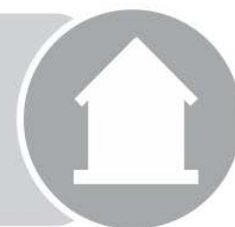


# ISET POLICY INSTITUTE REAL ESTATE PRICE INDEX



## February 2015

### Lari depreciation is behind a gradual reduction in Tbilisi housing prices

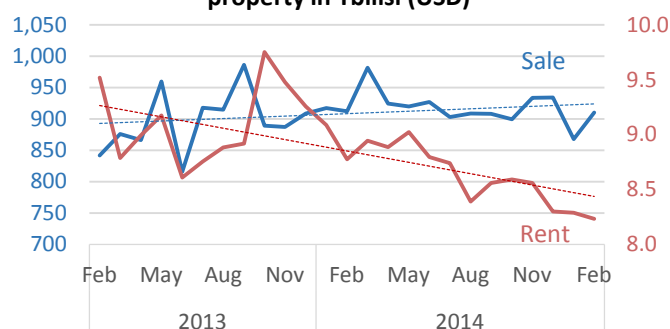
- The lari depreciation has started to affect real estate market prices in Tbilisi.
- The average rental price for residential property has continued to fall, reaching a new historical minimum in February 2015.
- In January 2015, for the first time since the beginning of the sample, Old Tbilisi was not the most expensive district on the rental market.

	Headlines	Dec-2014	Jan-2015	Feb-2015
For Sale	Monthly Index	<b>1.0366</b>	<b>1.0573</b>	<b>1.0418</b>
	Annual Change	<b>0.3%</b>	<b>1.5%</b>	<b>0.0%</b>
	Average Price (per m <sup>2</sup> )	<b>\$933.9</b>	<b>\$867.6</b>	<b>\$910.3</b>
For Rent	Monthly Index	<b>0.9670</b>	<b>0.9616</b>	<b>0.9477</b>
	Annual Change	<b>-4.3%</b>	<b>-6.2%</b>	<b>-2.9%</b>
	Average Price (per m <sup>2</sup> )	<b>\$8.30</b>	<b>\$8.29</b>	<b>\$8.23</b>

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 January and February 2015, there was no significant change in the rental and sale prices of residential property, but the price on both markets remained below their long run trends. Average rental prices declined in both months, reaching a new historical minimum of 8.23 USD per m<sup>2</sup> in February 2015. Likewise, in the first two months of 2015 the residential rental price index decreased by 6.2% and 2.9% respectively, compared to the same period in 2014. Moreover, average sale prices declined sharply to 867.6 USD per m<sup>2</sup> in January (the lowest level since June 2013), recovering only slightly in February.

Chart 1. Average prices per m<sup>2</sup> for residential property in Tbilisi (USD)



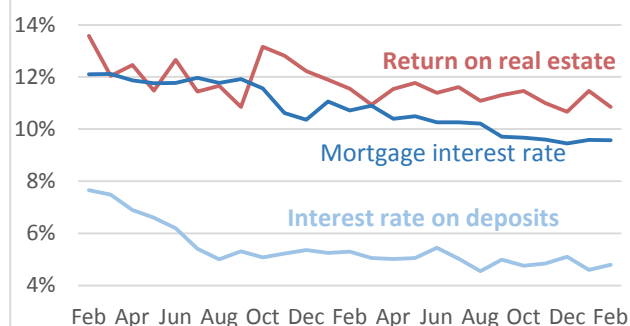
source: ISET-PI calculations

The decline of real estate market prices can, at least in part, be attributed to the significant depreciation of the lari in recent months. As we mentioned in the previous report, the Tbilisi real estate market is highly dollarized, with most transactions denominated in USD. Mortgage loans are highly dollarized as well, while the incomes of borrowers are mostly in lari.

We anticipated that the combination of these factors would lower demand, forcing the dollar denominated rental and sale prices to adjust downward to a new equilibrium. In such situations, price adjustments are typically slow. However, this month we are already observing varying degrees of average price decline on both rental and sale markets.

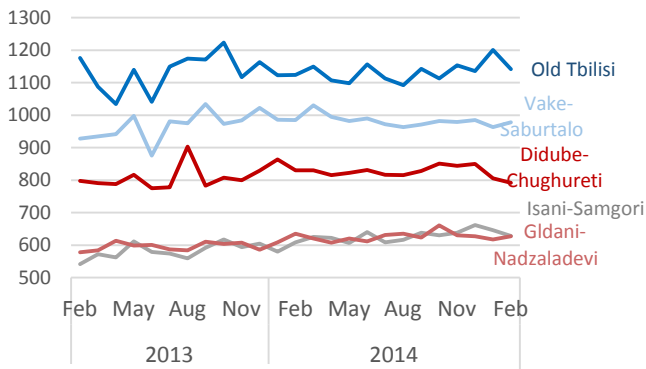
The rental price decline was more pronounced. This is not surprising. The rental market is typically more "flexible". Renting is mostly a short-run decision, while buying or selling a house reflects long-run behavior. Consequently, those with flats to rent lowered prices in response to decreased demand; whilst those who were planning to sell their houses chose to wait, thereby decreasing market supply rather than lowering prices. The evident decrease in the number of new sales advertisements in January 2015 lends support to our hypothesis. The decline is confirmed by both the data and our interviews with local real estate agencies.

