# Vietnam Real Estate Roundup 2016

For much of the past two years, Vietnam's real estate market has been among the most visible signs of the economy's expansion. Residential property sales have been robust, construction of condominiums and office towers are underway in the major cities, and industrial parks are rising on their outskirts. It does indeed appear that real estate has recovered from the bubble that burst in 2008. The sector is fundamentally stronger thanks to the numerous reforms enacted over the past few years, and 2015 saw a remarkable level of activity particularly in the residential sector.

2016 is shaping up to be a good year for property – but in different ways than 2015

While 2016 has seen solid growth, the year is shaping up somewhat differently than 2015. Nevertheless, we believe the property market continues to hold value, though it may be more difficult to uncover, and certain segments bear monitoring. Following are the key trends we are seeing in the property market today and into next year, and how VinaCapital is strategically responding to these trends.

**Commercial heats up**

A number of trophy operating assets sold

After two years with little activity – due largely to extremely high asking prices from sellers and little room for negotiation – the first half of 2016 has been notable for the flurry of commercial property transactions. In operating assets, the deal flow has been robust, including high profile sales such as Keangnam Tower Hanoi, Vietnam's tallest skyscraper, and Kumho Plaza, a mixed used property located in Ho Chi Minh City's (HCMC) District 1.

*Landmark Operating Asset Sales 2016*

| Property | Description | Seller/Buyer | 100% Enterprise Value* | Indicative Yield |
|---|---|---|---|---|
| IRT Danang | Mixed use (Grade A office and retail) in CBD | Crescent Point (HK)/Kajima (Japan) | USD17 m | 8.3-8.8% |
| Mixed used property, HCMC | Office component of mixed use building including a hotel in prime District 1 | Tien Phuoc/ Mitsubishi Estates *(pending)* | USD41-43 m | 7.5-7.8% |
| A&B Tower, HCMC | Grade A office in District 1 | A&B Corporation/ Fujita (Singapore) | USD68 m | 8.4-8.7% |
| Keangnam Tower Hanoi | Mixed use w/ serviced apts, hotel, office, retail | Bankruptcy Court of Korea /AON Building (Korea) | USD382.5 m | 6.2-6.8% |
| Kumho Plaza, HCMC | Mixed use, with Grade A office, hotel, retail and service apts in District 1 | Kumho (Korea)/ Mapletree (Singapore) | USD385 m | 8.7-9.0% |

* Total value of equity + debt. Source: VinaCapital research

With Grade A office space in HCMC continuing to be in demand and limited new supply available in the near term (just 95,000 sqm is under development through 2018; Grade A and B space currently totals approximately 900,000 sqm), operating assets have been some of top performers in the property market.

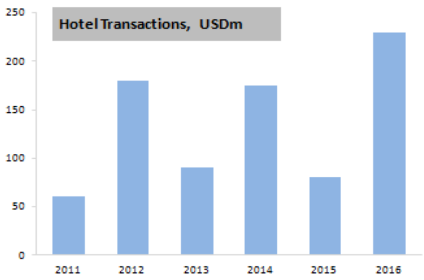
Limited supply, strong demand for Grade A offices in HCMC, less in Hanoi

Vacancies in Grade A buildings in HCMC have remained relatively stable at about 9% according to Cushman & Wakefield, and rents have increased an average of 4% to USD37.7 per sqm per month[i]. Demand is coming from multinational companies looking to establish or expand their presence in Vietnam as well as from a growing number of Vietnamese firms looking to upgrade their space. Meanwhile, in Hanoi the Grade A office vacancy rate stood at 26%[ii] and rents have seen a 6.3% decline to USD23.1 per sqm per month[iii].

With land in the central business districts (CBD) expensive and infrastructure struggling to keep pace, office decentralization has taken hold. In Hanoi, nearly 300,000 sqm of new office space will be built in the western part of the city around My Dinh, deemed the new CBD; a Japanese car maker is said to be looking for more than 15,000 sqm of Grade A space in that part of town. Likewise, in HCMC, a number of projects are being developed in the new CBD of Thu Thiem, the 657ha greenfield site located across the Saigon River from District 1. An additional four Grade A office buildings are under construction in District 7's Phu My Hung, joining several completed buildings housing the offices of a number of multinationals including Unilever.

