



December 2014

Business as usual for Tbilisi's real estate market, despite a sharp annual drop in rental prices

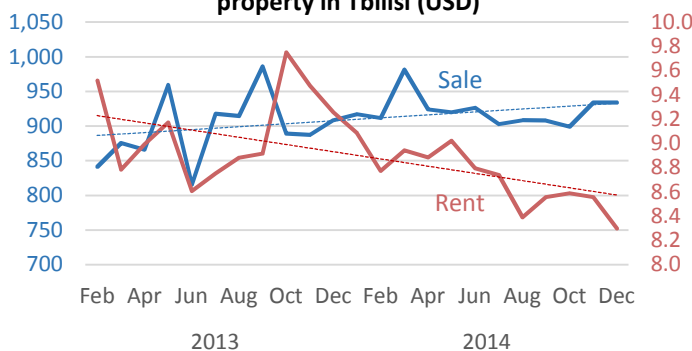
- Investments in real estate compensates for risk premiums (compared to money deposits) and more than covers its costs (Mortgage interest rate).
- Average rental price for residential property continues to fall and reaches its historical minimum since March 2013.
- Despite the lari depreciation, the average residential sale price did not decline and even increased by 0.3% compared to the same period in the previous year.

| | Headlines | Nov-2014 | Dec-2014 |
|----------|-------------------------------------|----------------|----------------|
| For Sale | Monthly Index | 1.0314 | 1.0366 |
| | Annual Change | 0.3% | 0.9% |
| | Average Price (per m ²) | \$933.8 | \$933.9 |
| For Rent | Monthly Index | 0.9839 | 0.9670 |
| | Annual Change | -8.8% | -4.3% |
| | Average Price (per m ²) | \$8.56 | \$8.30 |

Note: The real estate price index shows the evolution of price for a median residential (or commercial) unit. The price in March 2013 = 1.0

In December 2014, rental and sale prices of residential property continued to follow their long run trends. Average rental prices continued to decline in December, reaching a minimum of 8.3 USD per m², while the residential rental price index decreased by 4.3% compared to the same period of last year. Regarding sale prices, the average slightly increased relative to November, reaching 934 USD per m², while the sale price index increased only slightly by 0.9% in annual terms.

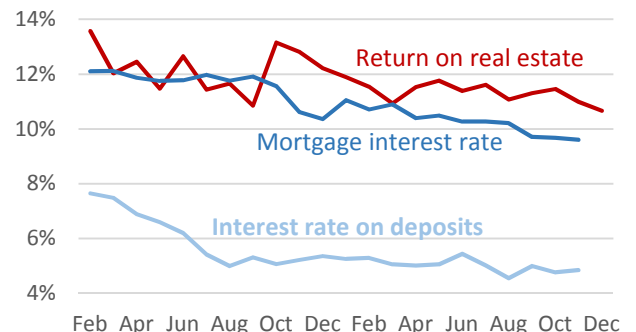
Chart 1. Average prices per m² for residential property in Tbilisi (USD)



source: ISET-PI calculations

The most significant development in the last two months of 2014 was the sharp depreciation of the lari, which mostly affected people who pay interest rates on loans in a foreign currency. As mortgage loans are the main source of financing real estate purchases, it was expected that demand for housing would fall, thus creating downward pressure on real estate prices. Sale prices, however, continued to increase in both year-on-year and month-on-month terms. This can be explained by the significant dollarization of the real estate market. A common way to pay for real estate investment is to rent out the property and, as rental prices are also in dollars, it may take a while before real estate market prices face the full effect of the Lari depreciation.

Chart 2. Return on Residential Real Estate Investment and Interest Rates



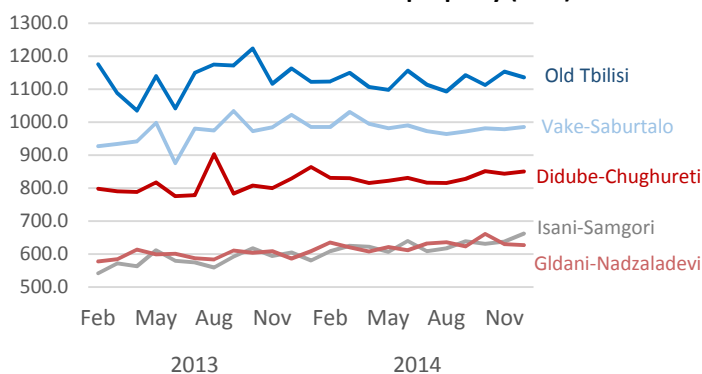
source: ISET-PI calculations

Dividing annual income gained from real estate (annual rental price) by the price of investment (sale price) we can calculate the so-called CAP, or Capitalization Ratio – a quick way to estimate the rate of return on real estate investment.

