BASE PROSPECTUS

FHB LAND CREDIT AND MORTGAGE BANK LTD.
(FHB FÖLDHITEL- ÉS JELZÁLOGBANK RÉSZVÉNYTÁRSASÁG)

(incorporated with limited liability in the Republic of Hungary)

EUR 1,000,000,000
Euro Mortgage Bond Programme
for the issuance of
Hungarian Mortgage Bonds (*jelzáloglevelek*)

Under this EUR1,000,000,000 Euro Mortgage Bond Programme (the **Programme**), FHB Land Credit and Mortgage Bank Ltd. (*FHB Földhitel- és Jelzálogbank Részvénytársaság*) (the **Issuer**) may from time to time issue Hungarian Mortgage Bonds (*jelzáloglevelek*) (the **Mortgage Bonds**) denominated in any currency agreed from time to time between the Issuer and the relevant Dealer (as defined below).

The maximum aggregate nominal amount of all Mortgage Bonds from time to time outstanding under the Programme will not exceed EUR1,000,000,000 (or its equivalent in other currencies calculated as described in the Programme Agreement), subject to increase as described herein.

An investment in Mortgage Bonds involves certain risks. For discussion of these risks, see "*Risk Factors*" beginning on page 11 of this Base Prospectus.

The Mortgage Bonds may be issued on a continuing basis to one or more of the Dealers specified under "*General Description*" and any additional Dealer appointed under the Programme from time to time by the Issuer (each a **Dealer** and together the **Dealers**), which appointment may be for a specific issue or on an ongoing basis. References in this Base Prospectus to the **relevant Dealer** shall, in the case of an issue of Mortgage Bonds being (or intended to be) subscribed by more than one Dealer, be to all Dealers agreeing to subscribe such Mortgage Bonds.

Application has been made to the *Commission de Surveillance du Secteur Financier* (the **CSSF**) in its capacity as competent authority under the Luxembourg Act dated 10 July 2005 on prospectuses for securities (*loi relative aux prospectus pour valeurs mobilières*) to approve this document as a base prospectus. Application has also been made to the Luxembourg Stock Exchange for Mortgage Bonds issued under the Programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market and to be listed on the Luxembourg Stock Exchange.

ARRANGER

DRESDNER KLEINWORT WASSERSTEIN

DEALERS

BAYERISCHE LANDESBANK | **BNP PARIBAS**

CITIGROUP | **DEUTSCHE BANK**

DRESDNER KLEINWORT WASSERSTEIN | **DZ BANK AG**

RZB - AUSTRIA RAIFFEISEN ZENTRALBANK ÖSTERREICH AG

The date of this Base Prospectus is 21 December, 2005.
This Base Prospectus replaces the Offering Circular dated 10 November 2004.

This Base Prospectus comprises a base prospectus for the purposes of Article 5.4 of Directive 2003/71/EC (the Prospectus Directive).

The Issuer (the Responsible Person) accepts responsibility for the information contained in this Base Prospectus. To the best of the knowledge and belief of the Issuer (having taken all reasonable care to ensure that such is the case) the information contained in this Base Prospectus is in accordance with the facts and does not omit anything likely to affect the import of such information.

References in this Base Prospectus to Mortgage Bonds being listed (and all related references) shall mean that such Mortgage Bonds have been admitted to trading on the Luxembourg Stock Exchange's regulated market and have been listed on the Luxembourg Stock Exchange. The Luxembourg Stock Exchange's regulated market is a regulated market for the purposes of the Investment Services Directive (Directive 93/22/EEC).

Notice of the aggregate nominal amount of Mortgage Bonds, interest (if any) payable in respect of Mortgage Bonds, the issue price of Mortgage Bonds and any other terms and conditions not contained herein which are applicable to each Tranche (as defined under "*Terms and Conditions of the Mortgage Bonds*") of Mortgage Bonds will be set out in a final terms (the "*Final Terms*") which, with respect to Mortgage Bonds to be listed on the Luxembourg Stock Exchange will be filed with the CSSF.

The Programme provides that Mortgage Bonds may be listed or admitted to trading, as the case may be, on such other or further stock exchange(s) or markets as may be agreed between the Issuer and the relevant Dealer. The Issuer may also issue unlisted Mortgage Bonds and/or Mortgage Bonds not admitted to trading on any market.

The Issuer may agree with any Dealer that Mortgage Bonds may be issued in a form not contemplated by the Terms and Conditions of the Mortgage Bonds herein, in which event a supplementary Base Prospectus, if appropriate, will be made available which will describe the effect of the agreement reached in relation to such Mortgage Bonds.

The figures in the section entitled "*The banking sector in 2003, 2004 and in the first half of 2005 – outstanding performance, slowing dynamism*" have been extracted from the "*Reports of the activities of the supervised sectors" for 2003, 2004 and the first half of 2005*, respectively published by the Hungarian Financial Supervisory Authority. The Issuer accepts responsibility that such information has been accurately reproduced and that, so far as it is aware, and is able to ascertain from information published by Hungarian Financial Supervisory Authority, no facts have been omitted which would render the reproduced information inaccurate or misleading.

This Base Prospectus is to be read in conjunction with all documents which are deemed to be incorporated herein by reference (see "*Documents Incorporated by Reference*" below). This Base Prospectus shall be read and construed on the basis that such documents are incorporated and form part of this Base Prospectus. This Base Prospectus may only be used for the purposes for which it has been published.

The Dealers have not independently verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Dealers as to the accuracy or completeness of the information contained or incorporated in this Base Prospectus or any other information provided by the Issuer in connection with the Programme. Neither the Dealers nor the Agent accept any liability in relation to the information contained or incorporated by reference in this Base Prospectus or any other information provided by the Issuer in connection with the Programme.

No person is or has been authorised by the Issuer to give any information or to make any representation not contained in or not consistent with this Base Prospectus or any other information supplied in connection with the Programme or the Mortgage Bonds and, if given or made, such information or representation must not be relied upon as having been authorised by the Issuer or any of the Dealers.

Neither this Base Prospectus nor any other information supplied in connection with the Programme or any Mortgage Bonds (a) is intended to provide the basis of any credit or other evaluation or (b) should be considered as a recommendation by the Issuer or any of the Dealers that any recipient of this Base Prospectus or any other information supplied in connection with the Programme or any Mortgage Bonds should purchase any Mortgage Bonds. Each investor contemplating purchasing any Mortgage Bonds should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer. Neither this Base Prospectus nor any other information supplied in connection with the Programme or the issue of any Mortgage Bonds constitutes an offer or invitation by or on behalf of the Issuer or any of the Dealers to any person to subscribe for or to purchase any Mortgage Bonds.

Neither the delivery of this Base Prospectus nor the offering, sale or delivery of any Mortgage Bonds shall in any circumstances imply that the information contained herein concerning the Issuer is correct at any time subsequent to the date hereof or that any other information supplied in connection with the Programme is correct as of any time subsequent to the date indicated in the document containing the same. The Dealers expressly do not undertake to review the financial condition or affairs of the Issuer during the life of the Programme or to advise any investor in the Mortgage Bonds of any information coming to their attention. Investors should review, *inter alia*, the most recently published documents incorporated by reference into this Base Prospectus when deciding whether or not to purchase any Mortgage Bonds.

The Mortgage Bonds have not been and will not be registered under the United States Securities Act of 1933, as amended, (the *Securities Act*) and are subject to U.S. tax law requirements. Subject to certain exceptions, Mortgage Bonds may not be offered, sold or delivered within the United States or to U.S. persons (see "*Subscription and Sale*").

This Base Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any Mortgage Bonds in any jurisdiction to any person to whom it is unlawful to make the offer or solicitation in such jurisdiction. The distribution of this Base Prospectus and the offer or sale of Mortgage Bonds may be restricted by law in certain jurisdictions. The Issuer and the Dealers do not represent that this Base Prospectus may be lawfully distributed, or that any Mortgage Bonds may be lawfully offered, in compliance with any applicable registration or other requirements in any such jurisdiction, or pursuant to an exemption available thereunder, or assume any responsibility for facilitating any such distribution or offering. In particular, no action has been taken by the Issuer or the Dealers which would permit a public offering of any Mortgage Bonds outside the European Economic Area or distribution of this Base Prospectus in any jurisdiction where action for that purpose is required. Accordingly, no Mortgage Bonds may be offered or sold, directly or indirectly, and neither this Base Prospectus nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations. Persons into whose possession this Base Prospectus or any Mortgage Bonds may come must inform themselves about, and observe, any such restrictions on the distribution of this Base Prospectus and the offering and sale of Mortgage Bonds. In particular, there are restrictions on the distribution of this Base Prospectus and the offer or sale of Mortgage Bonds in the United States, the European Economic Area (including the United Kingdom, the Republic of Hungary, Italy and France) and Japan, see "*Subscription and Sale*".

In connection with the issue of any Tranche of Mortgage Bonds, the Dealer or Dealers (if any) named as the Stabilising Manager(s) (or persons acting on behalf of any Stabilising Manager(s)) in the applicable Final Terms may over-allot Mortgage Bonds (provided that, in the case of any Tranche of Mortgage Bonds to be admitted to trading on a regulated market in the European Economic Area, the aggregate principal amount of Mortgage Bonds allotted does not exceed 105 per cent. of the aggregate principal amount of the relevant Tranche) or effect transactions with a view to supporting the market price of the Mortgage Bonds at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilising Manager(s) (or persons acting on behalf of a Stabilising Manager) will undertake stabilisation action. Any stabilisation action may begin on or after the date on which adequate public disclosure of the final terms of the offer of the relevant Tranche of Mortgage Bonds is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the relevant Tranche of Mortgage Bonds and 60 days after the date of the allotment of the relevant Tranche of Mortgage Bonds.

All references in this document to "*U.S. dollars*" refer to United States dollars. All references to "*HUF*" and "*Forint*" refer to Hungarian Forint. All references to "*Sterling*" and "*£*" refer to pounds sterling. All references to "*euro*", "*EUR*" and "*€*" refer to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended.

As at 20 December, 2005, the euro/HUF spot exchange rate published by the National Bank of Hungary was euro 1.00 = HUF 251.47.

Certain figures in this Base Prospectus have been subject to rounding adjustments. Accordingly, amounts shown as totals in tables or elsewhere may not be an arithmetic aggregation of the figures which precede them.

TABLE OF CONTENTS

GENERAL DESCRIPTION

This section "General Description" must be read as an introduction to this Base Prospectus and any decision to invest in any Mortgage Bonds should be based on a consideration of this Base Prospectus as a whole, including the documents incorporated by reference.

The following is qualified in its entirety by the remainder of this Base Prospectus.

Words and expressions defined in "*Form of the Mortgage Bonds*" and "*Term and Conditions of the Mortgage Bonds*" shall have the same meanings in this description.

Issuer:	FHB Land Credit and Mortgage Bank Ltd. (*FHB Földhitel- és Jelzálogbank Részvénytársaság*)
Description:	Euro Mortgage Bond Programme for the issuance of Mortgage Bonds
Arranger:	Dresdner Bank Aktiengesellschaft
Dealers:	Bayerische Landesbank BNP Paribas Citigroup Global Markets Limited Deutsche Bank Aktiengesellschaft Dresdner Bank Aktiengesellschaft DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main Raiffeisen Zentralbank Österreich Aktiengesellschaft and any other Dealers appointed in accordance with the Programme Agreement.
Principal Paying Agent:	Deutsche Bank AG, London Branch
Certain Restrictions:	Each issue of Mortgage Bonds denominated in a currency in respect of which particular laws, guidelines, regulations, restrictions or reporting requirements apply will only be issued in circumstances which comply with such laws, guidelines, regulations, restrictions or reporting requirements from time to time (see "*Subscription and Sale*") including the following restrictions applicable at the date of this Base Prospectus. **Mortgage Bonds having a maturity of less than one year** Mortgage Bonds having a maturity of less than one year will, if the proceeds of the issue are accepted in the United Kingdom, constitute deposits for the purposes of the prohibition on accepting deposits contained in section 19 of the Financial Services and Markets Act 2000 (**FSMA**) unless they are issued to a limited class of professional investors and have a denomination of at least £100,000 or its equivalent, see "*Subscription and Sale*".
Programme Size:	Up to EUR1,000,000,000 (or its equivalent in other currencies

calculated as described under "*General Description of the Programme*") outstanding at any time. The Issuer may increase the amount of the Programme in accordance with the terms of the Programme Agreement.

Distribution: Mortgage Bonds may be distributed by way of private or public placement and in each case on a syndicated or non-syndicated basis.

Currencies: Subject to any applicable legal or regulatory restrictions, any currency agreed between the Issuer and the relevant Dealer.

Redenomination: The applicable Final Terms may provide that certain Mortgage Bonds may be redenominated in euro. The relevant provisions applicable to any such redenomination are contained in Condition 3 of the Terms and Conditions of the Mortgage Bonds.

Maturities: Such maturities as may be agreed between the Issuer and the relevant Dealer, subject to such minimum or maximum maturities as may be allowed or required from time to time by the relevant central bank (or equivalent body) or any laws or regulations applicable to the Issuer or the relevant Specified Currency.

Issue Price: Mortgage Bonds may be issued on a fully-paid or a partly-paid basis and at an issue price which is at par or at a discount to, or premium over, par.

Type of Mortgage Bonds: For a description of certain aspects relevant to the Mortgage Bonds, see "*Certain Information relating to the Mortgage Bonds*".

Form of Mortgage Bonds: The Mortgage Bonds will be issued in dematerialised registered form as described in "*Form of the Mortgage Bonds*".

The Mortgage Bonds will be tradeable only in principal amounts of at least the Specified Denomination and (if so specified in the applicable Final Terms) integral multiples of the Tradeable Amount in excess thereof. If Mortgage Bonds are cleared through KELER, they will be tradeable only in principal amounts which are multiples of the Specified Denomination.

Fixed Rate Mortgage Bonds: Fixed interest will be payable on such date or dates as may be agreed between the Issuer and the relevant Dealer and on redemption and will be calculated on the basis of such Day Count Fraction as may be agreed between the Issuer and the relevant Dealer.

Floating Rate Mortgage Bonds: Floating Rate Mortgage Bonds will bear interest at a rate determined:

(i) on the same basis as the floating rate under a notional interest rate swap transaction in the relevant Specified Currency governed by an agreement incorporating the 2000 ISDA Definitions (as published by the International Swaps and Derivatives Association, Inc., and as amended and updated as at the Issue Date of the first Tranche of the

Mortgage Bonds of the relevant Series); or

(ii) on the basis of a reference rate appearing on the agreed screen page of a commercial quotation service; or

(iii) on such other basis as may be agreed between the Issuer and the relevant Dealer.

The margin (if any) relating to such floating rate will be agreed between the Issuer and the relevant Dealer for each Series of Floating Rate Mortgage Bonds.

Index Linked Mortgage Bonds: Payments of principal in respect of Index Linked Redemption Mortgage Bonds or of interest in respect of Index Linked Interest Mortgage Bonds will be calculated by reference to such index and/or formula or to changes in the prices of securities or commodities or to such other factors as the Issuer and the relevant Dealer may agree.

Other provisions in relation to Floating Rate Mortgage Bonds and Index Linked Interest Mortgage Bonds: Floating Rate Mortgage Bonds and Index Linked Interest Mortgage Bonds may also have a maximum interest rate, a minimum interest rate or both.

Interest on Floating Rate Mortgage Bonds and Index Linked Interest Mortgage Bonds in respect of each Interest Period, as agreed prior to issue by the Issuer and the relevant Dealer, will be payable on such Interest Payment Dates, and will be calculated on the basis of such Day Count Fraction, as may be agreed between the Issuer and the relevant Dealer.

Dual Currency Mortgage Bonds: Payments (whether in respect of principal or interest and whether at maturity or otherwise) in respect of Dual Currency Mortgage Bonds will be made in such currencies, and based on such rates of exchange, as the Issuer and the relevant Dealer may agree.

Zero Coupon Mortgage Bonds: Zero Coupon Mortgage Bonds will be offered and sold at a discount to their nominal amount and will not bear interest.

Partly Paid Mortgage Bonds: Subject to the prior written consent of KELER (as defined below), the Issuer shall not issue Partly Paid Mortgage Bonds.

Redemption: The applicable Final Terms will indicate either that the Mortgage Bonds cannot be redeemed prior to their stated maturity (other than for taxation reasons or following an Event of Default) or that such Mortgage Bonds will be redeemable at the option of the Issuer and/or the Holders upon giving notice to the Holders or the Issuer, as the case may be, on a date or dates specified prior to such stated maturity and at a price or prices and on such other terms as may be agreed between the Issuer and the relevant Dealer.

Mortgage Bonds having a maturity of less than one year may be subject to restrictions on their denomination and distribution, see "*Certain Restrictions*" above.

Denomination of Mortgage Bonds:	Mortgage Bonds will be issued in such denominations as may be agreed between the Issuer and the relevant Dealer save that the minimum denomination of each Mortgage Bond will be such as may be allowed or required from time to time by the relevant central bank (or equivalent body) or any laws or regulations applicable to the relevant Specified Currency, see "*Certain Restrictions*" above, and save that the minimum denomination of each Mortgage Bond admitted to trading on a regulated market within the European Economic Area or offered to the public in a Member State of the European Economic Area in circumstances which require the publication of a prospectus under the Prospectus Directive will be EUR 50,000 (or, if the Mortgage Bonds are denominated in a currency other than euro, the equivalent amount in such currency).
Taxation:	All payments in respect of the Mortgage Bonds will be made without deduction for or on account of withholding taxes imposed by a Tax Jurisdiction, subject as provided in Condition 7 of the Terms and Conditions of the Mortgage Bonds. In the event that any such deduction is made, the Issuer will, save in certain limited circumstances provided in Condition 7 of the Terms and Conditions of the Mortgage Bonds, be required to pay additional amounts to cover the amounts so deducted. The terms of the Mortgage Bonds contain a provision, pursuant to which the Agent must, at all times, be tax resident in Germany or the United Kingdom.
Negative Pledge:	The terms of the Mortgage Bonds will not contain a negative pledge provision.
Cross Default:	The terms of the Mortgage Bonds contain a cross default provision.
Status of the Mortgage Bonds:	The Mortgage Bonds will constitute unsubordinated obligations of the Issuer ranking *pari passu* among themselves. The Mortgage Bonds will be covered in accordance with the Hungarian Act on Mortgage Loan Credit Institutions and on Mortgage Bonds (*1997. évi XXX. törvény a jelzálog-hitelintézetről és a jelzáloglevélről*) and rank *pari passu* with all other covered and unsubordinated present and future obligations of the Issuer under mortgage bonds (*jelzáloglevelek*).
Subordination:	Mortgage Bonds may not be issued on a subordinated basis.
Listing:	Application has been made for Mortgage Bonds issued under the Programme to be listed on the Luxembourg Stock Exchange. The Mortgage Bonds may also be listed on such other or further stock exchange(s) as may be agreed between the Issuer and the relevant Dealer in relation to each Series. Unlisted Mortgage Bonds may also be issued. The applicable Final Terms will state whether or not the Mortgage

	Bonds are to be listed and, if so, on which stock exchange(s).
Clearing:	Mortgage Bonds will only clear through Központi Elszámolóház és Értéktár (Budapest) Rt. or its legal successor (**KELER**) and Clearstream Banking, société anonyme (**Clearstream, Luxembourg**), as more fully described under "*Form of the Mortgage Bonds*" and "*Settlement Procedures*" below. As at the date of this Base Prospectus, it is not envisaged that Mortgage Bonds will clear through Euroclear Bank S.A./N.V., as operator of the Euroclear system (**Euroclear**).
Governing Law:	The Mortgage Bonds will be governed by, and construed in accordance with, Hungarian law. In relation to the Mortgage Bonds, any Dispute may be settled by the Hungarian Money and Capital Markets Arbitration Court, in accordance with its own rules of procedure, as more fully described in the Terms and Conditions of the Mortgage Bonds.
Selling Restrictions:	There are restrictions on the offer, sale and transfer of the Mortgage Bonds in the United States, the United Kingdom, Japan, Hungary, France and Italy and such other restrictions as may be required in connection with the offering and sale of a particular Tranche of Mortgage Bonds, see "*Subscription and Sale*".
United States Selling Restrictions:	Regulation S, Category 1. TEFRA C.
Representation of the holders of the Mortgage Bonds	There is no provision for the representation of holders of the Mortgage Bonds.

For the purpose of calculating the euro equivalent of the aggregate nominal amount of Mortgage Bonds issued under the Programme from time to time:

(a) the euro equivalent of Mortgage Bonds denominated in another Specified Currency (as specified in the applicable Final Terms in relation to the Mortgage Bonds, described under "*Form of the Mortgage Bonds*") shall be determined, at the discretion of the Issuer, either as of the date on which agreement is reached for the issue of Mortgage Bonds or on the preceding day on which commercial banks and foreign exchange markets are open for business in London, in each case on the basis of the spot rate for the sale of the euro against the purchase of such Specified Currency in the London foreign exchange market quoted by any leading international bank selected by the Issuer on the relevant day of calculation;

(b) the euro equivalent of Dual Currency Mortgage Bonds, Index Linked Mortgage Bonds and Partly Paid Mortgage Bonds (each as specified in the applicable Final Terms in relation to the Mortgage Bonds, described under "*Form of the Mortgage Bonds*") shall be calculated in the manner specified above by reference to the original nominal amount on issue of such Mortgage Bonds (in the case of Partly Paid Mortgage Bonds regardless of the subscription price paid); and

(c) the euro equivalent of Zero Coupon Mortgage Bonds (as specified in the applicable Final Terms in relation to the Mortgage Bonds, described under "*Form of the Mortgage Bonds*") and other Mortgage Bonds issued at a discount or a premium shall be calculated in the manner specified above by reference to the net proceeds received by the Issuer for the relevant issue.

RISK FACTORS

The Issuer believes that the following factors may affect its ability to fulfil its obligations under Mortgage Bonds issued under the Programme. Most of these factors are contingencies which may or may not occur and the Issuer is not in a position to express a view on the likelihood of any such contingency occurring.

In addition, factors which are material for the purpose of assessing the market risks associated with Mortgage Bonds issued under the Programme are also described below.

The Issuer believes that the factors described below represent the principal risks inherent in investing in Mortgage Bonds issued under the Programme, but the inability of the Issuer to pay interest, principal or other amounts on or in connection with any Mortgage Bonds may occur for other reasons which are as yet unknown and the Issuer does not represent that the statements below regarding the risks of holding any Mortgage Bonds are exhaustive. Prospective investors should also read the detailed information set out elsewhere in this Base Prospectus and reach their own views prior to making any investment decision.

Factors that may affect the Issuer's ability to fulfil its obligations under Mortgage Bonds issued under the Programme

Like all other banks the Issuer is mainly exposed to credit risk and market risk (e.g. interest rate movements and currency movements).

These risk factors are addressed by the Issuer's own risk management procedures and exposures are constantly measured and supervised.

With the exception of the risk factors in this section entitled "*Factors that may affect the Issuer's ability to fulfil its obligations under Mortgage Bonds issued under the Programme*", the Issuer does not consider there to be any other risk factors relevant to its business.

Risk factors specific to the Issuer:

- Due to statutory restrictions FHB Ltd. cannot keep client accounts. Consequently, direct client-related information, which would automatically be available for account keeping banks, have to be obtained from other sources. FHB Ltd. signed an agreement with Bankközi Informatika Szolgáltató Ltd. (Inter-bank Information Service Providing Company) operating an inter-bank information system and other organisations to acquire, as soon as possible, information regarding eventual delays in client payments.

- Liquidity risk: Although the structure of FHB Ltd.'s assets and liabilities can be coordinated with the maturity structure of bonds to be issued, there is no guarantee that maturity adequacy will prevail at all times. The volatility of the interest environment will boost demands for prepayment. The fundamental goal of liquidity management is to eliminate this type of risk.

- Fund renewing risk: The maturity of FHB Ltd.'s 1 to 5-year interest assets is typically 5 to 20 years, and of liabilities, 5 to 15 years. In certain periods of time larger volumes of issue may be necessary in order to raise funds. The Bank has developed techniques to manage the risk of such future issues.

- Interest risk: As a result of FHB Ltd.'s activity as a mortgage company and the relevant specific legal regulations, the Bank has a special assets-liabilities structure within the Hungarian banking system. Loans to clients are typically long-term and annuity based, with 1 to 5 years interest brackets, and a price adjustment clause in the case of most of the subsidised loans. Liabilities, on the other hand, are largely long-term, fixed interest bearing liabilities raised on the capital market.

- Prepayment risk: Pursuant to the provisions of the Act on Mortgage Companies and Mortgage Bonds in force on the date of this Base Prospectus, prepayment on mortgage loans, i.e. full or partial repayment prior to the due dates set forth in the loan agreement can be prohibited. In cases where prepayment is allowed the mortgage institution is entitled to enforce its profit lost. In consideration of the relevant statutory provisions, FHB Ltd. allows prepayment subject to conditions preliminarily agreed upon. Besides long-term mortgage lending and typically fixed interest mortgage bonds, decreasing the interest alleviates prepayment risk.

- Exchange rate risk: The lending risk of the Bank's foreign exchange-based transactions is increased by the fact that the typical currency of income from customers may be different from the currency of collateral sales. Lending denominated in foreign exchange and funds raised in foreign exchange do not necessarily mean that the Bank's receivables and obligations arise in the same currency.

- FHB Ltd. is not involved in any litigation where the value contested exceeds 10% of the Bank's registered capital.

- FHB Ltd.'s public liabilities: As of the publication of this Circular the Bank has no social security or tax liabilities based on a valid order.

Risk factors stemming from the state of the Hungarian economy

- Due to its size and openness, the Hungarian economy is prone to international, particularly European, trends and processes. Deteriorating internal and external indicators may force the successive governments to adopt austerity measures. Moreover, it is not impossible that governments take economic policy, budget or monetary decisions that may have a negative impact on FHB Ltd.'s profitability.

- International trends have a quick and powerful bearing on the changes in Hungarian interest rates as well as on stock market and financial market prices. Such changes have a significant effect on the Bank's access to funds and the conditions of raising them. It was in an efforts to attenuate its vulnerability to risk in the capital market and to expand opportunities that the Bank decided to launch a mortgage bond programme in the international market from 2003.

- FHB's activities and the profitability of its operation is strongly affected by the macroeconomic environment and the domestic and international perception of the Hungarian economy. The macroeconomic situation will, on the one hand, determine the magnitude of disbursable housing loans and the quality of the portfolio through the size disposable income of the population. On the other hand, the deficit of the budget and of the balance of payments, inflation, interest rates and the rate of the forint have an effect on mortgage bond issues and the demand for mortgage bonds, and, as such, on the cost of funds, and thus, ultimately, affect the Bank's profitability.

- A possible negative trend in the real estate market may result in the need for supplementary coverage on mortgage bonds.

- Access to the European Union and integration into a more developed financial system means new challenges for FHB Ltd.

- While the inherent risks of the convergence of the Hungarian economy to the EU (rate of the forint and interest rates) are relatively easy to forecast in the medium term, due to the unknown character of the precise nature of the adaptation process, its intensity and volatility are unforeseen.

The maturity of the Mortgage Bonds issued within the scope of this Base Prospectus is maximum 15 years. The euro is likely to be introduced before the end of this period, therefore the last payments will be effected in a different currency, euro, at a forint-to-euro exchange rate to be determined at a future stage.

Factors which are material for the purpose of assessing the market risks associated with Mortgage Bonds issued under the Programme

The Mortgage Bonds may not be a suitable investment for all investors

Each potential investor in the Mortgage Bonds must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should:

(i) have sufficient knowledge and experience to make a meaningful evaluation of the Mortgage Bonds, the merits and risks of investing in the Mortgage Bonds and the information contained or incorporated by reference in this Base Prospectus or any applicable supplement;

(ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Mortgage Bonds and the impact the Mortgage Bonds will have on its overall investment portfolio;

(iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Mortgage Bonds, including Mortgage Bonds with principal or interest payable in one or more currencies, or where the currency for principal or interest payments is different from the potential investor's currency;

(iv) understand thoroughly the terms of the Mortgage Bonds and be familiar with the behaviour of any relevant indices and financial markets; and

(v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Some Mortgage Bonds are complex financial instruments. Sophisticated institutional investors generally do not purchase complex financial instruments as stand-alone investments. They purchase complex financial instruments as a way to reduce risk or enhance yield with an understood, measured, appropriate addition of risk to their overall portfolios. A potential investor should not invest in Mortgage Bonds which are complex financial instruments unless it has the expertise (either alone or with a financial adviser) to evaluate how the Mortgage Bonds will perform under changing conditions, the resulting effects on the value of the Mortgage Bonds and the impact this investment will have on the potential investor's overall investment portfolio.

Risks related to the structure of a particular issue of Mortgage Bonds

A wide range of Mortgage Bonds may be issued under the Programme. A number of these Mortgage Bonds may have features which contain particular risks for potential investors. Set out below is a description of the most common such features:

Mortgage Bonds subject to optional redemption by the Issuer

An optional redemption feature of Mortgage Bonds is likely to limit their market value. During any period when the Issuer may elect to redeem Mortgage Bonds, the market value of those Mortgage Bonds generally will not rise substantially above the price at which they can be redeemed. This also may be true prior to any redemption period.

The Issuer may be expected to redeem Mortgage Bonds when its cost of borrowing is lower than the interest rate on the Mortgage Bonds. At those times, an investor generally would not be able to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Mortgage Bonds being redeemed and may only be able to do so at a significantly lower rate. Potential investors should consider reinvestment risk in light of other investments available at that time.

Index Linked Mortgage Bonds and Dual Currency Mortgage Bonds

The Issuer may issue Mortgage Bonds with principal or interest determined by reference to an index or formula, to changes in the prices of securities or commodities, to movements in currency exchange rates or other factors (each, a **Relevant Factor**). In addition, the Issuer may issue Mortgage Bonds with principal or interest payable in one or more currencies which may be different from the currency in which the Mortgage Bonds are denominated. Potential investors should be aware that:

(i) the market price of such Mortgage Bonds may be volatile;

(ii) they may receive no interest;

(iii) payment of principal or interest may occur at a different time or in a different currency than expected;

(iv) they may lose all or a substantial portion of their principal;

(v) a Relevant Factor may be subject to significant fluctuations that may not correlate with changes in interest rates, currencies or other indices;

(vi) if a Relevant Factor is applied to Mortgage Bonds in conjunction with a multiplier greater than one or contains some other leverage factor, the effect of changes in the Relevant Factor on principal or interest payable likely will be magnified; and

(vii) the timing of changes in a Relevant Factor may affect the actual yield to investors, even if the average level is consistent with their expectations. In general, the earlier the change in the Relevant Factor, the greater the effect on yield.

Partly-paid Mortgage Bonds

The Issuer may issue Mortgage Bonds where the issue price is payable in more than one instalment. Failure to pay any subsequent instalment could result in an investor losing all of his investment.

Fixed/Floating Rate Mortgage Bonds

Fixed/Floating Rate Mortgage Bonds may bear interest at a rate that the Issuer may elect to convert from a fixed rate to a floating rate, or from a floating rate to a fixed rate. The Issuer's ability to convert the interest rate will affect the secondary market and the market value of the Mortgage Bonds since the Issuer may be expected to convert the rate when it is likely to produce a lower overall cost of borrowing. If the Issuer converts from a fixed rate to a floating rate, the spread on the Fixed/Floating Rate Mortgage Bonds may be less favourable than then prevailing spreads on comparable Floating Rate Mortgage Bonds tied to the same reference rate. In addition, the new floating rate at any time may be lower than the rates on other Mortgage Bonds. If the Issuer converts from a floating rate to a fixed rate, the fixed rate may be lower than then prevailing rates on its Mortgage Bonds.

Mortgage Bonds issued at a substantial discount or premium

The market values of securities issued at a substantial discount or premium from their principal amount tend to fluctuate more in relation to general changes in interest rates than do prices for conventional interest-bearing securities. Generally, the longer the remaining term of the securities, the greater the price volatility as compared to conventional interest-bearing securities with comparable maturities.

Risks related to Mortgage Bonds generally

Set out below is a brief description of certain risks relating to the Mortgage Bonds generally:

Modification

The conditions of the Mortgage Bonds contain provisions for calling meetings of Holders to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Holders including Holders who did not attend and vote at the relevant meeting and Holders who voted in a manner contrary to the majority.

EU Savings Directive

If, following implementation of this Directive, a payment were to be made or collected through a Member State which has opted for a withholding system and an amount of, or in respect of tax were to be withheld from that payment, neither the Issuer nor any Paying Agent nor any other person would be obliged to pay additional amounts with respect to any Mortgage Bond as a result of the imposition of such withholding tax. If a withholding tax is imposed on payment made by a Paying Agent following implementation of this Directive, the Issuer will be required to maintain a Paying Agent in a Member State that will not be obliged to withhold or deduct tax pursuant to the Directive.

Change of law

The conditions of the Mortgage Bonds are based on Hungarian law in effect as at the date of this Base Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to Hungarian law or administrative practice after the date of this Base Prospectus.

Integral multiples of less than EUR50,000

It is possible that certain Mortgage Bonds may be traded in the clearing systems in amounts in excess of €50,000 (or its equivalent) that are not integral multiples of EUR50,000 (or its equivalent). In such a case, should definitive Mortgage Bonds be required to be issued, Mortgage Bondholders who hold Mortgage Bonds in the relevant clearing system in amounts that are not integral multiples of a Specified Denomination may need to purchase of sell, on or before the relevant Exchange Date, a principal amount of Mortgage Bonds such that their holding is an integral multiple of a Specified Denomination.

Regulatory risk

- A significant risk relating to the legislative environment may stem from the amendment of the decree on housing subsidies. There were two major changes in 2003, both of which had an influence on the demand for loans, and thus affected the Bank's operation and profitability. The Bank monitors changes in the legislative environment and draws up models to explore their short-term and long-term impact on profitability and financial plans.

Competition

- The retail home lending market is a multi-agent market (with the participation of commercial banks, mortgage companies, savings banks, savings cooperatives and insurance companies). Competition is also keen in mortgage banking. EU accession facilitates for foreign banks to offer their services in Hungary, thus it is conceivable to expect further increase in the number of agents in the housing loans market.

- The Bank's own distribution network is narrower compared to that of other market agents. To offset this, FHB Ltd. developed a wide network of agents. Own lending is supplemented by refinancing.

The risk in this field stems primarily retaining refinancing customers and mounting competition in the refinancing market.

Risks related to the market generally

Set out below is a brief description of the principal market risks, including liquidity risk, exchange rate risk, interest rate risk and credit risk:

The secondary market generally

Although application has been made to list the Mortgage Bonds on the Luxembourg Stock Exchange, Mortgage Bonds may have no established trading market when issued, and one may never develop. If a market does develop, it may not be very liquid. Therefore, investors may not be able to sell their Mortgage Bonds easily or at prices that will provide them with a yield comparable to similar investments that have a developed secondary market. [This is particularly the case for Mortgage Bonds that are especially sensitive to interest rate, currency or market risks, are designed for specific investment objectives or strategies or have been structured to meet the investment requirements of limited categories of investors. These types of Mortgage Bonds generally would have a more limited secondary market and more price volatility than conventional debt securities. Illiquidity may have a severely adverse effect on the market value of Mortgage Bonds.]

Exchange rate risks and exchange controls

The Issuer will pay principal and interest on the Mortgage Bonds in the Specified Currency. This presents certain risks relating to currency conversions if an investor's financial activities are denominated principally in a currency or currency unit (the **Investor's Currency**) other than the Specified Currency. These include the risk that exchange rates may significantly change (including changes due to devaluation of the Specified Currency or revaluation of the Investor's Currency) and the risk that authorities with jurisdiction over the Investor's Currency may impose or modify exchange controls. An appreciation in the value of the Investor's Currency relative to the Specified Currency would decrease (1) the Investor's Currency-equivalent yield on the Mortgage Bonds, (2) the Investor's Currency-equivalent value of the principal payable on the Mortgage Bonds and (3) the Investor's Currency-equivalent market value of the Mortgage Bonds.

