WHAT'S NEXT

2021

by Cushman & Wakefield Georgia

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PREAMBLE

2020 has come to an end – a turbulent year, marked with the rampant, ravaging spread of the pandemic, restriction and isolation, and upending of a sense of normalcy for billions around the globe; a year that tested our resilience, resourcefulness, unity, commitment and accountability in the face of an engulfing crisis; a year that not many will look back upon with fondness. And a year with a ripple of consequences to mark both the immediate and the far future.

AT ITS CLOSURE, WE ARE LOOKING BACK AT 2020, UNRAVELING THESE CONSEQUENCES FOR THE REAL ESTATE MARKETS IN TBILISI AND **PRESENTING OUR PROGNOSES OF WHAT'S NEXT IN 2021.**

2020 PERSPECTIVE

The start of a new decade was marked by the discovery of a previously unknown type of virus in Wuhan, China, which by January had come to be known as COVID-19. By March, the epicenter of the virus had shifted to Europe. The first case of the novel coronavirus was detected in Georgia on February 27th. By the end of March, the State of Emergency had been announced and the better part of April was spent under a strict country-wide lockdown.

Summer served as a brief reprieve between the two waves of COVID-19, when most of the restrictions were lifted and life seemingly regained some semblance of normalcy. However, spikes in the daily number of cases in fall (precipitated to some extent by the relaxation of preventative measures and control) led to a second lockdown, under which the county remains as of the publication date of this report.

The effect of the initial onslaught of the pandemic was uniformly severe across all real estate sectors. Recovery however – aided in some cases with the fiscal stimuli from the government – has been varied.

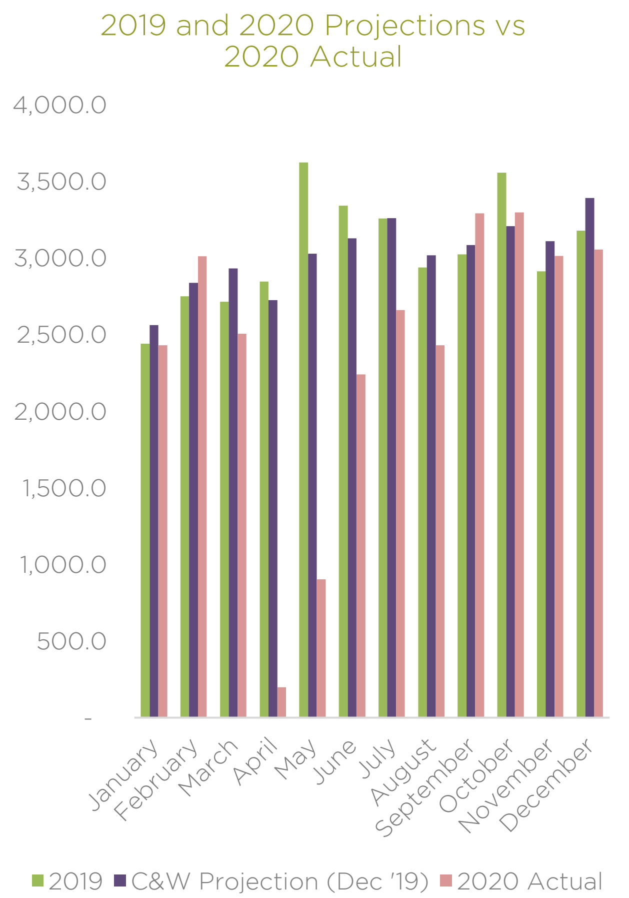
RESIDENTIAL MARKET

Dynamics on Tbilisi residential market at the beginning of the year followed a long-established trend: the number of transactions dropped in January (24% month-on-month) as is typically the case and then increased by 26% in February. The trouble started brewing in late March, but April proved to be the most testing period for the sector. Due to the complete countrywide lockdown – which among other things included restrictions on inter- and intra-city travel – the entire sector stalled. Sales dropped 92%, expectation became extremely bearish, and construction was halted at the majority of project sites. At the time developers projected that sales would drop 50-60% year-on-year, that the prices would similarly experience a 20% reduction and that there would be delays in delivery of pre-sold apartments.

