by David Blackhall

Vietnam's Solid Real Estate Fundamentals

Economic Stability and New Consumer Trends Are Benefiting Vietnam's Property Fundamentals

The past decade marked a significant turning point for Vietnam and the country's emergence as a global market participant. By 2007, Vietnam, like many emerging markets, had seen an extreme influx of capital from foreign investors. As the global economic crisis started to impact on all nations, Vietnam was not alone in facing the consequences. However, Vietnam's economic rollercoaster during the past two years took a slightly different course than many other Asian nations due to an internally generated crisis that preceded the global financial meltdown by more than six months. The outcome, pleasantly enough, was a smoother ride than most nations experienced through the bumpiest world economy in decades.

In early 2008, Vietnam's economy was overheating, with soaring inflation and a rising trade deficit. Real estate speculation was rampant, with lines of buyers queuing around the block for high-end apartment launches. The government was forced to put the brakes on the economy, resulting in a liquidity crunch in the first quarter of 2008. The result was not pretty for real estate and equities speculators, but by mid-2008 the government's monetary policies had started to reduce inflation, stabilize the economy and remove real estate speculation, seemingly putting Vietnam back on track. By the time Lehman Bros. collapsed in October 2008, Vietnam was unwittingly already well-braced for the economic crisis about to take hold of the world. As the global downturn spiraled through the end of 2008 and into 2009, given the early policy controls already in place, Vietnam was able to turn the corner quickly and move back onto a path of prosperity.

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In fact, Vietnam was the only ASEAN country to see GDP growth rise in each quarter of 2009, ending the year with 5.3 percent GDP growth — one of the highest rates in Asia. Early 2010 shows promise as well. Foreign direct investment (FDI) during the first two months of 2010 is up, by 15.4 percent year-on-year, to US$2.1 billion, and many analysts have predicted FDI to return to pre-crisis levels by the end of 2010. And, despite the slowdown in exports due to reduced demand in foreign countries, industrial production in the first two months of 2010 rose 13.6 percent year-on-year to reach US$6.1 billion.

REAL ESTATE INVESTMENT FUNDAMENTALS

With such a rapid recovery, Vietnam's economic performance has started to attract the attention of overseas real estate investors. While investors arriving in Asia predominantly look first to China for opportunities, Vietnam offers compelling overall fundamentals with less risk of a bubble emerging as substantial growth and development of the urban environment continues. Vietnam offers a broad resource base, favorable demographics, low labor costs and a central location in Asia. Two-thirds of the population is below the age of 35, with a population growth rate of 3.4 percent per year. Vietnam has 26 million urban dwellers in 2010 (30 percent of a total population of 86 million); by 2020, the country will need to provide housing, retail, entertainment amenities and office space for 45 million urban dwellers (45 percent of the estimated total population of 100 million).

Vietnam's cities are low-rise and overcrowded, with outdated electricity, water and drainage services the norm. In short, a complete transformation of Vietnam's urban environment remains in its early stages. Market yields for property owners are high compared to regional countries. The challenge for foreign investors is to navigate a complex terrain of business networks and legal frameworks that remain opaque.

FOREIGN INVESTMENT BASICS

For investors new to Vietnam, recognizing some of the basics is important. There are no REITs in Vietnam, and listed real estate equities are either small-cap or, if larger, are often part of diversified conglomerates that may not interest overseas institutional real estate investors. There are, however, numerous other routes to invest in Vietnam's real estate sector. Overseas investors are usually best served by partnering with an experienced real estate developer that has in-depth exposure to Vietnam. A team with a strong network, local expertise and a deep understanding of the legal terrain is the key to overcoming Vietnam's complex regulatory environment. Possible investment structures include:

- Business co-operation contracts
- Joint ventures with Vietnamese partners
- 100 percent FDI structures
- Co-investment into existing joint ventures and 100 percent FDI structures
- Overseas listed and unlisted real estate funds/companies

Land leases from the state or other organizations holding a land-use right can be issued to foreign investors for a maximum of 50 to 70 years (Decree 84/ND-CP) for real estate projects. Generally, a land lease is obtained through a native Vietnamese partner that contributes its right to use the land as part of its capital contribution to the joint venture. However, it also is the case that 100 percent foreign-owned entities can obtain investment licenses and land use rights for real estate development. More recently, effective from 1 January, foreigners can own a majority stake in a Vietnamese real estate joint stock company.

Of further note, residential foreign developers are now also permitted to participate in land auctions. Foreigners and overseas Vietnamese are allowed to buy apartments and houses for personal use in Vietnam, although as these purchases are limited to 50-year leaseholds, few have explored this market to date. As the second-home market emerges in Vietnam, even luxury resort housing developments are attracting mostly local buyers.

CURRENT MARKET OPPORTUNITIES

The main challenges for Vietnam in 2010 will be maintaining moderate inflation rates and controlling the trade balance. Pressure on the currency resulted in two devaluations between November 2009 and February 2010, resulting in depreciation against the U.S. dollar of more than 8 percent. Exports have improved as a result, and there is increasing evidence of economic stability. FDI is rising, and the domestic economy is healthy, with retail consumer sales maintaining consistent growth of about 20 percent year-on-year.

