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Tbilisi Retail and Office Real Estate

Shopping For Real Estate



Georgia | Real Estate |

Industry Overview

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Terms and Definitions

CEE – Central and Eastern Europe
FDI – Foreign Direct Investment
GDP – Gross Domestic Product
GeoStat – National Statistics Office of Georgia
GLA – Gross Leased Area
GRDI – Global Retail Development Index
GREMIC – Georgia’s Real Estate Investment Management Company
GREMO – Georgia Real Estate Market Overview
NBG – National Bank of Georgia
WB – World Bank

Executive Summary

Georgia is the 8th most attractive developing country for retail expansion in 2013, according to AT Kearney. Alongside economic growth and rising household incomes, Georgia is becoming an increasingly attractive country in which to do business. AT Kearney's Global Retail Development Index (GRDI) ranks the retail expansion attractiveness of emerging countries based on 25 variables, including economic and political risk, retail market attractiveness, retail saturation, and modern retailing sales area and sales growth.

Increased household spending has driven higher demand for retail space in Tbilisi over the last several years. Modern DIY stores and entertainment facilities are still few and far between. Despite the growing presence of international brands, vacancy rates at shopping centers are still elevated on the back of low consumer demand. This is partly a reflection of still low average incomes. Tbilisi's retail space density of only 153m² per 1,000 inhabitants is low compared to Sofia's 269m², Moscow's 374m², and Bratislava's 1,095m² that offer development opportunities as the levels of disposable income rise.

The growth in disposable incomes in Georgia will drive demand for higher quality retail infrastructure, in our view. Based on the experience of other developing markets and the growth in retail trade, the popularity of shopping centers will begin weeding out open-air markets (47% of all retail space), in our view. Moreover, as tourists from neighboring countries are starting to come to Georgia to shop, organized retail is likely to become more popular. The number of visitors traveling to Georgia for shopping has increased around 3x-4x between 2009-2013 on our estimates. These international visitors (e.g. from Azerbaijan) shop in retail outlets in Georgia to take advantage of price differences and product availability.

The growth in shopping mall numbers will drive the prices down while street retail may become more expensive. Unlike in many European cities, commercial rent is lower on the street than in shopping centers because most of Tbilisi's malls are located in the city center. However, the gap in rents between shopping centers and street retail has narrowed from US\$ 22.9/m² in 1H10 to US\$ 1.6/m² in 2H13. The completion of new trade centers outside the center will boost supply by an estimated 61% by 2017 to over 1.3mn m². This is likely to drive the shopping mall rental costs down as more shopping centers are built on the outskirts while street retail will remain relatively concentrated and limited.

Demand for quality office space has been increasing as a result of improvements in the investment climate. The strong GDP growth in recent years has increased the number of companies in Tbilisi by over 2.3x since 2005. Class D (43%) and Class B+ (31%) office space account for the majority of supply, while we expect the Class A segment to grow fastest in the coming years due to extensive pipeline which would put pressure on rents. Class A offices rent for US\$ 31/m² on average versus US\$ 18/m² for B+ and US\$ 9/m² for B and C.

We believe B+ space offers the best development opportunity. The recent decline in Tbilisi vacancy rates and the extremely low per-capita office space (0.2 in Tbilisi vs. 1.8 in Budapest and 0.5 in Kyiv) points to a significant supply-side opportunity. However, we believe that B+ offices are the most attractive in terms of location, quality and price trade-off. Most businesses in Georgia are still small- and medium-sized enterprises with a lower budget for office rentals. They represent a broader range of organizations that might be interested in B+ space compared to the few that can afford the high prices of class A offices.

Drivers of Demand

Real estate is one of the fastest growing sectors in the Georgian economy. Real estate, rentals and business activities¹ contributed US\$ 661mn, or 5.5% to 2012 GDP, up 4.1x from US\$ 162mn in 2007. FDI inflows in the sector were fairly modest in 2013, at only US\$ 27mn, or 2.9% of total FDI in Georgia.

Figure 1: Real estate value-added

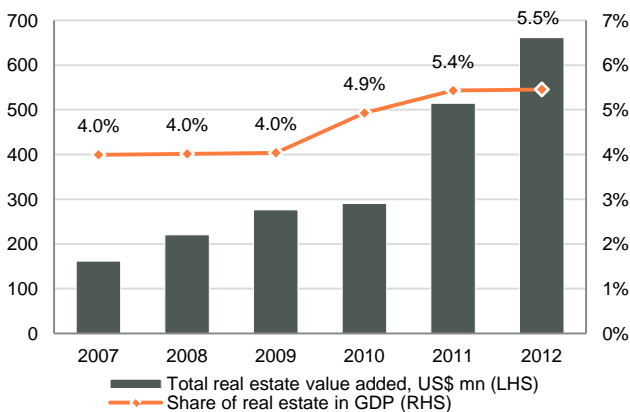
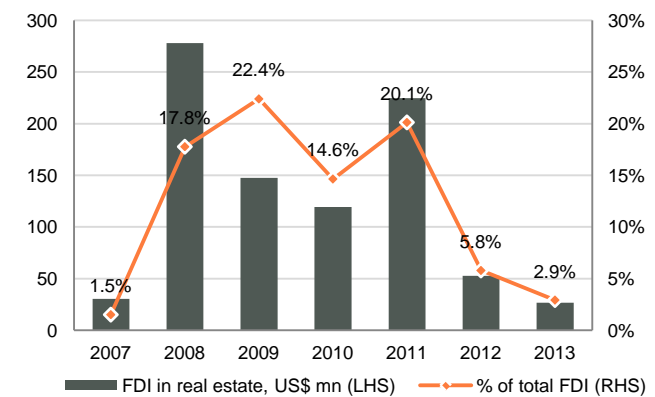


Figure 2: FDI inflows in real estate sector



Note: Real estate, renting and business activities. Value added is the net output of a sector after adding up all outputs and subtracting intermediate inputs (can be used as proxy to sector GDP contribution)

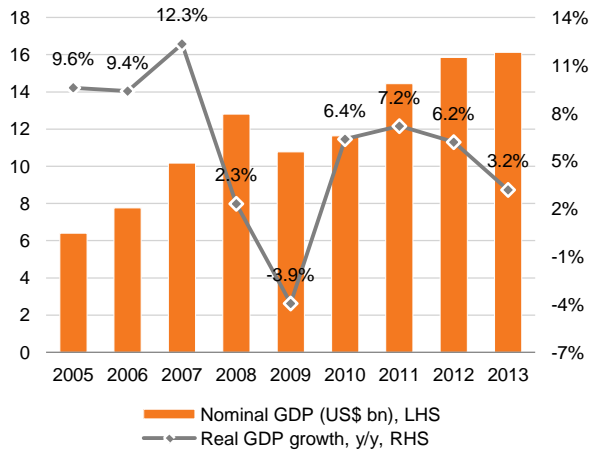
Source: GeoStat

Source: GeoStat

Rising purchasing power and economic development is highly correlated with the development of commercial/retail real estate. Growth in disposable income allows consumers to spend not just on subsistence items but on “want” goods as well. The consumer becomes more conscious of quality and shifts from open to well-organized retail markets and shopping centers. It is also important to note that around 1/4 of Georgia’s population live in Tbilisi and have higher purchasing power, hence Tbilisi remains the commercial focal point of Georgia. For example, average monthly cash consumption in Tbilisi is 4.1x and 4.6x higher than those of Adjara and Samegrelo regions, respectively.

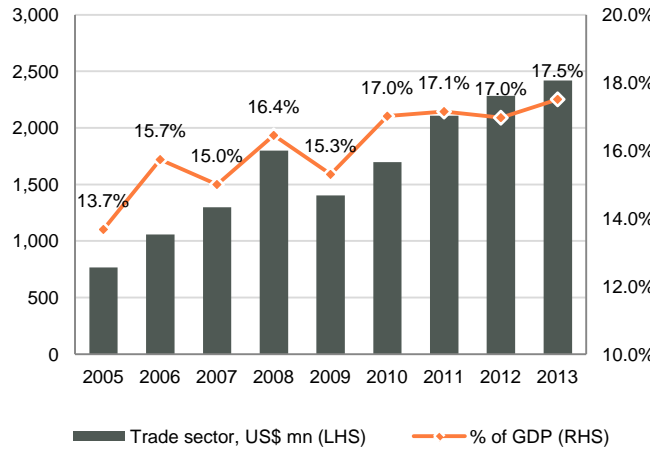
¹ Real estate, rentals, and business activities include activities which mainly focus on the business sector. But more or less all activities covered by this section can be provided to private households, too, e.g. renting of personal and household goods, database activities, legal activities, investigation and security services, interior decoration or photographic activities.