The state intervention came in the form of a subsidy on mortgage interest payments. Starting July 1st, the state has subsidized 4% of interest payment on mortgages valued at GEL 200,000 or less on apartments

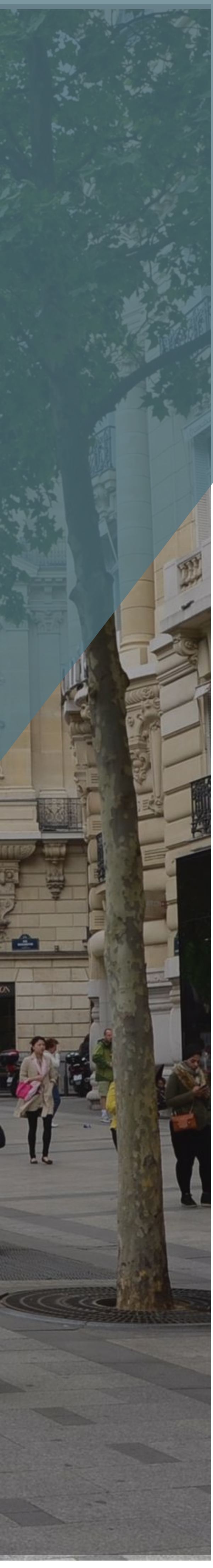
- ***Demand has grown on economy units but has lagged on midsegment and premium apartments;***
- ***Purchases of new apartments rose to nearly 70% of total transactions; in the past, this share has vacillated between 60-62%;***
- ***Total transaction volume has experienced a 20.6% drop year on year;***
- ***Citywide weighted average price dropped by 3% year on year. The reduction has primarily been driven by a drop in secondary unit prices; major developers have been able to maintain their price niches;***
- ***The volume of mortgages has been increasing since June (with only m/o/m reduction registering in August, when transaction*** numbers fell 9% m/o/m as well);

The subsidy program provided a much-needed boost to the market, not the least because it fortified the trust of the buyer in its maintained, state-supported stability. We may speculate, that by providing favorable conditions, it may have also hastened certain purchasing decisions. It sustained both demand and the average price point in the capital, which in turn enabled developers to maintain liquidity and resume ongoing projects. At the year's close, the residential market dynamics are slowly returning to the long-term curvature on the road to recovery.