Government and monetary authorities may impose (as some have done in the past) exchange controls that could adversely affect an applicable exchange rate. As a result, investors may receive less interest or principal than expected, or no interest or principal.

Interest rate risks

Investment in Fixed Rate Mortgage Bonds involves the risk that subsequent changes in market interest rates may adversely affect the value of the Fixed Rate Mortgage Bonds.

Credit ratings may not reflect all risks

One or more independent credit rating agencies may assign credit ratings to the Mortgage Bonds. The ratings may not reflect the potential impact of all risks related to structure, market, additional factors discussed above, and other factors that may affect the value of the Mortgage Bonds. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time.

Legal investment considerations may restrict certain investments

The investment activities of certain investors are subject to legal investment laws and regulations, or review or regulation by certain authorities. Each potential investor should consult its legal advisers to determine whether and to what extent (1) Mortgage Bonds are legal investments for it, (2) Mortgage Bonds can be used as collateral for various types of borrowing and (3) other restrictions apply to its purchase or pledge of any Mortgage Bonds. Financial institutions should consult their legal advisers or the appropriate regulators to determine the appropriate treatment of Mortgage Bonds under any applicable risk-based capital or similar rules.

DOCUMENTS INCORPORATED BY REFERENCE

The following documents which have previously been published and have been filed with the CSSF shall be incorporated in, and form part of, this Base Prospectus:

(a) the audited consolidated annual financial statements for the financial year ended 31 December 2003 and the audit reports thereon, the audited consolidated annual financial statements for the financial year ended 31 December 2004 and the audit reports thereon; the audited interim consolidated financial statements for the six months ended 30 June 2005 and the audit reports thereon of the Issuer; and

(b) the Articles of Association of the Issuer; and

(c) Stock Exchange Report for the third quarter of 2005.

Following the publication of this Base Prospectus a supplement may be prepared by the Issuer and approved by the CSSF in accordance with Article 16 of the Prospectus Directive. Statements contained in any such supplement (or contained in any document incorporated by reference therein) shall, to the extent applicable (whether expressly, by implication or otherwise), be deemed to modify or supersede statements contained in this Base Prospectus or in a document which is incorporated by reference in this Base Prospectus. Any statement so modified or superseded shall not, except as so modified or superseded, constitute a part of this Base Prospectus.

Copies of documents incorporated by reference in this Base Prospectus can be obtained from the website of the Issuer, www.fhb.hu. In addition, such documents will be available free of charge from the principal office in Luxembourg of Deutsche Bank Luxembourg S.A. for Mortgage Bonds listed on the Luxembourg Stock Exchange.

The Issuer will, in the event of any significant new factor, material mistake or inaccuracy relating to information included in this Base Prospectus which is capable of affecting the assessment of any Mortgage Bonds, prepare a supplement to this Base Prospectus or publish a new Base Prospectus for use in connection with any subsequent issue of Mortgage Bonds.

The following documents shall be incorporated in, and form part of, this Base Prospectus:

Document	**Section incorporated**
Consolidated IFRS Financial Statements for the financial years ended 31 December 2003	Pages i to 23
- Independent Auditors' Report	Page i
- Financial Statements:	
- - Statements of of Income	Page 1
- - Balance Sheet	Page 2
- - Statements of Cash Flows	Page 3
- - Statements of Shareholders' Equity	Page 4

-	Notes to the Consolidated Financial Statements	Pages 5 to 23

Annual Report 2004

Consolidated IFRS Financial Statements for the financial year ended 31 December 2004		Pages 4 to 120
-	Independent Auditors' Report	Page 69
-	Financial Statements:	
	- Statement of Income	Page 70
	- Balance Sheet	Page 71
	- Statements of Cash Flow	Page 72
	- Statements of shareholders' equity	Page 73
-	Notes to the Consolidated Financial Statements	Pages 74 to 95
Third quarter 2005 stock exchange report (containing interim financial statements prepared in accordance with IFRS for the nine months end 30 September 2005)		Pages 2 to 32
-	profit and loss statement	Page 18
-	balance sheet	Page 19
-	statements of cash flows	Page 20

The Articles of Association of the Issuer and any other documents incorporated by reference but not set out in the table above are incorporated by reference for information purposes only. Financial information incorporated by reference and also set out in this Base Prospectus shall be deemed to be incorporated by reference for information purposes only.

FORM OF THE MORTGAGE BONDS

Each Tranche of Mortgage Bonds will be in dematerialised registered form. The Issuer will, in accordance with Act CXX of 2001 on the Capital Markets (*2001. évi CXX. törvény a tőkepiacról*) (the **Capital Markets Act**) and Act XXX of 1997 on Mortgage Loan Credit Institutions and on Mortgage Bonds (*1997. évi XXX. törvény a jelzálog-hitelintézetről és a jelzáloglevélről*), issue and deposit with KELER a document (the **Document**), which does not qualify as a security, setting out the particulars of each Series of Mortgage Bonds. In the event that further Mortgage Bonds are issued or a part of the relevant Series of Mortgage Bonds are cancelled, in each case in accordance with the Terms and Conditions of the Mortgage Bonds, the Document will be cancelled and a new Document (the **new Document**) amended in accordance with the particulars of the further Mortgage Bonds or, as the case may be, the outstanding part of the relevant Series of Mortgage Bonds will be issued.

The Final Terms, or in the case of a Series with more than one Tranche, the latest Final Terms, for each Series of Mortgage Bonds (or the relevant provisions thereof) forms part of the related Document or new Document, as the case may be, and supplements the Terms and Conditions of the Mortgage Bonds and may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the Terms and Conditions of the Mortgage Bonds, replace or modify the Terms and Conditions of the Mortgage Bonds for the purposes of a particular Series of Mortgage Bonds.

Payments in respect of the Mortgage Bonds will be made in accordance with the rules and regulations of KELER as effective from time to time and taking into consideration the relevant laws on taxation to those securities account managers who are registered in the register of KELER with respect to such Mortgage Bonds at the close of the business on the Reference Date (as defined in the Terms and Conditions of the Mortgage Bonds) for that payment, as designated in the regulations of KELER effective from time to time. Payment shall be due to that person who is deemed to be the Holder (as defined below) on the Reference Date.

In accordance with Section 138(2) of the Capital Markets Act, any reference to a **Holder** or **Holders** in relation to any Mortgage Bonds means the person or persons, as the case may be, to whose securities account the Mortgage Bonds are credited until the opposite is proven. However, in respect of any Mortgage Bonds held on the securities account of Clearstream, Luxembourg at KELER, each person who is for the time being shown in the records of Clearstream, Luxembourg as the holder of a particular nominal amount of the Mortgage Bonds shall be entitled to exercise the rights of a Holder of that nominal amount of Mortgage Bonds in accordance with Clearstream, Luxembourg's standard procedures. For the avoidance of any doubt, payments of principal or interest on the Mortgage Bonds held on the securities account of Clearstream, Luxembourg at KELER will be made by, or on behalf of, the Issuer, through KELER, to the account of Clearstream, Luxembourg.

The Mortgage Bonds will be transferable only by debiting the seller's securities account and crediting the buyer's securities account and in accordance with the rules and procedures for the time being of KELER. Under Section 6(5) of the Capital Markets Act, the Holders will not be entitled to exchange dematerialised Mortgage Bonds for printed Mortgage Bonds. However, in the limited circumstances described in Condition 1(e) of the Terms and Conditions of the Mortgage Bonds, the Issuer will be obliged to procure the delivery of printed mortgage bonds to the Holders.

The Mortgage Bonds will be cleared through KELER and Clearstream, Luxembourg which has its registered office at 67, Boulevard Grand-Duchesse Charlotte, L-1331 Luxembourg, see "*Settlement Procedures*". As at the date of this Base Prospectus, it is not envisaged that Mortgage Bonds will clear through Euroclear.

If the applicable Final Terms specify any amendment to the Terms and Conditions of the Mortgage Bonds as described herein, it is envisaged that, to the extent that such modification relates only to Conditions 1, 3, 4, 5, 6 (except Condition 6(b)), 10, 11 (insofar as such Mortgage Bonds are not listed or admitted to trade on any stock exchange) or 12, they will not necessitate the preparation of a supplement to this Base Prospectus. If the Terms and Conditions of the Mortgage Bonds of any Series are to be modified in any other respect, a supplement to this Base Prospectus will be prepared, if appropriate.

SETTLEMENT PROCEDURES

The following information is a summary of the settlement procedures envisaged to be applicable, as at the date of this Base Prospectus, to each Tranche of Mortgage Bonds to be issued under the Programme.

Issue of Mortgage Bonds

Upon the issue of a Tranche of Mortgage Bonds, KELER will first credit the nominal amount of such Tranche to the Issuer's securities (creation) sub-account with it. KELER will then, pursuant to an instruction from the Issuer, debit the securities (creation) sub-account with the nominal amount of such Tranche and will credit that Tranche to another securities (settlement) sub-account of the Issuer with KELER.

The relevant Dealer or lead manager, as the case may be, will, on the relevant settlement day, instruct Clearstream, Luxembourg to give an "OTC buy" instruction to KELER for the nominal amount of the relevant Tranche indicating the securities (settlement) sub-account of the Issuer as "seller's account". In turn, Clearstream, Luxembourg will give the above "OTC buy" instruction to KELER.

The Issuer will give an "OTC sell" instruction to KELER for the nominal amount of the relevant Tranche indicating Clearstream, Luxembourg's securities account with KELER as "buyer's account".

If both the "OTC buy" and "OTC sell" instructions refer to the same number of Mortgage Bonds, price and settlement date and the buyer's and seller's account can be matched, the nominal amount of the relevant Tranche is credited to the securities (settlement) sub-account of the Issuer and there are sufficient funds (the purchase price) on Clearstream, Luxembourg's cash account with KELER, then KELER will settle the "OTC buy" and "OTC sell" instructions on a delivery versus payment basis.

Accordingly, KELER will (i) debit the securities (settlement) sub-account of the Issuer with the nominal amount of the relevant Tranche; (ii) credit the nominal amount of the relevant Tranche to Clearstream, Luxembourg's securities account with KELER; (iii) debit Clearstream, Luxembourg's cash account with the purchase price; and (iv) credit or transfer the purchase price to the Issuer's cash account for value on the relevant settlement date.

In turn, Clearstream, Luxembourg will, in accordance with its instructions received from the relevant Dealer(s) or lead manager, as the case may be, credit the nominal amount of the relevant Tranche to the securities account(s) with Clearstream, Luxembourg of the persons entitled thereto.

Upon credit of the relevant securities account(s) with Clearstream, Luxembourg, the relevant accountholder(s) may further allocate the Mortgage Bonds to the securities account(s) of their respective clients.

Payments

In relation to an issue of Mortgage Bonds, the Issuer will pay any amount due in HUF under the Mortgage Bonds to the HUF bank account of the Agent (as defined in the Terms and Conditions of the Mortgage Bonds) with a Hungarian bank and, in case of any amount due in a currency other than HUF, to such account as may be designated for such purpose by the Agent from time to time.

The Agent will then, based on the list of Securities Account Managers (as defined in the Terms and Conditions of the Mortgage Bonds) received from KELER ("*kifizetési diszpozíció*"), transfer the amount due to an account specified by KELER with an instruction to KELER to allocate the relevant funds to those listed on the "*kifizetési diszpozíció*", as appropriate (KELER will take such instructions subject to a separate agreement with the Issuer). Accordingly, KELER will credit the relevant funds to those listed on the "*kifizetési diszpozíció*", as appropriate, including crediting such funds to Clearstream, Luxembourg's cash account (or transferring such funds to the account of Clearstream, Luxembourg at a Hungarian bank) as are necessary to make the appropriate payments on the nominal amount of the relevant Tranche showing on Clearstream, Luxembourg's securities account with KELER. Clearstream, Luxembourg will credit such amounts received to the cash accounts of the relevant accountholders with it.

The relevant accountholders with Clearstream, Luxembourg will in turn credit the relevant amount to their respective clients.

FORM OF APPLICABLE FINAL TERMS

Set out below is the form of Final Terms which will be completed for each Series/Tranche of Mortgage Bonds issued under the Programme.

[*Date*]

FHB LAND CREDIT AND MORTGAGE BANK LTD.
(FHB FÖLDHITEL- ÉS JELZÁLOGBANK RÉSZVÉNYTÁRSASÁG)

Issue of [Aggregate Nominal Amount of Tranche] [Title of Mortgage Bonds]
under the EUR1,000,000,000
Euro Mortgage Bond Programme

PART A – CONTRACTUAL TERMS

Terms used herein shall be deemed to be defined as such for the purposes of the Conditions set forth in the Base Prospectus dated 21 December 2005 which constitutes a base prospectus for the purposes of the Prospectus Directive (Directive 2003/71/EC) (the Prospectus Directive). This document constitutes the Final Terms of the Mortgage Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive and must be read in conjunction with the Base Prospectus. Full information on the Issuer and the offer of the Mortgage Bonds is only available on the basis of the combination of these Final Terms and the Base Prospectus. The Base Prospectus is available for viewing at and collection from the registered office of FHB Land Credit and Mortgage Bank Rt. at Váci út 20., 1132 Budapest, Hungary and the office of Deutsche Bank Luxembourg S.A. (in its capacity as the Luxembourg Paying agent) at 2 Boulevard Konrad Adenauer, 1115 Luxembourg, Luxembourg and may be obtained from www.fhb.hu.

This Base Prospectus and the Final Terms applicable to each issue of Mortgage Bonds will be available on the website of the Luxembourg Stock Exchange: www.bourse.lu.

[*The following alternative language applies if the first tranche of an issue which is being increased was issued under a Base Prospectus with an earlier date*.

Terms used herein shall be deemed to be defined as such for the purposes of the Terms and Conditions of the Mortgage Bonds (the **Conditions**) set forth in the Base Prospectus dated [*original date*]. This document constitutes the Final Terms of the Mortgage Bonds described herein for the purposes of Article 5.4 of the Prospectus Directive (Directive 2003/71/EC) (the Prospectus Directive) and must be read in conjunction with the Base Prospectus dated 21 December 2005, save in respect of the Conditions which are extracted from the Base Prospectus dated [*original date*] and are attached hereto. Full information on the Issuer and the offer of the Mortgage Bonds is only available on the basis of the combination of these Final Terms and the Base Prospectus dated 21 December 2005 and [*original date*]. Copies of such Base Prospectuses are available for viewing at [*address*] [and] [*website*] and copies may be obtained from [*address*].]

[*Include whichever of the following apply or specify as "Not Applicable" (N/A). Note that the numbering should remain as set out below, even if "Not Applicable" is indicated for individual paragraphs or subparagraphs. Italics denote directions for completing the Final Terms.*]

[*When adding any other final terms or information consideration should be given as to whether such terms or information constitute "significant new factors" and consequently trigger the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive.*]

[*If the Mortgage Bonds have a maturity of less than one year from the date of their issue, the minimum denomination may need to be £100,000 or its equivalent in any other currency.*]

1.	Issuer:		FHB Land Credit and Mortgage Bank Ltd. (*FHB Földhitel- és Jelzálogbank Részvénytársaság*)
2.	(a)	Series Number:	[ ]
	(b)	Tranche Number:	[ ]
			(If fungible with an existing Series, details of that Series, including the date on which the Mortgage Bonds become fungible)
3.	Specified Currency or Currencies:		[ ]
4.	Aggregate Nominal Amount:		
	(a)	Series:	[ ]
	(b)	Tranche:	[ ]
5.	[(a)]	Issue Price (per Mortgage Bond):	[ ] per cent. of the Specified Denomination [plus accrued interest from [*insert date*] *(in the case of fungible issues only, if applicable)*]
	[(b)	Net Proceeds:	
		(*Required only for listed issues*)	[ ]]
6.	Specified Denominations:		[ ] [ ]
			[*The Mortgage Bonds will be tradeable only in principal amounts of at least the Specified Denomination and integral multiples of the Tradeable Amount (specified in Part B paragraph 9 below) in excess thereof.*]
			(N.B. If an issue of Mortgage Bonds is (i) NOT admitted to trading on a European Economic Area exchange; and (ii) only offered in the European Economic Area in circumstances where a prospectus is not required to be published under the Prospectus Directive the EUR50,000 minimum denomination is not required.
7.	(a)	Issue Date (value date):	[ ]
	(b)	Interest Commencement Date:	[ ]
8.	Maturity Date:		[*Fixed rate* - *specify date/* *Floating rate* - Interest Payment Date falling in or nearest to [*specify month*]]

9.	Interest Basis:	[[ ] per cent. Fixed Rate] [[BUBOR/LIBOR/EURIBOR] +/- [ ] per cent. Floating Rate] [Zero Coupon] [Index Linked Interest] [Dual Currency Interest] [*specify other*] (further particulars specified below)
10.	Redemption/Payment Basis:	[Redemption at the Specified Denomination] [Index Linked Redemption] [Dual Currency Redemption] [Partly Paid][*] [*specify other*] (*N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Mortgage Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply.*)
11.	Change of Interest Basis or Redemption/ Payment Basis:	[*Specify details of any provision for change of Mortgage Bonds into another Interest Basis or Redemption/ Payment Basis*]
12.	Put/Call Options:	[Investor Put] [Issuer Call] [(further particulars specified below)]
13.	[Date [Board] approval for issuance of Mortgage Bonds obtained:(	[ ] [and [ ], respectively]] (*N.B. Only relevant where Board (or similar) authorisation is required for the particular tranche of Mortgage Bonds)*
14.	Method of distribution:	[Syndicated/Non-syndicated]

PROVISIONS RELATING TO INTEREST (IF ANY) PAYABLE

15.	**Fixed Rate Mortgage Bond Provisions**	[Applicable/Not Applicable] *(If not applicable, delete the remaining subparagraphs of this paragraph)*
	(a) Rate(s) of Interest:	[ ] per cent. per annum [payable [annually/semi-annually/quarterly] in arrear] (*If payable other than annually, consider amending Condition 4*)

[*]Subject to the prior written consent of KELER, the Issuer shall not issue Partly Paid Mortgage Bonds.

	(b)	Interest Payment Date(s):	[[ ] in each year up to and including the Maturity Date]/[*specify other*] (*NB: This will need to be amended in the case of long or short coupons*)
	(c)	Fixed Coupon Amount per Mortgage Bond:	[ ] per Specified Denomination
	(d)	Broken Amount(s):	[*Insert particulars of any initial or final broken interest amounts which do not correspond with the Fixed Coupon Amount*]
	(e)	Day Count Fraction:	[30/360 or Actual/Actual (ICMA) or [specify other]]
	(f)	Determination Date(s):	[ ] in each year [*Insert regular interest payment dates, ignoring issue date or maturity date in the case of a long or short first or last coupon* *N.B. This will need to be amended in the case of regular interest payment dates which are not of equal duration* *N.B: Only relevant where Day Count Fraction is Actual/Actual (ICMA)*]
	(g)	Party responsible for calculating amounts payable:	[Agent/*if not Agent, insert details of Calculation Agent*]
	(h)	Other terms relating to the method of calculating interest for Fixed Rate Mortgage Bonds:	[None/*Give details*]
16.	**Floating Rate Mortgage Bond Provisions**		[Applicable/Not Applicable] (*If not applicable, delete the remaining subparagraphs of this paragraph*)
	(a)	Specified Period(s)/Specified Interest Payment Dates:	[ ]
	(b)	Business Day Convention:	[Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/[*specify other*]]
	(c)	Additional Business Centre(s):	[ ]
	(d)	Manner in which the Rate of Interest and Interest Amount is to be determined:	[Screen Rate Determination/ISDA Determination/*specify other*]

(e)	Party responsible for calculating the Rate of Interest and Interest Amount:		[Agent/*if not Agent, insert details of Calculation Agent*]
(f)	Screen Rate Determination:		
	–	Reference Rate:	[ ] (*Either BUBOR, LIBOR, EURIBOR or other, although additional information is required if other - including fallback provisions in the Agency Agreement*)
	–	Interest Determination Date(s):	[ ] (*Second Budapest business day prior to the start of each Interest Period if BUBOR, second London business day prior to the start of each Interest Period if LIBOR (other than Sterling or euro LIBOR), first day of each Interest Period if Sterling LIBOR and the second day on which the TARGET System is open prior to the start of each Interest Period if EURIBOR or euro LIBOR*)
	–	Relevant Screen Page:	[ ] (*In the case of EURIBOR, if not Telerate Page 248 ensure it is a page which shows a composite rate or amend the fallback provisions appropriately*)
(g)	ISDA Determination:		
	–	Floating Rate Option:	[ ]
	–	Designated Maturity:	[ ]
	–	Reset Date:	[ ]
(h)	Margin(s):		[+/-] [ ] per cent. per annum
(i)	Minimum Rate of Interest:		[ ] per cent. per annum
(j)	Maximum Rate of Interest:		[ ] per cent. per annum
(k)	Day Count Fraction:		[Actual/365 or Actual/Actual Actual/365 (Fixed) Actual/365 (ÁKK) Actual/365 (Sterling) Actual/360 30/360 or 360/360 or Bond Basis 30E/360 *Other*] (*See Condition 4 for alternatives*)

	(l)	Fallback provisions, rounding provisions and any other terms relating to the method of calculating interest on Floating Rate Mortgage Bonds, if different from those set out in the Conditions:	[ ]
17.	**Zero Coupon Mortgage Bond Provisions**		[Applicable/Not Applicable] (*If not applicable, delete the remaining subparagraphs of this paragraph*)
	(a)	Accrual Yield:	[ ] per cent. per annum
	(b)	Reference Price:	[ ]
	(c)	Any other formula/basis of determining amount payable:	[ ]
	(d)	Day Count Fraction in relation to Early Redemption Amounts and late payment:	[Conditions 6(e)(iii) and Condition 6(i) apply/*specify other*] (*Consider applicable day count fraction if not HUF or U.S. dollar denominated*)
18.	**Index Linked Interest Mortgage Bond Provisions**		[Applicable/Not Applicable] (*If not applicable, delete the remaining subparagraphs of this paragraph*)
	(a)	Index/Formula:	[*give or annex details*]
	(b)	Calculation Agent responsible for calculating the Interest Amount(s):	[ ]
	(c)	Provisions for determining Rate of Interest where calculation by reference to Index and/or Formula is impossible or impracticable:	[*need to include a description of market disruption or settlement disruption events and adjustment provisions*]
	(d)	Specified Period(s)/Specified Interest Payment Dates:	[ ]
	(e)	Business Day Convention:	[Floating Rate Convention/Following Business Day Convention/Modified Following Business Day Convention/Preceding Business Day Convention/*specify other*]
	(f)	Additional Business Centre(s):	[ ]
	(g)	Minimum Rate of Interest:	[ ] per cent. per annum
	(h)	Maximum Rate of Interest:	[ ] per cent. per annum
	(i)	Day Count Fraction:	[ ]

19.	**Dual Currency Interest Mortgage Bond Provisions**		[Applicable/Not Applicable] (*If not applicable, delete the remaining subparagraphs of this paragraph*)
	(a)	Rate of Exchange/method of calculating Rate of Exchange:	[*give or annex details, including notice period for currency selection*]
	(b)	Calculation Agent, if responsible for calculating the interest payable:	[ ]
	(c)	Provisions applicable where calculation by reference to Rate of Exchange impossible or impracticable:	[*need to include a description of market disruption or settlement disruption events and adjustment provisions*]
	(d)	Person at whose option Specified Currency(ies) is/are payable:	[ ]

PROVISIONS RELATING TO REDEMPTION

20.	Issuer Call:			[Applicable/Not Applicable] (*If not applicable, delete the remaining subparagraphs of this paragraph*)
	(a)	Optional Redemption Date(s):		[ ]
	(b)	Optional Redemption Amount of each Mortgage Bond and method, if any, of calculation of such amount(s):		[ ] per Mortgage Bond of [ ] Specified Denomination
	(c)	If redeemable in part:		
		(i)	Minimum Redemption Amount:	[ ]
		(ii)	Maximum Redemption Amount:	[ ]
		(iii)	Method of selection:	[ ]
	(d)	Notice period (if other than as set out in the Conditions):		[ ] (*N.B. If setting notice periods which are different to those provided in the Conditions, the Issuer is advised to consider the practicalities of distribution of information through intermediaries, for example, clearing systems and custodians, as well as any other notice requirements which may apply, for example, as between the Issuer and the Agent*)

21.	Investor Put:	[Applicable/Not Applicable] (*If not applicable, delete the remaining subparagraphs of this paragraph*)
	(a) Optional Redemption Date(s):	[ ]
	(b) Optional Redemption Amount of each Mortgage Bond and method, if any, of calculation of such amount(s):	[ ] per Mortgage Bond of [ ] Specified Denomination
	(c) Notice period (if other than as set out in the Conditions):	[ ] (*N.B. If setting notice periods which are different to those provided in the Conditions, the Issuer is advised to consider the practicalities of distribution of information through intermediaries, for example, clearing systems and custodians, as well as any other notice requirements which may apply, for example, as between the Issuer and the Agent*)
22.	Final Redemption Amount of each Mortgage Bond:	[ ] per Mortgage Bond of [ ] Specified Denomination /*specify other*/see Appendix] (*N.B. In relation to any issue of Mortgage Bonds which are expressed at paragraph 6 above to have a minimum denomination and tradeable amounts above such minimum denomination which are smaller than it the following wording should be added: "For the avoidance of doubt, in the case of a holding of Mortgage Bonds in an integral multiple of [ ] in excess of [ ] as envisaged in paragraph [6] above, such holding will be redeemed at its nominal amount."*) (*N.B. If the Final Redemption Amount is other than 100 per cent. of the nominal value the Mortgage Bonds will be derivative securities for the purposes of the Prospectus Directive and the requirements of Annex XII to the Prospectus Directive Regulation will apply.*)
23.	Early Redemption Amount of each Mortgage Bond payable on redemption for taxation reasons or on event of default and/or the method of calculating the same (if required or if different from that set out in Condition 6(e)):	[ ]

GENERAL PROVISIONS APPLICABLE TO THE MORTGAGE BONDS

24.	Additional Financial Centre(s) or other special provisions relating to Payment Dates:	[Not Applicable/*give details*] (*Note that this item relates to the place of payment and not Interest Period end dates to which items 16(c) and 18(f) relate*)
25.	Details relating to Partly Paid Mortgage Bonds: amount of each payment comprising the Issue Price and date on which each payment is to be made and consequences of failure to pay, including any right of the Issuer to forfeit the Mortgage Bonds and interest due on late payment:	[Not Applicable/*give details*][*]
26.	Redenomination applicable:	Redenomination [not] applicable (*if Redenomination is applicable, specify the applicable Day Count Fraction and any provisions necessary to deal with floating rate interest calculation (including alternative reference rates*))
27.	Other final terms:	[Not Applicable/*give details*] *(When adding any other final terms consideration should be given as to whether such terms constitute "significant new factors" and consequently trigger the need for a supplement to the Base Prospectus under Article 16 of the Prospectus Directive.)*

DISTRIBUTION

28.	(a) If syndicated, names of Managers:	[Not Applicable/*give names*]
	(b) Stabilising Manager (if any):	[Not Applicable/*give name*]
29.	If non-syndicated, name of relevant Dealer:	[*Name*]
30.	TEFRA rules applicable:	TEFRA C
31.	Additional selling restrictions:	[Not Applicable/*give details*]

[LISTING AND ADMISSION TO TRADING APPLICATION

These Final Terms comprise the final terms required to list and have admitted to trading the issue of Mortgage Bonds described herein pursuant to the EUR1,000,000,000 Euro Mortgage Bond Programme of FHB Land Credit and Mortgage Bank Ltd. (*FHB Földhitel- és Jelzálogbank Részvénytársaság*).]

RESPONSIBILITY

The Issuer accepts responsibility for the information contained in these Final Terms. [[ ] has been extracted from [ ]. The Issuer confirms that such information has been accurately reproduced and that, so far as it is

[*] Subject to the prior written consent of KELER, the Issuer shall not issue Partly Paid Mortgage Bonds.

aware and is able to ascertain from information published by [ ], no facts have been omitted which would render the reproduced information inaccurate or misleading].

Signed on behalf of the Issuer:

By:	………………………………………. *Duly authorised*	By:	………………………………………. *Duly authorised*

FHB FÖLDHITEL- ÉS JELZÁLOGBANK RÉSZVÉNYTÁRSASÁG

PART B – OTHER INFORMATION

1. LISTING

(i)	Listing:	Luxembourg/other (*specify)/None*
(ii)	Admission to trading:	[Application has been made for the Mortgage Bonds to be admitted to trading on [ ]. /Not Applicable.]
(iii)	Estimate of total expenses related to [ ]* admission to trading:	

2. RATINGS

Ratings: The Mortgage Bonds to be issued have been rated:

[S & P: [ ]]
[Moody's: [ ]]
[[Other]: [ ]]

(*The above disclosure should reflect the rating allocated to Mortgage Bonds of the type being issued under the Programme generally or, where the issue has been specifically rated, that rating.)*

[3. NOTIFICATION

The Commission de Surveillance du Secteur Financier [has been requested to provide/has provided – include first alternative for an issue which is contemporaneous with the establishment or update of the Programme and the second alternative for subsequent issues] the [names of competent authorities of host Member States] with a certificate of approval attesting that the Base Prospectus has been drawn up in accordance with the Prospectus Directive.]

4. INTERESTS OF NATURAL AND LEGAL PERSONS INVOLVED IN THE ISSUES

[Save for any fees payable to the Dealers, so far as the Issuer is aware, no person involved in the issue of the Mortgage Bonds has an interest material to the offer. – *Amended as appropriate if there are other interests*]

5. YIELD (*Fixed Rate Mortgage Bonds only)*

Indication of yield: [ ]

The yield is calculated at the Issue Date on the basis of the Issue Price. It is not an indication of future yield.

6. PERFORMANCE OF INDEX/FORMULA, EXPLANATION OF EFFECT ON VALUE OF INVESTMENT AND ASSOCIATED RISKS AND OTHER INFORMATION CONCERNING THE UNDERLYING (*Index-Linked Mortgage Bonds only*)

[*Need to include details of where past and future performance and volatility of the index/formula can be obtained.*]

[*Where the underlying is an index need to include the name of the index and a description if composed by the Issuer and if the index is not composed by the Issuer need to include details of where the information about the index can be obtained. Where the underlying is not an index need to include equivalent information.*]

7. PERFORMANCE OF RATE[S] OF EXCHANGE AND EXPLANATION OF EFFECT ON VALUE OF INVESTMENT (*Dual Currency Mortgage Bonds only*)

[*Need to include details of where past and future performance and volatility of the relevant rates can be obtained.*]

8. OPERATIONAL INFORMATION

(i)	ISIN Code:	[ ]
(ii)	Common Code:	[ ]
(iii)	Alphabetical code of Series:	[ ]
(iv)	Any clearing system(s) other than Clearstream Banking, société anonyme and KELER and the relevant identification number(s):	[Not Applicable/*give name(s) and number(s)*] (*If the Series of Mortgage Bonds is listed on the Luxembourg Stock Exchange, then clearing will occur through Clearstream, Luxembourg and KELER*) (*Mortgage Bonds may not be cleared through Euroclear*)
(v)	Delivery:	Delivery [against/free of] payment
(vi)	Names and addresses of additional Paying Agent(s) (if any):	[ ]
(vii)	List of such documents available for inspection or collection (free of charge):	[*insert list and place where such documents are so available*]]
(viii)	Place of issue:	Outside Hungary
(ix)	Place of creation of Mortgage Bonds:	Budapest
(x)	Number of Mortgage Bonds:	
	(a) Series:	[ ]
	(b) Tranche:	[ ]

9. TRADEABLE AMOUNT [[ ]/Not Applicable.

Certificate of the Hungarian asset controller (vagyonellenőr) to be attached to the Final Terms for each series of mortgage bonds pursuant to Section 11(2)(n) of the Act XXX of 1997 on Mortgage Loan Credit Institutions and on Mortgage Bonds (1997. évi XXX. törvény a jelzálog-hitelintézetről és a jelzáloglevélről).

TERMS AND CONDITIONS OF THE MORTGAGE BONDS

The following are the Terms and Conditions of the Mortgage Bonds which will form part of each Document (as defined below). The applicable Final Terms in relation to any Series/Tranche of Mortgage Bonds may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the following Terms and Conditions, replace or modify the following Terms and Conditions for the purpose of such Mortgage Bonds. The applicable Final Terms (or the relevant provisions thereof) will form part of each Document prepared in connection with each issue. Reference should be made to "Form of Final Terms" of this Base Prospectus for a description of the content of Final Terms which will specify which of such terms are to apply in relation to the relevant Mortgage Bonds.

This Mortgage Bond is one of a Series (as defined below) of Mortgage Bonds issued by FHB Land Credit and Mortgage Bank Ltd. (*FHB Földhitel- és Jelzálogbank Részvénytársaság*) (the **Issuer**).

References herein to the **Mortgage Bonds** shall be references to the Mortgage Bonds of this Series and shall mean units of the Specified Denomination in the Specified Currency.

The Issuer has entered into an Agency Agreement (such Agency Agreement as amended and/or supplemented and/or restated from time to time, the **Agency Agreement**) dated 22 December 2005 and made between the Issuer, Deutsche Bank AG as principal paying agent and agent bank (the **Agent**, which expression shall include any successor agent) and the other paying agents named therein (together with the Agent, the **Paying Agents**, which expression shall include any additional or successor paying agents).

As used herein, ***Tranche*** means Mortgage Bonds which are identical in all respects (including as to listing) and ***Series*** means a Tranche of Mortgage Bonds together with any further Tranche or Tranches of Mortgage Bonds which are (a) expressed to be consolidated and form a single series and (b) identical in all respects (including as to listing) except for their respective Issue Dates, Interest Commencement Dates and/or Issue Prices.

Copies of the Agency Agreement are available for inspection during normal business hours at the specified office of each of the Paying Agents. Copies of the applicable Final Terms (as defined below) are available for collection or inspection during normal business hours at the specified office of each of the Paying Agents save that, if this Mortgage Bond is an unlisted Mortgage Bond of any Series, the applicable Final Terms will only be available for collection or inspection by a Holder (as defined below) holding one or more unlisted Mortgage Bonds of that Series and such Holder must produce evidence satisfactory to the Issuer or, as the case may be, the relevant Paying Agent as to its holding of such Mortgage Bonds and identity. The Holders are deemed to have notice of, and are subject to, all the provisions of the Agency Agreement and the applicable Final Terms which are applicable to them. The statements in the Terms and Conditions of the Mortgage Bonds include summaries of, and are subject to, the detailed provisions of the Agency Agreement.

Words and expressions defined in the Agency Agreement shall have the same meanings where used in the Terms and Conditions of the Mortgage Bonds unless the context otherwise requires or unless otherwise stated and provided that, in the event of inconsistency between the Agency Agreement and the applicable Final Terms, the applicable Final Terms will prevail.

Words and expressions used in the applicable Final Terms shall have the same meanings where used in the Terms and Conditions of the Mortgage Bonds unless the context otherwise requires or unless otherwise stated.

1. TYPE, FORM, KIND AND TITLE

(a) *Type*

The Mortgage Bonds are registered securities.