**Tourist arrivals rise, and so do hospitality transactions**

Vietnam is finally appearing on the itineraries of more travelers. A number of international publications have highlighted the country's scenery and value, HCMC's energy and Hanoi's charm. *The New York Times* even named Dalat to its "Top 52 Places to Go" list earlier this year. The government is also starting to see the potential of tourism and is taking steps to make it easier to travel here through relaxed visa regulations and greater investment in marketing.



*Source: CBRE Research, Q2 2016. Transactions include hotel deals above US$10 million*

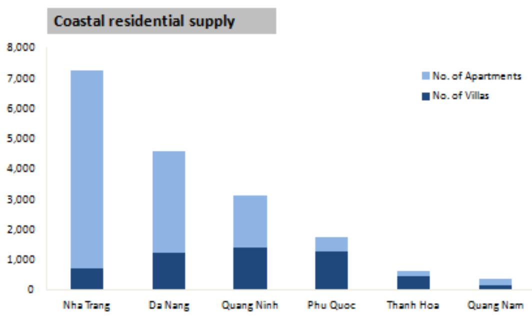
Sales of operating hotels have surged after little activity in 2015

Although it still lags its neighbors like Thailand, Vietnam has seen a steady increase in the number of tourist arrivals during the first seven months of 2016, reaching nearly 6.5 million visitors, a 25.4% increase on a year-on-year basis. This has been great news for the hospitality industry, with CBRE Vietnam reporting June occupancy rates of 65% and 75% for HCMC and Hanoi, respectively, the latter marking a five-year high.[iv] For comparison, the average occupancy rate in Bangkok was 75%, Singapore 83%, Kuala Lumpur 62% and Jakarta 49%; the average daily rate for HCMC and Hanoi exceed those of all of those cities except for Singapore[v]. The property firm foresees strong growth in the five-star and resort hotel segment, and already new hotels are under construction across the country, particularly coastal areas. Some of the largest international hoteliers such as Starwood, Marriott, and Hyatt have established presences in the country, particularly in Danang and Phu Quoc.

The segment's growth has also led to several transactions involving operating properties, with the sales of the luxurious Nam Hai Resort in Hoi An for USD63 million (USD630,000 per key), the Con Dao Six Senses for USD18 million (USD327,300 per key), and the Duxton Hotel Saigon, a four-star hotel in central HCMC for USD49 million (USD256,500 per key) among the more notable deals.[vi]

Second homes near the sea are popular, but are some local developers offering deals too good to be true?

Additionally, the surge of interest in Vietnam as a choice destination has led to a spate of second home projects in the coastal areas including Danang, Nha Trang and Phu Quoc, which have seen significant sales. The beautiful settings and increasing ease of travel have made these spots, particularly Danang, the focus for condo-tel (condos which are rented out as hotel rooms) projects. Some local developers of these projects are offering buyers a guaranteed rent return ranging from 5-10% for 5-10 years. In Phu Quoc, new villa projects launched by large local developers are offering an 8-10% rent guarantee for 8-10 years, which have proven highly popular with buyers from Hanoi. While foreign developers also offer rent guarantees, the terms tend to be less generous.



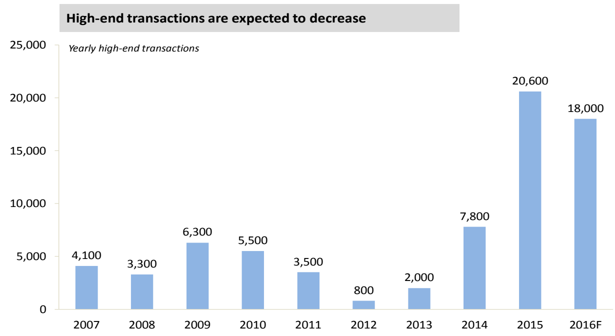
*Source: Savills research*

The future for hospitality looks bright. But as more international operators enter the market, local hotel brands will have to step up their game if they want to compete.