The residential real estate market is the sector gaining the most headlines, and with good reason, as the second-home market has emerged for higher-end residential resort properties. Additionally, a new mortgage business recently launched by the banks in Vietnam will facilitate further investment in projects focused on first home, low- and mid-range consumers (previously an area with very low margins). Demand for low- and medium-end projects in 2010 is expected to increase fourfold against 2008.

In Vietnam's largest city, Ho Chi Minh City, CB Richard Ellis' fourth quarter 2009 research update states that 60,000 housing units are expected to be completed by 2012, which remains far below expected demand of more than 110,000 units. By 2020, CB Richard Ellis estimates almost half a million new homes will be needed. In this environment, where demand is far outreaching supply, developers looking to bring affordable, good-quality modern housing to the market are increasing as there is great reward potential at hand.

The retail market also is an area seeing significant activity, as there is a very low supply base of modern shopping space in major cities — less than 800,000 square meters in Hanoi and Ho Chi Minh City. Vietnam rated sixth on A.T. Kearney's 2009 list of the world's top emerging market retail markets. There are many new developments on the drawing board, but large foreign hypermarket and supermarket chains are still actively pursuing opportunities. Sites with the right blend of size, location and cost are very hard to secure, and this has kept the pace of foreign investment in this sector relatively slow to date.

The hospitality sector was inevitably hit by the global economic slowdown. Hotel occupancy

Average Real Estate Yields in Asia Pacific Markets

	Class A Office (%)*	Retail (%)*	Residential (%)*	Industrial (%)*
Bangkok	3.5–4.5	6.5–7.5	4.0–4.5	8.0–9.0
Beijing	7.0–8.0	8.0–9.0	4.0–6.0	9.0–10.0
Chengdu	10.6	6.7	7.8	N/A
Guangzhou	6.3–7.8	6.0–8.0	2.4–4.6	N/A
Ho Chi Minh City	**12.5**	**12.5**	**11.5**	**14.0**
Hong Kong	3.1	4.2	3.0	6.8
Jakarta	8.1	4.4	10.0	8.0
Kuala Lumpur	6.3–6.8	7.0–7.9	6.0–7.7	N/A
Manila	7.0–10.0	N/A	7.0–10.0	N/A
Mumbai	13.0–15.0	14.0–16.0	3.5–5.0	N/A
New Delhi	10.0–12.0	10.0–12.0	2.5–3.0	11.0–13.0
Seoul	7.0–8.5	6.0–7.0	1.0–1.5	8.0–9.0
Singapore	4.8	6.1	2.7	5.3
Shanghai	8.0–10.0	10.0–12.0	8.0–10.0	8.0–10.0
Sydney	7.7	N/A	N/A	8.5
Taipei	3.8–4.5	4.0–5.0	N/A	4.0–5.0
Tokyo	3.5–4.0	3.5–4.0	5.5–6.5	5.3–5.8

** Data as of 30 June 2009*
Sources: CB Richard Ellis, Colliers International

and average daily rates dropped significantly in 2009 as tourist travel to Vietnam was down 20 percent for the year. The market is not expected to fully recover in 2010; however, the long-term potential remains strong with tourist visits expected to top 5 million by 2013. Domestic travel also is increasing rapidly as more budget airlines enter the market. Currently, three- to four-star business hotels in city centers are attracting the most attention from international investors.

The sector hardest hit by recent macroeconomic trends is the office market, where a significant increase in supply coincided with the global economic crisis. Vacancy across all office grades was 14.5 percent in Ho Chi Minh City at the end of 2009. Class A office buildings in Ho Chi Minh City have seen rents fall from more than US$60 per square meter in early 2008 to around US$35 per square meter currently. With a further 350,000 square meters of supply expected during 2010, rents are expected to soften an additional 10 percent to 15 percent.

ISSUES TO CONSIDER

Despite the merits of Vietnam's developing real estate market, there are many issues to consider. Investors should look carefully at the sector exposures and overall context of any investment platform. Investors also must pay great attention to the ability of the investment team to promptly and effectively manage the many issues specific to investing in real estate in Vietnam.

For instance, Vietnam's legal system and regulatory framework are fast developing, but weak by international standards. There is a resulting lack of transparency in many areas, such as land resettlement, which can take two to three years depending on the scale and location of the development. Urban infrastructure in Vietnam is poor, and the pace of development is slow, so real estate developers should carefully consider the impact of transport and other types of infrastructure on their projects.

Vietnam's government during the past two years has demonstrated an admirable ability to manage the economy and maintain a path of stable economic growth. The extreme speculation of 2006 and 2007 has been removed from the real estate market and is not likely to return in the foreseeable future. Going forward, investors and developers who are able to recognize issues early on and successfully negotiate Vietnam's challenges will be rewarded by a market eager for a complete transformation of its built environment. ❖

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