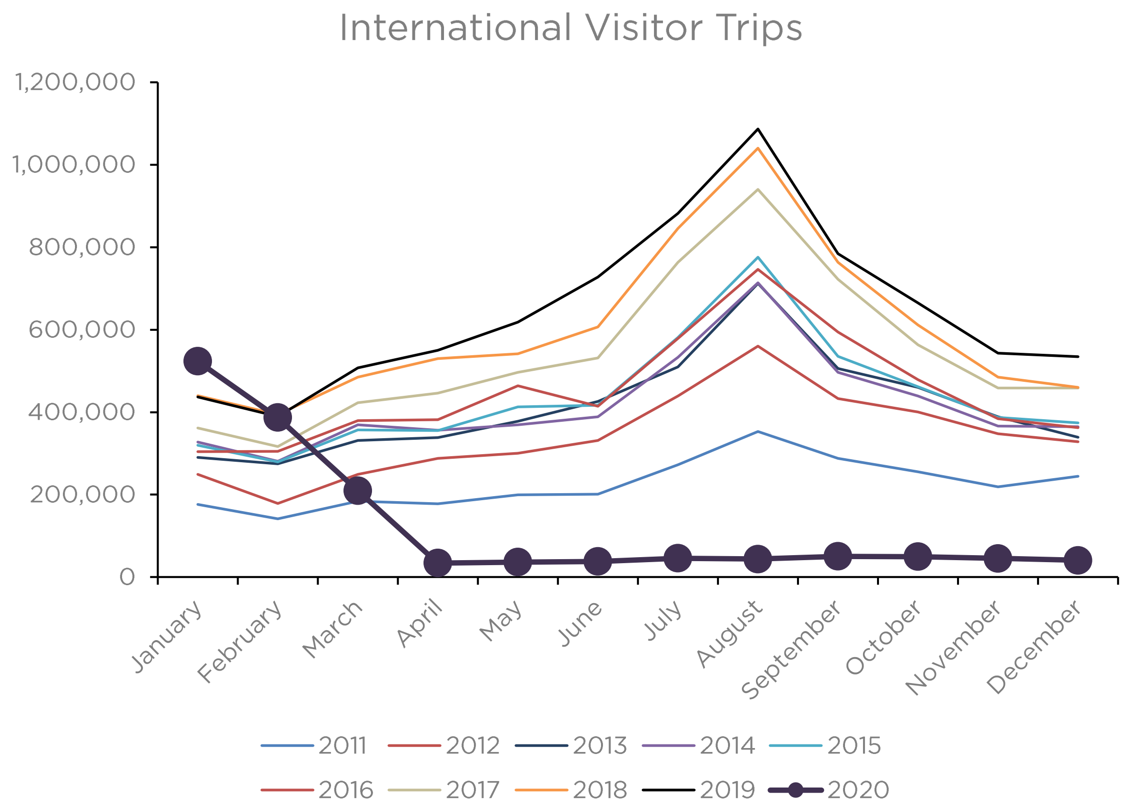


HOSPITALITY
MARKET

Hospitality market has been hit most severely by the pandemic. Booking cancellations started in late February and by mid-March hotels citywide had been closed. At the time, operators of both branded and non-brand facilities reported forward occupancies of 70-90% for June, July, August and September i.e. the high season for Tbilisi tourism. However, lifting of lockdown in May had next to no effect on the operaitonal performance of these hotels since borders remained closed and the situation in the source markets remained severe.



Continued cancellation of bookings forced vast majority of hotels to close down. The situation has remained unchanged since international travel has not yet been reinstated and monthly international visitor inflow has dwindled between 50,000-55,000. With 81% year-on-year reduction in international visitor trips and occupancy of 5-8% in branded facilities, hospitality sector in Tbilisi has been all but paralyzed during 2020.



RETAIL & OFFICE MARKET

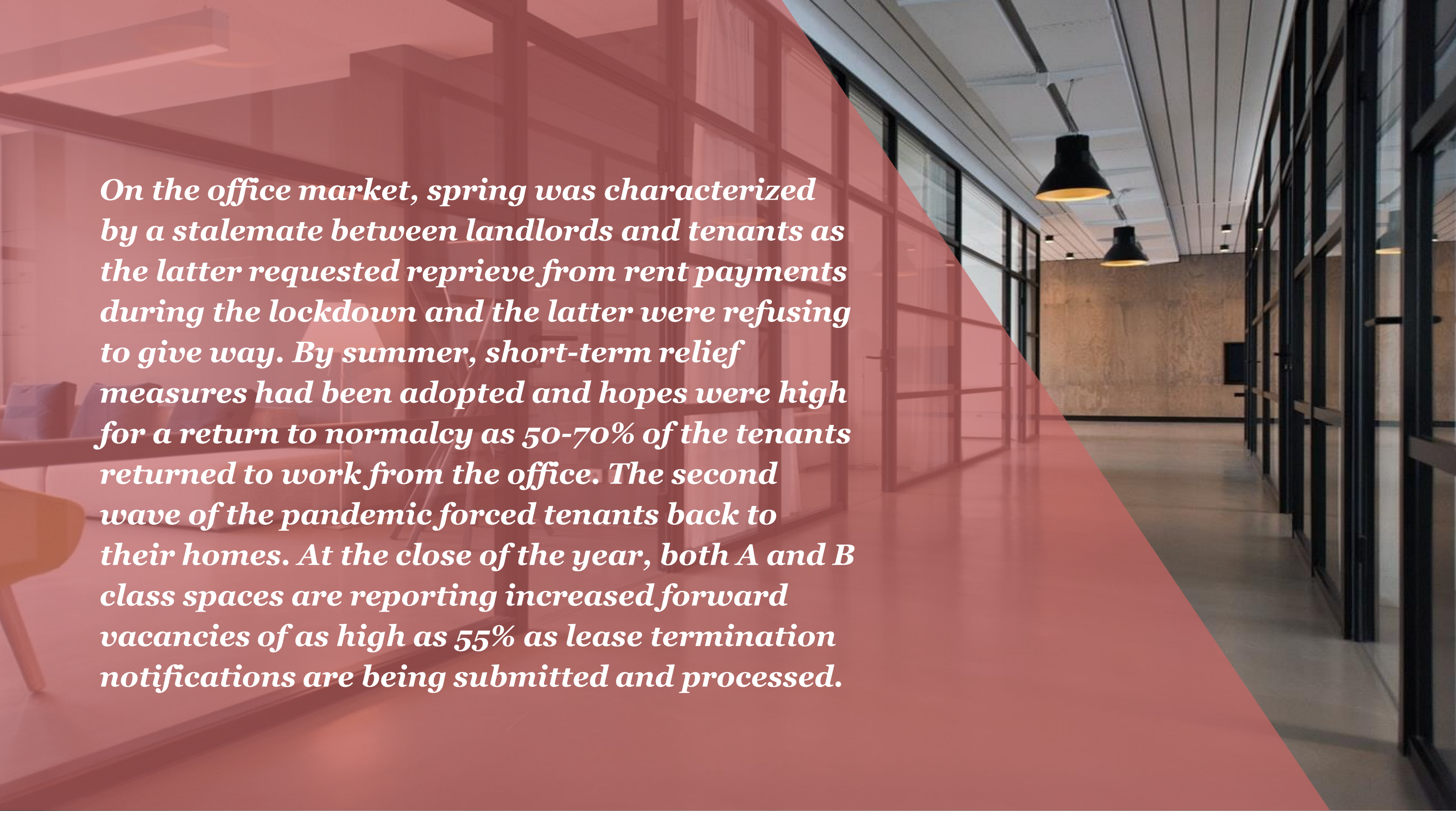
Retail market saw a brief reprieve during summer as lockdown was lifted, shopping centers and street units reopened and the pent-up demand, as well as huge discounts on the last seasons' products drew people to shop en masse. However, by early October, shopping centers were reporting 60% year-on-year drop in traffic, three brands including Yargici, Parfois and Promod had left the market completely and the street unit vacancy became visibly apparent.

