

Vietnam's Real Estate Market: Can it Sail through the Capital Puzzle?

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Abstract

The article provides an overview of the real estate market in Vietnam and points out the current problems of the market, followed by suggested solutions to those problems. Vietnam's real estate market is a young but fast-growing market faced with fundamental problems of a new market such as inefficient legal frameworks, lack of transparency and professionalism, and lack of financing sources. The potential policy solutions to these problems include governmental actions to improve market conditions and attract more foreign funds into the market. We further suggest encouraging strategic alliances between foreign and domestic real estate firms (short-term immediate solution) and real estate securitization (long-term solution).

Keywords: capital puzzle, real estate market, real estate securitization, REITs, Vietnam.

Introduction

The relatively young but fast-growing real estate market of Vietnam experienced a boom during 2007 and the first half of 2008. This coincided with Vietnam's entry into the World Trade Organization. Supply and demand in the four main real estate sectors—condominiums, office rental, hotel and retail—saw strong growth, with prices rocketing to as much as 200% of the level before 2007 (CBRE 2008). The main causes of the boom included a young and wealthier population, massive inflows of foreign capital, and supportive governmental policies. However, the recent economic downturn, high inflation and tightened monetary policy have slowed the market; consequently prices have decreased considerably, while growth in supply, demand and investment has almost halted. Fundamental problems of a younger market have begun to reveal themselves, among which the capital puzzle seems to be the most serious. Indeed, the market has been dependent on very few capital-raising channels, mainly commercial banks, which are providing very limited funds under current conditions. This article aims to provide readers with an overview of Vietnam's real estate market, to point out

the main problems the market is currently facing, and to suggest short- and long-term solutions to these problems with a particular focus on the capital puzzle.

Vietnam's Real Estate Market—Evolution

The history of Vietnam's real estate market has not been long. Since until recently Vietnam had remained an economy heavily dependent on agricultural activities; most of the land was used for agricultural purposes. During the feudal periods, the industry mainly existed in the form of leasehold from landlords to tenant farmers, in exchange for cash or agricultural products. However, this form was gradually eliminated after Vietnam's independence from France in 1945, when land was retrieved and managed by the Vietnamese government. Until the economic reform in 1986 (the "Doi Moi" program), the government's policies centered on collective agricultural activities and thus more than 90 percent of the land belonged to agricultural cooperatives, leaving no room for a formal market in real estate. In the period 1986–1992, however, there were some first attempts to transfer the utility rights of land to households in order to promote household farming.

The first years of the next ten-year scheme (1993 through 2003) saw a great swing from centralization to decentralization of property rights, along with the decentralization of both agricultural and industrial activities. Land owners were given five fundamental rights to *exchange, transfer, lease, inherit, and mortgage* real estate properties, at prices stipulated by the government (1993 Real Estate Law). During that period, two price systems co-existed: the market price, and the government-stipulated price, which was only 20–40 percent of the market price. Non-agricultural land prices rocketed from 50 to 100 times the original price within the ten-year period. The "asking-permitting" mechanism was the dominant characteristic of the real estate financial system during the period; consequently, corruption and bribery in land and housing management, speculation in usage, and savings through real estate ownership were common practices.

A new point in land reform was reached in 2003, when Decree 26-NQ/TW was passed during the 9th meeting session of the 11th National Assembly, and the new real estate law was enacted in the same year. This decree pointed out that land was not only a precious national resource and special manufacturing material, but also the country's internal strength and key capital. Under the decree, real estate pricing was shifted from the dual-price mechanism to the one-price mechanism, market price being utilized. The

“asking-permitting”¹ mechanism was removed and, as a result, corruption and bribery decreased notably; land speculation and savings in the form of real estate ownership also decreased.

Vietnam’s Real Estate Market—Recent Trends

Vietnam became the 150th member of the World Trade Organization (WTO) on November 7th, 2006, and in January 2007 it started to fulfill commitments to the WTO to gradually decrease or remove tariff and non-tariff barriers on foreign goods and services and improve legal and institutional settings for trading activities, etc. Vietnam has made remarkable efforts to open up its market for foreign companies and investors, including easing limits on foreign ownership in many areas, making way for tremendous flows of Foreign Direct Investment (FDI) into the country. According to Ministry of Finance figures, FDI inflow for 2007 was approximately US\$21 billion, double the figure for 2006 (approximately US\$ 10.5 billion).

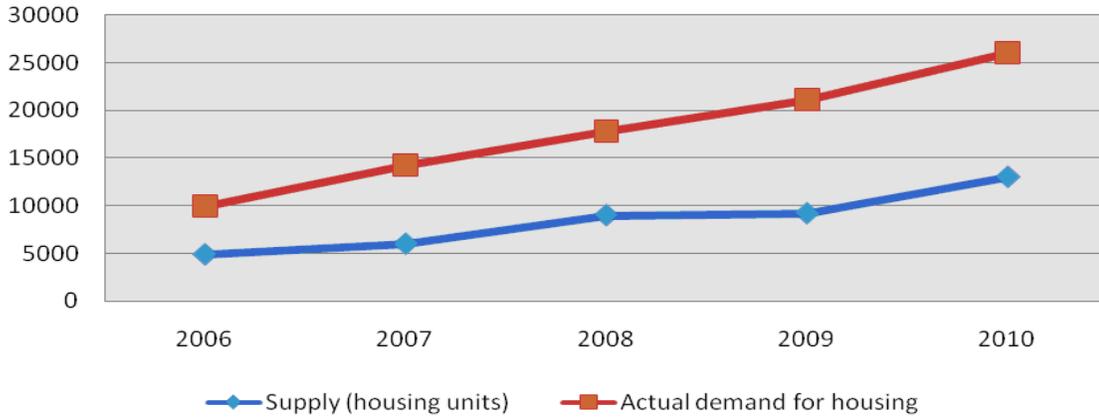
Year 2007 also saw an explosion of property fever in Vietnam, when high economic growth and stock market boom as well as significant increase in foreign investment created very strong demand for property (see for example Figure 1 on housing supply in Hanoi). The market for residential condos has been growing remarkably since the beginning of 2007.

