ECONOMIST'S NOTE

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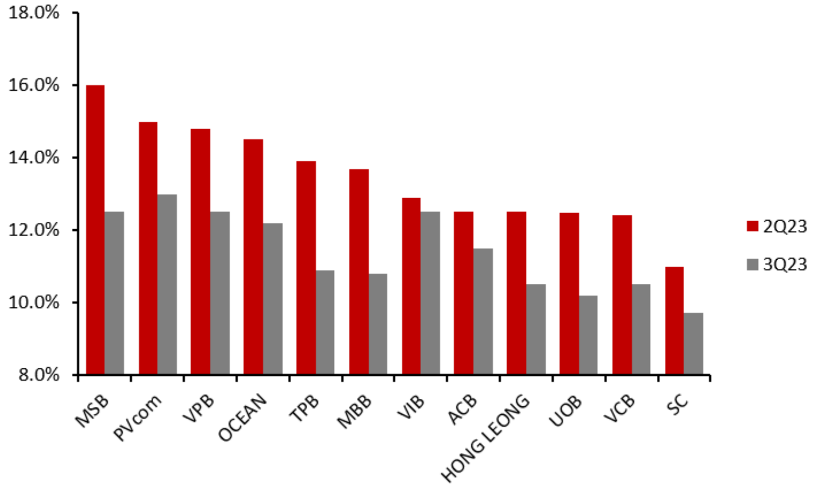
A REAL ESTATE REBOUND IN THE MAKING

Vietnam's real estate market has had an extraordinarily challenging year, but we believe the worst of the downturn has now passed. Mortgage rates peaked at as high as 16% at some banks in early 2023 but subsequently dropped dramatically, as can be seen in the chart below. They are now comparable to levels that prevailed before the Government's aggressive policy rate hikes last year sent borrowing rates soaring. Nevertheless, a full revival of sentiment and transaction activity is not likely until mid-2024.

The decline of mortgage rates helped propel purchases at some recent high-profile sales events, which in-turn attracted considerable attention and boosted sentiment among market participants. Around 80% of the new units Khang Dien House (KDH) launched for sale in its mid-market "Privia" project were immediately bought at the sales launch event. Meanwhile, 80% of Vinhomes' (VHM) new Glory Heights project units were sold, and 80% of Nam Long's (NLG) Akari project were immediately sold. All of these projects are located in periphery districts of HCMC (District 9 and Binh Tan District). That said, we understand that transaction activity in suburban areas (further away from the city center) is still moribund.

Mortgage Rates Have Dropped

(Mortgage Rates at Various Banks in Vietnam)



Source: VinaCapital compilation

The prices of new housing units offered for sale in HCMC and Hanoi are about flat year-on-year, but developers are reportedly offering mortgage assistance (e.g., extended grace periods) and other incentives to sell their units. Furthermore, prices of apartments in the secondary market for which the seller does not have clear legal ownership status (i.e., the owners of the apartments have not yet received a "red book" legal title document for their apartment that they purchased from the developer) have seen a drop of circa 10%. This is just one example of how legal and regulatory issues continue to be the main impediment to real estate development in Vietnam. While there has been some recent incremental progress towards resolving those issues, we do not expect meaningful progress until well into 2024; although we see green shoots in Vietnam's real estate market, a full recovery is by no means underway yet.

Finally, there has been a modest pickup in the total amount of credit expended to developers, which would also help them ramp up their development activity. However, Vietnam's latest credit growth figures also indicate continued weak demand for mortgages, although that is likely to change now that mortgage rates have dropped in recent months.

Leading Indicators

Two leading indicators that the worst is behind us are: 1) transaction volumes for plots of land – which is the most speculative segment of the market - increased significantly recently; and 2) there have reportedly been significant increases in the prices of selected prime real estate in HCMC/Hanoi city centers for properties where the current owner has clear ownership/title documentation. Prime real estate in the city center is expensive, so the recent uptick in prices is largely being driven by wealthy local investors taking money out of the bank - now that deposit rates are falling - and purchasing properties.

Monitoring the investment behavior of such experienced, sophisticated investors in Vietnam is a useful leading indicator of prices for the main investment channels that they invest in/rotate their money between real estate, stocks, bank deposits, and gold. For example, last year high net worth (HNW) individuals poured money into six-month bank deposits because reputable banks were offering rates as high as 10% at that time. When those term deposits matured earlier this year, investors poured the maturing deposit money in the stock market instead of rolling over their deposits at much lower interest rates.

That rotation explains the 20% run up in the VN-Index between end-2022 and August 2023, and the 50% increase in average daily trading value to USD900 million during that period. The rotation of HNW money out of bank deposits and into stocks happened fairly quickly in early-2023 (which we discussed in this report) and served as a useful leading indicator for the VNI's performance over the next six months. However, the rotation of those HNW investors into real estate is taking longer, primarily because purchasing physical properties is less of a "hot money" endeavor.

<u>Regulatory Relief in the Making?</u>

At the beginning of November, senior Government officials held high profile meetings with major Vietnamese developers to address issues that are impeding real estate development in Vietnam. Industry executives identified legal and regulatory issues as the source of most of the industry's current difficulties, identifying inconsistencies in the current regulations and legal framework as particularly problematic.

