

National Bank of Serbia

BANKING SECTOR IN SERBIA

First Quarter Report 2006

May 2006

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I. Banking Sector in the First Quarter 2006

Structure of Banking Sector in Serbia

As of March 31, 2006, 39 banks with NBS operating licenses are active in Serbia. The MB banka a.d. Niš had its operating license revoked in the observed period.

Number of banks

	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005	March 31, 2006
Number of banks	47	43	40	39
Number of OFI ¹	14	8	8	8

Banks' Organizational Networks

Description	Dec. 31, 2003	Dec. 31, 2004	Dec. 31, 2005	March 31, 2006
Number of business units	97	124	114	91
Number of branches	292	300	327	355
Number of branch offices	774	1,010	1,162	1,211
Number of counters	302	275	264	251
Total	1,465	1,709	1,867	1,908

In Q1 2006, the greatest expansion of organizational networks (the opening of new business units, branches, branch offices and counters (total)) was registered with the following banks:

Bank	Dec. 31, 2005	March 31, 2006
Meridian bank a.d. Novi Sad	71	82
Panonska banka a.d. Novi Sad	56	65
AIK banka a.d. Niš	26	31
Société Générale Yugoslav Bank a.d.Belgrade	44	48

The number of banking sector organizational units totaled 1,908, which implies the increase of 41 new organizational units in 2006. The following banks contributed most to the branching of banks' organizational network in Serbia: Meridian bank a.d. Novi Sad (11), Panonska banka a.d. Novi Sad (9), AIK banka a.d. Niš (5), and Société Générale Yugoslav Bank a.d.Belgrade (4).

¹ Other financial institutions – savings banks, savings-credit organizations and savings-credit cooperatives.

Number of Employees in Banking Sector

In the course of 2006, the total number of employees in commercial banks went up by 537, from 25,680 at end-2005 to 26,217 - recorded on March 31, 2006.

Banks' Ownership Structure

The ownership structure of 39 banks on March 31, 2006 was as follows:

- 19 banks in majority ownership of foreign shareholders,
- 9 banks in majority ownership of domestic physical and legal entities,
- 11 banks in majority ownership of the Republic of Serbia².

Market Share

As of March 31, 2006, the market share of banks grouped according to balance sheet total was as follows:

Balance sheet total	Number of banks	in CSD thousand	Share (%)
over CSD 45 billion	5	426,131,638	50.11
CSD 20–45 billion	5	157,604,436	18.54
CSD 10–20 billion	12	173,901,193	20.45
CSD 5–10 billion	8	61,354,973	7.22
below CSD 5 billion	9	31,320,680	3.68
Total	39	850,312,920	100.00

The share of five largest banks in the balance sheet total equaled 50%. The ten largest banks had a 69% share in the balance sheet total.

As of March 31, 2006, overall banking sector balance sheet total reached CSD 850 billion, of which the share of banks in majority ownership of foreign entities was CSD 584 billion or 68.7%. The share of banks in majority ownership of the Republic of Serbia stood at CSD 198 billion or 23.3%, while banks in majority private ownership accounted for CSD 68 billion or 8.0%.

² The banks in which the Republic of Serbia is the largest majority or individual, direct or indirect, shareholder.