## High-end condos cool off, with some exceptions

High-end condo sales may have peaked as competition, supply continue to grow

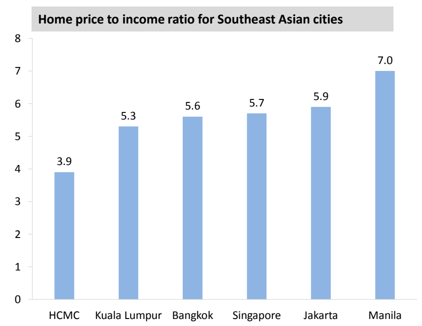
The residential property market – and the high-end condominium sector in particular – has captured most of the attention when it comes to real estate in Vietnam, as massive projects rise across Hanoi and HCMC. In 2014, 7,530 condos were sold in HCMC, according to CBRE Vietnam. At the start of 2015, roughly 21,000 unsold units were on the market, while a number of new projects launched, putting even more inventory up for sale. But by mid-2015, the appetite for condos seemed insatiable, and buyers eagerly snapped up 20,600 available properties. In 2016 to date, absorption rates have continued to be positive, although CBRE expects that the third quarter will see a decline from the second quarter. According to CIMB, overall property transaction volume was down by 13% although value was up 26% in the first six months of 2016.[vii]




*Source: VietCapital Securities, CBRE*

This is no surprise, as competition has intensified in 2016, with more players in the market and a higher supply of high-end units. This year, an enormous amount of inventory is expected to come onto the market, with 45,000 units in HCMC – more than the total sold in the city over the past three years – and 12,000 units in Hanoi set to launch. At the end of the second quarter, unsold property in Hanoi and HCMC totaled nearly USD556 million[viii]. According to CBRE Vietnam, the majority of high-end condo buyers tend to be investors looking to rent out their units (rental yields have been stable at about 5.7%[ix]) or speculators. The question is how many such buyers exist, given their strong purchasing over the past year, with most of the developments yet to be delivered. This end of the market may well have reached its capacity. Indeed two analysts recently used the term "inflection point" to characterize the current environment; growth is likely to continue, albeit at a slower pace. Jones Lang LaSalle expects overall apartment prices to rise 5-7% per year over the next three years, a slight slowdown from the 9% they have seen in the past 18 months, and a far cry from the 106% in 2005-2007[x].

Home prices in HCMC are still affordable compared to regional peers




*Source: JLL*

| Apartment Type | Q2 2016 price USD psm | Y-o-Y change | Apartment price USD | Home price to income ratio |
|---|---|---|---|---|
| Affordable | 827 | 7.9% | 62,025 | 3.9 |
| Mid-end | 1,414 | 4.6% | 106,050 | 6.6 |
| Premium | 2,192 | 8.7% | | |
| Luxury | 3,925 | -3.1% | | |

*Source: JLL*

Many of the more recent high-end launches have been in mega projects, ranging from 3,000 to 11,000 units. While these offer prime locations and a full range of amenities, these come at a cost, and there are signs that projects of this scale are losing their allure among buyers. A large local developer has been rumored to have had some difficulty in selling units in a new project centrally located in HCMC's District 1. With increasing prices, it is understandable that buyers at this level are looking for properties that feel more exclusive. Novaland, a local developer in which VinaCapital has an interest, has made a name for itself for building more manageably-sized projects throughout HCMC at rates that are more affordable compared to other projects, and sales have continued to grow.

Where there remains strong demand is the affordable condo segment. While not as alluring as luxury, the sheer demand for these properties makes this the next growth segment of the market, particularly as incomes rise and urbanization accelerates. Local developers are building more for this market, and its potential is even starting to attract foreign developers, even with lower margins.

