,153
Max	50,000	78,000	98,000	172,000	5,335,200	11,764,800	24,545	54,124

(1) Based on a Price to Income Ratio of 5.7 (Average for Prague in 2002)

(2) Based on a LTV Ratio of 70%, amortised over 20 years @ 5% annual interest

Source: Positions and Salaries-The Prague Tribune, May 2003, Borrowing potential based on salaries calculated by Erik Dempsey, Property in Prague



Source: Czech Statistical Office (Average Salaries) and Property in Prague (Average Price).

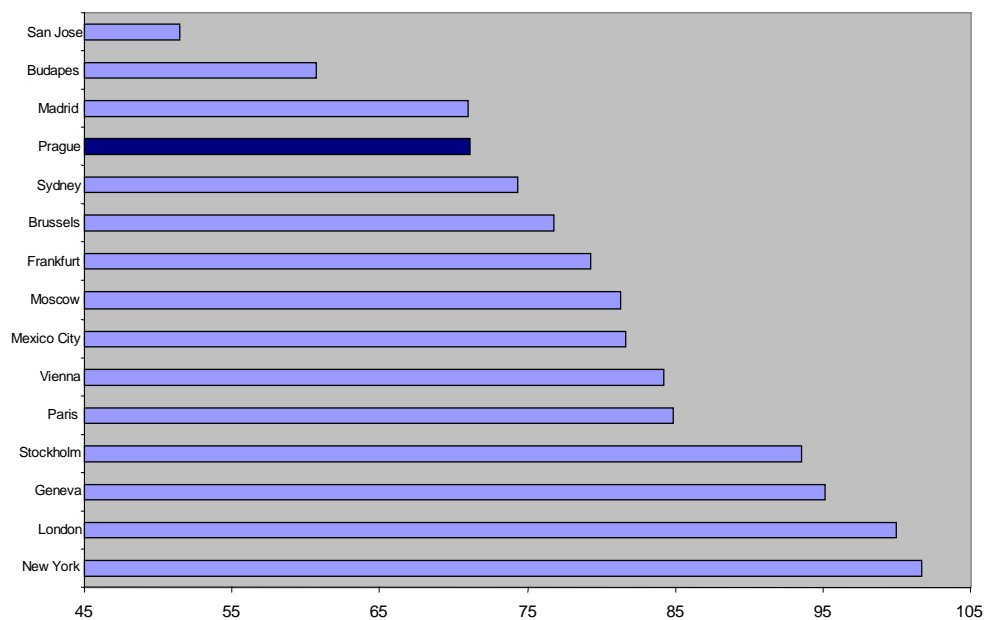
Cost of Living

Although in most respects life in the Czech Republic has rapidly approached Western standards of living, the cost of living remains substantially lower than in Western Europe. According to the Economist Intelligence Unit average prices in Prague are only 43 per cent of those in Vienna. Although the costs in the biggest tourist centres, Prague especially, but also the Bohemian spas, are higher than elsewhere, most things are still fairly cheap for Western visitors.

Cost of Living Index

London = 100

Figures were produced in August 2001 and based on the rate of exchange on 28 July 2001



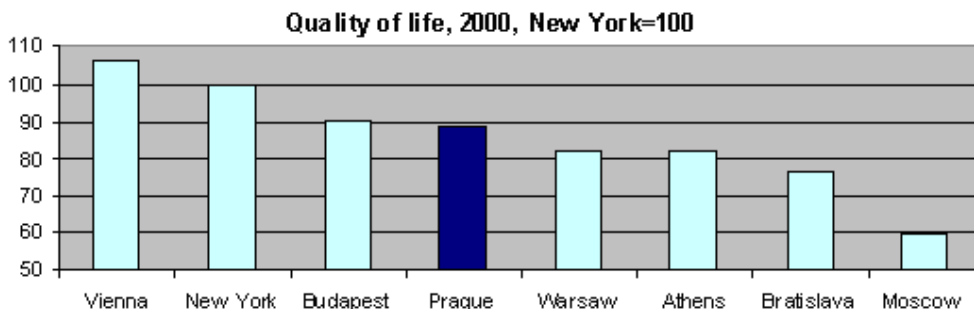
Source: William M. Mercer, 2002

Most foreign students find the price of goods and services in the Czech Republic to be relatively low compared to other European countries, despite the fact that the prices are always going up – a cup of coffee in a nice café costs the equivalent of about €1–1,5; a budget meal in a restaurant is about €2–5, a mid-range about €5–10; and a meal in a top end restaurant starts at €10.

A beer in an average pub costs 50 cents. Even tourist prices rarely make a beer cost more than €3. Tickets to the opera or ballet can be as little as €2! Train travel to nearby towns or castles is about €5. However, consumer goods such as electronics or cosmetics cost approximately as much as elsewhere in Europe.

Quality of Life

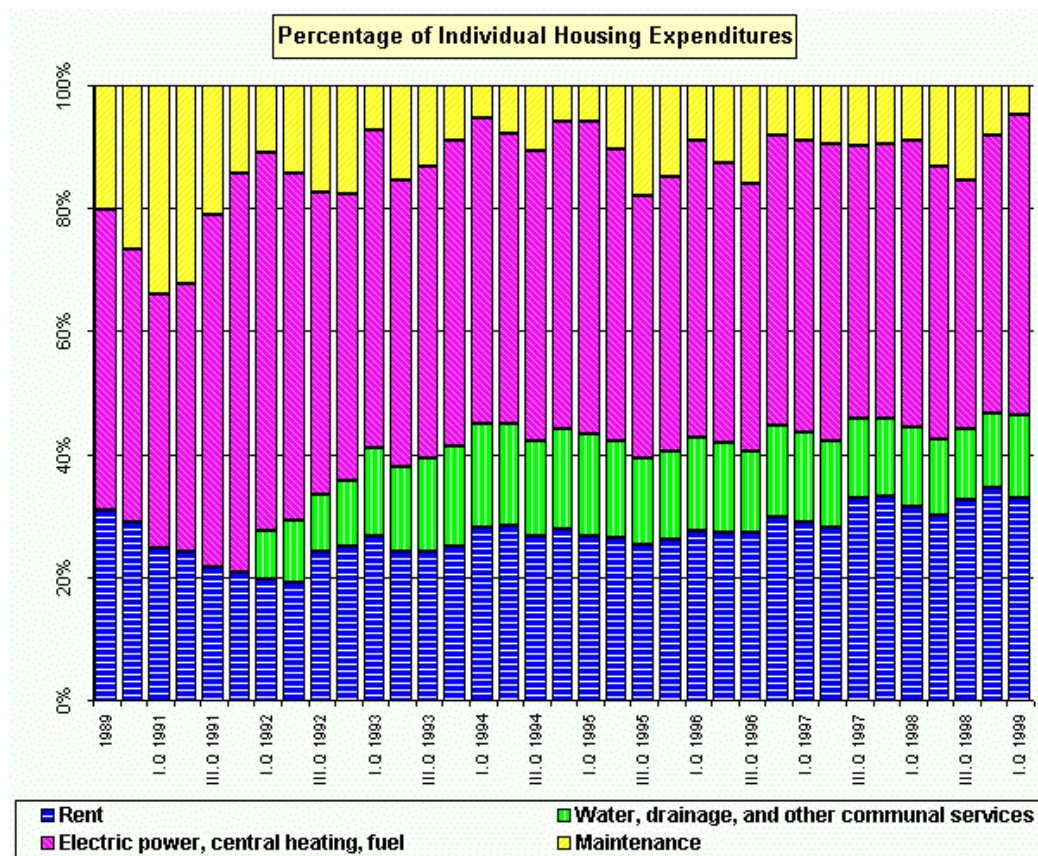
Despite the relatively low cost of living, Prague's overall rating of quality of life is approximately at ninety per cent of the New York's (see the chart below). The analysis was based on an evaluation of 39 quality-of-life criteria for each city including political, social, economic, and environmental factors; personal safety and health; education; transport; and other public services. Regardless of how scientific the study was, there are many in Prague that would strongly argue the City's quality of life in favour over New York City.