Figure 3: Nominal GDP and real GDP growth rate



Source: GeoStat

Figure 4: Georgia's trade sector



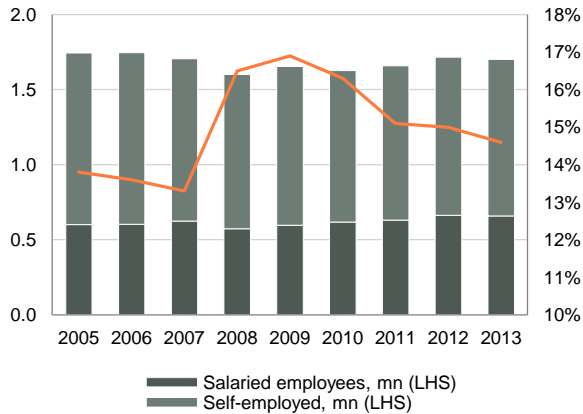
Note: The trade sector includes trade of motor vehicles and motorcycles, wholesale trade, fuel and repairs
Source: GeoStat

Trade and employment dictate the future demand for retail and therefore retail space. Trade has been growing fast in Georgia, posting an impressive 15.5% CAGR (US\$ terms) over 2005-2013. Trade is Georgia's largest economic sector, accounting for 16.1% of GDP on average in recent years, of which retail trade is approximately 60%. In 2011, Tbilisi held an 57% share of total trade in Georgia.

Although retail trade is growing, average per-capita consumer spending is still low, mainly due to high poverty levels. As of 2013, 21.4% of the Georgian population lived in relative poverty and 9.7% in extreme poverty, according to GeoStat. Average monthly household spending is still low relative to the developed retail markets, but it did increase 2.3x to US\$ 524 in 2005-2013. The increase was partly due to rise in salaries and wages and partly due to worker remittances from abroad.

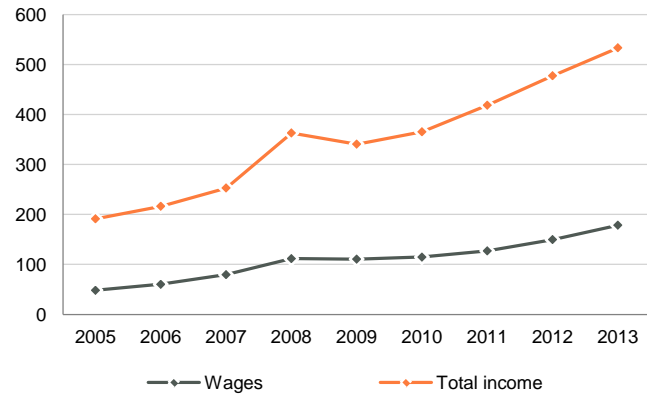
The labor market remains problematic, with little employment growth to match last decade's economic expansion. 14.6% of Georgia's population is unemployed while industrial and trade sectors remain largest employer accounting for around 22% and 21% of c. 1.7mn persons employed (incl. self-employed) in 2H13. On another note, share of salaried employees vs. self-employed increased from 34% in 2005 to 38% in 2013 and we expect this trend to continue in the coming years.

Figure 5: Total employed and unemployment rate



Note: Unemployment rate is calculated as total number of unemployed to labor force.
Source: GeoStat

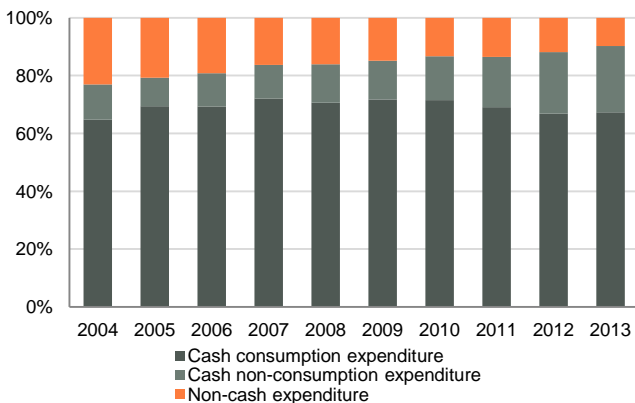
Figure 6: Total average monthly income per household, US\$



Source: GeoStat
Note: Total income includes both cash and non-cash inflows (e.g. interest income)

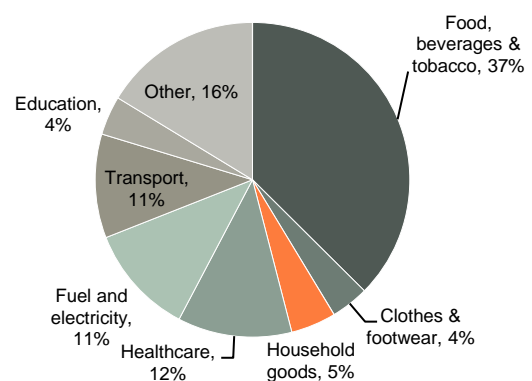
A large portion of the average monthly spending in Georgia comes on food, beverages, and tobacco (25% of total consumption expenditure and 37% of cash expenditure). However, its share of total cash consumption fell from 50% in 2005 to 37% currently, making way for other items like fuel and electricity, healthcare, transport, and education. Generally, high-income countries spend a smaller proportion of income on food, while lower-income countries like Poland, Hungary and the Philippines devote a larger share. The composition of EU-27 expenditure in 2011 showed that housing, water, electricity, gas and other fuels and transport accounted for the largest share of expenditures while food, beverages, and tobacco accounted for only 12% vs. 37% in Georgia in 2013.

Figure 7: Total average monthly expenditure per household in Georgia



Source: GeoStat
Note: Cash consumption expenditure includes spending on immediate consumption items such as food and beverage, transportation, fuel and electricity, healthcare and clothing; Cash non-consumption expenditure includes spending on agriculture, property acquisition and saving and lending; Non-cash expenditure includes depreciation, depletion and bad debt expenses

Figure 8: Breakdown of average monthly cash expenditure in Georgia, 2013



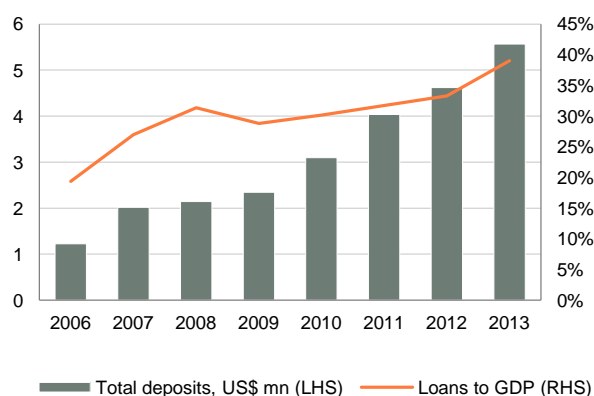
Note: Other consumption expenditure" includes household expenditures on communication, recreation and culture, restaurants and hotels, and miscellaneous goods and services
Source: GeoStat

In Tbilisi, average monthly consumption per household increased 1.7x since 2006. In 2012, the average monthly cash consumption expenditure per capita and per

household in Tbilisi stood at US\$ 123 and US\$ 429, respectively - 44% and 38% above the country average, respectively. Not surprisingly, most of Georgia's retail trade is located in Tbilisi given the capital's concentration of individuals with high disposable incomes.

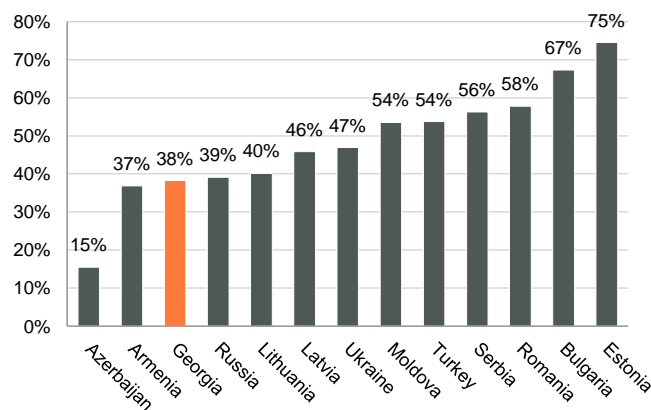
Domestic savings rate has improved in recent years on the back of increased real disposable incomes, tax breaks, and more affordable credit.

Figure 9: Banking sector deposits in Georgia



Source: NBG

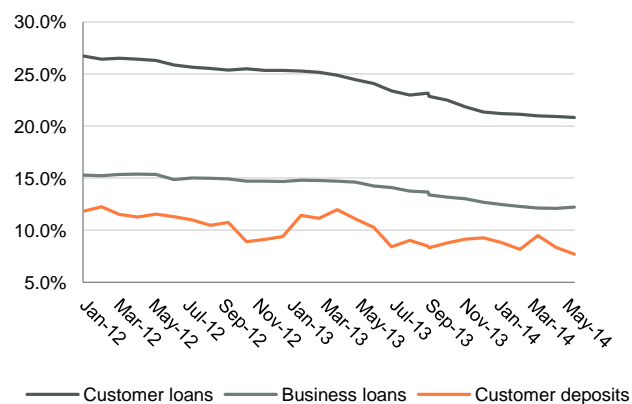
Figure 10: Deposits to GDP by country, 2013



Source: Central Bank of the Republic of Azerbaijan; Central Bank of Armenia; Bank of Russia; National Bank of Romania; Bank of Lithuania; NBG; National Bank of Moldova; National Bank of Serbia; Bank of Estonia; Bank of Latvia

High interest rates have been declining since the beginning of 2012, coming down to from 26.7% to 20.8% on customer loans and from 15.3% to 12.2% on business loans, both denominated in local currency. The lower loan rates have helped stimulate consumer spending. However, low incomes and still-tight credit conditions continue to force a large part of the population to spend disposable income on current consumption.