**Landed properties increasingly popular**

Detached and semi-detached homes are steadily increasing in demand as mega condo projects lose favor

| Project | Developer | Sales |
|---|---|---|
| Palm Residences | Keppel Land | 135/135 |
| Nine South Estates | VinaCapital | 373/381 |
| Lakeview City | Novaland | 570/964 |
| Venica | Khang Dien | 19/43 |

*Source: VinaCapital research*

If mega projects are losing favor, landed properties such as villas and townhouses, are seeing steadily rising numbers of buyers. Offering larger homes and international designs, landed properties have seen increasing absorption rates. Developments from local developers Novaland and Khang Dien House (another VinaCapital portfolio company) have seen good sales within a short time after launch, given their affordable prices. Singaporean company Keppel Land's Palm Residences sold out two months after launch. VinaCapital has almost sold out of homes at its Nine South Estates development in the new Saigon South area adjacent to District 7. While these developments tend to be a little further from the CBD, they offer attractive landscaping, amenities such as pools and clubhouses as well as a greater sense of privacy. We expect to see a number of new such projects in the mid-term, although the availability of prime land, such as clean riverfront sites, is becoming increasingly scarce.

Nine South Estates, a VinaCapital development in Saigon South

**Are foreigners actually buying homes?**

Vietnam compares favorably to Thailand and Indonesia when it comes to laws about foreign property ownership

Since the change in the Housing Law in July 2015, the market has seen a pickup in the number of foreigners buying properties, despite continued ambiguity around visas, the transfer of money in and out of the country, and receipt of the "pink book" ownership certificate. Foreigners are limited to owning a certain percentage of units in each building, but to date, just one new luxury development in HCMC's District 2 reached the 30% limit. Accurate statistics are hard to come by, but the HCMC Real Estate Association estimated that 700 foreigners bought high-end property in the city from 1 July 2015 to the end of Q1 2016[xi]. To put that in perspective, there were just 200 home sales to foreigners in the *five years* preceding that period. Thus far, foreign buyers seem to be more interested in second and third homes on the coast as opposed to 1-2 bedroom condos in the cities, which they would inhabit or rent out. We expect foreign sales will continue to rise as Vietnam gains prominence economically and as a holiday destination. It continues to offer good value and the foreign ownership laws, even with some of their ambiguities, compare favorably to neighboring countries like Thailand and Indonesia.

## Foreign investors flocking to Vietnam

Singapore's Keppel Land is betting big on Vietnam's property market

Until very recently, few established foreign real estate developers were willing to try their luck in Vietnam's notoriously difficult property market. Singapore's Keppel Land and CapitaLand were among the handful to make a bet on the property market's resurgence, with high-end condo projects in HCMC's District 2. By all accounts, those bets have paid off handsomely: those two projects sold out quickly and have been well-managed, and both companies are developing two additional residential projects there – both of which have also seen robust sales – as well as other projects. By all accounts, Keppel has made Vietnam one of its key focus markets. It is expanding Saigon Centre, a Grade A office and retail project located in the CBD. The company has also agreed to purchase a 40% stake in the Empire City project, located in HCMC's new CBD of Thu Thiem, where construction on a number of projects has finally gotten underway after years of delays. The company will spend USD1.2 billion to build a mixed-use complex which is to include an 86-storey tower.[xii] Its other major portfolio projects in Vietnam include Saigon Sport City, a residential development with 3,900 condos and landed homes; Palm City in HCMC's District 2, featuring 6,170 condos and landed homes; and Dong Nai Waterfront, with 7,850 condos and landed homes.

After more than a decade of delays, development of Thu Thiem is finally under way

The Singaporean companies now have greater competition, however, as other developers enter the market. Indeed, of Vietnam's robust foreign direct investment, property ranked second (after manufacturing) in the first six months of the year, accounting for 8.5% of registered capital.[xiii] Japanese companies have entered the fray, with Mitsubishi joining with local conglomerate Bitexco to develop an 8,700 unit middle-class housing project in Hanoi[xiv], while Creed Group is contributing to a mixed used development in HCMC's District 7.[xv] Korea's Lotte has also stepped up its property investment in Vietnam with its USD2.2 billion Eco Smart City project, also in Thu Thiem, in partnership with several Japanese companies.[xvi] Once completed, that development will join Lotte's portfolio which includes Lotte Center Hanoi – Vietnam's second tallest building – as well as hotels and an expanding retail presence. Some of the major property agents have also reported substantial interest from foreign funds for industrial lease-back plays around HCMC, an indication that foreign interest in Vietnam's property market extends to all sectors. Whatever concerns foreign companies might once have had about investing in Vietnam's property sector seem to have abated.