At one point last year investors were queuing overnight to buy condominium units, with prices of good-quality projects hitting US\$3,500 per square meter, around the same price as an average grade-A condominium project in Bangkok; prices doubled in 12 months and nearly tripled in some cases in 18 months (Global Property Guide n.d.).

Hanoi, the political capital, and Ho Chi Minh City, the economic capital of Vietnam, reported record-high office rental prices (demand increase is shown in Figure 2).

¹ The asking-permitting market-entry system: rather than clearly defining the areas where entrepreneurs could conduct business, the licensing system gave regulators broad discretionary powers to “fine-tune” the scope of business activities (Balme and Sidel 2007: 149).

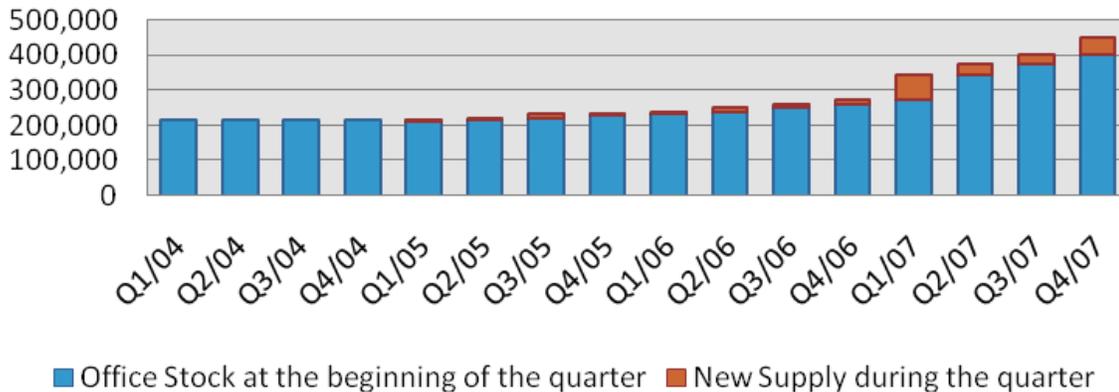
Figure 1: Housing Supply v Actual Demand in Hanoi



Source: CBRE (Vietnam) 2007b.

According to CB Richard Ellis’s research, last year’s Grade A office rental rate in Ho Chi Minh City increased by 97 percent to US\$63/sqm/m, while the average rate increased by 29 percent to US\$49/sqm/m, very close to the figure for downtown Manhattan (US\$53/sqm/m) and more than double that of Bangkok (US\$24/sqm/m). With this, Ho Chi Minh became the world’s 23rd most expensive city, ranked number one worldwide in real estate market development in 2007, at an amazing rate of 94 percent. Average grade A office rent in Hanoi also reached US\$36/sqm/m in Q2 2007, with average occupancy of 97 percent. The real estate market here has become very promising since Hanoi expanded to four times its original size, enhancing the capacity for investments in the area.

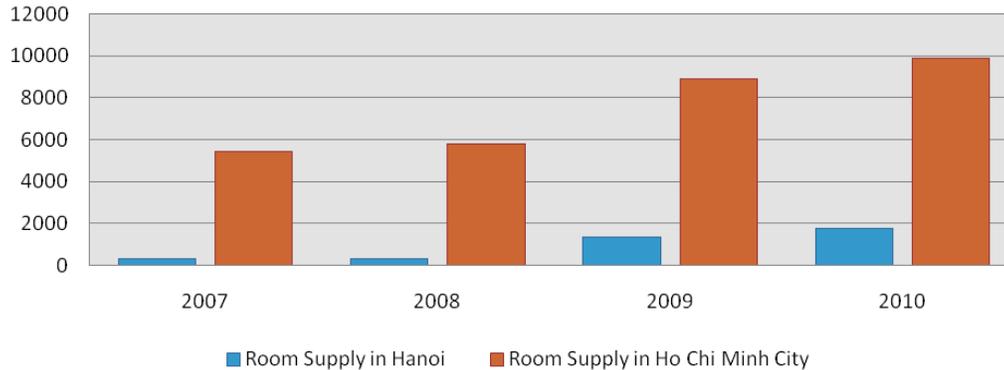
Figure 2: Ho Chi Min City’s Prime Office Stock (As at 2007)



Source: CBRE (Vietnam) 2007.

The hotel market was also booming (Figure 3). Thanks to the constant increase in the number of visitors to Vietnam in recent years, demand for hotel rooms was climbing faster than supply; hence room occupancy remained at nearly 100 percent.

Figure 3: Future Supply—Hanoi and Ho Chi Minh (4- and 5-Star Hotel Space)



Source: CBRE (Vietnam) 2007a.