$$\text{Return on Real Estate} = \frac{(\text{Average Rental Price}) * 12}{\text{Average Sale Price}}$$

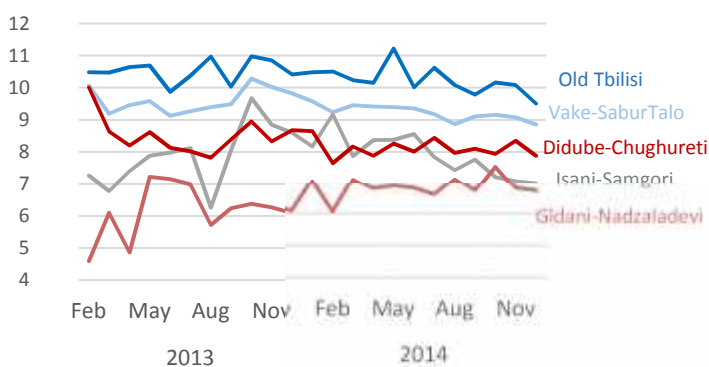
The graph above shows the return on real estate together with the interest rate on deposits in a foreign currency for individuals and the interest rate on mortgages for more than five years according to NBG data.

Chart 4. Average sales prices per sq. m in districts of Tbilisi for residential property (USD)



source: ISET-PI calculations

Chart 5. Average rental prices per m² in districts of Tbilisi for residential property (USD)



Source: ISET-PI calculations

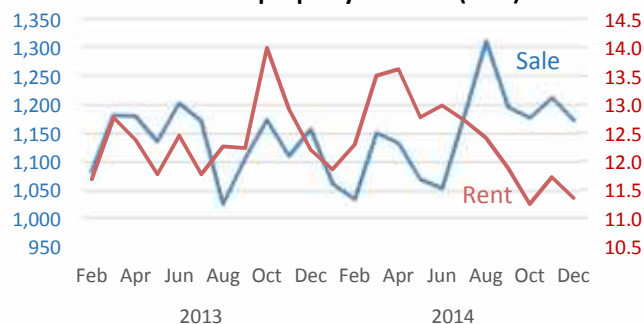
Regarding the different districts of Tbilisi, the average sale price in December increased in all districts except Old Tbilisi and Gldani-Nadzaladevi. The most expensive areas are still Old Tbilisi and Vake-Saburtalo, with averages of 1,136 USD per m² and 985 USD per m² respectively. Sale prices for Isani-Samgori and Gldani-Nadzaladevi property started diverging slightly, although the latter district still remains the cheapest in Tbilisi with an average of 662 USD per m² (see Chart 4).

The situation on the residential rental market also did not change much since last month. The average rental price decreased in all districts. Despite the fact that rental prices in Old Tbilisi revealed the sharpest drop and reached their historical minimum, the district still remains the most expensive for renting a flat, followed by Vake-Saburtalo with average prices of 9.0 and 8.4 USD per m² respectively. Gldani-Nadzaladevi holds the title of the cheapest district in Tbilisi on the rental market as well, with an average price of 6.2 USD per m² (see Chart 5).

As we have mentioned in previous reports, people have the option of either depositing their money in a bank to receive interest or of investing their money in real estate. The interest rate on bank deposits can thus be viewed as an opportunity cost – as what people are giving up when they invest in real estate. From the theoretical perspective, in equilibrium the return on real estate and the interest rate on deposits should move together. The difference (the higher return on the real estate market) can be explained by risk premiums, as investment on the real estate market is riskier and more uncertain than money deposits in a bank. The higher the divergence between the return on real estate and interest rates on deposits, the more profitable investments in real estate becomes. This, in turn, increases demand on the property market, leading to higher prices over time (as the general trend shows).

