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GEORGIA PRIVATIZATION AND PROPERTY MANAGEMENT STRATEGY

RECOMMENDED APPROACH, METHODS AND TOOLS

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GEORGIA PRIVATIZATION AND PROPERTY MANAGEMENT STRATEGY

RECOMMENDED APPROACH, METHODS AND TOOLS

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ABSTRACT

Georgia has made great strides in privatization. Now, almost 20 years after the process began, the State has sold or closed almost all former State owned industrial enterprises. This report outlines a set of operational changes to help the Government of Georgia (GoG) improve how it manages and prepares remaining state property and state-owned enterprises (SOEs) for sale. Its focus is primarily on SOEs and remaining buildings and non-agricultural land. Aside from some hospitals and a few core enterprises (which should either stay in State ownership or only be sold in well-prepared tenders), the National Agency for State Property Management (NASP) of the Ministry of Economy and Sustainable Development (MoESD) ¹ has very few real, operating companies left for sale. The report recommends a specific methodology how to analyze all still-functioning SOEs (other than the few core enterprises) and sell them as assets if their asset value seems greater than their going concern value.

While the Agency's inventory of viable and potentially interesting, functioning enterprises is small, its inventory of unsold real estate - an unknown amount of which is locked in unpromising corporate shells - is overwhelmingly large. Some of these real estate assets are large, valuable and should generate substantial sales revenues. But the asset mix is very mixed, and includes many smaller and less attractive properties. Almost all are suffering from deferred maintenance under State ownership. Both private investment and government administration are dragged down by this overhang of an uncounted number of random, leftover State assets, many with low or negative market value.

The report suggests that the Agency change its perception of its core privatization task. Instead of being an entity, which manages and sells the shares of SOE's, its primary privatization task really is managing and selling excess State owned real estate. To accomplish this task effectively, the Agency needs to remove assets from non-viable SOEs, place them in a temporary holding company, register and clear titles as efficiently possible, manage them properly, advertise them aggressively and sell or give them away. Clearly, the MoESD has done a great deal of good work, and is moving in this direction. However, current highly centralized rules, difficulties dealing with enterprise liabilities, a passive sales approach and tools not suited to the tasks block progress in a number of ways. This report discusses these blocks and suggests a variety of systemic approaches to remove them. One key recommendation is to include municipalities in the sales process for lower value assets of only local interest. Public education and transparent, simple, decentralized processes are especially needed to help the State justify shedding these assets in ways the public perceives as fair, without the "junk sales" harming sales of more valuable assets. Another key recommendation is for the Agency to become much more active as a seller, rather than waiting for others to initiate sales. As part of this re-activation of the Agency, this report suggests a careful review and re-definition of the role of third party agents in the sales process.

¹ The Agency is a Legal Entity of Public Law, formed by the MoESD in Fall, 2012 to assume ownership of State assets owned by the MoESD which will be subject to privatization. As the Agency did not exist until recently, references in this document to events happening or documents prepared before Fall, 2012 thus refer to the MoESD, even if the responsibility has since transferred to the Agency.

ACRONYMS

EPI	Economic Prosperity Initiative
GNIA	Georgian National Investment Agency
GoG	Government of Georgia
GIZ	Gesellschaft für Internationale Zusammenarbeit
GIS	Global Information System
GPS	Global Positioning Satellite
MOF	Ministry of Finance
MOESD	Ministry of Economy and Sustainable Development
NAPR	National Agency of Public Registry
PPP	Public Private Partnership
SOE	State Owned Enterprise
USAID	United States Agency for International Development
NASP	National Agency of State Property
SPMS	State Property Management System

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I. EXECUTIVE SUMMARY

Background: In November, 2012, the First Deputy Minister of Economy and Sustainable Development, Mr. Dmitri Kumsishvili, requested support from USAID to help develop the MoESD's privatization and state property management strategy.² This report is the result of two missions by consultant Paul Dodds to Tbilisi in December 2012 and in January 2013. The First Deputy's primary interest was specific suggestions on how to improve the GoG's privatization processes. Rather than an overall strategy or a report, which largely mirrors back what he already knows, Mr. Kumsishvili requested concrete, operational suggestions to improve privatization results.

Methodology: During the course of the missions, Paul Dodds and Tamar Buadze reviewed key reports and laws/regulations, and interviewed staff members of Agency in all key departments. They also interviewed several outside agencies and experts, to seek their impressions on how to improve privatization results going forward.

Findings: The Agency staff's skill level, and level of cooperation and openness was impressive. The team is strong and experienced in privatization and state property management. However, a number of approaches, processes and tools could be improved to help the team achieve greater results in terms of sales completed and return on the State's equity in the remaining assets. Enterprise privatization is gradually coming to an end in Georgia, but the privatization systems and administrative mentality have not yet caught up with the changed nature of the current and future tasks.

The lack of information about real estate owned by the Agency and its companies makes it very difficult to make any statements with certainty. This report is thus based on a set of practical, working assumptions. If an inventory proves them wrong, the findings and recommendations would need to be revised accordingly. The report assumes that:

- The Agency's real estate portfolio contains a few very good, valuable properties mostly located in city centers or desirable resorts.
- A large percentage of the MoESD's sales proceeds in the few years will come from successful sales of remaining, high value, high visibility objects.
- The Agency owns a larger group of reasonably good assets scattered around the country, which will generate some positive proceeds.
- The portfolio contains a great many low or even negative value properties.
- Almost none of these buildings are getting any better under Agency ownership. Most have likely had little or no maintenance for decades, and many have been seriously vandalized.
- MoESD is the biggest property owner in Georgia, or one of them.

Based on limited information received, it appears that the Agency is left with:

- Very few viable companies, which could and should still be sold as

² The short time frame of the mission did not permit EPI to go deeply into the complex questions of agricultural land privatization. EPI will be providing support on agricultural land reform under a separate scope. The primary focus of this report is on the interim management and privatization of SOE's and the thousands of buildings and attached land which are on the Agency and SOE balance sheets. The Agency's long term function as the owner and manager of public properties, which are expected to remain in state ownership permanently, is also largely beyond the scope of this report.

companies.

- A lack of structured process to assess whether the few still-profitable companies should be sold in share sales as on-going enterprises, or liquidated with their assets sold. Though some companies report profits, most do not. It was not possible in this short consultancy to review any individual enterprises to see if they are performing as they should or could.
- Many companies, which serve social or governmental functions, and which cannot be accurately assessed using strict profit maximization principles.
- Very limited capacity to manage its share assets to maximize return on equity through profits, for those companies, which should be strictly profit-maximizing.
- No ability to get new capital to the vast majority of its enterprises, and limited technical expertise or ability in practice to assess if they are operating properly.
- Many empty shell companies or non-functioning companies with debts and a few assets, but which demand too much administrative attention.
- An artificial line between “our property” vs. “company property,” even though the State is 100% shareholder. This has the Agency “pushing on the string” to get information from or to control the behavior of Company directors.
- Lack of meaningful company information or reporting. This limits the Agency’s ability to manage its share ownership effectively and creates room for company directors to use State assets to their own advantage through informal leasing or other means.
- A full warehouse of uncounted, uninventoried, unregistered and unvalued buildings to sell, currently probably numbering in the thousands.
- A rigidly applied valuation methodology, which is expensive to administer and limits the Agency’s ability to sell low value properties.
- Over-centralization of decision making, where a clear delegation framework, especially to municipalities, could help get rid of the backlogged inventory – fostering local investment in what are now probably often nuisance properties.
- An ineffectual marketing campaign, with a sales process responding to known investor interest, rather than creating new interest, except for a few prestige objects.
- A high level of dependence on brokers to drive the sales process, under a regulatory and contracting framework, which seems both costly and potentially open to abuse.
- Other than for a few high value objects, the Agency does not sell anything actively. Instead, it runs a demand-driven process, without a strategy to decide what should be sold first and why.
- As a corollary, lack of demand and lack of a means to differentiate sales approaches between low and high demand assets, which leads to unwillingness to use the auction process, as permitted by law, to sink prices to meet demand.

- Other than a few prestige objects and objects with known buyers, an empty store, with lack of publicly available information about all that is available for sale. This lack of public information feeds public mistrust and makes cost-sinking sales processes politically difficult. If everyone knew what leftovers the State has left to sell, public acceptance of lowered prices should be much easier to gain.
- Large piles of uncollectable debts to clear, mostly owed to the State, but with enough debts to third parties to be problematic – with no effective means to reach an overarching agreement with either State or private creditors and very slow liquidation or bankruptcy of emptied firms.

Recommendations: This report provides eleven key recommendations for MoESD's and the Agency's consideration, based on the findings. While this report has strived to develop ideas that can be implemented with minimal additional expense, largely using the MoESD and Agency's current staff and technology, the recommendations are broad-ranging and clearly cannot be implemented without effort and top-level support. Taken together, these recommendations represent a fundamental change in the way the Agency approaches many of its key tasks and organizes its work flow.

To implement these changes effectively, the MoESD may wish to establish a high level project management unit to take the lead. If funding is available, this unit could be staffed with a mix of foreign and Georgian experts, both from the MoESD and outside consultants, with a mandate to turn the Agency into the pro-active, directed sales entity envisioned here:

Recommendation #1: Set a framework for what companies to keep, sell, and hold.

In general, the strong preference should be to sell, rather than keep or hold. The State should only keep or hold companies if there are good, demonstrable economic or policy reasons to do so. This section suggests a variety of filters and approaches the Agency can apply in deciding what to keep, sell or hold strategically.

While most assets on the privatization list will be such obvious candidates for sale that review is not needed, others should be reviewed from the point of view of whether or not they constitute elements of Georgian patrimony or public goods, which should not be turned into purely private goods. This section also provides guidance on when to sell or hold profitable companies, based on the quality of their profits and business development.

Next Steps:

- Review and sort list of 477 remaining SOE's into "keep," "sell" and "strategic hold" applying the tests proposed.

Recommendation #2: Set basic guidelines for which sales method should be used when.

Detailed recommendations are made to help move the Agency away from over-reliance on third party sales agents, while ensuring that it only hires qualified brokers who are really working to maximize revenues for the Agency, rather than other clients or themselves. Substantial changes are recommended in how brokers are selected, how their contracts are structured and how they are managed by the Agency.

A key recurring recommendation is that the Agency must become a more active owner and seller. In this context, it is recommended that the Agency should, over time, strive only to

hire brokers for major asset sales needing international marketing and be its own market maker for domestic sales. The reader is recommended to review the [Findings section entitled “Third Parties”](#) for a more detailed assessment of the current MoESD regulatory and contracting framework.

The report recommends that the GoG should, as a general rule, “take the hit” of company liabilities, as it is typically in a far better position to deal with the liabilities than potential investors. This means the Agency should sell assets rather than shares, as a general rule, unless the Agency can realize as good or better value from a share sale. Tests for this are proposed.

The reports shares concerns raised in the Assessment Framework about direct sales. It recommends that direct sales be limited to share sales of higher value and complex companies, and made subject to appraisals and transparency requirements.

The report recommends that the Agency use long term leases for a limited number of “patrimony” assets. It also recommends that the Agency actively try to get interim lease revenues from commercial squatters in Agency owned properties, pending their sale.

While proposing to limit direct sales, the report recognizes that the current rigid, “one-size fits all” e-Auction methodology needs substantial tailoring to meet needs of different kinds of complex sales. Solutions are proposed to make this a more flexible and appropriate sales tool. Special auctions for high value objects are recommended, along with the option of having a bidder pre-qualification phase. Better ways to have e-Auctions with conditions are proposed. Attention is given to how to address potential bidders’ information needs more effectively. It is recommended that the high bid prepayment requirements be reviewed and payment terms brought into line with more normal commercial practice.

Next Steps:

1. Conduct a detailed internal review of MoESD current practices and experience with hiring third party advisors to conduct sales. Particularly review value received for services provided.
2. Only hire brokers by following the standard GoG tender procurement process, with clear bidder qualifications.
3. Establish brokerage contracts that protect the Agency against possible conflicts of interest.
4. Obligate brokers to work diligently and transparently to create a market and maximize potential bidder interest in e-Auction sales.
5. Only hire brokers to sell specific, identified objects, preferably larger and more valuable ones, rather than giving brokers general “hunting licenses” as under the current model.
6. Apply strict share vs. asset sale test to representative sample of remaining portfolio companies.
7. Continue the inventory of State owned commercial properties that are being used rent-free. Organize a tender for property manager to collect interim rents, pending privatization.
8. Conduct a detailed review of the e-Auction practice and develop a range of e-Auction variants – including rules, sample contracts and instructions – that are well suited to the range of shares and assets, which the Agency has for sale.
9. Review payment requirements for bidders and experiment to see if decreasing bidder prepayment requirements and active advertising of auctions leads to more competition.

Recommendation #3: Improving basic company information management.

The report proposes a standard, basic reporting format for active companies to complete, providing a good overview of their status and assets.

Next Steps:

1. Require all active companies to complete and return the forms.
2. Capture data received in the EPI-assisted management information software, starting to use this data base actively.

Recommendation #4: Break the Corporate Shell: Focus on Property (not SOE) Management.

At this advanced stage of privatization, the GoG has comparatively very few viable companies left, and a great many individual properties. The Agency should focus on its core task of real property management and sales.

To get this focus, unless there are strong reasons to keep a company as a company, the Agency can maximize its impact and return on shareholder equity by breaking the shells of most of the remaining companies it owns 100%, and proceeding with simple asset sales.

Next Steps:

1. Apply basic tests to decide which shells to break, and which not.
2. Pick a handful of “keep” enterprises that will be retained long term in State ownership as State companies and a limited number of “strategic hold” enterprises to retain for an interim period, based on solid and transparent reasons.
3. Review whether inactive companies are maintaining unnecessary employees on company books and move all assets to Agency balance sheets.
4. As part of basic object identification part of inventory, check for unapproved leaseholders and work to collect rent directly.
5. The few enterprises that are worth more “alive than dead”, and are not either keepers or holders, should be sold as soon as possible.

Recommendation #5: Develop Umbrella liability solutions for GoG debts, environmental damage and unpaid wages.

The lack of a clear GoG-wide agreement to clear enterprise debts undermines the ability of the Agency to attract investors and undermines the privatization progress. If the GoG wishes to maximize privatization revenues, it must provide the MoESD and Agency the support they need to conduct the clearest, simplest sales for the best price possible. A blanket debt release of all State agency claims against all SOE's still owned 100% by the Agency would provide this support. The agreement should include MoF and other State agency releases of liens on company assets.

Next Steps:

1. Lobby heavily within the GoG to establish an overarching debt release agreement with all State agencies,
2. Require all active companies to report any employee claims and unpaid wages in standard format.

3. Clean company books of lapsed employee claims.
4. Study legality of current process of collecting claims in a “Junkco.” Possibly seek Ministry of Justice opinion or change in bankruptcy law to ensure validity of approach.
5. Work with the Ministry of Environment on systemic solution to possible environmental claims.

Recommendation #6: Develop simplified real property inventory, valuation and registration procedures.

The Agency should follow a simplified process to get a handle of what it actually owns, both directly and through its enterprises. All asset information should be captured electronically in a format, which permits GIS mapping as a main tool for information organization.

As far as possible, the Agency should draw on existing data sources to locate its properties, get information relevant to registration and perhaps to establish baseline values for competitive auctions.

NAPR contains a wealth of data, which the Agency needs to be able to mine more effectively. Close and deep coordination with NAPR can be a key to Agency sales success. If NAPR does not make actual sales price information publicly available, the Agency should encourage this to be done to help establish solid, local price comparisons.

The Agency should begin to take responsibility for surveying and registering its own properties, rather than delegating this to brokers or potential purchasers. The report contains ideas about how to tender blocks of properties for survey, and have surveyors paid out of sales proceeds.

Next Steps:

1. Raise the inventory problem to the national level, perhaps by forming an inter-agency working group. Lobby for public disclosure of sales price information by NAPR.
2. Start inventory with basic object identification. Roll out object identification regionally, using digital cameras, GPS location technology and a standardized, electronic format.
3. Develop model tender for surveyors for blocks of properties to be paid from sales proceeds. Possibly offer surveyors lien against properties to be auctioned, with Agency commitment to e-Auction property within set time frame. Consider possibly extending model to appraisers.
4. Continue to fill State Property Management System with all relevant information about Agency properties.
5. Develop formula to establish three basic classes of real property – nationally, regionally and municipally administered. Begin process of moving administrative responsibility to lower levels of government for identified properties.
6. Use standard formulas to discount the value of vandalized or long vacant properties.
7. Link in with aggregated on-line real estate market data sources to help establish realistic baseline pricing for auctions.

Recommendation #7: Open the store and outlets, including municipal sales.

The MoESD needs to move from its current passive stance, and start to market its properties itself, and actively. The Agency regional offices and municipalities should be used fully in

this effort. The Agency should establish standard formulas for delegating decisions about disposing large amounts of medium value assets to its regional offices, and of conveying low value assets to municipalities.

Instead of just dropping low priced assets on municipalities without any preparation, the Agency should prepare packages of assets, provide training and require municipalities to sell the assets through the e-auction mechanism. Simplified e-Auction tools should be developed to help municipalities run auctions with investment conditions for low to negative value properties.

The Agency should fill its on-line store without any delays with whatever information it has about properties it wishes to sell. Non-priced listings, with disclaimers, should be permitted during the pre-auction phase. Thus, rather than waiting to put objects on line when they are entirely ready for sale, the Agency should “open the store” for browsing by putting as much information as possible on line about what it owns and plans to sell. These un-priced informational listings can have as many disclaimers as needed.

Next Steps:

1. Put object information on the web as soon as possible in pre-Auction phase, with non-priced object information presented on line in map format, with photographs.
2. Advertise the program heavily, as a way to start generating interest in possible offerings.
3. Establish a way to capture web-based inquiries about properties by having potential purchasers register, by tracking what they are looking at on line.
4. Provide simple ways for people to inform the Agency about errors in the pre-auction listings, or to offer non-binding estimates of what they would pay for specific objects.
5. Develop a municipal pilot program, incorporating the following elements:
 - a. Use aggregated on-line market price data to work with municipalities to develop benchmark per square meter local starting prices for different classes of lower value properties.
 - b. Develop overall Agency support package to help municipalities manage sales, including standard terms for transferring assets to municipal balance sheets.
 - c. Prepare simple e-Auction methods for municipal sales, including investment auctions for low to negative value properties.

Recommendation #8: Building public trust through well-packaged transparency.

The Agency should continue to develop its branding as a known, trusted entity for privatization.

As the Agency moves from SOE sales to real estate sales, it will have a simpler product to sell, and needs to adjust its public outreach accordingly. Careful explanation of the reasons for instituting price sinking auctions will be necessary.

As the Agency’s inventory of remaining objects is put on line, complete with pictures of low value and poorly maintained properties, this story line should become more convincing. Good GIS based, on-line information can be especially useful for this, and these on-line offerings will need special emphasis.

Good public outreach explaining SOE sales strategies for particular larger firms will continue to be necessary.

Some public trust may have been lost because of the lack of transparency of direct sales.

Publishing all direct sales results, possibly including compliance results could help regain this trust.