Demand was forecasted to stay strong in the coming years, thus many hotel projects were carried out throughout the country’s major cities, especially projects for 4- and 5-star hotels. During quarter 2 2007 alone, five licenses were granted to build new 4- to 5-star hotels in the My Dinh area, Hanoi.

Last but not least, the retail market in the big cities was also in its heyday. In 2006 and 2007 Vietnam was ranked the world’s third best destination for retail development by AT Kearny, jumping five steps from its position in 2005. New shopping malls, department stores, supermarkets and other retail centers were built everywhere, yet occupancy rate still nearly hit 100 percent due to even more rapid rise in demand. Average retail rental price in Ho Chi Minh for Q4 2007 was US\$84.44/sqm/m, an increase of 35 percent from the price in 2006, just before Vietnam entered WTO, and double that of 2004. Though still relatively lower than prices in other Asian key cities, this had surpassed the average office rental price in Manila (\$18), Jakarta (\$52), and Bangkok (\$60) (CBRE 2007b).

Vietnam’s Real Estate Market—The Boom

This real estate boom was driven by three main forces: increase in domestic demand and spending power; increase in foreign demand and foreign investments; and new policies supporting foreign investments in general, as well as the development of the property market in particular.

Domestic forces

The incredibly strong increase in domestic demand for property in 2007 was driven by strong economic growth of approximately 8 percent annually and a booming stock market that gave investors more than enough cash to spend (Figure 4). The strong and stable economic growth led to the birth, development and expansion of many industries, which in turn created new demand for factories and office spaces, as well as shelters in big cities for the flow of employees from less developed parts of the country. Meanwhile the stock market boom also enriched many households which led to the demand to improve their living environment. Other investors, on the other hand, tried to diversify their portfolios by investing in the real estate market. Many of these investors saw the potential in re-selling the assets in the near future at considerably higher prices or in leasing them back to foreign expatriates at twice or even triple the prices domestic customers would pay. Consequently, medium- to high-quality condominiums became the second hottest market, just behind the stock market—which at the time was considered very attractive by international investors. The incredible rise in prices, nonetheless, was believed to be the result of significant speculation among local buyers and was not sustainable in the long term.

Figure 4: VN Index - July 2000 ~ February 2007



Source: CBRE (Vietnam) 2007b.

The beginning of 2008, however, saw a tumble in the economy, followed by a serious downturn in the stock market. Tremendous losses and rocketing risks in the stock market and other forms of investment led to a new trend: investors were now putting money in the real estate market which was still booming and holding great potential in itself. Indeed, the real estate market was still growing strongly, though at a slower rate under the influence of the financial and currency crises. However, one thing was different: more investors were now looking at the long-term benefits instead of short-term speculation.

Foreign forces

Since Vietnam's entry to the WTO at the end of 2006, foreign investment, either direct or indirect, has poured strongly into the country. The very active real estate market benefited greatly from this phenomenon. The office, hotel and condominium markets warmly welcomed an enormous flow of both financial and human capital. As a result of the "post-WTO accession flood", Vietnam's Foreign Investment Agency (FIA) estimated that approximately US\$6 billion was disbursed during 2007, while registered FDI from January through May 2008 alone reached more than US\$14 billion, 45 percent of which were poured into office and apartment construction. The FIA also reported that for the first nine months of 2008, the country attracted US\$57.2 billion FDI, a five-fold increase over the same period the previous year. Investors were very keen on investing in industry and construction, putting over US\$32.3 billion (approximately 57.48 percent of the total capital) into 484 projects (AsiaPulse 2008). Malaysian investors had climbed up the ladder to rank number one of countries investing in Vietnam.

The retail market was also very active. World-famous retailers such as Lotte (Korea) and Parkson (Malaysia) opened shopping centers in Hanoi, Haiphong and Ho Chi Minh City, while others like Central (Thailand), Carrefour (France), Takashimiyu (Japan) and Wal-Mart (US) were reviewing the market for a near-future entrance. Investors were keen on buying projects already licensed and under construction because of their readiness, instead of leasing land and developing them from zero.

Common reasons for investment into Vietnam include strong and sustainable economic growth, political stability, stable business environment, cheap labor and materials, improvements in the regulatory environment and more relaxed policies by the government to accelerate capital inflows. Many firms prefer to open factories in Vietnam instead of China because Vietnam is reported to have the lowest labor costs in the region, while workers here have higher skills than Chinese workers. In addition, the ongoing US financial crisis is also stimulating investment into Vietnam, as a result of capital being withdrawn from the American market and diverted into emerging markets like Vietnam that are less dependent on the US economy.

Government's laws and policies

The Vietnamese government has been making great effort to attract more capital into the country. Vietnam's entry into the WTO opened wide the door to both outflows of goods and inflows of capital, but without the government's much more relaxed and encouraging policies, the flows would have been limited. Decrease or removal of trade barriers, faster and simpler visa procedures, bilateral and multilateral agreements on investment, trade and movements of human capital with the U.S., several European and South American countries and within the ASEAN have given access opportunities and

remarkably increased support to foreign firms. Remarkably, the Vietnam–U.S. bilateral market access agreement, signed in 2006, was viewed as a historical step in the relationship between these former enemies. Besides, the government also relaxed policies on foreign ownership, making it possible for 100 percent foreign-owned banks to be opened in Vietnam, with HSBC to be the first.

