7 September 2020

By Michael Kokalari, CFA
Chief Economist

Huyen Tran
Research Manager

Vietnam's Resilient Real Estate Market

Vietnam's real estate market has remained resilient in 2020, despite COVID-19:

- **Residential**: The total number of new apartments sold in Ho Chi Minh City and Hanoi is likely to drop by about 40% this year due to COVID (as well as due to certain legal and zoning issues), but the prices of housing products suitable for middle-class homebuyers are up about 10% yoy, partly because the demand for such products is greater than the supply.

- **Industrial**: The US-China Trade War prompted many manufacturers to re-locate to Vietnam, and COVID has accelerated this trend, resulting in industrial land rental rates rising 10-20% yoy, making this the hottest segment of the market.

- **Commercial**: The Vietnamese Government's adept handling of the COVID outbreak minimized the "social distancing" measures imposed on the country's consumers and office workers, so the office and retail sectors have been relatively unscathed.

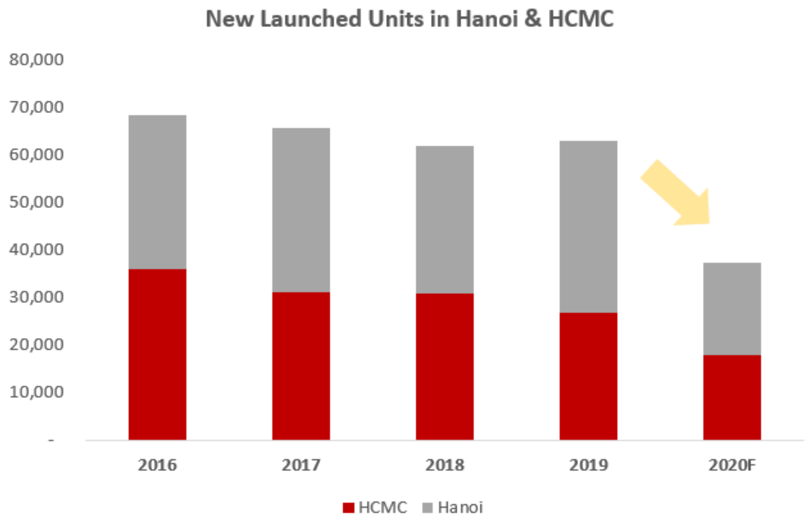
This report focuses on the residential and industrial sectors of Vietnam's real estate market, but we would note that office rents in Vietnam's major cities actually *increased* year-on-year (yoy), supported by low vacancy rates and limited supply. However, retail vacancy rates have surged, which has put modest downward pressure on retail rents and delayed the opening of many new shopping malls in Vietnam.

Residential Demand Driven By Middle-Class Homebuyers

The two main long-term growth drivers of Vietnam's housing market are the country's fast-growing middle class and its high urbanization rate. Regarding the latter, about 350,000 people currently move to HCMC and Hanoi (combined) each year, and the population of Vietnam's major cities grew at a fairly constant 3% annual rate over the last decade, reaching 9 million in HCMC and 8 million in Hanoi.

We expect Vietnam's urban population growth rate to decelerate to 2% CAGR over the next decade, which implies that nearly 11 million people will live in HCMC and 10 million people will live in Hanoi by 2030. We believe these forecasts are conservative, because less than 40% of Vietnam's 100 million citizens live in its major cities versus over 60% in China.[1]

Furthermore, the influx of people into Vietnam's major cities, coupled with about 100,000 new household formations per year (i.e., people getting married) means that the demand for new housing units in HCMC and Hanoi combined is around 200,000/year. However, only approximately 60,000 new units have been constructed per year in recent years, so supply is far less than demand!



Source: CBRE

Another growth driver for Vietnam's residential real estate market is the increasing availability of mortgages to finance the purchase of newly constructed housing units (mortgages are not widely available for secondary market purchases yet in Vietnam). In recent years, about half of new apartments that were developed by Vietnam's leading real estate developers and purchased by middle-class buyers were financed with mortgages. At present, Vietnam's mortgage penetration rate of 6%/GDP is still well below countries such as Thailand (24%/GDP).