Next Steps:

1. Publish direct sale results to date, following a change in the enabling regulation, if required.
2. Develop public outreach campaign to explain various changes being adopted in sales method and to position the Agency and its web-site as the “go to” place for exciting real estate opportunities.
3. Develop public awareness of the problem of vacant, leftover properties, and the Agency’s efforts to address it.
4. Research social media and other low-cost, Internet based ways to help foster viral spread of information about the Agency’s sales offerings and how to purchase.

Recommendation #9: Conduct active marketing, with good deals, following a sales strategy.

The Agency may wish to invest in customer relationship management software, and the internal procedures needed to make this support its sales efforts. Possible investor information should be captured and used for e-mail blasts and direct mailings

The MoF’s e-Auction web site needs to be reviewed and changed to provide more support to the Agency’s sales efforts.

Once the Agency has firmly established its brand, has generated demand and has its store open, perhaps it can levy charges for special information privileges. Until then, the Agency should broadcast as much information as possible about its offerings for free to as many potential purchasers as possible.

Next Steps:

1. Revise the e-Auction site to make more user-friendly and reflect any changes in auction procedures.
2. Activate Google Translate links on Agency and e-Auction web sites to permit non-Georgians to browse offerings. Prepare professional translations of key auction terms or legally important procedures.
3. Consider “clearance sales” and price sinking auctions as way to drive public interest in e-Auctions.
4. For very low or negative value properties, prepare simplified conditional auctions with competition over investment commitments, as a way to clear the inventory and prompt revival, similar to “urban homesteading” property give-aways used in distressed American cities.

Recommendation #10: Adopt Simplified Liquidation Procedures.

The Agency should continue to remove assets from inactive companies and consolidate the shells. There are some legal questions about the status of the shells, and neither bankruptcy nor liquidation are simple or quick procedures.

Eventually, it may be desirable for the Agency to have one large, bad company – owning all the debts and liabilities – and then put that “Junkco” through expedited bankruptcy. It is not, however, clear if this can be done.

Next Steps:

1. Research bankruptcy and liquidation law and practice to determine legal status of asset removal and shell consolidation program.

2. If possible, work with bankruptcy courts to develop systemic, efficient means to clear debts and remove possible uncertainty about transferred assets. If not, seek appropriate change in bankruptcy law.

Recommendation #11: Streamline Administrative Decision-making.

In addition to proposing a standard methodology for the Agency to delegate privatization responsibility to regional offices and municipalities, the MoESD and Agency are in the process of developing ways to delegate various aspects of privatization decision responsibility internally. This will free higher level staff to set policy and concentrate on more difficult issues or valuable assets. The project did not go into detail working on this administrative streamlining with MoESD and Agency counterparts, but this seems like a necessary and positive process.

II. APPENDICES

A. BACKGROUND

B. METHODOLOGY

C. FINDINGS

D. RECOMMENDATIONS

E. ADDITIONAL INFORMATION

A. BACKGROUND

PROGRESS IN PAST TWO YEARS

The MoESD has made significant progress down-sizing the number of non-functioning companies from 1,500 to 477. The decrease was achieved mostly through the merger of non-functioning companies, with assets moved either onto the Agency's balance sheet or to holding companies. Since 2011, hospital sales have represented most activity by value, followed by some smaller auction sales, especially of agricultural land. During this period, the MoESD received limited donor funded advisory help, with the exception of EPI's Framework Assessment and E-Government Report. The privatization activities have slowed under the new government, pending its review of the privatization strategy.

The existing list of state assets includes all SOEs under Agency management, including ones to be privatized and ones to keep in State ownership. The list does not identify "Keepers." The majority of the companies are service companies. By now, the remaining industrial companies are most likely little more than a collection of buildings and debt.

COMPANY AND ASSET INFORMATION

Due to limited company and asset information, the recommendations in this report are based on untested assumptions which must be fact checked as company information becomes available. During information gathering, Agency staff was very helpful and open. However, Agency counterparts had difficulty providing the most basic company information about employee numbers, reported enterprise profits and book values of assets in a simple overview format. After more than a week of work, the Agency was able to provide this in a basic Excel spreadsheet, but it clearly was not easy. The Agency's efforts were greatly appreciated, but they also imply a broader need for strategic investment in improved management information systems at MoESD. EPI has provided support to the MoESD with recommendations for a State Property Management System. Implementing this system in early 2013, as proposed by EPI recommendations, would make a great difference in the MoESD's ability to manage its property more effectively. With proper systems, the information that took so long to provide, could have been delivered instantly – and with far greater detail.

SCOPE OF CONSULTANCY

The information provided about companies and assets is only sufficient to make approximate suggestions. This short-term assignment is not designed for EPI to dive into details of any specific firms or assets, or to make recommendations about specific sales. Instead, the focus is on providing ideas for possible change, which the MoESD and other GoG counterparts can use as a basis:

- To foster internal discussion, both within the MoESD and within the GoG more generally,
- To bring procedures in line with suggestions which the MoESD finds useful,
- To seek needed budget or other GoG support to implement concrete steps, and
- To seek further donor support to complete specific tasks.

B. METHODOLOGY

This report follows and builds on an October 11, 2011 report funded by USAID and prepared by EPI privatization advisor Mr. Nick Towle, entitled “State Property Management Framework Assessment: Confidential” (the “Framework Assessment”). The Framework Assessment provided a comprehensive overview of the then-current state of Georgian privatization, and a set of recommendations for improvements. This report draws on the recommendations of the Framework Assessment, with more of a focus on the changes needed to improve operational implementation, and less on needed legal reforms. The USAID funded World Learning/FORECAST Georgia report from March, 2011 “Adoption and Implementation of E-Government Program: STAGE II” prepared for MOESD (“E-Government Report”) was also reviewed. Other relevant background documents were also reviewed, in a limited literature search, along with key laws and regulations.

The team conducted extensive interviews with Agency staff, during which meetings were held with all key departments. These interviews, which took close to a full week, and the documents supplied by the Agency about their holdings and regulatory framework, provided the main informational basis of this report. The team also spoke with various outside experts able to provide background information. These included:

1. GIZ funded experts in cadastral mapping here and in Germany,
2. A USAID expert in Georgian health sector reforms,
3. A USAID-funded advisor working with internally displaced persons about their experience with clearing title to Georgian State properties,
4. A Georgian commercial broker now working in London, and
5. GEC about their experience with MoESD management information systems.

See Appendix E, Contact List.

C. FINDINGS

The interviews and reviews of available documentation identified numerous findings grouped under headings provided in the narrative below.

OVERVIEW

FULL, DISORGANIZED WAREHOUSE AND EMPTY STORE

The Agency urgently needs to conduct an inventory of what it owns, and start to move assets into the “store” where the public can begin to consider what is available. Right now, the Agency’s asset “warehouse” contains at least 1,000 parcels of real estate, and probably much more than that when SOE real estate is considered. It is impossible for the Agency to say what it and its SOEs own where, much less what the assets might be worth or when they might actually come on the market. The MoESD has adopted a “demand driven” sales process, through which potential investors come to it, ask about specific properties, and these are then put into the auction. Otherwise, except for some high value objects, all of the Agency’s property stays in the “warehouse.”

A major constraint for effective disposition of state assets is that very few objects are available for sale. Even before the temporary stall of sales under the new government, no more than a tiny percentage of the State’s salable assets were ever put in auctions. Several reasons were given for this by Agency counterparts, including concerns about lack of clear title, the expense of valuation and registration, concerns about lowering price as part of the auction process, and worries about flooding the market. The current approach is to set a base price only after purchase inquiry. Nothing is put on line for viewing or into the e-auction until a serious, identified purchaser has stated a sales price.

OLD BUILDINGS AND OLD COMPANIES

The State’s property for sale consists mostly of old companies and old buildings whose value is diminishing with time. Some key issues identified include:

- Wasting assets.
- Low demand reinforced by lack of marketing.
- Low or negative value for many assets.
- Many assets located in shrinking towns or rural areas with declining populations.
- Ongoing security and maintenance problems.
- Nuisance properties burden neighbors, depress values in those markets.
- Buildings often not worth renovating, especially in weak regional market conditions.
- No funds available for demolition.
- Demolitions further restricted by appraisal processes that do not accurately reflect the fact many properties cannot be renovated economically.

RANGE OF PORTFOLIO ASSETS

The State assets held by the Agency consist of a range of different types of assets, including:

- State buildings and assets for continued State use.
- Communist legacy of shares in SOEs.
- At least one thousand buildings leftover after privatization or liquidation of SOE's.
- Thousands of buildings on SOE balance sheets, with an actual number unknown.
- Excess State properties transferred to the Agency for management and sale.
- Properties seized from criminals, tax evaders and others.
- Other miscellaneous assets.

REMAINING SOE'S TO SELL

The Agency provided the consultant team with a list of 477 remaining SOEs. After substantial effort, the Agency was also able to provide an address, employee numbers, profit or loss, sector and book value of assets for these SOE's. No further detail was provided. The Agency reported that it owns approximately 60 active and profitable enterprises. Other than in the medical field, no non-profitable companies are still active.

Many larger SOEs are not in the Agency's portfolio. These are often in LLCs owned and managed by either the GoG or line ministries (such as the Partnership Fund, Ministry of Agriculture, Ministry of Infrastructure and Regional Development, etc). In general, State LLC's are flexible, lightly regulated, and asset sales are permitted outside of usual privatization process.

The Agency has limited ability to manage its remaining SOEs pending privatization. While directors are unable to sell or lease SOE fixed assets without Agency permission, the Agency otherwise seems largely to be a passive owner representative. Unauthorized leasing of real property or sales of inventory or moveable assets may be widespread.

THIRD PARTIES

Amendments in 2010 to the Law on State Property (the "Law") led to a drastic increase in the use of brokers by the MoESD. The Agency reported that approximately 70% of the MoESD's 100,000,000 Lari in 2012 sales revenues were generated by broker-driven sales. The Law's provisions for hiring third parties are highly unusual. Given how generous they are, it is not surprising that third parties have quickly come to dominate Agency sales.

The Assessment Framework expressed reservations about the Law's third party provisions, finding:

"...the general lack of suitable parameters and limitations to the hiring of third party advisors in the (Law) is in our view not in accord with international best practice and action should be taken to lay down some minimum guidelines to prevent abuse and increase transparency." Framework Assessment, page 27.

The Framework noted in particular the Law's lack of controls or limitations on:

- "Procurement rules or competition procedures to apply to appointment of third

parties in appropriate circumstances.

- Guidelines or limits on the amount of reimbursement such persons are entitled to charge and collect.
- Restrictions on the payment of third parties by anyone other than the state counterparty.
- Minimum specifications and requirements for the kind of services to be rendered and the standards under which such services are provided.
- Requirements for professional qualifications or membership of/accreditation or registration with a professional body.
- Publication and appropriate scrutiny of the contractual arrangements.” Framework Assessment, page 27.

Although the MoESD could presumably have used its delegated power under the Law to provide more guidelines, the MoESD’s currently applicable “Standard on Cooperation with Broker Agents” from September 21, 2012 (“Standard”) does not do so.

Detailed research into the MoESD’s use of brokers was beyond the scope of this short consultancy. The following comments are based solely on a brief reading of the Standard and Law. Nevertheless, at first glance, the current heavy reliance on brokers to initiate sales seems both expensive enough, and open enough to possible abuse, that the MoESD and Agency may wish to conduct a careful review, before continuing the approach. In the Recommendations section, a very different approach to the use of third parties will be proposed as an alternative.

As no research was conducted into how brokerage contracts are given and managed in actual practice, these comments may be inaccurate. They only read between the lines in the few documents provided, and should be understood as provisional issue-spotting, without fact checking. Nevertheless, the documents, just on their face, do present a number of issues worth pursuing, including:

1. It is not clear why the broker selection process was exempt from the usual Georgian law requiring competitive tender contracts for services. Neither the Law nor the Standard have any requirements for competitive broker selection. It is not possible to tell from the Standard or the Law what process was used to select third parties. This is worrisome, as brokers must have earned millions in direct fees from the MoESD under these contracts in the past couple of years. As discussed below, they may also have earned millions more in undisclosed fees paid by buyers or by trading on their own behalf.
2. While presumably general procurement and conflict of interest rules would apply to the MoESD officers in charge of hiring brokers, neither the Standard nor the Law provide guidance to help ensure the integrity of MoESD third party hiring or management. This is potentially worrisome.
3. The Standard does not specify any minimum, required professional qualifications for the third parties. Although the third parties may be licensed brokers, this is not required. It appears that anyone can approach the MoESD to receive a contract as a third party. No guidance is provided to the MoESD or Agency decision maker regarding how to select who should get a contract.
4. After this poorly defined selection process, the Standard then gives chosen brokers carte blanche to find State properties that interest them, and potential buyers for them. No limit is given on which properties they can find, nor are any properties identified in the contract. This is thus more like an open-ended “hunting license,”

than a standard brokerage agreement.

5. After the contracts basically invite brokers to stake claims on undefined properties, no guidance is provided on how different brokers can avoid conflicts. If there is an agreement separating third parties into different “hunting areas,” this was not provided. While brokers clearly can only stake claims on properties if they have someone to present as a buyer, there is no process established to help the MoESD or Agency encourage or manage competition among brokers for highly prized properties. It seems likely that the broker who is first able to convince the responsible MoESD office of the “reasonableness” of an offer will get the prize of the fee for the sale of that property. However, the Standard does not provide guidance how this decision is actually made, if there are competing offers. There is nothing to stop collusion among brokers to limit competition by dividing the country into respective market shares.
6. The copy of the Standard, which EPI reviewed, expired in January, 2013. It is not clear if this means that the brokerage memorandum terminated then. No explicit time frame is set in the memorandum reviewed for the broker to find buyers.
7. Unlike standard brokerage agreements, the MoESD gave third parties this “hunting license,” without obligating the brokers in any way to advertise any property for sale or to create an open, competitive market for it. Quite to the contrary, the process is designed for the broker to find one buyer, get that one buyer to give an offer, and then use that offer as a basis for negotiation with the MoESD. How this buyer is found is not considered by the Standard. Thus, instead of retaining brokers to maximize competition among potential buyers for State properties, the process seems to encourage brokers to hand pick their favored purchasers, and steer them to parcels the brokers identify for them.
8. As the Agency’s store is empty, and it is not possible for potential purchasers to browse what is available, buyers are in an unusually weak position vis-à-vis brokers. It is understood that it may be common practice for the MoESD or Agency simply to refer potential purchasers inquiries to brokers, as the Agency is not as well equipped as the larger brokers are to say what the Agency has for sale. This should change.
9. The Standard places the broker in the middle of the State-potential purchaser negotiations. Unfortunately, neither the Law nor the Standard provide guidelines to ensure that the broker will work solely for the Agency, avoiding conflicts of interest or side payments, which might decrease Agency sales proceeds.
10. The potential for conflicts of interest is greatly increased by the lack of any requirement that the broker disclose side payments or side agreements. No limit is set on what the broker can charge the buyer. The process requires no disclosure to the MoESD of any fees the broker may receive from the buyer, in addition to what the MoESD pays. As the buyer’s offer price will clearly be discounted by the amount the buyer must pay the broker, the value of these side payments matters to the State.
11. The Standard places no restrictions on the broker purchasing the property itself through another person or entity, and not disclosing this to the MoESD. This means that the MoESD cannot ever really know if the broker is working for a real third party client, or is in fact acting for itself or as a member of an investor group in which the broker has an interest. This kind of conflict of interest can, of course, have a direct impact on the value that the State receives for a property.
12. Once a “reasonable” price is agreed upon as a result of this process, the MoESD will then put the identified property in the e-Auction process within a very short 5 day time period. Again, the broker assumes no obligation to help advertise the property or the auction, and could have strong interests not to encourage competition at the auction. Thus, unless the Agency itself actively advertises the auction (which it typically does not do), the bid deadline can easily pass with the pre-selected buyer winning the property. This seems to be very common.
13. The standards then guarantee brokers payment of a quite large percentage of the sales price, even when someone other than their selected buyer should learn of the

auction and submit a timely bid. While it may be necessary to pay brokers something for their marketing efforts, even when the final purchaser is not one of their contacts, the brokers under these peculiar contracts have no obligation to market properties aggressively and little incentive to maximize competition among potential purchasers. Under these conditions, it is difficult to see why the State should always reward them with a full fee.

14. The sales price percentages vary, depending on the level of service. In all cases, there is a full 2% payment to brokers for simply surveying and registering properties, which seems very generous for a purely technical service.
15. The highest brokerage fee is 10% for selling agricultural land. It is not clear why this fee should be so high, when selling land might be easier than selling buildings, and should be much easier than selling shares in companies.

EPI did not ask for or see a breakdown of which third parties received these agreements, who sold what to whom and how much they earned. There is no requirement in the Law or standards that any of the brokerage agreements or their outcomes be a matter of public record.

UNFINISHED INVENTORY

URGENT NEED FOR BETTER INVENTORY CONTROL AND MANAGEMENT INFORMATION SYSTEMS

USAID's October 2011 Framework Assessment identified the MoESD's lack of a centralized, electronic asset inventory as a major impediment to privatization progress. This finding was confirmed repeatedly with Agency staff during this assignment. The lack of inventory control applies to SOEs, real property assets owned by SOEs and real property assets directly on the Agency balance sheet. The EPI team did not receive or review any information about any real property owned by the Agency, other than the few high profile objects highlighted in Invest In Georgia brochures.

The Agency has allocated limited resources to collect asset information and capture it electronically using GIS mapping, with links to the National Agency of Public Registry (NAPR). The responsible department has 10 staff members, and many tasks besides this. The head of the department estimates that a proper inventory of real estate could require a dedicated team of 50 people on a project basis.

Until an SOE is in active privatization preparation mode, Agency knowledge of the SOE and its business seems limited. While the Agency certainly has more information about its SOEs than was shared with the EPI team, the data is not retained or structured to support Agency operations. Thus, for example, it appears that lists of companies are not maintained in a good data base format, which prevents the Agency from separating or sorting companies according to a variety of relevant fields. The software that EPI helped the MoESD to develop should provide an adequate architecture for a data base, but the data base needs to be filled. Until this is done, there will be no good data base of real property owned directly by the Agency, and even less information about either companies owned by the Agency, or company owned real property. Rapid changes in the list of paper companies have left Agency counterparts unclear about which assets are now located where.

AGRICULTURAL LAND EXTREMELY DIFFICULT TO INVENTORY

The Agency took ownership of many parcels of agricultural land under a statute that required registration or forfeit. Prior sales under this statute have led to a backlash from both non-registered users/owners and Agency purchasers. This has made the Agency understandably cautious about further agricultural land sales. The scale and political nature

of the land registration problems need to be addressed first, before these land sales proceed. This brief assignment has thus not focused on the agricultural land management and privatization strategies.

BUILDINGS COMPARATIVELY EASY TO REGISTER

An estimated 95% of buildings have Technical Registry records, which can be used as a basis to establish ownership and lot boundaries. While surveying and registering buildings and adjacent land with the NAPR is thus fairly easy to accomplish, the Agency has not done this for most of its portfolio properties. Until now, the Agency (or brokers or possible purchasers) typically only registers properties with NAPR when there is active privatization interest, as part of the auction or sale preparation. Companies are not required to provide building inventories to the Agency and current practice seems to be only to inventory buildings in preparation for a sale.