Source: William M. Mercer, 2000

Total Housing Costs, Affordability for Households

Housing costs are significantly differentiated depending on the type of housing (privately owned, cooperative, rental), the size and category of dwellings, size of the municipality, and the technology used for heating, production of hot water, and cooking. In the case of units with regulated rent, affordability of rental housing is, relatively high, a fact reflected in a high demand for this type of housing. Affordability of market-based rent is low. For the significant population made up of mostly younger workers who do not have the benefit of regulated rents, they have no choice but to rent at market rates or buy.



In 2001, housing-related expenditures of households totalled on average (i.e. in all types of dwellings) CZK 3,006 per month—this sum corresponds to 16.1% of net

Prague District (1-10)	Avg. Sale Price 60m2 CZK (Oct 2003)	Avg. Rent 60m2 flat/month CZK (Oct 2003)
1	4,752,676	25,941
2	3,569,799	22,899
3	2,604,331	14,705
4	2,087,950	13,385
5	2,277,544	14,734
6	2,768,603	15,674
7	2,550,047	15,053
8	2,050,816	13,603
9	1,935,309	13,638
10	2,269,095	14,195

household income. Due to rapidly increasing rental payments (relative to earlier times) and different structures of housing expenses, total costs of accommodation in rental units are higher, amounting to 20.3% of the average household income. The internal structure of housing expenses is very similar in households that belong to different social groups.

In 1990, the average purchase price of a completed dwelling in an apartment building totalled CZK 171,449. In 2000, these figures totalled CZK 1,449,000. Hence, the cost was approximately 8.5 times higher. In contrast, during the same period nominal net household income became only about 2.8 times higher.

In Prague, Brno, and other attractive cities, the price of older dwellings does not vary considerably from the cost of new construction. For example, in 2003 the average asking price of a 30-year old dwelling (3+1, 70m²) in Prague is CZK 1,700,000 or about CZK 24,200/m². The acquisition cost of a new dwelling in a similar outer city centre locality ranges between CZK 30,000/m²–35,000/m², depending on the construction technology, and type of structure.

House price to income ratios are high when compared to international experience. Price to income ratio at around 4 or 5 is considered to be fairly acceptable, although it shows that the level of affordability is somewhat low, and housing market is tight.

Given the average wage in Prague is CZK 24,883/month or CZK 297,996 annually, the house price to income ratio in Prague is above the threshold at around 9.6 indicating that housing markets are quite tight. Affordability level is marginally better in other cities in the Czech Republic.

The average price of a upper-middle range flat (3+kk, 80m²) is about CZK 4.4 Million. A 70% LTV loan requires an CZK 1,320,000 down payment and a monthly payment of about CZK 20,200 (@~5.0% fixed for 5-years, Amortised over 20-years).

As an aggregate population Czech loans are based on calculations designed to ensure that remaining discretionary income exceeds 1.6 times the minimum living income for that family size. The net effect, is for a payment-to-net income ratio of about 30-35%. For the upper-middle group of buyers, this figure can reach up to 50%.

Loan Statistics Specific for Prague	FY2001
Loans to Private Individuals (Principal in CZK 000's)	15,360,955
Loans to Private Individuals (# Count)	11,196
Average Loan Size (CZK/Loan)	1,372,004
Average Gross Annual Income (CZK)	220,848
Loan to Gross Income Ratio	6.2
Average LTV (Estimate)	65%
Implied Property Purchase Value	2,110,775
Implied Housing Price to Income Ratio	9.6

So based on this assumption, the “average” buyer would require a net household of about CZK 40,000 per month implying a combined (2 income) household gross salary of about CZK 60,000. This further implies our market would typically handle a housing price multiple of 6.1x annual household salary.

As far as acquisition costs are concerned, affordability of new home-ownership dwellings is very low. This is due especially to the fact that acquisition costs grew substantially since about 2000, a fact caused by liberalization of prices, a relatively high demand for good-quality housing, and recent sharp increases in the price of land.

Despite acquisition costs, affordability of home-ownership has increased as a result of lower interest rates on mortgage loans which in 2003 range between 4.0-6.0%, depending on the financial institution term of interest fixation (1-yr fixed=4.4%, 5-yr fixed=5.3%, 15-yr fixed=6.3%).

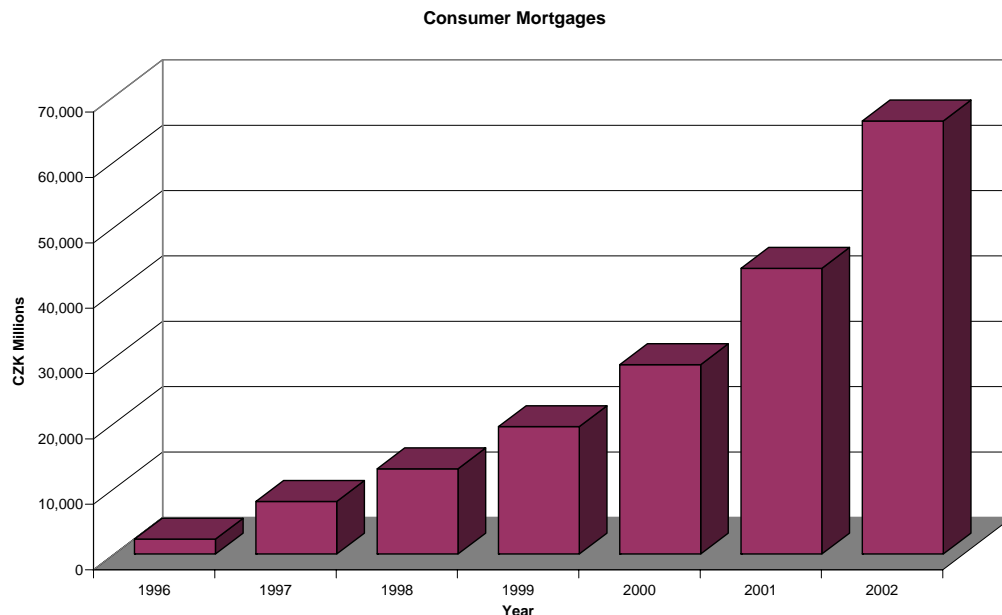
This means that a CZK 2.0 Million loan with 5% annual interest repayable over twenty years involves monthly instalments of CZK 13,144. These are amounts that roughly correspond to 200 - 300% of the regulated rent for a 60 m² apartment in Prague, but are approximately equal to market rent.