Balance Sheet Structure**Banking Sector Balance Sheet**

Position	31. 12. 2004.		31. 12. 2005.		31. 03. 2006.		Growth index in 2005	Growth index in 2006
	Sum	Share (%)	Sum	Share (%)	Sum	Share (%)		
ASSETS								
Cash and cash equivalents	62.837	12,3	72.781	9,4	57.165	6,7	116	79
Deposits and securities refinanceable with the central bank	23.002	4,5	150.827	19,4	172.755	20,3	656	115
Interest and fees receivable	2.047	0,4	3.197	0,4	3.532	0,4	156	110
Loans to and investments in banks	65.957	12,9	33.206	4,3	50.408	5,9	50	152
Loans to and investments to clients	290.799	57,0	426.528	55,0	470.322	55,3	147	110
Securities and other trading investments	2.739	0,5	9.875	1,3	12.185	1,4	361	123
Securities held to maturity	8.301	1,6	8.467	1,1	8.823	1,1	102	104
Equity shares and other securities available for sale	10.116	2,0	10.494	1,3	10.496	1,2	104	100
Intangible investments	2.272	0,4	4.287	0,6	4.494	0,5	189	105
Fixed assets	32.364	6,3	41.385	5,3	41.950	5,0	128	101
Other assets and prepayment and deferred expenditures	9.011	1,8	12.844	1,7	16.661	2,0	143	130
Deferred tax assets	647	0,1	1.522	0,2	1.522	0,2	235	100
TOTAL	510.092	100	775.413	100	850.313	100	152	110
LIABILITIES								
Liabilities to banks	43.078	8,4	35.803	4,6	45.379	5,4	97	127
Liabilities to clients	345.705	67,8	580.715	74,9	627.057	73,7	166	108
Interest and fees payable	478	0,1	936	0,1	827	0,1	196	88
Liabilities for securities	284	0,1	7	0,0	6	0,0	2	86
Liabilities from profits	175	0,0	201	0,0	265	0,0	115	132
Other operating liabilities	6.777	1,3	7.277	1,0	7.911	0,9	107	109
Provisions	7.671	1,5	7.320	0,9	8.544	1,0	95	117
Other liabilities and accruals	6.415	1,3	17.125	2,2	28.066	3,3	267	164
Deferred tax liabilities	59	0,0	368	0,1	368	0,1	634	100
LIABILITIES	410.642	80,5	649.752	83,8	718.423	84,5	158	111
Capital	99.450	19,5	125.661	16,2	131.890	15,5	126	105
Share capital and other capital	97.220	19,1	106.832	13,8	110.859	13,0	110	104
Reserves	9.661	1,9	19.168	2,4	21.583	2,5	198	113
Accumulated profit/loss	-7.431	-1,5	-339	0,0	-552	0,0	5	163
TOTAL	510.092	100	775.413	100	850.313	100	152	110
OFF-BALANCE SHEET ITEMS	510.889		726.007		882.757		142	122

On March 31, 2006, balance sum total of the banking sector amounted to CSD 850 billion, which implies a CSD 75 billion or 9.7% increase compared to end-2005.

Banks' off-balance sheet items reached CSD 883 billion, having climbed by CSD 157 billion or 21.6% compared to end-2005. Claims and liabilities from foreign currency savings bonds accounted for 30.9% of total off-balance sheet items.

On March 31, 2006, the greatest portion of banks' assets (61.6%) were claims on approved credits and lending (lending to banks, clients, interest and fees receivable), followed by deposits with the NBS and securities refinancable with the NBS (20.3%), with the foreign exchange required reserves with the central bank participating with 99.8%. Cash and cash equivalents make up 6.7% of the banking sector balance sheet assets.

External or borrowed sources of financing made up 84.5% of banking sector balance sheet liabilities, while capital and personal sources of financing accounted for 15.5%. Household, corporate and bank deposits had the greatest share in borrowed sources (61.8% of total liabilities).

Lending Activity

Lending Structure (Credits and Other Lending)

The survey of lending structure as of March 31, 2006, end-2005 and end-2004 is shown in the following table:

in CSD million

POSITION	31. 12. 2004.		31. 12. 2005.		31. 03. 2006.		Growth index in 2005	Growth index in 2006
	Sum	Share %	Sum	Share %	Sum	Share %		
CORPORATE	197.022	69,4	281.885	64,8	310.525	64,4	143	110
RETAIL	64.283	22,6	124.651	28,7	141.069	29,3	194	113
GOVERNMENT	20.130	7,1	23.812	5,5	25.991	5,4	118	109
Serbia and Montenegro	738	0,3	981	0,2	730	0,2	133	74
Republic of Serbia	18.124	6,4	20.683	4,8	22.854	4,7	114	111
Local government	1.268	0,4	2.148	0,5	2.407	0,5	169	112
OTHER FINANCIAL INSTITUTIONS	694	0,2	444	0,1	532	0,1	64	120
NON-PROFIT ORGANIZATIONS	1.702	0,6	3.765	0,9	4.045	0,8	221	107
TOTAL	283.832	100,0	434.527	100,0	482.162	100,0	153	111

The greatest amount of lending was extended to corporate customers (64.4%) and citizens (29.3%).

The year 2006 saw a CSD 48 billion or 11.0% rise in overall lending activity of the banking sector.