MANAGING FOR RETURNS

The Agency, like all post-Communist privatization agencies, has a complicated set of tasks, a complicated collection of assets and a mandate, which requires it to consider broader issues in the political economy. Sometimes maximizing shareholder return on equity should be the only consideration for the Agency. At other times, other considerations may legitimately play a role, such as when assets are important for the public health, represent a beloved part of the cultural heritage or are so essential to a fragile local economy that the need for new investment or maintaining employment will lead to a tradeoff of sales price for investor commitments. Commercial fund managers can focus solely on the goal of maximizing shareholder return on equity. The Agency does not have the luxury of this sole focus.

However, as the process of selling SOEs winds down, the Agency is left with a much simpler set of tasks. Instead of managing shares and companies, most of its remaining efforts should be devoted to managing real estate, and doing so properly. Going forward with a real estate management perspective, keeping a focus on return on equity should be easier than it has been in the past.

Although the Agency seems well managed compared to other post-Soviet property funds, it still has a weak handle on what it owns. This undermines its ability to make clear decisions about when and how it should act purely to maximize its return, and when it should consider broader issues. This lack of information also makes it difficult for the Agency to defend its decisions, which can lead, in turn to paralysis in decision-making.

As a seller, the MoESD at least over the past couple of years, has adopted a largely passive stance. Other than when the MoESD hired outside brokers to sell properties actively on its behalf, it typically waits for potential purchasers to come to it. The consulting team does not have enough information about the history of privatization in Georgia to know with certainty if the MoESD's passivity mostly took hold over the past couple of years, as dependence on brokers increased and new e-Auction processes came to dominate. The passivity may have resulted, in part, from an effort to reform privatization processes, to make them more transparent, appraisal based and professional. If it has led to decreased sales revenue, asset depreciation, lost investment and jobs not created, the passivity may have cost Georgia dearly. The Recommendations include a number of suggestions designed to make the new Agency much more active than the MoESD has been recently, while reaping the benefits of increased transparency and sales professionalism.

While some SOEs are generating profit, there is little information about the sources of their profit. This makes it impossible to assess if they are operating as well as they could or

should. Given the lack of information and the usual difficulties, which post-Soviet state property funds have in management, the profit quality of SOEs is questionable. The Agency has limited ability to improve SOE profits, other than by continuing to fire self-dealing or incompetent managers, and trying to replace them with honest and competent ones.

The Agency is not in a position to preserve its capital adequately by securing or maintaining real property from weather or vandalism. As this is likely to continue to be the case, shareholder value is expected to decrease further as the buildings' conditions continue to worsen. The only exception is found in properties in strong market areas, where rapid price increases can wipe out the losses generated by continued neglect under State ownership. Even in these places, the Agency, as a State representative, should consider the negative effect its neglected properties have on the surrounding area.³ The high current prices and weak demand for real estate in Tbilisi may be a sign of a bubble. This also would argue for the Agency to act sooner, rather than later, in its sales.

STATE PROPERTY MANAGEMENT

DIFFERENT PROPERTIES, DIFFERENT NEEDS, DIFFERENT DEMANDS

State assets present very different needs and demands, depending on their use and the Government's plans for them. Except for a few prestige objects or ones given to brokers, the Agency to date, like the MoESD before it, typically only takes action to prepare real property for privatization in response to demand, before an auction or direct sale. Until this time, there are too many properties and too few staff to take action on specific properties.

For many real properties, potential buyers or brokers do the "heavy lifting" of surveying and registering with NAPR before the auction. If they lose the auction, they will then be reimbursed for their efforts from the privatization proceeds. Further research is needed to determine how the reimbursement levels are set.

Further research is also needed to determine if the potential buyer and broker-driven sales preparation process contains sufficient checks on possible conflicts of interest to ensure that auctions are truly transparent and competitive. While there may be nothing at all inappropriate happening, it appears that an "insider track" has been created in the privatization process. There may inherent dangers in turning over to potential buyers and their brokers what would normally be an owner's sales preparation tasks, or the tasks of agents hired by and exclusively loyal to the owner. This process merits careful review to ensure its integrity, especially in light of concerns with third parties, discussed earlier.

It is not clear how far the Agency has gone to develop and implement clear, function-driven lines of responsibility and reporting to help manage its many assets. The staff seems very busy with pre-privatization issues of registration, titling, valuation and one-off debt release agreements. As a result, little time or budget remains for more active management of either companies or of real properties held.

Reports provided by the Agency included a mix of enterprises, not separating out which might fall into which category. The Agency was not able to provide any list of Agency real property assets. It is not clear how this asset list is maintained, and whether it is divided into "keepers," "sellers" or "holders."

³ "In a 2001 study, researchers from Philadelphia (USA) found that houses within (50 Meters) of a vacant or abandoned property experienced a net loss of \$7,627 in value. Properties within (50 to 100 meters) experienced a loss of \$6,819 (around 50-100 meters) and those within (100 to 150 meters) experienced a loss of \$3,542 (see diagram below). Philadelphia researchers also found "that all else being equal, houses on blocks with abandonment sold for \$6,715 less than houses on blocks with no abandonment." Vacant Properties: The True Costs to Communities, p. 9, The National Vacant Properties Campaign, [Vacant Property in USA](#) (parentheticals converted feet to meters)

The focus of this brief consultancy is on privatization and therefore specific issues related to the Agency's broader, on-going work with assets in the "Keep" column are not being addressed. These assets are, however, relevant insofar as the Agency may not yet have developed or implemented a clear strategy for separating the asset categories, to permit it to concentrate its administrative attention appropriately.

The Agency's Mobile Division reports that it pays guards at around 100 buildings, but the division is responsible for over 1,000 buildings. It is not yet clear if the list of 1,000 buildings includes "keepers." This does not, however, include any properties still on SOE balance sheets. The vast majority of properties thus appear to be unsecured.

The budget for building maintenance is very limited for buildings slated for privatization. It is assumed that the Agency does and will not have the resources to provide any but the absolutely most basic maintenance for its properties.

The maintenance of Agency-owned "keeper" properties used by other government agencies is the responsibility of the other agencies.

At this point, the Agency does not seem to have any active program for leasing properties pending privatization, or for capturing informal lease revenues, which may be diverted by company directors.

ASSET SALES, SHARE SALES AND LIABILITIES TO THE STATE AND EMPLOYEES

Counterparts in the Agency repeated several times that the MoESD has a long-standing preference for share sales, rather than asset sales. They also reported that the Government tried with multiple transactions to sell shares, and then switched to asset sales to get sales at all. The Agency prefers share sales largely because they do not want to have to deal with the problems of negotiating the release of creditor claims against the enterprise.

STATE CLAIMS

For many, if not most, SOEs, the most worrisome creditor to deal with in privatization is the State itself. This usually means the MoF, but can mean other agencies as well. Viewed from a whole of government perspective, it is absurd that these State internal debts should be so worrisome and difficult to resolve. The remaining SOE's – or better, their assets – only have the value they have. No more. The efforts of the MoF or other government agencies to collect old debts or levy charges for unpaid bills does nothing at all to improve the GoG's overall asset value. By creating uncertainty for potential investors, they have the opposite effect.

The lack of an overarching agreement among the MoESD, the Agency and other state agencies, especially the MoF, over the release of debt seems to pose a major block to privatization progress. Releases are negotiated on a one-off basis, rather than systemically. In a number of countries, including Germany, privatization agencies were put directly under the Ministries of Finance. This made dealing with SOE debt releases far easier than when they have to be negotiated between ministries.

It is very hard for the Agency to maximize overall return on equity, without the full backing of the GoG make the privatization process as simple as possible for potential purchasers. One would think that it should be much easier for the Agency or MoESD than an outsider investor to negotiate with other State claimants. The Agency's and MoESD's difficulties negotiating, especially with the MoF, are however, great enough that the MoESD keeps trying have investors take on this burden.

It seems likely that the MoESD-MoF pre-privatization debt relief problems lead to systemic

losses for the GoG. The team did not receive any research papers looking into this, but it could be a worthwhile avenue of independent study.

AUDITS

The GoG's attempts to get investors to carry the weight of the past seem especially ill-considered, as its companies' books are rarely audited. The GoG will cooperate with external audits for share sales, but the potential investor must fund the audits. This imposes a major expense and burden for the potential investor. This also means that only one potential investor will have accurate information about the company being sold. Unless an investor is interested enough in a firm to fund the audit, and certain enough that it will be the only potential purchaser, it seems unlikely that any firms will be sold with reliable balance sheets.

Unless the GoG is able and willing to fund its own pre-sale audits of firms, completed by known and reputable accounting firms, as long as it insists on share sales, it will always be in the position of trying to sell a "black box" of unknown liabilities. This puts the GoG at a terrible disadvantage in negotiations, and probably leads the GoG to have to make major concessions in order to attract potential investors to buy shares. The solution of having potential investors pay for audits solves the "black box" problem, but then makes the GoG captive to the investor who paid for the audits.

For valuable companies, it seems likely this refusal to prepare share sales properly by budgeting for pre-sale audit may have cost the GoG very dearly. It may also have contributed to a real loss of investor confidence in GoG share sales. Again, this could be a worthwhile area of possible research, to support the MoESD in its negotiations with the MOF.

TRANSFER TO MUNICIPALITIES

As one of the asset disposition strategies, the MoESD has rarely conveyed excess properties to municipalities because:

- The central government does not want to give municipalities a "present" without strings attached.
- Towns do not want liabilities of stock transfer without prior debt release.
- Towns do not have resources to reuse buildings.
- Towns are limited in ability to resell or lease properties, as most do not have a sales or property management infrastructure in place.

SUBSTANTIAL NEED TO IMPROVE MARKETING

DEMAND DRIVEN SALES PROCESS

The MoESD has, at least for the past few years, followed a demand-drive sales process, in part due to the difficulty of preparing properties for sale. Only a few "headline" objects are selected by the Georgian National Investment Agency (GNIA) for active marketing and sale. Historically, the marketing process was neither targeted nor active. Recent efforts to improve marketing are going in right direction, and need further support.

Similarly, the decision to lease instead of sell seems to be demand driven and responsive, and not strategic.

Agency staff claims to experience better results with investor-driven sales than with ones where Agency actively markets objects. While this may be true for higher-valued assets, this

limits the ability of the Agency to sell less desirable objects. It could also result in “picking out the raisins” and letting the remaining assets continue to deteriorate. To date, very little has been done to create market demand for the mass of State objects.

E-AUCTION LIMITATIONS IN PRACTICE

E-AUCTION ONLY USED WHEN THERE IS SPECIFIC BUYER, FOR SPECIFIC PROPERTY

The auction price is set at what an identified buyer is willing to pay. Therefore, the auction is not so much real auction, as a way to justify a sale to a known purchaser, and maintain prices by encouraging a known purchaser to think others may want the object. The E-auction tool is also not used to decrease price, though permitted by law. Very high bid requirements (30% of initial asking price) can also discourage competitive bidding.

ASSET VALUATION

There are currently numerous issues related to asset valuation. An individual appraisal must be prepared for each asset sale to set the minimum auction price. A State tender selected only one appraiser, who has been working for two years with the MoESD. The Agency seems to have concerns about the low values returned by the appraiser. This raises some transparency concerns in the appraiser selection and the overall appraisal standards used.

This consulting assignment did not conduct detailed research into the appraiser selection process, the MoESD’s past experiences with appraisers, what standards appraisers apply or what guidance the MoESD or Agency gives them. It is recommended later that the Agency include a careful review of the role of appraisers in the context of reviewing its asset valuation procedures.

Agency counterparts repeatedly mentioned that the Agency was constrained in demolishing buildings because appraisers uniformly find that Agency properties are worth more with the buildings than without them. Given the poor condition of many Agency properties and the weak markets in which they are located, it seems peculiar that appraisers would come to this conclusion, and even more peculiar that this would then restrict the Agency in its ability to act.

The appraisal process is quite expensive and slow. Appraisals are required of all objects, regardless of likely value. This relatively new process was implemented as a way to protect against non-transparent, low cost sales in the past – but it seems to have overshot the mark.

As a contrast, the Agency is comfortable with the decentralized, statutory process of setting sales prices for agricultural land, in which local communes provide standard agricultural land pricing for their areas, greatly simplifying agricultural land sales process. There is no similar process in place for the sales of buildings.

A key finding is that there seem to be very few viable, functioning companies left for sale, and a key recommendation is that most of these should be sold in asset, rather than share, sales. Thus, during the course of this brief assignment, issues of real estate valuation were addressed, but not the much more complex issues of enterprise valuation.

SALES PRICE VS. SALES CONDITIONS TRADE OFF

It is unclear if there is a framework strategy for when and how to trade sales price for other investor commitments. The decision process appears to be ad hoc. Investor-led trade off of conditions, especially in direct sales, could lead to drastic price reductions in exchange for investments or job creation commitments which investor would do anyway.

NON-NEGOTIABLE AUCTION CONDITIONS

The following questions need to be addressed with regards to non-negotiable auction conditions:

- How are they decided?
- Which objects are selected for conditional auctions, which not?
- What criteria are used and why?
- What is MoESD/Agency experience with auction commitment enforcement and compliance? Is the trade-off worth it?

CONFUSED TITLES OF SOE REAL PROPERTY

The titles of the real property of the SOEs under Agency ownership are not always clear. There is inadequate reporting of company-owned real property to the Agency. Company property can often be encumbered by tax or other liens, which the Agency may or may not know about. Typically, companies only own buildings, while land under them will remain in Agency ownership until transferred to the companies. This will usually only be done as part of privatization preparation. This means that until a company is actively preparing for privatization:

- Its buildings can be incorrectly or incompletely reported.
- Its buildings can be subject to unknown, undisclosed liens or other claims.
- Its buildings are not attached to the land, and the boundaries of company property are not surveyed.

This approach leaves potential problems open for later resolution, only when a potential investor appears. This is clearly not optimal stewardship of State assets by either SOE managers or the Agency, and seems likely to cause substantial, and poorly timed, complications for some privatizations.

POSSIBLY IMPORTANT SIDE ISSUE – CONDOMINIUM LAW REVISION?

Agency counterparts reported that the common areas and land of apartment buildings were often not sold when apartments were privatized. These have remained in State ownership, with the Agency as the agency in charge. This apparently leaves the Agency responsible for - but unable to do - basic maintenance on the common areas of many apartment blocks. Sometimes common areas were transferred, but basement storage areas, ground floor commercial areas and commercial areas, which occupy half basement/half first floor areas were kept in State hands.

Agency counterparts report that this has led to a backlog of many hundreds of one-off requests to turn over building common areas or basement storage areas to building owner associations. The lack of a simple way to respond to these requests has created an administrative burden for State, while preventing owners from investing to protect buildings.

During the early post-Soviet days, the lack of clear legal status of many ground floor and half basement commercial areas led to many commercial “squatters” simply moving in and taking over storefront areas. Some now have thriving shops and offices in State-owned prime locations, and have not paid any rent for years. Many may have made capital investments.

The law governing apartment buildings apparently also does not contain a provision

permitting owners associations to place liens on the property of owners who refuse to pay common charges.

A systemic solution needs to be found to turn over common areas and land to owners' associations, and to give them the ability to enforce common area assessments approved by the association. This could ease the administration burden on the Agency, improve building maintenance dramatically and spur investment, especially in older properties.

A systemic solution also needs to be found to deal with the problem of commercial squatters, so that they either pay rent or buy their locations for a fair market value.

D. RECOMMENDATIONS

This report contains eleven main recommendations with proposed approaches, methods and tools for the MoESD and Agency to consider implementing in order to move assets through the privatization process more effectively.

RECOMMENDATION #1: SET FRAMEWORK FOR WHAT COMPANIES AND ASSETS TO KEEP, SELL AND HOLD

Given its large number of other tasks and limited resources, the Agency is unlikely to be able to manage more than a small number of active companies effectively. It is thus critical for the Agency to continue its efforts to decrease the number of active companies in its portfolio as quickly as possible. As discussed elsewhere in more detail, as a general rule, the Agency should only retain shares in companies which:

- Will remain in State ownership for strong, strategic reasons, or
- Are clearly more valuable alive than dead and can be readied for sale in a realistic and limited time frame.

This report recommends strongly that the Agency minimize the complexities of owning and selling company shares, and concentrate on organizing the most effective asset sales possible - after getting its list of SOEs down to a minimum. The remaining SOEs should be moved as emptied shells into liquidation or bankruptcy.

The following table summarizes the main kinds of assets depending whether the State should keep, sell or hold them temporarily (see Table 1).

Table 1. Types of State Assets Based on State Management or Disposition Strategy

Keep	Sell	Strategic Hold
Assets intended to remain in State ownership indefinitely, including assets kept on the Agency balance sheet and assets delegated for management to other GoG entities. "Keepers" can include real property, shares or moveable assets.	Includes everything for sale in the near to mid-term and everything which might be transferred to municipalities for sale or holding. "Sellers" can include real property, shares or moveable assets.	Includes holdings retained for eventual use in public private partnership, management contract, long-term lease or other arrangement where the Agency will have a continuing interest and ongoing responsibilities or profit potential. May also include holdings, which the Agency wishes to try to improve prior to privatization, beyond fixing the usual title, tenant, debt and other issues. Real property and shares can be "strategic hold properties," but not moveable assets except in exceptional circumstances.

THE BASIC LIST OF "KEEPERS":

The Agency's current list of 477 SOE's mixes together SOEs to be privatized, with those that will stay indefinitely in State ownership. The Agency should develop and maintain separate

lists of “keep,” “strategic hold” and “sell” companies and assets. The “keepers” list should include assets used for on-going GoG administrative purposes, assets providing a public good, and patrimony assets.

In all countries, some assets will be retained in State or non-profit ownership, and not monetized as a matter of policy or tradition. While most assets on the privatization list will be such obvious candidates for sale that review is not needed, others should be reviewed from the point of view of whether or not they constitute elements of Georgian patrimony or public goods, which should not be turned into purely private goods. Some patrimony assets might be leased in public private partnerships, with title retained in State hands, subject to strict control.

Assets that merit review as possible patrimony assets include:

- Buildings located in public parks.⁴
- Public buildings of major architectural or historical importance.
- Centrally located public buildings, which serve an important administrative function.⁵
- Well located university or institute buildings which serve a broader public purpose.

In addition, public knowledge agencies or agencies creating or defending a public good (perhaps with knowledge assets separated from real property), include:

- Geology institutes with decades of collected information about Georgia’s underground public resources or seismology.
- TB, HIV and infectious disease institutes.
- Libraries and archives containing valuable collections of Georgian history.

WHAT TO SELL?

From the current list, the following State assets should be sold:

- Communist legacy SOEs, as share sales, when appropriate
- Communist legacy commercial and industrial properties as asset sales with their land
- Excess State buildings with their land
- Excess moveable objects
- Excess State land

Agricultural

Non-Agricultural

⁴ Public parks should be viewed as irreplaceable public goods, and typically not be privatized at all, though the buildings in them may be put under long-term lease or concessions, with strict conditions.