Figure 11: Interest rates on local currency loans and deposits (GEL-denominated)

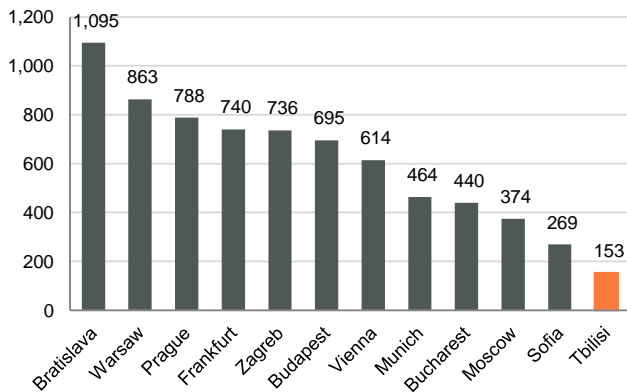


Source: NBG

Retail Real Estate

Georgia's retail real estate market is in the early stages of development. Tbilisi's retail space density (of units 4,000 m² and above) is 153m² per 1,000 inhabitants which is very low compared to other countries. As of 2H13, Tbilisi had 822,311 m² in total retail stock, subdivided into trade centers, street retail, and open markets.

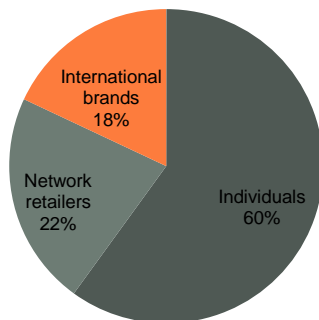
Figure 12: Retail space units (of 4,000 m² and above) per 1,000 inhabitants (m²), 2012



Note: Only the total area of trade centers in Tbilisi was used in order to make the figure comparable to European cities
Source: UniCredit, GREMIC, BoG Research

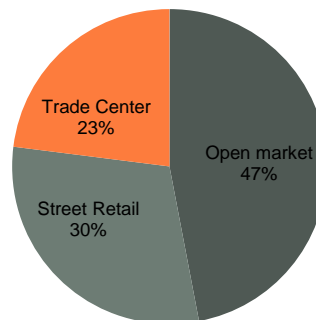
Demand for retail real estate is driven by individual retailers/sole proprietors, network retailers, and international brands. Individual retailers and sole proprietors make up the largest share of total demand for retail space. This segment of demand has low purchasing power, meaning they look for less prestigious retail streets and trade centers and account for 99% of open-air markets, while open air markets represent 47% of all retail space in Georgia. Individuals and sole proprietors usually occupy less than 100m². International brands and network retailers, on the other hand, mostly occupy prestigious and busy commercial streets and shopping centers and are practically non-existent in open markets.

Figure 13: Distribution of demand by retail users, 1H13



Source: GREMIC

Figure 14: Shares of three main types of retail space, 2H13

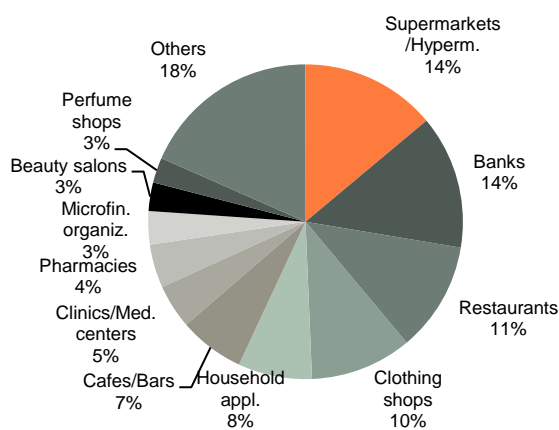


Source: GREMIC

Open Markets

Open-air markets and bazaars hold the largest share of retail at 47%, at around 386,000m². They are usually located in open places with limited or no customer facilities. Open-air markets are largely located in the suburbs and stretch across thousands of square meters. They are popular as rental prices are lower than in shopping centers or in high street shops.

Figure 15: Commercial retail space demand breakdown, 2H13



Note: Includes local organizations with more than 1 unit of retail space; footwear and apparel are excluded as most organizations with more than 1 store are international brands
 Source: GREMIC

Table 1: Main open markets in Tbilisi, 2H13

Open markets	Total space (m ²)	Rent (US\$/m ²)	
		min	max
Lilo	190,000	12	15
Vagzali	25,000	50	75
Gldani	15,000	15	20
Eliava	103,000	12	30
Varketili	13,000	3	10
Dezertirebi bazaar	10,000	78	78
Total	356,000	28	30

Note: All prices are net of VAT; Rental figures are as of 1H13; Please note that not all of the open markets are included, only the ones
 Source: GREMC

Shopping Centers

Shopping centers are a fairly new concept in Tbilisi and the retail sector is actively shifting from soviet-style open markets to organized retail. Tbilisi's shopping center stock grew 11.2% y/y to 192,650m² as of 2H13, mainly on the back of the opening of Sky Holdings and Grato City Centre. Unlike many European cities, Tbilisi's shopping centers are mainly located in the city center. Only the newly built Tbilisi Mall and Goodwill hypermarket are in the suburbs. The share of trade centers in total retail space increased from 14% in 2010 to 23% in 2H13.

In Tbilisi, shopping centers have higher vacancy rates than street retail and open markets due to higher rent rates and increased supply during the last two years. Vacancy rates increased 0.4ppts at shopping centers in 2H13 compared to 1H13, but declined 4.1ppts on the streets, according to GREMIC. At malls, the rates increased largely due to higher vacancy at Pixel and Shopping Gallery. Open market vacancy rates are comparatively low at around 5-8%, mainly due to high demand. The capitalization rate for shopping centers has dropped by 1.8% since 1H13 to 8.6% in 2H13.

Table 2: Existing shopping centers in Tbilisi, 2H13

Trade Centers	GLA m ²	Selling price US\$/m ²		Rent US\$/m ²		Vacant area, m ²	Vacancy rates	Capitalization rate ²
		Min	Max	Min	Max			
GTC	10,000	na	na	8	24	50	0.5%	na
Pixel 34	8,380	2,300	6,356	17	100	3,319	39.6%	9.79%
Tbilisi Central	20,000	na	na	15	35	800	4.0%	na
Karvasla	18,286	1,695	2,797	5	25	4,205	23.0%	6.26%
Kidobani new	9,200	3,000	5,000	8	50	1,150	12.5%	7.61%
Passage	4,500	na	na	60	80	15	0.3%	na
Bavshvta Samkaro	4,600	na	na	3	12	0	0.0%	na
Panda	3,000	na	na	18	18	0	0.0%	na
Metskhre Tsa	2,000	na	na	12	12	0	0.0%	na
Megaline	4,700	na	na	21	25	55	1.2%	na
Eurasia	4,000	na	na	13	34	40	1.0%	na
Didube Piazza	5,500	na	na	10	13	0	0.0%	na
Goodwill Didi Dighomi	4,600	na	na	30	50	24	0.5%	na
Shopping @ Axis	3,459	2,000	2,200	15	30	566	16.4%	10.75%
Goodwill Kavtaradze	3,500	na	na	32	32	0	0.0%	na
Tbilisi Mall	69,566	na	na	42	42	25,739	37.0%	na
Grato Passage	1,518	2,800	3,800	15	30	500	32.9%	5.49%
Shopping Gallery	7,600	na	na	45	100	700	9.2%	na
Isani Trade Center	3,200	na	na	4	5	0	0.0%	na
Sky holdings	2,000	na	na	17	45	16	0.8%	na
Grato City Center	3,041	na	na	16	30	1,000	32.9%	na
Total	192,650					38,179	19.8%¹	

Note: All prices are net of VAT

¹ The total vacancy rate is calculated by dividing the total vacant area by total GLA

² Capitalization rate = (average annual rent * (1 - vacancy rate))/average selling price

Source: GREMIC

Although all of Georgia's shopping centers have gone up over the last decade, almost none of them are modern by European shopping center standards; most are small and poorly built or poorly refurbished. However, compared to street retail and open markets, the shopping centers still provide more comfort. Tbilisi Mall, for example, has a free parking lot for over 2,700 cars.

Among existing shopping centers, rent is the highest at Tbilisi Mall, Shopping Gallery, Pixel 34, Passage, and Goodwill Didi Dighomi. As of 2H13, the average rent ranged from US\$ 19 to US\$ 48 per m². Of the existing malls, only 5 have commercial space for sale – the remainder rent exclusively. The average selling price is US\$ 2,932/m².

Tbilisi Mall, completed in April 2012, is Tbilisi's only large modern shopping center. The developer, Rakeen, leased many stores to the Georgia Retail Group (part of Saudi Arabia's Fawaz Al Hokair, the official franchisee of the Inditex Group), which brought in Zara, Marks & Spencer, GAP, Banana Republic, Aldo, and other international brands. In September 2012, hypermarket Carrefour was added as an anchor tenant. The mall is targeting middle to upper class customers, most of whom use their own cars to reach the mall.