Since the first attempt to liberalize the real estate market in 2003, the government of Vietnam has been quite quick and flexible in further improvements to the market. The Land Law was revised in 2006 with more open policies, followed by a new property trading law taking effect from January 1, 2007 with guidance on trading activities of real estate properties. With this, the market became more transparent, welcoming and less confusing to both domestic and foreign players. Moreover, Decree 84, passed in 2007, extended the period of land use right certificates for foreigners from 50 years to 70 years, and lessees can renew the contract without paying any further fees. This is the nearest condition to perpetuity, giving Vietnam a considerable competitive advantage over other countries in the region (Thailand’s maximum period for foreign leasing is currently 50 years).

Vietnam’s real estate market—Future trends

Since the middle of 2008, the situation in the real estate market has declined. The number of transactions have dropped dramatically, very few buildings have begun construction, prices have dropped by at most 50 percent in Ho Chi Minh city and 20 percent in Hanoi, while banks are tightening credits more than ever, creating a serious shortage of funds in the market. These are the results of very high inflation (estimated at 21 percent for 2008) caused by sharp rises in world commodity prices, prolonged economic downturn, stock market tumble and, consequently, decreased investor confidence. Some are now calling it a “frozen market”, but experts believe the situation is not that bad. Rather, the market has been going through an “adjustment period” in which prices are brought down to a more reasonable and sustainable level from the previously inflated prices. Additionally, investments in the industry continue to grow, and current demand remains much stronger than supply.

In the short term, economists forecasted that buyers will stay reluctant for foreseeable future; however, investors will continue to pour money into the market since the market is likely to have recovered by the middle of 2010. Prices, now having dropped by 40 percent on average, will come down until they reveal the real value of assets. In fact, many experts even think this is the best time to invest in Vietnam’s real estate market. Don Lam, CEO of VinaCapital, a leading Vietnamese real estate firm, stated that economic slowdown and Dong’s depreciation have made Vietnam “the cheapest market in the world”. “The average P/E was 38 times last year, but it has

dropped to only 9–10 times this year”, he said. It was further said, “despite the stock market slump, most companies, except those in banking and finance sectors, are still growing at 13–15% annually”(Nguyen 2008).

In the longer term, the market is expected to continue growing strongly, but its foci will shift. The market for condos will move towards its lower end to serve more, yet poorer, customers: young families with lower budgets. As Vietnam has a young population with over 50 percent of the nation below 30 years old (General Office for Population and Family Planning 2006–07), there is much potential demand in years to come. Meanwhile, the market for more luxurious apartments will still grow, but prices will correct or “normalize” to become more realistic and affordable. The office sector will also experience the same phenomenon: Grade A and B offices will continue to be a “hot market” as supply is anticipated to be much lower than demand, while the market for Grade C offices will grow even more quickly.

The hotel market has been affected greatly by the economic slowdown and serious inflation; however, in the long term, the number of tourists to Vietnam will still increase at an accelerating speed. New hotels and resorts will be established in new growing tourist destinations, especially along the beautiful and untouched beaches in the central part of the country. Besides, many middle-to-high-end quality hotels will be built, as there is still a serious shortage for quality hotels and tourism services in Vietnam.

The retail market, on the other hand, will become very active in the coming years as modern shopping facilities are only now starting to be developed and will appear in the major cities in the next few years. Kearny (2006) considers 2008 and 2009 as the perfect time to invest in Vietnam’s retail market, ranking the market first place in the global retail development index. As per capita income continues to grow, there will be greater and greater demand for brand products and other high-quality goods and services. This will increase the development opportunities for both retailers and real estate developers—their space suppliers.

One early signal of market recovery: real estate trading floors have been mushrooming over the past year. Moves by state management agencies to perfect the legal framework on real estate transactions have hurried enterprises in this race to transparency and better connection between supply and demand for property.

Vietnam’s Real Estate Market—Main Problems

Market infancy

Firstly, there is an imbalance in the current product mix of the property market. The property boom in 2007–08 was stimulated, after Vietnam’s entry into the WTO, by the establishment of a new class of customers with strong spending power, with massive

investments in middle- to high-end condos, offices, hotels and retail centers. Prices, therefore, were pushed up in a very short period of time to a new level of approximately 200 percent of the previous prices. Needless to say, this property bubble, created by speculative trading, cannot be considered as sustainable growth. Indeed, when the real estate market was hit by the recent economic downturn and tight monetary policies, prices fell dramatically, causing investors who entered the market during its peak to incur serious losses while making others reluctant to invest.

On the other hand, most of the demand for property comes from the rest of the population, with limited budgets. Nonetheless, this remains a nearly untouched segment with very few investments due to the fact that it is much faster and easier to earn high profits from investments in luxurious properties. The government seems to be the only developer of the market for people on lower incomes, with construction of some new apartment blocks; however, supply is still lagging far behind demand. Another reason for this mismatch of supply and demand is the serious lack of mechanisms allowing budgeted buyers to pay for the properties. Banks have been very strict on property loans, while the number of sellers who accept payment in installments is limited and installments required are usually larger than what people with low to average income can afford.

The lack of professionalism is very obvious in this infant market. There are many brokerage agencies, but their scale and networks are very limited. Furthermore, these agencies always give priority to profit speculation and, without proper regulation by the government, recklessness and fraudulence are not rare. Meanwhile, there is a serious shortage of standard trading floors; the first one was opened at the beginning of 2008. Online brokerage services, though mushrooming recently, mainly focus on foreign expatriates and upper-class buyers, and both the quantity and content of information provided are not very abundant. There have also been very few quality asset appraisers or appraising agencies and this, together with speculation, create a chaotic and inaccurate pricing system for real estate assets. The condition is expected to improve considerably soon, however, as the government has recently upgraded the requirements for qualified asset appraisers, while on the other hand opened the market to foreign agencies.