⁵ This might, for example, include the MOESD building itself, which is now listed for sale. While selling the building could certainly raise some much needed revenue, it is important to consider the substantial hidden long term costs to government and the public of following a strategy of moving key government offices to cheaper and more remote locations. There are good reasons why established, prosperous countries tend to keep key decision making ministries located conveniently near each other in major urban areas.

- Seized properties
- Properties returned after investors failed to meet contract commitments

KEEP-SELL- STRATEGIC HOLD DECISIONS FOR OPERATING SOE'S

In general, the strong preference should be to sell, rather than keep or hold. The State should only keep or hold companies if there are good, demonstrable economic or policy reasons to do so. This section suggests a variety of filters and approaches the Agency can apply in deciding what to keep, sell or hold strategically.

PRIVATE SECTOR COMPETITORS

If companies are directly competing with viable private sector enterprises for private or State clients, they should be put to the top of the privatization list for 100% asset or share sale, unless there is a strong public policy reason for holding the companies in State ownership. Reasons could include, for example:

- To protect the public from risk of infectious disease – TB clinics, infectious disease
- To complete and manage major public construction projects, such as Marabda-Kartsakhi Railway

NON-PROFIT LIKE ENTERPRISES (INCLUDING HEALTH SECTOR)

If companies provide services that meet a public need not being met by the market, of a kind, which in other countries is frequently served by non-profits, the Agency may consider transfer to non-profits. These transfers can be subject to the condition that they maintain the current profile permanently. This obligation can be reinforced with an Agency veto right over major asset sales, new debt or leases. These transfers could be no-cost and debt-free, if the State has a strong policy reason to support the mission of the non-profit. Possible examples could include:

- Various research institutes
- Polyclinics and hospitals
- Kutaisi Blood Bank
- Samtomashveli Mountain Rescue

The Agency may retain or transfer to non-profits health related companies that:

- Provide services essential to the Government's revised health policy universal coverage goals.
- Address needs that may not be adequately covered by existing private providers.
- Address critical needs that the State or a non-profit can provide more cost effectively than private, for profit companies. Possible examples could include:
 - Psychiatric hospitals
 - Hospitals for extremely ill children
 - Primary care local polyclinics concentrating on needs of State-insured or uninsured citizens.

The Agency reported that Ministry of Health (MoH) wishes to see many of the remaining health-related SOE's continue in operation and not be sold, even ones that are losing money and not paying staff. No opinion is expressed on the MoH's ability to manage health related

companies, but the MoH's position may leave the Agency few options other than to turn the remaining health related companies over to the MoH to manage. Were they not in such a sensitive sector, it would be recommended that money-losing enterprises be liquidated or put into bankruptcy, and their assets sold. However, given the public health needs and sensitivity of the sector, these assets cannot be treated like generic real estate - unless and until they are no longer in service.

“STRATEGIC HOLD” FOR KEY PUBLIC GOOD COMPANIES

The Agency should weigh whether to retain, subject to periodic review, larger companies, which provide key support to public infrastructure or key public goods. Such companies may be candidates for public-private partnerships, break-up or partial or complete privatization, if conditions warrant. Possible examples could include:

- Georgian Post
- Sakaeronavigatsia Air Navigation
- Sporthshenservisi (public sports construction)
- Larger, still unsold hospital complexes or polyclinic chains.

SELL THE REST

All other remaining operating SOEs should then be sold, either through share sale or asset sale. Tests are provided later to determine whether the Agency should try to sell them in a share sale or in an asset sale.

SELLING PROFITABLE COMPANIES?

Governments are often tempted to hold on to profitable or very promising companies, in the hopes of extracting even greater profits from them. This strategy tends to work best if the companies are protected monopolies or in an extractive industry, such as oil or mining. While some sovereign wealth funds have respectable investment success, as a whole, government owned, commercial enterprises tend not to do as well as privately-run ones. The bureaucracy and politics of government ownership too often get in the way of good business decision-making.

Because of this, it is strongly suggested that the Agency not give in to the temptation of holding onto profitable companies, unless the Agency has well-grounded other reasons to keep them as a “strategic hold.” If the companies really are profitable, providing a reasonable return on equity and getting better, even under State ownership, holding may be a viable option. The following three simple tests are suggested to determine this. Companies that fail any of these tests should be privatized, unless a strategic hold is otherwise justified:

Determine Three Year Net Operating Profit: If the SOE is active, review its past three year annual reports to determine the firm's sources of income. Determine if the profit is based on normal operations or an exceptional event (such as a one time property sale). Adjust net profit for exceptional events to get real operating profit. If the company does not show real operating profit, but instead shows operational losses excluding the exceptional event, this means that the company is losing money on operations. Proceed to fast track privatization.

Determine Average ROI – Sell Companies with less than 5%: If a company is active and its average net operating profit yields a three year return on investment of less than 5%, (measured as net profit divided by the estimated market value of assets), proceed to fast track privatization. At this point, an accurate appraisal of the market value is not required. A rough approximation is sufficient, based on the asset value estimates provided by the

company director or, if not available, book value. Either estimate will probably understate the value of the company's assets substantially, and thus overstate the ROI.

If ROI Looks OK, But Profit is Decreasing: If active and average net operating profit yields a three year return on investment greater than 5%, review reports to determine the direction of profitability. If profitability has decreased by 10% or more in the past three years, this means that the company is on a downward slope. Unless the Agency is certain that it can stop the trajectory and the enterprise should be a "strategic hold," proceed to fast track privatization.

These informal guidelines should not, of course restrict the Agency's freedom to sell any company, asset or shares in a company or its assets at any time, if it deems the sale appropriate, as provided by law and applicable regulations.

RECOMMENDATION # 2: SET BASIC GUIDELINES FOR WHICH SALES METHOD SHOULD BE USED WHEN.

TESTS FOR WHEN TO SELL SHARES OR ASSETS

As discussed elsewhere, the MoESD has typically preferred to sell shares in companies, rather than assets, because it did not wish to deal with the problems of company liabilities. This report recommends that going forward, the Agency should, as a general rule, "take the hit" of company liabilities, as it is typically in a far better position to deal with the liabilities than potential investors. This report thus urges the Agency to sell assets rather than shares. In certain situations, however, the Agency may be able to realize as good or better value from a share sale than an asset sale. Then, of course, share sales are viable options. However, it is recommended that the Agency only try share sales in cases, which meet the following strict tests:

- The company should have three years of balance sheets and financial statements with clean audit reports from recognized auditors, using domestically or internationally recognized auditing standards.
- The company's liabilities should be known, established and not under dispute.
- The potential investor should be in as a good a position as the GOG (taken as a whole), to resolve outstanding liabilities.
- The company should be a going concern.
- The company's going concern value should:

Be greater than its value when sold as a closed enterprise in a simple asset sale, or

There should be an overriding reason for the Agency to "leave the money on the table" in a share sale.

The Agency can, of course, continue to try to coax investors into buying shares of companies, which do not meet these tests. However, at least when dealing with investors of any sophistication, the more the Agency tries to get investors to take on unknown liabilities, the more it is likely to have to give away value in return.

TESTS FOR WHEN TO USE WHICH DISPOSAL METHOD

Georgian law provides the Agency with a range of different disposal methods, including e-auction (with or without conditions), direct sale, tender, lease and management contract. It is assumed that the Agency now owns only a handful of companies, if any at all, which are large enough to merit the bother of a complex tender. Even fewer companies may merit consideration to handover to a third party to do a pre-privatization turn-around under

management contract. The Assessment Framework discussed both of these disposal methods in detail, and that discussion will not be repeated here. If the Agency believes that a company can be turned around with better management, and then sold for a profit, it should consider as a first option trying to hire competent and trustworthy industry specialists to run the firm for it, compensating them well for performance.

DIRECT SALES

The Assessment Framework also discussed direct sales in detail, raising substantial concerns about the transparency of this method as it was then practiced. This report agrees with the conclusions in the Assessment Framework about direct sales, and will not repeat them in detail here. This report would add or highlight the following:

- First, it is recommended that, except in exceptional circumstances, direct sales only be permitted for share or asset sales of ongoing enterprises, and not for real estate. Compared to selling an on-going concern (especially one in a sensitive sector like health care), selling real property is quite a straightforward business. Unless the government is working to put together a whole property package for an overall commercial development, real property sales lend themselves well to a much more standard, auction sale – with or without conditions.
- Second, it is recommended that independent, professional appraisals be required of all real estate which is sold as part of a direct sale. To provide some balance, the appraisers should be selected by the Agency, and not directly by the President.
- Third, it is recommended that no direct sales be permitted for any companies which properties worth less than a certain threshold amount, say perhaps \$2,000,000. There is currently no lower limit on direct sales. This number should be based on the value of the real estate owned by a company, regardless of company liabilities.
- Fourth, it is recommended that no direct sales be permitted for less than the appraised value. However, if the investor is taking on liabilities, the appraised value may be decreased by the value of proven and audited liabilities, which the investor will assume. One possibility would be to provide that if the investor is taking on investment or job creation obligations, the sales price may be decreased by 25% of the value of the penalty which the investor will have to pay if it fails to meet the agreed obligations. A fractional decrease is suggested because the investor will benefit from the investment it makes and the jobs it creates, and allowing a 100% decrease in the purchase price could result in a windfall to the investor.
- Fifth, if a direct sale fails under these conditions, the property should be returned to the Agency to sell through an e-auction, with or without conditions.
- Sixth, the results of direct sales should all be published, including the name of the investor, commitments made and price paid.
- Seventh, limiting direct sales as suggested here should only be attempted if the Agency is able to market e-Auctions aggressively, and expand the e-Auction tool as recommended in this report, to be tailored more to the needs of particular sales.

LEASES

Given its ambitious, privatization revenue targets, the Agency will clearly need to be much more in the business of selling properties than leasing them. However, there may be some circumstances where the Agency should consider leases instead of sale.

INTERIM RENTALS

As a general rule, no one should be allowed to stay for free in State owned buildings, unless there is a strong social reason to permit them to do so (such as refugees) or they are working for the State or on a State project. The Agency may be able to realize some revenue by leasing real properties that are in the process of being prepared for sale.

EPI does not recommend leasing functioning enterprises, but if all the Agency has is an empty building which is in reasonably rentable condition, then it should try to get some money for the rental. The Agency should especially try to get lease money from commercial tenants who are squatting in State owned property – such as the commercial tenants occupying the ground floors and basements of many apartment blocks.

The issue of collecting past rents from squatting tenants appears to be quite a complicated one. Further research is needed to determine if and when the Agency can or should offer a partial or complete amnesty for unpaid past rents, in exchange for a commitment to pay future rents. The MoESD may have not been empowered to permit commercial squatters in its some of properties. This could, in turn, restrict the Agency's ability to settle past claims with them. If the squatters have made capital improvements in the property, this may give them grounds to resist collection of past rents. There are many questions regarding the timing of past rent (i.e. When did the squatters first move in? How is this proven?). There are also questions about establishing past rental values. If the MoESD has been collecting rent from some commercial spaces, but not from others, this may raise issues of unequal enforcement, and problems with tenants who have been paying rents all along. If the squatters are Internally Displaced Persons, they may be able to claim a special legal status, which makes dealing with them especially problematic. The problems will not, however, go away with inaction and the Agency may be foregoing a substantial amount of rent that it is under a legal obligation to collect. This topic will obviously need further research, and a coherent strategy developed.

If and when the Agency resolves the issues to the point of offering leases, the leases should be on a timetable that works with the Agency's schedule for privatizing the asset in question. This can be as short as at-will basis, with three months' notice, or as long as a couple of years. This will minimize the problems of getting tenants to move when the properties are sold. Leases should also preferably be on an "as-is, where-is" basis, to minimize the Agency's maintenance burden for rental properties.

As dealing with tenants and many leases is likely to be quite a headache – especially collecting rents from tenants who are used to staying for free – the Agency may want to hire a property management agent through a competitive tender to manage the leases and payments. The agent should probably be paid on the basis of a percentage of rent collected. The legal status of squatter commercial tenants should be researched in detail first, likely lease objects identified, and squatters sent stern letters.

LONG TERM LEASES OF PATRIMONY ASSETS:

A completely different category of leases may be considered for what is referred to here as "patrimony assets". While most of these assets should remain under State ownership and management, there may be some assets, which are commercial by nature, and could benefit from long-term, good quality commercial management. An example might be an historic inn located in the middle of a national park. The State does not want to be an innkeeper, nor does it want to sell a piece of the park to a private party. In such a case, a long term lease

subject to strict conditions to maintain the property and its profile may be in order.

E-AUCTIONS AND BROKERS

FROM ONE SIZE FITS ALL TO TAILORED APPROACH TO E-AUCTIONS:

The current e-auction process is a one-size-fits-all approach, used for everything from very small to very large objects, including both share sales and real estate assets, and auctions with and without conditions. It seems likely that the rigidity of the current e-Auction approach forces the GoG to do many more direct sales than would be needed, if e-Auctions were designed to handle more complex transactions.

It is recommended that the Agency develop clear auction guidelines to govern what are, in fact, quite different kinds of sales. When properties are sold subject to conditions, the e-Auction should be set up in a way that these conditions can be designed and monitored by the Agency, not by the MoF – which has set the system up solely to encourage price competition.

The e-Auction model needs to be expanded to include the possibility of two or more stage sales. Depending on the object being sold and the GoG's goals for it, the first stage may include buyer qualification, as described below for high value real estate sales. In share sales, it may be necessary to include a "due diligence" phase as well. In some sales, the GoG may wish to offer a set purchase price, and encourage buyers to compete on conditions above and beyond that purchase price.

For example, in the sale of a large hospital, the GoG may choose to sell the real estate at appraised value, or perhaps even a discount from appraised value, and ask bidders to compete on meeting various service, employment or investment commitments. If several commitments are included, the bid documents should include a formula to weight them. At the other end of the asset value chain, as described more below in Municipal Outlets, e-Auctions could be structured to encourage bidders to compete over how much they will invest to rehabilitate or build new construction on very low or no value properties in a set time frame.

Winning bidders should be required to enter standard form contracts, which also need to be carefully tailored to track the bid terms.

Elsewhere in this document, it is recommended that the Agency delegate some auction responsibility to municipalities and Agency regional authorities. Research is needed to determine how best to tailor e-Auction procedures to deal with the needs of smaller, regional and municipal offerings. Simple, clear and serviceable procedures, well tied to the kinds of properties to be sold and the municipalities goals for them could go far to ensure success.

MARKETING AND GETTING OFFERING INFORMATION TO POTENTIAL E-AUCTION BIDDERS

This report repeatedly urges the Agency to market objects for sale much more aggressively itself – and not just rely on brokers to do this. For e-Auctions to work more effectively, it is essential for the Agency to advertise the auction mechanism well, and to consider ways to advertise individual auctions better. It is recommended that, at least for some properties, the Agency prepare sets of properties for simultaneous auction in one geographic area. Enough properties should be for sale to justify advertising the auction in the region (perhaps, as suggested elsewhere, with cheap flyers or radio spots), so that some consumer excitement is created.

Consideration should be given to how to provide potential e-Auction bidders with improved access to specific, technical information about what is for sale. This goes beyond the

general advertising of e-Auctions – which it is recommended elsewhere should be dramatically increased.

For real estate sales, the Agency should strive to provide potential bidders with the most complete possible descriptions of each parcel. This should include the cadastral registration, photographs and any property descriptions that have been prepared, either during the course of object identification, by brokers or by the Agency as part of its sale. Potential bidders should have on-line access to this information, or be able to get the Agency to prepare a print out in exchange for a fee set to cover the costs.

If a broker has been retained by the Agency to lead the sales effort, the broker should be responsible for getting all available information to potential bidders promptly. If, as is recommended, Agency brokers are forbidden from representing bidders on the specific properties under contract with the Agency, they should have less incentive to withhold information from prospective bidders who are not their customers.

If the Agency is relying on brokers to convey information to prospective bidders, brokers should be required to track and report on who received information, and how long it took the brokers to respond to inquiries. Brokers who withhold information from potential bidders, or seek to require potential purchasers to enter contracts with them as a condition of receiving property information, should be terminated immediately and without pay. The Agency should provide potential bidders who do not want to hire buyers' brokers with an easy way to report possible broker abuse, and investigate complaints promptly. Results of investigations should be published.

Share sales are much more complex than real estate sales, with much higher informational needs before prospective bidders can make a decision on whether and how much to bid. These are discussed in more detail, below.

BOND AND PAYMENT REQUIREMENTS:

It is suggested that the Agency review the 30% bid bond requirement, and possibly decrease it. This seems like a very high percentage of the purchase price to require as a down payment in an auction, and it may act as a real deterrent to competitive sales. Further research is needed into comparative bidding rules, but 5-10% seems like a more typical amount to require for the right to place a bid.

The rules could then require the winning bidder to pay an additional third within a certain short time period – say five business days – or the Agency could either re-auction or offer the property to the next highest bidder, in its discretion. Payment in full would then be required as a condition to registering the property in the bidder's name. This should take place in an administratively reasonable time frame, say 30 days for smaller objects or perhaps up to 90 days for larger objects for which the bidder will need to get financing. For complex, financed sales the Agency should be able to permit extensions, perhaps up to six months, for investors to go secure needed financing after an auction. Extensions can be made conditional on the investor demonstrating best efforts, or on securing bank commitment letters.

TAILORED AUCTIONS FOR HIGH VALUE OBJECTS:

Including a pre-qualification stage could make e-auctions a much more useful tool for high value properties. For example, if the Agency is selling a property which it wishes to see redeveloped according to international standards as a hotel, the auction can specify a minimum investment amount and require that bidders must demonstrate that they are or represent a hotel chain meeting the required specifications. For this, no direct sale is

needed

E-auctions of high value properties also could and should be advertised heavily – especially by using the Agency’s and MoESD’s contact lists. Timetables for bidding and payment can be set appropriately for the size and complexity of the object. Further research is needed to determine if this would require regulatory change, or whether this kind of tailoring can be accomplished within existing rules.

E-AUCTION FOR SHARE SALES

The e-Auction method is a difficult one to use for share sales. Potential bidders have very high needs for information and access to be able to conduct due diligence on companies. A “one-size-fits-all” e-Auction procedure, that does not explicitly address these information needs, can only really be used to justify the sale to the one bidder who has had proper company information.

If the Agency wishes to use e-Auctions for company sales, it, or the advisor it hires for the sale, must take great pains to ensure that all potential bidders have equal access to the company’s executives and to all the company’s relevant records. If one potential bidder pays for audited financial statements (a practice which seems very problematic), that bidder should agree to give the Agency all company information it receives as part of the audit, as well as the audit results. The Agency would then share this information equally with potential bidders.

The company should have a data room, either physical or on-line, where potential bidders can access information. Potential bidders should enter confidentiality agreements, if the company could be damaged by the release of its information.

Much more could be said on this topic, which would be beyond the scope of this report. Suffice it to say that e-Auction share sales are complex, and detailed procedures need to be in place, at every stage of the process, to ensure that the e-Auction can, in fact, be an auction where competitors can bid with equal knowledge on company shares – rather than simply a tool to give sales an unearned appearance of transparency.

CHANGE BROKER SELECTION AND CONTRACTING PROCESS.

