



Dear CEO Letter No. 2/2009

**to Investment Fund Managers managing Real Estate Funds and to those managing Investment Funds that invest in Real Estate Funds**

The financial crisis that has recently rippled into Hungary as well, has had an extraordinary negative impact on the Hungarian investment fund sector, including real estate funds. As a result of the extensive withdrawal of capital, liquidity became tight for real estate funds and therefore both the market and the HFSA have taken measures to reinstate the liquidity of the funds (for more details see Annex No. 1).

The HFSA analyses and assesses the status of real estate funds on a daily basis and if required, it exercises its options allowed under the legal statutes. However, following the 10-day suspension by the HFSA of the trading of investment notes of real estate funds there was no emergency situation that would have necessitated immediate extraordinary measures to be taken.

The due dates for the financial settlement of redemption orders and the legislative framework enable real estate funds – subject to their business decisions – to continue their operations according to various scenarios, such as:

- They may continue to remain open-end funds;
- They may transform into closed-end funds; and
- They may decide to liquidate the fund.

In addition to the above, the fund manager may also request the redemption of the fund's investment notes to be suspended.

(See Annex No. 2 for more detail on the various alternative options.)

In relation to the revaluation of real estate properties owned by real estate funds I draw your attention to the fact that it is the task and the responsibility of the appraiser commissioned by the fund manager to determine the market values of the real estate properties, and he/she should specify the value of a real estate property using the most appropriate method prescribed under the Capital Market Act for the given market circumstances, with emphasis on the general trends of the real estate market, on the yields that can be achieved on the real estate market and on alternative investments, and on the time available for the sale of the real estate property. This principle should be in view when specifying the values of the real estate properties within the individual funds and when deciding on the revaluations that may be deemed as necessary. When choosing a method for the assessment of real estate the real estate appraiser must consider the future strategy of the given real estate fund.

The HFSA emphasises the importance of the protection of investors, and therefore expects investors to be informed in time of the future operating strategies of the fund management companies with regard to real estate funds; for this most complete information to enable them to make responsible decisions on the fate of their investments.

Fund management companies should make their own business decisions with regard to developing the future *modus operandi* for their managed real estate funds. With regard to the expiries of the 90 trading day deadlines available for settlement starting on 6 April 2009, by way of this CEO Letter the HFSA calls upon all *public, open-ended real estate investment funds* and all investment fund management companies *that invest in real estate funds*, to send to the HFSA, not later than **by 10 February 2009, their strategies presenting the future *modus operandi* of their managed real estate funds**

I hereby inform you that the HFSA shall publish this CEO Letter on its home page under the heading “HFSA/Regulation/CEO Letters”.