Investors in the real estate market and banks also have little professionalism. According to Minister of Construction Nguyen Hong Quan's report to the national assembly in October 2008, he noted that while some institutional developers seem to understand the market very well and are quick in grasping opportunities, many financially incapable and inexperienced enterprises also entered the market. Many spontaneous investments were not carefully planned, making the market imbalanced and unstable. What is more, lending during the boom period was easy and focused on a small

sector of the market, stimulating speculation and creating illusory demand. The sudden cessation of property lending without careful consideration, on the other hand, strongly hit the essential supply of property and has been worsening the imbalance between long-term supply and demand.

Undocumented trading is another problem with Vietnam's real estate market. This term refers to the exchange, transferring and lease of real estate directly from the transferor to the transferee without reporting to the local authorities. The transferee does not have to report to the local committee until after moving into the house or constructing a building on the land or using it for commercial purposes. Undocumented trading is a common practice because of its simplicity and convenience; there is no need to go through the licensing process, neither is there the need to pay taxes. Though unwanted by authorities, undocumented trading is still accepted under the current system due to the fact that most land owners, especially those who live in rural areas, have not been granted official certificates of ownership on their properties. Underground trading and the absence of proper ownership certificates are making it very difficult for the government to keep track of and control trading activities in the market. Furthermore, this also creates difficulties for banks to collateralize such assets for loans; consequently, they are either reluctant to lend on mortgages or charge high interest rates on such loans (21 percent on average as estimated by the State Bank of Vietnam, 2008).

Inefficient policies and legal frameworks

Vietnam is a socialist country and the communist party has strong control over all political, social and economic activities. Twenty-two years after the announcement of the so-called "socialist-oriented market economy" and schemes to liberalize the economy, the government still maintains its strong intervention in the market. The real estate market is tightly regulated with three sets of law: the land law, the housing law and the real estate business law. The problem is the government's efforts in regulating and supporting the market are hindered by opaque and confusing laws as well as many barriers to foreign entry.

Firstly, the legal framework on land ownership is unclear and this has resulted in confusion and law violations in property trading. Under the land law, land in Vietnam is a public asset which belongs to the whole nation, and the government manages the asset on behalf of all Vietnamese citizens. In other words, land does not belong to any single person or entity, and land owners actually only own the right to use it, certified by the certificate of land use right or the "red book" in Vietnamese. A long period of political and economic transition, limit governmental funds and red tape prevent this certificate from being distributed to the majority of Vietnamese households. In the past, when as many as 90 percent of Vietnam's population lived in rural areas and land trading was not

a common practice, this problem was never a major societal issue; however, with increasing urbanization the real estate market has started to develop in many formerly rural areas. At the same time, the absence of land use right certificates has become a serious problem, as it not only slows transaction processes but also allows for growing undocumented and illegal trading, corruption and bribery.

Secondly, the administrative regulations for investment, planning, project approval and land-related procedures on real estate investment projects are complicated and time consuming. Licensing of these projects is usually delayed because too many ministries are involved in the process, while these ministries' officials have insufficient understanding and experience for dealing with property regulations. According to a study conducted by the Ministry of Construction, the licensing procedure contains at least 33 steps, taking around one to two years to complete, even three to four years in some extreme cases. Vietnam also has a very bad reputation for administrative and trading transparency. In 2006 Vietnam ranked last in the global real estate transparency index by Jones Lang LaSalle. Although its position has improved, by Vietnam jumping six ranks up the list, moving from "opaque" to "low transparency", the fact that it still ranks 76th (2010) in the index reduces the market's competitiveness considerably.

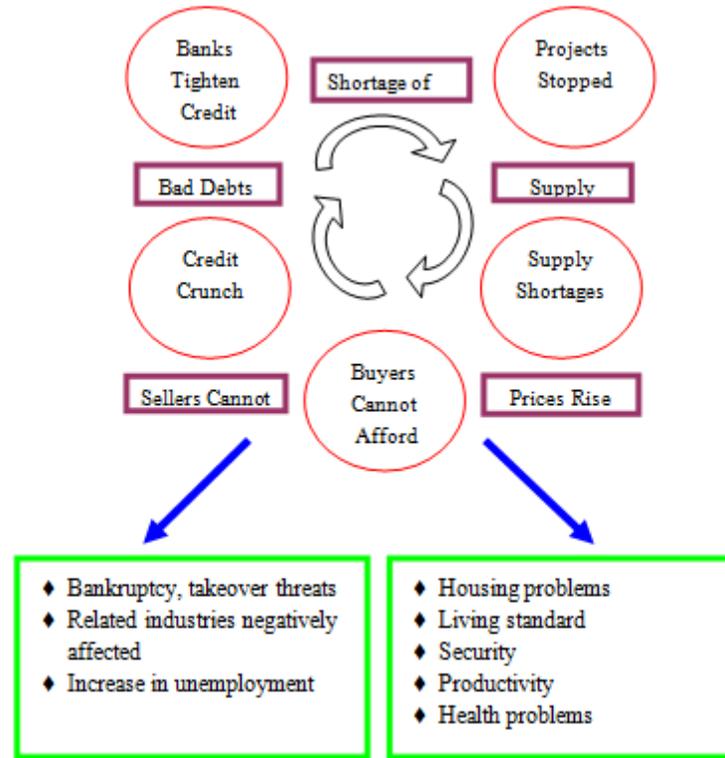
Thirdly, the current tax system on real estate trading has many drawbacks. Land-using taxes are too low, thus discouraging effective land usage and limiting speculation. In fact, taxes on land title transfer² and registration fees³ are too high, discouraging official, transparent and tax-paying transactions.

