



საქართველოს ეროვნული ბანკი
National Bank of Georgia

Real Estate Investment Funds (REITs): Main Features of REITs and Development Opportunities in Georgia

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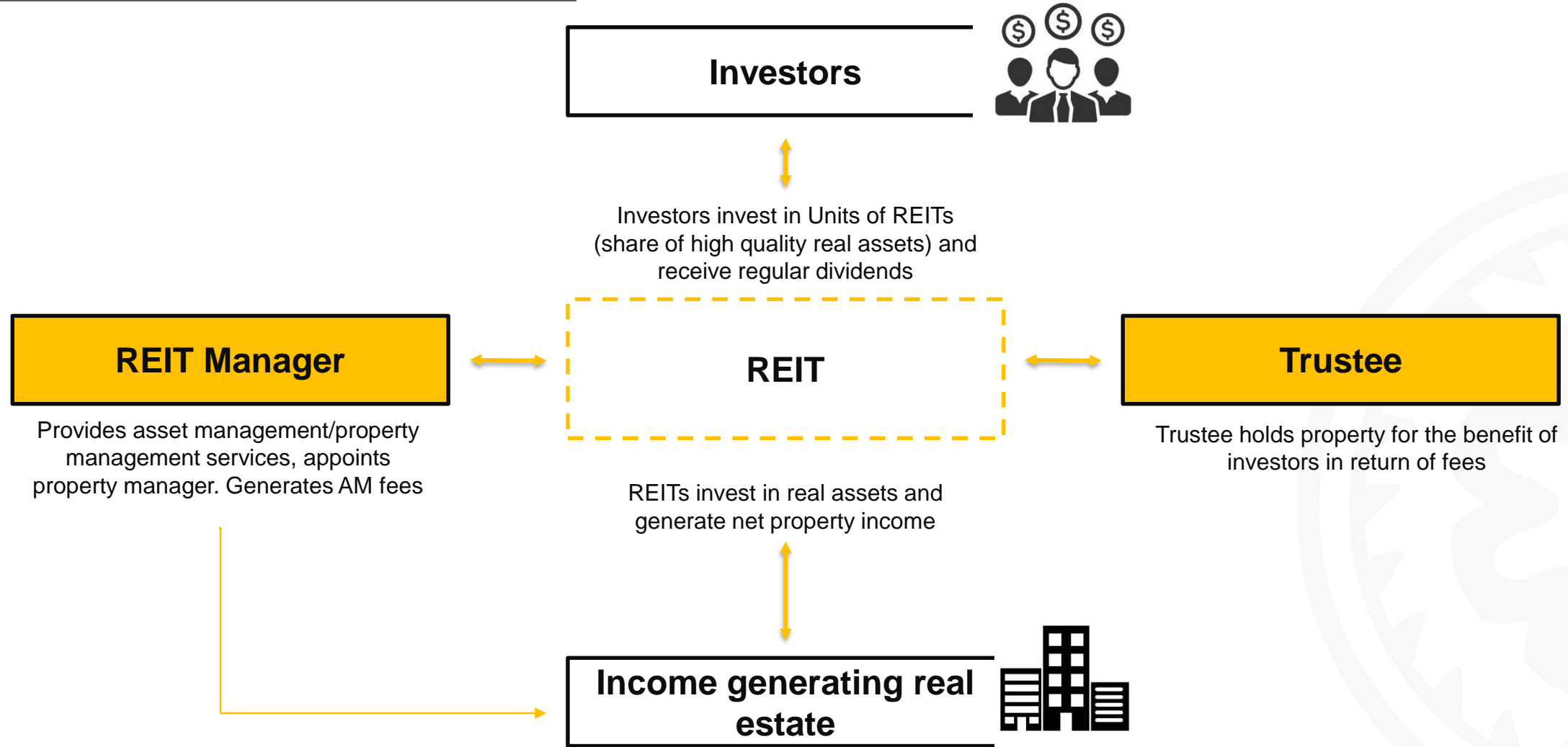
International Market Insights: Main Features of REITs

Main Features of REITs

REITs represent fund-like structure, enabling wider investor base participation in traditional segments of real estate, such as offices, malls, hotels, residential property, healthcare, etc. Due to its unique investment access to these segments, REITs can be regarded as complementary in real estate portfolio.

- ❖ REITs have rental-property-focused business model, with 75%+ ownership in completed and superior quality real estate projects;
- ❖ With a fund-like structure, REITs are professionally/actively managed through independent REIT management entities (Fund and Property Managers);
- ❖ REITs feature both - fixed income and equity instrument characteristics:
 - ❖ Typically are required to distribute at least 90% of their distributable income, providing relatively stable and predictable income streams;
 - ❖ Investors can gain from long term appreciation of real estate, however with moderate growth potential, as REITs put only secondary emphasis on development activities;
- ❖ Compared to traditional real estate investments, REITs provide relatively stable savings and better liquidity, also inflation hedge and broader diversification opportunities.