Finally, despite all of the positives delineated above, the number of new apartments sold in Ho Chi Minh City and Hanoi is likely to drop by about 40% this year. This is largely due to supply-side issues caused by COVID and attributable to legal and zoning issues which have impeded the launch of real estate projects in HCMC in recent years.

Consequently, the prices of the Affordable (USD900-USD1,100/sqm), and Mid-Tier (USD1,200 - USD1,600/sqm) condominium segments favored by middle-class homebuyers in the country's two largest cities are up about 10% year-on-year despite COVID, according to CBRE.

COVID's Modest Impact On Demand

In recent years, most newly constructed apartments in Ho Chi Minh City were bought by speculators and/or "buy-to-let" investors (in Hanoi, investors prefer to buy land). However, rents of the High-End apartments (USD2,500/sqm) that most investors favor are down about 20% in 2020, partly because Airbnb bookings by tourists evaporated. Also, before COVID, prices had been increasing at an annual

[1] Over the last decade, the proportion of China's population that lives in the cities increased from below 50% to above 60%. A comparable increase in the proportion of Vietnam's citizens living in the country's cities would entail over 10 million people relocating to the cities!

rate of about 8%, so the combination of higher prices and lower rents compressed rental yields down to 3-4%, which has left the high-end segment of the market moribund.[2]

Consequently, over 80% of new apartments are currently being bought by emerging middle class consumers who purchase Affordable and Mid-Tier homes that they intend to live in. Demand is resilient because:

1) Consumer confidence remains strong -- Vietnam has the second highest consumer confidence in the world according to Nielsen (click here for our recent report on this topic), and

2) Affordable and Mid-Tier housing products are still within reach of most emerging middle-class buyers despite years of price increases.

Further to that last point, the mortgage payment on a typical USD110,000 Mid-Tier apartment equates to about one-third of the combined income of a median white collar couple, with circa five-years work experience[3], which is considered the upper limit of affordability for home buyers.

Next, Vietnam's real estate developers recently started focusing on the suburbs of HCMC and Hanoi (circa 15-30 km from the CBD), for a number of reasons, including:

- Many buyers prefer detached houses or townhouses and are willing to live outside the city center to own a plot of land
- Infrastructure development is making it possible for people to live further from the CBD, and the construction of subways and light railway lines will accelerate this trend
- Developers have had difficulty sourcing appropriate plots of land near the CBD
- Surging CBD land prices have made it uneconomic for developers to build housing products that middle-income home buyers can afford in areas near Vietnam's city centers.[4]

The timing of developers' greater focus on suburban projects was fortuitous because COVID increased the desire of some Vietnamese urbanites to live outside the city – a trend seen in other countries, although not nearly pronounced as in places such as the US.