Fourthly, there are still high barriers to foreign entry into the market. Though foreign investors are interested in Vietnam's property market, by law they are not allowed to buy or own land, houses or other real estate assets, and the only option left for investment is to invest in estate development funds. Previously, foreign estate firms and brokerage agencies were not allowed to practice in Vietnam. In 2008, however, these barriers were lowered when foreigners and Vietnamese overseas were given the right to own one apartment for non-commercial purposes, while foreign brokerage agencies were granted permission to enter Vietnam's property market. According to the Ministry of Construction, the government is also drafting a new law allowing foreign property developers to enter the market.

² Tax on land title transfer: tax charged to the transferor on a commercial transaction of property, computed as follows: Tax amount = Transferred area x Land price x Tax rate; where the land price is specified by the local government, tax rate is 2% for farm land and 4% for other types of land. Source: Ministry of Environment and Natural Resources.

³ Registration fee: the amount a property owner has to pay upon registration of ownership, computed as: Due amount = Land area x Land price x 1%.

Figure 5: The Capital Puzzle



The capital puzzle

One of the most serious problems of Vietnam’s real estate market is that there are very limited channels for raising capital (Figure 5). Banks play a vital role in Vietnam’s debt-oriented financial markets (Binh Tran Nam and Chi Do Pham et al., 2003, being the prevailing source of finance for most companies and projects. The real estate market is no exception; besides residential projects which can partly generate funds by requiring periodic prepaid installments by future home buyers⁴, most projects heavily rely on bank loans for construction. Meanwhile, other fund-raising channels such as real estate investment funds, securitization, etc are nearly non-existent. It is very dangerous for the real estate market to depend heavily on banks as the only source of capital. At the end of 2007 and the beginning of 2008 when the market was booming, banks were eager to give out property loans, many offering to both estate developers and home buyers large loans at preferential interest rates. However, when the economy was struck by the recent global financial crisis and alarming inflation of 21 percent as estimated by the Ministry of Finance, banks suddenly became very strict on property loans. Most domestic

⁴ According to Vietnam’s construction law, developers may start to mobilize funding for construction from future house buyers when the base is finished.

commercial banks, fearing they would not be able to control the risks associated with the previous easy property loans, have closed the real estate market, while foreign and very few domestic banks are giving loans with very high requirements, one of which is the project(s) must be located at the centre of big cities. This tightened lending policy has created serious financial problems for real estate developers.

A credit shortage, especially in middle- to long-term credit, has made it extremely difficult for developers to complete on-going projects as well as start new ones, creating more imbalances between middle- to long-term supply and demand. Furthermore, interest rates are rocketing (the ceiling rate was 19 percent at the end of 2008 compared with 12 percent at the end of 2007, while prices and demand for houses are dropping dramatically, making it even more difficult for firms to pay back loans and interest. If the credit problems continue to persist, many real estate companies will be pushed towards either bankruptcy or foreign takeover.

The real estate market plays a vital role in the economy and an unhealthy property market will have a negative influence on related sectors such as materials, architecture and construction, consultation, finance and banking, insurance, tourism, etc. Also, the potential social impacts of property market breakdown include the loss of jobs, social anxiety and worsened social security. Therefore the current problems in the real estate market require prompt solutions from not only the government, but also from all players in the market, to prevent potential negative influences on both the economy and society.

Dealing with the Capital Puzzle

Policy solutions: Improving the legal frameworks

There is an urgent need for consistent and uniform legal frameworks to support real estate business activities, including revision of the land law, property use law and real estate business law. Firstly, there must be a fast, transparent and consistent system of property registrations as well as issuance of certificates of property use rights. This system will help increase the speed and transparency of real estate transactions while at the same time preventing undocumented property trading. Secondly, licensing and registration processes in real estate activities must be made more compact, convenient and transparent. The total number of involved institutions, documents required and procedures must be reduced so that licensing and registration processes can be faster and more convenient. This will help lower the costs incurred by both real estate developers and buyers, as well as reduce the amount of work and increase efficiency for management and administration of properties.

Thirdly, there must be concrete, uniform and efficient regimes of property taxes, real estate business taxes and related fees to encourage and support economical and efficient uses of land and other real estate assets, as well as healthy trading activities. Fourthly, the government must build legal frameworks to diversify methods of property investment and trading, particularly frameworks for securitization of real estate, establishment and operation of real estate investment trusts (REITs), issuance of real estate bonds, as well as other secondary products of the market.

Policy solutions: Boosting professionalism

The lack of professionalism by governmental bodies, real estate developers and other investors and buyers is an important reason for the volatile real estate market. To build a healthy and sustainable property market, the professionalism of all parties in the market must be increased. As the leading and most influential participant, the government should take the initiative in this process. On the national scale, there must be a complete, uniform and effective set of criteria for property appreciation. The government should also set up requirements for standard real estate trading floors and ban all unqualified floors and entities from participating in the market. Nationwide reputable organizations should run training programs to increase professionalism in real estate management, appraisal and brokerage practices.