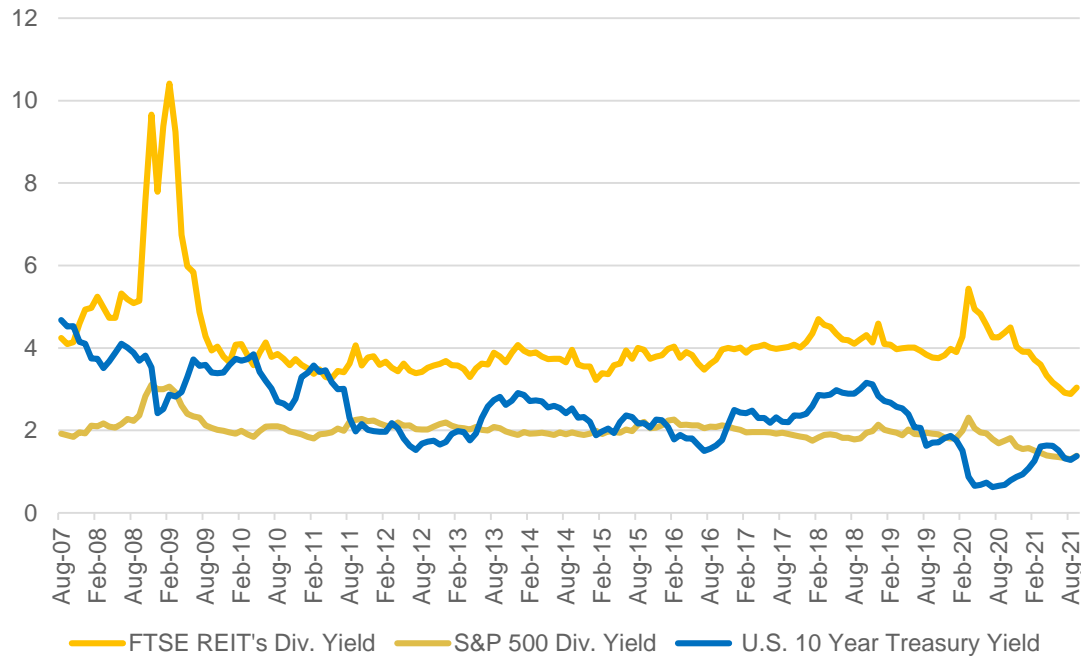
Basic Structure of Equity REITs



Risk-Return Profile of Equity REITs

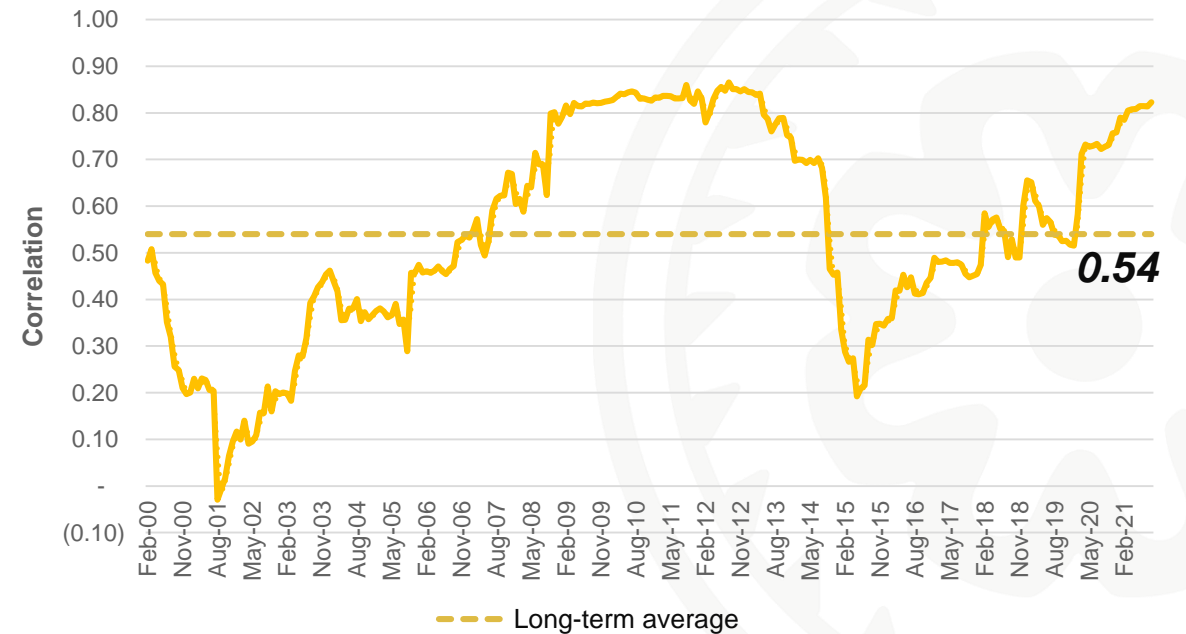
Due to mandated income distribution requirements, large-diversified tenant base and fairly stable rental income, REITs feature relatively high/stable income yields (dividend yield)

1.1. Yields by asset classes (%)



REITs are considered as a separate asset class, as it adds long term diversification benefits to the portfolio

1.2. Rolling 3 year correlation between US REIT (NAREIT) and S&P 500

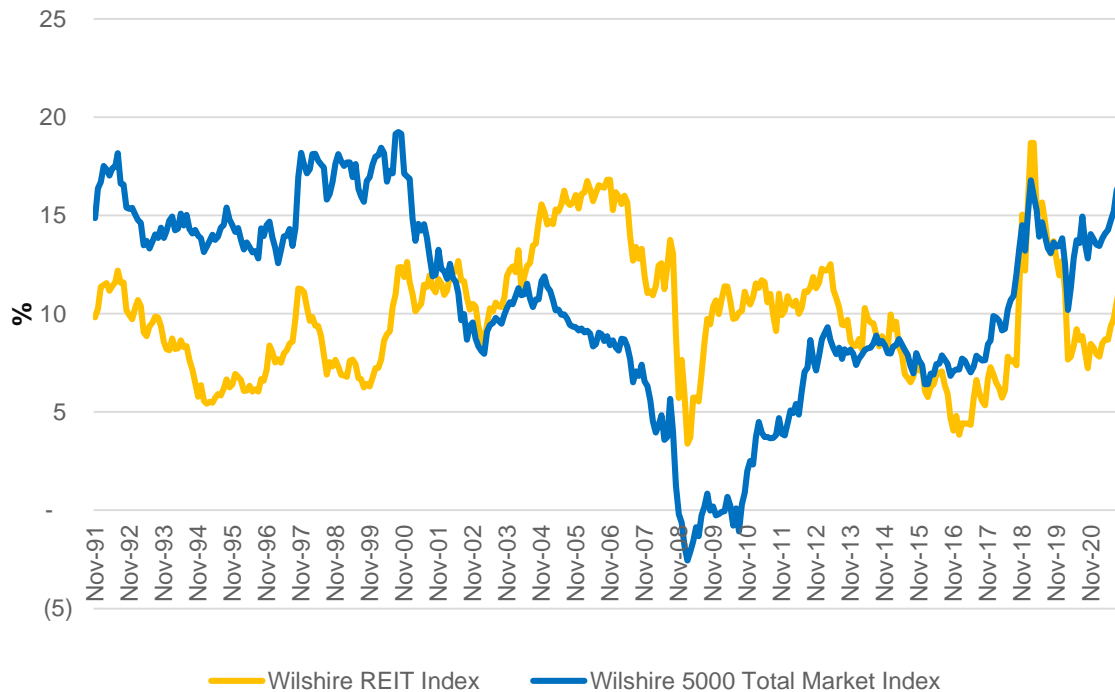


Source | Bloomberg

Long term view of Total Return* performance

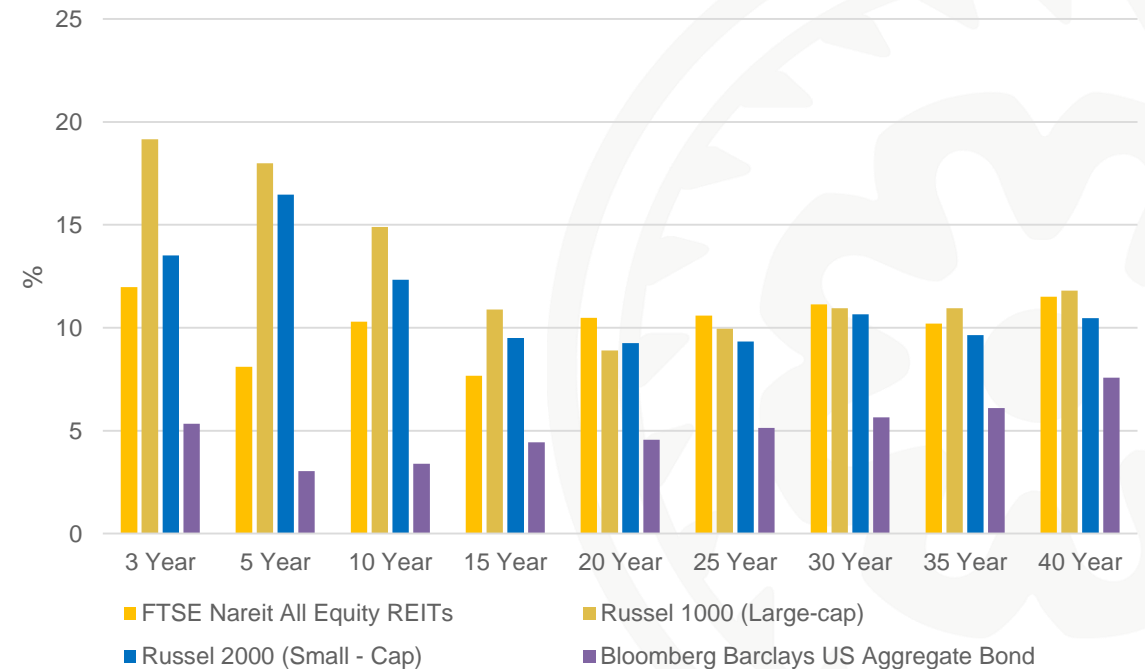
Historically, U.S. listed REITs have provided strong returns. Over most time horizons, REITs have returned somewhat less than broad-based equity indexes, but consistently more than broad-based bond market measures.