The face of street retail has been undergoing a transformation for a while now. Major apparel and footwear retailers have been gradually shifting towards shopping centers while street retail has been becoming more specialized, focused on miscellany and everyday shops and units as well as small F&B outlets. The events of 2020 may further speed up this process. However, as the matters stand, the vacancy on high streets is nearing a 60% mark.

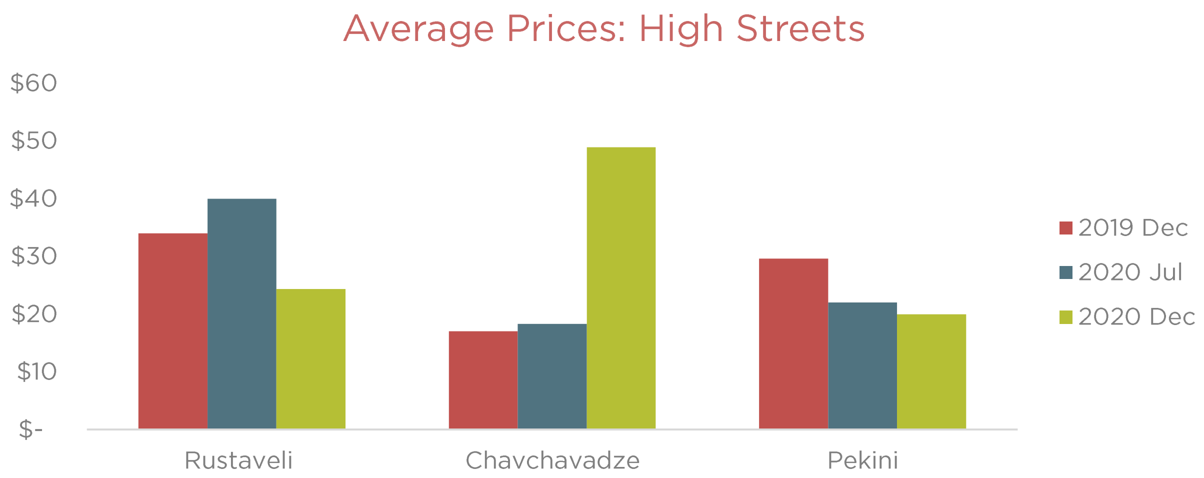
The effects on the average rents have been curious. Asking rents on Chavchavadze Ave have increased throughout 2020. This effect is temporary and is caused by the reluctance of independent landlords to lower rents in line with severely reduced demand.