(b) *Form*

The Mortgage Bonds are in dematerialised form. The Issuer will, in accordance with Act CXX of 2001 on the Capital Markets (*2001. évi CXX. törvény a tőkepiacról*) (the **Capital Markets Act**) and Act XXX of 1997 on Mortgage Loan Credit Institutions and on Mortgage Bonds (*1997. évi XXX. törvény a jelzálog-hitelintézetről és a jelzáloglevélről*), issue and deposit with Központi Elszámolóház és Értéktár (Budapest) Rt. or its legal successor (**KELER**) a document (the **Document**), which does not qualify as a security, with the particulars of this Series of Mortgage Bonds. In the event that further Mortgage Bonds are issued in accordance with Condition 12 or a part of this Series of Mortgage Bonds are cancelled in accordance with Condition 6(h), the Document will be cancelled and a new Document (the **new Document**) amended in accordance with the particulars of the further Mortgage Bonds or, as the case may be, the outstanding part of this Series of Mortgage Bonds will be issued.

The Final Terms for this Mortgage Bond (or the relevant provisions thereof) forms part of the related Document or new Document, as the case may be, and supplements these Terms and Conditions of the Mortgage Bonds (the **Terms and Conditions of the Mortgage Bonds**) and may specify other terms and conditions which shall, to the extent so specified or to the extent inconsistent with the Terms and Conditions of the Mortgage Bonds, replace or modify the Terms and Conditions of the Mortgage Bonds for the purposes of this Mortgage Bond. References to the ***applicable*** **Final Terms** are to the Final Terms relating to a Tranche of Mortgage Bonds (or the relevant provisions thereof) which forms part of the Document prepared with respect to this Mortgage Bond.

So long as the relevant clearing systems so permit, the Mortgage Bonds may be tradeable only in principal amounts of at least EUR50,000 (or equivalent) and integral multiples of such other amount as shown in the Final Terms.

(c) *Kind*

This Mortgage Bond may be a Fixed Rate Mortgage Bond, a Floating Rate Mortgage Bond, a Zero Coupon Mortgage Bond, an Index Linked Interest Mortgage Bond, a Dual Currency Interest Mortgage Bond or a combination of any of the foregoing, depending upon the Interest Basis specified in the applicable Final Terms.

This Mortgage Bond may be an Index Linked Redemption Mortgage Bond, a Dual Currency Redemption Mortgage Bond, a Partly Paid Mortgage Bond or a combination of any of the foregoing, depending upon the Redemption/Payment Basis specified in the applicable Final Terms.

(d) *Title*

In accordance with Section 138(2) of the Capital Markets Act, any reference to **Holder** or **Holders** in relation to any Mortgage Bonds shall mean the person or persons to whose securities account the Mortgage Bonds are credited until the opposite is proven. However, in respect of any Mortgage Bonds held on the securities account of Clearstream Banking, société anonyme (**Clearstream, Luxembourg**) at KELER, each person who is for the time being shown in the records of Clearstream, Luxembourg as the holder of a particular nominal amount of the Mortgage Bonds shall be entitled to exercise the rights of a Holder of that nominal amount of Mortgage Bonds in accordance with Clearstream, Luxembourg's standard procedures. For the avoidance of any doubt, payments of principal or interest on the Mortgage Bonds held on the securities account of Clearstream, Luxembourg at KELER will be made by, or on behalf of, the Issuer, through KELER, to the account of Clearstream, Luxembourg.

The Mortgage Bonds will be transferable only by debiting the seller's securities account and crediting the buyer's securities account and in accordance with the rules and procedures for the time being of KELER. Under Section 6(5) of the Capital Markets Act, the Holders will not be entitled to exchange the dematerialised Mortgage Bonds for printed mortgage bonds. However, in the limited circumstances set out in Condition 1(e), the Issuer will be obliged to procure the delivery of printed mortgage bonds to the Holders.

(e) *Closure of KELER*

(i) Upon the occurrence of an Exchange Event (as defined below) the Issuer undertakes at its own expense and in accordance with the then applicable laws, rules and regulations of any stock exchange on which the Mortgage Bonds are for the time being listed:

(a) to issue a new Series of Mortgage Bonds (the **Replacement Mortgage Bonds**) in replacement of the Series of Mortgage Bonds which were, in accordance with the records of KELER at the time of the occurrence of the Exchange Event, credited to securities accounts of each Securities Account Manager (as defined below) with KELER (the **Cancelled Mortgage Bonds**); and

(b) to procure that appropriate agency arrangements in line with the then prevailing market standards for the servicing of bearer debt securities are established in connection with the Replacement Mortgage Bonds.

Exchange Event means the Issuer has been notified that KELER has been closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or has announced an intention permanently to cease business or has in fact done so and no successor clearing system is available.

(ii) The Replacement Mortgage Bonds to be issued by the Issuer upon the occurrence of an Exchange Event will:

(a) constitute a new Series of Mortgage Bonds with terms (save for their respective issue dates and save as provided in (vi) below) identical to the Cancelled Mortgage Bonds which they are replacing;

(b) be delivered to the securities account managers who have Cancelled Mortgages Bonds credited to their securities account with KELER (the **Securities Account Managers**) in accordance with the last available records of KELER (as determined in accordance with Condition 1(f)); and

(c) be represented by printed certificates.

(iii) The Issuer will promptly (and in any event within 5 days of its occurrence) give notice to any stock exchange (in accordance with the then applicable rules and regulations of that stock exchange) on which the Mortgage Bonds are for the time being listed and to the Holders in accordance with Condition 11 upon the occurrence of an Exchange Event and the issuance of Replacement Mortgage Bonds. The Issuer will procure that the replacement of the Cancelled Mortgage Bonds with Replacement Mortgage Bonds shall occur no later than 45 days after the date of the giving of the notice referred to in the immediately preceding sentence. Subject to Condition 1(e)(ii), the Issuer will procure that Replacement Mortgage

Bonds are made available at the specified office of the Paying Agent for the time being in Luxembourg.

(iv) The aggregate nominal amount of Replacement Mortgage Bonds issued following the occurrence of an Exchange Event shall be equal to the aggregate nominal amount of Mortgage Bonds which, according to the records of KELER, were credited to the securities accounts of Securities Account Managers at the time of the occurrence of the Exchange Event.

(v) Upon the receipt of Replacement Mortgage Bonds by a Securities Account Manager, such Securities Account Manager and the Holder whose securities account is managed by such Securities Account Manager agree that the Mortgage Bonds which were credited to the securities account of such Securities Account Manager with KELER at the time of the occurrence of the Exchange Event shall be cancelled and shall cease to be of any further effect. Upon the receipt of the Replacement Mortgage Bonds, the Securities Account Manager agrees to hold them for the benefit and on behalf of Holders for whom the Securities Account Manager manages a securities account and in accordance with the balance of such securities account of such Holder. For the avoidance of doubt, to the extent that payments have been made in respect of Mortgage Bonds on or prior to the time that those Mortgage Bonds become Cancelled Mortgage Bonds, this shall relieve the Issuer of being required to make those payments in respect of the Replacement Mortgage Bonds. If any payment in respect of Mortgage Bonds falls due on or after the occurrence of an Exchange Event but prior to the date of delivery of Replacement Mortgage Bonds, then that payment shall only be required to be made by, or on behalf of, the Issuer at the time of presentation (and surrender, as the case may be) of the Replacement Mortgage Bond to the Agent or a Paying Agent by the holder of the Replacement Mortgage Bond. For the purposes of the immediately preceding sentence, interest shall continue to accrue on the Mortgage Bonds at the Rate of Interest (as defined below) in respect of the period from and including the due date for payment to but excluding the actual date of payment.

(vi) If Replacement Mortgage Bonds are issued pursuant to this Condition 1(e) then:

(A) The word "Type," in the heading of Condition 1 shall be deleted, Condition 1(a) shall be deleted, Condition 1(c) shall become Condition 1(b) and Conditions 1(b) and 1(d) will be replaced with the following, respectively:

"(a) *Form and Denomination*

The Mortgage Bonds are in bearer form (where the certificate indicates the name of the owner - *névreszóló*), serially numbered, in the Specified Currency and the Specified Denomination. Interest bearing Mortgage Bonds have interest coupons (**Coupons**) and, if indicated in the applicable Final Terms, talons for further Coupons (**Talons**) attached on issue. Any reference herein to Coupons or coupons shall, unless the context otherwise requires, be deemed to include a reference to Talons or talons. Any reference herein to Mortgage Bonds shall, unless the context otherwise requires, be deemed to include a reference to Coupons attached to such Mortgage Bonds."

"(c) *Title*

Title to the Mortgage Bonds and Coupons attached to such Mortgage Bonds will pass upon endorsement of the transfer of title on the Mortgage Bonds and delivery of the Mortgage Bonds and Coupons attached to such Mortgage Bonds following such endorsement of the transfer of title. The

Issuer and the Paying Agents will (except as otherwise required by law) deem and treat the bearer of any Mortgage Bond and Coupon attached to such Mortgage Bond as the absolute owner thereof (whether or not overdue and notwithstanding any notice of any previous loss or theft thereof) for all purposes, other than if the identity of the owner is indicated on the relevant Mortgage Bond and Coupon attached to such Mortgage Bond. Any reference to **Holder** or **Holders** in relation to any Mortgage Bond shall mean the holder or holders of the Mortgage Bonds. Any reference herein to **Couponholders** shall mean the holders of the Coupons and shall, unless the context otherwise requires, include the holders of the Talons. Any reference herein to Holder or Holders shall, unless the context otherwise requires, be deemed to include a reference to Couponholders";

(B) Condition 3(a)(ii) will be replaced with the following:

"the amount of interest due in respect of the Mortgage Bonds will be calculated by reference to the aggregate nominal amount of Mortgage Bonds presented (or, as the case may be, in respect of which coupons are presented) for payment by the relevant Holder and the amount of such payment shall be rounded down to the nearest euro 0.01;";

(C) The "." at the end of Condition 3(a)(v) shall be replaced by "; and" and the following new Condition 3(a)(vi) shall be added thereafter:

"the Mortgage Bonds shall be issued at the expense of the Issuer in such denomination as the Agent may decide in accordance with the then prevailing market practice for a redenomination of securities denominated in Hungarian Forint into euro and applicable Hungarian law."

(D) The definition of Business Day contained in Condition 4(b)(i) shall be amended by deleting:

"; and

(C) a day on which KELER and Clearstream, Luxembourg are effecting money and securities transfers."

at the end of that definition and replacing it with".";

(E) Condition 5(a) will be replaced with the following:

"Payments of principal will (subject as provided below and subject in all cases to any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 7) be made in the following manner:

(i) payments in a Specified Currency other than euro will be made by credit or transfer to an account in the relevant Specified Currency (which, in the case of a payment in Japanese yen to a non-resident of Japan, shall be a non-resident account) maintained by the payee with, or, at the option of the payee, by a cheque in such Specified Currency drawn on, a bank in the principal financial centre of the country of such Specified Currency (which, if the Specified Currency is Australian dollars or New Zealand dollars, shall be Melbourne and Wellington, respectively); and

(ii) payments in euro will be made by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by a euro cheque,

only against presentation and surrender of this Mortgage Bond, and payments of interest in respect of this Mortgage Bond will (subject as provided below) be made as aforesaid only against presentation and surrender of Coupons, in each case at the specified office of any Paying Agent outside the United States (which expression, as used herein, means the United States of America (including the States and the District of Columbia, its territories, its possessions and other areas subject to its jurisdiction)).

Fixed Rate Mortgage Bonds (other than Dual Currency Interest Mortgage Bonds or Index Linked Interest Mortgage Bonds) should be presented for payment together with all unmatured Coupons appertaining thereto (which expression shall for this purpose include Coupons falling to be issued on exchange of matured Talons).

Upon any Fixed Rate Mortgage Bond becoming due and repayable prior to its Maturity Date, all unmatured Talons (if any) appertaining thereto will become void and no further Coupons will be issued in respect thereof.

Upon the date on which any Floating Rate Mortgage Bond, Dual Currency Interest Mortgage Bond or Index Linked Interest Mortgage Bond becomes due and repayable, unmatured Coupons and Talons (if any) relating thereto shall become void and no payment or, as the case may be, exchange for further Coupons shall be made in respect thereof.

If the due date for redemption of any Mortgage Bond is not an Interest Payment Date, interest (if any) accrued in respect of such Mortgage Bond from (and including) the preceding Interest Payment Date or, as the case may be, the Interest Commencement Date shall be payable only against surrender of the relevant Mortgage Bond.";

(F) The definition of Payment Day contained in Condition 5(b) shall be amended by:

(i) deleting "; and

(iii) a day on which KELER and Clearstream, Luxembourg are effecting money and securities transfers."

at the end of that definition and replacing it with "."; and

(ii) inserting in Condition 5(b)(i) after the word "Budapest" the words", in the relevant place of presentation";

(G) Condition 6(c) shall be amended by replacing the last sentence thereof with:

"In the case of a partial redemption of Mortgage Bonds, the Mortgage Bonds to be redeemed (**Redeemed Mortgage Bonds**) will be selected individually by lot not more than 30 days prior to the date fixed for redemption. A list of the serial numbers of such Redeemed Mortgage Bonds will be published in accordance with Condition 11 not less than 15 days prior to the date fixed for redemption.";

(H) Condition 6(d) shall be amended by replacing the second paragraph thereof with:

"To exercise the right to require redemption of this Mortgage Bond the Holder of this Mortgage Bond must deliver, at the specified office of any Paying Agent at any time during normal business hours of such Paying Agent falling within the notice period, a duly completed and signed notice of exercise in the form (for the time being current) obtainable from any specified office of any Paying Agent (a **Put Notice**) and in which the holder must specify a bank account (or, if payment is required to be made by cheque, an address) to which payment is to be made under this Condition accompanied by this Mortgage Bond or evidence satisfactory to the Paying Agent concerned that this Mortgage Bond will, following delivery of the Put Notice, be held to its order or under its control. Any Put Notice given by a Holder of any Mortgage Bond pursuant to this paragraph shall be irrevocable except where prior to the due date of redemption, an Event of Default has occurred and is continuing in which event such Holder, at its option, may elect by notice to the Issuer to withdraw the notice given pursuant to this paragraph (d) and instead to declare such Mortgage Bond forthwith due and payable pursuant to Condition 9.";

(I) Condition 6(g) shall be amended by inserting after the words "Mortgage Bonds" in the first sentence:

"(provided that all unmatured Coupons appertaining thereto are purchased therewith)";

(J) Condition 11 shall be amended by

(i) inserting after the word "sent" in the last paragraph: "(together with this Mortgage Bond)"; and

(ii) deleting the end of the sentence from "together with" and replacing it with"."; and

(K) All references to KELER and/or actions to be taken by or in connection with KELER in the Terms and Conditions of the Mortgage Bonds shall be deemed to be deleted.

(f) *Records of KELER*

The records of KELER shall be evidence of the identity of the Securities Account Managers and the number of Mortgage Bonds credited to the securities account of each Securities Account Manager. For these purposes a statement issued by KELER stating:

(i) the name of the Securities Account Manager to which the statement is issued; and

(ii) the aggregate nominal amount of Mortgage Bonds credited to the securities account of the Securities Account Manager as at the close of business on the last day prior to the occurrence of an Exchange Event on which KELER is effecting money and securities transfers,

shall be evidence of the records of KELER.

2. STATUS OF THE MORTGAGE BONDS

The Mortgage Bonds constitute unsubordinated obligations of the Issuer ranking *pari passu* among themselves. The Mortgage Bonds are covered in accordance with Act on Mortgage Loan Credit Institutions and on Mortgage Bonds (*1997. évi XXX. törvény a jelzálog-hitelintézetről és a* *jelzáloglevélről*) and rank *pari passu* with all other covered and unsubordinated present and future obligations of the Issuer under mortgage bonds ("*jelzáloglevelek*").

3. REDENOMINATION

(a) *Redenomination*

Where redenomination is specified in the applicable Final Terms as being applicable, the Issuer may, without the consent of the Holders on giving prior notice to the Agent, the stock exchange(s) on which the Mortgage Bonds may be listed and KELER and at least 30 days' prior notice to the Holders in accordance with Condition 11, elect that, with effect from the Redenomination Date specified in the notice, the Mortgage Bonds shall be redenominated in euro.

The election will have effect as follows:

(i) the Mortgage Bonds shall be deemed to be redenominated in euro in the denomination of euro 0.01 with a nominal amount for each Mortgage Bond equal to the nominal amount of that Mortgage Bond in the Specified Currency, converted into euro at the Established Rate, provided that, if the Issuer determines, with the agreement of the Agent, that the then market practice in respect of the redenomination in euro of internationally offered securities is different from the provisions specified above, such provisions shall be deemed to be amended so as to comply with such market practice and the Issuer shall promptly notify the Holders, the stock exchange (if any) on which the Mortgage Bonds may be listed, KELER and the Paying Agents of such deemed amendments;

(ii) the amount of interest due in respect of the Mortgage Bonds will be calculated by reference to the aggregate nominal amount of Mortgage Bonds credited to the securities account of the relevant Holder and the amount of such payment shall be rounded down to the nearest euro 0.01;

(iii) after the Redenomination Date, all payments in respect of the Mortgage Bonds other than payments of interest in respect of periods commencing before the Redenomination Date, will be made solely in euro as though references in the Mortgage Bonds to the Specified Currency were to euro. Payments will be made in euro by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the Holder;

(iv) if the Mortgage Bonds are Fixed Rate Mortgage Bonds and interest for any period ending on or after the Redenomination Date is required to be calculated for a period ending other than on an Interest Payment Date, it will be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention; and

(v) if the Mortgage Bonds are Floating Rate Mortgage Bonds, the applicable Final Terms will specify any relevant changes to the provisions relating to interest.

(b) *Definitions*

In the Terms and Conditions of the Mortgage Bonds, the following expressions have the following meanings:

Established Rate means the rate for the conversion of the Specified Currency (including compliance with rules relating to roundings in accordance with applicable European Community regulations) into euro established by the Council of the European Union pursuant to Article 123 of the Treaty;

euro means the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty;

Redenomination Date means (in the case of interest bearing Mortgage Bonds) any date for payment of interest under the Mortgage Bonds or (in the case of Zero Coupon Mortgage Bonds) any date, in each case specified by the Issuer in the notice given to the Holders pursuant to paragraph (a) above and which falls on or after the date on which the country of the Specified Currency joins the European economic and monetary union; and

Treaty means the Treaty establishing the European Community, as amended.

4. INTEREST

(a) *Interest on Fixed Rate Mortgage Bonds*

Each Fixed Rate Mortgage Bond bears interest on its outstanding nominal amount (or, if it is a Partly Paid Mortgage Bond, the amount paid up) from (and including) the Interest Commencement Date at the rate(s) per annum equal to the Rate(s) of Interest. As used in the Terms and Conditions of the Mortgage Bonds, **Fixed Interest Period** means the period from (and including) an Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date. Interest will be payable in arrear on the Interest Payment Date(s) in each year up to (and including) the Maturity Date.

If interest is required to be calculated for a period other than a Fixed Interest Period, such interest shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

Except as provided in the applicable Final Terms, the amount of interest payable on each Interest Payment Date in respect of the Fixed Interest Period ending on (but excluding) such date will amount to the Fixed Coupon Amount. Payments of interest on any Interest Payment Date will, if so specified in the applicable Final Terms, amount to the Broken Amount so specified.

Day Count Fraction means, in respect of the calculation of an amount of interest in accordance with this Condition 4(a):

(i) if "Actual/Actual (ICMA)" is specified in the applicable Final Terms:

(A) in the case of Mortgage Bonds where the number of days in the relevant period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (the **Accrual Period**) is equal to or shorter than the Determination Period during which the Accrual Period ends, the number of days in such Accrual Period divided by the product of (1) the number of days in such Determination Period and (2) the number of Determination Dates (as specified in the applicable Final Terms) that would occur in one calendar year; or

(B) in the case of Mortgage Bonds where the Accrual Period is longer than the Determination Period during which the Accrual Period ends, the sum of:

(1) the number of days in the Accrual Period falling in the Determination Period in which the Accrual Period begins divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and

(2) the number of days in the Accrual Period falling in the next Determination Period divided by the product of (x) the number of days in such Determination Period and (y) the number of Determination Dates that would occur in one calendar year; and

(ii) if "30/360" is specified in the applicable Final Terms, the number of days in the period from (and including) the most recent Interest Payment Date (or, if none, the Interest Commencement Date) to (but excluding) the relevant payment date (such number of days being calculated on the basis of a year of 360 days with 12 30-day months) divided by 360.

In the Terms and Conditions of the Mortgage Bonds:

Determination Period means each period from (and including) a Determination Date to (but excluding) the next Determination Date (including, where either the Interest Commencement Date or the final Interest Payment Date is not a Determination Date, the period commencing on the first Determination Date prior to, and ending on the first Determination Date falling after, such date); and

sub-unit means, with respect to any currency other than euro, the lowest amount of such currency that is available as legal tender in the country of such currency (in Hungary, one Forint) and, with respect to euro, one cent.

(b) *Interest on Floating Rate Mortgage Bonds and Index Linked Interest Mortgage Bonds*

(i) *Interest Payment Dates*

Each Floating Rate Mortgage Bond and Index Linked Interest Mortgage Bond bears interest on its outstanding nominal amount (or, if it is a Partly Paid Mortgage Bond, the amount paid up) from (and including) the Interest Commencement Date and such interest will be payable in arrear on either:

(A) the Specified Interest Payment Date(s) in each year specified in the applicable Final Terms; or

(B) if no Specified Interest Payment Date(s) is/are specified in the applicable Final Terms, each date (each such date, together with each Specified Interest Payment Date, an **Interest Payment Date**) which falls the number of months or other period specified as the Specified Period in the applicable Final Terms after the preceding Interest Payment Date or, in the case of the first Interest Payment Date, after the Interest Commencement Date.

Such interest will be payable in respect of each Interest Period (which expression shall, in the Terms and Conditions of the Mortgage Bonds, mean the period from (and including) an

Interest Payment Date (or the Interest Commencement Date) to (but excluding) the next (or first) Interest Payment Date).

If a Business Day Convention is specified in the applicable Final Terms and (x) if there is no numerically corresponding day in the calendar month in which an Interest Payment Date should occur or (y) if any Interest Payment Date would otherwise fall on a day which is not a Business Day, then, if the Business Day Convention specified is:

(1) in any case where Specified Periods are specified in accordance with Condition 4(b)(i)(B) above, the Floating Rate Convention, such Interest Payment Date (i) in the case of (x) above, shall be the last day that is a Business Day in the relevant month and the provisions of (B) below shall apply *mutatis mutandis* or (ii) in the case of (y) above, shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event (A) such Interest Payment Date shall be brought forward to the immediately preceding Business Day and (B) each subsequent Interest Payment Date shall be the last Business Day in the month which falls the Specified Period after the preceding applicable Interest Payment Date occurred; or

(2) the Following Business Day Convention, such Interest Payment Date shall be postponed to the next day which is a Business Day; or

(3) the Modified Following Business Day Convention, such Interest Payment Date shall be postponed to the next day which is a Business Day unless it would thereby fall into the next calendar month, in which event such Interest Payment Date shall be brought forward to the immediately preceding Business Day; or

(4) the Preceding Business Day Convention, such Interest Payment Date shall be brought forward to the immediately preceding Business Day.

In the Terms and Conditions of the Mortgage Bonds, **Business Day** means any day which is:

(A) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in London, Budapest and any Additional Business Centre specified in the applicable Final Terms; and

(B) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than Budapest and any Additional Business Centre) and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Melbourne and Wellington, respectively, or (2) in relation to any sum payable in euro, a day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System (the **TARGET System**) is open; and

(C) a day on which KELER and Clearstream, Luxembourg are effecting money and securities transfers.

(ii) *Rate of Interest*

The Rate of Interest payable from time to time in respect of Floating Rate Mortgage Bonds and Index Linked Interest Mortgage Bonds will be determined in the manner specified in the applicable Final Terms.

(A) *ISDA Determination for Floating Rate Mortgage Bonds*

Where ISDA Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will be the relevant ISDA Rate plus or minus (as indicated in the applicable Final Terms) the Margin (if any). For the purposes of this sub-paragraph (A), **ISDA Rate** for an Interest Period means a rate equal to the Floating Rate that would be determined by the Agent under an interest rate swap transaction if the Agent were acting as Calculation Agent for that swap transaction under the terms of an agreement incorporating the 2000 ISDA Definitions, as published by the International Swaps and Derivatives Association, Inc. and as amended and updated as at the Issue Date of the first Series/Tranche of the Mortgage Bonds (the **ISDA Definitions**) and under which:

(1) the Floating Rate Option is as specified in the applicable Final Terms;

(2) the Designated Maturity is a period specified in the applicable Final Terms; and

(3) the relevant Reset Date is either (i) if the applicable Floating Rate Option is based on the Budapest inter-bank offered rate (**BUBOR**) or the London inter-bank offered rate (**LIBOR**) or on the Euro-zone inter-bank offered rate (**EURIBOR**), the first day of that Interest Period or (ii) in any other case, as specified in the applicable Final Terms.

For the purposes of this sub-paragraph (A), **Floating Rate**, **Calculation Agent**, **Floating Rate Option**, **Designated Maturity** and **Reset Date** have the meanings given to those terms in the ISDA Definitions.

(B) *Screen Rate Determination for Floating Rate Mortgage Bonds*

Where Screen Rate Determination is specified in the applicable Final Terms as the manner in which the Rate of Interest is to be determined, the Rate of Interest for each Interest Period will, subject as provided below, be either:

(1) the offered quotation; or

(2) the arithmetic mean (rounded if necessary to the fifth decimal place, with 0.000005 being rounded upwards or if the Reference Rate is EURIBOR rounded if necessary to the third decimal place with 0.0005 being rounded upwards) of the offered quotations,

(expressed as a percentage rate per annum) for the Reference Rate which appears or appear, as the case may be, on the Relevant Screen Page as at 11.00 a.m. (London time, in the case of LIBOR, or Brussels time in the case of EURIBOR) or 12.30 p.m. (Budapest time in the case of BUBOR) on the Interest Determination Date in question plus or minus (as indicated in the applicable Final Terms) the Margin (if any), all as determined by the Agent. If five or more of such offered quotations are available on the Relevant Screen Page, the highest (or, if there is more than one such highest quotation, one only of such quotations) and the lowest (or, if there is more than one such lowest quotation, one only of such quotations) shall be disregarded by the Agent for the purpose of determining the arithmetic mean (rounded as provided above) of such offered quotations.

The Agency Agreement contains provisions for determining the Rate of Interest in the event that the Relevant Screen Page is not available or if, in the case of (1) above, no such offered quotation appears or, in the case of (2) above, fewer than three such offered quotations appear, in each case as at the time specified in the preceding paragraph.

If the Reference Rate from time to time in respect of Floating Rate Mortgage Bonds is specified in the applicable Final Terms as being other than BUBOR, LIBOR or EURIBOR, the Rate of Interest in respect of such Mortgage Bonds will be determined as provided in the applicable Final Terms.

(iii) *Minimum Rate of Interest and/or Maximum Rate of Interest*

If the applicable Final Terms specifies a Minimum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is less than such Minimum Rate of Interest, the Rate of Interest for such Interest Period shall be such Minimum Rate of Interest.

If the applicable Final Terms specifies a Maximum Rate of Interest for any Interest Period, then, in the event that the Rate of Interest in respect of such Interest Period determined in accordance with the provisions of paragraph (ii) above is greater than such Maximum Rate of Interest, the Rate of Interest for such Interest Period shall be such Maximum Rate of Interest.

(iv) *Determination of Rate of Interest and calculation of Interest Amounts*

The Agent, in the case of Floating Rate Mortgage Bonds, and the Calculation Agent, in the case of Index Linked Interest Mortgage Bonds will at or as soon as practicable after each time at which the Rate of Interest is to be determined, determine the Rate of Interest for the relevant Interest Period. In the case of Index Linked Interest Mortgage Bonds, the Calculation Agent will notify the Agent of the Rate of Interest for the relevant Interest Period as soon as practicable after calculating the same.

The Agent will calculate the amount of interest (the **Interest Amount**) payable on the Floating Rate Mortgage Bonds or Index Linked Interest Mortgage Bonds in respect of each Specified Denomination for the relevant Interest Period. Each Interest Amount shall be calculated by applying the Rate of Interest to each Specified Denomination, multiplying such sum by the applicable Day Count Fraction, and rounding the resultant figure to the nearest sub-unit of the relevant Specified Currency, half of any such sub-unit being rounded upwards or otherwise in accordance with applicable market convention.

Day Count Fraction means, in respect of the calculation of an amount of interest in accordance with this Condition 4(b):

(A) if "Actual/365" or "Actual/Actual" is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 (or, if any portion of that Interest Period falls in a leap year, the sum of (A) the actual number of days in that portion of the Interest Period falling in a leap year divided by 366 and (B) the actual number of days in that portion of the Interest Period falling in a non-leap year divided by 365);

(B) if "Actual/365 (Fixed)" is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365;

(C) if "Actual/365 (ÁKK)" is specified in the applicable Final Terms, the actual number of days (except the 29th day of February in a leap year, if applicable) in the Interest Period divided by 365;

(D) if "Actual/365 (Sterling)" is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 365 or, in the case of an Interest Payment Date falling in a leap year, 366;

(E) if "Actual/360" is specified in the applicable Final Terms, the actual number of days in the Interest Period divided by 360;

(F) if "30/360", "360/360" or "Bond Basis" is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months (unless (a) the last day of the Interest Period is the 31st day of a month but the first day of the Interest Period is a day other than the 30th or 31st day of a month, in which case the month that includes that last day shall not be considered to be shortened to a 30-day month, or (b) the last day of the Interest Period is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month)); and

(G) if "30E/360" or "Eurobond Basis" is specified in the applicable Final Terms, the number of days in the Interest Period divided by 360 (the number of days to be calculated on the basis of a year of 360 days with 12 30-day months, without regard to the date of the first day or last day of the Interest Period unless, in the case of the final Interest Period, the Maturity Date is the last day of the month of February, in which case the month of February shall not be considered to be lengthened to a 30-day month).

(v) *Notification of Rate of Interest and Interest Amounts*

The Agent, or (if applicable) the Calculation Agent, will cause the Rate of Interest and each Interest Amount for each Interest Period and the relevant Interest Payment Date to be notified to the Issuer, KELER, the relevant regulatory authority and any stock exchange on which the relevant Floating Rate Mortgage Bonds or Index Linked Interest Mortgage Bonds are for the time being listed and notice thereof to be published in accordance with Condition 11 as soon as possible after their determination but in no event later than the fourth Business Day thereafter. Each Interest Amount and Interest Payment Date so notified may subsequently be amended (or appropriate alternative arrangements made by way of adjustment) without prior notice in the event of an extension or shortening of the Interest Period. Any such amendment will be promptly notified to the Issuer, KELER, the relevant regulatory authority and each stock exchange on which the relevant Floating Rate Mortgage Bonds or Index Linked Interest Mortgage Bonds are for the time being listed and to the Holders in accordance with Condition 11.

(vi) *Certificates to be final*

All certificates, communications, opinions, determinations, calculations, quotations and decisions given, expressed, made or obtained for the purposes of the provisions of this Condition 4(b) whether by the Agent or, if applicable, the Calculation Agent shall (in the absence of wilful default, bad faith or manifest error) be binding on the Issuer, the Agent, the Calculation Agent (if applicable), the other Paying Agents and all Holders and (in the absence as aforesaid) no liability to the Issuer and the Holders shall attach to the Agent or, if applicable, the Calculation Agent in connection with the exercise or non-exercise by it of its powers, duties and discretions pursuant to such provisions.

(c) *Interest on Dual Currency Interest Mortgage Bonds*

The rate or amount of interest payable in respect of Dual Currency Interest Mortgage Bonds shall be determined in the manner specified in the applicable Final Terms.

(d) *Interest on Partly Paid Mortgage Bonds*

In the case of Partly Paid Mortgage Bonds (other than Partly Paid Mortgage Bonds which are Zero Coupon Mortgage Bonds), interest will accrue as aforesaid on the paid-up nominal amount of such Mortgage Bonds and otherwise as specified in the applicable Final Terms.

(e) *Accrual of interest*

Each Mortgage Bond (or in the case of the redemption of part only of a Mortgage Bond, that part only of such Mortgage Bond) will cease to bear interest (if any) from the date for its redemption unless payment of principal is improperly withheld or refused or unless default is otherwise made in respect of payment. In such event, interest will continue to accrue at a level specified under Section 301(2) of Act IV of 1959 on the Civil Code (*1959. évi IV. törvény a Polgári Törvénykönyvről*) (the ***Civil Code***) until whichever is the earlier of:

(i) the date on which all amounts due in respect of such Mortgage Bond have been paid; and

(ii) five days after the date on which the full amount of the moneys payable in respect of such Mortgage Bond has been received by the Agent and notice to that effect has been given to the Holders in accordance with Condition 11.

5. PAYMENTS

(a) *Method of payment*

Payments in respect of the Mortgage Bonds shall be made through the Agent and the other Paying Agents in accordance with the rules and regulations of KELER as effective from time to time, and taking into consideration the relevant laws on taxation, to those Securities Account Managers to whose securities account at KELER such Mortgage Bonds are credited at close of business on the Reference Date (as defined below) for that payment, as designated in the regulations of KELER effective from time to time. Pursuant to current rules and regulations of KELER, the Reference Date is the day falling three Business Days immediately prior to the relevant Interest Payment Date (the **Reference Date**). Payment shall be due to that person who is deemed to be the Holder on the Reference Date.

(b) *Payment Day*

If the date for payment of any amount in respect of any Mortgage Bond is not a Payment Day (as defined below), the Holder thereof shall not be entitled to payment until the next following Payment Day in the relevant place and shall not be entitled to further interest or other payment in respect of such delay. For these purposes, **Payment Day** means any day which is:

(i) a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in Budapest and any Additional Financial Centre specified in the applicable Final Terms; and

(ii) either (1) in relation to any sum payable in a Specified Currency other than euro, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in the principal financial centre of the country of the relevant Specified Currency (if other than Budapest and any Additional Financial Centre and which if the Specified Currency is Australian dollars or New Zealand dollars shall be Melbourne and Wellington, respectively) or (2) in relation to any sum payable in euro, a day on which the TARGET System is open; and

(iii) a day on which KELER and Clearstream, Luxembourg are effecting money and securities transfers.

(c) *Interpretation of principal and interest*

Any reference in the Terms and Conditions of the Mortgage Bonds to principal in respect of the Mortgage Bonds shall be deemed to include, as applicable:

(i) any additional amounts which may be payable with respect to principal under Condition 7;

(ii) the Final Redemption Amount of the Mortgage Bonds;

(iii) the Early Redemption Amount of the Mortgage Bonds;

(iv) the Optional Redemption Amount(s) (if any) of the Mortgage Bonds;

(v) in relation to Zero Coupon Mortgage Bonds, the Amortised Face Amount (as defined below); and

(vi) any premium and any other amounts (other than interest) which may be payable by the Issuer under or in respect of the Mortgage Bonds.

Any reference in the Terms and Conditions of the Mortgage Bonds to interest in respect of the Mortgage Bonds shall be deemed to include, as applicable, any additional amounts which may be payable with respect to interest under Condition 7.

Amortised Face Amount shall be calculated in accordance with the following formula:

$$\mathrm{RP} \times (1 + \mathrm{AY})^{\mathrm{y}}$$

where:

RP means the Reference Price;

AY means the Accrual Yield expressed as a decimal; and

""*y* is a fraction the numerator of which is equal to the number of days (calculated on the basis of a 360-day year consisting of 12 months of 30 days each) from (and including) the Issue Date of the first Tranche of the Mortgage Bonds to (but excluding) the date fixed for redemption or (as the case may be) the date upon which such Mortgage Bond becomes due and repayable and the denominator of which is 360,

or on such other calculation basis as may be specified in the applicable Final Terms.