Clearly private housing stock is far beyond the reach of the low and lower-middle income groups, and do not provide them with housing options. On the other hand, it is argued that privatization gave households at least some savings to help to cushion the costs of the transition, and therefore privatization, or more precisely formation of private housing markets provide the poor with means to survive since their property after privatization can command high market prices. Indeed people sell their property (the ones in good conditions and in desirable locations) for cash and move into less desirable districts. The margin is used to meet basic needs such as food or kids’

education. Selling apartments is a manifestation of such a cushion during difficult days. Units in better locations and in reasonable conditions are filtered-up to the better-off families, and lower income groups start to concentrate in less desirable locations, mostly at outskirts areas that are not connected to job facilities or schools.

Mortgage Financing

The mortgage market is gradually maturing, thus paving the way for the Czech population to purchase rather than just rent their house or apartment. Accessibility to mortgage financing is the #1 driver behind demand for housing in the Czech Republic. New families usually get their first flat from their parents or the parents help to fund the purchase. The main source of these family funds is private saving fostered by widely known and used government programs. Banks usually offer products combining long-term saving with mortgage funding. The current government housing strategy includes financial support for saving and mortgages, including tax allowances and postponed annuities.



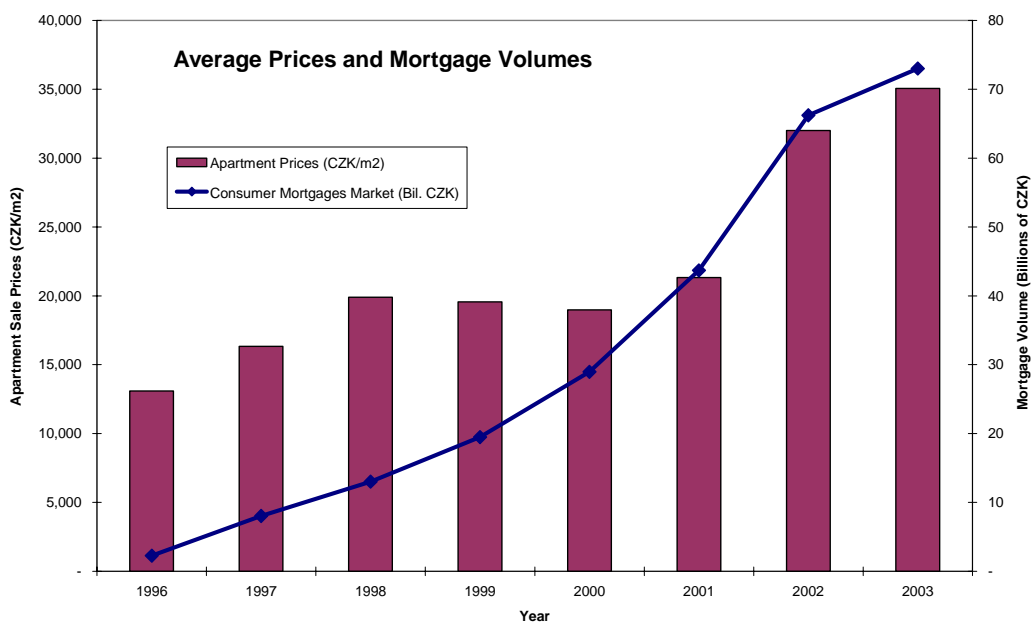
Source: Czech Statistical Office, 2003

Banks are expanding programs to provide mortgage financing for home or flat owners. Interest rates are on a level with Western norms and a growing portion of the Czech population is financially qualified for these mortgages, though mortgage amounts are well below levels in the West. The higher volumes of the approximate values of the residential buildings newly permitted for construction in 2003 were brought about by the favourable situation in the mortgage and saving-in-building-society market. With the mortgage market booming and providing momentum for the middle standard and price range developments, intensive and maturing competition between banks offering mortgage financing for apartments is further fuelling the residential market sales towards an upward trend which is expected to remain strong for at least another two years and even beyond modest rises in interest rates.

Czech mortgage banks registered a record number of clients in the first half of 2003, with the biggest interest in the purchase of completed flats and houses, and the growth

is expected to continue in the rest of 2003, mostly thanks to a recent interest rate cut by the central bank. While in 2002 the number of loans we provided rose by only 70% or so, last year they were up 210%. There are several reasons the number of mortgages growing so rapidly including: a) the growing purchasing power of the citizenry; b) the artificially evoked hysteria caused by concerns about real estate price increases after EU accession; and, especially c) record-low interest rates.

Mortgage loans provided to private individuals increased by 47% in 2002 reaching CZK 66.2 Billion and an estimated CZK 73 Billion in 2003. In 2001, when ČSOB started extending consumer loans, it granted 14,200. In 2002 it granted 25,500, and last year nearly 50,000. In the first half of 2003 Ceskomoravska hypotecni banka (CMHB) provided 4,169 mortgage loans worth CZK 4.17 Billion, which was a yr/yr increase of 70% with the average size of mortgage loans amounting to CZK 960,000. Ceska sporitelna (CS) concluded over 4,000 mortgage loan contracts worth a total of CZK 4.4 Billion during the same period. At the same period a year-ago it was at 3,500 loans. The average value of mortgage loans from CS also increased from CZK 940,000 to CZK 1.1 Million. The average mortgage loan GE Capital Bank granted in the capital of Prague was worth CZK 1.5 Million. Virtually all Czech banks offer the lowest rates on five year mortgage loans below five per cent. (Source: CTK, July 10, 2003)



Banks are providing most of their mortgages for single-generation family homes. In the future it is expected that the greatest interest will be in mortgages for family homes, later followed by apartments.

In the past mortgages drew clients mainly from the upper income groups, often foreigners. Now mortgages are becoming ever more a product for the masses, and banks are striving to make them affordable to the broadest possible portion citizenry. In 2002 mortgages accounted for approximately 3% of the GDP in this country, while the average in EU countries was over 30%. Some banks anticipate that over the next 10 years Czech Mortgages will reach the level of 15% of the GDP.

Rightly or wrongly households in the Czech Republic are consuming as much housing as they can afford but they are not over-stretching their finances to the extent of irresponsibility and are nowhere near the debt levels found in the EU nations¹; especially the UK. The latest available data shows that growth in mortgage market in 2002 and 2003 continues to be strong, yet only a small portion of the potential market has been tapped. Given the low interest rate environment we believe the growth will sustain in double-digit level through 2004 and possibly 2005 with reasonable certainty based on facts indicating that growth in the residential market has plenty of room for growth driven by availability of funds.

Regarding the issue of the rapid rise in credits granted to households and whether this rise is creating a “threat that might affect macroeconomic and financial stability in the future...”, it is generally considered as premature because of why and how these credits are actually rising. Household indebtedness is rising more rapidly than consumption. At the end of 2003 each of the nation's ten million citizens was indebted to the tune of about CZK 20,000, and excluding children and pensioners, the per capita figure jumps to CZK 42,000. But compared to household indebtedness in other European countries, Czech consumers still lag behind. While in this country the ratio of provided loans to household revenues is about 20%, in the EU it often reaches 70-80%.