## Retail sales steadily rising, but not all locations benefitting

Local and foreign retailers have ambitious expansion plans as overall retail sales continue to climb

As incomes have risen, so too have retail sales, which rose 9.4% in nominal terms during the first seven months of 2016. The industry has seen a huge amount of M&A over the past 12 months, with Thai companies purchasing the Vietnam operations of Metro and Big C. Korea's Lotte and Japan's Aeon also continue to expand their retail networks in the country. Local retailers are not standing still, however, with real estate developer Vingroup rapidly accelerating the growth of its convenience and electronics store brands, and Mobile World launching its small-format supermarket concept.

Source: The Economist Intelligence Unit

From a property perspective, this has brought about a number of changes, most visibly in the shopping center segment, which has seen mixed results. Shopping centers have been rising in all of the major cities, with Vingroup in particular opening several locations (it plans to open 440 shopping centers by end of 2019[xvii]). Keppel just opened the doors of its expanded Saigon Centre in the heart of District 1, with famed Japanese department store Takashimaya its anchor (a source of local pride as the store opened a branch in Vietnam before Thailand), and a full range of food and beverage options. Given its international design and construction standards and prime location, it is little surprise that the shopping center was fully committed six months before opening, and thus far, seems to be attracting a high level of foot traffic.

The same cannot necessarily be said for other western-style shopping centers. Those located outside of prime areas in the cities or in the suburbs still have significant vacancies. Meanwhile earlier this year, Parkson, a Malaysian retailer which has operated in Vietnam for several years, closed its store in HCMC's District 7, following the closure of its store in Hanoi last year, leaving just a handful of locations. During the first quarter of this year, the company said its retail sales had plummeted more than 14% on a year-to-year basis.

Western-style shopping centers have not yet found the right formula – with some exceptions

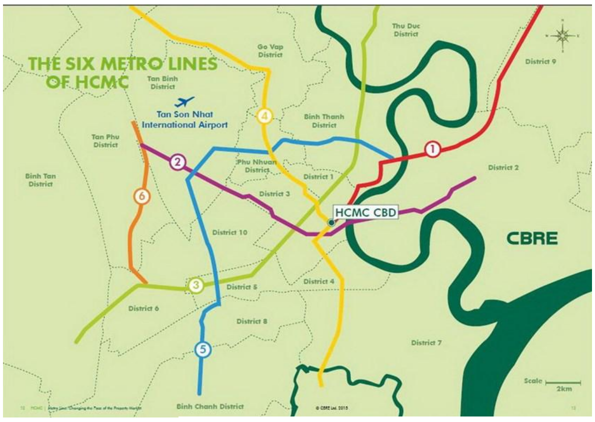
Given Vietnamese people's passion for shopping, why is this happening? As we outlined in greater detail last year, a few factors are at play. First, western-style malls are perceived as expensive. Second, the old habit of shopping at wet markets and local mom-and-pop shops has been hard to break. Third, some of the new shopping centers have been poorly designed and lack an alluring retail mix. Additionally, some landlords have been more focused on short-term profit, charging tenants very high rents for shorter periods of time, creating significant pressure on smaller, local retailers in particular and ultimately contributing to a large number of store vacancies. The most successful tenants today are food & beverage operators – whose margins tend to be slim and rely on foot traffic – and centers currently being designed designate up to 65% of net leasing area to F&B and entertainment.

New fashion and food brands continue to enter Vietnam, with Zara set to open in HCMC during the fourth quarter and Uniqlo to follow at some point next year. Demand will continue to be ripe for prime locations in HCMC's District 1 in the foreseeable future. However, we expect that retail rents in outlying areas will remain flat over the next few years.