(d) *General provisions applicable to payments*

The Holders shall be the only persons entitled to receive payments in respect of Mortgage Bonds and the Issuer will be discharged by payment to, or to the order of, the Holders in respect of each amount so paid. Each of the persons shown in the records of Clearstream, Luxembourg or KELER as the beneficial holder of a particular nominal amount of Mortgage Bonds must look solely to Clearstream, Luxembourg or KELER, as the case may be, for his share of each payment so made by the Issuer to, or to the order of, the Holders.

Notwithstanding the foregoing provisions of this Condition, if any amount of principal and/or interest in respect of Mortgage Bonds is payable in U.S. dollars, such U.S. dollar payments of principal and/or interest in respect of such Mortgage Bonds will be made at the specified office of a Paying Agent in the United States if:

(i) the Issuer has appointed Paying Agents with specified offices outside the United States with the reasonable expectation that such Paying Agents would be able to make payment in U.S. dollars at such specified offices outside the United States of the full amount of principal and interest on the Mortgage Bonds in the manner provided above when due;

(ii) payment of the full amount of such principal and interest at all such specified offices outside the United States is illegal or effectively precluded by exchange controls or other similar restrictions on the full payment or receipt of principal and interest in U.S. dollars; and

(iii) such payment is then permitted under United States law without involving, in the opinion of the Issuer, adverse tax consequences to the Issuer.

6. REDEMPTION AND PURCHASE

(a) *Redemption at maturity*

Unless previously redeemed or purchased and cancelled as specified below, each Mortgage Bond (including each Index Linked Redemption Mortgage Bond and Dual Currency Redemption Mortgage Bond) will be redeemed by the Issuer at its Final Redemption Amount specified in, or determined in the manner specified in, the applicable Final Terms in the relevant Specified Currency on the Maturity Date.

(b) *Redemption for tax reasons*

The Mortgage Bonds may be redeemed at the option of the Issuer in whole, but not in part, at any time (if this Mortgage Bond is neither a Floating Rate Mortgage Bond, an Index Linked Interest Mortgage Bond nor a Dual Currency Interest Mortgage Bond) or on any Interest Payment Date (if this Mortgage Bond is either a Floating Rate Mortgage Bond, an Index Linked Interest Mortgage Bond or a Dual Currency Interest Mortgage Bond), on giving not less than 30 nor more than 60 days' notice to the Agent and, in accordance with Condition 11, to the Holders (which notice shall be irrevocable), if:

(i) on the occasion of the next payment due under the Mortgage Bonds, the Issuer has or will become obliged to pay additional amounts as provided or referred to in Condition 7 as a result of any change in, or amendment to, the laws or regulations of a Tax Jurisdiction (as defined in Condition 7) or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective on or after the date on which agreement is reached to issue the first Tranche of the Mortgage Bonds; and

(ii) such obligation cannot be avoided by the Issuer taking reasonable measures available to it,

provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be obliged to pay such additional amounts were a payment in respect of the Mortgage Bonds then due.

Prior to the publication of any notice of redemption pursuant to this Condition, the Issuer shall deliver to the Agent a certificate signed by two members of the board of directors of the Issuer stating that the Issuer is entitled to effect such redemption and setting forth a statement of facts showing that the conditions precedent to the right of the Issuer so to redeem have occurred, and an opinion of independent legal advisers of recognised standing to the effect that the Issuer has or will become obliged to pay such additional amounts as a result of such change or amendment.

Mortgage Bonds redeemed pursuant to this Condition 6(b) will be redeemed at their Early Redemption Amount referred to in Condition 6(e) below together (if appropriate) with interest accrued to (but excluding) the date of redemption.

(c) *Redemption at the option of the Issuer (Issuer Call)*

If Issuer Call is specified in the applicable Final Terms, the Issuer may, having given:

(i) not less than 15 nor more than 30 days' notice to the Holders in accordance with Condition 11; and

(ii) not less than 15 days before the giving of the notice referred to in (i), notice to the Agent;

(which notices shall be irrevocable and shall specify the date fixed for redemption), redeem all or some only of the Mortgage Bonds then outstanding on any Optional Redemption Date and at the Optional Redemption Amount(s) specified in, or determined in the manner specified in, the applicable Final Terms together, if appropriate, with interest accrued to (but excluding) the relevant Optional Redemption Date. Any such redemption must be of a nominal amount not less than the Minimum Redemption Amount and not more than the Maximum Redemption Amount, in each case as may be specified in the applicable Final Terms. In the case of a partial redemption of Mortgage Bonds, the Mortgage Bonds to be redeemed will be selected in accordance with the rules of KELER and the applicable Final Terms not more than 30 days prior to the date fixed for redemption.

(d) *Redemption at the option of the Holders (Investor Put)*

If Investor Put is specified in the applicable Final Terms, upon the Holder of any Mortgage Bond giving to the Issuer in accordance with Condition 11 not less than 15 nor more than 30 days' notice the Issuer will, upon the expiry of such notice, redeem, subject to, and in accordance with, the terms specified in the applicable Final Terms, such Mortgage Bond on the Optional Redemption Date and at the Optional Redemption Amount together, if appropriate, with interest accrued to (but excluding) the Optional Redemption Date.

To exercise the right to require redemption of this Mortgage Bond the holder of this Mortgage Bond must deliver, within the notice period, at the specified office of any Paying Agent at any time during normal business hours of such Paying Agent both an ownership certificate issued by KELER or the relevant Securities Account Manager (which document certifies, in addition to the title of the Holder, that the Mortgage Bonds are held on an account blocked for the benefit of the Issuer) and a duly completed and signed notice of exercise in the form (for the time being current) obtainable from any specified office of any Paying Agent (a **Put Notice**). With respect to Mortgage Bonds credited to Clearstream, Luxembourg's securities account at KELER, to exercise the right to require redemption of the relevant Mortgage Bonds the Holder must, within the notice period, give notice to the Agent of such exercise in accordance with the standard procedures of Clearstream, Luxembourg (which may include notice being given on his instruction by Clearstream, Luxembourg to the Agent by electronic means) in a form acceptable to Clearstream, Luxembourg from time to time. Any Put Notice given by a Holder of any Mortgage Bond pursuant to this paragraph shall be irrevocable except where prior to the due date of redemption, an Event of Default has occurred and is continuing in which event such Holder, at its option, may elect by notice to the Issuer to withdraw the notice given pursuant to this paragraph (d) and instead to declare such Mortgage Bond forthwith due and payable pursuant to Condition 9.

(e) *Early Redemption Amounts*

For the purpose of paragraph (b) above and Condition 9, each Mortgage Bond will be redeemed at its Early Redemption Amount calculated as follows:

(i) in the case of a Mortgage Bond with a Final Redemption Amount equal to the Issue Price, at the Final Redemption Amount thereof;

(ii) in the case of a Mortgage Bond (other than a Zero Coupon Mortgage Bond and a Partly Paid Mortgage Bond) with a Final Redemption Amount which is or may be less or greater than the Issue Price or which is payable in a Specified Currency other than that in which the Mortgage Bond is denominated, at the amount specified in, or determined in the manner specified in, the applicable Final Terms or, if no such amount or manner is so specified in the applicable Final Terms, at its nominal amount; or

(iii) in the case of a Zero Coupon Mortgage Bond, at its Amortised Face Amount set out in Condition 5(c).

(f) *Partly Paid Mortgage Bonds*

Partly Paid Mortgage Bonds will be redeemed, whether at maturity, early redemption or otherwise, in accordance with the provisions of this Condition and the applicable Final Terms.

(g) *Purchases*

The Issuer may at any time purchase Mortgage Bonds at any price in the open market or otherwise. If purchases are made by tender, tenders must be available to all Holders alike.

(h) *Cancellation*

All Mortgage Bonds which are redeemed or purchased by the Issuer will forthwith be cancelled. All Mortgage Bonds so cancelled cannot be reissued or resold.

(i) *Late payment on Zero Coupon Mortgage Bonds*

If the amount payable in respect of any Zero Coupon Mortgage Bond upon redemption of such Zero Coupon Mortgage Bond pursuant to paragraph (a), (b), (c) or (d) above or upon its becoming due and repayable as provided in Condition 9 is improperly withheld or refused, the amount due and repayable in respect of such Zero Coupon Mortgage Bond shall be the amount calculated as provided in paragraph 5(c) above as though the references therein to the date fixed for the redemption or the date upon which such Zero Coupon Mortgage Bond becomes due and payable were replaced by references to the date which is the earlier of:

(i) the date on which all amounts due in respect of such Zero Coupon Mortgage Bond have been paid; and

(ii) five days after the date on which the full amount of the moneys payable in respect of such Zero Coupon Mortgage Bonds has been received by the Agent and notice to that effect has been given to the Holders in accordance with Condition 11;

and the Accrual Yield were increased by the default interest specified under Section 301(1) of the Civil Code.

7. TAXATION

All payments of principal and interest in respect of the Mortgage Bonds by the Issuer will be made without withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by or on behalf of any Tax Jurisdiction unless such withholding or deduction is required by law. In such event, the Issuer will pay such additional amounts as shall be necessary in order that the net amounts received by the Holders after such withholding or deduction shall equal the respective amounts of principal and/or interest which would otherwise have been receivable in respect of the Mortgage Bonds, in the absence of such withholding or deduction; except that no such additional amounts shall be payable with respect to any Mortgage Bonds:

(a) presented for payment by or on behalf of a Holder who is liable for such taxes or duties in respect of such Mortgage Bond by reason of his having some connection with a Tax Jurisdiction other than the mere holding of such Mortgage Bond; or

(b) presented for payment by, or by a third party on behalf of, a Holder who could lawfully avoid (but has not so avoided) such deduction or withholding by it complying, or procuring (if it is in the relevant Holder's control) that any third party complies, with any statutory requirements or by it making, or procuring (if it is in the relevant Holder's control) that any third party makes, a declaration of non-residence or other similar claim for exemption to any tax authority in the relevant place; or

(c) presented for payment more than 30 days after the Relevant Date (as defined below) except to the extent that the Holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day assuming that day to have been a Payment Day (as defined in Condition 5(b)); or

(d) where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive; or

(e) presented for payment by or on behalf of a Holder who would be able to avoid such withholding or deduction by presenting the relevant Mortgage Bond to another Paying Agent in a Member State of the European Union.

As used herein:

(i) **Tax Jurisdiction** means the Republic of Hungary or any political subdivision or any authority thereof or therein having power to tax; and

(ii) the **Relevant Date** means the date on which such payment first becomes due, except that, if the full amount of the moneys payable has not been duly received by the Agent on or prior to such due date, it means the date on which, the full amount of such moneys having been so received, notice to that effect is duly given to the Holders in accordance with Condition 11.

8. PRESCRIPTION

Claims against the Issuer for payment under the Mortgage Bonds may not be prescribed unless otherwise permitted by Hungarian law.

9. EVENTS OF DEFAULT

(a) *Events of Default relating to Mortgage Bonds*

If any one or more of the following events (each an **Event of Default**) shall occur and be continuing with respect to any Mortgage Bond (any reference to **Mortgage Bond** and **Mortgage Bonds** shall be construed accordingly):

(i) the Issuer fails to make payment of any principal or interest due in respect of the Mortgage Bonds and such failure to pay continues for a period of 15 days; or

(ii) the Issuer defaults in the performance or observance of or compliance with any other obligation on its part under the Mortgage Bonds and such default continues for a period of 30 days after written notice of such default shall have been given to the Issuer by a Holder; or

(iii) any order is made by a competent court in respect of the commencement of bankruptcy or insolvency proceedings against the Issuer, or the Issuer makes a general arrangement for the benefit of some or all of its creditors; or

(iv) any order is made or an effective resolution is passed for the winding up of the Issuer; or

(v) the repayment of any Indebtedness for Borrowed Money (as defined in Condition 9(b)) owing by the Issuer is accelerated by reason of default (howsoever defined) and such acceleration has not been rescinded or annulled, or the Issuer defaults (after whichever is the longer of any originally applicable period of grace and 14 days after the due date) in any payment of any Indebtedness for Borrowed Money or in the honouring of any guarantee or indemnity in respect of any Indebtedness for Borrowed Money, provided that no such event referred to in this sub-paragraph (v) shall constitute an Event of Default unless the Indebtedness for Borrowed Money whether alone or when aggregated with other Indebtedness for Borrowed Money relating to all (if any) other such events which shall have occurred shall exceed EUR25,000,000 (or its equivalent in any other currency or currencies); or

(vi) the Issuer becomes subject to any special supervisory authority of the Hungarian Financial Supervisory Authority pursuant to Section 157(1) or 163 of Act CXII of 1996 on credit institutions and financial enterprises (*1996. évi CXII. törvény a hitelintézetekről és pénzügyi vállalkozásokról)*, then any Holder may, by written notice to the Issuer at the specified office of the Agent, effective upon the date of receipt thereof by the Agent, declare any Mortgage Bond held by the Holder to be forthwith due and payable whereupon the same shall become forthwith due and payable at the Early Redemption Amount (as described in Condition 6(e)), together with the accrued interest (if any) to the date of repayment, without presentment, demand, protest or other notice of any kind. Pursuant to the relevant provisions of Act XXX of 1997 on Mortgage Loan Credit Institutions and Mortgage Bonds, in the event of the transformation, restructuring or liquidation of the Issuer, the Issuer may transfer its obligations arising from the Mortgage Bonds, together with the relevant asset cover, to another mortgage loan credit institution. This transfer is subject to the prior approval of the Hungarian Financial Supervisory Authority and the agreement of the transferee mortgage loan credit institution but is not subject to the consent of the Holders. As part of the transfer the Mortgage Bonds will be cancelled and the transferee mortgage loan credit institution will issue its mortgage bonds (the **New Mortgage Bonds**) to the Holders on the same terms and conditions as those of the Mortgage Bonds. In the case of such transfer by the Issuer, a Holder will not be able to declare a Mortgage Bond held by it to be due and payable pursuant to this Condition 9(a), although this will not prejudice any rights a Holder may have under the New Mortgage Bonds.

(b) *Definitions*

For the purposes of this Condition 9:

Indebtedness for Borrowed Money means, any present or future indebtedness for or in respect of: (i) money borrowed; or (ii) any notes, bonds, mortgage bonds or other debt securities offered, issued or distributed whether by way of public offer, private placement, acquisition consideration or otherwise and whether issued in cash or in whole or in part for consideration other than cash.

10. PAYING AGENTS

The names of the initial Paying Agents and their initial specified offices are set out below.

The Issuer is entitled to vary or terminate the appointment of any Paying Agent and/or appoint additional or other Paying Agents and/or approve any change in the specified office through which any Paying Agent acts, provided that:

(a) there will at all times be an Agent which is tax resident in Germany or the United Kingdom;

(b) so long as the Mortgage Bonds are listed on any stock exchange or admitted to listing by any other relevant authority, there will at all times be a Paying Agent, which may be the Agent, with a specified office in such place as may be required by the rules and regulations of the relevant stock exchange or other relevant authority; and

(c) the Issuer undertakes that it will ensure that it maintains a Paying Agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any law implementing or complying with, or introduced in order to conform to, such Directive.

In addition, the Issuer shall forthwith appoint a Paying Agent having a specified office in New York City in the circumstances described in Condition 5(d). Any variation, termination, appointment or change shall only take effect (other than in the case of insolvency, when it shall be of immediate effect) after not less than 30 nor more than 45 days' prior notice thereof shall have been given to the Holders in accordance with Condition 11.

In acting under the Agency Agreement, the Paying Agents act solely as agents of the Issuer and do not assume any obligation to, or relationship of agency or trust with, any Holders. The Agency

Agreement contains provisions permitting any entity into which any Paying Agent is merged or converted or with which it is consolidated or to which it transfers all or substantially all of its assets to become the successor paying agent.

11. NOTICES

All notices regarding the Mortgage Bonds will be deemed to be validly given if published in a leading English language daily newspaper of general circulation in London, and, for so long as the Mortgage Bonds are listed on the Luxembourg Stock Exchange, in a daily newspaper of general circulation in Luxembourg. It is expected that such publication will be made in the *Financial Times* in London and in the *d'Wort* or the *Tageblatt* in Luxembourg. So long as the Mortgage Bonds are listed on the Luxembourg Stock Exchange, the Issuer will also request that notices to holders of the Mortgage Bonds be published on the website of the Luxembourg Stock Exchange. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules of any the relevant stock exchange or other relevant regulatory authority. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers, and, in the case of publication on the website of the Luxembourg Stock Exchange, on the date of such publication.

Notices to be given by any Holder shall be in writing and sent to the Agent, together with evidence satisfactory to the Agent of ownership which may include certification to this effect by KELER.

12. FURTHER ISSUES

The Issuer shall be at liberty from time to time without the consent of the Holders to issue further mortgage bonds having terms and conditions the same as the Mortgage Bonds or the same in all respects save for the amount and date of the first payment of interest thereon and so that the same shall be consolidated and form a single Series with the outstanding Mortgage Bonds.

13. GOVERNING LAW, SUBMISSION TO JURISDICTION AND WAIVER OF SOVEREIGN IMMUNITY

(a) *Governing law*

The Mortgage Bonds are governed by, and shall be construed in accordance with, Hungarian law.

(b) *Submission to jurisdiction*

The Issuer and the Holders agree to subject any disputes which may arise out of or in connection with the Mortgage Bonds, the issue thereof or any document created in connection with such issue (the ***Disputes***), except cases specified under Section 207 of the Capital Markets Act, to the exclusive jurisdiction of the Money and Capital Markets Arbitration Court defined under Section 376 of the Capital Markets Act. The Money and Capital Markets Arbitration Court shall proceed in accordance with its own rules of procedure provided that the arbitration proceedings shall be conducted in the English language.

(c) *Waiver of sovereign immunity*

The Issuer hereby irrevocably and unconditionally waives with respect to the Mortgage Bonds any right to claim sovereign or other immunity from jurisdiction or execution and any similar defence and irrevocably and unconditionally consents to the giving of any relief or the issue of any process, including without limitation, the making, enforcement or execution against any property whatsoever (irrespective of its use or intended use) of any order or judgment made or given in connection with any Disputes.

14. MEETING OF HOLDERS AND MODIFICATION

The Agency Agreement contains provisions for convening meetings of the Holders to consider any matter, including the sanctioning by Extraordinary Resolution of a modification of the Mortgage Bonds, or any of the provisions of the Agency Agreement. Such a meeting may be convened by the Issuer and shall be convened by the Issuer if required in writing by Holders holding not less than ten per cent. in nominal amount of the Mortgage Bonds for the time being outstanding. The quorum at any such meeting for passing an Extraordinary Resolution is one or more persons holding or representing not less than 50 per cent. in nominal amount of the Mortgage Bonds for the time being outstanding, or at any adjourned meeting one or more persons being or representing Holders whatever the nominal amount of the Mortgage Bonds so held or represented, except that at any meeting the business of which included the modification of certain provisions of the Mortgage Bonds (including modifying the date of maturity of the Mortgage Bonds or any date for payment of interest thereon, reducing or cancelling the amount of principal or the rate of interest payable in respect of the Mortgage Bonds or altering the currency of payment of the Mortgage Bonds), the quorum shall be one or more persons holding or representing not less than two-thirds in nominal amount of the Mortgage Bonds for the time being outstanding, or at any adjourned such meeting one or more persons holding or representing not less than one-third in nominal amount of the Mortgage Bonds for the time being outstanding. An Extraordinary Resolution passed at any meeting of the Holders shall be binding on all the Holders, whether or not they are present at the meeting.

The Agent and the Issuer may agree, without the consent of the Holders, to:

(a) any modification (except as mentioned above) of the Mortgage Bonds or the Agency Agreement which, in the sole opinion of the Issuer, is not prejudicial to the interests of the Holders; or

(b) any modification of the Mortgage Bonds, or the Agency Agreement which is of a formal, minor or technical nature or is made to correct a manifest or proven error or to comply with mandatory provisions of the law.

Any such modification shall be binding on the Holders and any such modification shall be notified to the Holders in accordance with Condition 11 as soon as practicable thereafter.

15. LANGUAGE

These Terms and Conditions of the Mortgage Bonds are in the English language. A Hungarian language translation of these Terms and Conditions has been deposited with KELER in accordance with its rules and regulations. The English language version of these Terms and Conditions of the Mortgage Bonds and the applicable Final Terms in the English language shall be legally binding.

USE OF PROCEEDS

The net proceeds from each issue of Mortgage Bonds will be applied by the Issuer for the financing of its mortgage loan business. If in respect of any particular issue, there is a particular identified use of proceeds, this will be stated in the applicable Final Terms.

DESCRIPTION OF THE ISSUER

History and development of the Issuer

FHB Land Credit and Mortgage Bank Ltd. (*FHB Földhitel- és Jelzálogbank Részvénytársaság*) (the **Bank**, the **Issuer** or **FHB**) was established on 21 October 1997 and registered in Hungary by the Court of Registration of the Budapest Metropolitan Court under Cg. 01-10-043638 on 18 March 1998. Its registered address is Váci út 20., 1132 Budapest; telephone: +36 1 452 9100. FHB operates exclusively in Hungary as a specialist credit institution. It has ten local sales units through which it develops business directly with borrowers and it also establishes relationships from its head office with the main Hungarian commercial banks from whom it purchases mortgages (independent lien, in Hungarian "*önálló zálogjog*").

Due to the specific conditions in the Hungarian mortgage banking market, including government policies specifically designed to stimulate the sector in recent years, the Issuer's business and balance sheets have expanded materially since its establishment in 1997. Total assets have risen from 4.8 billion Hungarian forints at year-end 1998 to approximately 467.9 billion Hungarian forints as at 30 September 2005 according to IFRS. On establishment in 1997, the Issuer had 75 employees whereas as at 30 September, 2005 the figure was 281 (on a consolidated basis).

The Issuer's business

The Issuer's mission is to increase shareholder value by operating on a prudent, sound and profitable basis as a significant participant in the Hungarian mortgage lending market and as a recognised issuer in both the domestic and international capital markets.

Under Act XXX of 1997 on Mortgage Credit Institutions and Mortgage Bonds (the **Mortgage Credit Institution Act**), the Issuer's business is restricted to extending mortgage loans, the appraisal of collateral value and management of real estate used to secure mortgage loans and the provision of custody and administrative services in connection with its own securities issues and other ancillary activities. It may not take deposits and its investment in real estate (except for operating premises) may not exceed five per cent. of its share capital. The Issuer itself is the operating entity which directly holds all the loan assets or independent liens and issues the mortgage bonds.

The Issuer's objectives are:

- to provide long-term housing loans to the widest possible eligible client base through different distribution channels;
- to maintain its position as a service-provider;
- to enhance the range of refinancing transactions with commercial banks;
- to obtain low-risk, long-term funding from domestic and international markets;
- to increase market share in the field of retail housing loans;
- to improve the efficiency of its operations and profitability;
- to secure sufficient credit rating through prudent operation and strict internal rules;
- to maintain its position in product innovation both in refinancing and in retail lending; and
- to exploit, as fully as possible, the advantages derived from its status as a specialist mortgage bank.

It provides its services through two main distribution channels:

- refinancing mortgage loans generated by Hungarian commercial banks; and
- providing loans to individuals and house builders directly or through different agents.

Refinancing – The Issuer's refinancing activity (wholesale business)

The Mortgage Credit Institution Act allows the use of transferable independent liens as mortgage bond collateral. The Issuer makes use of this to provide long term funding and subsidy transfers to its partner credit institutions. The Issuer co-operates very closely with its eight partner credit institutions. When a partner credit institution grants a residential mortgage in the retail market, the partner credit institution offers the independent lien, pledged as collateral for the mortgage, to the Issuer for purchase. At the same time, the partner credit institution undertakes to repurchase the lien, in accordance with the underlying mortgage repayment terms. Partner credit institutions originate mortgages on which they carry the risk according to their own internal rules. This means that in these cases the Issuer is not involved in customer acquisition, marketing, credit assessment, contracting, client-monitoring and other activities in the retail market.

However, the Mortgage Credit Institution Act (amongst other regulations) only permits the Issuer to purchase independent liens pledged on real estate which has been valued by the Issuer. To meet this requirement, the Issuer provides valuation services for all of its partner credit institutions before refinancing takes place. This ensures that by the time a partner credit institution makes a decision on granting a loan, the permitted value of the loan accepted by the Issuer is known, allowing the Issuer to comply with regulatory limits.

Direct lending – The Issuer as originator (retail business)

The Issuer is also engaged in direct lending through its 10 sales offices. It has almost 2,500 official agents employed by 7 insurance companies, 37 saving cooperatives, 191 other firms. In the majority of cases, direct lending is in the form of residential mortgage loans. The volume of lending to corporates is negligible. The Issuer's direct lending objectives are achieved by enhanced use of agents and by maintaining innovative product development. The agents currently used are a combination of networks of specially trained insurance company agents, one "*Bausparkasse*" company, saving co-operatives and independent private companies.

In the third quarter of 2005 the Bank introduced a new product within its own lending activities: project financing activity appeared for the first time on the Bank's balance sheet.

The Issuer's business mix is strictly governed by the Mortgage Credit Institution Act, which limits its business to granting loans secured by a mortgage. Its lending policy is focused on financing the development and acquisition of residential real estate, the extension of housing loans with or without state subsidy and the provision of loans for residential construction on a commercial basis. The Issuer is one of three mortgage banks currently eligible to receive a government interest subsidy on its funding. See "*The Hungarian Housing and Mortgage Market - Government Housing Policy and Subsidised Loan Scheme*" below.

History

The Land Mortgage Bank Foundation (*Földhitelintézeti Alapítvány*) (the **Foundation**) was established in 1992, based on an initiative of the National Commercial and Credit Bank Plc. (*Országos Kereskedelmi és Hitelbank Rt.*). The Foundation's role was to prepare new legislation for the re-establishment of a long-term mortgage market, to prepare a feasibility study on the establishment and operation of the institutional framework to support the new market and to make proposals concerning the necessary amendments to other relevant pieces of legislation.

Following an initiative of the Minister of Finance, five banks established a joint venture company in 1996 in order to prepare for the incorporation of the Issuer (*Jelzálog Hitelintézetet Előkészítő Részvénytársaság*), the role of which was to establish the first bank after the Second World War to undertake exclusively the business of mortgage lending and the refinancing of such by issuing securities.

The Mortgage Credit Institution Act was approved by Parliament in April 1997 and FHB was established on 21 October 1997. Four banks (*Magyar Befektetési és Fejlesztési Bank Rt., Mezőbank Rt., Postabank és Takarékpénztár Rt., and Pénzintézeti Központ Bank Rt.)* and the Ministry of Finance together contributed 3 billion Hungarian forints of share capital (state entities controlled 85% of the shares). The Issuer's operating licence was granted by the predecessor of the Hungarian Financial Supervisory Authority (*Pénzügyi Szervezetek Állami Felügyelete*, the **PSZÁF**) to start its operation as a specialist credit institution under Act CXII of 1996 on Credit Institutions and Financial Enterprises (the **Credit Institutions Ac**t) on 5 March 1998.

The objectives in establishing a specialist mortgage bank included the alleviation of the capital shortage which was still a dominant feature in the Hungarian economy, the introduction of long-term real estate financing in Hungary, the provision of new safe investment opportunities for long term savings (of which the volume was expected to increase dramatically) and the promotion of real estate development.

For the first two and a half years, the Issuer's business grew slowly due to ownership and strategy changes as a result of political developments. In addition, finance was still unaffordable for the vast majority of the population. In late 1999, a stimulus was provided in the form of a government interest subsidy, which was greatly increased in 2001. Mortgage bonds totalling 780 million Hungarian forints, 2 billion Hungarian forints and 6.7 billion Hungarian forints were issued in 1998, 1999 and 2000, respectively, through private issues in the domestic Hungarian market. In 2001, the Issuer began to issue mortgage bonds by public auction which were listed on the Budapest Stock Exchange. Mortgage bonds totalling 17 billion Hungarian forints were issued in 2001, 75 billion Hungarian forints in 2002, 190.2 billion Hungarian forints in 2003, 121.3 billion Hungarian forints in 2004 and 58.3 billion Hungarian forints in the first six months of 2005. The total volume of outstanding mortgage bonds had reached 402 billion Hungarian forints by September 2005.

In September 1999, the Hungarian Privatisation and State Holding Company (ÁPV Rt.), which was then the majority shareholder of the Issuer, issued a tender for the privatisation of the Issuer. Despite a fair offer being submitted, the Hungarian government (the **Government**) cancelled the sale, having decided to promote a substantial residential mortgage market through domestic institutions. Since early 2000, the Issuer's long term strategy has been fixed and it has played the key role in the implementation of the Government's housing subsidy system. In co-operation with a variety of commercial banks, savings banks and insurers, the Issuer has also contributed to faster building programmes through the provision of long-term mortgage loans.

In 2003, the Hungarian Government decided to privatise a minority stake (up to 50 % of the voting share capital minus 1 voting share) of the Issuer's share capital (Government Decisions 2094/2003 (V. 20.) and 2165/2003 (VII. 22.)).

The most significant recent event was the successful partial privatisation of FHB and the listing of its shares on the Budapest Stock Exchange in November 2003. The listing price of the shares on the first day of trading (24 November, 2003) was 4,300 Hungarian forints. After the privatisation a total of 3,511,431 shares remained with ÁPV Rt., reducing state ownership of FHB from 94.7% to 53.2%. The holding of FHB Rt., 349,000 common shares (equivalent to 5.3% of the share capital) was disposed of by means of a combination of a public and private placement (the private placement being pursuant to an employee stock ownership plan).

Realising the potential in the field of mortgage lending, two further banks decided to establish their mortgage lending units: a HypoVereinsbank subsidiary commenced business in 1999 and a subsidiary of OTP, the largest commercial bank in Hungary started its operations in 2002.

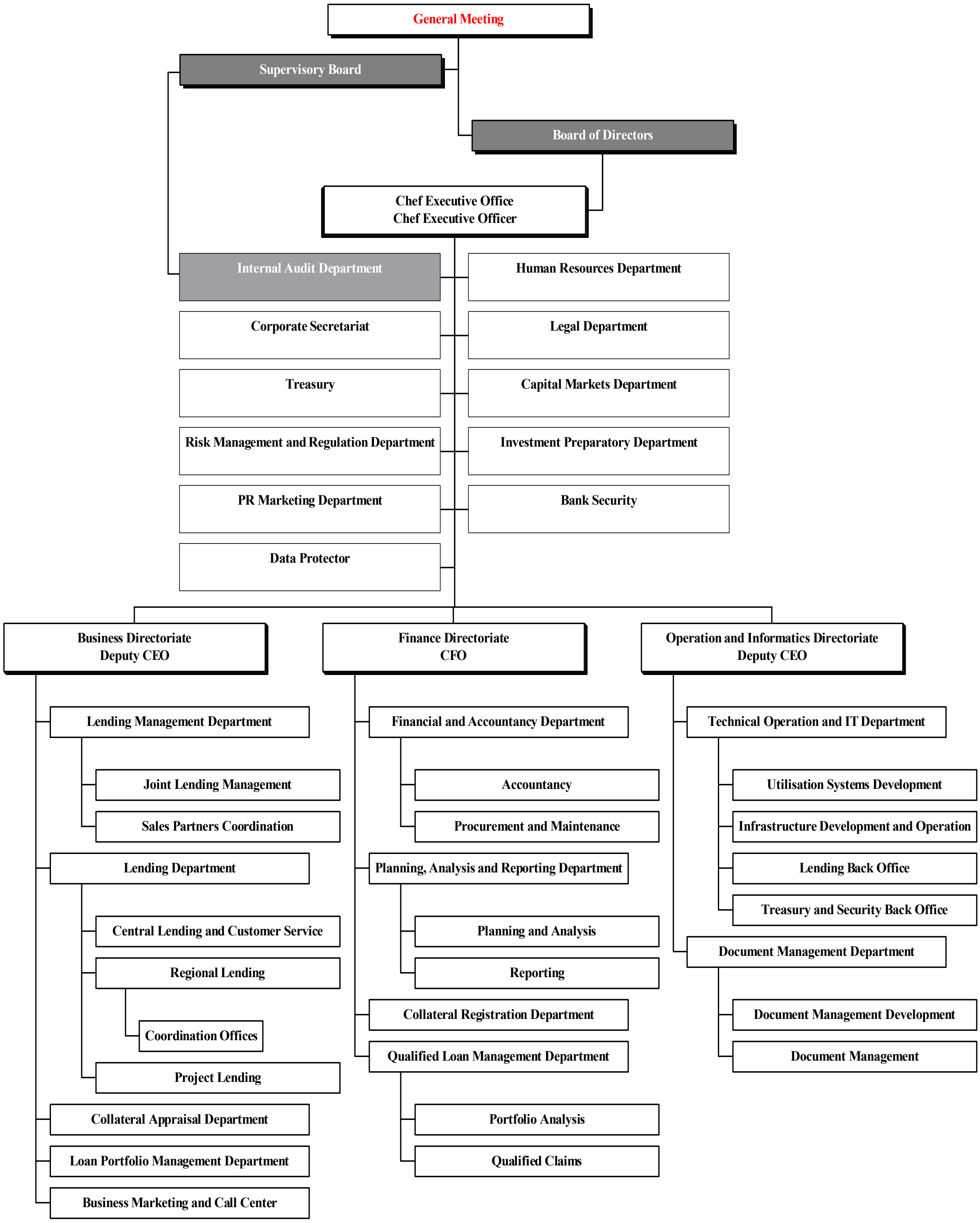
In May 2005, the ÁPV Rt. announced a new tender for the privatisation of FHB. A few weeks later Moody's Investors Services Limited (**Moody's**) put FHB on its watch list with a possible downgrade. But in September 2005, as the privatisation tender was announced as unsuccessful, Moody's confirmed the A2/P-1 foreign currency deposit and debt ratings and A1 covered bond rating of FHB, following the government-related issuer methodology. In the same rating action, Moody's also upgraded to D+ from D, FHB's Financial Strength Rating. All outlooks are stable. The review focused on the stability of FHB's ownership structure, anticipated government support in case of need, and the long-term viability of FHB's business model. In December 2005 Moody's separated the ratings for FHB's Hungarian Forint and non-Hungarian Forint denominated covered bonds: the non-Hungarian Forint denominated covered bond rating is A1 and the Hungarian Forint denominated covered bond rating is Aa2.

The FHB Group

FHB has one subsidiary, FHB Szolgáltató Rt. (FHB Service Provider Plc.), which is not of a material size.

Organisational Structure

The Issuer's organisational structure is shown in the following diagram:



Administrative, management and supervisory bodies

Directors and Officers

Members of the Board of Directors

Ferenc Karvalits Chairman: Appointed in May 2005. In 1988 he graduated at the Budapest University of Economics from the faculty of economics. In 1993 he earned his Master of Economic Policy Management at the Columbia University. Between 2002-2005 he was CEO of CIB Central European International Bank Ltd.

Dr. Márton Vági: Appointed in July 2002. He obtained his degree at the Foreign Economy faculty of the Budapest University of Economics in 1987, and his doctorate in 1994. Since 1994 he has hold a candidate's degree in economic sciences. Since 1 April, 2000 he was managing director of the Energy Industry Asset Management and Infrastructure Directorate of Hungarian Privatisation and State Holding Company (ÁPV Ltd)., and from 1 January, 2005 its the deputy CEO.

Dániel Gyuris: Appointed in January 1999. He has been CEO of FHB since January 1999. He obtained a degree at the University of Agricultural Sciences in Gödöllő in 1984, which was followed by a degree at the University of Economics, Budapest in 1996.

László Harmati: Appointed in July 2002. Member of the Board of Directors of FHB Ltd., Deputy CEO. He obtained his degree at the Budapest University of Economics in 1995 from the faculty of economics. [In 1993 he attended a financial course at the Leuven University]. From 2000 he was the head of department of the Regulation Policy at the Hungarian National Bank.