The fast rise in credits granted to households (people) is a result of the effect of several important factors: (1) the expansion of banks' credit products, (2) the fact that market conditions have become more attractive (e.g. the interest rate for new mortgages has fallen below 5%), (3) Czech's changing approach to incurring debt, (4) attractive prices of some products available in the retail network, (5) Czech's urgent need to resolve their housing problems, etc.

Mortgage Terms

More than ever before, Czech consumers are taking out consumer loans, buying goods on installment plans, using mortgages to pay for apartments, and buying cars through leasing plans. But indebtedness can be a rude awakening. Banks finally became properly involved in providing loans, and the tough battle for clients led to easier conditions and broader offers of loans. It is now easier than ever to take out a loan or get a credit or payment card, and those who have succumbed to home-ownership fever are taking advantage.

Interest Rates

As of December 2003, loans are being offered at rates of 4.50–6.50% fixed for the first 5 years. Rates are usually fixed for 1 or 5 years with some banks offering more flexibility. At least one bank (HVB) now allows for fixed interest rates up to 15 years. The interest on the loan is currently tax deductible, which reduces the effective real rate of interest to about zero percent in today's low inflationary environment, at least for high-income borrowers.

¹ Although the year-on-year rise in credits granted to households is impressive (+30.7%), it is a rise from a relatively low basis. Compared to developed countries, Czechs' indebtedness is still very low – approximately 9% of GDP – while in the Eurozone, for instance, this rate is almost five times higher. (Source: CSOB, Monthly Review, Oct-2003).

The Czech mortgage market currently only offers repayment mortgages; no interest-only mortgages.

Banks often state the minimum interest rate, which is generally dramatically different from the actual rate. Hardly any clients get loans at the minimum rate, as the actual rate depends on the client's ability to repay the loan. And the zero down payment that finance companies like to advertise only refers to the direct payment that the client has to make up front. The information a client should keep in mind when choosing a loan is the so-called RPSN - i.e., the annual percentage rate for costs, which covers all costs connected with arranging and drawing on and repaying the loan. This is the only figure you can use to reliably compare various package offers.

For example, take the example of a bank advertising an attractive consumer loan offer starting at just 7.9% interest, while a finance company offered a zero down payment. But the finance company's offer also had, in fine print, the note, "RPSN 22.9%". At the bank, however, one could still discover that due individual economic situations the loan would be at 13% interest.

Loan maturities

Maturity of mortgage loans ranges from 5 to 30 years. For most Czechs the standard design for mortgages is a 20-year term, with a rate that is fixed for 1 or 5 years and prepayment that is subject to high, but negotiable, fees. It is advantageous for most households to take the full 20-year term and it appears that most do.

20 years is the maximum for foreigners buying their property through a local company; though a 15-year maturity is the maximum maturity for foreigners when the property is purchased as an investment (i.e. not as a primary residence).

Early repayments within the fixed interest rate period typically require a penalty; theoretically equal to the interest that the bank would forego until the end of the fixed interest rate period.

Leverage in a mortgage transaction

The leverage ranges from 50% to 85% of the purchase price with the mean being 65%. The leverage will depend on the bank valuation of the property, the size and structure of the deal and the buyers creditworthiness. Because payments must contain a portion of principle, rental income will typically only support leverage ratios of under 50-65%.

Underwriting on these loans is based on calculations designed to ensure that discretionary income exceeds 1.6 times the minimum living income for that family size. The net effect is for a payment-to-net income ratio of about 30-35%. In making these calculations, the share of the tax savings due from deducting the interest paid is removed from the net mortgage payment.

Collateral

It is most common to take a mortgage against the subject property's value. Optionally, one could use another privately owned Czech property as collateral as long as equity in the property can be adequately proven. Assets in foreign countries are generally not accepted as collateral.

Collateral can also exist where the buyer personally generates enough documented income to support the mortgage payments. Income is usually verified via tax returns;

either local or foreign. This factor becomes more important when higher LTV ratios are sought. Also, personal guarantees based on an individual wealth or superior credit rating are conceivable, but not common.

The Mortgage Process

Theoretically one could get a mortgage pre-approved before a suitable property is found. Nevertheless, in most cases clients go for the final approval after they have found the property, as the pre-approval takes a long time and some substantive information is missing until the client has found a suitable property (e.g., expected rental income from property).

It usually takes 4 - 8 weeks to arrange a mortgage from the filing of the mortgage application to signing of the mortgage agreement. Prior to the filing of the mortgage application, the company must be established (in the case of foreign ownerships), the bank valuation of the property completed and all satisfactory documents supporting the mortgage application collected.

The bank will release mortgage funds against registration of mortgage and property title transfer in the land registry. It is, however, possible to negotiate individual conditions for releasing of the mortgage funds. The alternative of negotiating individual terms is used frequently at present, as the registrations in the land registry can take up to 5 months.

Repossessions of Homes

If a person runs into problems with his mortgage payments, it certainly doesn't mean that there will automatically soon be a forced auction of his real estate. The bank has a logical interest in finding the client a way out since the entire process can drag on for a relatively long time. So, if you miss one payment you will definitely not lose your new apartment.

The simplest solution is to arrange different payment agreements or restructuring measures, which can include an interruption of interest, a change in the interest rate, a postponement of payments, or financial assistance from other persons who can become involved in the credit relationship. More complicated measures include the selling off of the receivable, assignment of the debt, accession to the debt, or auctions and bankruptcy proceedings.

Banks will first try to determine why payments aren't being made and often try to stipulate a corresponding solution. In the first phase reminders are sent to the client. The collection call centre employees start calling the client and they try to agree on remedial measures. But if no remedy can be found after a few months, or if the client doesn't want to communicate with the bank, the case goes to the credit risk management department. This sets off marathon proceedings that can drag on for several years - in the worst case resulting in a forced auction.

In reality there are an insignificant number of cases that go all the way towards auction. ČMHB, which together with Česká spořitelna and Komerční banka controls most of the mortgage market, has taken 96 clients to auction during its existence. 23 cases resulted in actual auctions, while six went through properly conducted but unsuccessful auctions.

Comparison of typical payment schedules via cash vs. mortgage financing

Payment in cash - payment schedule:

Reservation fee CZK 20,000 [EUR 625]

- 30% of the sale price within 10 days of the signing of the pre-contract for the future sale contract,
- 20% of the sale price within 10 days of receiving notice of the completion of the shell, including completion of the masonry for the inner walls, enclosure walling, and completion of the roof cladding,
- 30% of the sale price within 10 days of receiving notice of the completion of the structure's envelope - i.e. the external facade rendering and internal coatings,
- 10% of the sale price within 10 days of receiving notice of the legal force of the occupancy permit decision,
- 10% of the sale price plus VAT in the amount set by law [currently 5%], as calculated from the total sale price prior to the signing of the sale contract.

Mortgage credit - payment schedule:

- Reservation fee CZK 20,000 [EUR 625]
- 30% of the sale price within 10 days of the date of the signing of the pre-contract for the future sale contract,
- Supplementary payment from own resources plus 30% of the mortgage credit amount upon notice of the completion of the shell,
- 60% of the mortgage credit amount upon notice of the completion of the structure's envelope - i.e. external facade rendering and internal coatings,
- Final instalment of the sale price including VAT, within 10 days of the signing of the sale contract and the filing of a petition for the registration of the title to the apartment in the Land Register.