Banks registered highest growth in lending to corporate customers (CSD 29 billion or 10.2%) and households (CSD 16 billion or 13.2%).

Deposit Activity

Structure of Deposits

The survey of the sector structure of deposits as of March 31, 2006 and previous periods is presented in the following table:

in CSD million

	31. 12. 2004.			31. 12. 2005.			31.03. 2006.			Growth in 2006		
	CSD	foreign currency	total	CSD	foreign currency	total	CSD	foreign currency	total	CSD	foreign currency	total
Total deposits	103.442	209.815	313.256	142,211	342,472	484,683	145,387	379,833	525,220	3,176	37,361	40,537
Banks	6.871	23.597	30.467	7,315	64,964	72,279	87,020	10,741	86,137	3,426	21,173	24,599
Domestic banks	6.851	8.158	15.009	7,249	11,672	18,921	10,009	17,526	27,535	2,760	5,855	8,614
Foreign banks	12	8.412	8.424	56	53,248	53,304	720	68,571	69,291	665	15,323	15,987
Subordinated and associated banks	8	7.026	7.034	11	44	55	12	40	52	1	-4	-3
Public enterprises	14.947	8.464	23.411	18,468	13,058	31,526	16,954	11,972	28,926	- 1,514	- 1,086	- 2,600
Other enterprises	45.630	51.636	97.265	65,934	53,928	119,862	63,001	53,528	116,529	- 2,933	- 399	- 3,333
Public sector	10.552	584	11.136	14,082	946	15,028	17,178	1,574	18,752	3,096	628	3,723
Serbia and Montenegro	122	95	217	284	401	685	318	471	789	34	70	104
Republic of Serbia	1.250	468	1.718	2,370	506	2,876	3,960	1,059	5,019	1,590	553	2,143
Local government	9.180	22	9.202	11,428	39	11,467	12,899	44	12,943	1,471	5	1,476
Other clients	6.502	2.447	8.949	9,193	3,324	12,517	9,010	2,772	11,782	- 184	- 552	- 735
Foreign legal and physical entities	1.246	12.223	13.469	1,578	16,334	17,912	2,829	15,916	18,745	1.251	- 417	834
Citizens	16.016	110.682	126.698	22,268	190,025	212,293	22,415	207,517	229,932	148	17,491	17,639
Physical entities	12.721	110.587	123.308	16,525	189,823	206,348	17,672	207,322	224,995	1,147	17,499	18,646
Entrepreneurs	3.295	95	3.390	5,743	203	5,946	4,743	195	4,938	- 999	- 8	- 1.007
Other	1.667	295	1.962	3,474	343	3,817	3,259	416	3,675	- 215	73	- 142
Current maturities of long-term loans	9	-113	-104	-102	-450	-552	0	0	0	102	450	552
Banks	0	-135	-135	-1	-73	-74	0	0	0	1	73	74
Other clients	9	21	30	-101	-377	-478	0	0	0	101	377	478

The highest percentage of deposits consisted of household deposits (43.8%), followed by corporate deposits (22.2%) and bank deposits (16.4%).

Out of all deposits at the level of the banking sector, foreign exchange deposits accounted for 72.3%, dinar deposits 27.7%, demand deposits 48.6%, and short-term time deposits 43.7%.

In 2006, total deposit potential growth of the banking sector was CSD 41 billion or 8.4%. Foreign exchange deposits rose by CSD 37 billion or 10.9%, and dinar deposits rose by CSD 3 billion or 2.2%.

Observed by sectors, bank deposits rose to the greatest degree - by CSD 25 billion or 34.0%, followed by household deposits - CSD 18 billion or 8.3%.

Privatization in Banking Sector

Name of bank	Share capital (in CSD)	RS percentage share ³	Note
Niska banka a.d. Nis	1,012,690	99.84	In early November 2005, negotiations with OTP BANK RT. (Hungary) started. Legal procedure concerning the purchase of the bank ended in the first quarter of 2006.
Vojvodjanska banka a.d. Novi Sad	4,817,900	99.42	The procedure is under way.
Panonska banka a.d. Novi Sad	3,220,357	87.39	The procedure is under way.
Credy banka a.d. Kragujevac	1,300,090	72.36	The procedure is under way.