Dr Gábor Csányi: Appointed in May 2005. He is Member of the Board of Directors of FHB. In 1986 he graduated as a lawyer from the faculty of law at the University of ELTE. Since 1989 he has been a counsellor and a is member of Csányi, Rátkai and Zala Lawyer's Office. From 2002 he has been member of the Board of Directors of ÁPV Rt.

Dr Gyula Czok: Appointed in May 2005. He is Member of the Board of Directors of FHB Rt. In 1986 he graduated at the Budapest University of Economics on the faculty of economist. Between 2002-2004 he is investment expert at the Agricultural and Regional Development Ministry.

Dr. Zoltán Szedlacskó: Appointed in May 2003. He obtained his degree at the Budapest University of Economics in 1976. At present he is employee of Kárpát Holding Kft. and member of the supervisory Board of the Budapest Transport Ltd., and member of the Board of Directors of WizzAir.

Ádám Terták: Appointed in April 2004. Between 1972-1976 he obtained his degree as a business administrator in charge of system organisation. In 1977 he took his degree as a system engineer at SZÁMALK. Between 1984-1986 he graduated at the Budapest University of Economics from the faculty of economics (absolutorium). In 1997 he attended a post-graduated Management Programme at HBS AMP ISMP in Boston. From 1989 until 2004 worked with Ernst & Young, where he was CEO until 2003, and a Chairman and Head of the Regional Education between 2003-2004. He is member of the Board at Transparency International and MGYOSZ (National Federation of the Hungarian Industrialists); he is member of the management of the Joint Venture Federation, the National Federation of the Managers, the Hungarian Management Institute and the Central-European University.

Members of the Supervisory Board

Róbert Somfai: Appointed in July 2002. Chairman of the Supervisory Board of FHB. He obtained his degree at the Budapest University of Economics in 1985 from the faculty of economics. Since 1990 he has been a director for the Capital Financial Advisory Ltd. He is a specalist in credit mediation, crisis management, administration of property, establishment of special purpose companies.

Ágnes Winkler Appointed in July 2002. Member of the Supervisory Board of FHB. She obtained her degree at the Budapest University of Economics in 1995 from the faculty of economics in 1985 she obtained a financial specialist economics degree. Since 2002 she has been the managing director of Gravopack Kft. She is a member of the Supervisory Board of Kraft Ltd.

Péter Heim: Appointed in April 2005; Member of the Supervisory Board. In 1996 he graduated at the Budapest University of Economics from the faculty of finance. He is CEO of AEGON Magyarország Investment Portfolio Management Ltd.

Orsolya Kata Molnár: Appointed in May 2005; Member of the Supervisory Board. In 1998 she graduated at the State Administrative University. Since 1999 she has been working at ÁPV Rt; she is human political manager at the Human Resources Economy Directorate, then she is manager assistant and managing director at the Secretariat of the Deputy CEO of this area.

Éva Baranyi: Appointed in May 2005; Member of the Supervisory Board. In 1990 she graduated from the Technical University from Heavy Industry, in 1996 obtaining the Special Engineer degree on General Informatics at the Technical University of Kálmán Kandó. Since 1997 she has been a chartered accountant and from 1999 Deputy Managing Director at the Privatisation Settlement Directorate of ÁPV Rt.

Dr Károly Salamon: Appointed in April 2004. In 1977 he obtained his degree as a certified electrical engineer from Kálmán Kandó Electric Industry and Technical College. In 1983 he took his degree in applied mathematics at Lóránd Eötvös University of Sciences; in 1990 he obtained his MBA in the United States (Pittsburgh). Later he took his degree in strategic information systems at the Budapest University of Economics. Since 1995 he has been Deputy CEO of the Hungária Insurance Company.

Dr Gábor Borsányi: Appointed in April 2004. In 2000 he graduated as a lawyer from the faculty of Law at the University of Miskolc; between 2002-2004 he took his degree at Ferenc Deák post-graduate Institute of Law at Péter Pázmány Catholic University and in December, 2003 obtained the certificate on information and data protection. Between May 2001 and September, 2002 he was a member of the Supervisory Board of CIB Securities Ltd; since March, 2002 he has been member of the Supervisory Board and Chairman of CIB Investment Fund Management Ltd.

Pablo Arnoldo Fritz Sepúlveda: Appointed in April 2004. In 1994 he graduated as an economist from the Budapest University of Economics. Since 2003 he has been working as a Head of Investment Services at Inter-Európa Bank (securities market, branch network and public issue).

Mónika Kék: Appointed in May 2005; Member of the Supervisory Board. In 1996 she graduated at the Budapest University of Economics from the faculty of economics. From 2004 she has been Deputy Head of the Financial Services department. She is member of the Supevisory Board of Hungarian Export-Import Bank Ltd.

Management of FHB

Members: Dániel Gyuris CEO, Jenő Siklós CFO, and László Harmati deputy CEO of Business Directiorate, and Tamás Foltányi deputy CEO of Operation and Informatics Directoriate.

The address of each of the member of the board of directors and supervisory board is Váci út 20., 1132 Budapest, Hungary.

Conflicts of Interest

There are no conflicts of interest between the duties of the members of the board of directors and the supervisory board to FHB, and their private interests and other duties.

Major Shareholders

Ownership structure of FHB (as at 30 September 2005):

Shareholder	Number of shares	Ownership share in the share capital
Series "A" ordinary shares		
ÁPV Rt. – Series "A"	33,001,020	50.00%
Domestic institutional investors / companies	2,596,362	3.94%
Foreign institutional investors / companies	21,171,502	32.07%
Domestic private individuals	1,107,189	1.68%
Foreign private individuals	5,255	0.01%
FHB employees	116,622	0.18%
FHB	2,060	0%
Total:	58,000,010	87.88%
Series "B" voting preference shares		
ÁPV Rt. – Series "B"	2,114,300	3.20%
Institutional investors – Series "B"	5,885,700	8.92%
Total:	8,000,000	12.12%
Shares total:	***66,000,010***	***100.00%***

Owners holding more than 5% ownership share of the equity capital (at the end of the September 2005)

Name	Number of shares (pcs)	Ownership share (%)	Voting rights (%)
ÁPV Ltd.	35,115,320	53.20	53.20

FHB's registered capital consists of 66,000,010 registered shares of 100 Hungarian forint nominal value each. Of the shares 58,000,010 of a total nominal value of 5,800,001,000 Hungarian forint are Series "A" registered ordinary shares.

The remaining 8,000,000 of 100 Hungarian forint nominal value each are Series "B" registered voting preference shares. Holders of Series "B" registered voting preference shares are entitled to sell, transfer, contribute to another company, or otherwise alienate (for the purpose of this provision: transfer) all or some of their Series "B" voting preference shares. Holders of voting preference shares are entitled to all powers pertaining to ordinary shares as well as the additional rights defined in the Statutes. Upon the request of a simple majority of holders of Series "B" voting preference shares the Chairman of the General Meeting may order a secret ballot on particular issues. Voting preference rights can only be exercised at the General Meeting in person or by proxy.

The General Meeting may only adopt a resolution regarding the following issues in the event of a "yes" vote of a simple majority holders of Series "B" voting preference shares attending:

a) Amendment of the Statutes, including the change of the form of operation of the Bank;

b) Decision on the merger and consolidation of the Bank into, or de-merger from, another company limited by shares, or the transformation of the Bank into another corporate form; and on the increase or reduction of the registered capital;

c) Election and recall of the members of the Board of Directors and the auditor;

d) Resolution on an issue not laid down in the Statutes as the exclusive competence of the General Meeting pursuant to a statutory provision, or on an issue on the agenda which falls within the competence of another body of FHB.

Given the method of their production and the fact that FHB is a lending institution, registered shares may not be converted into other types of shares.

Within the scope of the relevant statutory provisions and the statutes, the shares of FHB are freely transferable; they may be acquired or transferred in the manner determined by a separate legal regulation solely through crediting or debiting to securities accounts.

Shareholders have a right to receive a portion of the after-tax profits of FHB in proportion to the nominal value of their shares (dividend) pursuant to the legal regulations on accounting, ordered to be distributed by the General Meeting. At least twenty business days shall elapse between the day of the resolution providing for the initial date of dividend payment and the initial date of dividend payment. Dividend payment shall be due on the 60th day following the resolution of the General Meeting.

The Bank and the holders of voting preference shares signed a syndication agreement with effect from 14 December, 2004. The Agreement sets out the legal relationship between the parties, specifically issues relating to the transfer of voting preference shares.

FINANCIAL INFORMATION

CONSOLIDATED STATEMENT OF INCOME

The following table shows the audited consolidated Statement of Income of the Issuer according to International Financial Reporting Standards for the years ended 31 December 2003, 31 December 2004; for the six months ended 30 June 2005 and 30 June 2004 and consolidated non-audited for the nine months ended 30 September 2005 and 30 September 2004, respectively:

(all amounts are expressed in thousands of Hungarian forints)

	Period ended 30 September 2005 (non-audited)	Period ended 30 June 2005 (audited)	Year ended 31 December 2004 (audited)	Period ended 30 September 2004 (non-audited)	Period ended 30 June 2004 (audited)	Year ended 31 December 2003 (audited)
Interest income	39,375,723	25,818,631	46,846,974	33,502,052	20,846,315	25,954,989
Interest expense	(27,125,748)	(17,746,990)	(31,920,697)	(22,804,800)	(14,321,460)	(16,307,414)
Net interest income	12,249,975	8,071,641	14,926,277	10,697,252	6,524,855	9,647,575
Fee and commission income	861,812	535,976	847,764	583,157	364,002	640,928
Fee and commission expense	(532,928)	(292,310)	(608,709)	(427,575)	(271,918)	(1,433,608)
Profit from FX transactions	290,477			8,901		
Change in fair value of trading derivatives	233,423	259,516		-		
Gain less losses from securities	263,491	183,234	(959,967)	85,498	164,650	151,673
Other operating income	514,225	339,191	566,993	376,098	264,154	1,457,728
Other operating expense	(17,136)	(16,199)	(219,790)	(19,125)	(17,204)	(116,331)
Operating income	13,863,339	9,171,097	14,586,770	11,304,206	7,028,539	10,347,965
Losses/Provisions on loans and advances	(173,655)	(110,337)	(157,744)	(132,775)	(81,697)	(102,294)
General and administration cost	(5,330,428)	(3,289,970)	(5,697,267)	(4,301,985)	(2,999,830)	(5,927,812)
Profit/(Loss) before tax	8,359,256	5,770,790	8,731,759	6,869,446	3,947,012	4,317,859
Taxation expense	(1,858,059)	(1,242,090)	(1,209,246)	(1,089,033)	(633,027)	(893,619)
Profit (Loss) for the period	**6,501,197**	**4,528,700**	**7,522,513**	**5,780,413**	**3,313,985**	**3,424,240**

The Bank's risk management strategy and accounting policy corresponding to IFRS had been reviewed in the second quarter of the year with due regard to the increased number and value of hedge transactions as well as to the standards applicable since 2005. The purpose of the modifications was to ensure the minimum volatility of the after-tax profit caused by the hedge transactions in line with the Bank's risk management strategy and mortgage banking activities. Simultaneously with the changes a more advanced method has been introduced, which improves the evaluation of the efficiency of the Bank's FX and interest rate risk management.

In the framework of the review, based on international accounting standards, the Bank has reclassified its hedge transactions, and recorded and reported them accordingly hereinafter. Different accounting methods have been applied depending on the type of the hedge:

- In case of ***cash flow hedges***, the efficient part of the change in fair value appears in shareholder's equity. This is how the Bank accounts its fixed-fixed-interest Hungarian forints /FX hedge transactions.

- In case of ***fair value hedges***, gains or losses from revaluation have been accounted in the profit and loss statement. For the time being, the Bank does not have this type of hedge. The Bank considers its variable-rate FX-FX and Hungarian forints -FX derivative transactions as ***trading transactions***, thus the revaluation gains or losses appear directly in the profit and loss statement.

For information purposes, the Bank has presented the fair value of its loans and mortgage bonds also by applying new methodology. The fair value of loans have been established on the basis of an internal model, while the internal evaluation model applied to date to mortgage bonds shall be replaced by a more advanced valuation model in the framework of the improvement of the Bank's risk management system.

CONSOLIDATED BALANCE SHEET

The following table shows the audited consolidated Balance Sheet of the Issuer according to International Financial Reporting Standards as at 31 December 2003, as at 30 June 2004, 31 December 2004, 30 June 2005 and 30 June 2004 and consolidated non-audited for the nine months ended 30 September 2005 and 30 September 2004, respectively:

(all amounts are expressed in thousands of Hungarian forints*)*

	30 September 2005 (non-audited)	30 June 2005 (audited)	31 December 2004 (audited)	30 September 2004 (non-audited)	30 June 2004 (audited)	31 December 2003 (audited)
Assets						
Cash	2,376	2,191	1,924	1,373	1,907	4,777
Due from National Bank of Hungary	5,698,330	23,630,103	10,162,635	22,593,242	6,724,393	17,232
Placements with other banks	18,186,591	14,026,094	18,743,934	8,953,211	12,458,858	3,055,215
Investments available for sale	3,991,852	3,837,322	3,854,179	3,000,235	3,503,942	3,490,256
Loans	157,888,773	144,915,968	132,015,233	125,069,248	119,341,011	106,046,648
Refinancing of mortgage loans	255,220,243	248,087,401	241,080,095	238,497,562	233,248,630	192,538,401
Property and equipment	1,561,178	1,441,537	1,133,552	865,898	800,345	763,006
Other assets	25,405,600	15,363,838	8,594,658	4,211,809	848,130	3,394,471
Total Assets	467,954,933	451,304,454	415,586,210	403,192,578	376,927,216	309,310,006
Liabilities						
Deposits from banks	21,580,318	7,467,480	8,989,330	2,556,605	-	6,000,000
Mortgage bond liabilities	400,944,013	402,053,467	367,278,862	362,671,700	346,325,946	278,525,898
Other liabilities	24,585,102	22,298,585	21,820,714	20,750896	16,173,422	13,010,245
Total Liabilities	447,109,433	431,819,532	398,088,906	385,979,201	362,499,368	297,536,143
Subordinated debt	-	-	-	-	-	-
Shareholders' Equity						
Share capital	6,600,001	6,600,001	6,600,001	6,600,001	6,600,001	6,600,000
Treasury Shares	(2,849)	(2,849)	-	-	-	-
Share premium	1,446,047	1,446,047	1,709,014	1,709,014	1,709,014	1,709,014
General reserve	1,761,790	1,563,036	1,157,536	1,024,879	782,434	446,109
Cash flow hedge reserve	(2,771,773)	(2,139,278)	(1,139,073)	319,101		
Stock option reserve	124,368	103,791	220,393	-		
Retained earnings/(deficit)	13,687,916	11,914,174	8,949,433	7,560,382	5,336,399	3,018,739
Total Shareholders' Equity	20,845,500	19,484,922	17,497,304	17,213,377	14,427,848	11,773,863
Total Liabilities and Shareholders' Equity	467,954,933	451,304,454	415,586,210	403,192,578	376,927,216	309,310,006

CONSOLIDATED CASH FLOW STATEMENT

The following table shows the audited consolidated Cash Flow Statement of the Issuer according to International Financial Reporting Standards as at 31 December 2003, as at 30 June 2004, 31 December 2004, 30 June 2005 and 30 June 2004 and consolidated non-audited for the nine months ended 30 September 2005 and 30 September 2004, respectively:

(all amounts are expressed in thousands of Hungarian forints)

	Period ended 30 September 2005 (non-audited)	Period ended 30 June 2005 (audited)	Year ended 31 December 2004(audited)	Period ended 30 September 2004 (non-audited)	Period ended 30 June 2004 (audited)	Year ended 31 December 2003 (audited)
Cash flows from operating activities						
Net profit / (loss)	6,501,197	4,528,700	7,522,513	5,780,413	3,313,985	3,424,240
Non cash adjustments to net income (loss) to net cash from operating activities:						
Depreciation	313,922	198,644	303,866	199,866	135,067	247,823
Provision for losses	125,938	63,514	127,281	126,533	76,815	25,743
(Profit) / loss on sale of fixed assets	(1,794)	(612)	163,199	32	2,857	1,336
Share option reserve	65,515	44,939				
Cash flow hedge reserve	(233,422)	(1,000,205)				
Operating profit / (loss) before changes in operating assets	**6,771,356**	**3,834,980**	**8,116,859**	**6,106,844**	**3,528,724**	**3,699,142**
Refinancing of mortgage loans	(14,140,148)	(7,007,306)	(48,541,694)	(45,959,161)	(40,710,229)	(151,361,818)
Loans	(25,998,013)	(12,962,945)	(26,094,667)	(19,147,951)	(13,371,194)	(40,855,468)
Accrued interest receivable	(460,100)	(843,794)	(858,714)	(197,381)	(79,354)	(201,336)
Other assets	(16,071,927)	(5,925,385)	(4,413,934)	(619,957)	2,625,695	(2,273,742)
Increase (decrease) in operating liabilities:						
Due to other banks	12,590,988	(1,521,850)	2,989,330	(3,443,395)	(6,000,000)	4,000,000
Accrued interest payable	647,704	(1,123,333)	7,166,707	6,202,279	1,956,803	7,756,262
Other liabilities	(819,142)	419,689	(71,922)	941,921	32,724	364,626
Net cash from operating activities	(37,479,283)	(25,129,944)	(61,708,035)	(56,116,801)	(52,016,894)	(178,872,334)
Cash flows from investing activities						
Increase in available for sale investments	(137,673)	16,857	(363,923)	490,021	(13,686)	(1,333,198)
Proceeds from sale of property and equipment	2,021	1,428	28,916	4		10,013
Purchase of property and equipment	(741,775)	(507,445)	(866,527)	(302,794)	(175,263)	(223,209)
Net cash used in investing activities	(877,427)	(489,160)	(1,201,534)	187,231	(188,949)	(1,546,394)

Cash flows from financing activities						
Capital increase						2,500,001
Share premium received						4
Repayment of subordinated debt						(1,500,000)
(Purchase)/sale of own shares	(265,816)	(265,816)				913,420
Cash flow hedge reserve						
Instalment from mortgage bonds	(23,888,700)	(23,888,700)	(15,949,830)	(8,196,260)		(13,980,000)
Proceeds from issue of mortgage bonds	57,490,020	58,523,515	104,690,668	92,596,432	68,313,714	191,592,247
Net cash from financing activities	33,335,504	34,368,999	88,740,838	84,400,172	68,313,714	179,525,672
Net increase / (decrease) in cash and cash equivalents	(5,021,206)	8,749,896	25,831,269	28,470,602	16,107,934	(893,055)
Cash and cash equivalents at beginning of year	28,908,493	28,908,493	3,077,224	3,077,224	3,077,224	3,970,279
Cash and cash equivalents at end of period	23,887,287	37,658,388	28,908,493	31,457,826	19,185,158	3,077,224
Cash and cash equivalents comprises of:						
Cash	2,376	2,191	1,924	1,373	1,907	4,777
Due from Central Bank	5,698,330	23,630,103	10,162,635	22,593,242	6,724,393	17,232
Placements with other banks, with a maturity of less than 90 days	18,186,581	14,026,094	18,743,934	8,953,211	12,458,858	3,055,215
Cash and cash equivalents at end of period	23,887,287	37,658,388	28,908,493	31,547,826	19,185,158	3,077,224
Supplemental information:						
Interest received	38,930,608	25,000,372	46,017,455	33,335,270	20,794,802	25,920,917
Interest paid	(26,478,044)	(18,870,323)	(24,753,990)	(16,602,521)	(12,364,657)	(8,551,152)
Tax paid	(710,792)	(710,792)	(1,215,577)	(281,519)	(48,624)	(868,624)

STATEMENT OF CONSOLIDATED SHAREHOLDERS EQUITY

The following table shows the statement of audited consolidated Shareholders' Equity of the Issuer according to International Financial Reporting Standards as at 31 December 2003, 31 December 2004, 30 June 2005 and 30 June 2004 and consolidated non-audited for the nine months ended 30 September 2005 and 30 September 2004, respectively:

(all amounts are expressed in thousands of Hungarian forints*)*

	Share Capital	Treasury Shares	Share premium	General reserve	Cash-flow hedge reserve	Stock Option Reserve	Retained earnings (deficit)	Shareholders' Equity
31 December 2001	**4,100,000**	**-**	**1,743,562**	**-**	**-**	**-**	**(860,763)**	**4,982,799**
Treasury shares purchase	-	(350,000)	-	-	-	-	-	(350,000)
Profit for the period	-	-	-	-	-	-	303,399	303,399
Transfer to general reserve	-	-	-	42,539	-	-	(42,539)	
Transfer to accumulated deficit	-	-	(597,971)	-	-	-	597,972	-
31 December 2002	**4,100,000**	**(350,000)**	**1,145,590**	**42,539**	**-**	**-**	**(1,931)**	**4,936,198**
Share capital increase	2,500,001	-	4	-	-	-	-	2,500,005
Sale of treasury shares	-	350,000	563,420	-	-	-	-	913,420
Transfer to general reserve	-	-	-	403,570	-	-	(403,570)	-
Profit for the period	-	-	-	-	-	-	3,424,240	3,424,240
31 December 2003	**6,600,001**	**-**	**1,709,014**	**446,109**		**-**	**3,018,739**	**11,773,863**
Transfer to general reserve	-	-	-	336,325	-		336,325	0
Adjusted change of cash flow hedge reserve	-	-	-	-	-	-	-	-
Treasury share repurchased	-	-	-	-	-	-	-	-
Creation of stock option reserve	-	-	-	-	-		(660,000)	(660,000)
Profit for the period	-	-	-	-	-		3,313,985	3,313,985
30 June 2004	**6,600,001**	**0**	**1,709,014**	**782,434**	**0**	**0**	**5,336,399**	**14,427,848**
Transfer to general reserve	**-**	**-**	**-**	242,445	**-**	**-**	(242,445)	0
Adjusted change of cash flow hedge reserve	**-**	**-**	**-**	**-**	319,101	-	-	319,101
Profit for the period	**-**	**-**	**-**	**-**	**-**	**-**	2,466,428	2,466,428

30 September 2004 (Adjusted)	**6,600,001**	**0**	**1,709,014**	**1,024,879**	**319,101**	**0**	**7,560,382**	**17,213,377**
Transfer to general reserve	-	-	-	132,657	-	-	(132,657)	0
Adjusted change of cash flow hedge reserve	-	-	-	-	(1,458,174)	-	-	(1,458,174)
Creation of stock option reserve	-	-	-	-	-	220,393	(220,393)	0
Profit for the period	-	-	-	-	-	-	1,742,100	1,742,100
31 December 2004 (Adjusted)	**6,600,001**	**0**	**1,709,014**	**1,157,536**	**(1,139,073)**	**220,393**	**8,949,432**	**17,497,303**
Transfer to general reserve	-	-	-	234,518	-	-	(234,518)	0
Adjusted change of cash flow hedge reserve	-	-	-	-	(694,520)	-	(87,641)	(782,161)
Treasury share repurchased	-	(250,917)	-	-	-	-	-	(250,917)
Creation of stock option reserve	-	-	-	-	-	85,497	-	85,497
Profit for the period	-	-	-	-	-	-	2,249,005	2,249,005
31 March 2005 (Adjusted)	**6,600,001**	**(250,917)**	**1,709,014**	**1,392,054**	**(1,833,593)**	**305,890**	**10,876,278**	**18,798,727**
Transfer to general reserve	-	-	-	170,982	-	-	(170,982)	0
Changes in fair value of cash-flow hedge reserve	-	-	-	-	(305,685)	-	-	(305,685)
Shares granted	-	248,068	(262,967)	-	-	(224,208)	-	(239,107)
Creation of stock option reserve	-	-	-	-	-	22,109	161,544	183,653
Dividends for 2004	-	-	-	-	-	-	(1,320,000)	(1,320,000)
Profit for the period							2,367,334	2,367,334
30 June 2005	**6,600,001**	**(2,849)**	**1,446,047**	**1,563,036**	**(2,139,278)**	**103,791**	**11,914,174**	**19,484,922**
Transfer to general reserve	-	-	-	604,254	-	-	(604,254)	0
Adjusted change of cash-flow hedge reserve	-	-	-	-	(1,632,700)	-	(87,641)	(1,720,341)
Treasury share repurchased								
Shares granted	-	(2,849)	(262,967)	-	-	(224,208)	-	(490,024)
Creation of stock option reserve	-	-	-	-	-	128,183	161,544	289,727
Dividends for 2004	-	-	-	-	-	-	(1,320,000)	(1,320,000)
Profit for the period							6,588,835	6,588,835
30 September 2005	**6,600,001**	**(2,849)**	**1,446,047**	**1,761,790**	**2,771,773)**	**124,368**	**13,687,916**	**20,845,500**

The Bank's 2004 shareholders' meeting approved a two-year (2004-2005) free of charge share allocation scheme for the members of the Bank's Board of Directors, and for its executive and senior managers. The first shares had been allocated under this scheme in May 2005.

Pursuant to IFRS 2 rules, FHB should present at fair value the share based benefits to be granted in the form of shares. Thus the fair value of shares specified in the scheme but not yet allocated shall be accounted as expenses. Due to the retrospective application of this standard, the Bank's after-tax profit decreases by 220 million Hungarian forints in 2004.

MATERIAL CONTRACTS

In 7 September 2005 FHB signed a CHF 150,000,000 Term Loan Facility. The mandated lead arrangers are the Bayerische Landesbank and the KBS Bank NV. The term is 5 years. The purpose of the facility is general funding purposes. This facility is a subordinated obligation of FHB.

BUSINESS OVERVIEW

The financial information in this Base Prospectus has been extracted from the audited consolidated annual and semi-annual and non/audited preliminary 3rd quarter financial reports of the Issuer.

The main activities of the Issuer, as a specialist financial institution, include financing the development and purchase of retail housing and extending state subsidised housing loans. In order to reach the broadest possible range of the population with its services, the Bank opened two new regional co-ordination offices in Zalaegerszeg and Nyíregyháza.

In the second half of 2004, the Bank started to grant non- Hungarian forints denominated loans to its clients to meet the requirements of the market and broaden the scope of its services. In addition, from the beginning of 2005, the Bank has offered new products to corporate clients in the field of project financing.

Scope of Activities

The Issuer is authorised for the following activities (on the basis of the list of licensed operations (TEÁOR)):

Other lending operations (TEÁOR No. 6522)

Within the above group of operations, FHB is licensed to perform only the following activities from among the operations specified in Article 3 of the Mortgage Credit Institution Act, specifically:

- acceptance of repayable funds from the public, not including the collection (management) of deposits;
- extension of money loans under coverage secured by mortgages established on real estate located in the territory of Hungary;
- provision of loans without stipulating mortgage, under joint and several surety provided by the state;
- provision of surety and bank guarantee and assumption of other bankers' commitments,

Other financial operations not listed elsewhere (TEÁOR No. 6523)

- interest rate swap transactions and foreign exchange swap transactions to hedge interest rate risks of foreign exchange liabilities (funding sources), and other options and hedging transactions;

Other supplementary financial operations not listed elsewhere (TEÁOR No. 6713)

- mortgage brokerage;
- currency conversion.

Products

In line with the business strategy for 2005 FHB continued to offer its clients a wide range of retail home loan facilities including products developed by the Bank and lien purchase offered by partner banks.

The Bank's traditional home loan products with subsidised interest offered to its retail customers are as follows:

- home purchase mortgage loan;
- home extension mortgage loan;
- home building mortgage loan;
- home modernisation mortgage loan;

- mortgage loan to consolidate home loans (re-mortgage loans);
- general mortgage loan (home equity loans); and
- remodelling loan.

Since the second half of 2004 the amount of home equity loans extended to retail customers is also significant, although this product does not involve state subsidies. In addition, FHB also offers preferential home building schemes, tax refund support and support for accessible housing.

Breakdown of loans disbursed

Type of loan	Year ended 31.12.2002 (%)	Year ended 31.12.2003 (%)	Year ended 31.12.2004 (%)	6 months ended 30.06.2005 (%)	9 months ended 30.09.2005 (%)
Building	19.84	23.30	30.02	18.70	18.22
Purchase	65.50	65.60	50.83	53.20	48.70
Extension	8.36	6.30	6.56	2.70	2.41
Modernisation	2.89	2.20	3.30	1.20	0.89
General mortgage loan	2.20	1.80	7.78	21.80	26.14
Remodelling	1.11	0.80	1.50	2.40	2.99
Re-mortgage			0.03	0	0.65

In 2004 the total amount of loans originated by the Bank exceeded 35.5 billion Hungarian forints, which was 71.3 per cent. of the previous year, but a 43.8 per cent. rise on original projections. Home purchase and building loans continued to be the leading retail products of the Bank. Home purchase loans comprised 50.8 per cent. of the total loans extended to retail customers in 2004, followed by building loans at 30.0 per cent. The ratio of home equity to building loans increased significantly, from 2003. In the second half of 2004 the Issuer started to offer currency-based retail products, which gained momentum, the ration of the FX linked loans was 17 per cent. between July and December 2004, and the ratio of the total disbursement was 8.6 per cent. in 2004. In the last quarter of 2004 the Issuer started to refinance FX–linked and non-subsidised housing loans.

In the first half of 2005 the Issuer started to make mortgage loans on commercial property, although the current strategy still gives priority to residential mortgage lending.

The own originated loans grew in the first half of 2005 by 8.1 billion Hungarian forints, representing a 9.8 per cent. increase in comparison to 31 December 2004. The portfolio of mortgage loans sold by the Issuer increased by 25.7 billion Hungarian forints i.e. by 21.5 per cent. between 30 June 2004 and 2005. The Issuer disbursed 96.1 per cent. of home equity loans and 95.5 per cent. of the home renovation loans on FX basis in the second quarter of 2005.

Over the past year up to 30 September 2005, the outstanding net value of loans sold by the Bank grew by 32.8 billion Hungarian forints or 26.2 per cent. and reached 157.9 billion Hungarian forints. The increase amounted to 25.9 billion Hungarian forints over the first nine months of 2005, 19.6 per cent. higher than the year-end figure for 2004. In the third quarter of 2005 the Bank disbursed loans directly to customers in the amount of 16.1 billion Hungarian forints, 44.6 per cent. of which was FX-based loans. This means an over 8 percentage points increase in the contribution of FX-based loans over the previous quarter. The proportion of FX loans is particularly high in some of the non-subsidised areas: 96.8 per cent. of home equity loans and 94.9 per cent. of home improvement loans were denominated in foreign exchange in the third quarter.

In the first three quarters of 2005 the Bank disbursed a total of 34.8 billion Hungarian forints loans directly to customers through its branches, agents and consortial partners. Compared to the first nine months of 2004 own lending was 34.7 per cent. almost nine billion Hungarian forints higher in 2005.

Contractual term of FHB's own loans

Term	31.12.2002 (%)	31.12.2003 (%)	31.12.2004 (%)	30.06.2005 (%)	30.09.2005 (%)
0-5 yrs	2.30	0.30	0.27	0.79	0.32
5-10 yrs	12.30	6.080	4.95	7.06	3.73
10-15 yrs	36.20	27.30	23.72	23.73	21.38
15-20 yrs	29.60	32.30	33.55	31.06	32.55
20-25 yrs	19.10	31.90	35.33	35.24	39.48
Above 25 yrs	0.50	1.50	2.18	2.06	2.54

Maturities of loans have not changed significantly since the end of 2004, the ratio of loans with maturities of between 5-10 years has increased. However, in the third quarter of 2005 the ratio of the loans with maturity of between 20-25 years grew by more than 4 percentage points.

Distribution of own loan portfolio by interest period

Interest period	31.12.2002 (%)	31.12.2003 (%)	31.12.2004 (%)	30.06.2006 (%)	30.09.2005 (%)
Within year	1.10	0.10	0.58	6.73	10.20
1 year	25.20	15.90	13.39	15.31	13.25
5 years	73.70	83.80	84.66	75.63	73.79
10 years	0	0.20	1.37	2.23	2.27

In 2005 the ratio of loans with interest periods of under one year grew highly compared to the previous years, reflecting the increase in CHF-denominated loans with floating interest.

Direct FHB distribution network

From the point of view of loan disbursement, own lending decreased in 2004 comparing to the previous year. This phenomenon was in line with the trends on the Hungarian housing market. In 2005 the own lending has grown dynamically and has exceeded the planned figures and has significantly contributed to the expansion of the loan portfolio surpassing projected growth levels.

Calculated from the point of view of own originated loans, nearly 60 per cent. of loans disbursed in the third quarter of 2005 were extended through the Bank's own distribution network, compared to nearly 46 per cent. in the third quarter of 2004

Agency activities – improvement of services

In order to expand its external distribution channels, the Bank signed contracts with new companies in 2004 and in the first half of 2005, specifically with ÁB-Aegon Insurance Ltd. FHB's products could only be sold by individuals trained and duly examined by the Bank. The number of agents almost doubled in 2003 compared to the previous year, and increased further reaching 1,800 and 2,500 by the end of 2004 and of September 2005, respectively.

There has been a substantial change in the performance of the various distribution channels of own lending over 2005. At the end of 2004 the Bank commenced a dynamic development of its network of agents, and individual entrepreneurs as well as smaller agencies appeared in addition to former major partners (insurance companies and home savings institution). As a result 51.8 per cent. of the 2005 disbursements were contributed by the network of agents, and their contribution reached 59.0 per cent. in the third quarter compared to 40.9 per cent in 2004 and 35.4 per cent. in 2003.

Refinancing

Implemented through the purchase of independent liens, FHB's refinancing business was operating with ten (after mergers: eights) partners at the end of September 2005. Framework cooperation agreements were signed with Kereskedelmi és Hitelbank Ltd. (Commercial and Credit Bank Co.) and CIB Közép-Európai Nemzetközi Bank Ltd. (CIB Central European Bank Co.) in 2001, and with ERSTE Bank Hungary Ltd., Inter-Európa Bank Rt, MKB Hungarian Foreign TradeBank Ltd. (Hungarian Foreign Trade Bank Co.), Konzumbank Ltd. (largely merged with MKB Ltd.) Postabank és Takarékpénztár Ltd. (Postabank) (largely merged with Erste Bank Ltd.) and Raiffeisen Bank Ltd. in 2002, with Általános Értékforgalmi Bank Ltd. (General Banking and Trust Co. Ltd.) in 2003, and with ELLA (First Housing Loan Bank) in 2004.

FHB's refinancing portfolio with these banks decreased in 2004 and even forther in the first nine months of 2005; the amount was 76.3 per cent. of the new portfolio in 2003, 64.9 per cent. at the end of 2004 and around 48 per cent. in September 2005. Offers and purchases of refinancing batches still took place on a regular basis and was scheduled to suit the partner bank's business cycles.

Refinancing (Bln Hungarian forints)

	Q1 2003	**Q2 2003**	**Q3 2003**	**Q4 2003**	**Q1 2004**	**Q2 2004**	**Q3 2004**	**Q4 2004**	**Q1 2005**	**Q2 2005**	**Q3 2005**
Bln Hungarian forints	29,539	36,989	45,756	47,980	25,476	22,718	9,728	8,145	6,960	11,822	13,941

At the end of 2004, the number of loans refinanced by the Bank was 12,643. The refinanced portfolio on 30 June 2005 increased by 6.4 per cent. to 248.1 billion Hungarian forints compared to 30 June 2004. The portfolio of refinanced loans showed a year-on-year increase of 16.7 billion Hungarian forints or 7.0 per cent. and amounted to 255,220 billion Hungarian forints as of 30 September 2005.