Consumer Protection on Deposits

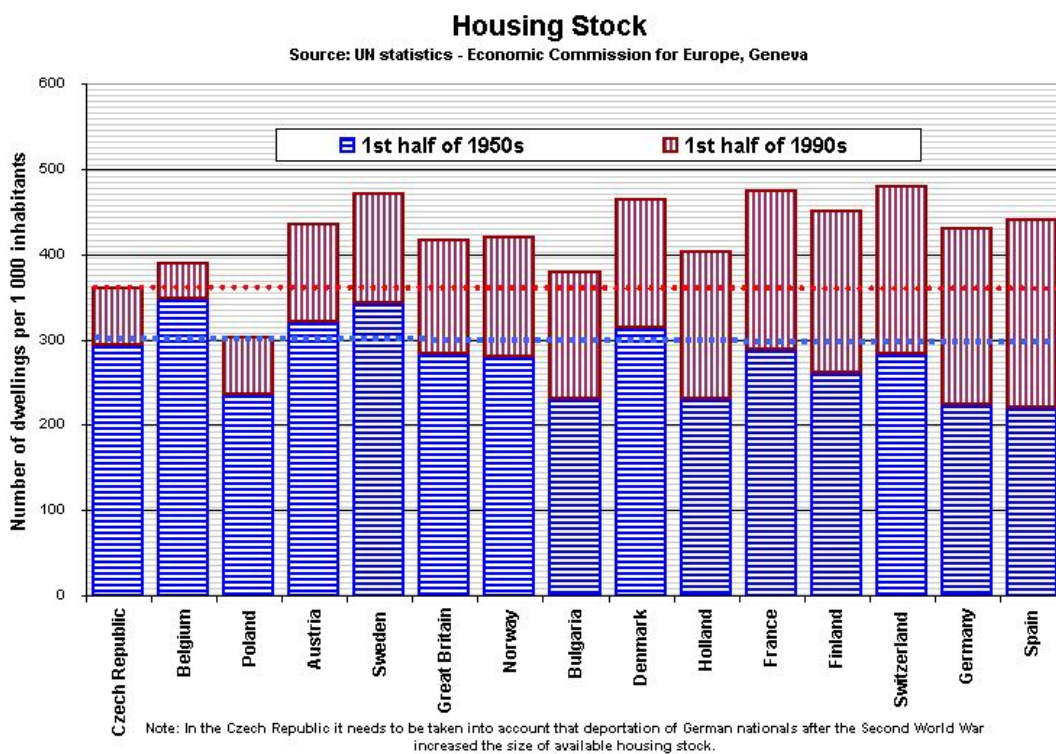
The Czech legal system provides little protection in the event buyers wish to withdraw their purchase intention despite a deposit. Previously, Czech courts looked at the contracts to determine breach of duties, and if none were found the ruling would likely be made in favour of the seller in spite of any substance issues the buyer may present. However, in the future most Czech consumer rights legislations will follow that of the EU's directives. Still, the Czech court system is notoriously inefficient at processing cases. In the event of a bankrupt developer, customer deposits have little hope of being returned.

Housing Stock

Quantities

Current Czech housing stock includes pre-war apartment buildings and single-family houses, many in need of repair, and Soviet era panel apartment buildings (or "panelaks"). These panelaks amount to 31% of all housing in the Czech Republic. There were around 62,456 panel apartment buildings built between 1959 to 1990. The number of apartments in these buildings is 1,165,000.

Housing construction declined from 45,000 to 67,000 dwellings completed annually between 1985 and 1990 to 12,662 in 1995. Since 1995 housing construction has been slowly increasing with activity concentrated especially in large cities and their suburban districts. In 2002, 27,292 housing units were completed and 33,606 started in the Czech Republic. The respective figures for Prague are 7,822 and 6,532.

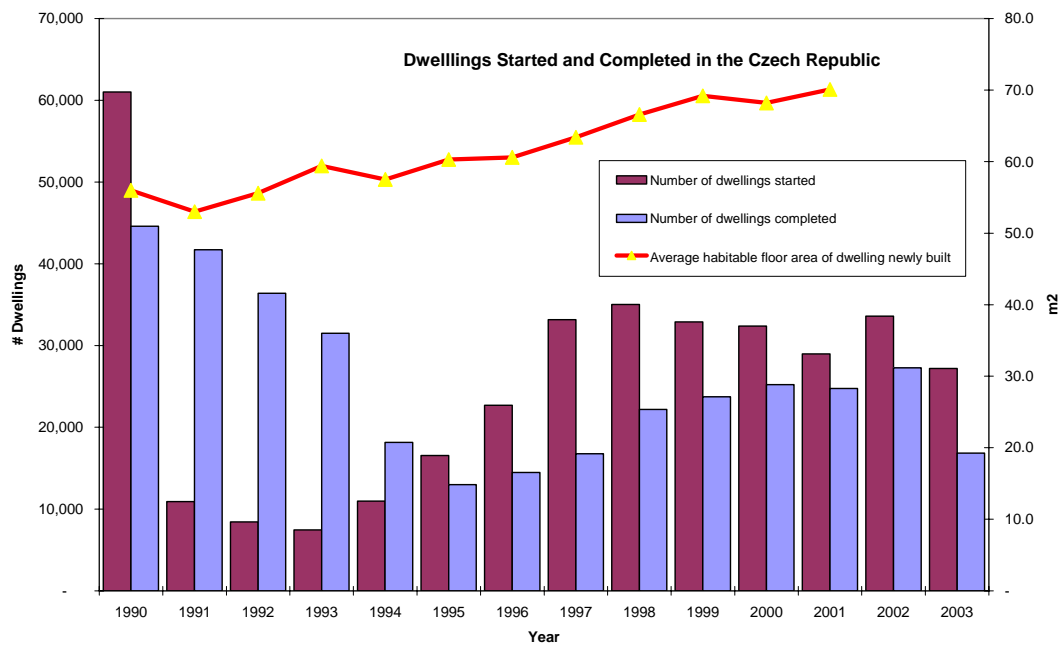


Because of the scarcity of development equity financing and the population's low purchasing power, however, housing construction accounts for only a small fractions of the country's construction investments. Moreover, the number of completed housing units per 1,000 inhabitants, which is around 1.5 is substantially lower than in developed countries.