Table 3: Share of organized retail in select countries, 2006

Country	Total Retail Sales, US\$ bn	Share of Organized Retail (%)	Share of Unorganized Retail (%)
USA	2,983	85%	15%
Japan	1,182	66%	34%
China	785	20%	80%
United Kingdom	475	80%	20%
France	436	80%	20%
Germany	421	80%	20%
India	322	4%	96%
Brazil	284	36%	64%
Russia	276	33%	67%
Indonesia	150	30%	70%
Poland	120	20%	80%
Thailand	68	40%	60%
Pakistan	67	1%	99%
Argentina	53	40%	60%
Philippines	51	35%	65%
Malaysia	34	55%	45%
Czech Republic	34	30%	70%
Vietnam	26	22%	78%
Hungary	24	30%	70%
Georgia	3	53%	47%

Note: Outdated data used for demonstrative purposes only

Georgia's share of the unorganized market is equivalent to the open market and its share of the organized market is equivalent to trade centers and street retail

Source: Planet Retail; Technopak Advisers; GREMIC

As disposable incomes grow, we expect consumers to switch to a preference for organized retail. In developed countries, retail is mainly organized and open markets or unorganized retail is practically non-existent. Retailers are becoming increasingly globalized even in developing markets and the percentage of unorganized retail in developing countries is declining.

GREMIC expects a 2.4x increase in the total area of trade centers in the next 2 years. A total of 317,238m² of space is in the pipeline for completion over the next 4 years. Of this, 91,000m² at three shopping centers is scheduled for completion by the end of 2014, which will increase total supply 47%. The supply increase should drive rent lower and pump up vacancy rates. The main development project in the pipeline for 2014 is Tbilisi East Mall, a 65,000m² mall in two phases. Nearby, construction has started on the Olympic Village for the 2015 Youth Olympic Games to be held in Tbilisi.

Table 4: Future Projects, 2013-2016

Project	GLA (m ²)	Scheduled completion
Irao	7,000	2014
Gldani Mall	19,000	2014
Tbilisi East Point	65,000	2014
Gldani Plaza	6,300	2015
Didube Mega Trade	13,380	2015
Maxhome	13,752	2015
Niba Delisi	16,000	2015
Olympic Village (Hualing Mall)	135,946	2015
Magti (Rustaveli ave. 7)	19,213	2016
Tbilisi Plaza	21,647	2017
Total	317,238	

Source: GREMIC

High Street Retail

Unlike shopping centers, high street retail is well-developed in Tbilisi, although it is facing competition from malls. High street stores usually occupy the first and second floors of residential buildings, usually rented out/sold by individuals. As of 2H13, Tbilisi has 245,661m² of high street retail area. Tbilisi has four major high street retail destinations: Rustaveli Ave., Chavchavadze Ave., Aghmashenebeli Ave. and Marjanishvili St. (which intersects Aghmashenebeli Ave.), and Pekini St. and Vazha-Pshavela Ave. (which intersects Pekini St).

Around 30% of retail premises in Tbilisi (including cafes and restaurants) are owner-operated, with 70% leased space. Rents depend on unit size, condition, street side, and location. Rent is also significantly affected by factors such as stairs, partitions, etc.

Map 1: Main retail streets in Tbilisi



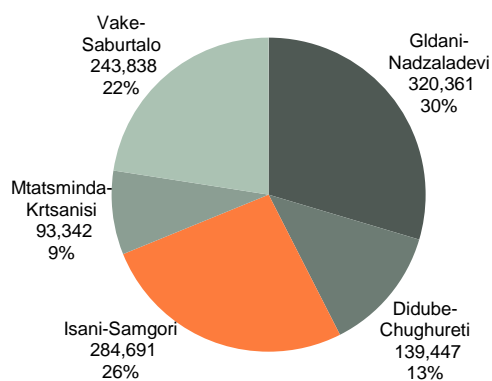
Source: BoG Research

Other retail clusters have been established near densely populated residential areas, including the areas around the Gldani and Varketili metro stations, which are high traffic, low income areas.

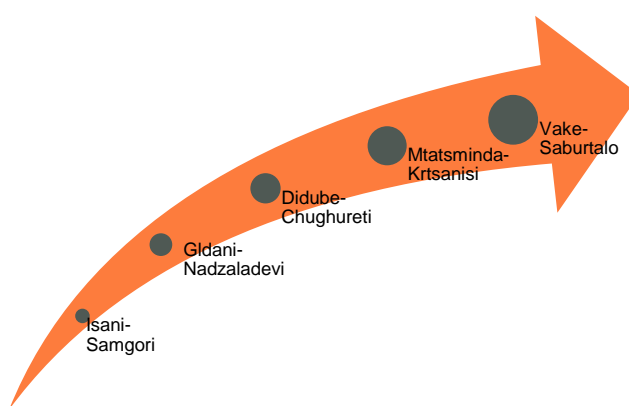
Table 5: Main retail streets in Tbilisi

Street	District	River bank	Represented brands*	Demography
Pekini St.	Saburtalo	Right bank of Mtkvari	Celio, Tom Tailor, VOGG, Etam, Mango, Benetton, Mexx, Ecco, Colin's, Sela, Sisley, Okaidi, Kookai	Middle/high income
Rustaveli Ave.	Old Tbilisi	Right bank of Mtkvari	Massimo Dutti, Zara, Klondike, Smart, Swarovsky, Next, Mothercare, Villeroy & Bosch, Nike, Adidas, Giordano	Middle/high income
Chavchavadze Ave.	Vake	Right bank of Mtkvari	Guess, Lacoste, Yves Rocher, Roberto Bravo, Levi's, Bata	Middle/high income
Aghmashenebeli Ave.	Didube	Left bank of Mtkvari	Aldo, Baldi, Bata, Monte Napoleone, Samikitno, Ioli	Middle income

* The list of represented brands is not exhaustive
 Source: BoG Research

Figure 16: Population of Tbilisi by districts, 2002*


* A population census by administrative districts has not been conducted since 2002; the data is due to be updated in 2014. Since 2002, the total population of Tbilisi increased 8% to 1,171,200 as of January 1, 2013.
 Source: GeoStat

Figure 17: Purchasing power per capita by districts in Tbilisi


Source: BoG Research; GeoStat

Unlike many European cities, commercial rent is lower on the street than shopping centers, mainly because most of Tbilisi's malls are located in the city center. As of 2H13, the average street rent for commercial space was US\$ 26.9/m², unchanged from 1H13. The average selling price added just 0.4% compared to the first half to US\$ 2,639/m² in 2H13. Rents and selling prices are highest on Pekini St. and Rustaveli Ave. However, street retail rentals are higher than shopping centers on central streets such as Pekini, Rustaveli and Chavchavadze.

Of the four main retail streets, Chavchavadze has the highest vacancy rate at 28% and Rustaveli the lowest at 1.5%. The high vacancy rate on Chavchavadze is mainly the result of newly added retail space. Generally, the average vacancy rate in Tbilisi grew 4ppts since 1H13 to 15% in 2H13. The highest capitalization rate is on Pekini, while the lowest rate is on Chavchavadze Ave., because the selling price and vacancy rate on Chavchavadze are proportionally higher. Certain sections of Pekini street are the most expensive retail properties to buy with prices up to US\$ 8,000-10,000 per m².

Table 6: Street retail in Tbilisi

Street	District	GLA m ²	Selling price US\$/m ²		Rent US\$/m ²		Vacant area m ²	Vacancy rate	Capitalization rate
			Min	Max	Min	Max			
Pekini	Saburtalo	10,522	3,882	4,744	50	61	1,361	12.9%	13.4%
Rustaveli, Kostava	Old Tbilisi	16,959	4,960	6,063	46	57	250	1.5%	11.1%
Chavchavadze	Vake	13,705	4,095	5,005	32	40	3,853	28.1%	6.8%
Aghmashenebeli, Marjanishvili	Didube	22,925	3,171	3,875	29	36	5,833	25.4%	8.3%
Abashidze, Paliashvili	Vake	34,947	2,087	2,551	19	23	6,055	17.3%	9.1%
Kazbegi, Vazha-Pshavela, Kostava, Pekini – less busy part ¹	Saburtalo	50,053	1,791	2,189	19	23	10,164	20.3%	10.2%
Tsereteli, Tamar Mepe, Tsabadze	Didube	28,708	1,901	2,323	22	26	4,932	17.2%	11.3%
Leselidze, Pushkini	Old Tbilisi	5,065	3,122	3,816	29	36	1,152	22.7%	8.6%
Gldani Metro area	Gldani	12,880	2,390	2,921	25	31	833	6.5%	11.7%
Ketevan Tsamebuli	Isani	9,188	1,228	1,501	14	18	1,811	19.7%	11.3%
Varketili Metro area	Varketili	10,122	1,561	1,907	19	24	193	1.9%	14.5%
Dadiani, Guramishvili	Nadzaladevi	30,586	1,271	1,553	14	17	1,800	5.9%	12.4%
Total		245,661					38,237	15.6% ²	10.3%