1.3. 10 year rolling average annualized total return: US REITs vs US Equity market total return index, %



*Total return index reflects total returns, which do include reinvested dividends

1.4. Total returns by asset classes over extended historical periods through June 2021, %

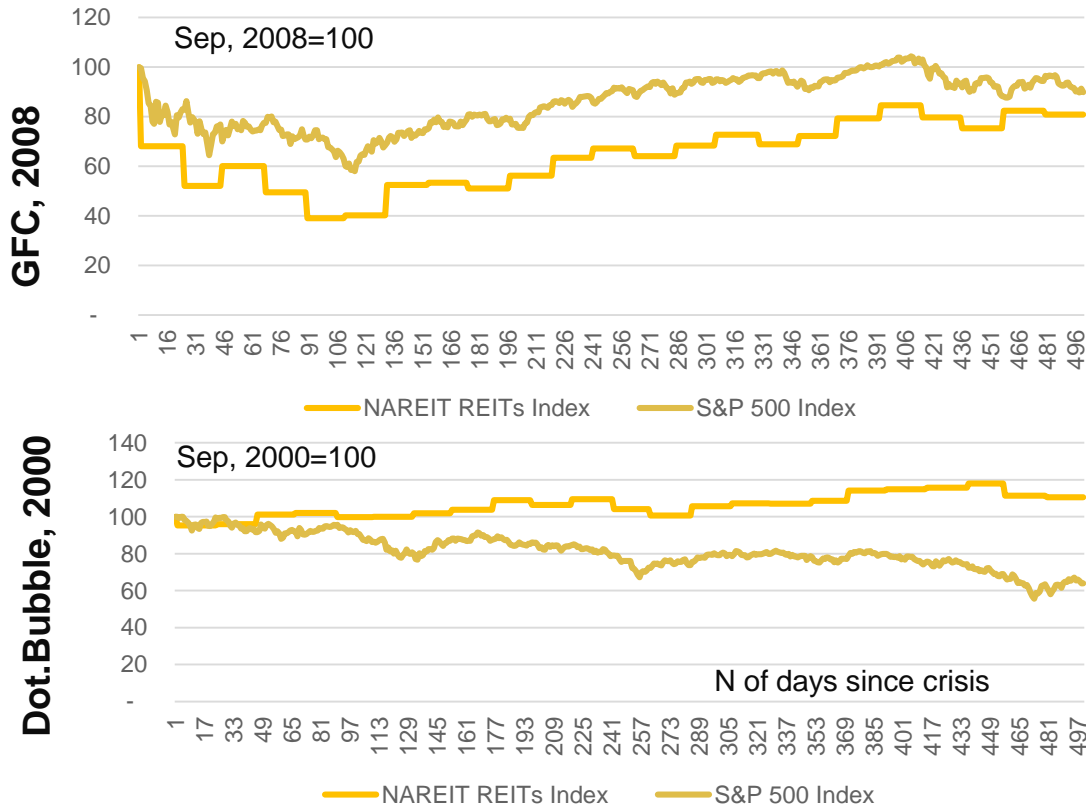


Source | FRED, Nareit

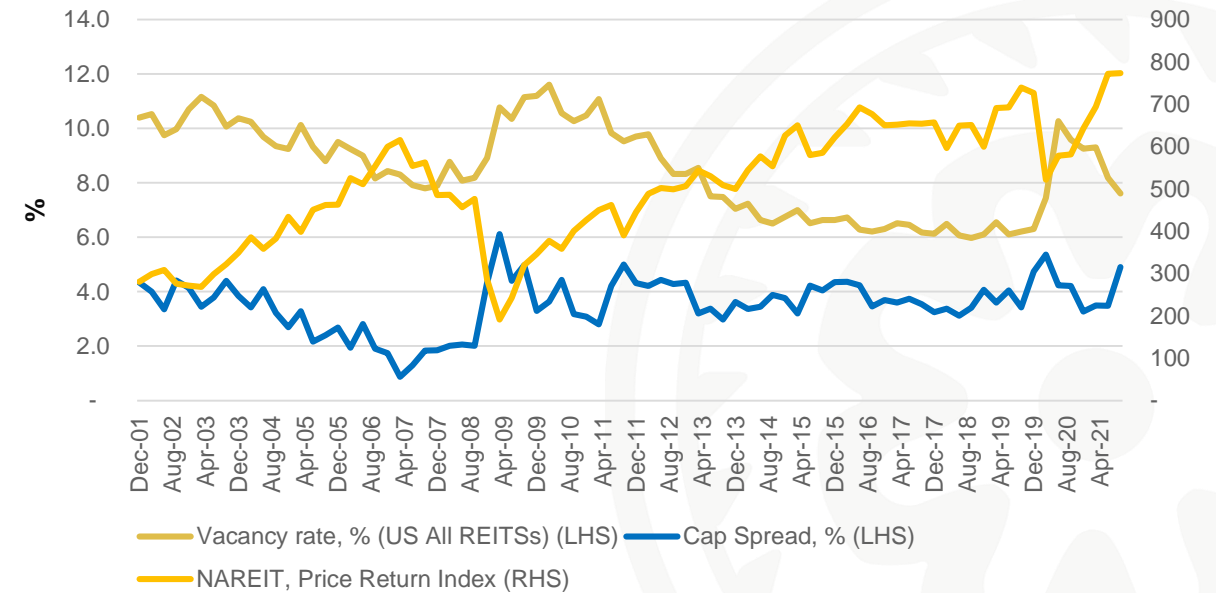
Risk-Return Profile of Equity REITs

In long run REITs are driven by same fundamental factors as private real estate (interest rates, vacancy rates, etc). While demand characteristics support stable cash flows, property valuations are subject to wide and volatile fluctuations over the course of the real estate cycle.

1.5. Daily price return index: S&P 500 vs REITs



1.6. Nareit index vs RE fundamentals



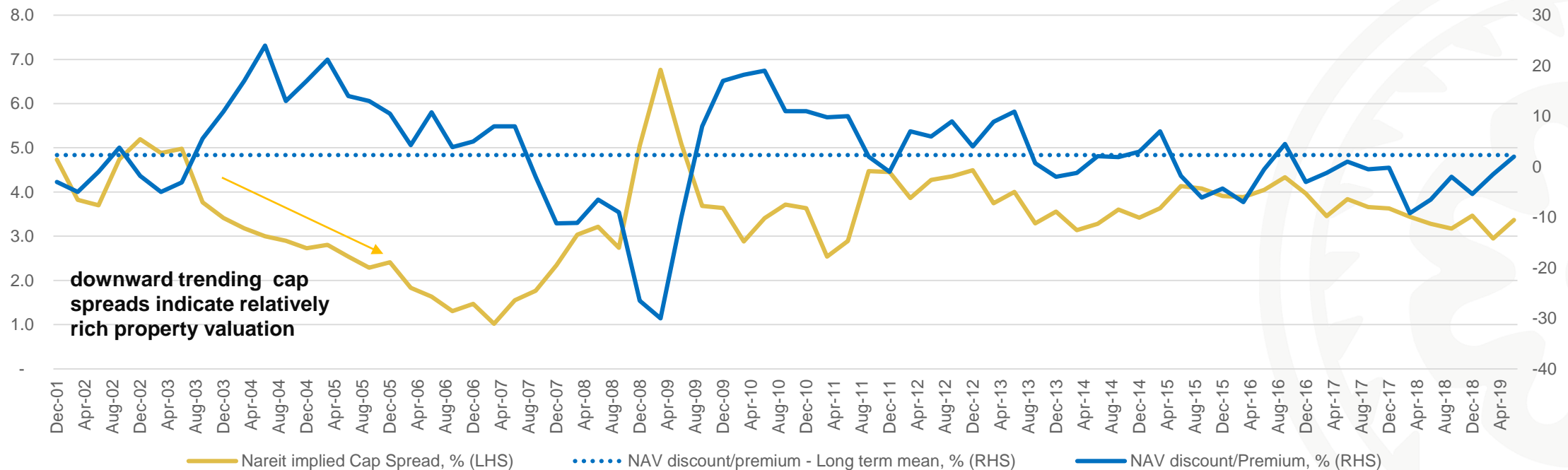
*Cap spread: **Cap rate** (Net operating profit of REIT/property value or recent transaction value) minus **10 y US treasury yield**). Proxy to RE risk premium

Source | Bloomberg

Risk-Return Profile of Equity REITs

In short run listed REITs are also subject to stock market sentiments and delinations from property market fundamentals. Historically, US REITs have demonstrated sharp valuation disparities (measured by NAV discount/premium) relative to the value of their underlying real estate. Such dislocations are not persistent and follow reverting tendency towards its long term mean (close to NAV).