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



source: ISET-PI calculations

**Chart 4. Average sales prices per m<sup>2</sup> in districts of Tbilisi for residential property (USD)**

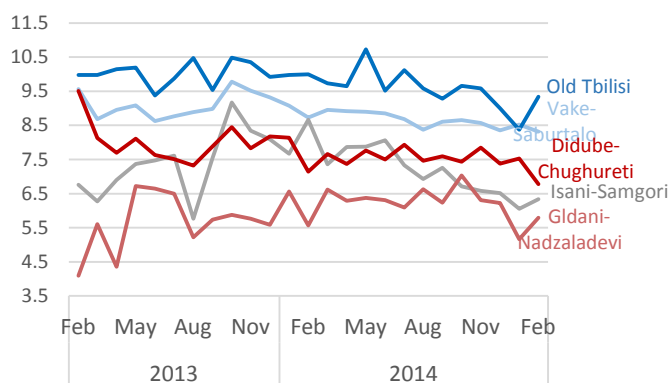


source: ISET-PI calculations

Regarding the different areas of Tbilisi, the average sale price decreased in all districts, except Old Tbilisi, in January; and everywhere but Vake-Saburtalo and Gldani-Nadzaladevi in February 2015. The most expensive areas in February were still Old Tbilisi and Vake-Saburtalo, with average prices of 1,411 and 978 USD per m<sup>2</sup> respectively. As for the cheapest areas, the sale prices for Isani-Samgori and Gldani-Nadzaladevi continued to converge to an average of 628 and 627 USD per m<sup>2</sup> respectively (see Chart 4).

As for the residential rental market, in January, for the first time since March 2013, Vake-Saburtalo briefly overtook Old Tbilisi as the most expensive district. The average rent there reached 8.5 USD per m<sup>2</sup>. However, in the subsequent month Old Tbilisi regained the title of the most expensive area in the city with an average price of 9.3 USD per m<sup>2</sup>. The cheapest districts for renting flats were still Gldani-Nadzaladevi and Isani-Samgori, with average prices of 5.8 and 6.3 USD per m<sup>2</sup> respectively in February 2015 (see Chart 5).

**Chart 5. Average rental prices per m<sup>2</sup> in districts of Tbilisi for residential property (USD)**



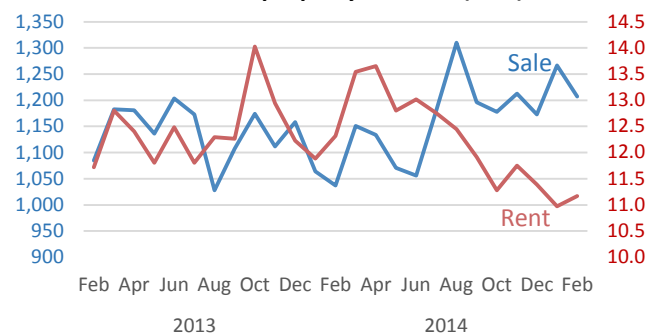
source: ISET-PI calculations

Chart 2, above, shows the return on real estate investment and compares this to average deposit interest rates. The return on real estate can be roughly estimated by dividing annual income gained from real estate (annual rental price) by the price of investment (sale price).

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

As can be seen, the return on real estate investment continues to hover above the mortgage interest rate. This makes real estate investments more lucrative, as the return from investment more than compensates the cost of taking out a mortgage. Such a pattern is feeding demand for property on the sales market, and at the same time depresses rental prices. In this situation, rental prices fall faster than sales prices – which is something that can be directly observed in the data.

**Chart 3. Average prices per m<sup>2</sup> for Commercial property in Tbilisi (USD)**



source: ISET-PI calculations

On the commercial property market, the average sale price first increased to 1,267 USD per m<sup>2</sup> (the highest level aside from an unusual peak in August 2014) and then decreased slightly to 1,207 USD per m<sup>2</sup> in February (Chart 3). The situation was reversed on the rental market, where prices first declined to their historical minimum, reaching 10.97 USD per m<sup>2</sup>, before slightly increasing to 11.17 USD per m<sup>2</sup> in February.

It is worth mentioning that the government is planning to decrease the rental tax rate from 20% to 5%. Although this development is less likely to affect the residential rental market – since people find ways to avoid these taxes – in all probability this tax decline will affect the rental market for commercial real estate, increasing supply and thereby further decreasing rental prices.

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 January and February 2015 was 1.06 and 1.04 respectively; it did not change at all in annual terms last month. As for the rental price index, in January (0.96) and February (0.95), compared to the same months of the previous year, it continued to decrease by 6.2% and 2.9% respectively.

**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%
Jan-15	1.06	1.4%	1.5%	0.96	-2.3%	-6.2%
Feb-15	1.04	2.1%	0.0%	0.95	-3.9%	-2.9%

**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 February 2015, there were 129.013 useable observations. While we have data from all over Georgia, given limitations with the sample size this analysis is limited to Tbilisi.