Refinancing (Pieces)

	Q1 2003	**Q2 2003**	**Q3 2003**	**Q4 2003**	**Q1 2004**	**Q2 2004**	**Q3 2004**	**Q4 2004**	**Q1 2005**	**Q2 2005**	**Q3 2005**
Pieces	6,372	7,543	8,728	9,247	4,799	4,205	2,021	1,618	1,567	2,472	3,229

The amount of loans refinanced in the second quarter of 2005 (11.8 billion Hungarian forints) exceeded significantly the amount refinanced in the first quarter, i.e. by 69.9 per cent. In the second quarter of 2005, the share of FX loans increasing each month has continued to grow within the disbursed refinancing portfolio: while a total of 17.0 per cent. of refinancing was FX-linked in the first quarter, their ratio was 44.7 per cent. in April, 51.8 per cent. in May, and 56.5 per cent. in June, resulting in an aggregate share of 51 per cent. in the second quarter of 2005.

In the third quarter of 2005 new refinanced loans amounted to 13.9 billion Hungarian forints, considerably – 17.9 per cent. – higher than in the second quarter of 2005. Within the refinancing portfolio the proportion of FX-based loans continued its steady increase during in the third quarter of 2005: while in the second quarter of 2005 a total of 51.0 per cent. of independent lien purchases were denominated in foreign exchange, the same figure was 58.8 per cent. in July 2005, 70.1 per cent. in August 2005 and 61.9 per cent. in September 2005.

Contractual term of refinanced loans

Term	31.12.2003 (%)	31.12.2004 (%)	31.03.2005 (%)	30.06.2005 (%)	30.09.2005 (%)
0-5 yrs	0.40	0.05	0.06	0.06	0.05
5-10 yrs	23.30	19.34	3.01	3.12	3.27
10-15 yrs	24.90	24.35	20.24	19.73	19.18
15-20 yrs	48.30	48.97	25.77	25.76	25.68
20-25 yrs	1.60	5.36	47.61	48.06	48.64
Above 25 yrs	1.50	1.93	3.31	3.27	3.19

The term of refinanced loans from purchase to maturity tends to shift towards the longer term: while at the end of 2002 the share of loans with terms exceeding 15 years was 42 per cent., in 2003 it was over 51 per cent., reached 56 per cent. at the end of 2004 and was over 77.5 per cent in the third quarter of 2005.

Syndicated loans and partners

The Bank's standard products (including mortgage bonds, and home purchase, extension and modernisation loans with subsidised interest) are sold in the context of syndicated cooperation. The loans are secured by the real estate property valued by, and encumbered with the lien of, the bank, and the debtors (guarantors) meet the Bank's requirements.

In 2003, the Bank bought a total of 777 outstanding accounts from its syndicated partners amounting to 3.2 billion Hungarian forints in value. In 2004, the volume exceeded 1.55 billion Hungarian forints which is 50 per cent. less than in the previous year. The biggest partner became a refinancing partner. From the end of 2004, the syndicated partnership contains only savings cooperatives. The ratio of total syndicated loans decreased further in the first nine months of 2005.

Portfolio analysis

The Bank's classified assets amounted to 392.1 billion Hungarian forints, its pending commitments amounted to 5.4 billion Hungarian forints (397.6 billion Hungarian forints in total) as at 31 December 2004.

At the end of 2004, receivables from customers amounted to 132.3 billion Hungarian forints (33.3 per cent. of the portfolio) in addition to 5.4 billion Hungarian forints (1.4 per cent.) disbursement commitment based on valid loan agreements. Of these receivables, 3.5 billion Hungarian forints attached to 884 contracts and 0.1 billion Hungarian forints commitments were classified in the categories watch to bad, with 0.377 billion Hungarian forints total loss in value and provisions.

The refinancing loans portfolio amounted to Hungarian forints 241.1 billion Hungarian forints (60.6 per cent.), and was classified as problem-free. The Issuer had placements in the form of sight and term deposits with 13 commercial banks in an amount of 18.7 billion Hungarian forints (4.7 per cent.). The Issuer has one subsidiary, FHB Szolgáltató Rt (FHB Service Provider Plc.), an investment of 65 million Hungarian forints which was also classified as problem-free.

The Issuer has maintained the high quality of the portfolio. The ratio of problem-free loans has not changed significantly either in the total portfolio or in the loan portfolio. Owing to the special features of collateral for mortgage loans, the solvency of the customers exceeded the average value in the bank sector: at the end of 2002, the ratio of problem-free accounts receivable constituted 97.7 per cent. in the Bank's total portfolio, and it was 99.1 per cent. at the end of 2003 and also for 30 September 2004 and 31 December 2004.

The structure of the Bank's **total portfolio** retained its excellent quality in the third quarter. The rate of problem-free accounts receivable was 99.0 per cent. at the end of the third quarter of 2005 as opposed to 99.1 per cent. in both the third quarter of 2004 and second quarter of 2005. The amount of classified loans (substandard, doubtful or bad) increased by 282 million Hungarian forints compared to the previous quarter, resulting in a 63 million Hungarian forints increase in loss in value and provisions to cover for such loans. The rate of loss in value and provisions within the entire portfolio is around a stable 0.1 per cent.

The ratio of substandard, doubtful and bad loans was 0.3 per cent. as at 31 December 2003, 0.3 per cent. as at 31 December 2004, 0.34 per cent. as at 30 June 2005, 0.38 per cent. as at 30 September 2005, the watch category was 0.6 per cent. as at 31 December 2003, 0.6 per cent. at the end of 2004, 0.5 per cent. as at 30 June 2005 and 0.6 per cent. as at 30 September 3005.

The average loss in value of the total portfolio as a whole continued to diminish and was in 2004, 0.1 per cent., at the end of 2004 and the same at end of September 2005.

Breakdown of portfolio by classification, loss in value and provision
Data in million Hungarian forints

CLASSIFI-CATION	31.12.2003			31.12.2004			30.09.2005		
	Total accounts receivables	Loss in value and provisions	Ratio (%)	Total accounts receivables	Loss in value and provisions	Ratio (%)	Total accounts receivables	Loss in value and provisions	Ratio (%)
Problem-free	306,736	0	0.00	393,995	0	0.00	435,024	0	0.00
Watch	1,882	1	0.00	2,188	0	0.00	3,435	2	0.10
Substandard	324	37	11.50	305	32	10.50	529	57	10.80
Doubtful	508	185	36.30	1,061	329	31.60	1453	443	30.10
Bad	28	28	100.00	16	16	100.00	1	1	100.00
TOTAL	309,478	250	0.10	397,565	377	0.10	440,441	503	0.10

In the first half of 2005 the proportion of problem-free loans in the self originated **loan portfolio** had increased to 98.94 per cent. from 97.4 per cent. as at the end of 2004 and 97.6 per cent. as at the end of 2003, while the proportion of the to be watched, substandard, doubtful and bad loans remained unchanged even at the end of 2004 and September 2005 (between 1.06-2.6 per cent.) compared to the previous years.

Collateral valuation

There was a substantial decrease in the number of valuations compared to the previous two years. In 2004, 28,000 properties were valued, compared to 58,000 in 2003 and 46,000 in 2002.

In 2004, FHB's income from its collateral valuations was 553 million Hungarian forints against payments of 441 million Hungarian forints to external valuation agencies. This was a 58.6 per cent. decrease in valuation fee profit compared to 2003 and a 60.1 per cent. drop compared to 2002. Collateral appraisal activity as a whole increased by 6 per cent. in the third quarter and 8 per cent. in the fourth quarter compared to the second quarter of 2004.

In 2005 the previous trend has continued: as at the 30 June of 2005 the Bank paid 333 million Hungarian forints, and at the end of September 2005 552 million Hungarian forints to the external valuation agencies, versus the income from the collateral appraisal activity of 320 million Hungarian forints in June and 490 million Hungarian forints in September 2005 respectively.

Funding, Liquidity and Capital Resources

The issuance of mortgage bonds is the primary means of fundraising available to the Issuer. The cost is advantageous owing to the Hungarian government's interest subsidy policy.

In the first two years of its existence, FHB issued small sized mortgage bonds exclusively through private placements. This strategy has been gradually replaced by the introduction to the public market of series with higher nominal values and increased liquidity. These issues are sold by public auction and listed on the Budapest Stock Exchange. Private placements can still be made, but are likely to form a less significant proportion of mortgage bond issuance in future.

At the beginning of 2003, the value of the portfolio of mortgage bonds was 101,644 million Hungarian forints the year-end portfolio value amounted to 277,906 million Hungarian forints. The total face value of mortgage bonds issued throughout the year was 190,242 million Hungarian forints.

The fourth quarter of 2003 was a milestone for the Bank, with the approval by the Luxembourg Stock Exchange of its EUR 1,000,000,000 Euro Mortgage Bond Programme. In December 2003, the Bank issued its largest series under the Programme, (33,202,500,000 Hungarian forints or EUR125,000,000 equivalent in nominal amount).

The value of mortgage bonds issued by FHB in 2004 amounted to 121.3 billion Hungarian forints, 10.8 per cent. more than the Bank's estimate of 109.5 billion Hungarian forints. During the previous year four repurchases were effected at a cost of 32.4 billion Hungarian forints, with one series of mortgage bonds maturing for a repayment figure of 200 million Hungarian forints. Taking into account changes in exchange rates, the Bank's mortgage bond portfolio increased by 88.8 billion Hungarian forints during 2004.

The year 2004 was a milestone for the Bank, as it issued mortgage bonds directly in Euros for the first time. Furthermore, its capital market activities concerning the trade of mortgage bonds was extended by repurchases.

The pricing for mortgage bonds in 2004 has derived from the reference yield of Hungarian government securities and the swap curve of similar maturities. The spread over the government bond paid by the Issuer has ranged from 25-40 basis points in the Hungarian capital market and from 18-28 basis points abroad.

The volatile interest environment and the higher yield expectations of domestic investors forced the Bank to cover the majority of its financing needs from foreign capital market sources; an adequate background for this purpose was provided by FHB's effective international bond programme and its good credit rating. In 2004 – deviating from previous regular monthly auction activities – only two domestic mortgage bond series were issued in the domestic market.

As at 30 June 2005, FHB issued a total of 58.3 billion Hungarian forints new mortgage bonds, down from Hungarian forints 67.4 billion during the same period of 2004. Repayments amounted to 5.2 billion Hungarian forints in the first quarter of the year and 0.5 billion Hungarian forints in the second quarter. The value of bonds repurchased in the second quarter was 15 billion Hungarian forints, while bonds repurchased in the first half of the year amounted to 18.2 billion Hungarian forints, resulting in a total net placement face value of 34.4 billion Hungarian forints in the first six months of 2005.

In the third quarter of 2005 the Bank issued no new mortgage bond series in the Hungarian or international markets, nor did it effect repurchase transactions. Up to 30 September 2005 the Bank’s new mortgage bond issues amounted to a total of 58.3 billion Hungarian forints. The long term funds involved during the first three quarters of 2005 amounted to 67.9 billion Hungarian forints including the syndicated loan.

The aggregate face value of the series issued and not yet repaid under the Bank's international EMTN scheme amounts to EUR 690 million calculated at the exchange rate applicable at the date of issue, approximately EUR 640 million using the exchange rate as of 30 June 2005 and of 30 September 2005 (there were no new issues in the third quarter of 2005). In the first nine months of 2005 the share of mortgage bonds issued abroad exceeded 47 per cent. within the total outstanding portfolio. This indicates the importance of international placements has further increased, and international investors continue to purchase mortgage bonds with decreasing spread. Due to favourable spreads and decreasing Hungarian forints rates, the Bank's funding costs continued to decrease in the second and third quarter of 2005.

International issues of mortgage bonds was made possible by the Bank's good rating: Moody's maintained its A2 rating and took the Bank off its "watch" list; the rating of mortgage bonds was A1 (with "watch" status), the Bank's financial strength was again rated D+ with "positive outlooks" added by the rating company. FHB and OTP Mortgage Bank both achieved international ratings.

The stock market turnover of FHB's mortgage bonds amounted to 7.4 billion Hungarian forints in the second quarter of 2005, exceeding the previous quarter's 5.8 billion Hungarian forints. Investment in fixed-rate mortgage bonds reached its highest figure in the third quarter of 2005.

In the third quarter of 2005 stock exchange trading of FHB's mortgage bonds was 2.3 billion Hungarian forints, which fell short of the previous quarter's figure (5.8 billion Hungarian forints) as well as of the same period of 2004 (4.6 billion Hungarian forints). A large portion of trading was again contributed by fixed interest rate mortgage bonds.

The aggregate mortgage bond portfolio of the three Hungarian mortgage banks amounted to 1,263 billion Hungarian forints as of 30 September 2005, showing a minimal decrease over the past quarter. The Bank's share of the mortgage bond market was 31.7 per cent. in the third quarter of 2005, unchanged compared to the previous quarter.

The Issuer funds its new mortgage business on a temporary basis from local banks in the short term money market and by a CHF 150 million syndicated loan. The facility was signed in September 2005.

Mortgage bond coverage

FHB decided, at the beginning of 2004 – almost half a year earlier than stipulated by law (from 10 June 2004) – to keep a stricter mortgage bond coverage ratio, i.e. to ensure principal-to-principal adequacy at all times. In line with this decision, the aggregate amount of net ordinary coverage principal – minus loss of value – and supplementary collateral principal exceeded the sum of the nominal value of outstanding mortgage bonds in circulation but not yet repaid at all times. The same adequacy rule prevailed with respect to interest-to-interest adequacy.

In accordance with the Mortgage Credit Institution Act and the provisions of its own regulations on collateral the Bank monitored the collateral situation and compliance with proportionality stipulations, thus ensuring it has fulfilled all internal and external coverage requirements.

At the end of the fourth quarter in 2004 the net value of ordinary collateral amounted to 713.1 billion Hungarian forints, a 31.6 per cent. increase in value against the 31 December 2003 amount (541.7 billion Hungarian forints).

The value of assets involved as collateral as at 31 December 2004 was as follows:

Outstanding mortgage bonds in circulation	**Hungarian forints**
face value:	366,332,210,000
interest:	211,649,442,000
total:	577,981,652,000

Ordinary collateral value	**Hungarian forints**
principal:	370,958,866,000
interest:	324,153,154,000
total:	713,112,020,000

Value of assets involved as supplementary collateral	Hungarian forints
principal:	0
interest:	0
total:	0

The value of assets involved as collateral as at 30 June 2005 was as follows:

Outstanding mortgage bonds in circulation	Hungarian forints
face value:	400,946,010,000
interest:	194,918,387,000
total:	545,864,397,000

Ordinary collateral value	Hungarian forints
principal:	389,907,761,000
interest:	337,721,734,000
total:	727,629,495,000

Value of assets involved as supplementary collateral	Hungarian forints
principal:	12,900,000,000
interest:	0
total:	12,900,000,000

The value of assets involved as collateral as at 30 September 2005 was as follows:

Outstanding mortgage bonds in circulation	Hungarian forints
face value:	399,960,760,000
interest:	189,112,180,779
total:	589,072,940,779

Ordinary collateral value	Hungarian forints
principal:	409,104,337,951
interest:	335,679,722,042
total:	744,784,059,993

Value of assets involved as supplementary collateral	Hungarian forints
principal:	0
interest:	0
total:	0

Assets involved as supplementary collateral are loans with state guarantee.

As at the end of September 2005 the Issuer has 47 series in circulation with a total nominal value of 400,944 million Hungarian forints. (Series denominated in euro are considered at the National Bank of Hungary mean foreign exchange rate as at 31 December 2004).

The number of fixed interest mortgage bonds in circulation is 36, their total nominal value is 360,531,330,000 Hungarian forints.

The number of variable interest mortgage bonds in circulation is 11, their total nominal value is 40,339,930,000 Hungarian forints.

The position of the Issuer in the Hungarian Banking System/Market

It was not until the commencement of FHB's operation in March 1998 that post-Second World War mortgage banking was launched in Hungary. The introduction of the highly novel form of operation and investment was a slow process in the domestic market.

Established in 1999, HypoVereinsbank Jelzálogbank Ltd., the second mortgage bank in Hungary initially focused on corporate financing. OTP Bank Ltd. established its own mortgage bank, the third such institution in Hungary, 2001.

Mortgage loan companies are specialist credit institutions, whose operation and legislative regulation is significantly different from other credit institutions. The most important special feature of mortgage loan institutions is that they may extend loans only under coverage of a mortgage on real estate or state guarantee. Unlike in the case of commercial banking regulations, in the course of the mortgaging of real estate as collateral a mortgage loan institution is entitled and obliged to impose a prohibition of alienation and encumbrance on the property, and have it entered on the Land Register. The majority of its loans must be long-term loans with a minimum maturity of five years. One prerequisite for the provision of such loans is that the real estate offered as coverage for a loan should be marketable, and it should be possible to establish its value; furthermore, its ownership should be clear and it should be covered by an appropriate page of title of ownership in the Land Register.

When a customer fails to meet his repayment obligations the credit institution may keep possession of the real estate, including agricultural land, serving as collateral for the loan (on a temporary basis, for up to three years).

The Bank may extend loans up to a maximum of 70 per cent. of the lending value of the real estate collateral as established by the mortgage loan institution. The lending value is established on the basis of the market value of the real estate net of the identified risks expressed in terms of money. (The principles and methods of the establishment of the lending value are regulated by Decree No. 25/1997 (VIII.1.) of the Minister of Finance on the Principles and Methodology Applicable to the Establishment of the Lending Value of Real Estate not Qualifying as Agricultural Land, and by Decree No. 54/1997. (VIII.1.) of the Minister of Agriculture on the Principles and Methodology of the Establishment of the Lending Value of Agricultural Land.)

The funding sources for the loans to be extended are raised by FHB by issuing long term covered mortgage bonds. The security of this type of investment is guaranteed by strict legislative regulation of mortgage banks, the low risks of the credit portfolio underlying the covered mortgage bonds, and the very strict and stable coverage system. The existence of the collateral of covered mortgage bonds as regulated by law is checked by the Property Supervisor at the time of each issue as well as after each issue, on an ongoing basis. The maturity of covered mortgage bonds is typically longer than five years, in line with the maturity of loans.

In making efforts to fully embrace the advantages of mortgage banking in the area of raising long term funding, FHB aims to channel the funds into long term housing and real estate financing, and, by rapid but secure growth, to reach the efficiency and profitability standards of international mortgage banks as soon as possible. The management of the Bank expects its share of the home lending market to stabilise around 30 per cent. in the long run.

Mortgage bonds market shares

	31.12.2002 %	**31.12.2003 %**	**31.12.2004 %**	**30.09.2005 %**
OTPJ	61.40	63.10	64.70	62.66
FHB	35.20	31.20	30.00	31.66

HVBJ	3.40	5.70	5.30	5.68

Source: banks' flash reports

Mortgage loans market shares

	31.12.2002 %	**31.12.2003 %**	**31.12.2004 %**	**30.09.2005 %**
OTPJ	62.00	63.90	63.20	62.51
FHB	35.20	31.50	30.50	30.91
HVBJ	3.40	4.60	6.30	6.57

Source: banks' flash reports

Competition in mortgage banking

After-tax profits as well as the ROAE and ROAA of mortgage banks continued to soar in 2003, a trend which continued in 2004 and in the first nine months of 2005, although housing lending peaked in July 2003, before the tightening of interest subsidies by the government. Since then, the pace of growth has slackened. Some of the banks successfully launched foreign exchange-based loans in order to keep up borrowers' interest in home loans.

Major indicators of the Hungarian mortgage banks (bn Hungarian forints)

Item	**HVBJ**			**FHB**			**OTPJ**		
	2003	2004	H1 2005	2003	2004	H1 2005	2003	2004	H1 2005
Balance sheet total	62.7.	88.00	99.70	310.10	415.00	467.9	674.2	885.9	892.5
Subscribed capital	3.00	3.00	3.00	6.60	6.60	6.60	17.00	20.00	20.00
Own equity	4.57	6.08	7.08	12.19	17.34	20.84	24.71	31.40	38.02
Interests received	3.33	8.53	4.88	26.00	46.85	39.38	64.07	115.20	60.38
Interests paid	2.38	6.13	3.52	16.30	31.92	27.13	40.38	75.90	36.02
Net interest	0.95	2.40	1.36	9.70	14.93	12.25	23.70	39.30	24.37
Earnings before taxes	0.71	1.77	1.01	4.95	8.38	8.36	8.55	12.65	8.73

Source: banks' flash reports

In recent years the sector has shown a tremendous growth. In 2003 FHB's earnings before taxes were ten times that of the previous year, and that dynamism stayed through the first half of 2005. In 2003 the balance sheet total more than doubled, from 115.56 billion Hungarian forints to 310.1 billion Hungarian forints, and the year 2004 was also successful, but the dynamism has decreased in the first six months of 2005. OTPJ's 2003 earnings before taxes was also more than ten times the 2002 figure, and its balance sheet total tripled, with the trend continuing in the first half of 2005. In the last two years and the first six months of 2005 HVBJ's achievement is also spectacular, though its dynamism is not on a par with the other two mortgage banks. The table above illustrates the three banks' respective market shares.

On the liabilities side, in the third quarter of 2005 OTPJ had 62.66per cent., FHB 31.66 per cent. and HVBJ 5.68 per cent. market share. (The shares on the assets side does not entirely correspond to this distribution, though the difference is not substantial.) The commercial banks also contribute to the mortgage loan portfolio, which exceeds 1,598 billion Hungarian forints in total.

The three mortgage banks' aggregate income from interest was 93.9 billion Hungarian forints in 2003, 170.58 billion Hungarian forints in 2004 and 104.64 billion Hungarian forints in the first half of 2005. Their combined earnings before taxes reached 14.2 billion Hungarian forints in 2003, increased to 22.8 billion Hungarian forints in 2004and exceeded 18 billion Hungarian forints in June 2004.

In 2004 and the first nine months of 2005 the quality of the three mortgage banks' assets remained excellent, the rate of problematic loans is below 1 per cent. for each, which was mainly due to their carefully conceived lending policy coupled with stringent rating. Maturity of assets and liabilities is well co-ordinated, the share of stable liabilities was high.

HUNGARIAN HOUSING AND MORTGAGE MARKET

Overview

In contrast to other Central and Eastern European countries, home ownership was possible in Hungary even during the period of Communist rule. A significant part of individual savings were invested in real estate. In addition, during the 1990s, local municipalities and the Government sold off, relatively cheaply, most of the state-owned housing to the former tenants. This explains why over 90 per cent. of Hungarian homes are owner-occupied.

House prices are still very high relative to income levels. Between seven and eleven years' income, on average, is required for the purchase or building of a dwelling. Despite this, the ratio of owner-occupied property is still high, while the volume of rental accommodation is lagging behind demand.

During the 1990s, construction of new houses in Hungary fell well below official targets of 40,000 homes per annum, partly due to a lack of affordable finance. While in 1990 close to 44,000 new dwellings were constructed, this number dropped below 20,000 for the year 1999. Currently, there are approximately four million flats and houses in Hungary with a ratio of 400 flats per 1,000 residents being close to the European average. However, the existing housing stock was not properly maintained and at least 25 per cent. thereof is in need of modernisation.

From the end of 1990 to mid 1999, the proportion of total bank lending for housing purposes fell from 16.6 per cent. to 1.8 per cent. The volume of housing-related loans dropped from 192 billion Hungarian forints in 1993 to 129 billion Hungarian forints in 1999.

This situation prompted the Government to introduce a new housing policy in February 2000.

Government Housing Policy and Subsidised Loan Scheme

A key strategic objective of the Government is to enable as many Hungarians as possible to acquire and maintain their own home.

The main method by which home ownership is being stimulated is the interest subsidy received by mortgage banks on mortgage bonds covered by residential mortgage loans meeting the criteria set out in Government Decree No. 12/2001 (I. 31.) on the state subsidy regime on housing, as amended by Government Decrees No. 79/2003 (VI.6.), No. 221/2003 (XII.22.), No. 251/2004 (VIII.30.), No. 3/2005 (I.12.), No. 155/2005 (VIII.11.), No. 203/2005 (IX.28.) and 244/2005 (X.31.) (the **Decree**). Through the interest subsidy scheme, the Government aims to cap mortgage loan interest rates at a level acceptable to the vast majority of potential customers. As at the date of this Base Prospectus, the following are the main criteria set out in the Decree:

(a) the loan is granted for the acquisition, construction, enlargement or commercial development of residential property;

(b) a loan may not be granted to finance the purchase of a property by an individual from his/her spouse, common law spouse or close relative;

(c) at least one of the debtors is a Hungarian national; or a foreign person authorised by the minister responsible for regional development to receive direct subsidy;

(d) the amount of the loan must not exceed 15,000,000 Hungarian forints if a home is built or a new home is purchased or 5,000,000 Hungarian forints if a second hand home is purchased or a home is expanded and upgraded;

(e) members of the same family living together in a property shall not have more than one subsidised loan secured by the property. If more than one member of a family living together has a subsidised loan, the borrowers must jointly undertake to repay the existing loan within 360 days of signing the new mortgage contract. If repayment of the old loan is not made within the time specified, the new loan will cease to be eligible for the interest subsidy and any subsidy received up to that time shall be repayable to the lending institution; and

(f) the joint annual rate of transaction interest and during the period of receiving subsidies (except for the cases of violating the contract and making an advance payment), the cost charged on any grounds and other considerations may not be more than 110 per cent. of the yield on gilt-edged securities calculated in accordance with the relevant provisions of the Decree, increased by 4 per cent., and reduced by the interest subsidies calculated in accordance with the relevant provisions of the Decree.

Prior to 16 June 2003, the Government interest subsidy payable to the Issuer on its mortgage bond funding was equal to the relevant new mortgage bond coupon plus 2 per cent., with a cap of 10 per cent. This interest subsidy calculation was valid for 5 years only. All mortgage bonds issued by the Issuer prior to 16 June 2003 will continue to benefit from the interest subsidy according to this calculation for 5 years from the date of issue.

On 16 June 2003 the Government's new interest subsidy regime came into effect. The key changes were as follows:

- the method of interest subsidy calculation is now fixed for any maturity of a mortgage bond, up to 20 years.

- the interest subsidy is no longer calculated according to the coupon of the new mortgage bond being issued but by reference to the weighted average yields on Government treasury bonds of similar maturities during auctions over the preceding 3 months.

- the maximum amount of interest subsidy which can be claimed by a mortgage bank is 105 per cent. of the average Government treasury bill yield (in the case of financing loans for the building or purchasing of a new residential property) or 105 per cent. *less* 1 per cent. (in the case of financing loans for the purchasing or improvement of a used property). If the coupon on the Issuer's newly issued mortgage bonds is lower than the maximum interest subsidy allowed on the basis of the treasury bill average, the former will be the applicable interest subsidy rate. All calculations are made at the time a new mortgage bond (or tap issue) is issued.

On 22 December 2003 the Government's modified interest subsidy regime came into effect. The key changes were as follows:

- the rate of interest subsidies is equal to 60 per cent. of the yield on gilt-edged securities (see below) when constructing or purchasing a new home, and is equal to 40 per cent. of the yield on gilt-edged securities in case a second-hand home is purchased, expanded or upgraded.

- interest level cap is abolished.

- different rules (see below) and amounts exist for new (15 million Hungarian forints) and old homes (5 million Hungarian forints).

The method of calculation of the interest subsidy was amended in 2004 and came into effect from 7 September 2004 as follows:

The rate of interest subsidy is equal to 60 per cent. of the yield on gilt-edged securities with respect to the construction or purchasing of a new home, and to 40 per cent. of the yield on gilt-edged securities in the case of purchasing, expansion or upgrading of second hand homes.

The definition of a yield on gilt-edged securities is the following: the arithmetical mean of average yields emerging from gilt-edged securities auctions held in the three calendar months prior to the monthly publication of such average yields by the Government Debt Management Agency Ltd. (*Államadósság Kezelő Központ Rt.;* **ÁKK Rt.**), when such an arithmetical mean is weighted by the quantities accepted at the relevant auctions. The rate of subsidies is to be determined for the same term as the series of mortgage bonds serving as a resource, and lacking this it is to be determined by taking the yield on gilt-edged securities relating to the next term as a basis, provided that in case the next two terms are involved, then the arithmetic mean of the associated yields on gilt-edged securities must be taken into consideration. Term is defined in accordance with the definition of the remaining average term pursuant to Section 5(1)(49) of Act CXX of 2001 on the Capital Markets (the **Capital Markets Act**). In the case of a fixed interest mortgage bond, the rate of subsidy must be determined on the basis of the yield on gilt-edged securities applying at the time of issuing the mortgage bond, for the full term of the mortgage bond, but not more than 20 years.

In those cases where the mortgage bank has not itself generated the loan, the benefit of the interest subsidy is passed on to the commercial bank in the cost of the refinancing loan, less a margin retained by the mortgage bank to cover its costs.

The interest subsidy is claimed by mortgage banks in relation to eligible mortgage bonds which are covered by residential mortgage loans meeting the criteria set out in the Decree. Payments of interest subsidy are made according to an agreement entered into by the mortgage bank and the Ministry of Finance and monies are transferred by the Hungarian State Treasury (*Magyar Államkincstár*).

There is no legal requirement that the Government maintain the interest subsidy scheme in its current form. Should the interest subsidy be terminated by the Government, mortgage banks will continue to be entitled to claim the interest subsidy in relation to relevant mortgage bonds issued prior to the termination of the interest subsidy scheme or issued after the date of termination but covered by relevant mortgage loans granted prior to the date of such termination. Accordingly, termination need not have any effect on existing qualifying mortgage loan borrowers.

In 2005 a new "Nest building programme" was introduced. The main features are:

- young couples under 30 are eligible for buying a first home
- low level (10 per cent.) of own resources acceptable
- government guarantee for the remaining part between 60-90 per cent. LTV ratio
- deferred start of instalments

Any new measure: extension of the state guarantee for civil servants' and public sector employees' mortgage loans.

The most important legislative changes that took place in the third quarter of 2005 pertain to state subsidies on housing and the valuation of non-agricultural property involved as loan collateral. The Decree has been repeatedly amended during the year. The August 2005 amendment reduced the maximum available amount of housing support while at the same time it expanded the scope of personal criteria to be certified by the municipal clerk which are required of applicants for direct support. Decree No. 25/1997 (VIII. 1.) PM of the Minister of Finance on the Methodology of Valuation of Non-agricultural Property Involved as Loan Collateral was also amended in August 2005. The comprehensive amendment of this later Decree has upgraded the former regulation based on the accumulated experience of the mortgage lending sector.

Hungary is a member of the European Union, and is subject to European law and legislation including, among other things, the state aid rules of the Treaty establishing the European Community, as amended (the **Treaty**). The Subsidy Supervision Office of the Ministry of Finance reviewed the Government Decree No. 12/2001 (I.13.) on state subsidies for housing purposes, and, based on this investigation, stated that the Government Decree referred to above does not contain elements that would be incompatible with either Hungarian or EU provisions governing state subsidies. While the need for and, if any, the scope of amendments to the current Hungarian regime is unclear, potential amendments may occur.

Trend Information

There are no trends, uncertainties, demands, commitments or events that are reasonably likely to have a material effect on the Issuer's prospects for at least the current financial year.

The data, information, figures, analyses are based on the KSH DEM Information and Economical Research Institute and on the prognosis of GKI Economic Research Institute.

THE HUNGARIAN BANKING SYSTEM AND CAPITAL MARKET

Evolution of the Hungarian banking system and its performance in 2003, 2004 and the first half of 2005

The history and evolution of the Hungarian banking system

The first phase of the modernisation of the banking sector commenced in the early 1980's by loosening the centralised capital allocation regime that had been established in the one-tier banking system. After two years of preparations and a year of simulation experiment the two-tier banking system was introduced in early 1987, where banks performing their operations on a commercial basis were institutionally separated from the NBH performing the tasks of the central bank. Besides commercial banks and savings co-operatives licensed to perform a wide range of banking operations financial institutions specialised in more specific sets of operations also entered the market at a later stage. The Act on Financial Institutions (the **Financial Institutions Act**) entered into effect in 1991 and laid the foundations of regulation and supervision along the guidelines of the Bank for International Settlements (BIS).

The main functions of the Financial Institutions Act were as follows: creation of a secure and prudent banking system; reinforcement of savings; strengthening investors' trust; promotion of lending operations in conformity with the demands of economic development; expansion and upgrading of the choice of services offered by banks; regulation of undertaking risk; and expedition of the integration of the Hungarian banking system in international money and capital markets and in the international banking business.

The establishment of certain supplementary institutions promoted the strengthening of the Hungarian financial sector. They included Hitelgarancia Ltd. (Credit Guarantee Plc.), which was founded in 1992 to provide guarantees primarily on loans extended to medium-sized enterprises to alleviate the credit risks entailed by this particular segment. Országos Betétbiztosítási Alap (National Deposit Insurance Fund) has operated since 1993, providing guarantees for deposits up to one million Hungarian forints per individual deposit. OTIVA (National Institution Protection Fund of Savings Co-operatives), the joint organisation of savings co-operatives has been co-ordinating issues of legislation pertaining to savings co-operatives since 1993, based on the participants' mutual interests. Eximbank and MEHIB Ltd. (Hungarian Export Credit Insurance Company) are also important supplementary institutions promoting the banking system in the areas of export credit insurance and in the provision of insurance coverage against exchange rate risks

Owing to the portfolios of bad debts they inherited, the difficulties of the transformation of the economy, a diminishing propensity of households to save, the sizeable deficit of the budget, and the collapse of the former CMEA market, banks experienced a progressive deterioration in their positions from 1991. Banks suffered substantial losses as a result of the new and increasingly tough regulations and laws, and ultimately the state decided on providing assistance to the banking system. The bank consolidation scheme implemented in 1993 by the state restored the operability of banks, however, it did not improve their profitability. Consequently, this was followed by another set of state interventions. In 1994 the state effected capital increases – providing subordinated loan capital – in the majority of banks. The result was a substantial increase of state ownership in the banking sector.

From mid-1996 the balance sheet positions of banks started to gradually improve, their balance sheet totals grew, decision making improved, consequently, the quality of their lending portfolios also improved. In 1997 a more spectacular growth took shape, primarily owing to an increasingly dynamic growth in the economy of Hungary, which started about the same time. Privatisation of banks also accelerated in the same year, and the largest Hungarian banks were taken over by foreign owners.

In 1997 the Financial Institutions Act was replaced by the Credit Institutions Act. One of its major purposes was to facilitate the Hungarian banking system to adopt the unified banking standards of the European Union.

The development and evolution of the Hungarian banking market has been following the relevant international trends: the directives aimed to create a single European market give preference to the universal banking model. The legislation on the Hungarian money and capital market is aimed at helping banks catch up with the vanguard of the industry. Hungary was the first country in the region to pass new laws (regulating certain specialist lending institutions, home savings funds and mortgage loan institutions), which promoted specialisation, and at the same time – in line with the principle of universal banking – enabled lending institutions to provide traditional investment banking services as well, to trade in securities and to participate in the public issue of securities as lead managers or co-managers. Since 1998 foreign lending institutions are permitted, in line with the EU standards, to establish branch units in Hungary pursuant to European procedures. The new regulation on sovereign risks establishing the mandatory level of reserves to be generated was also introduced in 1998.

In the mid-1990s a drastic reduction began in the number of lending institutions. In the first half of 2000 the co-operative sector was primarily affected by this trend. Despite the mergers observed in the domestic banking sector in recent years the concentration of the banking market diminished somewhat – while in 1989 the asset portfolio of the five largest lending institutions accounted for 80 per cent. of the market, and in late 2000 the corresponding figure was only 50 per cent. In the period between 2002 and 2004, in the wake of some of the latest mergers (BACA-Hypobank, KHB-ABN-Amro, Erste-Postabank) concentration has increased again. With its 12 per cent. market share the new K&H has become the second, and HVB Bank Hungary the fifth largest bank in Hungary.