1.7. US REIT long-term NAV discount/premium, %



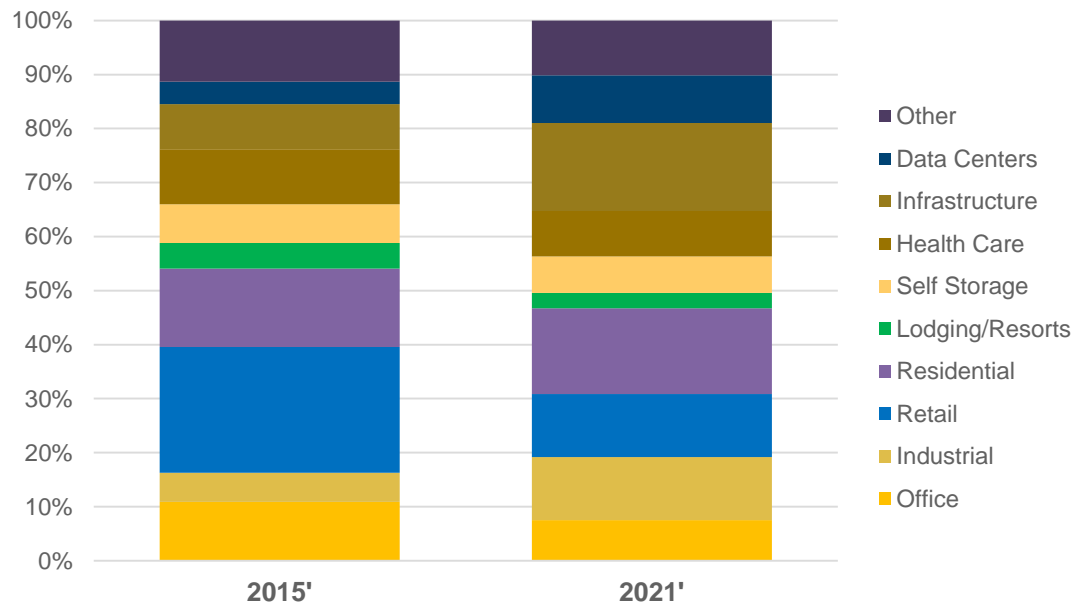
Price to NAV is ratio similar to price-to-book value used when comparing traditional stock

Source | Bloomberg, JH investors

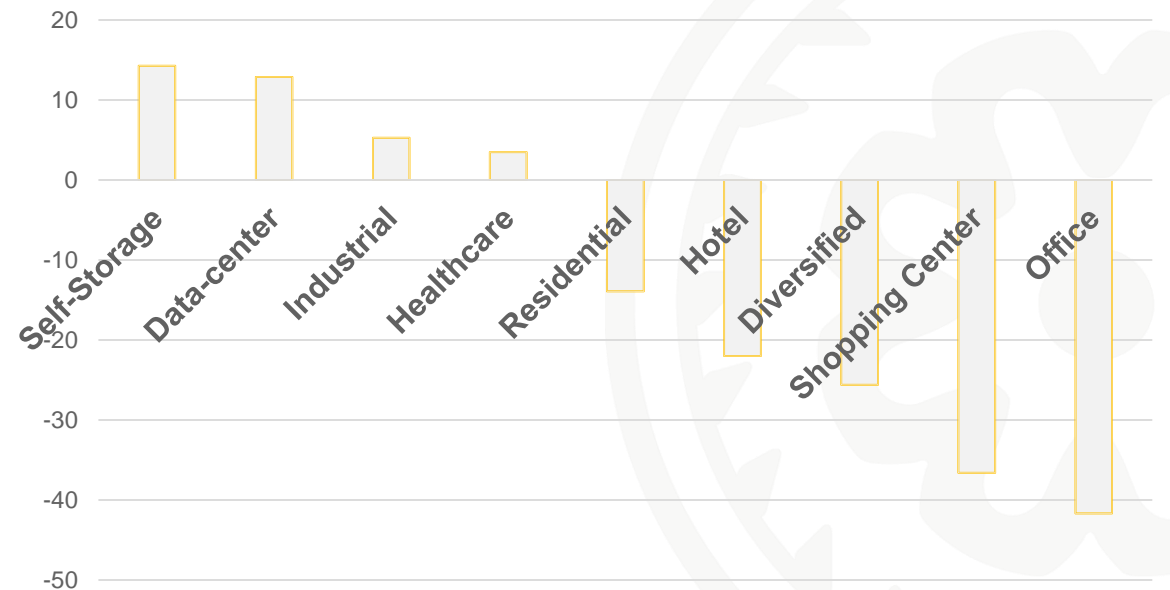
Risk-Return Profile of Equity REITs: Sector allocation

REIT sub-sectors do not tend to follow the same cycle. Due to various structural and cyclical factors, as well as investor sentiments, the performance distribution across sectors is uneven. During past years US real estate sectors supporting digital economy (storage, datacenters, infrastructure, warehouse) are relatively expensive compared to more traditional sectors (malls, office, lodging and resorts). Such price discrepancies between public-private markets also drive sectoral dislocations on public markets.

1.8. Sectoral composition of FTSE All REITs Index, 2015 vs 2021



1.9. Median discount/premium to NAV (%) of US REITS as of September, 2020



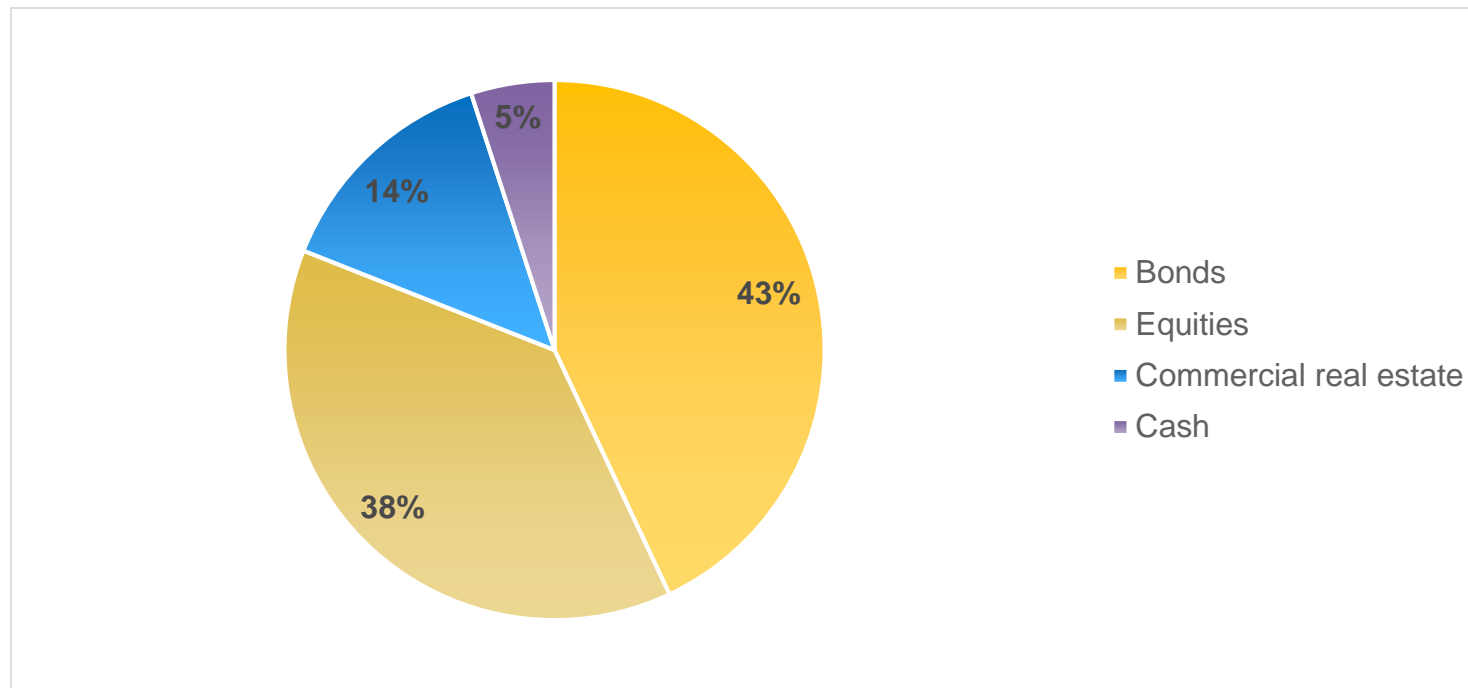
See Appendix 1 for sector definitions

Source | Nareit, Statista

Investments in commercial real estate

Commercial real estate has an important share in total investable market basket. REITs represent alternative instrument to gain exposure to real estate portfolio and is particularly well suited instrument for institutional investors with long term investment horizon (pensions, endowments and foundation funds).