Note: All prices are net of VAT; Certain sections of Pekini street are the most expensive retail properties to buy with prices up to US\$ 8,000-10,000 per m²

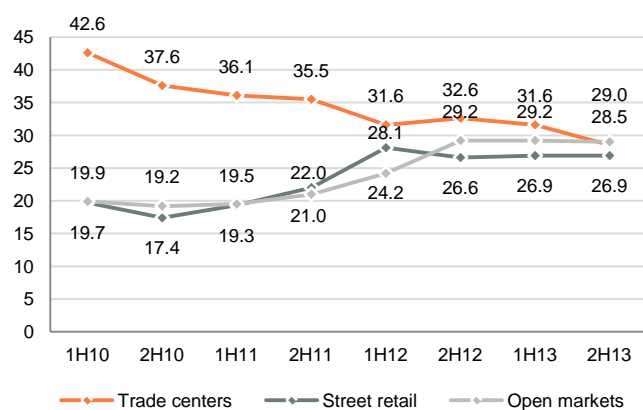
¹ From Vazha-Pshavela intersection to Gagarini Square

² The total vacancy rate is calculated by dividing the total vacant area by total GLA

Source: GREMIC; BoG Research

Rents & Capitalization rates

Rental rates in Tbilisi shopping centers are higher than in open markets and retail streets, respectively. Over the past three years, rental rates in shopping centers dropped 24%, while street and open market rents increased 55% and 51%, respectively. Street and open market space is limited, while the supply of shopping center space has risen gradually, which is driving the rent trends. The only addition of street retail space would be to turn the remaining first floor space into a retail space, but this represents a very small share of the existing retail space.

Figure 18: Average rent in Tbilisi, US\$/m²


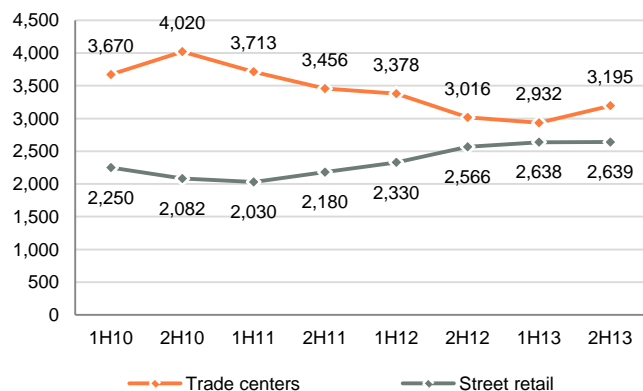
Note: All prices are net of VAT

Source: GREMIC

The average selling price of street retail properties is 17% lower than shopping centers. The average price per square meter in Tbilisi shopping centers increased 6% y/y in 2H13 to US\$ 3,195. On the other hand, the average price per square meter for street retail rose 3% y/y to US\$ 2,639, to the highest level in three years. But yet again, the average selling prices for properties in central streets (Pekini, Rustaveli, Chavchavadze) are c. US\$ 4,000 – 6,000 per m², higher than that of shopping centers which is in the range of US\$ 2,500 – 4,000 per m² except several very centrally outliers. In open markets, property sales do not transfer full ownership to the buyer,

which is why property prices are 3-4x lower than those of retail streets and trade centers.

Figure 19: Average selling prices in Tbilisi, US\$/m²



Note: All prices are net of VAT
 Source: GREMIC

Tbilisi's average capitalization rate of 9.6% is higher than the 6.2% average in Europe. Rental rates in shopping centers and street retail in Tbilisi are significantly lower than in Europe.

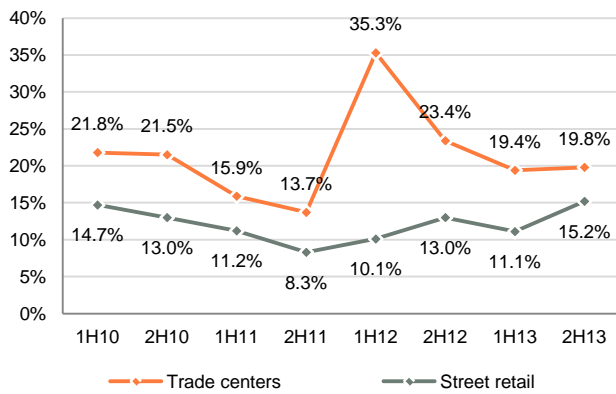
Table 7: Rents and capitalization rates comparison

	Country	City	Rent/m ² , (US\$)	Capitalization rate
1	France	Paris	1,303	3.9%
2	England	London	1,252	2.8%
3	Switzerland	Zurich	1,057	3.2%
4	Germany	Munich	483	4.2%
5	Italy	Milan	517	5.5%
6	Germany	Berlin	441	4.4%
7	Austria	Vienna	421	4.0%
8	Italy	Rome	460	5.5%
9	Netherlands	Amsterdam	333	4.2%
10	Spain	Madrid	287	4.8%
11	Norway	Oslo	236	5.0%
12	Denmark	Copenhagen	231	4.5%
13	Ireland	Dublin	216	5.5%
14	Finland	Helsinki	204	5.1%
15	Belgium	Brussels	213	4.3%
16	Sweden	Stockholm	184	4.5%
17	Russia	Moscow	177	9.0%
18	Ukraine	Kiev	153	13.9%
19	Hungary	Budapest	138	7.0%
20	Turkey	Istanbul	186	6.6%
21	Russia	Saint-Petersburg	133	11.0%
22	Greece	Athens	130	6.8%
23	Poland	Warsaw	124	5.9%
24	Portugal	Lisbon	124	7.0%
25	Israel	Tel Aviv	111	8.0%
26	Czech Republic	Prague	117	6.3%
27	Slovakia	Bratislava	90	7.0%
28	Romania	Bucharest	79	8.3%
29	Serbia	Belgrade	48	8.5%
30	Croatia	Zagreb	31	8.3%
31	Georgia	Tbilisi	28	9.5%

Note: All prices are net of VAT
 Source: GREMIC

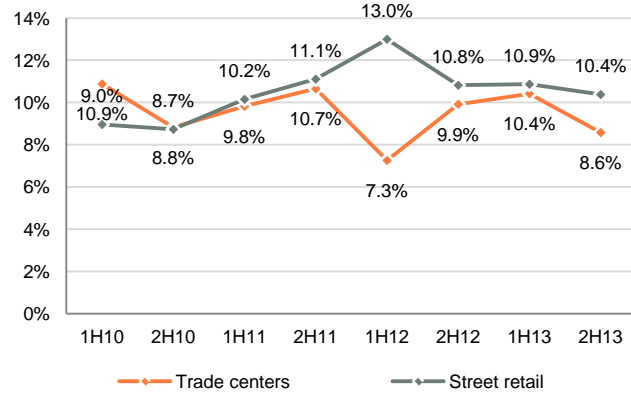
Capitalization rates for shopping centers and street retail decreased by 1.3% and 0.4% y/y in 2H13. The shopping center capitalization rate dropped partly due to an increase in selling prices. The capitalization rate on street retail decreased along with an increase in vacancy rates.

Figure 20: Vacancy rates in Tbilisi



Source: GREMIC

Figure 21: Capitalization rates in Tbilisi

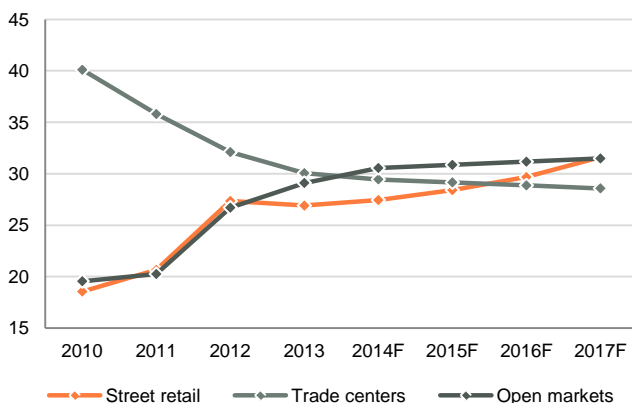


Source: GREMIC

Conclusion

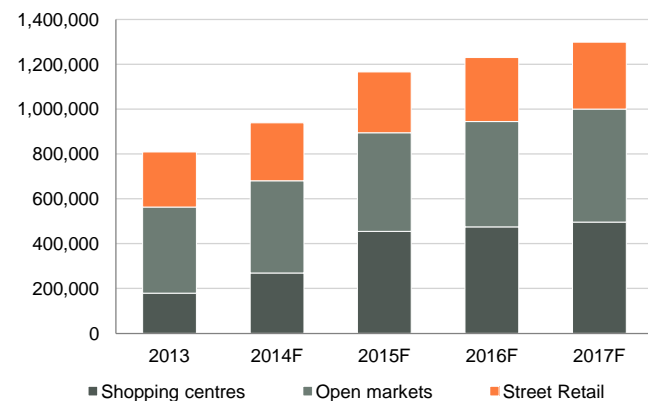
We expect average rents in shopping centers to decline by 4.9% in total until 2017 to US\$ 28.6/m² due to new projects being completed. We expect rents for open markets to remain stable and rents for street retail to rise by 17.5% over 2013-2017. In terms of supply, the pending trade center projects will add an estimated 66.5% of all new retail space by 2017 to a total 1.3mn m². In the meantime, we estimate that supply of street retail and open markets space will increase by 21.6% and 31.6% over 2013-2017, modest growth in comparison to the 177.5% growth that we expect in trade center retail space. Since the only addition of street retail space would be to turn the remaining first floor space into retail space, this will be insufficient to meet demand and will result in rental price growth projected above.