There should also be a national body specializing in real estate management and housing problems with branches at the provincial level. The current real estate market is co-managed by three ministries, namely the Ministry of Natural Resources and Environment, Ministry of Construction, and Ministry of Planning and Investment. This sophisticated system inhibits communication between involved parties and usually creates disagreements among authorities or conflicting instructions to real estate developers. These incur unnecessary costs for both administrator and applicants as many projects are delayed or rejected. Therefore a specialized real estate administrative body is needed to carry out the work in a much more timely, professional and transparent manner. The United States' Federal Housing Administration (FHA) may be a good example of a government agency which works to improve housing standards and provide home financing to the public.

Policy solutions: Opening up the market

According to CBRE's 2008 report, the government's prohibition on foreign ownership of property and restrictions on repatriation of foreign capital have been significant barriers to capital inflows into Vietnam's real estate market. These regulations not only hinder foreign investment in the market, but also create difficulty for companies seeking space for factories and offices, as well as expatriates looking for apartments. Foreign

companies and real estate firms which have a considerable foreign customer base have proposed that the government lower the barriers by granting property use rights to foreigners (CBRE (Vietnam) 2008). The government has responded positively to this proposal by allowing each expatriate or overseas Vietnamese to buy and own an apartment for non-commercial use (Vina Capital Funds 2008). However, greater effort can be made to open the door more widely to overseas investment: by perfecting the legal frameworks for foreign investment and the operation of foreign real estate companies, accelerating the licensing process for overseas capital registration, more favorable taxation, etc.

Policy solutions: Credit easing

After a period of generous lending at the end of 2007 and the beginning of 2008, from the middle of 2008 many commercial banks suddenly stopped lending on property loans while others were still lending but on very strict terms. Explaining this, the state bank said many banks were worried about bad debts from real estate loans, as property is not a liquid asset. However, in his report to the national assembly in October 2008, Minister of Construction Nguyen Hong Quan pointed out that credit loans on real estate were still in the safe range, totaling 115.5 thousand trillion VND, which accounted for only 9.15 percent of the total lending of all commercial banks.

Experts therefore suggest that banks should restructure their loan portfolios and continue to lend on real estate loans to prevent a systematic credit crunch. They also suggest that the adjusted interest rates (12–13% on average, with a ceiling rate of 16 percent, estimated by State Bank) are still high given that commodity costs are rising while the number of sales and lease transactions are decreasing (CBRE Vietnam 2008); therefore companies still hesitate to borrow. Now that inflation has been brought under control, many banks, including Vietinbank, the fourth biggest bank in Vietnam, have recently proposed that the state bank of Vietnam further lower interest rates and required reserve ratios so that banks can lend more.⁵

Market solutions: International strategy

Experts believe that this is the best time for foreign real estate developers and investment firms to enter Vietnam's real estate market as prices of property products are much lower than a year ago, reducing the costs of investment in this market considerably.

⁵ According to Vietnam state bank's Decision number 2810 QD-NHNN, effective from November 21, 2008, among the state bank and other state-owned commercial banks: refinancing rate is 12.0% per year; SBV discount rate is 10.0% per year; and overnight rate is 12.0% per year.

According to Vietnam's state bank's Decision number 2811 QD-NHNN, effective from December 1, 2008, the required reserve ratio for almost all Vietnam's state commercial banks is 8% of all deposit amounts for deposits under 12 months or sight deposits; 2% for all deposits on over 12-month terms.

Furthermore, the market remains attractive in the middle to long term as it still holds the potential for a large future customer base (54 percent of Vietnam's population of 84 million are people below 30 years old who will soon demand separate living space from their parents (General Office for Population and Family Planning 2006)); a stable and growing economy; and governmental policies which encourage foreign investment. The most suitable way for foreign firms to enter Vietnam's market at the moment is through strategic alliance with domestic real estate developers. Indeed, this mode of entry will benefit both the foreign firms and their local partners in several ways.

Griffin and Pustay (2007) pointed out four benefits from strategic alliances for the foreign firm: ease of market entry, shared risk, shared knowledge and expertise, and synergy and competitive advantages. Firstly, cooperation with domestic firms helps overseas companies avoid the barriers to foreigners such as ownership restrictions, the limit on repatriation of profits, and the slow licensing process. It also helps reduce market research and marketing expenses. Secondly, the risks associated with being unfamiliar with the legal system, economy and industry risks are also lowered. As discussed above, the real estate market of Vietnam is a young market with mechanisms and regulatory frameworks still in formation; thus it remains a risky market for foreign investors. Cooperating with local developers who understand the market will help reduce or control these risks. Thirdly, knowledge and expertise can be shared effectively through the cooperation of the two firms: the foreign firm may share expertise and experience in management of assets internationally, while the domestic firm can share knowledge and tactics for operating in the specific conditions of Vietnam's real estate market. Being a local enterprise, the domestic partner is often quicker than the foreign firm in searching for information on current trends and needs in the market, as well as the government's upcoming planning and policies. Fourthly, the combination of the above benefits gives foreign real estate companies in alliance with domestic firms considerable competitive advantage over enterprises which enter Vietnam's market alone.

Besides the benefits shared with their foreign partners, one significant advantage Vietnamese real estate firms can enjoy from strategic alliance is the abundant funding they can receive from foreign sources. Especially in this situation where obtaining credit from banks is costly and the stock market is not yet a common source of finance, foreign capital will be a good solution to the current capital problem of real estate companies.