1.10. Commercial real estate share in total investable market basket (US), as of 2020

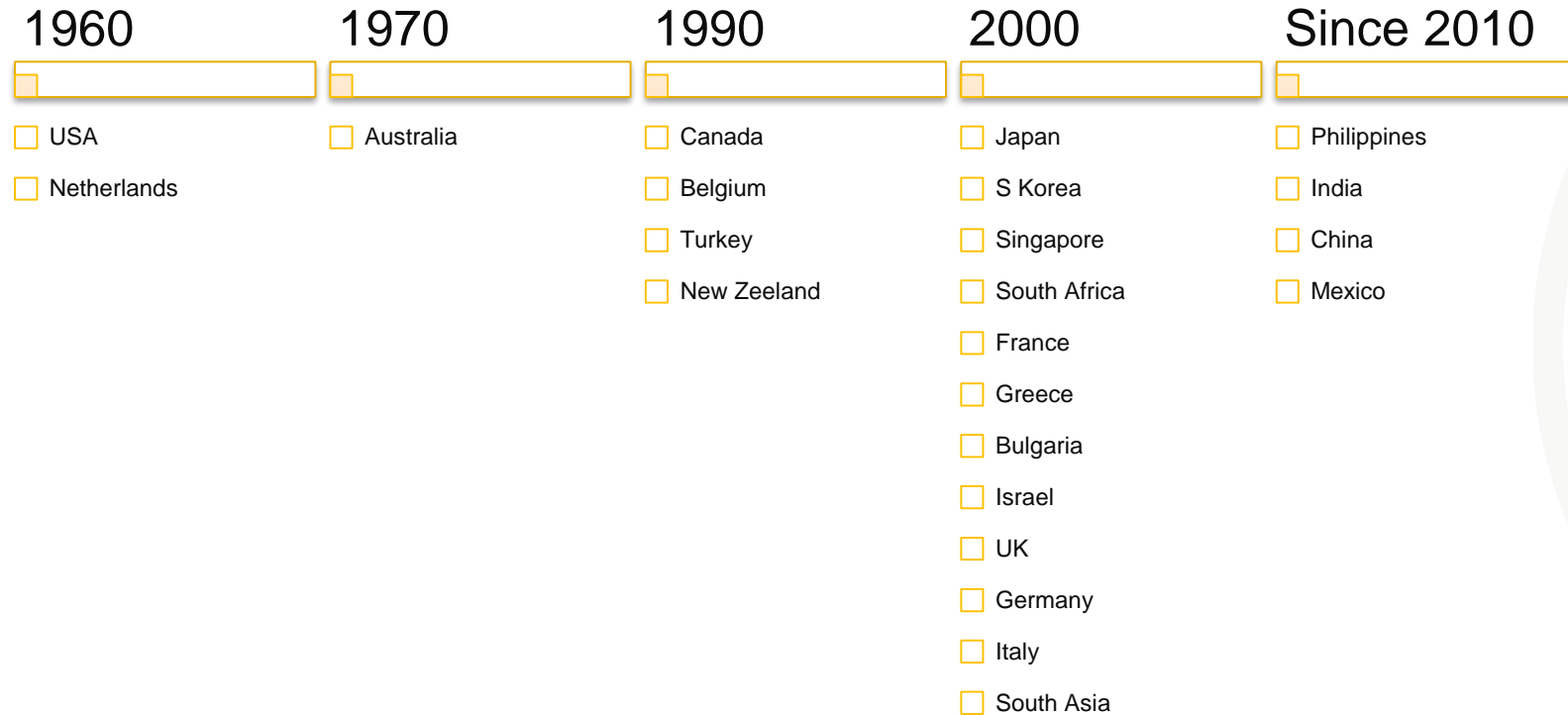


Source | Nareit

Evolution of Global REIT market

Global REITs performance varies widely, depending on differences that arise due to various factors, such as legal, tax and regulatory frameworks that govern real estate ownership, cultural factors, preferences for owner-occupation, and other fundamental factors that influence the way markets develop over time. Industry dynamics also vary among the subsectors within real estate, such as office, industrial, healthcare, retail, residential, hotel, and self-storage

1.11. Launch of REITs framework by countries:



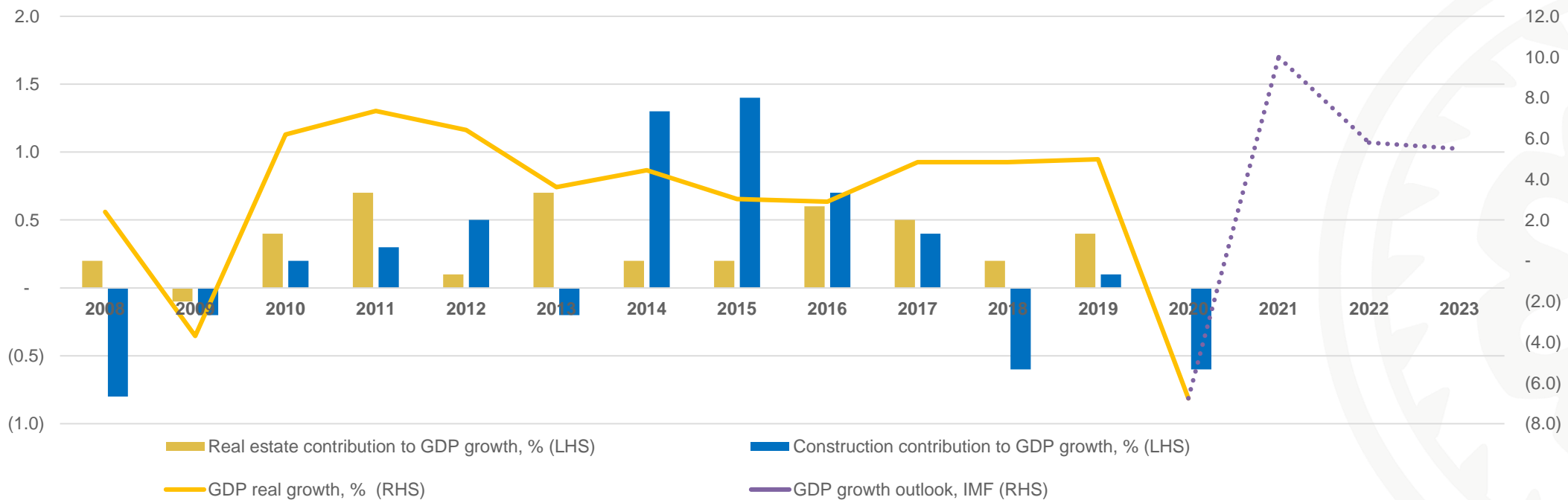
Source | CFA

Real estate sector at a glance and REITs development opportunities in Georgia

Real Estate Market at a Glance

Real estate sector in Georgia went through rapid expansion phase over past decade, fueled by fast growing tourism, large scale public reforms (healthcare), better accessibility to mortgage market and other demand factors, such as declining household size and urbanization trends.