Figure 22: Retail space rental rate projections, Tbilisi (US\$/m² per month)



Source: GREMIC, GeoStat, BoG Research

Figure 23: Tbilisi retail GLA projection

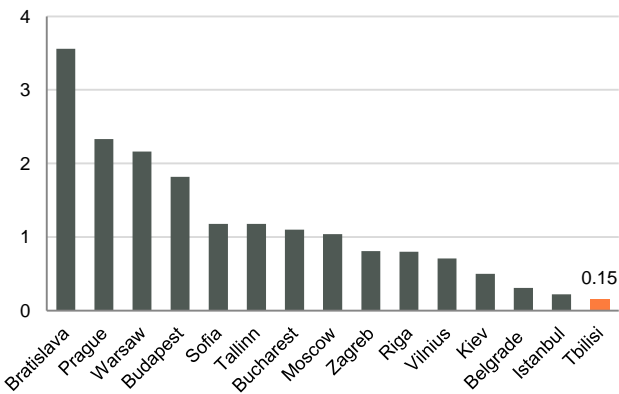


Source: GREMIC

Office Real Estate

Georgia's office real estate segment remains underpenetrated. Tbilisi's per-capita office real estate stock is far below European levels, at 0.15m². This underpenetration is related to the lack of large corporations and international businesses and the dominance of small firms.

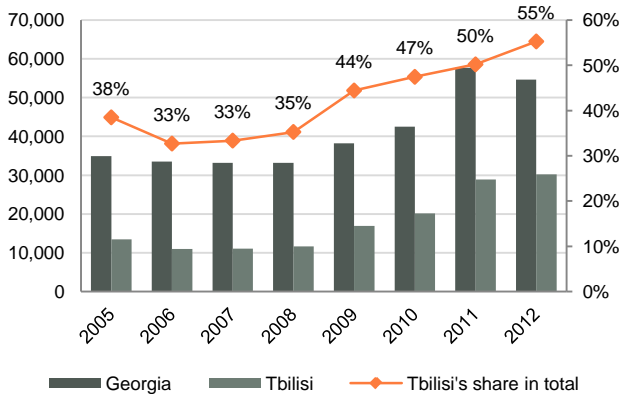
Figure 24: Office space per inhabitant, class A and B offices*, m²



*Includes central business districts and non-central business districts
 Note: Calculations for Tbilisi includes class A, B+ and B office stock as of 1H13
 Source: UniCredit, GREMIC

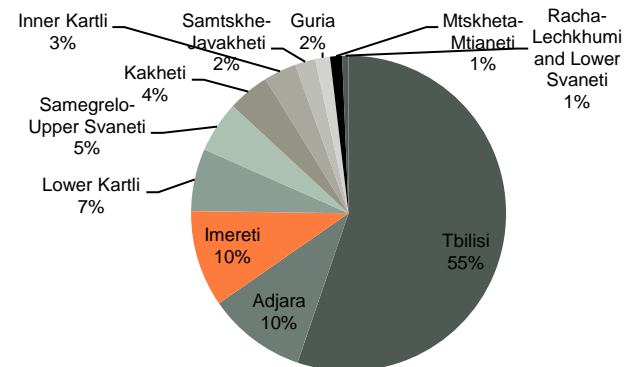
Most businesses in Georgia are local small- and mid-sized enterprises involved in trade and services. For cost reasons they prefer to be located in private apartments and not purpose-built offices. Due to dominance of smaller businesses, demand for high-end office space is extremely price elastic. Rent is a decisive factor for tenants and B+ class space is easier to fill than class A offices.

Figure 25: Number of active businesses



Source: GeoStat

Figure 26: Breakdown of businesses by region, 2012



Source: GeoStat

Most business activity is concentrated in Tbilisi. Modern offices are almost entirely concentrated in Tbilisi, the country's administrative center. As of 2012, Tbilisi accounted for 55% of Georgia's businesses, up from 38% in 2005. Large service firms and branches of large international companies are all headquartered in

Tbilisi. These include Bank of Georgia, TBC Bank, telecom providers Magticom and Geocell, PWC, Deloitte, KPMG, Ernst & Young, DLA Piper and many more.

Table 8: Main indicators by office categories, Tbilisi, 2H13

Office class	Main tenants	Number of business centers	m ²	Vacancy %	Average rent US\$/m ² /month
A	International corporations, diplomatic organizations and wealthy local organizations	8	24,216	27.4%	31
B+	International corporations, diplomatic organizations and wealthy local organizations	31	144,165	12.2%	18
B	Local organizations	3	6,771	11.2%	9
C and D	Local organizations and owners of office space	N/A	292,250	N/A	9
Total		42	467,401	14.3% ¹	

Note: The same rent on class B, C, and D space is a consequence of the fact that class B offices are usually located in less prestigious and central districts, while a good part of class C and D offices are located centrally.

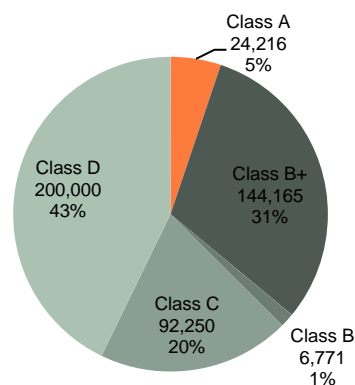
¹ The total vacancy rate is calculated by dividing the vacant area of all A, B and B+ offices by the total area of A, B and B+ offices
 Source: GREMIC

Class A offices have low tenant turnover but high vacancy rates. International companies, diplomatic missions, and wealthy local companies account for most class A demand. As of 2H13, the total class A office stock reached 24,216m² (or 5.2% of total).

Class B+ offices account for almost 1/3 of Tbilisi's office supply (144,165m²). Some are located in prestigious neighborhoods and are high quality but do not qualify as class A space. Due to the lower rent, class B+ tenants in office centers are local companies and international organizations.

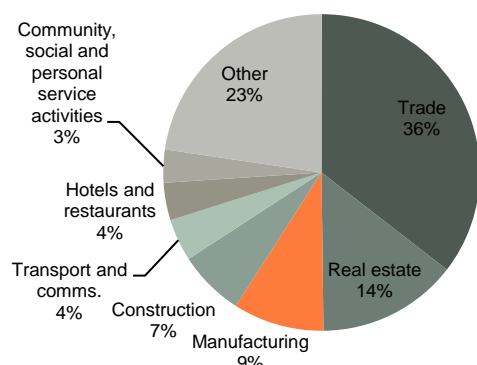
Class B offices mainly satisfy the same benchmarks as class B+ offices; the only difference is location as class B offices are mostly located in less prestigious areas. Currently, Tbilisi only has 3 class B business centers, with a total area of 6,771m² (1.5% of supply).

Figure 27: Supply by office classes, 2H13

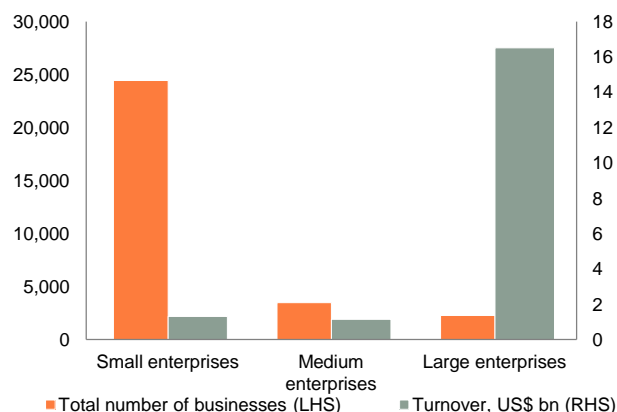


Source: GREMIC

Class C and D offices hold the biggest share of total office supply in Tbilisi and are mainly old, Soviet period residential spaces that tenants rent or buy. These buildings need repair and are mostly occupied by the owners. With the right management and investment, the C-class offices have the potential to become higher class space. The total class C and D supply is estimated at 92,250m² and 200,000m² (20% and 43%), respectively.

Figure 28: Business breakdown by sector, Tbilisi, 2012


Source: GeoStat

Figure 29: Breakdown of turnover and number of businesses by size, Tbilisi (2012)


Source: GeoStat

Demand is growing for A-class stock. In recent years, class A, B, and B+ offices have been gaining a greater share at the expense of class C and D offices. Most newly built and planned office centers are high class buildings, while the supply growth of low class offices is falling behind as less residential areas are being converted into offices. The total supply of business centers in Tbilisi grew 37.5% y/y to 467,401m².

The largest share of tenants (40%) are looking for space of 200m² and above, according to ERDO. Approximately 30% of businesses look for space of less than 100m² and the same percentage are looking for between 100-200m².