As discussed in the [Findings](#) section, a simple review of the Law and Standard governing hiring of third parties raised a great many questions about the MoESD’s heavy reliance on outsiders to start and manage the sales process. Resolving these questions could be key to assuring successful, competitive and transparent sales going forward.

Many of the recommendations included in this report revolve around the basic concept that the Agency needs to become a much more active owner, manager and seller of its properties. The current reliance on brokers, especially under the lax guidance of the Law and Standard, may have had the unintended consequence of weakening the MoESD, and leaving it less able to do its core tasks efficiently.

It is thus recommended that the Agency conduct its own internal review of the pros and cons of its and the MoESD’s experience with third parties over the past couple of years. This review should consider the costs, distribution of payment to different brokers, value received for services rendered and other issues relevant to deciding whether to continue with the current model or not.

While, again, this brief consultancy has not gone into any detail reviewing brokerage contracts or the MoESD processes of hiring or managing brokers, it is recommended that the MoESD and Agency keep an open mind as part of its review, and be willing to consider fundamentally changing how it uses brokers and third parties going forward.

One possible outcome would be for the Agency to limit its use of external third parties to well-established brokers, charged with working strictly for the Agency, to market selected, identified and very valuable objects both domestically and abroad.

For smaller properties of mostly domestic interest, the Agency should, in time, be fully capable of creating enough visibility to generate demand for its wares. The Agency is, after all the major seller of property in Georgia. Up until a couple of years ago, when the new rule on hiring third parties went into effect, the MoESD was not so reliant on brokers. It should again use its weight to get attention of potential buyers, and not just count on expensive outsiders to do this for them.

However, given the ambitious sales targets for the Agency for 2013, it may not be possible for the Agency to wean itself from overdependence on brokers right away. Some brokerage agreements may still be needed to secure sales smaller properties.

Brokers should, in any case, only be retained following standard governmental tender procedures for purchasing services, under clearly defined mandates. Instead of giving brokers “hunting license” mandates, brokers should instead only receive contracts to sell specified properties, within a defined time frame. Clear broker qualification requirements should be laid out in the tender documents. Contracts between brokers and the Agency should take care to protect the Agency against possible broker conflicts of interest, and require full disclosure to the Agency of payments made. Brokers and their affiliates should be forbidden, directly or indirectly, from participating in any bids on properties they are selling. Brokers should, of course, be required to advertise properties for sale, and advertise the terms of any e-Auctions. Specific advertising tasks should be specified. In some cases, the Agency may want to specify minimum advertising budgets.

The Agency should, of course, continue to work with third parties who have been retained by buyers to represent them. Sales should continue to be initiated at the demand of potential purchasers or their brokers, but it is difficult to see why brokers should be paid for this, by both the Agency and the buyers.

See [Recommendation #6](#), for a proposal to separate brokerage from property survey and registration services, and buy the latter in bulk, after tenders. This could dramatically decrease the cost of surveying – which is currently 2% of the sales price in broker-contracted agreements.

CONDITIONAL AUCTIONS FOR LOW VALUE OBJECTS

At the other end of the market, [Recommendation #7, Opening Municipal Outlets](#) contains some ideas about using conditional auctions of very low priced objects as a way to encourage investment in properties that need to be demolished or completely renovated.

RECOMMENDATION # 3: IMPROVING BASIC COMPANY INFORMATION MANAGEMENT

IMPROVING COMPANY INFORMATION

Although Agency staff was very helpful and open, it was difficult for them to provide company information in a useful overview format. It is beyond the scope of this brief consultancy to provide detailed advice to the Agency on setting up a management information system, but lack of accurate information about both companies and assets was a recurring theme. The MoESD has received some advice from EPI about ways to improve its management information systems, including company reporting, and these recommendations will not be repeated here. Unlike the E-Government team, this team did not do a detailed analysis of the Agency's IT needs and capacities.

Our recommendations assume that the Agency's existing IT infrastructure is largely adequate to support the changes proposed here. The problems identified here are mostly ones, which can be fixed quite easily with some political will, administrative attention, interest in coordinating information flow and at times a few new gadgets – like GIS locators to give to students to help measure approximate real estate parcel sizes. The recommendations about information rely much more on reporting, communication and process, than on new technology. They focus on getting the Agency to “know what it knows,” supported by a GoG which also “knows what it knows.”

It is especially important for the Agency and NAPR to coordinate well, so that real estate data can be presented accurately in a GIS format for potential investors.

The Agency has a wide range of different management tasks, each of which require it to keep track of different information to do its work effectively. Obviously, trying to manage ownership of active companies is entirely different from managing empty corporate shells. Pre-sale management of empty real estate is different from managing commercially leased properties, which is different yet again from managing formal ownership of buildings used and maintained by other government agencies.

For each of these tasks, the Agency needs to establish – and continually reinforce and update – management information flows, which provide it the data needed to make informed and prompt decisions.

This report urges the Agency to concentrate on the core function of pre-privatization management of real property, and getting the information needed for that task. This is where, at this stage of privatization, the Agency needs most to be an effective owner. It is also a much simpler task than effectively managing ownership of active corporations.

OBTAINING BASIC COMPANY INFORMATION

While the Agency has been making great efforts to improve its management information, it does not yet have company information readily available in a way to help it make the basic keep/sell/hold decision recommended above.

To do this, detailed information about the company and its real estate and other assets needs to be received and reviewed. If this has not yet happened, company directors of functioning firms should be required to complete standard forms in a set time frame. For each portfolio company, the Agency should collect and maintain the following items of information in a standardized, electronic format, which permits easy comparison. The information could be simplest to track and use, if it is clearly divided between company

information, and information about its real and moveable assets. The following reporting format could give the Agency good overview information in a manageable framework.

INFORMATION ABOUT THE COMPANY AS A GOING CONCERN

Company Status Information Report	
Active	Inactive
Profitable	Non-Profitable
Income from Core Operations	Income from Property Leasing
Profit or Loss for Past Three Years	Total Per Employee(per year) Total as a percent of asset value (per year)
Stated Book Value	Estimated Market Value of Assets
Company Financial Records	Unaudited ρ Audited. ρ If Audited: Name, Address and Contact Information of Auditor Date of Audit
Top Five Creditors	Amount of Debt Owed Each Creditor, including <ul style="list-style-type: none"> • Age of Debt • Amount of Overdue Debt
Total Number of Current Employees Number of Active Employees Number of Employees on Leave	Number of Employees Three Years Ago ⁶
Sector of Current Activity	Sector of Past Activity
Key Competitors	In Sector In Region
Total Number of Customers	Total Value of Sales from Operations
Top Five Customers	Names and Locations Percentage of Total Sales for Each
Estimated Market Value for Company	Based on: Director's good faith assessment ρ Other source: ρ If other source, provide name and contact information for source and date estimated value provided.
Potential Buyers, Investors, Lessees in Company or its assets	Name Contact Information Date of Last Contact Interested in?:

The reports will help the Agency to quickly assess:

- Whether the company is active vs. inactive: An active company with a clean balance sheet is more likely to be salable as shares instead of assets.
- Whether the company is profitable vs. non-profitable, if profitable, whether the

⁶ See Employee Unpaid Wages Reporting Form, below

core business function is a source of income vs. leasing of buildings/property: this will help the Agency determine whether the company has actual potential as a company, or whether it should be sold as property/real estate.

- The Stated (book value) vs. Estimated Market Value of Assets: this will help the Agency determine an approximate value of assets in case of an asset sale.
- The level of debt and types of creditors: this will give a better understanding to the Agency of the magnitude of the debt issue and whether a systemic solution of debt elimination with the MoF would make the company viable for share sale.

INFORMATION ABOUT THE COMPANY’S ASSETS

Each active company should provide the following information about its main immovable and moveable assets:

Land and Buildings	Uses and Identification
Total number of square meters of buildings	Office Factory Warehouse Residential Other use
Total number of occupied square meters of buildings	Office Factory Warehouse Residential Other use (specify)
Total number of occupied square meters of buildings used by Company	Office Factory Warehouse Residential Other use (specify)
Information about Individual Buildings and the land attached to them	Address Current land use NAPR Registration Number, if any. Technical Register Number Number of square meters of land If used by third parties, <ul style="list-style-type: none"> • # of square meters third parties are using • Gross monthly rental income received If encumbered by lien: <ul style="list-style-type: none"> • Name, address and contact number of lienholder • Date lien first put on property. • NAPR or Technical Registry Lien Number • Total stated amount of lien
Information about Company-owned land not included above	Address Original Use (office, factory, warehouse, residential, other) NAPR Registration Number, if any. Technical Register Number Number of square meters of built space.

Land and Buildings	Uses and Identification
	Number of square meters of land registered with building Occupied or Vacant If vacant, year vacancy began If occupied, <ul style="list-style-type: none"> • # of square meters rented • Gross monthly rental income received If vandalized or in major disrepair identify major damage: <ul style="list-style-type: none"> • Holes in roof • Plumbing missing • Wiring missing • Doors and windows missing • Structural damage (specify) If encumbered by lien: <ul style="list-style-type: none"> • Name, address and contact number of lienholder • Date lien first put on property. • NAPR or Technical Registry Lien Number Total stated amount of lien
Movable Assets	Uses and Identification
Vehicles	Type of Vehicle Vehicle Registration Number Vehicle age Kilometers driven
Inventory	

RECOMMENDATION #4: BREAK THE CORPORATE SHELL: FOCUS ON PROPERTY (NOT SOE) MANAGEMENT

Based on the analysis of company data, all inactive SOEs that have not been classified as SOEs to be kept, should then proceed towards resolution.

If an SOE is inactive, regardless of creditors or location:

- And without assets, proceed to liquidation or merger and then liquidation,
- And with assets, unless there is an extremely strong, factually-based reason for not doing so:
 - Request company director to justify retention of employees other than security guards.
 - Remove assets to the Agency balance sheet, if permissible.
 - Merge empty shell with “Junkco” and keep all liabilities with “Junkco” for later simplified liquidation (as described below).
 - Have an Agency agent visit all properties to check for unapproved leaseholders as part of inventory.

- If found, put them on month to month tenancies paying rent directly to the Agency, subject to immediate termination when the asset is sold.
- Or have police remove them.

If the company appears to be potentially viable under private ownership, even if it is currently inactive, put the shares or assets on fast track for sale, with advertising targeted to possible sectoral investors as a way of capturing possible residual value. Otherwise, just treat as standard real estate sale.

RECOMMENDATION # 5: DEVELOP UMBRELLA LIABILITY SOLUTIONS FOR GOG DEBTS, ENVIRONMENTAL DAMAGE AND UNPAID WAGES

UMBRELLA DEBT AGREEMENT

SOEs and state-owned real estate only have the value they have. Other than the modest 7% that the Agency keeps from privatization revenues for its sales efforts, all sales proceeds go directly to the Government.

When individual ministries assert individual pre-privatization claims against SOEs or their assets, they cannot possibly create more value in the sale. Instead, their individual claims depress values by creating investor uncertainty and market confusion. They slow sales by creating administrative blocks. The current practice is for the GOG to set ambitious privatization targets. Unfortunately, these targets are set without the GOG seeing that its' own claims of individual agencies against privatization objects present some of the greatest obstacles to successful sales. Seen from a GOG-wide viewpoint, there is no "us" versus "them". This is all "us". Privatization must be understood as a whole-of-government task.

This report proposes that the GOG pass an overarching regulation that would bind the MoF as well as all other State creditors, including SOEs. Claims for unpaid employee withholding will explicitly need to be dealt with as part of this overarching agreement. This is outlined in seven brief clauses, below. The regulation is based in a release of claims. While this may sound extreme, as sales proceeds all go back to the Government, the release does not give away anything. It just recognizes reality, and frees the Agency to do its absolute best to get the most money it can for what it has to sell. Without the release, it cannot do this.

The pre-sale release simply removes the potential cloud on title from assets, and removes the GOG from the backs of potential investors. It moves the fight over unpaid State claims on State assets from before privatization, where it only creates problems and confusion, to after privatization, where it belongs. The release recasts the issue as an intra-governmental debate over division of sales proceeds, where it can be handled without harm. Now, it is a destructive debate among various GOG agencies and potential investors over collection of old and often unclear debts, which have nothing to do with the investors.

Proposed clauses 6 and 7 give MoF the first tranche of the sales proceeds. Other State claimants can then work with the MoF to be paid from individual asset or SOE sales from what is left, if anything. The MoESD and Agency are out of the discussion, and freed to do their job of maximizing sales proceeds. Potential investors are freed to invest in their new businesses without fear.

A regulation with the following terms could go far to:

- Ease the Agency's difficulties selling the shares of its companies,

- Ease liquidations and bankruptcies, and
- Give potential investors needed comfort that they will not buy troubles with the GOG when they buy State assets:
 1. The regulation should automatically release all SOE's in 100% State ownership from all claims against them from all GoG agencies for any debts owed for any reason.
 2. Lest company directors somehow benefit unfairly from the release, the automatic release should only take effect when a company enters liquidation or at the moment when the Agency sells 100% of its shares.
 3. The release should apply immediately to all 100% State-owned companies currently in liquidation and bankruptcy.
 4. The release should apply to all Ministries, State agencies and 100% State owned enterprises, and bind them all, so that none can make any claims against any of the company assets or shares at any later time.
 5. When the Agency completes the sale of the company assets or shares, it will report this amount to the Government, and transfer the usual 93% of the proceeds to the Government, identifying the proceeds as coming from the sale of that company's assets.
 6. If a Ministry, State agency or SOE wishes to make a claim to the MoF for part of the sales proceeds based on the company debts released, it may do so.
 7. The MoF may, in its discretion, allocate privatization sales proceeds to repay a ministry (including the MoF), State agency or 100% SOE up to the full amount of the debts released.

The Agency may find it worthwhile to do some analytic research into how the current approach may have affected privatization results. It seems intuitively obvious that the current practice should lead to depressed sales prices and lost investors. However, this has not yet been proven. The Agency's case for change could be strengthened if this assumption can be demonstrated in both numbers and stories from investors. If the Agency can also quantify the amount of time it, potential investors and the MoF have had to spend on individual pre-privatization debt release negotiations, this would strengthen the argument. If debt releases were negotiated in the context of direct sales, it could also be worth studying whether the presence of GOG claims may have made undermined both transparency and the Government's ability to encourage competition among potential investors.

ENVIRONMENTAL DAMAGE CLAIMS

Further research is needed to determine what the possible impact might be of possible environmental claims on real properties sold by the Agency. Under some countries' laws, environmental claims can last for many years, follow ownership and may be impossible to discharge in liquidation, or perhaps even bankruptcy. Under German privatization practice, for example, responsibility for environmental clean-up and compliance was often a major topic of negotiation, especially for industrial sites. The German government often ended up assuming responsibility for pre-privatization environmental damage, which was documented by careful environmental assessments before the sales.

If the Agency and the Ministry of Environment have not yet established an agreement about how to assess and cope with environmental damage on the sites owned by the Agency and

its portfolio companies, this should be made a priority. Like old MoF claims, this is something, which the Agency should be in a far better position to resolve on a systemic basis than individual investors.

DEVELOP SYSTEMIC SOLUTION FOR EMPLOYEE CLAIMS

Employee claims against SOEs for unpaid wages were mentioned repeatedly as a problem in preparing enterprises for liquidation or privatization. Employees typically represent the largest non-State group of potential claimants against SOEs. The statute of limitations for employees to get wages paid is apparently only three years, unless a formal claim has been filed. This consultancy did not research the process for filing claims, which is apparently through a court filing. It seems plausible that there could be thousands of older claims on file against hundreds of SOEs, with a total value in millions of Lari. Presumably, until they are resolved through payment, settlement or discharge, these filed claims do not go away.

If it is not already being done, at a minimum, company books should all be cleaned of all wage arrears older than three years, for which formal claims have not been filed. If companies have been inactive for longer than three years and no claims have been filed, (if this is permissible under Georgian law and accounting practice), all wage claims should just be taken off the books. For companies that have been active in the past three years, or are still active, a process needs to be set up to age unpaid wages and get them off the books, if a formal claim has not been filed within the statutory period. This exercise will need to be done for all companies, including those currently in liquidation.

Separate disclosure is needed of employees who are on unpaid leave, including the date the leave started. Employees in this status should be accruing no additional wage or benefit claims. Research is needed to determine what steps are needed to terminate employment formally, at the end of unpaid leave status.

Depending on the quality of company record-keeping (which is likely to be generally quite poor), setting this up could be a large and tedious job. Active companies should be provided standard electronic reporting formats, and required to send them back to the Agency. The format should include the following line items for all employees terminated in the past three years who may be owed wages:

Unpaid Employee Wages Status Report	
Name of Employee Owed Wages Address and Contact Information	Currently Employed – Yes or No If terminated, date of termination
Is the employee on unpaid leave?	If so, when did the unpaid leave begin?
Total amount of wages unpaid in past three years	Provide breakdown by month
Has the company received notice that the employee has filed a formal claim for unpaid wages?	If so, provide: The date of the claim The claim number The office where filed The amount claimed The time period covered by the claim.
Total value of unpaid wages older than three years old, and for which no claim has been filed.	

<p>Did the employee receive any compensation in lieu of wages in the past three years, including payments from third parties for services performed on the Company property?</p>	<p>If so, what services were performed? Estimate monthly compensation received in lieu of wages.</p>
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The Agency raised concerns about unpaid wages that are continuing to accrue, especially unpaid wages at money-losing hospitals and clinics. These are problematic. It seems safe to assume that employees are in fact being compensated, or they would not be still coming to work. Their compensation probably comes from providing services to patients on a fee basis, perhaps as informally as nurses charging for giving individual shots, or support staff charging to change sheets or bring a cup of tea. In many countries this side compensation, which may be illegal, often exceeds the nominal, unpaid wages from the SOE.

It seems likely that many would-be employee claimants have in fact been working on the side, using the cover of the SOE as a way to run their small businesses. For various bad reasons, in many countries, employees are often kept on nominal State or SOE payrolls, accruing unpaid wages, long after they cease showing up for work at all. If and when it comes time to deal with individual claimants, these could be defenses against payment.

As the Agency merges companies and removes assets, both the filed claims and unpaid wages younger than three years old then sit on the books of then emptied shells. Over time, as long as employees do not file formal claims, many of these unpaid wage claims will simply expire. The longer they are held, the fewer they will become. This argues for letting these claims be gradually annulled by passage of time.

Unpaid wages tend to be a highly emotional and easily politicized theme. It is very easy for the press to present coverage of sympathetic, older workers being abused by an unfair system. No government official wants to be cast on TV as the heartless defender of non-payment of wages owed to poor and honest workers.

The Agency has not mentioned whether any lawyer representing employee claimants has sued to block the process of merger and asset removal. In some legal systems, this could be a substantial risk, especially if class action lawsuits are an option. If a court were to rule that the Agency’s merger and asset removal process denied former employees their right to have their claims satisfied, this could put a stop to it. In the worst case (from the point of view of the Agency) it could potentially raise questions about whether or not old employee claims might be satisfied by attaching already sold company assets.