Takeover and Merging

Procedure for issuing the approval of the National Bank of Serbia with regard to the merger of Alpha banka a.d. Belgrade and Jubanka a.d. Belgrade is under way.

³ The Republic of Serbia (RS) is involved either directly or indirectly. Indirect participation implies participation through banks in bankruptcy.

Risks in Banking Sector

1. Credit Risk

Quality of Assets in Serbian Banking Sector⁴

As of	Total balance assets and off-balance sheet items	Total classified assets, calculated deductibles	Classified assets		Share of bad assets (C, D, E) in total classified assets, after deduction (%)
			A+B	C+D+E	
31.12.2003	746,151	256,280	198,654	57,626	22.49
31.12.2004	1,126,832	343,117	263,143	79,968	23.31
31.12.2005	1,642,494	472,800	363,228	109,572	23.17
31.03.2006	1,851,447	506,657	398,616	108,041	21.32

in CSD million

The share of bad assets in total classified assets and off-balance sheet items after the calculation of deductibles dropped relative to end-2005 and on March 31, 2006 stood at 21.3%. Bad assets are composed of assets classified into categories B, C and D according to the level of collectibility. The share of potential losses in banking sector capital went down from 49.7% on December 31, 2005 to 42.1% on March 31, 2006.

2. Liquidity Risk

Banks' Daily Liquidity Indicators as of March 31, 2006

Banks	Gyro-account balance	Calculated required reserve	Column difference (2-3)	Deposited liquid funds surpluses	Daily liquidity loans
Total in Republic of Serbia	24,940,715	26,386,869	-1,446,154	590,000	-

in CSD thousand

Out of the total number of banks, 19 of them used required reserve funds in the total amount of CSD 2,629 million or 14.2% of total calculated required reserves. No bank used daily liquidity loans.

During the observed three months, banks' liquidity indicator ranged between 1.04 and 30.68.

⁴ Based on quarterly reports for the first quarter 2006.

Maturity matching of assets and liabilities⁵

The table below illustrates the maturity matching of banking sector assets and liabilities at the end of the first quarter:

in CSD thousand						
1–7 days	8–15 days	16–30 days	31–90 days	91–180 days	181–365 days	over 366 days
-29,564,074	3,472,883	13,521,990	-30,607,756	15,372,937	45,305,343	-17,501,321

Observed by each bank, the mismatching of assets and liabilities for the maturity 1-7 days is evident with 21 banks, and mismatching for over 366 days is present with 22 banks.

3. Foreign Exchange Risk

In accordance with the Decision on Detailed Conditions for the Application of Articles 26 and 27 of the Law on Banks and Other Financial Organizations, the foreign exchange risk indicator was prescribed as a control measure of banks' foreign exchange risk. It was determined that a bank's total daily net foreign exchange risk position should not exceed 30% of capital. The total daily foreign exchange risk position represents the sum of long and short open net foreign exchange positions of a bank by all currencies and precious metals.

The survey of the balance of daily bank positions at the level of the banking sector as of March 31, 2006 showed that total daily open foreign exchange position stands at CSD 50.2 billion, which implies a CSD 30.6 billion increase compared to the value of total open foreign exchange position at end-2005. The foreign exchange risk indicator amounted to 38.1% (it was 15.8% and 16.9% in the previous quarter and end-2004, respectively).

Total long open foreign exchange position at the level of the sector reached CSD 46.4 billion. Total short open foreign exchange position was CSD 3.8 billion. Relative to the previous quarter there was an increase in total long open foreign exchange position by CSD 32.5 billion and a decrease in total short open foreign exchange position by CSD 2.0 billion. It is noteworthy that 6 banks with the net short open position by all currencies in the total amount of CSD 2.9 billion were exposed to a pronounced foreign exchange risk. As of March 31, 2006 all banks, save one, expressed their foreign exchange risk indicator in line with the prescribed level⁶ of bank's capital.

⁵ Based on quarterly reports for the fourth quarter 2005.