The vast majority of planned projects are Class A office buildings. Excluding the suspended projects, over 47,117m² of modern office space (or 1.9x times the current stock) is expected to be completed in the next three years. The additional supply will create stronger competition among landlords, which will bring rent down and hike vacancy rates.

Table 9: Pipeline of new office space

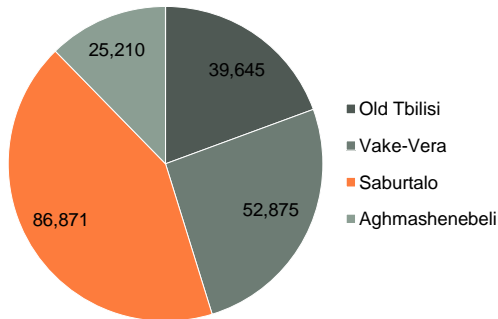
Name	Location	Class	m ²	Completion	Status
Freedom Square	Pushkini St.	Class A	7,500	2013	Ongoing
Gamomtsemloba	Kostava St.	Class A	18,300	2014	Ongoing
Vake Plaza	Chavchavadze Ave.	Class A	11,148	2014	Ongoing
Chavchavadze 29	Chavchavadze Ave.	Class A	5,636	2014	Ongoing
Tabukashvili Business Center	Tabukashvili St.	N/A	10,000	2015	Preparatory phase
Olympic Village	Nearby Tbilisi Sea	N/A	N/A	2015	Ongoing
Muza	Kostava St.	Class A	2,000	2017	Suspended
Fabrique	Leselidze St.	Class A	3,000	N/A	Suspended
Posta Building	Rustaveli Ave.	Class A	15,863	N/A	Suspended
Tiflis Properties Group	Pekini Ave.	Class A	6,900	N/A	Suspended
Uptown Tbilisi	Aghmashenebeli Ave.	Class B	N/A	N/A	Preparatory phase
Rustaveli Ave. 42	Rustaveli Ave.	Class A	4,533	N/A	Ongoing
Kazbegi Ave. 1	Kazbegi Ave.	Class A	2,000	N/A	Suspended
Total			86,880		

Source: GREMIC

Tbilisi's stock of modern office space is concentrated in several locations. These main zones accommodate over 43% of the city's total office stock. Most international businesses are located in Old Tbilisi, the area around Freedom Square, extending towards parts of Old Tbilisi and Rustaveli Ave. According to real estate agency ERDO Group, Old Tbilisi enjoys the greatest demand for office space.



Figure 30: Supply by main zones, m², 2012

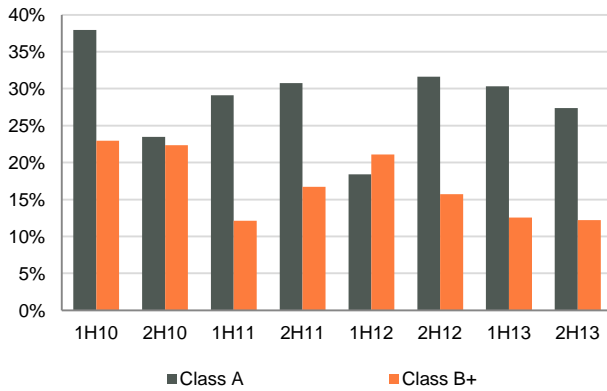


Source: GREMO

Vacancy rates

The class A vacancy rates dropped at the end of 2H13 as supply did not increase in 2013. Vacancy rates declined from 32% in 2H12 to a still-high 27% in 2H13. The vacancy rates of class B+ offices decreased 3% in 2H13 from 2H12 level.

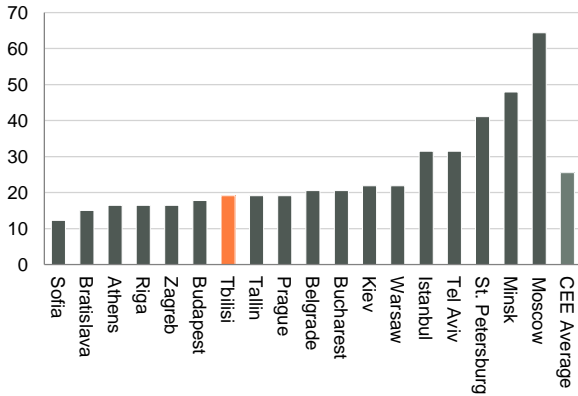
Figure 31: Average vacancy rates by office space classes



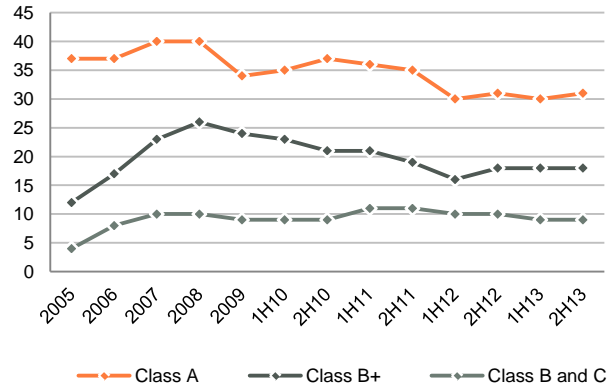
Source: GREMIC

Rents & Capitalization rates

The average monthly rent of US\$ 19/m²/month on Class A and B offices in Tbilisi is 1.9x lower than the average monthly rent in Central and Eastern European cities.

Figure 32: Average office rent in Central and Eastern European cities, 2H13 (US\$/m² per month)


Source: GREMIC

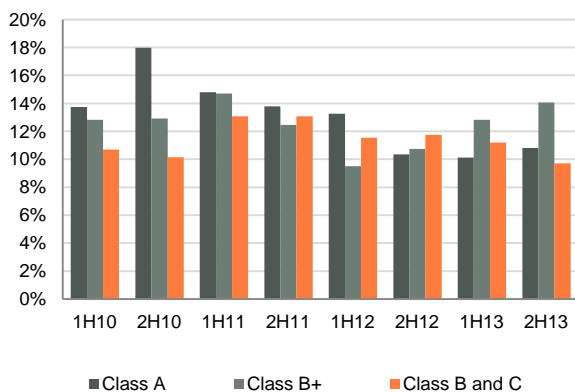
Figure 33: Average office rent in Tbilisi (US\$/m² per month)


Note: All prices are net of VAT

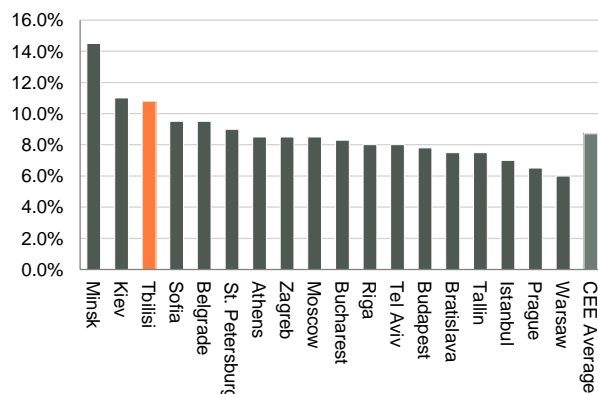
Source: GREMIC

The gap between rent on A- and B+ class space began narrowing in 2007 as rent on B+ offices rose sharply. After rates peaked in 2008, the economic crisis caused rent for both classes to fall. Compared to rent in 2008, current rates on class A and B+ offices are down 23% and 31%, respectively to current US\$ 31/m² and US\$ 18/m², respectively. In the meantime, rents on class B and C offices have declined over the same period by 10%. Tbilisi's average capitalization rate of 10.8% for Class A and B offices is approximately 1.3x the average capitalization rate in European cities.

Class A property prices and rents have remained flat in the past year, while vacancy rates are down. The average class B+ property price dropped from US\$ 1,657/m² in 2H12 to US\$ 1,504/m² in 1H13 and the vacancy rate fell from 16% to 13%. These factors hiked the capitalization rate from 11% to 13%.

Figure 34: Capitalization rates by office space classes


Source: GREMIC

Figure 35: Capitalization rates in European cities, 2H13


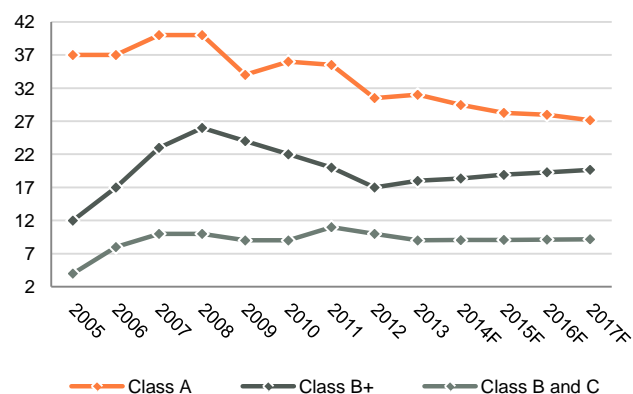
Source: GREMIC

Conclusion

We expect rental rates in Tbilisi to start recovering from a fall in recent years for Classes B+, B and C office space, while Class A rents will continue to fall.