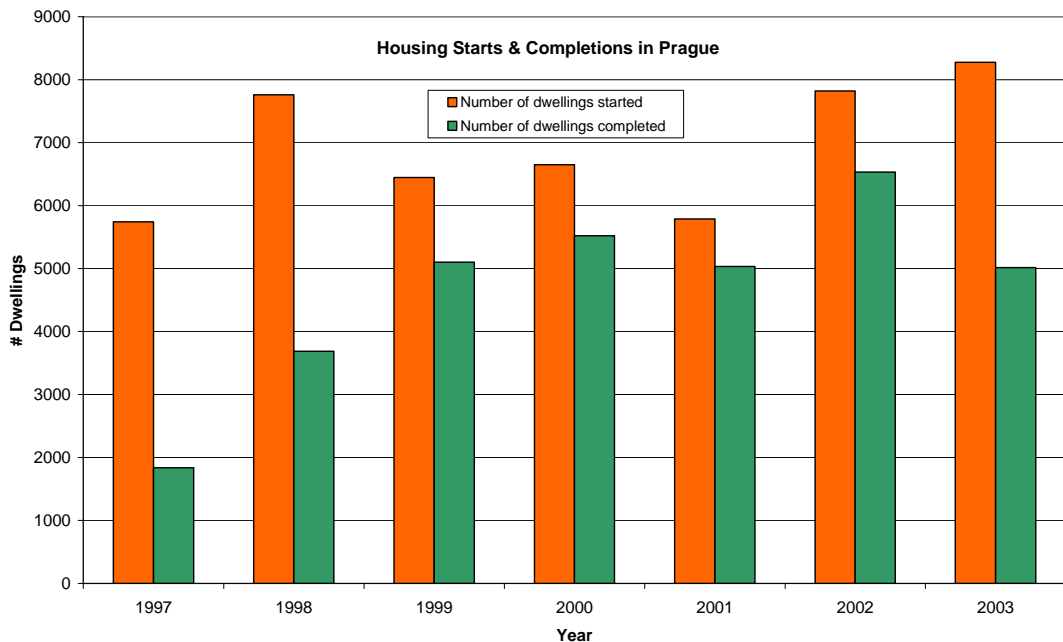
Furthermore, although the number of completed dwellings has been increasing steadily since 1995, it has not attained the number of dwellings where construction has started. Increases of the housing stock are continually reduced by diminutions of the housing stock which have fluctuated between 2,000 to 4,000 dwellings annually during the past four years.

Contrary to popular belief, the Czech Republic does not actually suffer from an overall housing deficit. Disproportions on local housing markets are mostly due to an

unsuitable distribution of the housing stock, and not an actual shortage of dwellings. Further, there are differences in the availability of housing between individual regions. While the best situation exists in Prague, the worst availability of housing can be found in the Zlín Region. The high demand for financially accessible housing in Prague and some other cities which seems to contradict the data on availability of dwellings is due to the attractiveness of these settlements and a shortage of relatively inexpensive housing for lower-income families. In contrast, there is a surplus of vacant dwellings in structurally affected regions and other localities.



Source: Czech Statistical Office, 2003



Source: Czech Statistical Office, 2003

New Apartment Dwellings in Prague by Year and Prague District

Survey of Developments (Jan-2004)			P1	P2	P3	P4	P5	P6	P7	P8	P9	P10
Year Completed	# Units	# Developments Surveyed										
1998	845	8	-	8	285	-	410	-	-	92	-	50
1999	1,185	5	-	-	-	-	196	-	-	686	-	303
2000	1,155	9	40	-	-	169	296	24	-	24	602	-
2001	1,171	13	12	-	-	286	463	8	24	58	-	320
2002	2,019	26	25	-	-	391	769	99	-	54	214	467
2003	3,690	52	56	122	2	642	610	781	70	788	459	160
2004	6,954	98	69	77	211	719	1,340	983	-	449	1,390	1,514
2005	5,905	47	-	33	-	1,507	1,299	785	74	133	1,386	688
2006	3,085	8	-	-	560	600	581	250	444	-	-	650
2007	686	2	-	-	-	-	-	-	-	-	556	130
Total	26,695	268	202	240	1,058	4,314	5,964	2,930	612	2,284	4,607	4,282
			1%	1%	4%	16%	23%	11%	2%	9%	17%	16%

Source: Erik Dempsey, © 2004, Property In Prague

Building Permits Granted in Prague by District in Year 2002

District	Total # Building Permits Granted		Buildings	Of these Buildings				Other	Total number of new Flats
	Total	% Total		of these					
				Residential		Commercial			
				New Builds	Change to Existing Buildings	New Builds	Change to Existing Buildings		
Praha 1	970	7%	644	0	246	2	396	181	44
Praha 2	557	4%	399	1	214	1	183	10	82
Praha 3	632	5%	566	1	523	9	33	54	127
Praha 4	2,165	17%	1,874	104	1,525	61	184	136	765
Praha 5	2,033	16%	1,518	123	1,214	66	115	187	1,019
Praha 6	1,012	8%	740	90	575	10	65	158	559
Praha 7	361	3%	319	6	230	5	78	21	38
Praha 8	1,248	10%	1,133	42	913	18	160	77	441
Praha 9	2,390	18%	1,671	178	1,103	158	232	241	1,696
Praha 10	1,623	12%	1,356	87	1,018	29	222	115	682
Total Prague	12,991	100%	10,220	632	7,561	359	1,668	1,180	5,453

Source: Czech Statistical Office, 2003

Sizes

The size of dwellings improved during the 1990s. While in 1991, the average living area of a permanently occupied dwelling was 45.9 m², it increased to 53.7 m² in 1999. This improvement is owing to new construction of housing; for example new dwellings completed in 2001 had an average living area of 70.9 m². A survey of new developments in Prague shows the “average-average size of new flats in the survey is 93.9 m²”.

Selected Data Measurements	Average of the		
	Average	Smallest	Largest
Internal Areas (m2)	93.9	51.4	163.7
Price per m2 (CZK)	47,248	38,729	57,650
Advertised Price per m2 (CZK)	39,371	19,030	100,000
Total Price of Apartments (CZK)	4,524,700	2,501,943	9,206,447
Average Parking Space Ratios	1.2	0.3	3.8
Average Price / Parking Space (CZK)	257,036	129,000	435,000

Source: Erik Webb Dempsey, © 2003 Property In Prague

Aggregate Proportion of New-Build Units Dedicated to Layouts with X # rooms

1+kk	20%
2+kk	36%
3+kk	22%
4+kk	11%
5+kk	8%
>6+kk	4%

Source: Erik Webb Dempsey, © 2003 Property In Prague

Floor Levels

A significant portion of Prague's older housing stock is in the form of Panelak buildings typically 10-16 floors. The fact that the majority of newly built apartment buildings seldom rise above 7-8 storeys has more to do with construction cost escalations that become disproportionately higher for each floor roughly above the 6th level.

Prague offers some of the most spectacular rooftop views of any city in Europe. Our studies have shown a significant correlation between the value of internal areas of a given apartment and its position level within the building.. Consequently, the higher up one's flat is within a building, the greater the value. Such value is compounded when straight-line views of the castle are available.

Aggregate Price Adjustments to new-build flats according to Floor level using Level 3 as Base (100)											
Floor	Ground	1	2	3	4	5	6	7	8	9	10
Price Adjustment	94%	92%	97%	100%	107%	108%	115%	134%	129%	134%	142%

Source: Erik Webb Dempsey, © 2003 Property In Prague

Age

The average age of the housing stock is relatively high. In 1991, dwellings were 42.4 old, and the average age of family homes was as high as 60.3 years. A problem that exists in this regard are high energy requirements of dwellings.

A serious problem is neglected maintenance of the housing stock due to a lack of maintenance over a protracted period of time which has resulted in a decrease of the financial and utility value of residential structures. Specific problems exist in respect of prefabricated-panel buildings (Panelaks). Due to construction and design flaws and insufficient maintenance, these problems are exacerbated by the fact that buildings of this type account for close to one third of the housing stock. Another problem is a lasting lack of funds for regular repairs and maintenance, repair of defects caused by maintenance neglected in the past, modernization, and reconstruction.