⁶ See NBS Regulatory Activity

Open Foreign Exchange Positions by Currencies in Banking Sector

in CSD million

Long open EUR position	Short open EUR position	Long open USD position	Short open USD position	Long open position in other currencies	Short open position in other currencies	Long open position, total	Short open position, total	Net short open position by all currencies	Total open foreign exchange position
40,976,972	2,224,714	3,802,334	1,250,215	1,541,632	360,078	46,367,048	3,835,007	2,931,941	50,202,055
								total capital	131,747,110
								currency risk indicator	38.10
Number of banks	Number of banks	Number of banks	Number of banks	Number of banks	Number of banks			Number of banks	
33	6	27	12	31	8			39	

Capital Adequacy⁷

In line with the provisions of Articles 26 and 27 of the Law on Banks and Other Financial Organizations, as well as the Decision on Detailed Conditions for the Application of Articles 26 and 27 of the Law on Banks and Other Financial Organizations, banks should maintain the capital adequacy indicator at the level of 12% relative to risk weighted assets.

The table below shows capital adequacy indicators for 40 banks operating at the end of the first quarter of 2006:

Capital adequacy indicator	Number of banks	Share in total number of banks (%)
below 12%	0	0.0
from 12 to 20%	9	23.1
from 20 to 30%	9	23.1
over 30%	21	53.8
Total	39	100.0

As of March 31, 2006 no bank in Serbia had the capital adequacy indicator below the prescribed minimum of 12%. Average value of adequacy indicator for total banking system equaled 25.0%.

⁷ Based on quarterly reports for the fourth quarter of 2005.

Profitability Indicators of Banking Sector Operations

The table below contains the survey of profitability indicators:

Banking sector	PROFITABILITY INDICATORS					Financial result (in CSD thousand)
	Gross revenues/total assets (%)	Net revenues from interest/total assets (%)	Operational expenditures/total assets (%)	Net extraordinary revenues/total assets (%)	Operational expenditures/net revenues from interest and fees (%)	
31. 12. 2003	29.78	5.06	6.83	0.01	80.81	(1,055,152)
31. 12. 2004	37.72	4.66	6.27	0.02	84.52	(4,989,821)
31. 12. 2005	33.63	4.47	5.55	- 0.00	80.95	7,271,925
31. 03. 2006	9.95	1.50	2.13	0.00	82.29	2,654,962

Aggregate Report on Revenues and Expenditures

in CSD million

	2004	2005	March 2006
NET PROFIT/LOSS BASED ON INTEREST	23.787	34.654	10.090
Revenues from interest	32.171	49.015	15.336
Expenditures from interest	8.384	14.361	5.246
NET PROFIT/LOSS BASED ON FEES AND COMMISSIONS	14.050	18.469	5.004
Revenues from fees and commissions	18.189	23.478	6.346
Expenditures from fees and commissions	4.139	5.009	1.342
NET PROFIT/LOSS BASED ON INTEREST, FEES AND COMMISSIONS	37.838	53.123	15.094
NET PROFIT BASED ON SECURITIES SALE	958	1.592	165
Profit on the basis of securities	981	1.622	234
Losses on the basis of securities	23	30	69
NET REVENUES/EXPENDITURES FROM CURRENCY DIFFERENTIALS	11.202	9.978	1.531
Positive currency differentials	86.156	122.529	43.485
Negative currency differentials	74.954	112.551	41.954
REVENUES FROM DIVIDENDS AND SHARE	331	243	80
OTHER BUSINESS REVENUES	50.196	57.372	16.991
EXPENDITURES FROM PERMANENT WRITE-OFFS OF LOANS AND RESERVATIONS	55.978	73.396	20.577
OTHER BUSINESS EXPENDITURES	53.581	47.061	12.600
NET REVENUES/EXPENDITURES FROM CHANGE OF VALUE OF PROPERTY AND LIABILITIES	3.941	5.425	1.969
Revenues from change in value of property and liabilities	4.262	6.500	2.118
Expenditures from change in value of property and liabilities	322	1.075	149
PROFIT/LOSS FROM REGULAR OPERATIONS	-5.093	7.275	2.653
NET EXTRAORDINARY REVENUES/EXPENDITURES	104	-3	1
Extraordinary revenues	142	10	1
Extraordinary expenditures	38	13	0
GAIN/LOSS IN PERIOD PRIOR TO TAXATION	-4.990	7.272	2.654

Total net gain prior to taxation for the first quarter of 2006 totaled CSD 2,654 million.