Budapest, 30 January 2009

**Csaba VARGA**  
Director General of the HFSA

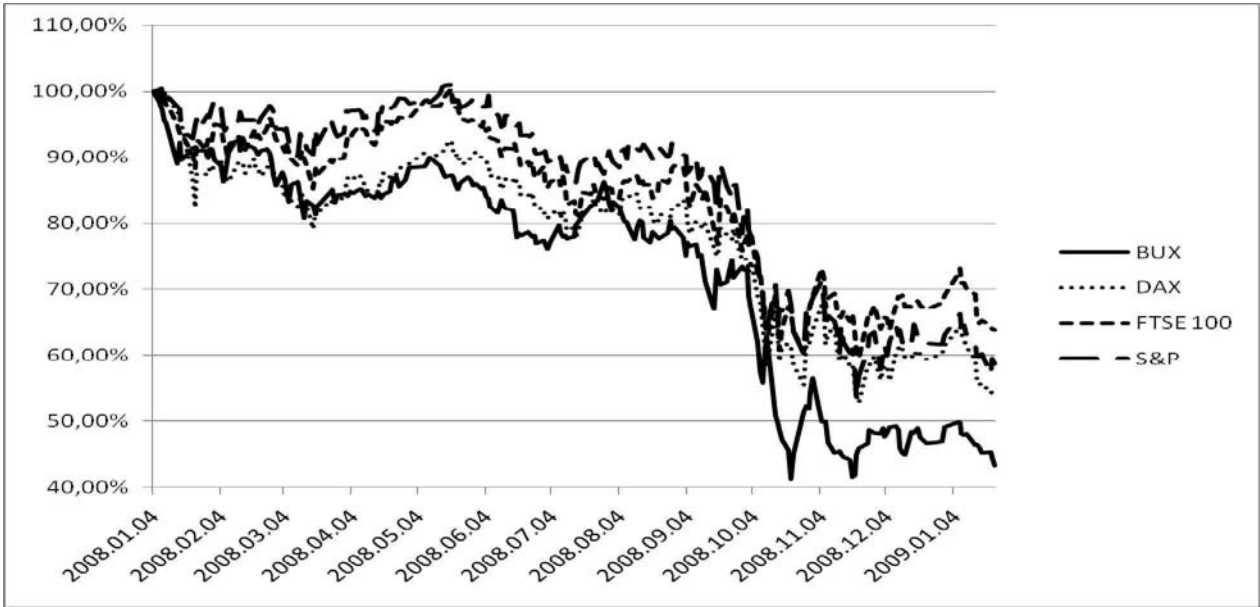
## Annex No. 1

Assets managed by Hungarian investment fund managers in investment funds have dropped by nearly HUF 640 billion in 2008, from HUF 3,161 billion to HUF 2,524 billion, as a consequence of known market processes. HUF 178 billion of this represented losses in yields while HUF 460 billion represented the outflow of capital. With regard to yield losses funds with high equity exposures were in the most unfavourable situation, pure equity funds and funds with a predominance of equity suffered losses of over 40%, but even the losses of balanced funds with mixed portfolios exceeded 20%, while money market and fixed income funds and real estate funds achieved positive yields. When examining the net outflows of capital we find the direct opposite. Investors withdrew most money from money market and fixed income funds, as well as from real estate funds, primarily due to a hike in interest rates offered on deposits by the banks. In the case of real estate funds the amount of the capital that was withdrawn exceeded HUF 210 billion and investors in real estate funds issued redemption orders for several additional billions of HUF worth in investment notes. The greatest outflow of capital was found with fixed income funds, a total of HUF 451 billion was withdrawn from liquidity, money market and fixed income funds.

Ordering of Funds	Funds at the start of 2008		Change in 2008				Funds at the end of 2008	
	Net Asset Value	No.	Net capital flow	Effect of yield	Yield (%)	Change in NA	Net Asset Value	No.
<b>Investment Policy</b>								
Other Non Classified Funds	63 771	8	12 902	-8 254	<b>-12,94%</b>	4 648	68 419	10
Guaranteed Funds	452 775	111	87 958	-20 753	<b>-4,58%</b>	67 205	519 979	163
Long Term Fixed Income Funds	146 655	19	-60 125	-70	<b>-0,05%</b>	-60 195	86 460	21
Real Estate Funds	615 119	31	-213 495	14 570	<b>2,37%</b>	-198 925	416 194	32
Balanced Mixed Funds	118 753	27	-30 779	-28 628	<b>-24,11%</b>	-59 407	59 346	28
Predominantly Fixed Income	144 249	22	-79 444	-5 908	<b>-4,10%</b>	-85 352	58 897	22
Liquidity Funds	600 551	12	-68 207	44 689	<b>7,44%</b>	-23 518	577 033	16
Money Market Funds	347 691	22	-135 168	18 950	<b>5,45%</b>	-116 218	231 473	23
Predominantly Equity Funds	328 298	34	31 823	-143 075	<b>-43,58%</b>	-111 253	217 046	51
Short Term Fixed Income Funds	189 608	9	-108 457	816	<b>0,43%</b>	-107 641	81 967	7
Derivative Funds	33 262	16	10 154	-1 212	<b>-3,64%</b>	8 942	42 204	23
Pure Equity Funds	120 971	15	94 351	-49 839	<b>-41,20%</b>	44 511	165 482	27
<b>Total:</b>	<b>3 161 702</b>	<b>326</b>	<b>-458 487</b>	<b>-178 715</b>	<b>-5,65%</b>	<b>-637 202</b>	<b>2 524 301</b>	<b>423</b>

The processes that have run their course on the fund management market – both the yield losses of equity funds and the withdrawal of capital from fixed income and real estate funds – are caused by the same world economic crisis and crisis of confidence that has unfolded from the American sub-prime crisis, which has concurrently caused losses in the values of capital market investments as well as increases in risk premiums.