Ownership

In 1991, the housing stock comprised state-owned dwellings (approx. 40%), cooperative dwellings (approx. 20%), and privately-owned dwellings (approx. 40%). Fundamental changes have taken place in the structure of the basic forms of housing since 1989. According to data from a selective survey of the Czech Statistical Office collected in 1999 and partial data of the 2001 Public Census, the housing stock is as follows:

Ownership Situations in Prague (2002)

<u>Occupant's Ownership Status</u>	<u># Flats</u>	<u>% Total</u>
in own house	55,893	11%
in own dwelling	54,796	11%
rented	234,599	47%
in dwelling of housing association	64,737	13%
Other	86,915	17%
Total	496,940	100%

<u>Of the Rented Stock:</u>	<u># Flats</u>	<u>% of Rentals</u>	<u>% of Total</u>
Municipal rental housing	114,804	49%	23%
Private rental housing	34,940	15%	7%
Cooperative rental housing	84,855	36%	17%
Total Rented Stock in Prague	234,599	100%	47%

Private rental sector

The private rental sector, created mainly based on property restitutions, accounts for about 7% (7% in Prague) of permanently occupied dwellings. Only about 2% of housing in Prague is actually rented at market rates. Many of these are buildings that have rent-controlled tenants, yet are privately owned by profit-oriented individuals or companies. Effectively, the restitution process returned properties to their original owners prior to the Communist takeover or immediate ancestors thereof; often in poor condition and in need of immediate repair. The catch was (and is), the restituted owner of many residential buildings also inherited the rent controlled tenants. Most problems derive from the fact that many rental buildings are in a very poor condition and the low controlled rent often does not cover operating expenses, much less capital repairs and/or investments. The restituted owner has no profit incentive to serve the tenants.

Investors are generally not interested in the rent-controlled housing sector, as investment into controlled rental housing has a long period of return in comparison with privately-owned dwellings and involves a great deal of "time-line" risk with regards to the process of relocating existing low-rent tenants. It should be noted that the risk of "accidentally" buying a building with regulated tenants is low, given the situations are quite transparent for even the lightest due-diligence effort to snag. Additionally, no "new build" stock offered by developers would be subject to such restrictions.

The size of the rent-controlled sector remains more or less constant or slightly declining as some properties are successfully vacated and developed to their full potential. Many existing property-owners have retained rental buildings, taking into consideration the expected eventual elimination of rent control (declared by the government to be gradual over the next 3-5 years).

The municipal rental sector

The municipal rental sector, created after 1991 by transferring state-owned dwellings to municipalities, accounted for approx. 23% of permanently occupied dwellings (23% in Prague). The size of this sector is gradually decreasing, as municipalities privatize a part of their housing stock. Privatization schemes include sale of entire buildings to legal entities (most often cooperatives) formed by existing tenants and direct sale of individual dwellings, usually to existing tenants. This sector faces similar problems as the private rental sector. Nonetheless, some new dwellings are constructed thanks to state subsidies. Owing to differences between the approach used by individual municipalities and the in-progress elimination of rent control, the form and function of municipal housing are not entirely clear.

City	Rental Values		
	Standard, 68 m2 Flat in the City Rent/m2/month		
	Regulated	Market	% Diff
Teplice	1,292	3,196	147%
Ostrava	1,700	3,808	124%
Opava	1,360	4,828	255%
Liberec	1,564	5,100	226%
Kolin	1,088	5,100	369%
Olomouc	1,768	5,440	208%
Pizen	1,768	5,712	223%
Brno	1,836	6,664	263%
Hradec Kralove	1,360	6,596	385%
Praha	2,516	9,112	262%

The Future of Regulated Rents Standard Flat, 3+1, 80m2

	2003	2004	2005	2006
Praha	2,966	3,263	3,589	3,948
over 100,000	1,981	2,179	2,397	2,637
50-100,000	1,465	1,611	1,773	1,950
10-50,000	1,314	1,445	1,590	1,749

SOURCE: MF Dnes, 7-Jan, 2004 from CVUT, RK Evropa

The average value of index of underevaluation (the difference between the market price and the controlled price of rent divided by the controlled price of rent) was 20.82 for all municipal flats in Prague in 1996; this means that every municipal flat was on average underevaluated by 2082% because of rent regulation! The index equals 11.24 for municipal flats in the Czech Republic. (Source: Martin Lux, 2000)

The cooperative sector

The cooperative sector, which consists mainly of dwellings formerly owned by People's Housing Cooperatives (Druzstvo), accounted for approx. 17% of the occupied portion of the housing stock (13% in Prague). In addition to People's Housing Cooperatives, this sector includes dwellings owned by former members of these cooperatives and dwellings owned by legal entities, mostly cooperatives, established by tenants for the purpose of privatizing their buildings (approx. 1.5% of the total number of permanently occupied dwellings). The size of the cooperative sector is decreasing slightly, as dwellings owned by People's Housing Cooperatives are being privatized—this process started in the first half of the 1990s. From the

viewpoint of users, the situation in this sector is relatively satisfactory. Almost no housing construction is taking place, however, as support from the state is not perceived as sufficiently motivating.

The privately-owned housing sector

The privately-owned housing (osobni vlastnictvi) sector consists mainly of family homes and individual privately-owned dwellings in apartment buildings—these dwellings have been acquired either as part of privatization of municipal or cooperative housing or come from new construction. This sector represents 47% of permanently occupied dwellings (22% in Prague). Over the long term, the privately-owned housing sector is the most rapidly expanding segment of the housing market. Factors which contribute to this trend include the increasing wealth of Czech tenants combined with declining conditions of existing dwellings to the point that the cheap rent no longer justifies the living conditions.

APPENDIX A: Major Concentric Zones in Prague

Prague has very rich socio-spatial structure, consisting of scattered patterns of various building types with people of different social status. However, five major concentric zones can be distinguished. There is the central city with traditionally higher than average social status. The inner city consists of neighbourhood which in time of their construction exhibited both working class and bourgeois status. The inner city neighbourhoods are characterized by rental housing stock (four to five storey apartment houses with ten to thirty apartments) build in the second half of nineteenth century and 1920-30s. At the edge of the inner city there are garden towns like communities, with the highest social status in Prague's social urban geography. The fourth zone is a ring of housing estates build under Communism using prefabricated technology. Fifth zone consists of villages and small rural communities.