This all argues for a strategy of continuing to merge shells, take assets and let the unpaid wage arrears lapse over time. However, it is recommended that the Agency:

- Study the legality of the process carefully, and adjust as needed to ensure that it complies with existing law and that no claims can be placed against privatized assets;
- Get a good handle on the scope of unpaid wages that are less than 3 years old;
- Prepare careful records of claims actually filed;
- Possibly prepare a concept note for discussion with the MoF for an overall set-aside fund of privatization proceeds to satisfy properly filed and uncontested employee claims;
- As an alternative to a set-aside fund to satisfy employee claims, seek a clear legal ruling from the Ministry of Justice, or if needed, a change in bankruptcy

law, clearing the way to aggregate employee (and other third party) claims against one or more large “Junkcos,” which will then be taken through a structured bankruptcy.

- Given the huge number of potential claimants and the political nature of the problem, even in bankruptcy, it may be necessary to include a set-aside fund to distribute. If there are multiple Junkcos, as far as practicable, the set aside amount should be give claimants against different companies’ equal treatment.
- One possible source of complexity will be tracking claims against assets. The proposal for GOG claims would track claims of individual agencies and individual ministries against assets from individual companies. The MoF would then be responsible for settling up with other agencies, based on the sales proceeds received for that individual company’s assets. This approach is feasible for government or SOE debt, because the number of creditors is likely to be small and the claims reasonably well documented. It is also an intra-governmental negotiation. This approach would not, however work so well with employee claims, where the process will need to deal with masses of potential claimants with badly documented claims, many of which may be of questionable merit. It also could lead to real unfairness in the treatment of employee claims, as employees would only be paid based on the random chance of the value received for the property in which they worked. Forming an employee claim reimbursement pool from a part of the asset sale proceeds from assets of many companies would permit payment on a more rational basis.

RECOMMENDATION # 6: DEVELOP AND ADOPT SIMPLIFIED REAL PROPERTY INVENTORY, VALUATION, SURVEY AND REGISTRATION PROCEDURES

INVENTORY

If the lack of a proper inventory of Agency real property assets has not yet been raised to the entire GoG as an object of concern, it needs to be made enough of an issue that the GoG develops the political will to resolve this. Adequate resources and attention are essential to fix this long-standing problem. Given the distributed nature of information about companies and their assets, it cannot be fixed property unless the Agency gets cooperation from multiple other ministries and agencies of government. The Agency can and should, however, do what it can, to complete the parts of the inventory it can, even if other GOG agencies are not as cooperative as one might hope.

Some progress can be made by requiring managers of active companies to provide data, as provided above. However, company directors as a group, should probably not be entirely trusted with conducting an inventory, as some may have a strong interest in under reporting or concealing information. Also, for assets already on the Agency balance sheet or the balance sheets of inactive shell companies, there will typically be no one at a company level to whom to delegate.

It will be necessary for the Agency to be creative in making local eyes and ears active in the search for missing properties. As discussed below, the municipalities should be motivated, as they will get a portion of the proceeds of selling assets. They should have much better local information than the Agency, and if they are given a strong enough interest, should be willing to disclose what directors might otherwise want to hide. Employee records of

companies should be checked to find the names and contact information, if possible, of the head bookkeepers of companies where assets might be concealed. Perhaps a modest prize program could motivate bookkeepers to help out in this game of hide-and-go-seek. In addition to these “carrots,” the Agency may wish to use the stick of very public shaming and punishing of directors who have been actively non-cooperative or concealing assets. When directors are requested to help with the inventory process, they should receive very stern letters reminding them of their fiduciary duty to the State, and the possibility of prosecution if they conceal State assets. The inventory process, as well as these letters, may also be worth using as a public relations event. Cast properly, it should show the Agency in a positive light as an active and responsible steward of State property.

It could help to appoint a high-level, inter-ministerial working group, focused only on the asset inventory. To prepare for forming a working group, the Agency may wish to hold a workshop and a press conference to discuss inventory issues. Ideally, this should be done jointly with NAPR.

The inventory problem may be easier for a new government to address, than it would have been for the prior government. It is, in effect, a leftover house-keeping chore. The fact that it has not been done yet shows that it was not made a priority, but it does leave everyone trying to deal with disorganized and incomplete information about real property in an uncoordinated way, when a systemic, deep cleaning and data organization is needed.

In the course of doing the inventory, some problems might be revealed, but this will need to be understood from the beginning as part of the exercise. So, for example, if as part of the inventory, it appears that company directors or GoG staff members have been informally leasing company or State assets or otherwise using them for their personal benefit, decisions will need to be made regarding possible prosecution or amnesty. It is possible that a well-publicized mix of the two could bring positive results for the Agency in terms of increased lease revenues, increased political support for the inventory process and increased interest in the remaining assets to be sold.

BREAK INVENTORY INTO MANAGEABLE PIECES

Overwhelming tasks, such as the unfinished inventory of State and SOE real property assets, are less overwhelming when broken into pieces. In inventory discussions with Agency team members, the inventory process tends to be conflated to include:

- Inventory of physical property
- Survey of boundaries
- Registration of property rights
- Resolution of competing claims to property, and possibly
- Property valuation.

The task would be simpler if it were broken into separate, more manageable tasks, within a structured framework.

Inventory progress is being made as the Agency further develops the State Property Management System (SPMS), which includes receiving applications from individuals or legal entities, distribution of tasks among staff and external parties (appraisers/auditors) and decision-making. The system assigns tasks to staff, defines necessary inputs (documents and data) and generates output documents. The web services of the NAPR and the Civil Registry Agency are integrated into the system. Before its programmers left for other positions, the Agency development team was working on implementing the module for the management of unregistered state property and the module of monitoring fulfillment of

liabilities imposed on privatized/leased state property. This work should clearly continue, and be deepened, and recommendations regarding both inventories of company and Agency assets should be implemented to flow as seamlessly as possible into the developing SPMS. It is hoped that the agency's new structure will permit it to pay market wages to the qualified programmers it needs to ensure that these key tasks are done properly.

COORDINATED DATA MINING

The Agency should begin first by seeking to “know what it knows” by developing a structured and flexible data base of its real property assets. At a minimum, this list should include the addresses and approximate locations of all the “sell” or “hold” properties, which both the AGENCY and its portfolio companies own. Some key parts of the inventory task may already have been done by other agencies, but not yet adequately fed back to Agency. Where companies have directors, they should be explicitly required to report this data, as described above. EPI has worked with the Agency to develop a good software framework for this – and other – management information tasks, but the agency has yet to take the information it has and put it into the new software. The sooner this happens, the better.

The Agency and NAPR should then coordinate a review of this list of properties, in which the NAPR would share with the Agency, in digital form, all information, it has about all of the listed properties, broken down for each property. This information may include GIS locations, survey information, land registration information, satellite photographs, photographs of the property or any other data which the Agency and NAPR agree should be shared. If the old Technical Registry information is digitized, this should be included as well. If not, the Agency and NAPR may wish to coordinate scanning and digitizing Technical Registry information for the identified parcels. If possible, the Agency should seek help from experts trained by the GIZ in their mapping program to help identify what exactly NAPR has, and how best to share it in a way that is most useful for Agency's purposes. Other possible sources of information within the GoG should also be reviewed for the inventory.

This inventory clearly cannot be undertaken for all real property assets in the entire country at once. It should be started on a trial basis, in one or two selected regions to determine the level of effort required, so that the Agency can budget and plan appropriately for the task, in a sequenced, national roll-out.

OBJECT LOCATION AND BASIC IDENTIFICATION

Where NAPR does not have sufficient information for the basic inventory, the Agency should establish a standardized, simple way of collecting the following information – in electronic form – about all of its “sell” or “hold” real property assets, including those held by SOE's:

- Find GIS location of the main entrance at minimum.
- Establish tentative boundaries with square meters of buildings and clearly related land.
- Take digital pictures of object and surroundings.
- Write basic object descriptions, which might influence value or privatization process (example: plumbing and wiring removed; holes in roof; squatters with potentially valid claims present, evidence of possible environmental damage, such as signs of spilled oil, asbestos or heavy industrial usage).
- Estimate number of years building has been unused based on company director or employee/neighbor statements.
- Establish Object boundaries.

LAYING A FOUNDATION FOR MAPPING AND DATA MANAGEMENT

It is very important to put all this data in a format, which will be supported by GIS mapping. The Agency does not need another long list, with too much information on it. The more the Agency is able to get this information organized using GIS, so that users – both in the GoG and in the private sector – can click on properties one by one, going around the map and find out the information attached to each of these points (including photographs, descriptions, estimated boundaries) – the better. Again, the software platform that the Agency developed with the assistance of EPI could, once used, and if properly coordinated with NAPR, provide the proper data format.

From the start, this needs to be conceived of and organized as a data point mapping exercise, tied to specific parcels. As the Agency collects more information about the various parcels (such as exact cadaster filing information, survey results, appraisals, property estimates, auction dates, minimum prices, etc.), all of this should be captured in a standard format, which can be fed into the GIS framework. The more information which can be shared digitally with the NAPR, the better – with data coming and going from both agencies. This is not just about collecting random pieces of data. It is about putting data into a framework, which will support strategic decision-making and help market players to find what they want promptly.

COMPANY PROPERTY

The artificial distinction “our property” vs. “their property” – for assets of 100% SOE’s – needs to be dropped. Company directors have not been ordered to conduct an inventory of their assets. The Agency should let them all know that an inventory will be required, and tell them specifically what data and documents they should collect, as outlined above.

In order to ensure that a consistent format it is followed, it is probably best for the Agency to coordinate GIS based inventory and photographic documentation. Agency staff may need part-time helpers as reinforcement to let them actively learn and document what real property assets are within companies it owns. Much of this work may be done by students or regional staff, trained to follow a standardized reporting format, and provided with the basic GIS tools, cameras and transport. Geography or cartography students could be especially useful for this task.

The process of photographing and documenting actual company properties can also be used to document possible unapproved leases for later action.

BASIC CLASSES OF REAL PROPERTY

As part of the inventory process, the Agency should break its real property assets into three basic classes:

Nationally administered – This class of property should include properties of large enough scale and potential value to merit national level attention. If properties are already valued, the Agency should pick a reasonable cut off appraisal value, such as GEL 300,000, which it will try to sell through national auctions or direct sales which are managed directly by the National headquarters. If properties are not already valued, the Agency should pick a basic per square meter size, which seems likely to be worthwhile for national level attention. For smaller cities, this could, for instance, perhaps be a minimum 1,000 square meters for offices, 3,000 square meters for a factory or warehouse, minimum 1 ha for land, etc. Adjustments to the formula could be made to Tbilisi or other larger cities as appropriate.

Regionally administered – This class of property should include mid-sized properties, which are still large enough for the Agency to sell itself and keep on its balance sheet, but which

could be adequately handled by Agency regional offices. A value range of GEL 100,000 to GEL 300,000 could perhaps be established for these properties, with comparable square meter amounts. Depending on the strength of the regional office, the Agency can delegate more or less responsibility. This report did not study any Agency regional offices or the regional structure. If they are very small branch offices, regional delegation may not be realistic as an option.

Municipally administered – This class of property should include all smaller real properties, unless the Agency, in its discretion, decides to keep them on its balance sheet and sell them in national or regional sales. Ownership of these properties should then be transferred to municipalities. The Agency should also be able to transfer larger assets to municipalities, at the request of the municipality (further details provided below).

SURVEYING AND REGISTRATION

The problem of surveying and registering properties remains a serious one, which the Agency has not yet begun to attack systemically. As described above, there are substantial concerns about the Agency's current approach of delegating this task – which really is the job of a responsible owner – to potential purchasers and their brokers.

Once the Agency has made real progress on the basic object identification process above, it should be in a much better position to hire surveyors in a series of competitive tenders to get proper cadastral mapping of its parcels, and to work out an umbrella agreement with NAPR about registration.

Instead of having its own real estate surveyed and registered on a one-by-one basis by others with potential conflicts of interest, the Agency should do this job itself by buying the needed surveying services wholesale. Surveyors should be able to give quite good prices for batches of 25 or more parcels, located in reasonable proximity to each other.

It may be possible for the Agency to fund this by offering to pay surveyors for their services out of the sales proceeds of identified objects which the Agency will agree to put up for sale in e-Auction within a set time frame. If this is not possible to do directly, the Agency could perhaps agree to let surveyors put liens on some selected properties, which would then have to be repaid of sales proceeds.

Sooner or later the Agency will have to figure out what it owns, register it properly and pay for the registration. The current process of trying to get buyers to pay for this may well save small upfront cash outlays in exchange for substantial and hidden costs later. Hidden costs could especially arise because the Agency does not receive sufficient funding to manage its property properly, and must depend on parties with conflicts of interest to help it do so.

VALUATION AND PRICING TO SELL

APPRAISAL AND MARKETING – IN GENERAL

The Agency acts as a fiduciary of State owned assets. There has been a history of assets being sold cheaply, and the public is very concerned about possibly corrupt sales. The Agency must be extremely careful not to sell assets for less than their true value, unless, as in negotiated direct sales, substantial benefits in terms of job creation, investment or other more general benefits can be realized as part of the transaction. Finally, there is a risk to the Agency of possible public censure, or even prosecution for individual officials, for selling assets too cheaply. These concerns and risks are real, and must be taken seriously.

At this point in the privatization process, however, when the Agency is left with thousands of buildings, many of quite low to negative value, it is important for the Agency to consider whether its current valuation and pricing approach will clear its inventory in a reasonable

time frame.

The current process appears to present three great potential barriers to the Agency being able to price its remaining assets for quick sale:

1. Except for a few high value properties, the Agency does not actively create market demand for what it has to sell, but instead responds to individual investor enquiries.
2. An individual appraisal is required for every single object of real property sold, regardless of its potential value. Individual appraisals can cost several hundred dollars, for a property worth \$2,000. Appraisers are also currently conducted by only one appraiser.
3. Although the law permits the Agency to use auctions to allow prices to sink, the Agency has made the administrative decision not to allow price sinking auctions, out of fear that these will destroy the market for the properties it wishes to sell.

The issues are closely inter-related, and need to be resolved as a system. The Agency's lack of marketing probably leads to a lack of demand. While the general public vaguely know that the Agency is responsible for most sales, as the shop is both empty and not yet adequately branded or advertised (as discussed below), it seems likely that no one is really watching what they can buy in the Agency shop. As the highest profile sales were typically direct sales managed by the President, this may also lead to public confusion about the Agency's role. Basically, the market is not working, because the Agency is not marketing its goods.

Lack of marketing could also mean that most people are unaware of auctions, do not know how to bid and may well think the process is somehow rigged against them. The current process of auctioning (only after a particular person expresses an interest in a particular object) may well reinforce a public perception that these weakly-advertised auctions are "done deals".

Clearly, some properties will be unattractive, no matter how much they are advertised. For these, even if aggressive marketing would not stimulate demand, it is still worthwhile, especially if it is low-cost, Internet based marketing. It will generate transparency, and provide a documented basis to help justify price lowering or a giveaway.

APPRAISALS

Because the Agency has not made a market for most of its remaining goods, it is forced to rely heavily on appraisals, as a functional replacement for real market-set pricing. While appraisals are clearly needed for higher value properties as a way to give cover to official decision makers, appraisals are always subjective and are an imperfect substitute for active marketing and transparent decision processes. This consultancy did not conduct a detailed review of how the MoESD has hiring appraisers, of what standards appraisers use to reach their recommendations or of what role appraisal reports play in privatization decisions. However, several observations may help the Agency going forward:

1. As before, the Agency should continue to tender for appraisers under the state procurement law. The tenders should explicitly include expected appraisal standards and methodology and expected appraisal formats.
2. It was mentioned that appraisers can limit the Agency's ability to demolish properties which the Agency believe are not worth repairing. It is not clear how appraisers have this power. To limit it, when appraising structures in disrepair, the Agency may wish to provide guidance to ensure that the reasonably likely cost of renovations is

reflected in the appraisal. To do this, the Agency could provide appraisers with standard guidance about the standards of expected completion for various properties. The appraisal should also provide an estimate of market value of the property following renovation in accordance with the standard guidance. If the appraiser finds that the market value when done is less than the “as is” appraisal cost plus the renovation costs, this would then justify a sale for demolition or repair – unless the property is of particular historic importance.

3. As the Agency markets its properties more actively, establishes good baseline data from existing market sources and expands the e-Auction process to provide more tailored solutions, it may wish to consider whether it can use in-house appraisals for lower cost objects as the basis for auction starting prices. See below.

MARKET INFORMATION COLLECTION AND REVIEW

It seems safe to assume that the Agency (including its SOEs) is one of, if not the, largest owners of real property in Georgia. While it does not need to have good market information about the many State buildings, which are on its balance sheet and will not be sold, the Agency does need good market information about the properties it wishes to sell. If the information is reliable enough, it could, for some lower priced objects, be used to set the baseline prices for auction, in lieu of appraisal, especially for municipal level sales (See below). Good market information could also provide the Agency a benchmark against which to test appraisal results for the more valuable properties it will sell.

It is recommended that the Agency carefully research how it might access publicly available market information to give itself a good map of possible market prices where its properties are located.

- Possible sources may include: NAPR database of stated purchase prices (if this stated price is generally considered reasonably close to the actual price paid) and/or
- Asking prices listed in services such as place.ge.

The goal would be to establish rough, per square meter prices for different general classes of structures and different parcels of non-agricultural land attached to Agency owned buildings in various locations.

As part of the process of delegating sales responsibility to municipalities or regions, discussed below, the Agency may wish to consider proposing an analogue to the agricultural land pricing model, extended to buildings. Thus, after the Agency has worked with the NAPR and other sources to get current market information about selected regions, the Agency could provide this baseline data to municipalities. Municipalities could be asked to review the pricing derived from national level data mining, and adjust accordingly using their local knowledge. The more granular the price mapping can be from the national data mining, the better the results will be. More locations, broken down according to more building categories using a standard format will yield more credible baselines.

The goal would be for municipalities to set what they think are fair per square meter auction baseline asking prices in their towns for different property categories. Starting with baseline data would provide local decision makers a rational basis for their initial pricing, while the process would let them adjust for local conditions, and give them a sense of ownership of the process. With luck, the national data driven indicative prices can give good price range information that municipalities can use for benchmarking. The Agency could then put these benchmark prices on-line, as part of its support to local sales and to generate broader

interest.

Unlike in the agricultural sector, these prices would not be the final market prices for the properties. Instead, they would be the initial asking prices (subject to quality adjustments, see below) for properties being auctioned. In auctions with many bidders, the prices would go up. If there are no bidders, the prices would sink in the next auction.

As a reference, the Agency should review a well-known US based service, Zillow <http://www.zillow.com/> to see the power of an aggregated data base. The Zillow “Zestimates” do not reflect any individual special features of properties (good or bad), so they are often quite inaccurate, but as an aggregate pricing tool, they can be very helpful.

PUBLIC DISCLOSURE OF SALES PRICE INFORMATION

Zillow’s accuracy is greatly helped by the fact that real estate sales prices in the U.S. are a matter of public record. While sellers may have an incentive to understate sales prices to decrease their tax burden, buyers will typically want to have actual sales prices reflected to justify bank financing and to use as their tax basis for depreciation (for investment properties) or eventual sale (for all properties). Stating a false amount can be considered fraudulent, and lead to prosecution. The fact that market players can get access to actual sales prices as they are recorded is a tremendous strength of the U.S. real estate market, and helps make pricing brutally accurate.