2.1. Real estate is the second largest sector, with approximately 11% share to total GDP

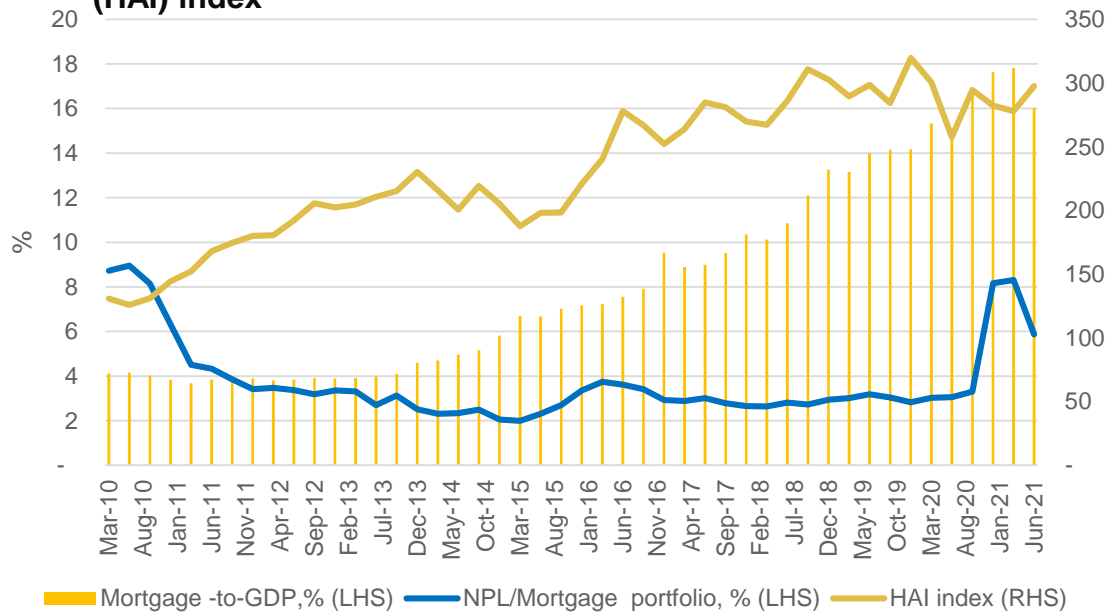


Source | Geostat, IMF

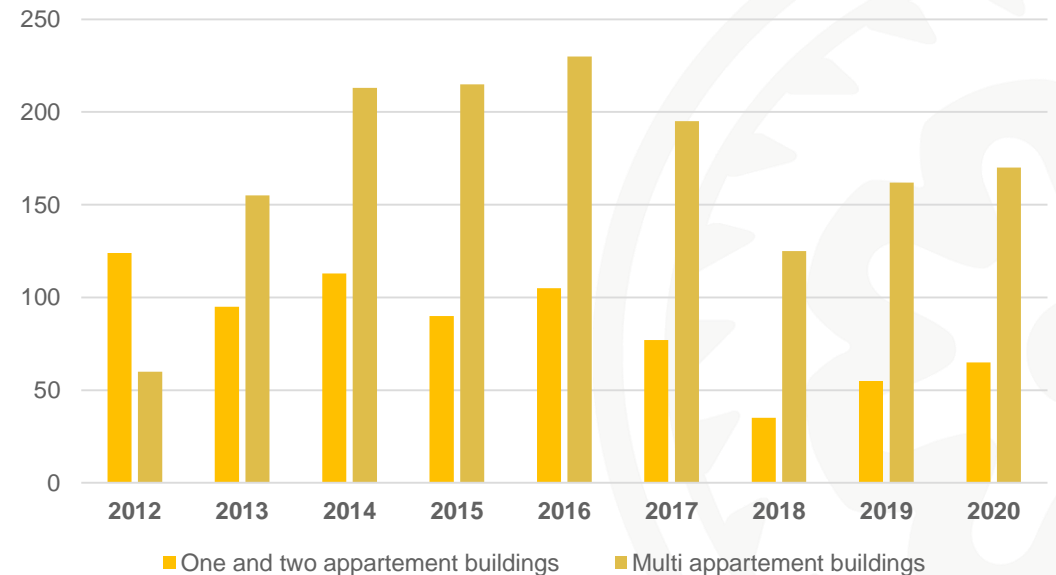
Residential Sector

Rising housing demand and improved home affordability has been met by significant pickup in construction over the years. Approximately 50% of home purchases are funded through mortgage loans (banks), which has demonstrated fairly stable credit quality over years. In 2019 NBG has introduced responsible lending framework (PTI and LTV limits), which also supported softening the impact of the crisis during 2020-2021. Going forward, with the economic recovery, NPL level is expected to decline further.

2.2. Mortgage market penetration, NPL and housing affordability (HAI) index



2.3. Construction permits

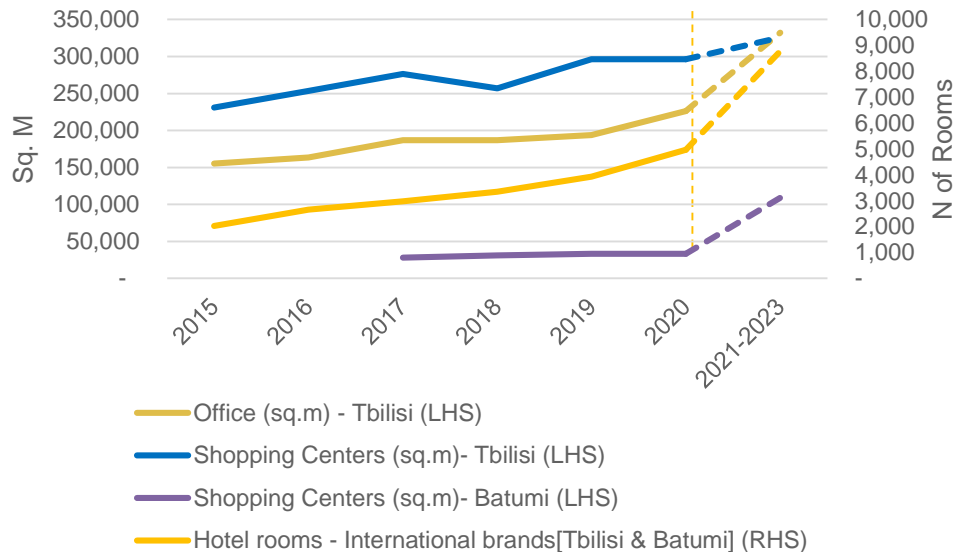


Source | NBG, NAPR

Commercial Real Estate (CRE) Sector

CRE market is dominated by traditional sectors, such as retail, hotels, healthcare and offices. Due to small market size and slow e-commerce penetration trends, industrial (warehouse) and other sectors (data-centers) supporting digital economy remain underdeveloped.

2.4. Existing and expected pipeline of selected commercial real estate segments



During the past decade there was significant rise in supply of high quality/large scale real estate projects.

Modern shopping centers have replaced low-quality and bazaar spaces, achieving app. 40% market share in total retail space supply in Tbilisi. Similar trend is expected to take place in Batumi.

The hotel accommodation stock almost doubled between 2015-2020. Going forward, international branded room supply (app. 22% of total market) is expected to double again by 2023 in Tbilisi and Batumi. There is increasing pipeline of projects outside main cities as well, including underpenetrated regions, such as Abastumani, Racha, etc.

Modern leasable offices have remained relatively underpenetrated, amounting app. 25% of total office space in Tbilisi. By 2023, expected growth in modern office space supply is app 50%.

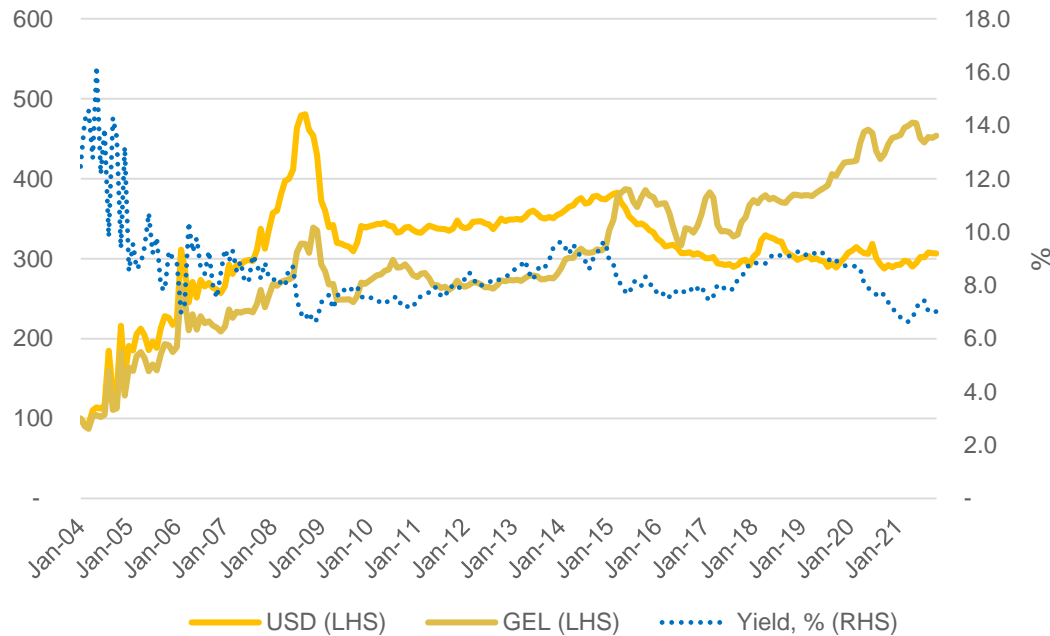
Healthcare sector went through massive transformation driven by large scale privatization reforms, introduction of state Universal Healthcare Program in 2013 and market consolidation (GHG is largest healthcare group with app 22% market share in total bed supply). Approximately 90% of total bed capacity is under private ownership. Bed occupancy rate increased from 30% (2003) to 53% (2019), along with the significant rise in bed supply (30% increase between 2015-2018).