Following the phase of intensive development starting in 2000, the dynamics of the establishment of branch offices has diminished, although competition between banks for retail customers has been intensifying. Cost cutting and staff reduction has become essential for lending institutions with diminishing profitability. The introduction and rapid spread of electronic banking services has played an important role in this process.

The major institutional, regulatory and professional development that had occurred in the banking sector over the past fifteen years resulted in the emergence of ownership, institutional and product structures which characterise a modern market economy. Today, the Hungarian banking system essentially meets the requirements of the EU's single money and capital markets in terms of both regulation and competitiveness. In 2001 Hungary concluded harmonisation of the capital adequacy requirements of banks and investment companies with the EU's Directive 93/6. No major structural or business changes are expected after Hungary's accession to the European Union on 1 May 2004. EU membership means that Hungary has become a part of the internal market, which has considerably simplified procedures for EU lending institutions wishing to operate in the Hungarian market, to engage in cross-border transactions, and to establish branch offices in Hungary.

Banks play a prominent role within the financial sector. About three-quarters of mediated capital is concentrated at banks. However, despite the spectacular development experienced since the introduction of the two-tier banking system, the level of penetration continues to be low in international comparison (amounting to 76 per cent. of the GDP at the end of June 2005 compared to 36.6 per cent. of the end of 2002, 69 per cent. at the end of 2003, 72 per cent. in December 2004) as opposed to 100-200 per cent. in non-Central European emerging markets, and over 200 per cent. in developed EU member states.

Supervision and regulation of the banking system

In the Hungarian banking system both the NBH and the PSZÁF by its Hungarian acronym, perform supervisory functions. Between them the two institutions undertake supervision of all of the legal entities engaged in banking in Hungary.

(B) National Bank of Hungary

NBH controls the volume of money in circulation and foreign exchange management; it adopts decisions and resolutions on the governance of the money market, interest rates, foreign exchange transactions and the supply of statistics. NBH demands that all lending institutions place in reserve funds amounting to a specified portion of their adjusted liabilities.

NBH may act as an ultimate resort to assist lending institutions faced with transitional liquidity problems. Any loan that NBH extends to a commercial bank will become an unguaranteed obligation of the borrowing bank. Furthermore, NBH is also capable of extending liquidity to credit institutions through the repo transactions system, in accordance with the current monetary policy. In addition, NBH has ongoing consultations with the banks, and holds on-site audits in its capacity of supervisory organisation.

(C) Hungarian Financial Supervisory Authority

Since April 2000 duties of supervision of the banking sector have been carried out by a consolidated authority supervising the entire Hungarian financial sector including banks, investment service providers, investment fund managers, insurers and pension funds, the PSZÁF, but the NBH has retained some supervisory powers. In co-operation with the Governor of the NBH and the Minister of Finance, PSZÁF supervises compliance with the provisions of the Credit Institutions Act and the Capital Markets Act (paying special attention to capital adequacy, operations, liquidity and the valuation of assets).

The PSZÁF's authorisation is required, among others, for establishment of a bank and the modification of its scope of business. Certain activities such as, for instance, issuance of cash substitutes including direct debit and credit cards, operation of electronic transfer systems of accounts settlement, and money processing require a special licence issued by NBH. The PSZÁF is entitled to launch site audits, to take actions in the interest of compliance with the Credit Institution Act, and to initiate proceedings. The PSZÁF is obliged to audit every mortgage bank on their respective premises every other year, and audits NBH every year.

The PSZÁF can avail itself of a large choice of devices to eliminate deficiencies and irregularities detected at lending institutions, from notification and enforcement of mandatory decisions, restrictions or bans on certain functions of the offending institution, delegation of a superintendent, to the ultimate measure of withdrawing the licence of operation of the credit institution. Apart from the above administrative powers, as an exceptional measure, the PSZÁF may also impose a fine for infringement of legal regulations and NBH orders pertaining to financial services and supplementary financial services, or for failure of compliance with the Credit Institutions Act, the Mortgage Credit Institution Act, and the PSZÁF's decisions, or for late or insufficient compliance.

The banking sector in 2003, 2004 and in the first half of 2005 – outstanding performance, slowing dynamism

The performance of the banking sector was particularly outstanding in 2004 and this also continued in 2005. Home loans reached unprecedented heights. Moreover, banks' involvement in financing enterprises increased along with a substantial growth in overdraft and consumer credits.

The aggregate balance sheet total of the banking sector at the first half of 2005 amounted to 15,936 billion Hungarian forints, 8 per cent. higher than in 2004. This increase is due to soaring lending, and in particular, FX loans. In the first half of 2004 the balance sheet total was 7 per cent. higher than the 2003 year-end figure, while the year-on-year increase was 19.8 per cent. This dynamic growth slackened in the first half of 2004. Hungary's accession to the European Union on 1 May 2004 brought no change in terms of the number of agents in the Hungarian banking sector: as of 30 June 2004 there were 31 banks and five specialist financial institutions in operation.

Main characteristics of the Hungarian banking sector in 2003, 2004 and in the first half of 2005

Feature	2002	2003	2004	06/2005
Number of institutions	37	36	35	n.a.
Number of employees	26,594	27,167	27,190	n.a.
Balance sheet total (bn Hungarian forints)	10,196	12,860	14,756	15,936
Credits/loans (bn Hungarian forints)	6,097	8,126	9,383	10,260
Deposits (bn Hungarian forints)	6,660	7,277	7,852	8,107
Shareholders' equity (bn Hungarian forints)	888	1,071	1,245	1,447
Earnings before taxes (bn Hungarian forints)	125.00	212.20	323.80	190.80*
Return on average assets (ROAA)	1.70	1.80	2.00	2.48
Return on average equity (ROAE)	18.30	21.10	23.40	28.11
Interest margin	4.20	3.90	3.91	4.00

Source: PSZÁF reports for 2003, 2004 and first half of 2005

* after tax profit

Return and efficiency indicators improved considerably in the wake of keener activity. While the average return on assets (ROAA) was only 1.69 per cent. at the end of 2002, in 2003 it reached 1.85 per cent., reached 2 per cent. in 2004 and stood at 2.48 at the first half of 2005. The average return on equity (ROAE) in the banking sector was 21.1 per cent. in 2003, it reached 23.4 per cent. in 2004 and stood at 28.11 per cent. at the first half of 2005. These indicators are extremely favourable in international comparison. Besides the growth in the balance sheet total and lending, the fact that this growth did not entail an increase in a similar increase in operating costs was also a significant contribution to profitability

The 2003 decrease in interest margin was not detrimental for banks as cost effectiveness coupled with the net result from commissions and other items substantially improved profitability. However, the interest margin increased again during 2004 and 2005.

The boom in home lending had a positive effect on the securities portfolio of the banking sector. At the end of 2003 the securities portfolio grew to reach 2,156.1 billion Hungarian forints, thus achieving a 42.1 per cent. year-on-year increase. The increase in the securities portfolio was due primarily to an increase in mortgage bond issues. The rapid growth of 2003 couldn’t be repeated in 2004 (2,090 billion Hungarian forints) and 2005 (2,229 billion Hungarian forints).

Change in major assets in the banking sector

Item	31 Dec 2002	31 Dec 2003	31 Dec 2004	30 June 2005
Total assets (bn Hungarian forints)	10,195.6	12,860.00	14,756	15,936
Including cash and settlement accounts (bn Hungarian forints)	490.73	452.23	722.30	592.74
Securities (bn Hungarian forints)	1,517.23	2,155.04	2,090.54	2,229.48
NBH and inter-bank deposits (bn Hungarian forints)	1,444.53	1,286.82	1579.86	1763.61
Loans (bn Hungarian forints)	6,096.70	8,126.00	9,383.20	10,260.32

Source: PSZÁF report for 2004 and first half of 2005

Lending increased in 2004: disbursements were 1,357.2 billion Hungarian forints, or 16.7 per cent. higher than in the previous year. The contribution of loans denominated in foreign exchange to entrepreneurial loans increased, but Hungarian forint loans continue to dominate, contributing about 60 per cent.

As regards loans extended to households, the increase in housing mortgage loans was high in 2004: home loans, reached 1,774 billion Hungarian forints. Overdraft and consumer credits also went up, but their contribution was dwarfed by housing mortgage loans. Overdraft credits increased by 23.5 billion Hungarian forints, or 35 per cent., and consumer credits grew by 155.1 billion Hungarian forints, or 23.8 per cent. in 2004 compared to December 2003. Foreign exchange denominated lending produced an even more spectacular growth than home loans, but its contribution to banks' household financing continues to be small with growing tendency.

The year of 2004 was characterised by a slowing in the growth of lending: the loan portfolio was only 18.3 per cent. up compared to the previous year, and this continued in the first half of 2005 as well. The portfolio of slowly increased.

In houshold financing and corporate lending, the decline was most noticeable in terms of Hungarian forint-based loans, while at the same time a highly dynamic growth occurred in foreign exchange-based loans: for example, home loans were 80 per cent. higher at the end of June 2004 than at the end of 2003, amounting to 32 billion Hungarian forints, and it reached 145 billion Hungarian forints at the end of 2004, the trend remained unchanged in 2005 as well.

By the end of June 2005 the quality of the portfolio of the entire banking sector deteriorated compared to the end of 2004. At the end of 2005, 5.22 per cent. of the entire portfolio belonged to the watch category, and 1.73 per cent. of items were problematic[*] loans.

[*] Problematic items include substandards, doubtful and bad loans.

Rate of problematic items in the portfolio of the banking sector (%)

Item	Problem-free				To be watched				Problematic			
	12.2002	**12.2003**	**12.2004**	**06.2005**	**12.2002**	**12.2003**	**12.2004**	**06.2005**	**12.2002**	**12.2003**	**12.2004**	**06.2005**
Total balance sheet items	88.60	90.70	92.62	90.06	7.80	6.30	4.52	7.15	3.70	3.00	2.86	2.78
Placement to lending institutions	96.40	98.50	99.75	98.10	3.00	1.20	0.22	1.83	0.60	0.30	0.03	0.06
Entre-preneurial credits	84.60	85.20	88.84	84.78	11.70	11.10	7.24	11.67	3.70	3.60	3.92	3.55
Retail credits	91.10	94.90	94.43	93.09	5.50	2.60	3.16	4.35	3.40	2.40	2.41	2.56
Foreign Placement	82.50	82.80	81.36	78.41	14.90	14.30	15.65	16.90	2.60	3.00	2.99	4.68
Off-balance sheet items	97.20	97.60	97.73	96.76	2.40	2.00	1.62	2.83	0.40	0.40	0.64	0.42
Categorised items	92.80	94.10	94.80	93.05	5.10	4.20	3.29	5.22	2.10	1.70	1.92	1.73

Source: PSZÁF report for 2004 and the first half of 2005

Foreign ownership continued to dominate in the banking sector in 2003: 81.9 per cent. of the total subscribed capital in the banking sector was directly owned by foreign proprietors, 3.6 per cent. more than in 2002. The almost 39 billion Hungarian forints increase resulted from privatisation and capital increase. There was barely any change in ownership structure in 2004 and 2005.

Ownership structure in the banking sector based on subscribed capital (%)

Description	**12.1999**	**12.2000**	**12.2001**	**12.2002**	**12.2003**	**03.2004**	**12.2004**	**06.2005**
State ownership	19.50	21.30	25.00	6.90	0.90	1.00	0.90	n.a.
Domestic private ownership	12.80	9.40	8.70	10.20	13.10	12.80	11.50	n.a.
Foreign ownership	65.40	66.70	63.00	78.30	81.90	82.00	80.40	82.1
Preferential shares	2.40	2.60	3.20	4.60	4.00	4.30	7.28	n.a.
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	

Source: PSZÁF report for 2004, and first half of 2005

Concentration in the bank sector continues to be strong. In December 2004 the ten largest banks contributed 77.5 per cent. of the total assets of the entire sector. Concentration is also conspicuous at the level of lending and deposits. There is an even heavier concentration in home loans. More than half of the market is ruled by OTP Group, although it lost some of its share to the other lending institutions.

The banking sector's performance was outstanding in 2003, 2004 and in the first half of 2005. The sector's aggregate earnings before taxes soared to 323.8 billion Hungarian forints at the end of 2004 from 212.2 billion in 2003 and the after tax earnings stood at 190.8 billion Hungarian forints at the end of the first half of 2005. This excellent performance is due primarily to an increase in the loan portfolio, the high domestic yield and interest rate, and the cheapness of foreign funds.

HOUSING POLICY, MORTGAGE AND REAL ESTATE MARKET

Housing policy – growth of the mortgage lending sector in 2000-2005

The strategic goal of the government's housing policy is to enable as much of the population as possible to acquire their own homes, and to help them to maintain their homes. To this end the government's housing policy was modified in July 2000 by virtue of Government Decree No. 1041/2000 (V.31.) Many of the components of the multi-stage system were retained, for example the home building benefit (the so-called social policy benefit), home extension benefit, tax refund, reduced duty fee to young persons, support on housing-related savings, prefab loans, support to accessibility-related conversions, etc.

In addition, as of July 2000 supplementary interest subsidy was granted not only to married couples under 35 years of age and families supporting three or more minor children as well as couples having a third child within three years, but it was extended to all married couples and single parents. Another benefit was low-interest loans extended to not only those who built or purchased their first new home but also for building or purchasing any new home. The maximum amount of loan increased from eight to thirty million Hungarian forints.

The duty formerly levied on new homes purchased was lifted, procedure was simplified, and from 2001 the Land Registries were obliged to enter mortgage loans in the context of an extraordinary procedure. The leased homes programme implemented by the municipalities was also launched.

From October 2001 the market instrument that had already been applied earlier – the general interest subsidy – whereby the state provides a three percentage point budgetary subsidy on interests on mortgage bonds used as the funding source for loans – was retained, indeed, the rate of the subsidy was increased from 3 per cent. to 10 per cent., and the duration of subsidy, was increased to 20 years (Government Decree No. 207/2001 (X. 30.)). Based on the general interest subsidy the three mortgage banks make available long term funds raised in the capital market by way of mortgage bonds to the commercial banks participating in the programme pursuant to refinancing agreements. Under this programme, from February 2000 loans may be taken out in the market at interest rates more than 10 per cent. below the rates prevailing in earlier years, for purchasing new or used dwellings, for the enlargement or modernisation of homes, for residential construction and for the renovation of the jointly owned parts of condominiums.

The solvent demand emerging in the wake of the implementation of the new housing policy of the Government stimulated residential construction, boosted turnover in the housing market and reinvigorated domestic economic processes. As a result of an improvement of the economy, in the wake of the increased participation of the state in residential construction the volume of residential construction is expected to enter a boom period during the coming years.

Some of the significant legislative changes included the Decree. Aimed at the approximation of Hungarian regulations with those of the EU, the amendments expanded the scope of eligibility to include EAA workers and their family members. The scope of financial institutions providing services relating to the types of support specified under the Decree was more accurately delineated.

The Government Decree on housing support extended by the state was amended twice in 2003. In June, there was a change in the rules of settlement based on the yield on government securities resulting in a narrowing of interest margin that could be achieved by banks. The amendment passed in December reduced the size of government support and increased interest rates borne by clients. At the same time the maximum amount of loan was also reduced. The amendments, along with the expansion of FEX-based loans offered by commercial banks contributed to a drop in demands for subsidised Hungarian forint loans.

Clients' expectations of a new increase in housing support and benefits did little to boost the number of new loan transactions and resulted in postponing loan applications. The decree on subsidised housing envisioning an increase in residential construction support entered into effect as of 1 April 2004.

Another significant change in the legislative environment was the amendment of the Mortgage Credit Institution Act. Entered into effect as of 14 June 2004, the amendment was generated by Act XLVIII of 2004 on the Amendment of Certain Acts on Financial Services. It enables credit institutions to purchase mortgage loans or independent liens from other lending institutions or insurance companies even in cases where such institutions and companies are not entitled to impose a restriction on alienation or encumbrance of the mortgaged property. In such instances it is sufficient for the lender to notify the client in the loan agreement that in case the mortgage loan (or independent lien) is purchased, the mortgage loan institution is bound by a restriction of alienation and encumbrance.

The amendment paved the way for FHB to offer its partner banks to refinance non-subsidised mortgage loans (including foreign exchange-denominated mortgage loans). The law also provided for the combined value of principal receivable considered as cover, less loss in value, should exceed the outstanding nominal value of mortgage bonds in circulation, and the same applies to interest. This amendment further enhanced the security of cover of mortgage bonds, in keeping with international regulatory requirements.

As a result of changes in the provisions relating to interest subsidy it became unequivocal that subsidised interest is applicable for mortgage bonds denominated in currencies other than the Hungarian forint, subject to the terms and conditions set forth in the Decree. The legislators also determined that loans with subsidised interest can only be extended in Hungarian forints.

The Credit Institutions Act was amended several times in the course of 2004. In terms of the Bank's operation, the most significant amendments related to the rules of debtor registration, and full-fledged client information in respect of FEX-based housing loans.

The legislative changes which took place in the first quarter of 2005 brought significant changes in the rules of consumer loans under the Credit Institutions Act, and widened the group of people eligible for state surety.

According to the amendment, the Capital Markets Act's provisions pertaining so far only to consumer loans are mandatory for personal loans as of 1 January 2005. Accordingly, the legal consequence of failure to include in the loan agreement the items specified by law (such as, for instance, the total loan fee indicator in terms of annual percentage, all costs related to the loan, etc.) will be the annulment of the agreement.

The amendments promulgated as part of Act CXXXV of 2004 on the Budget for 2005 extended the scope of State surety to include, in addition to civil servants, debtors who are public employees, employees in the service of the prosecutor’s office, the judiciary and the military, or serve in public security. This means that debtors working in the public sector are eligible for home loans with uniform terms and conditions. The Decree was also amended: the amount of preference attached to home construction was increased, and the rules of housing support extended to young people were delineated.

A new feature in the State’s involvement is Decree No. 4/2005. (I. 12.) Korm. of the Government setting forth the detailed rules of undertaking and enforcing State surety in connection with loans extended to young debtors. The Decree is aimed at helping young people to acquire a home of their own who have only a minimum of own funds and although they would be able to make repayments, they cannot raise sufficient loans in the absence of coverage. State guarantee amounts to the portion exceeding 60 per cent. of the loan-to-value ratio, up to a maximum of 100 per cent.

The housing market at the turn of the millennium

Partly due to the lack of solvent demand, the domestic housing market was quite idle up to 1998. The number of newly built dwellings declined across Hungary as a whole until it bottomed out in 1995. In 1999 some 23,000-25,000 new homes were built, whereas the established objective was to build some 40,000 new homes each year. The quality of the housing stock was not quite up to the expected standards: a substantial proportion of the existing dwellings lacked all or some of the standard modern conveniences. Renovation and refurbishment projects were hardly launched in Hungary at all. By contrast, in Western Europe the value of renovation and refurbishment accounts for about half of the total value of new construction. Some 78 per cent. of the total of approximately four million dwellings were built more than 20 years ago, moreover, about half of these are older than 50 years.

Another characteristic feature of the domestic housing market is the small proportion of leased homes – more than 90 per cent. of dwellings are owner-occupied. The corresponding figures in Germany, France and the USA are 41 per cent., 54 per cent. and 64 per cent., respectively. This is one of the reasons for the very low level of mobility of the Hungarian population in terms of housing, particularly by international standards. By contrast, housing prices are extremely high in Hungary in comparison with household incomes, judged by the corresponding indicators and ratios of western countries. While in the United States of America two or two and a half years' average income of a household will buy a home (in Great Britain it takes 3-4 years' income), in Hungary 7-11 years' average household income is required, on average, for purchasing or building a home.

Banks provided very modest funding for this market in 1999: the share of lending for housing purposes had dropped from the 16.6 per cent. in 1990 to 1.8 per cent. by mid-1999 within the operations of credit institutions. The portfolio of housing loans was also very small in comparison with household incomes, at 2.6 per cent. (by contrast, in France and in the USA the corresponding percentages are 48 and 69 per cent., respectively). In Hungary less than 10 per cent. of the purchase price of dwellings is financed from loans, compared to 70 per cent. in western countries.

Analyses revealed that about 40,000 new dwellings should be constructed each year and a very large number of existing homes needed renovation, the annual credit requirement of which would be at least 4-500 billion Hungarian forints. In international comparison, the volume of housing loans varies between 20 per cent. and 40 per cent. of the GDP of various countries – in the case of Hungary this would assume a market of 3,000-5,000 billion Hungarian forints by 2001.

The market has been characterised by a monopolistic structure: it is dominated by OTP and the savings co-operatives who have a joint market share of 90 per cent. The market share of the rest of the banks is negligible, at the end of 1999 the mortgage-type housing loan portfolio within their total portfolio amounted to merely 15 billion Hungarian forints, equalling some 0.3-0.4 per cent. of their balance sheet total figures. By the end of year 2001 this proportion had improved somewhat, and in the field of mortgage-based housing loans, a fundamental change in the market share started from 2002. Banks entering the market of housing loans are still faced with a variety of obstacles, including the still rather high rate of inflation, the low levels of solvent demand on the part of retail customers, the poor repayment discipline, the substantial costs of network building, etc.

Other real estate business in 2000-2005

Budapest has remained the most active area within the Hungarian real estate market. There was a massive drop in utilisation of real estate for housing and traditional residential service provision purposes in the inner districts of the capital city. This was replaced by real estate development for business and commercial purposes, and a governmental and banking district of high standards has evolved along with infrastructure projects aimed at satisfying the demands of this sector. Some 70-80 per cent. of the branch offices of the largest banks of the world are located in this district in Budapest. It is highly likely, however, that demand will also steadily increase in provincial large towns of Hungary in the coming years, and a permanent growth is expected in all areas of the real estate market together with increasing demands for funding. Demand for real estate in Hungary has been dynamically growing since 1996, and over the next decade the market is expected to undergo a gradual consolidation process.

As for the office-block market: although, after the political changeover, well-positioned head offices and other premises of former state-owned enterprises were available in Budapest, substantial construction projects were also launched. However, the office blocks constructed four or five years ago are becoming increasingly insufficient to satisfy increasingly high standards of demand. Many lessees are seeking to use undivided up-to-date spaces of a minimum of 1500-2000 square metres. This is the reason for the growth in demand for 'Category A' office blocks outside the city centre. No real office block market has evolved in Hungary outside Budapest as yet, however, vigorous growth is expected to take place in the coming years. In 1998 demand for some 50,000 m2 office space was recorded, and there was a substantial new offer in the 'Category A' market. The total office space on offer was about 84,500 m^2. The total new offer in 1999 was some 118,000 m2, most of which was constructed along Váci út.

In the category of commercial real estate concepts satisfying the requirements of multinational enterprises, offering commercial premises, retail facilities of large floor areas and those combining shopping with catering and entertainment have been successful so far. In 2000 there were already about 40 shopping malls operating in Budapest. Competing networks have started to expand to larger provincial towns as well, and many so-called commercial/trading parks have appeared around Budapest.

In the market of warehouses, logistics centres and industrial parks, high-standard real estate is practically unavailable; the offer is comprised primarily of real estate in need of refurbishment. The demand for real estate of appropriate functional and technical standards will gradually increase over the next few years. Real estate of a total area of between 500 and 1000 m^2 is in highest demand. The demand for logistics companies for warehouses tailored to their requirements is expected to grow dynamically in the near future. The majority of the large-scale green field investment projects are implemented in industrial zones called industrial parks.

The housing market in 2004 and in the first half of 2005

In 2003 the production of the building industry surpassed the previous year's level by 0.7 per cent. While still lagging far behind the dynamism of recent years, this modest overall growth is considered positive compared to the spectacular decline in early 2003. Building constructions continued to be dominated by subsidised homes as well as industrial and commercial buildings. The year of 2003 was medium-to-good for the real estate market: after a drop in sales in the first three quarters there was a turn in the last quarter and an upward trend took shape. On the one hand, people bought lots for construction earlier than originally planned because of the pending introduction of VAT on land; on the other hand, many people decided to buy at the end of the year because of the government's move to reduce the amount of loan with subsidised interest available for purchases of existing homes. The combined effect was a boom in both land and sales of existing homes.

According to Euroconstruct's forecast, the growth of construction investment in the CEE countries is expected to exceed the GDP growth from 2004 on, which in Hungary's case means a 7 per cent. expansion of the building sector in 2005.

CSO statistics confirmed 2003 to be an outstanding year in terms of housing construction: 2003 brought a peak since 1986 in the number of new home building permits and the number of accomplished homes was also highest since 1991. In 2003 licence of usage was issued for a total of 35.5 thousand homes, and the construction of more than 59 thousand new homes was started on the basis of newly issued permits. This massive expansion in housing construction was due predominantly to developments that occurred in the fourth quarter, when 39 per cent. more new building permits and 28 per cent. more licences of usage were issued than in the previous year. 62 per cent. of the homes accomplished and ready for use were built in the retail sector, one-third by business enterprises, and 4 per cent. by municipalities. The average floor area of new homes (95 square metres) did not change compared to 2002, however, the average construction time became a month shorter (412 days).

Changes in the housing loans portfolio in 2004 were not only quantitative but also structural. There was a significant drop in the growth of monthly housing loan portfolios from the beginning of the year along with keener foreign exchange-based mortgage lending. The shrinking of the monthly portfolio slowed until it came to a halt in August, but the monthly increase of loans continued to lag behind the 2003 figures.

Appearance of foreign exchange-based mortgage loans reversed the negative trend and the monthly loan portfolio started to slowly pick up in April. The unequivocal sign of foreign exchange-denominated loans gaining ground is that by the end of the summer of 2004 the contribution of FEX-based loans to the overall growth of home loans was about the same as that of Hungarian forint home loans. When analysing the changing trend, it is to be noted, however, that FEX loans only contribute 5.1 per cent. to total loans, and that Hungarian forint loans have been substantially reduced through repayment.

In the first half of 2004 retail home loans increased by 14.1 per cent. or 196.2 billion Hungarian forints, as opposed to 44.4 per cent. in the first half of 2003. The difference is due partly to the fact that a number of people contemplating housing loans rescheduled to apply earlier, having learned about the cuts envisioned in subsidies. Consequently, after the 89.7 billion Hungarian forints peak in July 2003 there was a steady decline in the amount of new housing loans until it bottomed out at 18.9 billion Hungarian forints in May 2004. The drop in the number of housing loan contracts came to a halt in June 2004. Competition among the banks seemed to have shifted to the FEX-based home lending.

Residential building permits

	1st half 2002	2nd half 2002	1st half 2003	2nd half 2003	1st half 2004	2nd half 2004	1st half 2005
Number	22,615	26,147	25,902	33,339	27,862	29,597	24,865
Total		**48,762**		**59,241**		**57,459**	**24,865**

Source: Central Statistics Office of the Republic of Hungary

Occupancy permits

	1st half 2002	2nd half 2002	1st half 2003	2nd half 2003	1st half 2004	2nd half 2004	1st half 2005
Number	10,015	21,496	9,181	26,362	13,659	32,485	15,102
Total		**31,511**		**35,543**		**46,144**	**15,102**

Source: Central Statistics Office of the Republic of Hungary

There was an unprecedented expansion in the retail home loan market in 2003: growth amounted to 1,394 billion Hungarian forints, double the 2002 year-end figure of 693 billion Hungarian forints, and exceeded 1,589 billion in the first half of 2004. The bulk of the increase was contributed by mortgage bond-based housing loans offered by financial institutions with extremely favourable terms and conditions.

Residential loan portfolio

	June 2002	Dec 2002	June 2003	Dec 2003	June 2004	Dec 2004	June 2005

Portfolio bn Hungarian forints	393.90	692.80	1,007.30	1,393.90	1,589.10	1,816.6	2,075,1

Source: Central Statistics Office of the Republic of Hungary

The growth rate of housing loans of households in 2004 returned to the normal level, due to the reduction of subsidies granted by the state, the increase in the Hungarian forint interest level, and to the ceasing demands carried over from 2003 at the beginning of the year –, which level considerably fell behind the vigorous rate of growth during the previous years. As an effect of the decree on subsidies the proportion of such loan portfolio increased by 141 per cent. in 2002 compared to 2001; annual growth in 2003 amounted to 94 per cent. As a consequence of the amendment of the decree in December 2003 and of the changing market conditions, the housing loan portfolio in 2004 surpassed the year-end figure of 2003 only by 27 per cent.; the portfolio as of 31 December 2004 amounted to approx. 1,910 billion Hungarian forints.

The rate of growth of the level of Hungarian forint housing loans also indicates a significant slow-down: the extension of the loan portfolio slowed down to one-fourth between July 2003 and April 2004; the monthly average growth rate in the year 2003 amounting to 59 billion Hungarian forints fell back to 23 billion Hungarian forints in 2004. The regression of the growth in Hungarian forint loan portfolio – in parallel with the intensification of foreign currency based mortgage loan disbursements – stopped after the bottom in April and a slow growth started; nevertheless from August 2004 it declined again and fell far behind the same period of the base year.

An unequivocal sign of the foreign currency housing loans gaining ground is that the importance of foreign currency housing loans exceeded that of Hungarian forint housing loans in the second half of 2004 in the growth of the housing loans portfolio. The increase in the portfolio achieved 100 billion Hungarian forints during this period. However, it has to be mentioned that the change in the Hungarian forint loan portfolio in 2004 already included a significant level of repayment, while in the case of foreign currency housing loans with a portfolio starting practically from zero included a minimum level of repayment (owing to annuity repayments).

The increase in foreign currency loans also implied in 2004 the restructuring of loans granted to retail customers covered by mortgage established on real estate. Home loans increased merely by 25.2 per cent., while the level of *other non-home mortgage loans went up by 70.8 per cent. amounting to 82 billion Hungarian forints* during the past year. Within this Hungarian forint loans (typically with market interest rates) decreased by 25 billion Hungarian forints, while the portfolio of foreign currency loans grew by 107 billion Hungarian forints.

The slow-down of the growth rate of the housing loan portfolio in the last year continued in the first half of 2005 as well. The annual growth rate has developed in the following way since 2001: the retail housing loan portfolio increased by 140 per cent. in 2002, by 93.7 per cent. in 2003, and by 26.6 per cent. in 2004; and by 7.5 per cent. in the past period of 2005. The growth rate of the monthly portfolio of Hungarian forints housing loans (particularly in the first quarter of 2005) decreased significantly, nevertheless, it reached a monthly amount of 32 billion Hungarian forints by the second quarter; still it represents only an average growth witnessed in 2004.

The first quarter of the year reflects a considerable setback in relation to 2004. Neither the "Nest Building" Program introduced nor the demand impact of the significantly decreasing FX and Hungarian forints interest rates could compensate for the stopping short of the growth rate in the first quarter. The monthly growth figures of the second quarter, nevertheless, indicate the overall revival of the housing loan market, the result of which is the increased disbursement activity witnessed since May. FX housing loans have taken over the leadership in the growth of the housing loan portfolio, and have significantly exceeded that of the Hungarian forints housing loans since August 2004 in terms of both amount and growth rate. The permanently low CHF interest rate and the strong Hungarian forints in spite of decreasing interest rates have driven demands towards FX loans even if unambiguous reduction has taken place in the annual percentage rate of Hungarian forints loans.

In 2005 the growth in housing loans has been somewhat slower compared to previous years: after a 730 billion Hungarian forints (93.7 per cent.) leap in 2003, and a 402 billion Hungarian forints (26.7 per cent.) growth in 2004, housing loans to retail customers increased by 263 billion Hungarian forints (13.8 per cent.) during the first nine months of 2005. There is a significant difference in the growth of forint-denominated and FX-denominated loans within the portfolio. Whereas housing loans denominated in forint increased by only 36 billion Hungarian forints, or 2.1 per cent., in the first three quarters, FX loans soared by 227 billion Hungarian forints, or 156.3 per cent. Of FX-denominated loans, 90.8 per cent. is contributed by non-euro-based loans, denominated primarily in Swiss franc. The dynamics of increase in the housing loan portfolio has been improving over the year. The September increase exceeded that of the best month in 2004.

In the first nine months of 2005 the average monthly increase was 29 billion Hungarian forints, still considerably below the 2004 average of 34 billion Hungarian forints. At the same time, the dynamics of the average monthly increase was up by more than five billion Hungarian forints in the past quarter. There was a sharp plunge in the first three months of the target year, but monthly rates of increase were back to the 2004 levels by the second quarter and exceeded them in the third quarter. The increase in housing loans continues to be driven by FX-denominated loans, supported, on the one hand, by CHF interest rates, which have proved to be low in the long term, and on the other hand, by the forint, which managed to retain its strength despite falling interest rates. The decrease in the APR of Hungarian forints-based loans had no appreciable influence on the structure of growth in the past quarter.

RISK MANAGEMENT

Management of lending risk

(a) Customer rating

Before undertaking risks and obligations FHB examines its potential customers' capabilities and readiness to repay loans as well as the value and marketability of real estate collaterals offered by them as coverage. The Bank performs simple and complex customer rating, classifies loan applicants into categories from 1 to 5, and determines a limit for each. Rating is based on a scoring system specially developed for the purpose. Thus the size of the loan extended is based on the rating of the customer, the limit determined for the customer, and the lending value of the real estate collateral. In the case of foreign exchange-denominated loans the exchange rate risk is also taken into consideration when determining the loan to be extended.

(b) Rating of lendings

When rating its lendings the Bank applies the categories and provision limits prescribed by its internal rules and relevant legal regulations.

The categories of qualification and the related limits of provisioning are as follows:

- "**A**" problem free (0 per cent. provision)

  A receivable is problem free if the likelihood of its recovery is documented and the Bank does not expect loss on the receivable, or where the payment default period is not longer than 15 days - or 30 days in the case of retail loans.

- "**B**" to be monitored separately (0-10 per cent. provision)

  Receivables, investments and off-balance sheet commitments are assigned to the 'to be monitored' category, if there is no likelihood of a loss at the time of the categorisation but the Bank has acquired information according to which the given risk assumption needs different management than the regular risk management. This category also holds items that need special management based on the type of the loan, the identity of the debtor or other relevant conditions, but no concrete threat is perceived at the time of categorisation.

- "**C**" below average (11-30 per cent. provision)

Receivables, investments and off-balance sheet commitments are assigned to the 'below average' category if on the basis of available information they entail risks higher than the regular risks or if at the time of the categorisation an uncertain degree of capital or capital type loss is expected.

- "**D**" doubtful (31-70 per cent. provision)

Receivables, investments and off-balance sheet commitments are assigned to the 'doubtful' category where it is clear that it will result in losses to be booked by the Bank but the amount of such loss is not known at the time of the categorisation and if the delay in repayment is considered 'long' (over 90 days) or if it is regular, and is sued for a receivable.

- "**E**" bad (71-100 per cent. provision)

Receivables, investments and off-balance sheet commitments are assigned to the 'bad' category if the loss to be incurred is expected to be higher than 70 per cent. of the amount of the risk assumed by the Bank and the debtor fails to settle its repayment obligation despite repeated requests to do so or if the debtor is subject to liquidation (with the exception of the receivables that are generated during the liquidation procedure).

(c) *Rating of collaterals*

FHB accepts as loan coverage mortgage lien on independently marketable real estate free of legal action, claims, and encumbrance and retaining its value, registered typically as first mortgage lien. The Bank is entitled to sell the real estate collateral independently or jointly with the customer.