The extraordinary losses in the values of capital market investments are easily observed on both Hungarian and foreign stock exchange index curves:



The crisis of confidence that accompanied the world economic crisis froze the interbank market; banks stopped lending to each other and the risk premiums for emerging countries increased by several hundred basis points. This process forced Hungarian banks to satisfy their funding requirements with the collection of deposits and they offered various interest rate campaigns in order to obtain as large a share as possible of the monies available for investment within the limitations on capital. The advertised campaign interest rates of 12-14% lead investors to rearrange their portfolios, and they re-positioned their investments that were liquid or that were thought to be liquid and which have not yet suffered losses of principal, into investments that promised higher yields on the short term, which by the end of the year 2008 lead to a drastic fall in the assets of fixed income funds and real estate funds.

Although the amount of capital withdrawn was lower for real estate funds than for fixed income funds, due to the peculiar investment policies of real estate funds and the composition of their portfolios (high proportion of illiquid assets) the continuous withdrawals of capital predicted a liquidity problem. Between 29 September and 7 November 2008 the liquid assets of real estate funds decreased by HUF 100 billion and the proportion of liquid assets for certain funds fell below the statutory minimum of 15%. The trend in the withdrawal of capital proved to be lasting in the given period, and for certain funds the fulfilment of additional redemption orders by day T+3 could not be ensured.

In order to prevent a crisis of confidence spreading beyond the individual real estate funds and fund managers to the entire Hungarian investment fund market or to the entirety of the financial and capital market, on 10 November 2008 the HFSA – following market consultations – suspended for 10 trading days the trading of open-ended real estate funds and funds investing into real estate funds. During the period of the suspension fund managers adapted their fund management regulations to the changed market circumstances and for open-ended funds they modified the fulfilment practice of T+3 days, as employed thus far, to the T+90 days as allowed under Act CXX of 2001 on the Capital Market (the Capital Market Act – CMA). The CMA that was also amended during the same period created the option for open-ended real estate funds to transform into closed-end funds.

After 24 November 2008 three real estate funds requested a 180-day suspension of the redemption of their investment notes. Certain funds took steps to transform into closed-end funds to avoid potential future liquidity problems. During the elapsed period fund managers have revaluated their assets in accordance with the market circumstances and thus in certain cases the values of the real estate properties in their portfolios have decreased.

## **Annex No. 2**

It is the position of the HFSA, that within the effective statutory environment real estate funds have the following modus operandi options:

### *1. Continue to operate as an open-ended real estate fund*

This alternative assumes that the real estate fund has an adequate liquid asset ratio and that the fund will be able to continuously fulfil orders for the redemption of its investment notes, or that purchase order values will increase. This category also includes real estate funds that will regain their liquidity as a result of their current successful measures (such as through the acquisition of new investors, or if old investors purchase investment notes from those leaving the fund, or through a merger).

### *2. Continue to operate as a closed-end fund*

In this situation, in accordance with the contents of [CEO Letter No. 7/2008](#), the redemption orders of leaving investment note holders are fulfilled and the fund continues to operate as a closed-end fund, thereby significantly reducing its liquidity risk.

### *3. Liquidation of the real estate fund*

Pursuant to the provisions of the CMA, a fund manager may liquidate an investment fund of an indefinite term and a positive equity, subject to an authorisation received from the HFSA. If the duration of the suspension reaches 180 days, the HFSA may issue a resolution for the liquidation of the investment fund.

*In addition to the above, an investment fund manager may request that the redemption of the investment notes of the real estate fund be suspended.*

Following the occurrence of any one of the conditions included in its provisions effective as of 24 November 2008 (CMA Article 251 Paragraph (2)), the investment fund manager requests within 5 trading days the suspension of the redemptions of the real estate fund's investment notes.

Using the legal institution enacted by the amended CMA, 3 real estate funds have so far used the option to suspend the redemption of their investment notes (of which in the case of one the suspension has since been terminated on the request of the fund manager). These funds, in accordance with CMA Article 251 Paragraph (2) and within five trading days from the occurrence of the conditions specified in the same section, have requested the HFSA to suspend the redemption of their investment notes. At this point in time the condition specified under CMA Article 251 Paragraph (2) Section a) has already been met for most real estate funds, but the conditions under sections b) and c) can only be met if the real estate funds begin to fulfil (settle and pay) the redemption orders that were issued earlier.

In the case of any requests for suspension the HFSA will assess whether or not real estate fund managers that were unable to remedy the liquidity situations of their funds by the April date should be granted an extension of another 180 days to remedy their liquidity situations in a reassuring way, also with consideration to the fact that no potential suspension will have a delaying force on the timely fulfilment of redemption orders already delivered.