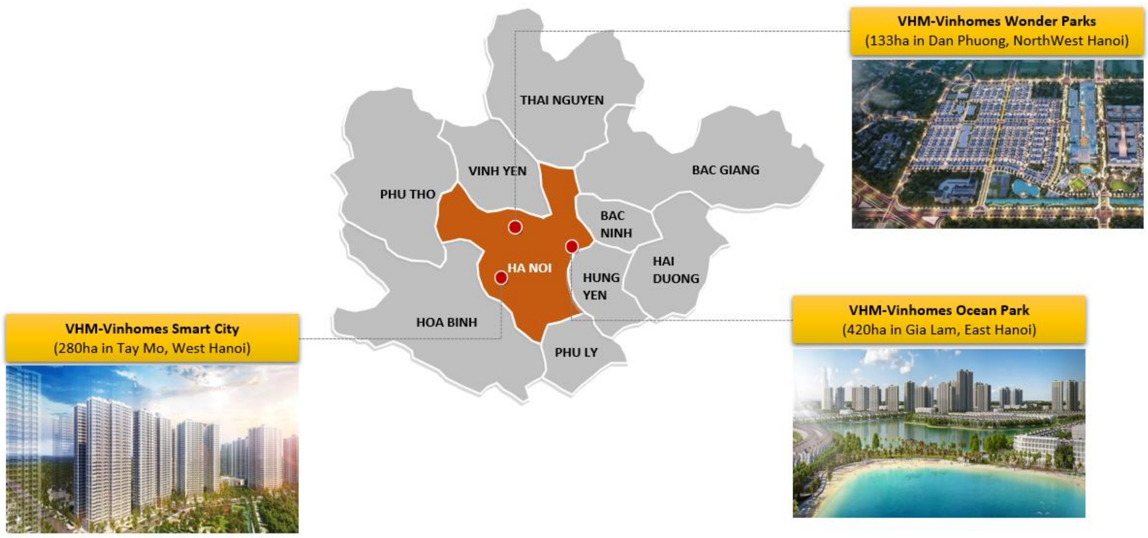
---

[2] Note that: 1) Overseas Vietnamese and Chinese buyers who typically purchase a substantial proportion of newly constructed High-End units cannot currently travel to Vietnam, and 2) VN Dong deposit interest rates have fallen by over 100 bps this year, which has supported prices somewhat as local investors do not have attractive, alternative investment opportunities.

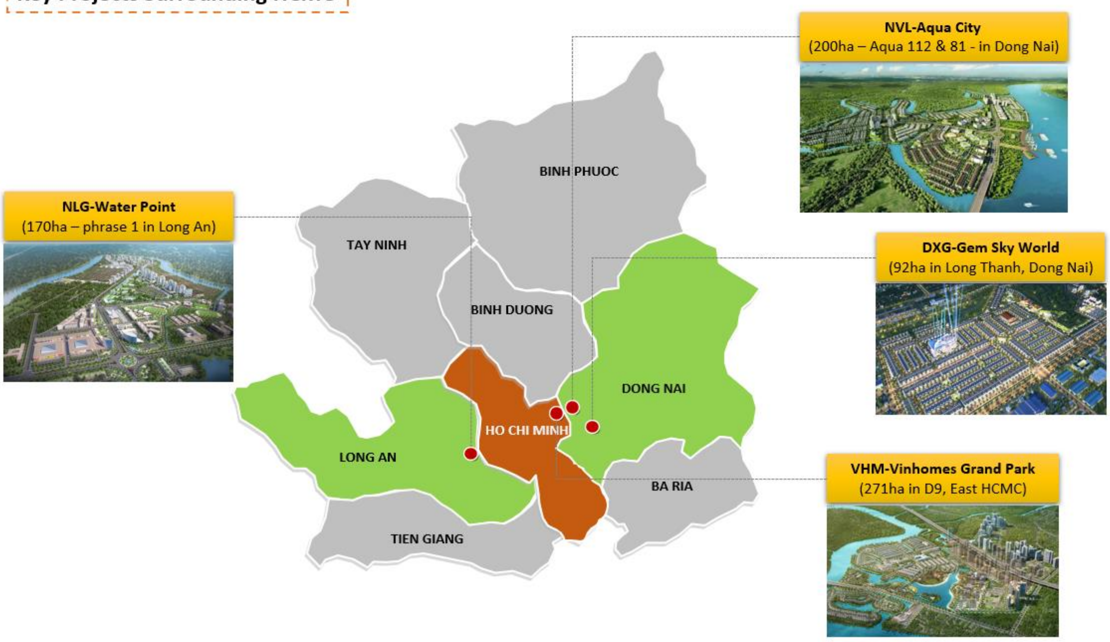
[3] We assume that our hypothetical, dual-income couple puts a 20% down payment on a 75 square meter apartment located about 20 minutes from the CBD (e.g., in HCMC's Tan Binh District near the airport), and they finance the balance via a 15-year mortgage with a ~10% floating interest rate. Note that: 1) floating rate mortgages are standard in Vietnam, but interest rates are unlikely to increase substantially, and 2) the rental yield on such an apartment is currently around 5-6%.