2020 HAS MADE RETAIL MARKET A TENANT'S MARKET.

LANDLORDS AT BOTH INDEPENDENT STREET UNITS AND LARGE SHOPPING CENTERS WILL HAVE TO LEARN HOW TO ADAPT.



On the office market, spring was characterized by a stalemate between landlords and tenants as the latter requested reprieve from rent payments during the lockdown and the latter were refusing to give way. By summer, short-term relief measures had been adopted and hopes were high for a return to normalcy as 50-70% of the tenants returned to work from the office. The second wave of the pandemic forced tenants back to their homes. At the close of the year, both A and B class spaces are reporting increased forward vacancies of as high as 55% as lease termination notifications are being submitted and processed.



WITH NEARLY

31,000M² OF A CLASS SUPPLY

IN THE PIPELINE, WE EXPECTED THERE TO BE A LARGE GAP BETWEEN DEMAND ON THE MARKET AND THE PROVISION, WHICH WILL SHIFT TIDES IN TENANTS' FAVOR.

OUTLOOK 2021

Perhaps 2020 is the year that will most strongly be associated with COVID-19 and the destruction wreaked in its wake. But the reality of the matter is that we are not leaving the pandemic behind. With uncertainties related to the vaccine distribution timeline and the new variant of the virus spreading globally, the recovery trends and timeline are still very much ambiguous. In many ways, the year gone has been a transformative period; the year coming will be the year when lessons learnt need to be put to practice.

RESIDENTIAL

As noted, residential market in Tbilisi was boosted up by the governmental support; however, the program is no longer active in 2021. During the last few weeks of 2020, developers had been openly asking for the government to continue subsidizing interest on mortgages into 2021 as well, however no budgetary provision has been made for such a decision.

We project that transactions will show a month-on-month reduction between January and December but will continue dropping in February and March as well, unless another exogenous stimulus is pumped into the sector. No longer supported by the subsidy program, developers will likely start reducing prices, which will pull the city-wide average further down. We do not expect demand to rise on subsegments that experienced lack of it in 2020, specifically midsegment and premium units, and secondary flats. Overall, the first quarter of 2021 at least will be characterized by the downward tendencies.

On a larger longitudinal scale, our models predict that the transaction volume will not reach the pre-pandemic levels until the end of 2022. Sales prices will drop within the first half of 2021 but are expected to stabilize further down the line. On the supply side, this may result in reduced developer activity and termination or postponement of pipelined projects.

Based on the trajectory of the recovery, demand may rise on suburban houses and land plots. There were indications in 2020 of rising demand on lands in the mountainous suburbs surrounding Tbilisi as well as in the vicinity of Mtskheta. We may see the continuation of this trend in 2021 as well.

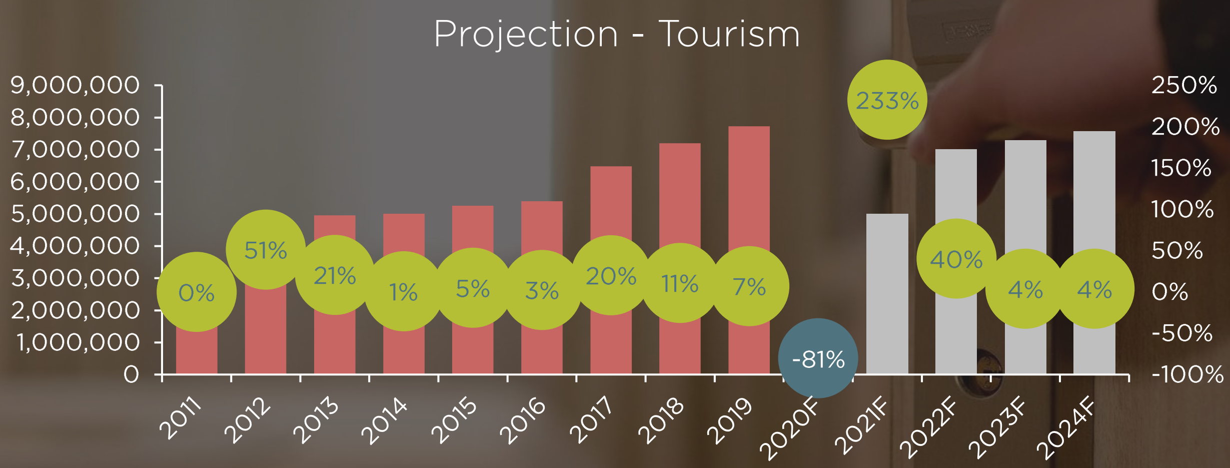
HOSPITALITY

Recovery in the hospitality market is directly related to the effective distribution of the vaccine and in line with this – recovery of the crisis of confidence that the pandemic engendered. Our forecasting models suggest that given the historic dynamics as well as the current situation here and abroad, the volume of international visitor inflow will not reach the pre-pandemic levels until 2023.

