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exclusive interview with
Giorgi Kvirikashvili, PM of Georgia

Collective investments in Real Estate – an alternative investment opportunity in Georgia

Dr. h.c. Sascha Ternes overviews Real Estate sector in Georgia and shares his idea on investment solutions provided by The TERNES Real Estate Fund, the pioneer in collective investment solutions for high-yielding real estate portfolios in Georgia. The Fund has been set-up and is led by Dr. h.c. Sascha Ternes, a German citizen and a long-term resident of Georgia, with 20 years of emerging market experience. Having previously served as CEO of ProCredit Bank Georgia and Deputy CEO of Bank of Georgia, Dr. Ternes recently has been elected by the Parliament of Georgia as Board Member of the new Financial Supervision Agency. He also serves on a volunteer basis as Chairman of the German Business Association and the German International School, both organisations which he co-founded.

The development of the financial sector in Georgia has been a success story throughout the country's youngest history, supported by an efficient and business friendly government in a politically stable environment, dominated by a strong performing and well capitalised banking sector.

Over the years, the population of Georgia got used to rather high interest rates, both on the side of borrowings and savings, which made them prone to high-yielding profit expectations when engaging in business. Those with less entrepreneurial risk-appetite or lacking any good business opportunities could live well on their savings when just placed into foreign currency bank deposits delivering a double-digit return in Georgia.

With interest rates significantly coming down in Georgia over the past years, the situation has changed. Depositors feel uncomfortable with current low one-digit savings rates and reach out for other investment options.

At least at this point one of the key weaknesses of Georgia's financial sector becomes visible: the lack of a functioning capital market. Just few companies are listed on the Georgian Stock Exchange, but without any material trading volumes. The main bottleneck is the absence of domestic institutional investors, something which hopefully will be improved by the expected reform of the public pension system.

Meanwhile many people divert their savings into real estate investment, an asset class which is widely accepted in Georgia. Predominantly the focus is on residential apartments, with the aim to rent out the property and either to speculate on higher sales prices, or just to keep them for future needs of other family members.

However, many people found themselves in troubles having underestimated the complexity of such investment. Most often apartments are purchased during the construction process, before they are finished. Dealings with real estate developers, as well as with construction and renovation works, can be a full-time job, and especially when

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you are not from that industry, each lesson might have its price. Also, when it comes to the process of finding a tenant, frequent lease renewals, or maintaining the property in a good shape, things won't necessarily turn out as envisaged.

For those who want to avoid such headaches, or whose savings are simply not sufficient to individually afford buying a property, it might be appropriate to consider investing into a Real Estate Fund.

While the idea of collective investments is successfully practiced worldwide already since decades, it is a novelty in Georgia. However, last year a new player emerged on the Georgian market to fill the gap: TERNES Real Estate Fund (www.ternes.ge), the pioneer in collective investment solutions for high-yielding real estate portfolios in Georgia. The real estate investment firm provides asset and property management and is specialised to deliver integrated services along the entire value chain of commercial property investments.

According to Colliers International, Tbilisi has a very limited supply of modern office stock (293m² per 1.000 inhabitants), which is far behind CEE average (1.436m² per 1.000 inhabitants). Prime office rents in Tbilisi are the same as CEE average (ca. 21 \$/m²), while Tbilisi's prime office yield (12%) exceeds average CEE figure (8,2%) significantly. Colliers also noted that the vacancy rate of modern business centers in Tbilisi declines gradually.

This is exactly the segment which is top priority for TERNES, with a focus on commercial properties in premium locations, generating a stable cash-flow (fully occupied, diversified, long-term rent contracts).

Potential investment situations are identified and selected to be presented to the investors case by case. For each Property a separate Fund Company is established under Georgian legislation. This guarantees a high level of transparency. As a result, the investors focus on real assets – unlike with blind pool investments, where you

only get a rough idea about the nature of your commitment.

The Real Estate Investment Funds created by TERNES are catered to local and foreign institutional, high-net-worth and family office clientele, who appreciate the secure, asset-backed structure.

As a clear signal of commitment, TERNES co-invests alongside its clients in the equity base of the Fund Companies, which makes up in total usually around 70% of the Fund size. The remaining 30% is debt-financed for leverage purposes, for example with support of the European Bank for Reconstruction and Development (EBRD).

Investors benefit from the opportunity to capitalize on two different sources of income: 1) Dividends distributed by the Fund Company on annual basis, based on the operational profitability, i.e. the difference between generated rent income and operational expenses; 2) Upside profit potential, released through an increased sales prices of the Property upon maturity of the Fund Company, driven by yield compression towards CEE levels and macro+market driven increases in rental rates and real estate market prices. The first projects suggest a solid IRR of 12-14% after taxes and fund fees.

Another big advantage is actually the exclusion of any currency risks, as the equity is contributed in USD and real estate transactions in Georgia are typically fixed in USD as well (both, buy/sell as well as rent).

The typical time horizon for the Fund Company is 7 years, after which the Property shall be sold, and the shareholders/investors will be paid out through liquidation of the Fund Company.

One of the main future targets for TERNES is to attract additional foreign institutional investors as potential participants in the Fund. Majority of them still focus on their traditional markets and yet have to discover Georgia as an attractive and stable investment destination. **GE**



DR. H.C. SASCHA TERNES
Managing Partner

Sascha, a citizen of Germany, has 20 years of experience in emerging markets, with a proven track record in finance and banking. Sascha resides in Georgia since 2007, where he initially served as CFO and later as CEO of ProCredit Bank Georgia (the 3rd largest bank in the country, the market leader in MSME lending) and subsequently as Deputy CEO of Bank of Georgia. Prior to relocating to Georgia, Sascha held various senior executive positions over the course of 13 years in a German Technology Group which focused on international development and investment. Here he was responsible for the implementation and supervision of numerous operations in 10 countries, with duties including assignments to Central and Eastern Europe and the Middle East. Furthermore, Sascha has extensive experience in the development and construction of business-centers, both in Germany and Georgia (e.g. ProCredit's head office in Tbilisi of 12.000 m²). Sascha has a background in finance and business administration and was awarded with an honorary doctoral degree, affirmed by the German Ministry of Education & Science. Sascha is a Board Member of Georgia's Financial Supervision Agency (FSA). He also serves on a volunteer basis as Chairman of the German Business Association (DWW) in Georgia and Armenia as well as a Chairman of the German International School Tbilisi, both organisations which he co-founded.

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