**Infrastructure's growing importance in HCMC**

New roads and rails cannot come fast enough as 3% per year urbanization swells the populations of Hanoi, HCMC

"Build it and they will come" has long been the mantra of property developers in Vietnam, with projects developed with little regard to good access to highways. In some cases, developers would commit to modernizing or expanding an adjacent roadway as part of their applications for government approval. While this practice still occurs, the fact is the government has committed substantial attention and capital to improve and expand infrastructure. Most visible is the construction of metro systems in both Hanoi and HCMC, the first lines of which are expected to be operational by 2018 and 2020, respectively. Although HCMC's subway is still years away from opening to the public, it has already spurred development along its first line (there are six lines planned) in Districts 1, 2 and Binh Thanh. In District 2 in particular, a number of high-end condominium projects are under construction adjacent to the line, and sales have been robust: in 2012, there were 329 condo sales in the district; in 2014, the year construction on the line started, condo sales hit 3,710, according to CBRE.[xviii]



*Source: CBRE Vietnam*

Surface roads and highways are also being built. Ring roads are under construction or in final planning stages that will link some of HCMC's more distant districts, such as Thu Duc, Nha Be and Dong Nai. When completed, these roads will in some cases reduce by half the drive time into the central business district – certainly a selling point for the many developers increasingly building in these areas.

**Conclusions**

A multi-asset approach has allowed us to participate in property's growth across segments

VinaCapital's multi-asset approach has enabled us to participate in the property market's recent success in several ways. We have equity stakes in some of the leading developers, as well as in companies benefitting from the sector's growth such as construction and materials. Our direct developments such as Nine South Estates, Ocean Suites, Dai Phuoc Lotus and Azura have seen strong interest from both potential and actual buyers. Our hospitality holding in Hanoi, the Sofitel Metropole, is consistently ranked as one of the top hotels in Southeast Asia. Meanwhile, the current market environment has enabled VinaLand to make significant progress in its realization strategy and focus on the developments that offer the greatest potential returns.

We remain encouraged by the property market's direction, but as always are closely monitoring trends

The most common question asked about Vietnam's property market is whether another bubble is forming – always an issue in high- and fast-growth markets. Clearly the high-end condo market as a whole has reached a saturation point, although select new projects might do well. How many buyers of such properties can exist? Further, the high number of speculative buyers of such units is cause for concern. The government seems to recognize the potential oversupply of high-end condos, with the Ministry of Construction and State Bank of Vietnam recently recommending that banks control lending to such projects.

In the near term, however, the property market is generally on solid footing. Residential sales, while slower than last year, continue to be solid. Although Vietnam's mortgage industry is still in its infancy, the numbers of home buyers taking loans is slowly rising. Banks would be well advised to further develop this part of the industry which, if done properly, would benefit consumers, developers and banks alike. Additionally, we believe that housing developers should consider shifting toward mid-range projects; the demand is there, and will only increase as urbanization accelerates. Commercial property is strong, and buying for operating yield is at its highest level ever, trends we see continuing in the short term given the lack of supply. All in all, we remain generally encouraged by the direction of Vietnam's real estate market.

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[i] CBRE Q1 2016 Market Insights
[ii] Cushman & Wakefield Q1 Office Snapshot
[iii] CBRE Q1 2016 Hanoi Market Insights
[iv] "Hanoi's hotel occupancy rate hits five-year high," *VN Express*, August 24, 2016
[v] "Room remains for growth in luxury hotel segment," *Vietnam Investment Review*, August 26, 2016
[vi] VinaCapital estimates
[vii] "Property market reaches an inflection point," CIMB/VNDirect, July 12, 2016
[viii] "Ghost month hampers real estate sales," *Business Times*, August 18, 2016
[ix] "Ho Chi Minh City trip report: The opportunity lies in building homes," JLL, August 2016
[x] Ibid.
[xi] "Foreigners buy houses in Vietnam as green light turns on," *Vietnam Net Bridge*, June 20, 2016
[xii] "Foreign capital keeps flowing to property sector," *Vietnam Net Bridge*, August 4, 2016
[xiii] Ibid.
[xiv] "Japan's Mitsubishi bets on Vietnam's real estate market," *Thanh Nien News*, July 27, 2016
[xv] "Foreign capital keeps flowing to property sector," *Vietnam Net Bridge*, August 4, 2016
[xvi] "$2.2 billion Thu Thiem Eco Smart City project to kick off in July," *Vietnam Investment Review*, April 18, 2016
[xvii] "Retail competition intensifies in Vietnam," *Financial Times*, August 15, 2016
[xviii] "The untapped Gold of Saigon: Property investment opportunities for Singapore investors," *Singapore Business Review*, August 22, 2016

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