There are certain long-term tendencies that give us the confidence to project a relatively faster recovery. First, leisure visitors consistently add up to 40-43% of the total visitors; business visitors make up only about 6-8%. The future of leisure tourism is not under question while the future of MICE/business tourism very much is. Additionally, 70-75% of visitors typically come through the land borders, which gives the sector a measure of independence from the fate of air travel. Finally, it is likely that at least at the beginning of the recovery phase, tourists will prefer "off-the-beaten-track" locations to the heavily trodden ones. Georgia as a whole is and can further be positioned as one, to partake in the catchment.

Hotels here and globally will have to adapt to the new requirements of the end-users. Reduction of contact points, integration of high-tech, flexibility towards refunds and cancellation policies – these are some of the requirements that guests will likely have of hotels going forward. Hotels will have to fare with increased operational costs as well. Research suggests that globally, economy hotels are faster to recover than upper upscale and luxury ones. Whether this will be the case in Tbilisi as well is under question. Due to the lack of market transparency, it is hard to project what share of Tbilisi hotels will reopen once tourist inflow is reinstated to begin with.

FINALLY, AT THE END OF 2019, THERE WERE 25 BRANDED FACILITIES IN THE PIPELINE. OF THESE 6 WERE SUPPOSED TO OPEN IN 2020 AND FURTHER 5 IN 2021. WE PROJECT THAT THE PIPELINE WILL BE ON HOLD UNTIL INTERNATIONAL TRAVEL IS REINSTATED.



RETAIL AND OFFICE

Closure of stores is December has worsened the expectations for the retail sector. December is typically the most active month of the year and operators had hoped for a relatively active sales season. Given the low retail activity, there is a possibility that more brands may exist the market during the first half of the new year. Operators project that even in 2021, turnover will lag by 20% compared to the 2019 numbers.

We expect lease renegotiation to take place and some of the temporary reprieves to take a permanent character. Sector-wide shift from fixed rent to completely revenue-based rent is also expected. Given that retail market has become a tenant's market, we expect landlords in shopping centers and high streets alike to oblige.

Office market will likely see greater shifts in 2021 than what was apparent in 2020. First consideration is the extent to which COVID-19 has affected business center tenants. How many of these will be back to resume operations once the crisis is over? Another consideration has to do with space uptake. Many tenants have started to realize that having 100% of the staff in the office at all times is not necessarily a recipe for heightened performance. A number of companies on the market have already raised the issue of reducing the rented space. Others have shifted completely to the coworking options. It is expected that market-wide vacancy in office buildings will rise further while demand on coworking spaces will increase.

Market-wide rents will continue to drop, given the lack of demand. In the last couple years B+ office spaces have been providing a robust competition to A class spaces. With similar amenities, good locations and about 2/3 of the asking rent compared to the A class offices, B+ offices have been gradually retaking a higher share of the tenant market. This has put a downward pressure on the A Class rents; a further downward pressure on these is expected.

The extent to which rents are lowered will dictate the directionality of tenant movement between office spaces. However, timelines of change for office spaces are much longer than those of other markets given then longevity of rent agreements and the length of the landlord notification period (typically at 6 months). Much like the hospitality pipeline, we expect office pipeline to also be in complete stall until the market recovers.

CONSCLUSION

WITH THE NEW YEAR AND A NEW POST-PANDEMIC ERA ON OUR DOORSTEP, **ADAPTATION WILL BE THE NAME OF THE GAME.**

Assessing what happened in 2020, foreseeing shifts in demand as well as new requirements of the end-users and tapping into these will be crucial for continued survival of all businesses, not just those operating in the real estate markets. There may be some more months of turbulence left until the sector can emerge safely from the storm, which means that now more than ever is the right time to plan ahead on how to stick the landing.

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