If Georgian law does not require buyers or sellers to disclose their actual prices paid and make these a matter of public record, it is recommended that the Agency propose this as a potent market reform tool. Putting this in place would directly benefit the Agency by providing it much more reliable baseline figures to justify its auction starting prices. It could also help the transparency and efficiency of the Georgian real estate market in general, by feeding accurate price signals back to the market as soon as they are given.

In the U.S., many local papers typically publish actual sales prices for identified properties, with identified owners on a weekly basis. There, the public policy decision was long ago made that the cost in embarrassment to individual owners is a small price to pay in exchange for accurate market data. If this degree of personal disclosure is politically unacceptable in the Georgian context, some seller and buyer anonymity can be offered by publishing the sales data with names removed, and perhaps only street addresses provided. If this is too much information, sales data could be provided using another metric – such as postal code. Clearly, the less granular the data, the less useful it is for the market, as real estate values are so heavily location dependent.

While NAPR published actual sales data would provide great support to the Agency to justify its initial pricing decisions, as a fallback position, the Agency would be helped by gaining access to this data, even if it is unpublished. Market players will know accurate from inaccurate sales price estimates, and the closer the Agency can get to accuracy, the better.

VALUE ADJUSTMENTS FOR DAMAGED GOODS

Many of the Agency and SOE owned properties are in poor condition. There has been a great deal of vandalism and little maintenance, often for decades. If the Agency uses a standard valuation model, as proposed above, the base price value should be decreased, based on the inventory report and the photographs received. Something like the following adjustment factors may be considered:

- X% for stripped wiring
- X% for hole in roof
- X% for stripped plumbing

- X% for missing windows
- X% per year for each year property vacant, etc.

RECOMMENDATION #7: OPEN THE STORE AND OUTLETS, INCLUDING MUNICIPAL SALES

ONE, EMPTY STORE

Under current Agency practice, regional Agency offices are not used for sales, and there is no process for municipalities to take responsibility for selling anything. From the point of view of the public, this means that there is only one possible store to buy State assets – and that is the Agency central office in Tbilisi.

The Agency's practice is only to put a property up for e-auction, if there has been a specific request from a particular person about the property. This is understandable from an administrative and bureaucratic point of view, given the large number of objects in the Agency's portfolio and the work it takes to prepare for a sale. However, from a sales point of view, it is wholly ineffectual.

When the consultant looked at the e-auction site for the first time, there were only six buildings listed for sale under the "buildings" heading. A later search uncovered only ten buildings, being sold by various agencies (with non translated names). The effectiveness of the e-auction site as a marketing tool is further discussed below. It is understood that this is less than the normal amount, as the new government is waiting to develop its strategy before proceeding aggressively with sales.

However, even at its fullest, the only properties ever put on the e-auction list are ones which are fully ready for sales – *and* ones for which there is already a known, interested buyer. This means that the vast majority of the Agency's available properties are always just sitting in the warehouse, waiting for someone to figure out that the Agency might be responsible for them, to figure out who in the Agency is in charge and figure out how to prod the Government into putting the property up for sale. Seen this way, the process seems far better designed to filter out all but the most persistent and patient potential buyers, than it is to sell properties.

On line, or in person, there is no way for anyone to go to the Agency's store to browse the inventory, and see what might be interesting. That is simply impossible. Other than a few prestige objects, until you know you want it, the Agency will not tell you it owns a property, and then will not put it up for sale. "Hide and go seek" is not a winning sales strategy.

PUTTING GOODS IN THE STORE

It is critical for the Agency to move as many of its goods from the warehouse to the store as possible, as soon as possible.

As soon as the Agency has basic information about its and its companies' immovable assets, this should be put on-line for the general public to review. The estimated asset value should be excluded from the company information, as this is likely to be inaccurate, as should any price information about immovable properties.

This information could be put either on the Agency web site or on the e-auction site. If it is only on the Agency web site, the E-auction site should be changed to include a link to find

this information. This can be presented as “Pre-Auction Properties”, “Preview Properties” or something else that makes clear that they are not yet priced, checked and for sale, but are in the Agency portfolio and can be prepared if there is interest.

For future marketing, the Agency should probably have visitors to the site register with their names, e-mail and physical addresses and whether they are brokers, possible investors or other intermediaries. This will permit the Agency to track what their interests are, and contact them when properties come up for auction. Registration should be free of charge.

All this pre-auction information can be published subject to as many disclaimers as the Agency needs to be comfortable. In particular, the Agency should make clear that immovable properties may not yet have been surveyed or registered, and that they may be subject to conflicting claims. The pre-auction web page should contain a clearly marked place where people who have or may know of conflicting property claims can report them. This will help the Agency identify possible problems and work to resolve them. Unless someone has a claim, which specifically attaches to identified real or moveable property which the Agency wants to sell, it is probably best not to offer a simple way to assert the claim. The point of including this box on the pre-auction site is not to get every unpaid employee to stand up and complain. It is instead to get banks, individual property users, leaseholders or others with real potential conflicting rights against identified objects. Property numbers should be assigned to every pre-auction parcel, and the site set up so that any inquiries received will automatically include the parcel number.

Clearly, this pre-auction information is likely to include many errors. It does not have to be perfect to be useful. Even imperfect information can start to develop market interest in what the Agency has to sell. If it turns out that someone else has a better claim to the property than the Agency, little is lost from putting this information up on line. These will be non-priced, pre-sale showings. The Agency will still retain discretion when and how to sell the properties.

Agency staff members expressed concerns that the Agency could swamp the real estate market by putting too much up for sale at once, and this would force it to sell for distress prices, if it could sell at all. Clearly, markets change constantly. Once the State finally gets a handle on what it owns and lets the public know what it has to sell, this could cause some price decrease in certain markets, if the State is seen as drastically increasing the local supply of property for sale. However, real estate markets tend to be very local and specialized, and it is quite hard to predict the impact of the State becoming a transparent market actor.

It is, presumably, widely known that the State owns thousands of pieces of real estate, which it will eventually sell. People with local market knowledge, such as brokers, bankers and investors are likely to have a fairly good general knowledge of what is in the State's hands. While putting the inventory on line for review might contain some surprises, it seems unlikely to cause major market disruption. If the Agency is concerned about this, it can, of course, put the inventory out in pieces, to test market reaction. The inventory will take time, and the information would presumably be put on line over a period of months, and not all at once.

A similar step-by-step approach will presumably be taken to putting the inventory out for sale. It will be impossible for the Agency to do the sales preparation for all objects at once. Much of the inventory will only be surveyed, registered, given clean title and valued gradually.

The upside potential of having the store filled, rather than empty, seems worth the risk. By

doing a full disclosure of what it owns and plans to sell, the Agency should be able to awake great interest in the sales process. Potential buyers will make themselves known to the Agency. The longer properties are placed on line pre-auction without eliciting any interest, the better the Agency's protection, if it eventually has to sell the object at a low cost or just give it away.

WHAT'S IT WORTH TO YOU?

The Agency may consider including a form to elicit non-binding estimates from the public for what they would pay for the properties in the pre-Auction inventory. As the Agency will not be in a position to sell the properties which are in the inventory right away, it cannot accept binding bids, but collecting this market information could be useful as a way to measure how much people might, at least in principle, be willing to pay for what will be coming on the market. Anonymous estimates should not be permitted, to decrease the possibility of bothersome or irresponsible bidding.

OPENING REGIONAL OUTLETS – HYBRID E-AUCTIONS

The Agency may wish to use its regional offices as sales outlets for regional properties. The degree of delegation to these offices would depend on individual office capacity. As the Agency becomes more active, regional offices can play a role getting out information about what is coming up for sale at a regional level, and work to help municipalities to arrange successful e-Auctions.

Regional offices may also be used to organize “bulk” regional auctions, where a number of mid-priced objects of regional interest will be offered in hybrid e-Auctions, which include a public, in person auction component to awaken interest and competition. In these public/e-Auctions, regional offices could rent a hotel conference room for day, work to get regional press coverage and help bidders who are there in person to participate actively in the e-Auction. The e-Auction would be carried on a screen in real time, projected for all in the conference room to see, and in person bidders would compete with unknown, on-line bidders.

OPENING MUNICIPAL OUTLETS

As described in Basic Classes of Properties, above, it is suggested that the Agency do a basic “triage” of the properties in its portfolio to separate them into national, regional and municipal properties. The basic division could be made according to estimated market value, if available, the square meter amount or another reasonably easy to find and calculate metric. Accordingly, the Agency should transfer ownership of its smallest and least valuable properties to municipal authorities for disposal. Under Georgian law, these properties would then all immediately go onto the balance sheets of the various municipalities, and the profit or losses from their ownership and sale would go to municipal budgets.

Based on the limited information the Agency has about its (and its SOE's) portfolio of real property, it is not possible yet to estimate either the worth or the number of the properties, which should go into the each group. If the total number of properties is in the range of 3,000, with perhaps 2/3 of these being small enough to merit being given to municipalities for sale, this may in the aggregate be important enough for local economies if used properly, to put some thought into how to get them sold and re-used most efficiently. If so, the following ideas may be useful.

The Agency will probably want to work out some profit-sharing agreement with the

municipalities, rather than giving them thousands of properties with nothing in exchange for the Agency. How this is done in a way to motivate both the Agency and municipalities to maximize sales proceeds and speed will need to be researched carefully.

Having municipalities take charge has the advantage of bringing decisions about objects of local interest to the local level. Done properly, it should help develop confidence in the transparency of sales of lower value objects. If the transfers are made in a way which makes it very clear to all local residents what is in the local inventory for sale, this will help create demand for the objects transferred. For properties with a positive value, the prospect of sales revenues should motivate municipalities to act sooner rather than later to organize transfers. Potential sales proceeds, which are too small to be of interest at the national level, can be meaningful enough for municipal budgets to prompt attention. Local officials are likely to be much more aware of possibly conflicting claims on State property, and are in a better position than national officials to tailor acceptable solutions to them.

Municipalities are most damaged by the presence of State-owned nuisance properties. Transferring problem properties to municipalities will place pressure on local governments to deal with them. Now, at a local level, if there is a problem State property, it seems likely that people can only point at Agency headquarters, where there is limited capacity to fix local problem properties.

Local officials would likely feel under much more pressure than national level officials to try to find solutions for problem properties, once they own them. This presents an opportunity to get some real change at a local level, but may burden municipalities with more than they can handle. Some municipalities in weak market areas may already be struggling under the weight of excess property, which they cannot either maintain or sell. In deciding what properties to hand over to municipalities, when and how, if there are in fact (as suspected) quite a few negative value properties in the Agency portfolio, it would be desirable to include a mix of both positive and negative value objects in the package, and make the municipalities responsible for dealing with all of them.

If municipalities have the option to refuse to take title to these properties, it might be worth it to offer the packages of good and bad properties on a “take it or leave it” basis, lest Agency be left holding the worst of the worst. Large and complex negative value properties – such as now-useless large factory buildings or former industrial land, which has suffered serious environmental damage – should remain national-level responsibilities.

While it is understood that the Agency could, under current law, decide just to transfer properties to municipalities en bloc, without direction or support, another approach is recommended.

The integrity of the municipal privatization process could be helped by requiring municipalities to sell transferred properties through the standard e-auction procedure. Many municipalities are likely to have inadequate administrative capacity to handle large numbers of sales. Transparency is also often a question in local sales, especially in smaller areas where people tend to know each other’s business all too well, where the tendency to help friends is great and collusion among bidders is a very active risk. National level training to municipal colleagues in how to use this procedure, and how to prepare properties for privatization could help achieve better results. Consistency could be further helped with a clear, simplified set of procedures, guidelines and standard documents for municipal administrators to use.

Following standard valuation procedures, as described above, could help provide municipal

officials comfort to make sales decisions. National level Internet advertising of available properties in the pre-auction stage, as described above, could help improve demand and make municipal level auctions achieve better results. Guidelines should be provided for required postings in city halls, local post offices or other public buildings. It would be desirable if there were some oversight and reporting mechanism for compliance. Transfers to municipalities of more valuable properties could, for example, be made subject to the municipalities agreeing to conditions on how they will sell them.

For some very low value or nuisance properties, municipalities may wish to conduct simple auctions subject to conditions to ensure that buyers will in fact bring the properties into a usable condition, rather than just buying them to hold for speculation, to the detriment of their neighbors. As discussed in more detail in the Framework Assessment, it is recommended to use restraint in applying conditions to sales, but there are some sales where they may be necessary. Municipalities may want to consider requiring buyers of low value or free property to bring it up some basic standards and start using it within a certain time period, or lose the property and any improvements made.

It probably does not make sense to require compliance with complicated, foreign building codes as part of this. Instead, purchasers should agree to simple list of main repairs, such as fixing the roof, ensuring structural integrity, fixing windows, fixing the façade, installing locking doors and if the property is used for residential, factory or office, installing basic electricity and heating. In the alternative, unless the building should be protected from demolition as an historic structure, purchasers should be given the option of demolishing the building and leaving the site clean. A reasonable time frame, such as three months to demolish or a year to repair, should be allowed. If the property is subject to rules requiring repair (for instance, if it is in an area of historic significance, where failure to maintain can lead to sanctions), the auction conditions should include a reference to this requirement as well.

Some vacant parcels may be only interesting to abutting neighbors. Some distressed cities have “side lot” give away programs, where neighbors can get lots for free, but are required to clean and maintain them. For low value properties, municipalities may wish to keep a minimum price, to help cover at least the cost of the sale, such as the appraisal, if any, title clearing work, advertising, etc.

The Agency may wish to offer some services to municipal recipients of properties, such as advertising, valuation, title clearing or help with contract monitoring. This can be directly provided by Agency staff, or through experts contracted to the Agency. These services could be provided free of charge, or could perhaps be provided on a fee-for-service, cost recovery basis. Cost recovery could make sense especially for services the Agency has to contract or which entail direct expense to the Agency.

While this may be a reasonable approach for smaller or less valuable properties which are likely to be of purely local interest, it is complex enough, that the Agency should first try this transfer on a trial basis to make sure the model is tested before rolling it out nationally. In addition, Agency should provide relevant training to municipal officials how to go about selling the property in order to facilitate the sales.

RECOMMENDATION #8: BUILDING PUBLIC TRUST THROUGH WELL-PACKAGED TRANSPARENCY

As discussed, privatization is always contentious, always under close public scrutiny and often condemned by unrealistic public expectations. At this late stage in the privatization

process, the Agency has the difficult task of selling mostly leftover and less desirable goods, in a way that:

- Maintains public trust in the process;
- Encourages investment;
- Generates sales revenues;
- Encourages maximum competition among potential purchasers; and
- Does not let the “junk sale” nature of the process decrease the sales prices for more attractive objects.

A clear, consistent and deep application of the principle of transparency – presented in a well-conceived public relations and marketing campaign – can go far to achieve these goals. The combination of transparency and “spin” is a potent tool to form public perceptions.

Under the new budget, the Agency also has the task of raising a great deal of money from privatization sales. It seems likely that a majority of the sales proceeds will come from a few prize properties. As discussed above, it is especially important that the highly visible, prize property sales are advertised as well and organized and implemented with as much transparency as possible.

COMPANY VS. REAL ESTATE SALES

As mentioned repeatedly, the Agency has few enterprises, and many parcels of real estate, left to sell. Enterprise sales are far harder to explain to the public than real estate sales, and there is far more room to conceal what it is really going on. If the Agency agrees with the impression that it is far more a real estate property management than a State enterprise management agency, then its public outreach and transparency task is simplified dramatically.

The Agency will, of course, need to deal with its few remaining real SOEs in a responsible and transparent way. It will need to tailor its public outreach message to deal with the particulars of larger SOE share sales or public private partnerships. These are one-off cases, each of which will need its’ own story.

DISCLOSURE OF DIRECT SALE RESULTS

A number of questions have been raised about direct sales completed by the last government. The Framework Assessment noted with regret that the law had been changed to permit the Government to keep confidential information about direct sales results. E-Auction results are easily accessible on line, while direct sales results are wrapped in secrecy. This secrecy feeds public mistrust. One action possibly worth considering, if it does not violate any contractual obligations entered by the former government, would be to publish results of direct sales to date, including investor names and conditions. The Agency might also wish to publish compliance monitoring results.

If this is done, it should be done as much as possible as an across the board measure. Otherwise, it could easily be seen as selective enforcement, and undermine the exact transparency goals the effort should seek to foster.

REAL ESTATE SALES: TELLING THE STORY WITH MAPS AND PICTURES

Unless the real estate sales effort is first wrapped in a clear, consistent story, the large

amount of information which the Agency will put out – and the large number of decisions it must make – can be hard for the public to digest, and hard for the Agency to explain. The story line the Agency presents with the information will help public to see what it has for sale in a context the Agency defines. Transparency will help the public and market to see what the Agency has for sale, and to assess it realistically. If it is possible to present the public with on-line parcel information in a mapping format, this could, as described above, help greatly. The more pictures available for people to review of what is for sale, the better.

Online pictures and maps can be especially helpful for justifying low price sales of less desirable properties. Nothing convinces the public that you have sold a ruin in the middle of nowhere, more than proving the location and the true condition. If these pictures are on line for all to see long before the sale and long after, with the Agency able to track – and demonstrate to others when asked - how many times they were viewed and how many inquiries were made.

As the inventory proceeds and the Agency gets a better sense of what it really has to sell, it may be desirable for the Agency to work to set public expectations about what remains in the inventory. If, as expected, there are many low value assets, the Agency will need to develop and maintain a good standard party line, emphasizing the potential of its properties, but recognizing that after decades of deferred maintenance, new, private investors are needed. This will help justify transferring large numbers of properties to municipalities for free, and will help justify low price sales. Framed correctly, this should also help get potential investors interested in the opportunities the Agency has to offer.

BRANDING AGENCY PRIVATIZATION

Current Agency efforts to develop a recognizable privatization "brand" are commendable. This branding should include a logo, a web site and a name, which sounds good in Georgian, Russian and English. The logo and web site address should appear on all correspondence, publications and business cards related to privatization. If it has not happened already, the brand should be announced with a high profile "kick off" event. It would be useful if this event coincides with the time when a web site, linked to the E-auction site, goes live containing the basic information about hundreds of properties for sale. Of course, before going live, Agency staff should be as prepared as well possible to answer questions from potential investors and provide them with relevant information, so that the moment is not lost.

GETTING OUT THE MESSAGE

On-line ways to get out the message are by far the least expensive and most effective tools to publicize, at least to anyone who is on-line. The new agency seems to be working hard to develop its on-line marketing efforts, and to link them in as well as possible. Social media platforms, such as Facebook, Google+ and LinkedIn should, of course, be used as aggressively as possible.

Clearly, much of the population of Georgia is not yet online. For them, more traditional means of outreach such as press releases, radio spots and local newspapers will be more effective. While the GNIA booklets are of high quality, they are expensive to produce and likely have a very narrow distribution.