The most significant items in banking sector revenues in the first quarter of 2006 are the following: positive currency differentials, with the share of 51.4% in total revenues, revenues from the abolishment of unused write-offs and provisioning (19.3%) and revenues from interests (18.1%) and fees (7.5%). On the side of expenditures, negative currency differentials participate with 51.2%, indirect write-offs of lending and provisioning with 25.1%, operational costs with 8.4% and wages with 6.7%.

II. NBS Regulatory Activity

During the first quarter of 2006, the National Bank of Serbia, within its regulatory competence (in the field of control and supervision of banks' operations), adopted the following secondary legislation (decisions and guidelines):

- ***Decision on the Amendments and Supplements to the Decision on Criteria for Classification of On-balance Sheet Assets and Off-balance Sheet Items According to the Level of Collectibility and Level of Special Provisions of Banks and Other Financial Organizations*** ("RS Official Gazette", No. 16/06). According to the Amendments to the Decision, category D includes claims under credits approved to physical entity, except for housing loans, if the monthly installment for the repayment of the approved credit, including monthly obligations in respect of the already disbursed credits, exceeds 30% of the physical person's monthly net income, or if the physical person to whom the credit has been approved, placed a downpayment or deposit which is less than 20% of the amount of approved credit. The provision according to which claims from the debtor for whom the bank does not have the report of the Credit Bureau on his/her obligations, are classified into one category less favorable than the one in which they would be classified otherwise, has been revoked. At the same time, provisions according to which claims from the debtor for which the bank does not have an updated and complete data are classified into category D, except if only less significant data are partly missing or are not updated, in which case claims from such debtor are classified into one category less favourable than the one they would have been classified otherwise, have been retained. When calculating the basis for the calculation of the bank's special provisions, deductibles will include the following: a) 50% of the value of the bank's on-balance sheet claims from legal entities secured by mortgage on real estate whose value, as established by authorized appraisers, is at least equal to the total amount of the bank's claims and other claims secured by the first right of pledge over the same real estate provided that such real estate has been appraised in the last three years, that no significant changes in prices in the real estate market occurred in the mentioned period, and that no more than 360 days have elapsed from the original maturity date; b) 50% of the value of the bank's on-balance sheet claims

with respect to housing loans secured by mortgage on real estate whose value, as established by authorized appraisers, is no less than the total amount of the bank's claims and other claims secured by the first right of pledge over the same real estate provided that such real estate has been appraised in the last three years, that no significant changes in prices in the real estate market occurred in the mentioned period, and that no more than 360 days have elapsed from the original maturity date.

- ***Decision on the Amendments to the Decision on Detailed Requirements for the Application of Articles 26 and 27 of the Law on Banks and Other Financial Organizations ("RS Official Gazette", no. 16/06).*** According to the provisions of the Decision the following two exemptions from the calculation of the foreign exchange position have been revoked: a) claims arising from long-term foreign exchange credits, assumed by the government and converted into capital, b) claims in foreign currency and/or dinars with a foreign currency clause – up to the level of share capital paid in foreign currency. Banks whose foreign exchange indicator exceeded 30% on the day when this Decision entered into force, because claims, excluded from the calculation of the foreign exchange position until that day, were included, are obligated to make sure that the mentioned percentage does not increase any more, namely to have the percentage by which they surpassed foreign exchange indicator reduced by at least 50% on June 30, 2006, and to bring the foreign exchange indicator within the prescribed range on December 31, 2006. In line with the Amendments, when calculating the risk-bearing assets, banks are obligated to apply the 50% weight only on claims from legal entities secured by mortgage on real estate whose value, as established by authorized appraisers, is no less than the total amount of the bank's claims and other claims secured by the first right of pledge over the same real estate provided that such real estate has been appraised in the last three years, that no significant changes in prices in the real estate market occurred in the mentioned period, and that no more than 360 days have elapsed from the original maturity date. The 50% weight will also be applied on the bank's claims with respect to housing loans secured by mortgage on real estate whose value, as established by authorized appraisers, is no less than the total amount of the bank's claims and other claims secured by the first right of pledge over the same real estate provided that such real estate has been appraised in the last three years, that no significant changes in prices in the real estate market occurred in the mentioned period, and that no more than 360 days have elapsed from the original maturity date.