The Bank considers the realistic valuation of real estate to be of key importance in maintaining the security of mortgage lending on an ongoing basis. The Bank has so far relied on its own units in the valuation of real estate offered and accepted as collateral, in keeping with the provisions of Decree No. 25/1997 (VIII.1.) of the Minister of Finance on the principles and methodology applicable to the establishment of the lending value of real estate not qualifying as agricultural land and Decree 54/1997 No. (VIII.1.) of the Minister of Agriculture on the principles and methodology applicable to the establishment of the lending value of agricultural land, and created a data base built on data from the Duty Offices to support the valuation activity. In the wake of the modification of its scope of business, the Bank signed agreements with two independent valuation agencies, involving them in the valuation of prospective real estate collateral. However, the lending value of real estate will still be established by the Bank's expert staff.

(d) *Property Supervisor*

In addition to performing its duties prescribed by the relevant statutory provisions, the Bank's Property Supervisor (PriceWaterhouseCoopers Kft.) reviews the work of FHB's valuation expert in cases determined by the Property Supervisor, and performs spot checks of valuation.

Strict internal regulation

Determination of lending values as well as registration of ordinary and supplementary collateral is based on stringent internal regulations approved by the PSZÁF.

Interest rate risk management

The Bank's interest risk arise from the following factors:

- Changes in the capital and money market during the period from the disbursement of loans and the issuance of mortgage bonds;
- Discrepancy of the interest periods and price adjustment of loans and funds;
- Reinvestment risk, i.e. the difference between the yield achieved by reinvestment of funds released by prepayments and the original loan interest;
- Differing repayment rates of annuity-based loans and mortgage bonds; and
- Differing maturity structure of assets and liabilities.

Interest rate risk is managed primarily by natural hedging, i.e. by approximation of the maturity structures of liabilities and assets, the adjustment of re-pricing periods, and the limitation of possible discrepancy between fixed and variable assets and liabilities. However, interest rate risk management at the portfolio level is becoming increasingly important, along with the involvement of derivative transactions, such as swaps, for hedging purposes. To this end, last year FHB signed ISDA agreements with several reputable international financial institutions.

The Bank monitors special liquidity indicators, the rate of liquid assets and the coverage on mature mortgage bonds on a daily basis. Monthly analysis includes maturity coverage limits and mismatches occurring in the various maturity brackets.

Liquidity risk management

Maintaining liquidity is a fundamental element of banking. The Bank maintains liquidity through the adequacy of maturity of receivables and obligations. At the same time, in order to maintain profitability, the Bank applies maturity transformation controlled by limits while maintaining solvency at all times.

Management of maturity mismatch

In addition to primary liquid assets, the Bank proposes to finance liquidity shortages, by the time they arise, from funds generated by the issuance of new mortgage bond series. Some of the ordinary coverage required for mortgage bond series issued for this purpose is available on a continuous basis in the form of long-term mortgage loans released from the mortgage bonds when principal repayments are made at the due dates. Additional ordinary coverage on new series is constituted by the increment of the regular collateral portfolio generated by lending.

Prepayment risk management

With the exception of extraordinary prepayment, the Bank sets conditions for, and charges a fee on, prepayment. Imposing charges alleviates the risk of prepayment.

Exchange rate risk management

In accordance with its business policy, the Bank intends to keep the risk stemming from the fact that receivables and payables arise in different foreign exchanges at a low level. In order to manage this type of risk the Bank determines position limits and monitors their observation.

Hedging risk also involves the utilisation of derivative instruments (swaps).

The collateral system of covered mortgage bonds

Cover requirement

Article 14 of the Mortgage Credit Institution Act provides for the coverage of covered mortgage bonds. Article 14(1) provides that mortgage credit institutions at all times must hold security or collateral ("*fedezet*") available at a value higher than the amount of nominal value and interest of outstanding mortgage bonds in circulation. Article 14(2) provides that the above requirement must be fulfilled in a way that:

(a) the combined value of principal receivable considered as collateral minus the loss in value must exceed 100 per cent. of the nominal value of the outstanding mortgage bonds in circulation, and

(b) the interest due on combined value of principal receivable considered as collateral minus the loss in value must exceed 100 per cent. of the nominal value of interest due on the outstanding mortgage bonds in circulation.

The role of the Coverage Supervisor

- Checking of the existence of coverage items

Articles 16 and 17 of the Mortgage Credit Institution Act provide for the commissioning of the Coverage Supervisor and the activities of the same. The Coverage Supervisor carries out its activities to protect the interests of investors (holders of the covered mortgage bonds). The Coverage Supervisor monitors the existence of the required coverage of the covered mortgage bonds and the entering of the mortgaged property used as the regular coverage of the covered mortgage bonds and its lending value. The commissioning of the Coverage Supervisor is valid with the authorisation granted by the Hungarian Financial Supervisory Authority. The Coverage Supervisor of FHB is PricewaterhouseCoopers Kft.

- Checking of the satisfaction of the requirements of proportionateness

The aggregate coverage registry contains the up-to-date data, aggregated at the portfolio level, of the outstanding covered mortgage bonds in the market, the mortgaged property items constituting the regular coverage for the covered mortgage bonds and the regular and substitute coverage values. The aggregated maturity register contains the data of the liabilities relating to the outstanding covered mortgage bonds in the market and the credit receivables specified as regular and substitute coverage, in a monthly breakdown.

In the covered mortgage bond the Coverage Supervisor certifies the existence of the prescribed coverage, without which the mortgage bond issued does not qualify as a covered mortgage bond.

Valuation of the coverage items

The Mortgage Credit Institution Act and the Credit Institution Act provide for the valuation of coverage items. The principles and methods of the establishment of the lending value are regulated by law: by Decree No. 25/1997. (VIII.1.) of the Ministry of Finance on the principles of the methodology applicable to the establishment of the lending value of real estate not qualifying as agricultural land and by the Decree No. 54/1997. (VIII.1.) of the Ministry of Agriculture on the principles of the methodology of the establishment of the lending value of agricultural land. Accordingly, the key tasks of the valuation of the coverage items are as follows:

- preliminary evaluation of the acceptability of the coverage item from the aspect of legal requirements (as a general rule, the Bank accepts only unencumbered real estates),

- assessment of the long-term permanent nature of the value of the real estate,

- the time requirement of the mobilisation of the real estate,
- establishment of its lending value.

Registration of coverage items

Pursuant to the applicable legal requirements FHB is keeping a coverage register of the mortgaged property items constituting the regular coverage for the covered mortgage bonds and of the value of the regular and substitute coverage. The coverage registration rules of FHB were approved by the legal predecessor of PSZÁF by its Resolution No. I-1403/2004, and have been audited by the Coverage Supervisor. The statements of the coverage register of FHB records, at a portfolio level and on an individual basis, the updated data of the coverage items underlying the covered mortgage bonds. The aim of the portfolio level statements is to check compliance with the proportionateness requirements and that of the maturity matching between the covered mortgage bonds and the credit receivables.

Secure position of the holder of the covered mortgage bonds in the ranking of creditors

The Mortgage Credit Institution Act provides for the rules applicable in the case of the insolvency of a mortgage credit institution, as follows.

In the case of liquidation proceedings against a mortgage credit institution the rules governing the liquidation of credit institutions must be applied with the following differences:

After the settlement of the costs of liquidation the following items must be used exclusively for the settlement of the liabilities owed to holders of the covered mortgage bonds

(a) ordinary and supplemental cover entered into the coverage register; and

(b) other, in particular liquid, assets of the mortgage credit institution, which are needed to satisfy all claims arising from the mortgage bonds if the ordinary and supplemental covers were not sufficient.

If the total assets of the mortgage credit institution were not sufficient to satisfy the claims arising from the mortgage bonds, the holders of the mortgage bonds will be satisfied, in priority to other senior unsecured creditors, on a pro-rata basis.

Pursuant to the above in case of the insolvency of the Bank the following happen:

- The claims of the holders of the covered mortgage bonds are settled in the course of liquidation proceeding in priority to the claims of any other senior unsecured creditor of the Bank. This position in the ranking of creditors is so strong that it overrides any legal security that may be stipulated by other creditors, in respect of the covered mortgage bond holders. Only the costs of liquidation may be settled before the claims of the holders of the covered mortgage bonds.

- The law specifies not only the exclusive utilisation of the ordinary and supplemental cover items as the source for the settlement of the claims of the holders of the covered mortgage bonds, but a much wider range of sources. Accordingly, practically all assets of the Bank are to be used as a cover for the claims of the holders of covered mortgage bonds.

- The liquidation of a debtor who has taken out a mortgage loan may have a very restricted impact on the holders of the covered mortgage bonds even if the Bank were to be liquidated itself. In this case if the holder of covered mortgage bonds were satisfied in the course of the liquidation of the Bank by such a credit receivable whose debtor is under liquidation or becomes subject of liquidation during the maturity period, the holder of the covered mortgage bonds would be entitled to all of the rights in the liquidation proceedings that would be available for the Bank that has originally extended the loan. Accordingly, there is a mortgage established on a mandatory basis on real estate underlying the receivable, which is then secured by a restriction on alienation and encumbrance, since disbursement may not take place before the registration of the mortgage. And if the receivable is secured by mortgage, then, based on the ranking of creditors for settlement as specified in Article 57 (1) of IL Act of 1991 on bankruptcy proceedings, liquidation proceedings and voluntary winding-up proceedings (the **Bankruptcy Act**), the amount is settled in the second place (in the so-called category 'b'), i.e. after the settlement of the costs of liquidation. According to the applicable general rules the following restrictive circumstances may influence this second ranking position:[1]

- If there are more than one mortgage rights on the mortgaged real estate and each of these secure receivables is settled in the liquidation procedure, the ranking among such receivables depends on the establishment of the mortgage rights (ranking rule). According to the main rule adopted by FHB therefore, first ranking mortgage is an indispensable requirement;

- The priority in settlement of receivables exists only to the extent of the value of the given mortgaged property, i.e. if the given real estate has been sold in the liquidation procedure, and after the distribution of the received purchase price – after the deduction of the costs of liquidation – the creditor(s) still have an outstanding receivable, the remaining receivable shall (or shall not) be settled in the 'f' category.

- Should FHB be subject to liquidation and should the above listed coverage items still not be enough to satisfy the legitimate claims of the holders of the covered mortgage bonds, then the proceeds of the sale of the Bank's assets will also be used to settle the claims of the holders of covered mortgage bonds.

Special status of the covered mortgage bond

Summing up the rules laid out in this chapter, the following is a list of the six basic pillars on which the special strength and security of the covered mortgage bond relies:

- Cover system

The ordinary cover for the covered mortgage bonds is provided for by mortgage loans adjusted with the lending values established on the basis of detailed and strict statutory regulations. Each mortgage loan may only be taken into account as coverage to an extent not exceeding 60 per cent. of the lending value. Where there is no sufficient ordinary cover, supplemental cover must be used on a mandatory basis, which may only be comprised of assets guaranteed by the state (e.g. government securities, state loan).

- Strictly defined coverage proportions

From among the coverage items the substitute coverage may account for a maximum of 20 per cent. from the third year of the operation of the bank, while the covered mortgage bond refinancing limit may be up to 60 per cent. of the lending value in the case of each loan.

- Independent Coverage Supervisor

The registration, current portfolio and the covered mortgage bond Issues are supervised and checked by the independent Coverage Supervisor appointed to provide for the protection of the investors.

- Priority in the settlement of receivables

[1] The Bank's risk management techniques laid out in the sub-chapter 'Risk factors' are aimed to prevent the occurrence of such cases.

Holders of the covered mortgage bonds enjoy priority over other creditors of the Bank as specified in the above sub-sections.

- Special supervision by the PSZÁF

Pursuant to the Mortgage Credit Institution Act the PSZÁF is obliged to carry out comprehensive on-site audits of mortgage credit institutions on an annual basis.

- Increased publicity

A mortgage credit institution is obliged to provide information to the public each quarter, concerning the value of the covered mortgage bonds in the market and that of the available coverage items.

There are no recent events which are to a material extent relevant to the evaluation of the FHB's solvency.

CERTAIN INFORMATION RELATING TO THE MORTGAGE BONDS

Mortgage bonds ("*jelzáloglevél*") are transferable debt securities issued exclusively by mortgage credit institutions pursuant to Act XXX of 1997 on Mortgage Loan Credit Institutions and on Mortgage Bonds (1997. évi XXX. törvény a jelzálog-hitelintézetről és a jelzáloglevélről).

Mortgage credit institutions grant financial loans secured by mortgages on real estate located in the territory of the Republic of Hungary, the funds for which they procure by way of issuing mortgage bonds. The offering of mortgage bonds must comply with the Capital Markets Act.

Mortgage credit institutions must at all times have "cover" ("*fedezet*") available at a value which is more than the equivalent to the outstanding nominal value and interest of the relevant mortgage bonds. In order to achieve this the mortgage credit institution must ensure that: (a) the total amortised value of those principal claims which are taken into consideration as cover, exceed 100 per cent. of the outstanding principal of all outstanding mortgage bonds, and (b) that the total amount of interest payable on the amortised value of those principal claims which are taken into consideration as cover must exceed 100 per cent. of the interest payable on the outstanding principal of all outstanding mortgage bonds. Such cover may consist of ordinary cover and supplementary cover. Principal and interest claims arising from mortgage loans may serve as ordinary cover, if the mortgage and the prohibition of sale and encumbrance on the property securing the loan is registered with the real estate registry. The supplementary cover, which may be up to 20 per cent. of the total cover, may consist of the following instruments: (a) money held on a separate blocked account at the National Bank of Hungary; (b) government securities; (c) securities issued with first demand suretyship provided by the government ("*állami készfizető kezességvállalás*"); or (d) certain loans extended with first demand suretyship provided by the government.

If the mortgage bonds and their respective cover are denominated in different currencies, mortgage credit institutions are required to hedge their foreign exchange risk by derivative transactions. These derivative transactions may, subject to further rules, also be taken into consideration as cover for the mortgage bonds.

In the event of the transformation or liquidation of a mortgage credit institution it may transfer its obligations arising from mortgage bonds to another mortgage credit institution. This transfer is subject to the permission of the PSZÁF, but does not require the prior consent of the holders of the mortgage bonds. The obligations arising from mortgage bonds may only be transferred together with the related ordinary and supplementary cover. The mortgage credit institution accepting the portfolio must offer new mortgage bonds on the original terms and conditions.

In the event of liquidation of a mortgage credit institution, after the settlement of liquidation expenses, the following may be used only for the satisfaction of obligations towards holders of mortgage bonds: a) the ordinary and supplementary cover registered in the cover register, and b) other, in particular liquid, assets of the mortgage credit institution, which are needed to satisfy all claims arising from the mortgage bonds if the ordinary and supplementary covers were not sufficient. If the total assets of the mortgage credit institution are not sufficient to satisfy the claims arising from the mortgage bonds, the holders of the mortgage bonds will be satisfied, in priority to other senior unsecured creditors, on a pro-rata basis.

TAXATION

Hungarian Taxation

The following is a general discussion of certain Hungarian tax consequences of the acquisition and ownership of Mortgage Bonds. It does not purport to be a comprehensive description of all tax considerations which may be relevant to a decision to purchase Mortgage Bonds, and, in particular, does not consider any specific facts or circumstances that may apply to a particular purchaser. This summary is based on the Issuer's interpretation of the laws of Hungary currently in force and as applied on the date of this Base Prospectus, which are subject to change, possibly with retroactive effect.

Prospective purchasers of Mortgage Bonds are advised to consult their own tax advisers as to the tax consequences of the purchase, ownership and disposition of Mortgage Bonds, including the effect of any state or local taxes, under the tax laws of Hungary and each country of which they are residents. The acquisition of the Mortgage Bonds by non-Hungarian Holders, or the payment of interest under the Mortgage Bonds may trigger additional tax payments in the country of residence of the Holder, which is not covered by this summary, but where the provisions of the treaties on the avoidance of double taxation should be taken into consideration.

Taxation of foreign resident corporation Holders

Under the Act LXXXI of 1996 on Corporate Tax and Dividend Tax (the **Corporation Tax Act**), Hungarian resident taxpayers have a full, all-inclusive tax liability, while foreign resident corporations have a limited tax liability in Hungary. Generally, resident persons are those established under the laws of Hungary (i.e. having a Hungarian registered seat). In the event that the tax residency is not determined on the basis of the registered seat, a taxpayer is deemed to have a Hungarian tax residency, in line with international conventions, if the place of management of the taxpayer is in Hungary. The same applies from 1 January 2006 if there is no double tax convention concluded between Hungary and the other country.

Foreign resident corporations are subject to Hungarian taxation on the income received through a permanent establishment in Hungary or dividends received from Hungary. However, as from 1 January 2006, dividend tax will not be levied on dividends paid by a Hungarian resident corporation to a foreign corporation.

Interest on Mortgage Bonds paid to foreign resident Holders by resident legal entities and any capital gain realised by foreign resident Holders on the sale of Mortgage Bonds is not subject to tax in Hungary, if the foreign resident Holders has no permanent establishment in Hungary.

Taxation of foreign resident individual Holders

The Act CXVII of 1995 on Personal Income Tax (the Personal Income Tax Act) applies to the tax liability of Hungarian and foreign private individuals. The tax liability of Hungarian resident private individuals covers the worldwide income of such persons, while foreign resident private individuals' tax liability is limited only to their income originating in Hungary or income that is otherwise taxable in Hungary on the basis of international treaties or reciprocity.

In the case of foreign resident individual Holders, the income derived from interest payments or the income deriving from the difference between the issue price and the nominal value of the Mortgage Bonds, is subject to zero per cent. tax.

The Personal Income Tax Act determines which type of income and the maximum amount up to which the realised income can be treated as "interest". All other interest type income which is not covered by the definition of the Hungarian Personal Income Tax Act or which exceeds the amount defined there is treated as "other income" for Hungarian tax purposes.

Pursuant to the provisions of the Personal Income Tax Act, the origination of "other income" is the state where the private individual has a tax residency. Therefore, such other income realised by a foreign resident private individual is not taxable in Hungary, since it is deemed to be originating from the state where the foreign resident private individual has a tax residency.

In the case of foreign resident individual Holders, the income derived from capital gains will not involve tax payment liability in Hungary under the provisions of the Personal Income Tax Act except if the foreign resident private individual has a permanent establishment in Hungary.

Luxembourg Taxation

The following summary is of a general nature and is included herein solely for information purposes. It is based on the laws presently in force in Luxembourg, though it is not intended to be, nor should it be construed to be, legal or tax advice. Prospective investors in the Mortgage Bonds should therefore consult their own professional advisers as to the effects of state, local or foreign laws, including Luxembourg tax law, to which they may be subject.

General

Under Luxembourg tax law, there is currently no withholding tax on payments of principal, premium or interest, nor on accrued but unpaid interest, in respect of the Mortgage Bonds, nor is any Luxembourg withholding tax payable upon redemption or repurchase of the Mortgage Bonds. As from 1 July 2005, Luxembourg will levy withholding tax on interest payments made by a Luxembourg paying agent to individual beneficial owners who are tax resident of (i) another EU Member State, pursuant to the Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, or (ii) of certain non-EU countries and territories which have agreed to adopt similar measures to those provided for under the Council Directive 2003/48/EC (see section on EU Savings Directive below). Responsibility for the withholding of such tax will be assumed by the Luxembourg paying agent and not by the Issuer.

Income Taxation of Holders

A Luxembourg holder of Mortgage Bonds that is governed by the law of 31 July 1929, on pure holding companies, as amended, or by the laws of 30 March 1988 and 20 December 2002 on undertakings for collective investment, as amended, is neither subject to Luxembourg income tax in respect of interest accrued or received, nor on gains realised on the sale or disposal of Mortgage Bonds.

A corporate holder of Mortgage Bonds, who is resident of Luxembourg for tax purposes or who has a permanent establishment or a fixed place of business in Luxembourg, to which the Mortgage Bonds are attributable, must include any interest received or accrued, as well as any gain realised on the sale or disposal of Mortgage Bonds, in its taxable income for Luxembourg income tax assessment purposes. The same inclusion applies to an individual holder of Mortgage Bonds, acting in the course of the management of a professional or business undertaking, who is resident of Luxembourg for tax purposes or who has a permanent establishment or a fixed place of business in Luxembourg, to which the Mortgage Bonds are attributable.

An individual holder of Mortgage Bonds, acting in the course of the management of his/her private wealth, who is resident of Luxembourg for tax purposes, is subject to Luxembourg income tax in respect of interest received under the Mortgage Bonds. A gain realised by an individual holder of Mortgage Bonds, acting in the course of the management of his/her private wealth, who is resident of Luxembourg for tax purposes, upon the sale or disposal of Mortgage Bonds, is not subject to Luxembourg income tax, provided this sale or disposal took place more than six months after the Mortgage Bonds were acquired. However, any portion of such gain corresponding to accrued but unpaid interest income is subject to Luxembourg income tax.

Net Wealth Taxation of Holders

Any holder of Mortgage Bonds, whether he/she/it is resident of Luxembourg for tax purposes or, if not, he/she/it maintains a permanent establishment or a fixed place of business in Luxembourg to which the Mortgage Bonds are attributable, is subject to Luxembourg wealth tax on such Mortgage Bonds, except if the holder of Mortgage Bonds is governed by the law of 31 July 1929, on pure holding companies, as amended, or by the laws of 30 March 1988 and 20 December 2002 on undertakings for collective investment, as amended, or is a securitisation company governed by the law of 22 March 2004 on securitisation, or is a capital company governed by the law of 15 June 2004 on venture capital vehicles.

Other Taxes

Neither the issuance nor the transfer of Mortgage Bonds will give rise to any Luxembourg stamp duty, value added tax, issuance tax, registration tax, transfer tax or similar taxes or duties.

Where a holder of Mortgage Bonds is a resident of Luxembourg for tax purposes at the time of his death, the Mortgage Bonds are included in his taxable estate for inheritance tax assessment purposes.

Gift tax may be due on a gift or donation of Mortgage Bonds if embodied in a Luxembourg deed or recorded in Luxembourg.

EU Savings Directive

Under EC Council Directive 2003/48 on the taxation of savings income, Member States are required, from 1 July 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State. However, for a transitional period, Belgium, Luxembourg and Austria are instead be required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries). A number of non-EU countries and territories including Switzerland have agreed to adopt similar measures (a withholding system in the case of Switzerland) with effect from the same date.

SUBSCRIPTION AND SALE

The Dealers have, in a programme agreement (the **Programme Agreement**) dated 22 December 2005, agreed with the Issuer a basis upon which they or any of them may from time to time agree to purchase Mortgage Bonds. Any such agreement will extend to those matters stated under "*Form of the Mortgage Bonds*" and "*Terms and Conditions of the Mortgage Bonds*". In the Programme Agreement, the Issuer has agreed to reimburse the Dealers for certain of their expenses in connection with any future update of the Programme and the issue of Mortgage Bonds under the Programme and to indemnify the Dealers against certain liabilities incurred by them in connection therewith.

United States

The Mortgage Bonds have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S under Securities Act) except in certain transactions exempt from the registration requirements of the Securities Act.

The Mortgage Bonds are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986 and regulations thereunder.

Until 40 days after the commencement of the offering of any Series of Mortgage Bonds, an offer or sale of such Mortgage Bonds within the United States by any Dealer (whether or not participating in the offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with an available exemption from registration under the Securities Act.

Each issuance of Index Linked Mortgage Bonds or Dual Currency Mortgage Bonds shall be subject to such additional U.S. selling restrictions as the Issuer and the relevant Dealer may agree as a term of the issuance and purchase of such Mortgage Bonds, which additional selling restrictions shall be set out in the applicable Final Terms.

Japan

The Mortgage Bonds have not been and will not be registered under the Securities and Exchange Law of Japan (the **Securities and Exchange Law**) and each Dealer has agreed, and each further Dealer appointed under the Programme will be required to agree, that it will not offer or sell any Mortgage Bonds, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or other entity organised under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan or to a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Securities and Exchange Law and any other applicable laws, regulations and ministerial guidelines of Japan.

European Economic Area

In relation to each Member State of the European Economic Area which has implemented the Prospectus Directive (each, a **Relevant Member State**), each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the **Relevant Implementation Date**) it has not made and will not make an offer of Mortgage Bonds to the public in that Relevant Member State, except that it may, with effect from and including the Relevant Implementation Date, make an offer of Mortgage Bonds to the public in that Relevant Member State:

(a) in (or in Germany, where the offer starts within) the period beginning on the date of publication of a prospectus in relation to those Mortgage Bonds which has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the competent authority in that Relevant Member State, all in accordance with the Prospectus Directive and ending on the date which is 12 months after the date of such publication;

(b) at any time to legal entities which are authorised or regulated to operate in the financial markets or, if not so authorised or regulated, whose corporate purpose is solely to invest in securities;

(c) at any time to any legal entity which has two or more of (1) an average of at least 250 employees during the last financial year; (2) a total balance sheet of more than EUR 43,000,000 and (3) an annual net turnover of more than EUR 50,000,000, as shown in its last annual or consolidated accounts; or

(d) at any time in any other circumstances which do not require the publication by the Issuer of a prospectus pursuant to Article 3 of the Prospectus Directive.

For the purposes of this provision, the expression an "offer of Mortgage Bonds to the public" in relation to any Mortgage Bonds in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the Mortgage Bonds to be offered so as to enable an investor to decide to purchase or subscribe the Mortgage Bonds, as the same may be varied in that Member State by any measure implementing the Prospectus Directive in that Member State and the expression **Prospectus Directive** means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

United Kingdom

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that:

(a) in relation to any Mortgage Bonds which have a maturity of less than one year, (i) it is a person whose ordinary activities involve it in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of its business and (ii) it has not offered or sold and will not offer or sell any Mortgage Bonds other than to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or as agent) for the purposes of their businesses or who it is reasonable to expect will acquire, hold, manage or dispose of investments (as principal or agent) for the purposes of their businesses where the issue of the Mortgage Bonds would otherwise constitute a contravention of Section 19 of the FSMA by the Issuer;

(b) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of any Mortgage Bonds in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; and

(c) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to any Mortgage Bonds in, from or otherwise involving the United Kingdom.

Hungary

The Base Prospectus has not been and will not be submitted for approval to the Hungarian Financial Supervisory Authority and the Mortgage Bonds will not be offered in the Republic of Hungary in a public offer or a private placement as defined in the Act CXX of 2001 on the Capital Markets. Each Dealer has confirmed, and each further Dealer appointed under the Programme will be required to confirm, its awareness of the above and has represented, and each further Dealer appointed under the Programme will be required to represent, that it has not offered or sold and will not offer or sell the Mortgage Bonds in the Republic of Hungary in a public offer or private placement and will not offer the Mortgage Bonds for sale to the general public in the Republic of Hungary.

Italy

The offering of Mortgage Bonds has not been cleared by CONSOB (the Italian Securities Exchange Commission) pursuant to Italian securities legislation and, accordingly, no Mortgage Bonds may be offered, sold or delivered, nor may copies of the Base Prospectus or of any other document relating to Mortgage Bonds be distributed in the Republic of Italy, except:

(a) to professional investors *(operatori qualificati),* as defined in Article 31, second paragraph, of CONSOB Regulation No. 11522 of 1st July 1998, as amended; or

(b) in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of Legislative Decree No. 58 of 24th February 1998 (the **Financial Services Ac**t) and Article 33, first paragraph, of CONSOB Regulation No. 11971 of 14th May 1999, as amended.

Each Dealer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that any offer, sale or delivery of Mortgage Bonds or distribution of copies of the Base Prospectus or any other document relating to Mortgage Bonds in the Republic of Italy under (a) or (b) above must be:

(i) made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act and Legislative Decree No. 385 of 1st September 1993 (the **Banking Act**); and

(ii) in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy, as amended from time to time, pursuant to which the issue or the offer of securities in the Republic of Italy may need to be preceded and followed by an appropriate notice to be filed with the Bank of Italy depending, *inter alia,* on the aggregate value of the securities issued or offered in the Republic of Italy and their characteristics; and

(iii) in compliance with any other applicable laws and regulations.

France

Each of the Dealers and the Issuer has represented and agreed, and each further Dealer appointed under the Programme will be required to represent and agree, that it has not offered or sold and will not offer or sell, directly or indirectly, Mortgage Bonds to the public in the Republic of France, and has not distributed or caused to be distributed and will not distribute or cause to be distributed to the public in the Republic of France, this Base Prospectus or any other offering material relating to the Mortgage Bonds, and that such offers, sales and distributions have been and shall only be made in France to qualified investors (*investisseurs qualifiés*) acting for their own account, as defined in, and in accordance with, Articles L.411-1 and L.411-2 of the *Code Monétaire et Financier* and décret no. 98-880 dated 1 October 1998.

General

Each Dealer has agreed and each further Dealer appointed under the Programme will be required to agree that it will (to the best of its knowledge and belief) comply with all applicable securities laws and regulations in force in any jurisdiction in which it purchases, offers, sells or delivers Mortgage Bonds or possesses or distributes this Base Prospectus and will obtain any consent, approval or permission required by it for the purchase, offer, sale or delivery by it of Mortgage Bonds under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such purchases, offers, sales or deliveries and neither the Issuer nor any of the other Dealers shall have any responsibility therefor.

None of the Issuer and the Dealers represents that Mortgage Bonds may at any time lawfully be sold in compliance with any applicable registration or other requirements in any jurisdiction, or pursuant to any exemption available thereunder, or assumes any responsibility for facilitating such sale.

With regard to each Tranche, the relevant Dealer will be required to comply with such other restrictions as the Issuer and the relevant Dealer shall agree and as shall be set out in the applicable Final Terms.

GENERAL INFORMATION

Authorisation

The establishment of the Programme and the issue of Mortgage Bonds was duly authorised by resolution 43/2002 of the Board of Directors of the Issuer dated 25 September 2002 and resolution 96/2003 of the Asset and Liability Committee of the Issuer dated 5 November 2003. The first update of the Programme was authorised by resolution 49/2004 of the Board of Directors of the Issuer dated 27 October 2004 and resolution 96/2004 of the Asset and Liability Committee of the Issuer dated 26 October 2004. The second update of the Programme was authorised by resolution No 30/2005 of the Board of Directors of the Issuer dated 27 June 2005 and resolution No 92/2005 of the Asset and Liability Committee of the Issuer dated 27 October 2005.

Listing of Mortgage Bonds

Application has been made to the CSSF to approve this document as a base prospectus. Application has also been made to the Luxembourg Stock Exchange for Mortgage Bonds issued under the Programme to be admitted to trading on the Luxembourg Stock Exchange's regulated market. The Luxembourg Stock Exchange has allocated the number 12825 to the Programme for listing purposes. The Luxembourg Stock Exchange's regulated market is a regulated market for the purposes of the Investment Services Directive (Directive 93/22/EEC).

Documents Available

For the period of 12 months following the date of this Base Prospectus, copies of the following documents will, when published, be available (in the case of (d) below, for inspection only) from the registered office of the Issuer and from the specified office of the Paying Agent for the time being in Luxembourg:

(a) the constitutional documents (with English translations thereof) of the Issuer;

(b) the consolidated and non-consolidated audited financial statements of the Issuer in respect of the financial years ended 31 December 2004 and 2003 (with English translations thereof), together with the audit reports prepared in connection therewith. The Issuer currently prepares audited consolidated and non-consolidated accounts on an annual basis;

(c) the most recently published unaudited interim (quarterly) financial statements of the Issuer (with an English translation thereof), in each case together with any audit or review reports prepared in connection therewith. The Issuer currently prepares audited consolidated and non-consolidated accounts on an annual basis;

(d) the Programme Agreement, the Agency Agreement and the KELER Agreement (as defined in the Agency Agreement);

(e) a copy of this Base Prospectus;

(f) any future base prospectuses, offering circulars, prospectuses, information memoranda and supplements including Final Terms (save that the Final Terms relating to an Mortgage Bond which is neither admitted to trading on a regulated market in the European Economic Area nor offered in the European Economic Area in circumstances where a prospectus is required to be published under the Prospectus Directive will only be available for inspection by a Holder of such Mortgage Bond and such Holder must produce evidence satisfactory to the Issuer and the Paying Agent as to its holding of Mortgage Bonds and identity) to this Base Prospectus and any other documents incorporated herein or therein by reference; and

(g) in the case of each issue of Mortgage Bonds listed on an EEA Stock Exchange and subscribed pursuant to a subscription agreement, the subscription agreement (or equivalent document).

This Base Prospectus and the Final Terms applicable to each issue of Mortgage Bonds will be available on the website of the Luxembourg Stock Exchange: www.bourse.lu.

Clearing Systems

The Mortgage Bonds have been accepted for clearance through KELER and, through a bridge with this clearing system, Clearstream, Luxembourg (which are the entities in charge of keeping the records).. Unless waived under the rules of the Luxembourg Stock Exchange for an individual Tranche of Mortgage Bonds, KELER is required to provide, for each issue of Mortgage Bonds to be listed on the Luxembourg Stock Exchange, certification as to, *inter alia*, the existence of a bridge with Clearsteam, Luxembourg for each Tranche of Mortgage Bonds. Upon receipt of such certification, Clearstream, Luxembourg will issue a confirmation to the Luxembourg Stock Exchange that such Tranche has been accepted for clearing. The appropriate Common Code and ISIN for each Tranche of Mortgage Bonds allocated by Clearstream, Luxembourg or KELER, as the case may be, will be specified in the applicable Pricing Supplement. If the Mortgage Bonds are to clear through an additional or alternative clearing system the appropriate information will be specified in the applicable Pricing Supplement.

The address of KELER is Asbóth u. 9-11., 1075 Budapest, Hungary and the address of Clearstream, Luxembourg is 42 Avenue J.F. Kennedy, 1855 Luxembourg, Luxembourg.

As at the date of this Base Prospectus, it is not envisaged that Mortgage Bonds will clear through Euroclear.

Conditions for determining price

The price and amount of Mortgage Bonds to be issued under the Programme will be determined by the Issuer and the relevant Dealer at the time of issue in accordance with prevailing market conditions.

Significant or Material Change

There has been no significant change in the financial position of the Issuer or its group which has occurred since 30 September 2005 and there has been no material adverse change in the financial position or prospects of the Issuer since 31 December 2004.

Litigation

The Issuer is not and has not been involved in any governmental, legal or arbitration proceedings (including any such proceedings which are pending or threatened of which the Issuer is aware) in the 12 months preceding the date of this document which may have or have in such period had a significant effect on the financial position or profitability of the Issuer.

Auditors

The auditors of the Issuer are Ernst & Young Audit Ltd. of Váci út 20, H-1132 Budapest, Hungary, who have audited the Issuer's consolidated accounts, without qualification, in accordance with International Financial Reporting Standards for each of the two financial years ended on 31 December 2003, and 31 December 2004. The auditors of the Issuer have no material interest in the Issuer. Ernst & Young Audit Ltd. are members of the Chamber of Hungarian Auditors.

Ernst & Young Audit Ltd. have also audited the Issuer's unconsolidated accounts in accordance with International Financial Reporting Standards for each of the two financial years ended 31 December 2003 and 31 December 2004. Those accounts are qualified because, and only because, those accounts have been published earlier than the consolidated accounts in accordance with International Financial Reporting Standards for the corresponding periods and as a result could not include consolidated financial information.

The reports of the auditors of the Issuer are included or incorporated in the form and context in which they are included or incorporated, with the consent of the auditors who have authorised the contents of that part of this Base Prospectus. As far as the Issuer is aware and is able to ascertain, no facts have been omitted which would render the reproduced information inaccurate or misleading.

Post-issuance information

The Issuer does not intend to provide any post-issuance information in relation to any issues of Mortgage Bonds.

Dealers transacting with the Issuer

Certain of the Dealers and their affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform services to the Issuer and its affiliates in the ordinary course of business.

REGISTERED OFFICE OF THE ISSUER

FHB LAND CREDIT AND MORTGAGE BANK LTD.
(*FHB FÖLDHITEL- ÉS JELZÁLOGBANK RÉSZVÉNYTÁRSASÁG*)
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Germany

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