1. **Prague's Old Town (Stare Mesto).** It is located between Old Town Square, Charles Bridge and National Theatre and Mustek (Venceslas Square), in the heart of city tourist area on busy routes from Prague Castle to the Prague's CBD. Many foreign firms have their business residences in the area or in adjacent streets. It has excellent public transport connections by underground (Metro) and trams. Car parking is difficult, but everything is in a walking distance. Most buildings were constructed prior 20th century and many were in quite dilapidated state at the beginning of 1990s.
2. **Vinohrady,** a traditionally upper social status neighbourhood built in nineteenth century. Dilapidation of housing stock due to under maintenance and decline in social status due to subdivision and redistribution of bourgeois dwellings to working class families changed the character of neighbourhood during Communism. However, as educational and professional characteristics show, the neighbourhood partly retained its spirit through all the years under Communism. Excellent public transport (Metro, trams), proximity to city highway, possibilities for car parking on streets and inside blocks of houses, vicinity of central city, adjacent new office developments and structurally sound buildings made this neighbourhood very attractive for potential investments into residential rehabilitation. Orco Group (www.orcogroup.com) is one such developer who focused almost exclusively on the Vinohrady neighbourhood throughout the 1990s. It would be fair to give credit to Orco for effectively reconstructing the neighbourhood into one of the finest areas for upscale living today. As of 2003, however, most of the neighbourhood has been developed and large scale projects are few and far between.
3. **Zizkov,** a lower social status neighbourhood adjacent to Vinohrady. It has been historically characterized by higher proportion of working class people, romanes (gypsies), oldest and most dilapidated housing stock in Prague. However, it is located close to Prague's downtown to which it is linked with tram lines. Two Metro stops are within walking distance. Two universities are located in the vicinity: Prague School of Economics and Central European University (however, CEU is now moving most activities out of Prague). The neighbourhood offers cheaper accommodation for foreigners (often non-business people), alternative and very local culture in pubs and restaurants (U vystrelenyho voka, Akropole). As of 2003, early stages of gentrification can be seen since the recent saturation of development opportunities in the Vinohrady area has turned attention towards neighbouring Zizkov (and also

Vrsovice on the southerly border of Vinohrady) to absorb the demand for city centre housing at more affordable prices. Additionally, several significant projects are being developed, together amounting to well in excess of 100,000 m² of new retail and office space. Some of these include the Flora Shopping Mall by Africa-Israel, Luxembourg Plaza by Orco, Czech Savings Bank's Housing Loan Facility, and a major shopping and office project developing at the former Žižkov cargo station.

4. **Nusle and Vrsovice**, a predominantly working class neighbourhood, build during the first half of this century. High proportion of working class people and presence of romanes (gypsies), busy square and retail strip, tram exchange and proximity to downtown form the general character of area. Both neighbourhoods are adjacent to Vinohrady, but Vrsovice is best positioned to capture the values of Vinohrady's wealth expansion.
5. **Bubeneč** is a neighbourhood built predominantly in 1920-30s. It is adjacent to one of the most attractive residential areas of Prague, consist of apartment houses in good shape, has population with higher than average education and with higher share of employed in tertiary sector. Two Metro stops and busy retail strip makes area valuable for inhabitants. Furthermore, station on the expected rapid railway to Prague airport can furthermore increase attractiveness of the neighbourhood. This area was deliberately added for comparison with areas characterized by dilapidated housing stock.

Average Prices of Sales and Rentals of Selected Neighbourhoods of Prague

Source: Erik Webb Dempsey, © 2003 Property In Prague

Prague District (1-10)	Area	Gross Yield (2003)	Avg. Sale Price/m ² CZK (Aug 2003)	Avg. Rent /m ² /month CZK (Aug 2003)
1	Mala Strana	5.77%	93,656	451
2	Nove Mesto	6.75%	56,471	318
1	Nove Mesto	7.25%	61,884	374
5	Smichov	7.40%	46,482	287
1	Stare Mesto	6.50%	84,001	455
2	Vinohrady	7.77%	61,066	395
10	Vinohrady	6.90%	45,786	263
3	Vinohrady	7.04%	44,094	259
10	Vrsovice	6.73%	45,774	257
	3 Zizkov	6.72%	43,698	245

Substantial revitalization is present in all of the five Prague-central neighbourhoods. However, its scope varies greatly, depending on the location of unit within the city and on the impact of change in the ownership. The most remarkable revitalization occurred in in the Staro Mesto city centre and Vinohrady, the traditionally higher status neighbourhood. The extent of revitalization has so far been lower in the remaining three areas, but this is soon to change.

Initially revitalization appeared mostly in the form of commercialization of the current building stock, including changes from residential to non-residential use. Changes within the residential sector are very limited. However, as of 2003 the supply of office space has met or exceeded demand. Consequentially, when KPMG moved out of their office in Vinohrady, the developer/owner (Skanska), quickly converted the building into luxury flats (Residence Charolletta). This is a sure sign that the market is indicating the "highest and best use" should return back to residential.

APPENDIX B: How Projects are Marketed

New developments these days employ a very similar approach to sales and marketing across the board. Their media mix comprises the following:

- An informational Website (often high quality with extensive interactive information. See: www.korunnidvur.cz, www.havlickovysady.cz, www.hrebenka.cz)
- Web listings in search databases (netrealit.cz, sreality.cz, reality.atlas.cz, reality.cz)
- Real Estate Agents (Lexus is often a standard for big new build projects, though most developers don't like it.)
- Real Estate Magazine advertisements (RealCity, Realit)

Budget wise, real estate agent fees typically amount to about 3% of the gross sales price. Marketing budgets typically range from 5% to 10% of a projects sales volume.

Advertising costs are usually passed straight to the developer, though there are cases where such costs could be reduced by sharing space and/or purchasing power with agents and their other projects.

Although there are a substantial number of estate agencies in Prague (over 60,000), most are unreliable at best. In reality, few do little more than place advertisements in local media and wait by the telephone or e-mail. The overall knowledge, motivation and competence of most residential leasing agents is poor at best.

However,

Real estate agencies can be a valuable source of leads and should not be completely dismissed. In practice, most prospective buyers deal with a real estate agent up to the point of signing a contract. Ideally, the agents should act only as a source of pre-qualified buyers that would be handed over and professionally managed by the developers' internally dedicated marketing support systems throughout the rest of the buyer's process of acquisition. There is still some observable room for improvement in certain developers' handling of buyers.

Some large developers, such as Skanska, IPB Real and Metrostav, have taken it upon themselves to market their own properties via their in-house estate agents. Such a decision clearly requires a large scale of offerings. The large developers typically have at least 4-6 of their own development projects actively marketed at any given time.

<u>Developer</u>	<u>Projects</u>	<u># Flats</u>
Skanska	13	1,192
Metrostav	14	1,621
IPB Real	13	2,790
ICKM	9	635

Source: Erik Webb Dempsey, © 2004 Property In Prague

Promotional materials should be supplied to agents in order to control the image of the project and ensure a consistent presentation to each potential buyer.

Marketing Blunders of Previous Projects

Zvonarka:

Developed by the large Austrian company, UBM, Zvonarka sits on one of the most attractive locations in Prague within exclusive Vinohrady neighbourhood. One of its most distinguishing feature is its hilltop view of the South and West of Prague overlooking the roofs of the buildings in the Nusle valley. Zvonarka had and still has massive marketing and advertising budgets, but extremely poor and surly administrative support. Hence, all promotional money was wasted when the sales-girl covering the phone hates her job and refuses to answer. Additionally, it was clear that the agents had no training whatsoever, and they relied on part-time students to view apartments with clients.

Back in the summer of 2002, the wife of the author of this report personally attempted have an informational brochure mailed. When the sales agent learned we lived only around the corner, she insisted my wife should come to the office to pick up the materials personally. Our interest in the project led us to pursue a viewing, but scheduled meetings were cancelled at least 3 times and we never did get to view it before it sold out.

Despite this, almost 100% of the units were sold prior to the completion of construction due to the quality materials used and extraordinary attractiveness of the location and the development scheme itself. We were ultimately only able to view the project as a potential rental tenant when my wife learned that a girl from her school was a part-time agent.

Lesson: carefully coordinate and properly train marketing support staff for media campaigns.

Source: Erik Webb Dempsey, © 2003 Property In Prague