[4] Urban planners in HCMC are also encouraging the formation of new satellite city centers in periphery districts such as Thu Duc and District 9, and hope to attract Grade 'B' office buildings to those "satellite CBDs"

Key Projects in Hanoi



Key Projects Surrounding HCMC



Source: VinaCapital

Developers Weather COVID

The financial health of Vietnam's real estate developers has improved dramatically since the market's last downturn ten years ago. Developers have sold about USD3 billion of corporate bonds to investors this year, according to SSI (accounting for over 40% of Vietnam's total YTD issuance), while some real estate developers secured equity investments and/or co-investments in specific projects from overseas developers. KKR led a group that bought a 6% stake in Vietnam's leading real estate firm Vinhomes for USD650 million.

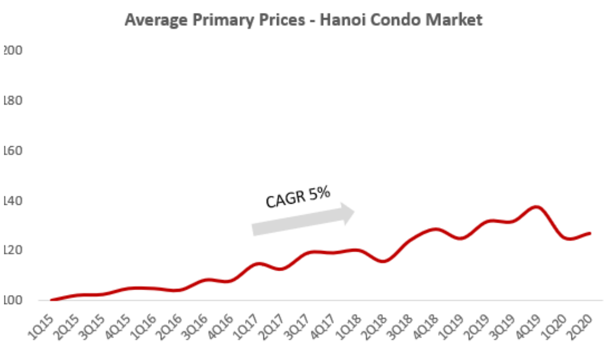
This improved financial position has enabled Vietnam's real estate developers to weather the COVID storm and to offer buyers attractive incentives such as extended payment terms (from 18 months to around three years). Some developers are also paying for the cost of fitting out of the bare shell units that home buyers purchase and are pouring more money into amenities such as swimming pools and enhanced common areas. These are effective strategies to motivate buyers since end-users – rather than investors – are currently driving the demand for newly constructed housing products.

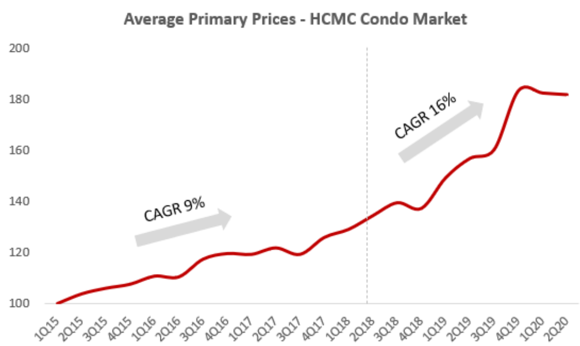
Zoning & Approvals Issues Impact Supply And Prices

Starting from 2018, it became difficult for developers to secure approvals for new real estate projects in HCMC for a variety of reasons, including the increased scrutiny of prior zoning decisions/project approvals and land sales from State-Owned Enterprises to developers.

Prior to 2018, the HCMC residential real estate market had become somewhat oversupplied following the launch of several large projects. Some say it is possible that city planners also wanted to restrict new supply somewhat to give the market a chance to absorb these newly constructed housing units at that time.

The HCMC market subsequently became about 50% *undersupplied* by some measures, so prices in that city have increased at a much faster pace than in Hanoi since 2018, as can be seen in the chart below.[5] However, developers have now started facing similar issues in Hanoi following the recent completion of two large projects (Vinhomes Ocean Park, 424ha & Vinhomes Grand Park 281ha).





Source: JLL

In our understanding, these issues are likely to abate after Vietnam's next Communist Party Congress (CPC) is held early next year. Nevertheless, the supply and demand of new housing units in Vietnam is unlikely to come back into balance until 2022 given the amount of time it typically takes to secure approvals for new projects.

[5] Another reason that HCMC real estate prices have been increasing at a faster rate than those in Hanoi is because the HCMC market has three pools of buyers/investors: 1) local homebuyers and investors, 2) Hanoi-based investors, and 3) overseas Vietnamese. In contrast, demand for new housing units in Hanoi is more-or-less limited to local homebuyers and investors.

Booming Industrial Real Estate

Trade tensions between the US and China began escalating about three years ago, and since that time lease rates in the industrial parks (IPs) located at the periphery of Ho Chi Minh City (i.e., Binh Duong, Dong Nai, Long An) have been increasing at a ~20% annual rate, according to VietCapital Securities. According to industry insiders, rents for those IPs are now above USD100/sqm (albeit with a very wide range of prices in different geographic areas), but it is rare to find 5-10 hectares (ha) of immediately occupiable industrial land within 30 km of HCMC's CBD.