Regional Agency offices may want to coordinate their e-auctions with those of municipalities, and perhaps prepare and distribute booklets or flyers on cheap newsprint regionally, with pictures and basic descriptions of properties for sale.

RECOMMENDATION # 9: CONDUCT ACTIVE MARKETING WITH GOOD DEALS FOR LOW VALUE PROPERTIES, FOLLOWING A SALES STRATEGY

As noted already, other than active marketing of a few prestige objects through GNIA, the Agency's marketing of both its SOEs and its properties has not been strong. Currently, at least for real properties, the Agency responds only to specific investor requests.

The Agency is clearly aware of this, and is taking steps to address the problem. Filling the store, as described above, is necessary to start creating a market, but marketing is needed to draw people to look in the store. The Agency also needs a sales strategy to help inform how it will allocate its scarce marketing resources to best advantage.

CUSTOMER RELATIONSHIP MANAGEMENT

If the Agency and MoESD do not yet have any customer relationship management (CRM) software in place, it may be worthwhile considering this purchase. While CRM systems may be expensive and difficult to put in place and maintain, losing information about potentially valuable contacts, or having all the information be held by individuals in the Agency, rather than the Agency itself, can be even more expensive. If the Agency does not have a way of capturing and centralizing investor inquiry information, this should be put in place as soon as possible. At a minimum, on-line inquiries should contain a place for investors to enter their information. If their interest is in a particular object, it should be possible to set up the inquiry form so this is captured automatically. Staff members responsible for being the public "face" of the Agency, and who have contact with investors and multipliers, such as brokers, bankers, appraisers, attorneys or consultants should be provided standard, online contact report forms, to feed into the Agency's contact data base.

For higher-ranking MoESD and Agency officials, these forms may be too time consuming to complete. For them, dedicating a clerical staff member part time to the mundane but very useful task of collecting and scanning business cards, identifying who received them and getting them into a database can yield great results. If the official could just note on the cards what the person was interested in, in some standardized way, this could be coded, captured and returned to the official electronically for download to his or her address book. The contact lists can then, of course, be used for general e-mail blasts, newsletters, invitations, sharing with relevant regional or municipal officials and notices of specific properties coming up for sale which might be of interest.

E-AUCTION WEB SITE

The Agency and MoF may wish to do a joint review of the e-Auction web site to improve its effectiveness for selling Agency properties. While there is the value of having a single window site devoted to sales of all manner of State properties - ranging from land, to licenses, to leftover cell phones, such sites can get quite cluttered and a bit confusing to use. The e-Auction site should be carefully reviewed from the perspective of a possible privatization investor, and changed where it seems flawed. It could be useful for the Agency and MoF to have some focus groups of people unfamiliar with the site to provide feedback.

For example, when the consultant looked on the site for buildings, he missed another 13 possible buildings for sale, as they were under the unexpected heading "Land". Under this heading, buildings were found under the initially invisible sub-heading, "Non-Agricultural Building with Land". This makes one wonder if the heading "Buildings" is only for the sale of

the confusing and difficult category of buildings located on land, which is not for sale with the building. If one was not aware of this issue, (which is far from an obvious one) one might find oneself bidding on a problem, without knowing it.

The Agency is an important enough seller that it might be able to get a corner of the e-Auction web site for its offerings, rather than having them mixed in with everyone else's. If the Agency decides to put its pre-auction offerings on its own web site, separate from the e-Auction, there should certainly be a link on the e-Auction site to this, preferably under some flashing heading like "Sneak Preview of Upcoming Offers."

TRANSLATIONS

To attract international investors, web sites should be translated into English, where possible – with disclaimers that the Georgian version prevails. As translations are only courtesy translations, perfection should not be the goal, and Google-translation may be sufficient, at least for descriptions of individual objects. For individual objects, the point is to give non-Georgian speaking users the ability to search the web site to find objects of possible interest. More accurate translations would be desirable for auction terms or other legally important procedures.

CLEARANCE SALE OFFERS

Almost all businesses use special offers and good deals to attract customers. While the Agency clearly has to honor its fiduciary duty to the public, offering well-advertised and fully transparent special deals for lower value property, as a way to drive business into the Agency's store, could be consistent with this duty. Everyone understands the concept of a "clearance sale". Twenty years into the privatization process, it seems worth the risk to try putting some cheap objects up for sale, explicitly at clearance prices. The German government clearly did this with catalog sales of leftover real estate at the end of their privatization process, selling thousands of objects with the experiment.

CHARGE TO ENTER STORE?

In several discussions with Agency counterparts, they mentioned that they are planning to offer access to information about companies and assets for sale on a fee for service basis. Given the Agency's weakness in marketing so far, transparency issues, the large number of assets to sell and the fact that these assets are not getting any better with time, this approach will likely cause more harm than good. Requiring people to pay to see what is for sale could greatly limit the number of potential inquiries and purchasers. It is especially problematic for smaller, less valuable objects. Instead of holding inadequate shreds of information tightly and selling it to a few intermediaries, the Agency should get adequate information, and distribute it for free to as many people as possible. The market needs to be created for these objects, not choked from the start with entry fees.

The Agency receives 7% of the sales price of assets it sells. If the Agency is seeking to raise funds, a better and less distortive way to raise funds and incentivize Agency staff to make privatization progress would be to sell more, more quickly and more aggressively, offering a bonus pool based on reaching agreed targets.

Once the Agency has firmly established its brand, has generated demand and has its store open, it may make sense to levy charges for special information privileges, such as e-mail alerts, broker information or tender documents for valuable and high-interest properties.

RECOMMENDATION # 10: ADOPT SIMPLIFIED LIQUIDATION PROCEDURES

While the MoESD and Agency have done an excellent job shrinking the overall number of companies through mergers, and should continue to do this, liquidation and bankruptcy rules continue to make it difficult to close the books entirely on emptied shell firms. As it is understood, there are a number of empty shells on the Agency's books, which have entered a legal dead end. They cannot be closed through bankruptcy, because courts now refuse to allow the Agency to bankrupt shells with no assets. And they cannot be closed through liquidation, because their creditors have claims greater than their assets, and liquidation is only permitted when all creditor claims can be settled or satisfied in full. It is not clear how much of a problem these emptied shells cause in the real world. While their existence inflates the Agency's company numbers – at least until they are all merged into one, large empty entity – if they cost nothing to maintain, and pose no practical administrative problems, they may be a non-issue.

If they are an issue, it might be possible for the Agency to merge all of its inactive companies and all companies not worth keeping alive into as little as one, large shell. This could then be stripped of all but a nominal amount of assets, filled with all the liabilities belonging to all the consolidated firms, and taken through bankruptcy. If the process of creating one huge "Junk Company" or "Junkco" is too burdensome, the Agency should aim for a manageable number of empty shells, and take them through bankruptcy one by one.

To do this in an efficient way may require an amendment of the bankruptcy law, to create a one-time exemption to permit mass clearing out of SOE's in an expedited manner. The current practice in bankruptcy courts seems to be to permit the Agency to proceed with bankruptcy of stripped shells, as long as some assets remain in the shells. This appears to be an informal, administrative solution to the problem, rather than established law. It would be desirable for a revision of the bankruptcy law or governing regulations to provide a simple, systemic solution the issue of how many assets must remain in a shell for bankruptcy to proceed. For the Agency, it would be best to have only a symbolic amount of assets be sufficient. To make this solution more palatable, the law should provide that the Agency may only claim this exception for companies in which it is the 100% shareholder.

At least in theory, the Agency's portfolio companies, both shell companies and otherwise, can be subject to a wide range of possible creditor claims or potential liabilities, including:

- State creditor claims
- Employee claims
- Leaseholder or squatter claims
- Supplier or other commercial claims
- Potential environmental liabilities
- Claims in litigation.

Under many countries' laws, moving assets out of a company prior to filing for bankruptcy can be considered a transfer intended to defraud creditors. If this is so under Georgian law, there may, at least in theory, be some doubt about the validity of asset transfers, which leave empty, indebted shells. MoF claims and employee wage claims were discussed in detail, earlier. Other claims seem less worrisome, but they have not been discussed in detail with

Agency counterparts. Like wage arrears, they may also be subject to statutes of limitations, which will lead to their gradual disappearance if they are not anchored with a formal, legal complaint demanding collection. Again, it may take an amendment of the bankruptcy law to permit these asset transfers to be on firm legal ground.

RECOMMENDATION #11: STREAMLINE ADMINISTRATIVE DECISION-MAKING

Under current procedures, all decisions about how to privatize State assets are made at the National level, regardless of the size of the object. When this consultancy project began in December, all sales decisions within the Agency, regardless of size, were made only after being reviewed by one committee of perhaps ten people. While this may have been a useful way for the new First Deputy Minister to understand how his staff prepares objects for sale and thinks about privatization choices, it consumed too much top-management time to be viable as a long-term approach.

We understand that since then, the Agency has developed a three tier internal decision-making structure, to help delegate decisions to more appropriate organizational levels of the organization. The project did not go into detail working on this administrative streamlining with MoESD and Agency counterparts, but this seems like a necessary and positive process.

This report contains a number of suggestions about how to delegate privatization organization and decisions to both the regional and municipal level, based on formulaic assessments of the possible value of assets to be sold. It also recommends systemic solutions to recurring problems rather time consuming individual solutions. These suggestions should also help free national level staff to concentrate on policy, larger problems and larger opportunities.

BOTTLENECK ANALYSIS

The consulting team prepared a “Bottleneck Analysis” tool, which the Agency may wish to use to analyze the various problems it is facing in a structured way. This analysis is included in Appendix E. Applying this tool to various problems the Agency faces may help it to get a clearer handle on what steps need to be taken, and what resources are needed to resolve the issues presented. The general topics covered are Information, People, Money, Rules, Administration, GoG and the Public. For each, a series of questions are presented in tabular format, walking the reader through a series of questions organized according to where the system is blocked in reaching its goals. It is hoped that the Agency will find this useful as a format to build on as it proceeds to clear the path to make progress on its many, important tasks.

E. ADDITIONAL INFORMATION

CONTACTS

People Interviewed at the National Association for State Property Management

1. The First Deputy Minister of the Ministry of Economy and Sustainable Development – Dimitri Kumsishvili
2. Deputy Head of the National Agency for State Property Management (NASPM) – Ekaterine Danelia
3. Head of the Privatization Department of NASPM – Tea Gardnari
4. Specialist at the Privatization Department (NASPM) – Katy Genebashvili
5. Specialist at the Privatization Department (NASPM) – Nino Cholikishvili
6. Specialist at the Privatization Department (NASPM) – Ani Gogelashvili
7. Chief Specialist at the Privatization Department (NASPM) – Giorgi Mikheladze
8. Chief Specialist at the Privatization Department (NASPM) – Zura Mekvabishvili
9. Head of the Monitoring Department of NASPM – Dima Shanidze
10. Chief Specialist at the Monitoring Department (NASPM) – Ana Kurtanidze
11. Chief Specialist at the Monitoring Department (NASPM) – Jumber Shalikashvili
12. Head of the Mobile Group Department of NASPM – Irakli Shengelia
13. Specialist at the Mobile Group Department (NASPM) – Pavle Otashvili
14. Specialist at the Mobile Group Department (NASPM) – Zakro Tsiklauri
15. Head of the Property Management Department of NASPM – Mirian Chachava
16. Head of the Enterprises Management Division of NASPM – David Mikhadze
17. Specialist at the Enterprises Management Division (NASPM) – Maka Samkharadze
18. Specialist at the Enterprises Management Division (NASPM) – Giorgi Zguladze
19. Acting Head of the Property Management Division – Lika Khutsishvili

Other People Interviewed

Ms. Ekatarina Katamadze GEC Development

Dr. Jeffrey Fredericks, Chief of Party, Tetra Tech, Municipal Infrastructure and IDP Housing Rehabilitation Project (GMIP)

Mr. Conrad Graf Hoyos, GFA Consulting Group, Hamburg, Germany

Prof. Dr. Joseph Salukvadze, Head of Human Geography Department, Tbilisi State University

Mr. Sergo Vashkamadze, Colliers, London, England

BOTTLENECK ANALYSIS

Bottleneck Analysis and Removal

<Identify Individual Bottleneck>

Source of Bottleneck	Description ⁷	Resolution: Who, When, How and How Much?
Information	Is the problem due to a lack of information or lack of knowledge sharing? Do you have enough raw data for your decision?	
<i>Baseline</i>	Have you established a good baseline of information for your decision? Where did the information come from? Is the source reliable?	
<i>Collection</i>	Do you need to collect more information? How will the information collection need to take place? How long will it take? How does it need to be organized? Who needs to be involved?	
<i>Format</i>	Do you have a good format to capture the information electronically in a standardized way? Do you need additional software or hardware to support the format?	
<i>Sharing</i>	Can everyone who needs to share the information share it easily in electronic format? Does information need to be made available to the public? Shared with other GOG agencies? Shared with Agency contractors? Should it be free	

⁷ Include in this section a summary of the bottleneck and the issues it presents. This column includes a list of the kinds of questions to ask or issues which may be presented for particular bottlenecks. Not all will be relevant to all bottlenecks, and this does not attempt to cover all possible issues. It is just meant as a template, which will need to be changed for different bottlenecks.

Source of Bottleneck	Description⁷	Resolution: Who, When, How and How Much?
	or sold? If sold, how?	
People	Who in the Agency organization or elsewhere is dealing most directly with the bottleneck? Whose desk is this on? Who needs to get active to resolve it?	
<i>Workload</i>	Given the workload of those responsible, is it realistic to expect them to fix this? Where is it on their priority list? What other work will not get done if this is moved up?	
<i>Agency Staff</i>	Can this bottleneck be resolved by Agency staff, working alone?	
<i>Outside Experts</i>	Do outside experts need to be engaged to help fix the bottleneck? What specific expertise is needed (example: computer programmers, GIS experts, lawyers, accountants, etc)	
<i>Suppliers</i>	Besides outside experts, what suppliers are needed to address this bottleneck? Does the Agency need to buy anything other than people-time to fix this?	
<i>Company Directors</i>	Are the company directors part of the problem? Do they need to be part of the solution?	
<i>Training</i>	Are the people involved properly trained to take care of the problem?	
Money		
<i>Incentives</i>	Are the people involved compensated to make them want to remove the problem? Do they have any advantages	

Source of Bottleneck	Description⁷	Resolution: Who, When, How and How Much?
	from maintaining the bottleneck?	
<i>Liabilities</i>	Does the bottleneck have to do with the level of liabilities in the company or attached to the assets? If so, what are the liabilities? Are they clearly known? Is their legal status firmly established? Are they particular to this entity, or systemic? Who are the main potential creditors?	
<i>Sales price</i>	Does the bottleneck come from how the sales price is set? What aspect of the sales price is the problem?	
<i>Who wins?</i>	Who gains from the current system? Does the bottleneck benefit anyone? Is the benefit specific to one person or group, or distributed? How?	
<i>How much?</i>	What benefits are going to the beneficiary of the bottleneck? Are they measurable? How? Where is the measurement data?	
<i>When?</i>	At what point or points in the process do the benefits flow? How?	
<i>Who loses?</i>	Who loses from the current system? Is the loss specific or distributed?	
<i>How much?</i>	Are the losses measurable? If so, how?	
<i>When?</i>	At what point or points in the process do the losses flow? How? How to measure?	
Rules	Is the bottleneck created or reinforced by a law or rule of general legal application? If so,	

Source of Bottleneck	Description⁷	Resolution: Who, When, How and How Much?
	exactly what law or rule creates the bottleneck?	
<i>Problem?</i>	What exactly is the problem caused by the law or rule? What problem was the rule intended to address? Is the bottleneck an unintended consequence of the rule or law, or is it a basic part of the rule or law in question?	
<i>Level of Legal Change Needed</i>	What level of legal act is causing the bottleneck? Can it be fixed by MOESD action alone without a PM decision? Does it need a PM decision? Or can it only be fixed by a change in law?	
<i>Difficulty of change?</i>	Will the change be difficult to get passed? What “political capital” will the MOESD need to use to get it done? What are the risks of legal challenge? Can the bottleneck be removed “surgically” in a way which only removes the bottleneck, or will removal have wider systemic implications?	
<i>Who has to change what?</i>	If the law or rule is changed, who will have to change what behavior? How will this be implemented administratively? What will its impact be on market actors?	
<i>Easier options?</i>	What is the easiest way to address the bottleneck? What is the lowest governmental level that can take care of it?	
Administration	Is there a bottleneck within the Agency or MOESD, related to how it administers the activity? Can the MOESD or Agency increase its efficiency by	

Source of Bottleneck	Description ⁷	Resolution: Who, When, How and How Much?
	improved administration or delegation?	
<i>Municipal Delegation</i>	Could this bottleneck be eased by delegating some decision making power to municipalities, and removing this from central responsibility?	
<i>Decision Guidelines</i>	Is the bottleneck caused by insufficient guidelines to MOESD or Agency staff decision-makers or outsiders? Are they being slow because they are uncertain? Can simple, formulaic guidelines help speed and improve decisions?	
<i>Internal Delegation</i>	Is the bottleneck caused by problems with internal delegation of decisions? Is there a growing pile of unmade decisions on one desk? What is stopping delegating those decisions? How much discretion should be retained at what level of administration?	
<i>Contracting standards and processes</i>	Is the problem caused by outsiders under contract with the MOESD or Agency to do particular tasks? If so, have the contracting standards and processes, payment terms, expectations and performance goals been reviewed in detail to see if these may be the source of the bottleneck?	
GOG	Is the bottleneck one which the MOESD or agency can only resolve by working with other GOG ministries or agencies?	
<i>Inter-Agency Cooperation</i>	Which other GOG agencies need to cooperate with the MOESD to fix the bottleneck?	

Source of Bottleneck	Description ⁷	Resolution: Who, When, How and How Much?
	<p>What are their incentives to help fix the problem? What good does keeping the problem do them? What level of staff effort would it cost the other agency to help remove the bottleneck? What financial cost? What benefit could they receive?</p>	
<i>PM Action</i>	<p>Is this an issue that can only be resolved by action of the Prime Minister? If so, what exactly does the PM need to do to fix it? What would the PM gain or lose by getting involved?</p>	
Public	<p>Who in the public is affected by this bottleneck or its removal? What will the public reaction be to MOESD or Agency action or continued inaction</p>	
<i>Marketing</i>	<p>Does removing the bottleneck require the Agency or MOESD to market specific objects in a different way than before?</p>	
<i>Media</i>	<p>What kind of media outreach does the MOESD or Agency need to support its efforts to remove the bottleneck? Is it necessary to buy print, radio or TV time for this? What kind of on-line or social media outlets can be used to help?</p>	
<i>Public Opinion</i>	<p>Is the current bottleneck a public issue yet? If not, why not? Will taking action “stir up a hornet’s nest” of public reaction? How many people will be directly affected by removing the bottleneck? Are they vocal and powerful?</p>	
<i>Politics</i>	<p>Does the change have political impacts? Does it represent a major shift from how the</p>	

Source of Bottleneck	Description⁷	Resolution: Who, When, How and How Much?
	previous government did business? Is there a potential for scandal or major political resistance in raising the issue?	
Other	Add anything else relevant to analyzing the bottleneck and how it might best be removed.	

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