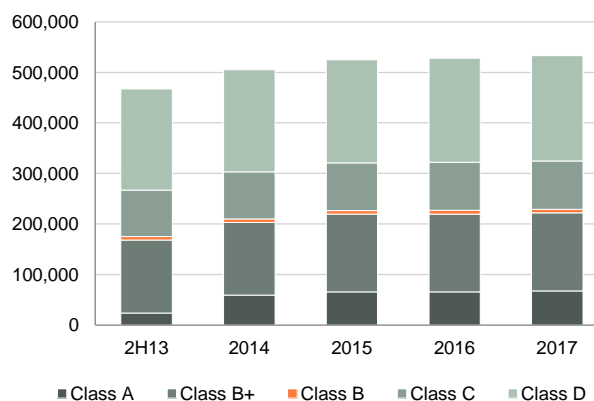
The supply of office space over the next 6 years is mainly dependent on new Class A office developments, which will add around 50,000 m² by 2017 (11% of current all office space supply). Consequently, we expect rents for Class A office space to fall by 12% to US\$ 27/m² by 2017 as a result of increased supply and higher vacancy rates. We also expect rates on class B+ and B/C to increase by 9% and 2%, respectively, by 2017.

Figure 36: Average office space rent projections by class, Tbilisi (US\$/m² per month)



Source: GREMIC; GeoStat; BoG Research

Figure 37: Tbilisi office space supply projection



Source: GREMIC; BoG Research

We believe B+ office space offers the best development opportunity given the nature of the majority of tenants in Georgia. The prestigious location and high quality construction of these offices can accommodate the rising number of international corporations as well as local companies that seek superior offices. These tenants represent a broader range of organizations compared to the few that can afford the high prices of Class A offices.



Appendix 1: Buying, Leasing, and Building

Table 10: Advantages and disadvantages of buying, leasing, and building

Option	Advantages	Disadvantages
Buying	Ownership Operating flexibility Quick occupancy Accessibility to traffic Asset appreciation	Long-term commitment Initial capital outlay Adaptability Initial facility condition Maintenance costs
Leasing	Quick occupancy Relatively low initial costs Reduced commitments	Operating inflexibility Changing lease terms Initial facility condition Adaptability Lease nonrenewal
Building	Ownership Operating flexibility Facility condition Asset appreciation Location flexibility	Long-term commitment Initial capital outlay Construction time Maintenance costs

Source: Mason, J. B., Mayer, M. L., & Ezell, H. F. (1988)

Appendix 2: Office Stock Classification

Table 11: Office Stock Classification System

Characteristics	Class A	Class B+	Class B
Management system of the building	M ¹	OP ²	N/A ³
Heating, ventilation and air-conditioning	M	M	OP
Fire alarm system	M	M	M
Elevators	M	M	M
Max. waiting time for elevator - 30 seconds	OP	N/A	N/A
Additional energy supply source	M	OP	OP
Security system	M	M	M
Ceiling height 2.7-2.8m and higher	M	OP	OP
Efficient floor plan	M	M	OP
Floor depth ⁴	OP	OP	OP
Loss factor ⁵	M	OP	OP
Allowed weight between floors 400kg/m ²	M	OP	OP
Equipping building façade	M	M	M
Dropped ceiling	M	N/A	N/A
Insulation	OP	OP	OP
Location	M	OP	N/A
Access ⁶	M	OP	OP
Parking Type (closed parking lot and access)	M	M	M
Parking Ratio ⁷	OP	OP	OP
One Owner	M	N/A	N/A
Transparent ownership system	OP	OP	OP
Unified management system	M	M	M
High quality internet provider	M	M	OP
Lobby	OP	OP	N/A
Café/Dining Room	M	M	M

Note:

1. Mandatory

2. Optional

3. Not applicable

4. Max. 18-20m from window to window

5. Loss ratio (the ratio of used and rented space) of no more than 12%

6. Easy access (transport connection)

7. At least 1 parking space (underground and above ground) per every 100m² of rental space

Source: GREMIC

Appendix 3: Main Modern Office Buildings in Tbilisi

Table 12: Main modern office buildings in Tbilisi, 2H13

Office	Location	Class	m ²	Vacancy %	2H13		Selling price US\$	Vacancy %	1H13		Selling price US\$
					Rent				Rent		
					min	max			min	max	
GMT Plaza	Freedom Square	A	3,000	0%	35	55	-	0%	35	45	-
Green Building	Marjanishvili St.	A	2,416	5%	21	31	-	9%	21	31	-
Aword Business Center	Melikishvili St.	A	4,000	20%	19	21	-	16%	21	21	-
Sheraton Metekhi Palace	Telavi St.	A	1,400	8%	42	42	-	5%	40	42	-
Tabidze 1	Tabidze St.	A	3,100	8%	45	45	-	13%	45	45	-
DGM Realty Corp.	Khetagurovi St.	A	2,100	34%	22	27	-	5%	21	25	-
Grato	Kostava St.	A	2,200	20%	23	23	-	50%	18	23	-
Pirimze	Vekua St.	A	6,000	70%	25	25	-	80%	25	25	-
BCV	Vazha-Pshavela Ave.	B+	6,715	4%	23	25	-	2%	23	23	-
Pixel 34	Chavchavadze Ave.	B+	11,235	30%	25	30	-	40%	23	30	-
Besiki Business Center	Besiki St.	B+	3,000	1%	21	21	1,800	9%	21	21	1,700
Office at Mitskevichi Str	Mitskevichi St.	B+	4,740	8%	15	15	-	11%	15	15	-
BCL	Kikodze St.	B+	1,650	0%	16	16	-	0%	17	17	-
Renovatio	Tamar Mepe Ave.	B+	2,552	33%	-	-	800	-	-	-	1,200
Geo Real Group	Q. Tsamebuli Ave.	B+	3,500	14%	13	16	-	50%	14	19	-
Green Office	Tamar Mepe Ave.	B+	3,600	9%	15	15	1,500	75%	12	17	1,500
Maidan Palace	Kote Apkhazi St.	B+	10,000	1%	21	21	-	0%	20	25	-
Mantashevi Rows	Bambis Rigi	B+	5,000	2	21	21	-	5%	20	25	-
Axis Palace 1	Gamreli St.	B+	10,000	10%	-	-	1,150	-	-	-	1,200
Tbilisi Central	Vagzali Square	B+	1,600	50%	17	17	-	69%	15	15	-
Cartu Group	Chavchavadze Ave.	B+	7,200	0%	30	30	-	0%	30	30	-
Liberty Tower	Chavchavadze Ave.	B+	15,411	10%	8	40	-	27%	8	40	-
Metekhi Business Group	Avlabari Square	B+	2,100	0%	15	27	-	1%	17	21	-
Didube Plaza	Tsereteli Ave.	B+	5,000	0	8	15	-	40%	9	15	-
The Printing House	Marjanishvili St.	B+	3,011	30%	13	21	-	35%	16	21	-
Kalasi Business Center	Leselidze St.	B+	800	10%	17	25	-	15%	17	25	-
Trade Rows at Meidan	Gorgasali Square	B+	2,500	0%	20	25	-	0%	20	25	-
Palati	Kazbegi Ave.	B+	7,800	9%	17	19	-	8%	15	17	1,800
Brand House (Galaxy)	Gamsakhurdia Ave.	B+	3,400	0%	14	14	-	0%	-	-	-
Tiflis Business Center	Akura St.	B+	9,500	6%	19	19	-	17%	18	18	1,750
Pride Palace	Kazbegi Ave.	B+	2,683	67%	14	15	-	8%	14	17	-
Business center at Kipshidze	Kipshidze St.	B+	1,445	0%	15	15	2,076	16%	17	21	1,231
Panorama	Vakhushti St.	B+	1,720	20%	17	17	-	1%	17	17	-
INDEKO	Borjomi St.	B+	1,205	0%	11	15	-	0%	12	14	-
Cristal Palace	Bochorishvili St.	B+	3,134	0%	15	15	-	5%	15	15	-
Office at Vakhushti Str	Bochorishvili St.	B+	2,471	40%	13	15	1,270	10%	13	13	1,017
Uznadzis 57	Uznadze St.	B+	2,200	20%	9	17	-	20%	8	21	-
Rea	Shartava St.	B+	6,332	40%	-	-	847	-	-	-	1,000
Tiflis at Vazha-Pshavela	Vazha-Pshavela Ave.	B+	2,660	0%	13	13	-	0%	15	15	1,548
Mion	Chachava St.	B	1,300	23%	9	11	-	50%	8	12	-
Office at Agmashenebeli Alley	Agmashenebeli Alley	B	3,943	0%	8	10	-	0%	8	10	-
Office at Agmashenebeli Alley	Agmashenebeli Alley	B	1,528	30%	8	10	-	30%	8	10	-
Total A class			24,216	27%	29	34		30%	28	32	
Total B+ class			144,165	12%	16	20		13%	16	20	
Total B class			6,771	11%	8	10		33%	8	11	
Total C and D classes			292,250								
Total office supply			467,401								

Source: GREMIC

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