Source | Colliers, 2019, GHG

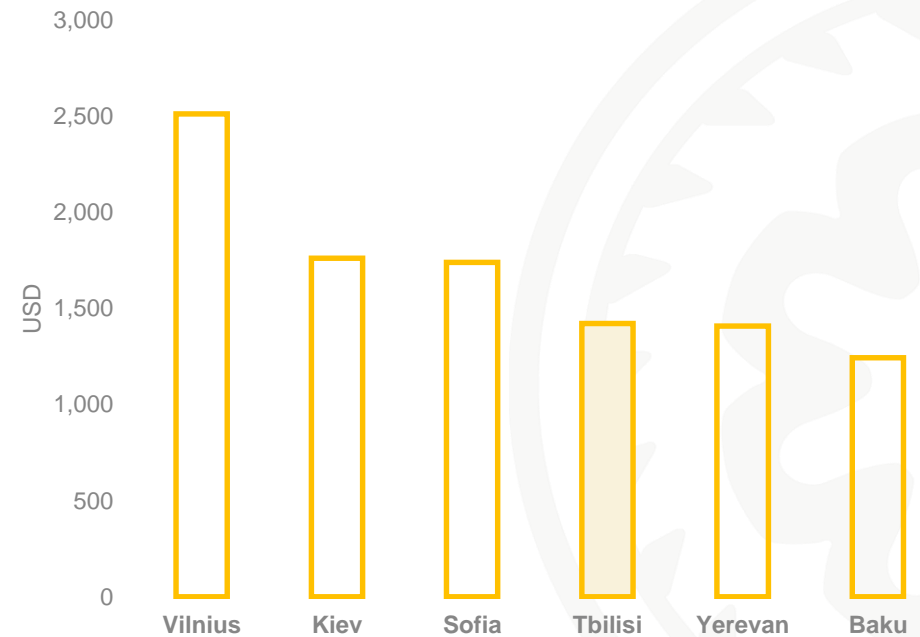
Real Estate Price Development

During past decade **residential** property prices have remained largely stable in dollar terms and there appear to be no signs of overvaluation

2.5. Residential property price index vs yield



2.6. Average sale price of residential flats in central districts, as of 2019

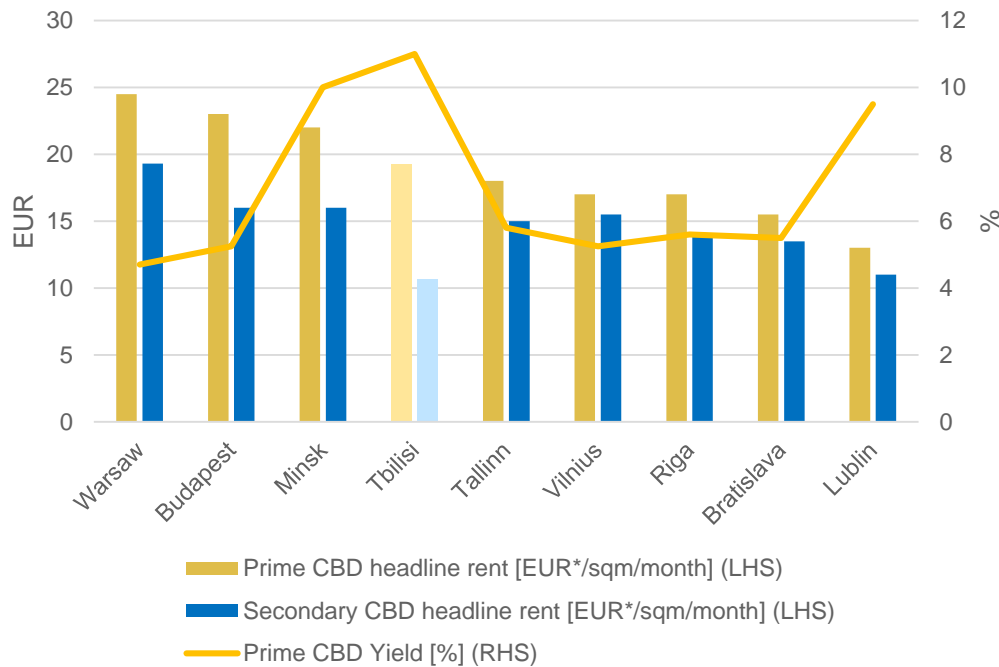


Source | NBG, Colliers

Real Estate Price Development (cont'd)

As **commercial real sector** enters maturity phase, yields/rents are expected to converge with peer country levels. In short run, price adjustments in certain sectors (including hotels) are also likely to take place due to anticipated rise in supply and still constrained demand factors (Covid-19,) such as office work resumption, business travel, tourism flow and other patterns.