Rental rates are also increasing in northern Vietnam (i.e., Haiphong, Bac Ninh, Thai Nguyen), but by about 10%/year because:

1) The approval and compensation process of converting *farmland* for industrial park use in the north can take around two years, but in the south *rubber plantations* are the primary source of new IP land, and the machinations entailed in converting rubber plantations into industrial land takes much longer.[6]

2) The US-China trade war primarily impacted companies that produce low value-added products such as garments and furniture, and these firms are clustered in the south – so the trade war initially prompted a surge of new IP rentals there[7].

3) Electronics manufacturers and other large FDI companies are concentrated in the north, and these larger firms can often negotiate better rental rates with IP developers than the smaller companies that operate in the south can.

In addition to the points above, there are currently nine new major expressways under construction in the north (versus two in the south) that will make it easier to transport products to China. These will also enable the development of IPs in more remote areas of the north, where there is less competition for labor.

Sufficient Supply For FDI

The US-China Trade War, COVID-19, and rising wages are likely to prompt 20% of factories in China to relocate out of the country within the next ten years, and most firms leaving China prefer to re-locate their factories in Vietnam (click here to read our report on this topic).

However, when US-China trade tensions first escalated, it prompted a surge in Vietnam's IP rental rates, which in turn raised concerns that Vietnam would not be able to absorb a meaningful proportion of China's production. We addressed those well-publicized concerns in a report titled "Is Vietnam Too Full For More FDI?" in which we concluded that Vietnam can realistically absorb about 4-5% of China's accumulated FDI inflows.

---

[6] In our understanding, negotiations between the Vietnam Rubber Group (a powerful SOE that has a 200,000ha land bank), IP developers and local government authorities are fraught with complexity and competing self-interests. That said, it appears that Vietnam's central government is addressing this issue to ensure that the country has a sufficient supply of industrial land to encourage FDI inflows into the country.

[7] Electronics producers currently account for about ~40% of current IP inquiries and are primarily interested in leasing space in northern Vietnam. The combined inquiries of garment and furniture makers also accounts for about 40% of total inquiries, but those firms are primarily interesting in leasing space in the south.

The research we conducted for this report confirmed that Vietnam has a sufficient pipeline of industrial land projects to support FDI inflows for years to come. Our discussions with various industry insiders lead us to believe that the annual demand for new IP space in Vietnam is somewhere around 3,000-4,000ha per year, although there is much less market-wide data for the industrial sector than for the residential sector, so this is a well-educated guess.

Vietnam currently has between ~70,000ha and ~100,000ha of industrial park land (depending on how it is measured), and:

- Vietnam Rubber Group has plans to convert an additional 5,000ha of its 200,000ha land bank for use as industrial parks
- Viglacera, a leading building materials firm, is in the process of developing an additional 2,500ha of Ips, in addition to the 3,000ha it has already developed
- Vingroup reportedly wants to develop 30,000ha of IP space

Finally, in addition to this pipeline of IP projects, we understand that there is about 100,000ha of farmland in the north that can readily be converted into IP space.

Summary: VinaCapital's View

VinaCapital's investment team prefers to invest in companies that profit as local consumers' incomes increase, so we believe that the long-term prospects of the developers of affordable and mid-tier housing products are outstanding. That said, the stock prices of those companies are currently fairly valued at a circa 10% discount-to-NAV (net asset value), on average.

Further to that last point, this report focuses on condominiums, but some developers focus on the "landed properties" niche, which entails developing detached houses and/or townhouses. We are equally enthused about the long-term prospects of this sector given the desire of many locals to own land.

Finally, with the next wave of FDI coming to Vietnam, selected industrial park operators will benefit as will certain listed rubber plantations that are steadily converting their land from agricultural to industrial park use. We also believe that the long-term growth prospects are positive for companies related to real estate, such as certain high-quality construction companies and manufacturers of construction and building materials.