Two weeks later, Vietnam's Prime Minister set up a special Government task force to address those issues[1]. By the end of November, some new legislation was enacted to clarify certain specific issues such as the exact options developers have in order to fulfill their obligation to produce affordable/social housing, and how much deposits developers are allowed to collect from home buyers before a project's construction is commenced. In light of that apparent quick pace of progress, many market participants are now hopeful that an overhaul of Vietnam's land law that will address one of the key bottlenecks impeding real estate development in Vietnam is imminent: the determination of land values and the fees payable by developers to the Government.

Assessing Land Values and Taxes in Vietnam

Land in Vietnam is owned by the state, so when, for example, a developer wants to build an apartment building, that developer must pay a "Land Use Rights" fee to the Government to secure the right to develop the project on that plot of land. However, the calculation of that LUR fee is opaque and there are reportedly multiple methods that may be used to assess the amount that the developer must pay to the Government.

Many expect the Government to overhaul the current LUR regime in favor of a system in which specific land plots (and individual pieces of real estate more generally) would have an officially assessed value - which is the norm in jurisdictions across the world. In such a system, the amount that the developer would need to pay for the right to develop their real estate project would presumably be determined by applying a standardized rate (or formula) to the officially assessed value of the land.

The implementation of such a system should dramatically speed up the approvals process because bureaucrats would be less hesitant to approve projects in system that relies less on their judgment and instead uses standardized formulas to assess property values and LUR payments. The current process to determine LUR fees has ambiguities embedded that essentially entail judgment calls by bureaucrats on a case-by-case basis in order for individual projects to proceed.

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[1] https://theinvestor.vn/pm-forms-special-task-force-to-help-property-developers-out-of-the-woods-d2588.html

Hope for a Quick Resolution of Long-Standing Issues

There is widespread hope that the Land Valuation/LUR issue will be resolved at the next regularly scheduled meeting of the National Assembly in May 2024. There is even some hope that the National Assembly will hold a special session in January to resolve of these complex issues. However, the Government has not publicized any specific details about the details of a potential solution to the LUR problem, and we are aware of other proposals that entail a completely different approach to the one outlined above. Consequently, it is not clear to us how quickly these complicated issues can realistically be resolved.

Vietnam Versus China

We continue to receive questions from clients based on articles in the international business press comparing the slow real estate market in Vietnam to China. It is important to note that these articles seem to ignore the fact that the situation in China and Vietnam are completely different: Vietnam's housing market is vastly ***undersupplied***, so prices did not fall meaningfully last year when mortgage rates spiked, while China's market is vastly ***oversupplied***, so it will take years to work through that country's excess inventory of empty housing units.

China's challenges ensure that the country faces years of depressed prices and market activity, but that the nature of Vietnam's difficulties enable a quick rebound in the market, especially as mortgage rates in Vietnam drop. The main difference is that for years, Chinese policy makers pursued an economic development strategy in which real estate development was one of the country's main economic growth drivers while Vietnam's economic development strategy is focused on industrialization and on growing domestic consumption.

China grew is economy at extraordinarily (and artificially) high GDP growth rates for years because the construction of new apartment buildings, plus the infrastructure required for the development of brand-new cities, entails very high levels of annual investment. This ***temporarily*** boosts economic growth while that construction is under way. Consequently, real estate makes an extraordinarily high contribution to China's economy (an estimated 20%/GDP in recent years versus less than 10% in Vietnam). Now that China has all the housing units it needs for the foreseeable future, that frenetic construction activity is necessarily winding down, weighing on the country's GDP growth.

Oversupply in China, Undersupply in Vietnam

The main consequence of China's strategy to "boost GDP growth by building apartment buildings" is that the country now has far too many housing units – an estimated 25% of which are empty. In contrast, Vietnam's vacancy rate is below 5%, and the country does not produce anywhere near enough housing units every year to satisfy the annual demand of emerging middle class home buyers. We estimate that the demand for housing units outstrips supply by a factor of about 2-to-1.

That last point gets to the core of the current issues in Vietnam's real estate market: developers have been severely impeded by an inability to secure zoning/approvals for their projects, which has in-turn made it difficult to secure long-term financing for those projects. The net result is that the supply of new housing units is not meeting the demand, which is being driven by new household formation (i.e., people getting married), urbanization, and an increasing number of consumers entering the middle-class income bracket.

Conclusions

The downturn in Vietnam's real estate market has bottomed out, partly because mortgage rates peaked and are now headed lower. While a full-scale revival in the market is not likely to take root until mid-2024, there are some signs that a rebound is already in the making, including significant increases in the prices of prime properties in downtown HCMC/Hanoi and a pickup in the volume of land lots changing hands. The latter is a segment of the market which had been completely dead for months, and the recent activity is a good indication that long term investors (as well as speculators) have started paying attention to the real estate market again.

We will continue to watch for additional signs that the market is fully recovering. These include an increase in the sales of units at large, suburban projects, which would confirm that a full-scale market recovery has taken root. We also remain hopeful that the Government will take the necessary measures to alleviate the legal and regulatory bottlenecks that currently impede development activity in Vietnam. A recovery in the market would have broader implications for the overall economy, not just for real estate developers, and would go a long way toward boosting consumer confidence in Vietnam, which would in-turn also help support stock prices next year./.