2.7. Office rents vs Yields, Peer countries, as of 2021 Q3



2.8. Retail rents vs Yields, Peer countries, as of 2020 Q2

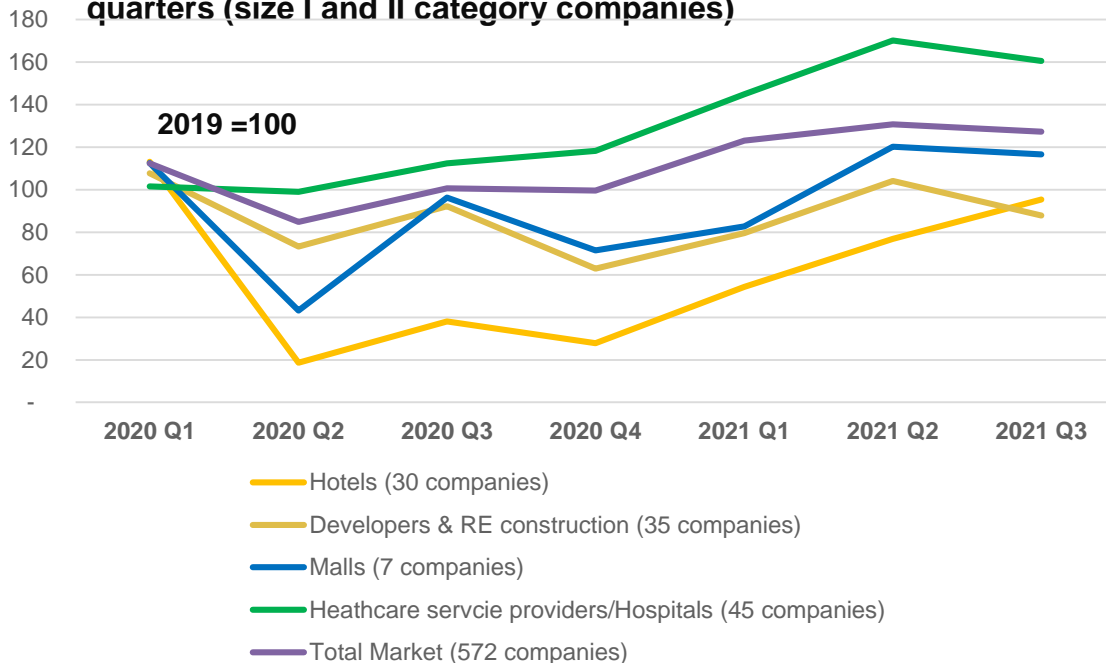


Source | NBG, Colliers

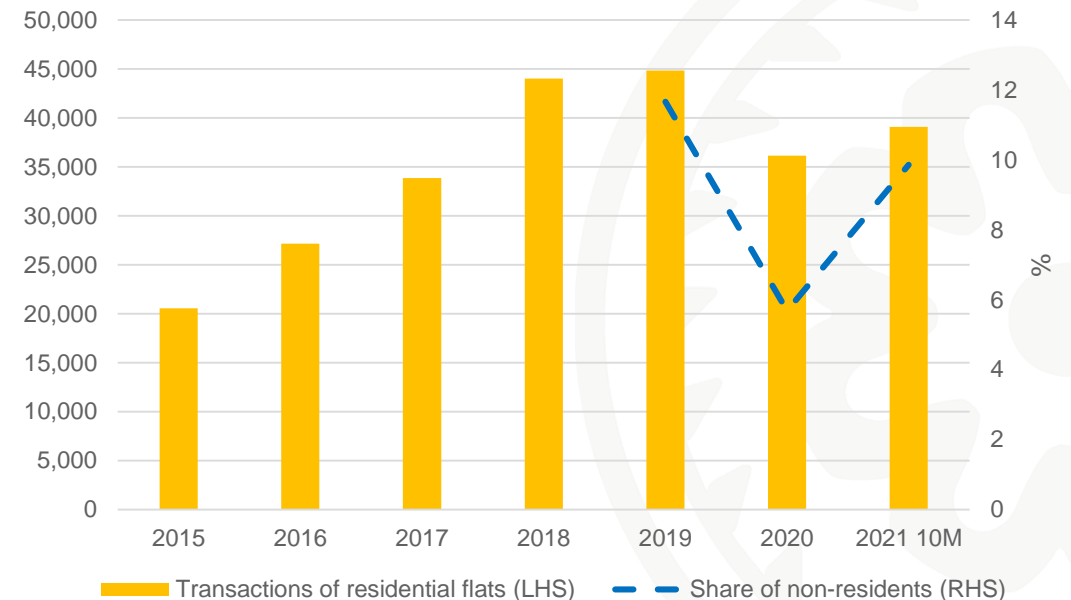
Covid-19 impact on Real Estate Sector

COVID-19 shock has disproportionately affected real estate sectors, as expected. In terms of turnover, **hotel** sector, with the largest drag, is on recovery path along with the tourism flow, but still below the pre-pandemic level. **Healthcare – hospitals** strongly outperformed the market. The weighted average vacancy rate of **office** space increased from 14% (2019) to 26% in 2021Q1, while the **shopping mall** vacancy rates remained close to pre-pandemic level and fully recovered in 2021. **Housing** activity recovered relatively well after the first national lockdown during the spring of 2020, also supported by various government subsidy programs. As year 2019 was historical peak in housing transactions, developers turnover remains still near 2019 level.

2.9. Same –store quarterly turnover, indexed to 2019 relevant quarters (size I and II category companies)



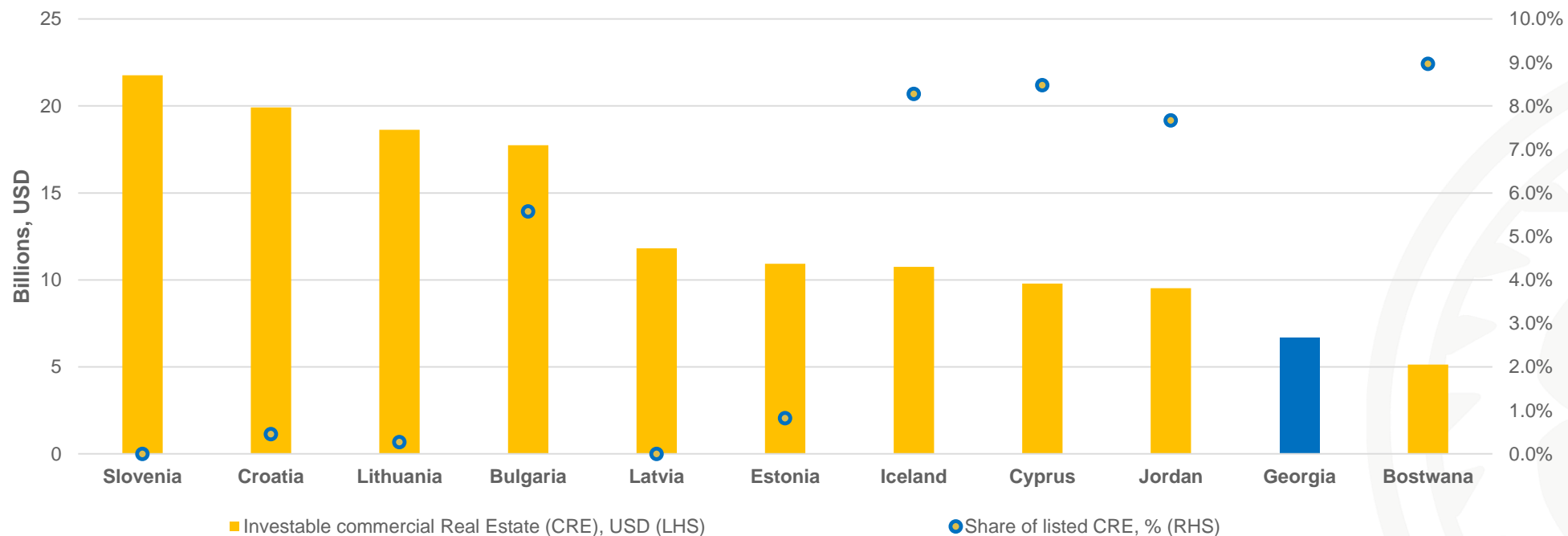
2.10. Transactions of residential flats, Tbilisi & Batumi



Source | Revenue service, NAPR

Estimated Size of Real Estate Stock

2.11. Estimated size of high quality, “investable” real estate stock in small economies and share of listed CRE, as of 2018



*The estimated size of individual country commercial real estate stock is based on GDP- top down methodology developed by Prudential Real Estate Investors (2003). Data excludes private residential holdings.

**Listed CRE include market cap of listed real estate sector under FTSE classification system (subsectors: heavy construction, home construction)

Source | EPRA, NBG

Final Remarks

Combination of certain factors provide interesting medium term opportunities for REITs development in Georgia:

- ❖ Over past years real estate sector has achieved significant scale, while risk of price bubble is low;
- ❖ Current sectoral allocation supports construction of optimal portfolios, out of cyclical and less-cyclical sectors;
- ❖ Related infrastructure, including property management services has improved significantly;
- ❖ REITs may create interesting funding alternatives and exit options for current CRE holdings;
- ❖ Real estate is a preferred and traditional asset class across regional investor base. REITs can improve diversification of current RE holdings;
- ❖ Emergence of large scale institutional investor base (pension/insurance) increases development opportunities;
- ❖ REITs could contribute to development of specific sectors, such as *Agriculture*. Through engagement of professional property managers and by allowing shared land-ownership, such structure may contribute to consolidation of fragmented Agri-land and its better productive utilization chances;

Going forward, it will be interesting to explore performance of REITs in/of small markets and incentive structure, supporting its development.

Appendix 1: REITs sector definitions

- **Healthcare:** Hospitals/rehabs, medical centers, senior housing;
- **Hospitality:** Hotels, resorts, theme parks
- **Industrial:** Distribution centers, factories, warehouses
- **Infrastructure:** Cell towers, cable networks, pipelines
- **Office:** Office buildings, business parks
- **Residential:** Apartment buildings, dormitories, rental homes
- **Retail:** Malls, shopping centers, freestanding stores
- **Storage:** self- storage, computer data centers
- **Timberland:** Forest land, woods

In case of questions, contact at:
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