On the other hand, the main sources of investment funding on the real estate market are mortgage loans. People borrow money, buy real estate and rent it out to cover the mortgage. As we can see from the graph, interest rates on mortgages and the return on real estate are highly correlated and are moving together. Moreover, since October 2013, the return on real estate has been higher than the interest rates on mortgages, meaning that investment in real estate more than covered its cost. These developments made investment in the Tbilisi real estate market even more desirable.

Chart 3. Average prices per m² for Commercial property in Tbilisi (USD)



source: ISET-PI calculations

As for the commercial property market, the average sale price continued to fall from the unusual peak in August, reaching 1,173 USD per m² in December (Chart 3). Average rental prices exhibit the same behavior, falling to 11.4 USD per m² (slightly higher than the historical minimum of 11.3 USD per m² in October 2014). However, the situation is different if we look at the indices: while average prices decreased compared to the previous month, the index increased both for sale (from 0.84 to 0.86) and rental (from 0.86 to 0.94) prices, meaning that although prices have increased, people have tended to rent/buy cheaper commercial real estate with worse conditions (in terms of location etc.).

The real estate price indices for both the sale and rental of residential property in Tbilisi are provided in Table 1 below.

The indices are calculated using the Fisher Index methodology. The table reports the original index, with prices in March 2013 normalized to 1. The table also reports the annual percentage change as well as the three months on three months percentage changes in residential property prices.

The Fisher Index for sales in November 2014 is 1.04; it has increased insignificantly only by 0.9% annually. As for the rental price index (0.98), it decreased by 4.3% comparing to December 2014.

Table 1

| | Residential Property for Sale | | | Residential Property for Rent | | |
|--------|-------------------------------|-----------------------------|-----------------|-------------------------------|-----------------------------|-----------------|
| | Fisher Index | 3 month on 3 month % change | Annual % change | Fisher Index | 3 month on 3 month % change | Annual % change |
| Mar-13 | 1.00 | N/A | N/A | 1.00 | N/A | N/A |
| Apr-13 | 0.95 | N/A | N/A | 0.98 | N/A | N/A |
| May-13 | 1.05 | N/A | N/A | 1.03 | N/A | N/A |
| Jun-13 | 0.90 | N/A | N/A | 0.97 | N/A | N/A |
| Jul-13 | 1.05 | N/A | N/A | 0.97 | N/A | N/A |
| Aug-13 | 1.03 | -0.9% | N/A | 1.04 | -0.8% | N/A |
| Sep-13 | 1.11 | 9.8% | N/A | 1.01 | 1.4% | N/A |
| Oct-13 | 1.01 | 5.0% | N/A | 1.10 | 6.0% | N/A |
| Nov-13 | 1.03 | 6.0% | N/A | 1.08 | 6.8% | N/A |
| Dec-13 | 1.03 | -3.7% | N/A | 1.01 | 5.3% | N/A |
| Jan-14 | 1.04 | -1.4% | N/A | 1.03 | -1.2% | N/A |
| Feb-14 | 1.04 | -1.1% | N/A | 0.98 | -5.6% | N/A |
| Mar-14 | 1.08 | 3.1% | 8.2% | 0.99 | -6.1% | -1.0% |
| Apr-14 | 1.04 | 1.9% | 9.8% | 0.98 | -5.4% | 0.4% |
| May-14 | 1.01 | 0.5% | -4.0% | 1.00 | -1.4% | -3.3% |
| Jun-14 | 1.03 | -2.7% | 14.0% | 0.99 | -0.8% | 1.2% |
| Jul-14 | 1,01 | -3,7% | -3,7% | 0,99 | 1,1% | 2,6% |
| Aug-14 | 1,04 | -1,9% | 1,2% | 0,97 | -0,6% | -6,9% |
| Sep-14 | 1,02 | -0,5% | -8,6% | 0,99 | -0,4% | -2,4% |
| Oct-14 | 1,02 | 1,2% | 1,6% | 1,02 | 0,0% | -7,1% |
| Nov-14 | 1,03 | 0,0% | 0,3% | 0,98 | 1,3% | -8,8% |
| Dec-14 | 1,04 | 0,9% | 0,3% | 0,98 | 0,4% | -4,3% |

Notes:

The data is drawn from the online real estate marketplace. The marketplace collects information about residential and commercial real estate sold in different locations of the country. Data is collected on a daily basis from the marketplace. For the period of December 2014, there were 117,806 useable observations. While we have data from all over Georgia, the analysis here is limited to Tbilisi given the limitations with sample size.