The market can also benefit from the cooperation of domestic and foreign real estate companies, as this cooperation will diversify capital-raising channels for the market as well as the real estate product mix. Less pressure on budgets and loans will allow real estate firms to choose from a variety of projects to develop instead of focusing only on luxury projects with higher returns—which is already a saturated market. Buyers,

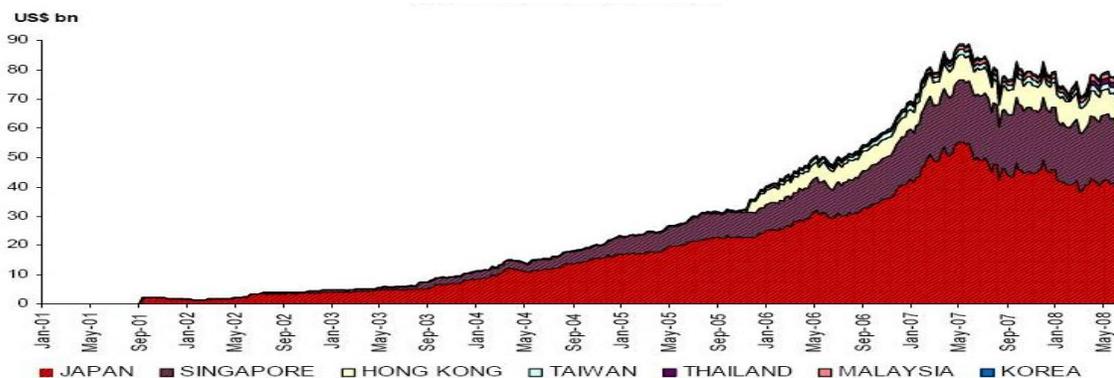
especially those with limited budgets, will also benefit when there is a greater variety of products at a wider range of prices and payment packets to choose from.

Market solutions: Real estate securitization

Real estate securitization is not a new idea; in fact, this concept was introduced in the United States as early as the end of the 1960s, and has since been widely applied all over the world (Kothari 2006). This process involves the pooling and conversion of individual mortgages into homogeneous, liquid instruments that can be traded efficiently in capital markets. Real estate securitization and mortgage-backed securities markets have been financing housing for large volumes of mortgage borrowers by refinancing their mortgage loans. Two main tools of real estate securitization are the real estate investment trust (REIT), an entity which specializes in real estate investment and which normally distributes the ownership of properties among public investors; and the creation of commercial mortgage-backed securities (CMBS), a method of pooling and restructuring of mortgage loans into securitization products tradable on primary and secondary securities markets.

The merits of REITs and CMBSs include: providing relatively cheaper financing alternatives to real estate developers than the traditional methods; allowing smaller and retail investors to invest in a more diversified portfolio of properties; converting properties into much more liquid and flexible assets; and facilitating a more active real estate market that would benefit all players in it (Opar and Bersani 2005).

Figure 6: Market Capitalization of REIT Markets in Asia – Jan 2001 ~ Jun 2008



Source: Bloomberg, APREA Research (2008)

REITs and CMBSs have been successfully applied in many markets, especially in Asian markets such as Japan over the past decade (Figure 6). The huge impact securitization has had on activating the real estate market of Japan is undeniable: the concept was introduced in 1997 and by 2004 the accumulated total amount of real estate

securitizations had exceeded 20 trillion Yen, making Japan's commercial real estate market the second largest market in the world. The securitization of real estate assets is also progressing rapidly in other Asian markets such as Korea, Hong Kong, and Singapore (Manglani and Wright 2005).

Considering the current conditions of Vietnam's real estate market and its future prospects, apart from the benefits mentioned above, the application of real estate securitization will not only be the potential long-term solution to the current capital puzzle but will also play an important role in stabilizing the market and balancing a product mix of properties in the long term. In fact, the idea of securitizing real estate assets was proposed and approved by Vietnam's government in 2006 and at the beginning of 2007 Prime Minister Nguyen Tan Dung also requested that legal infrastructures be established to support the application of real estate securitization (Nguyen 2006). However, to date there is still no sign that the idea will be applied in Vietnam in the short term. The current economic slowdown and the 2007 sub-prime problem in the United States might have delayed the process. To prepare the infrastructure for real estate securitization, Vietnam has to:

- Improve the current legal system for real estate business, increase the speed and transparency of licensing and procurement, and build strong taxation and accounting systems.
- Increase professionalism of both administrative bodies and players in the market; lower the barriers to foreign investors and real estate developers.
- Establish governmental offices specializing in housing problems in general, and financing housing in particular. The United States' Federal Housing Administration (FHA) and Veterans' Administration (VA) may be good examples.

These problems may not be solved promptly; however, considering the strong potential of the real estate market and the Vietnamese government's remarkable improvements in regulating the economy, it is not hard to believe real estate securitization will occur in the not too distant future.

Concluding Remarks

Vietnam's real estate market has been facing the fundamental problems shared by all young real estate markets, including imperfect legal infrastructures and governmental administration; lack of transparency and professionalism of both administrators and players in the market; and especially limited sources of funding for real estate development and trading.

The proposed policy solutions to these problems are action by the government to perfect the legal framework for the real estate industry; increase the professionalism of administrative officials, real estate firms, appraisals, brokers and investors; lower the barriers to foreign investors; and encourage banks to lend more at more favorable rates to real estate developers and buyers. The suggested solutions include an immediate solution and one long-term solution. The immediate solution is a strategic alliance between foreign and domestic real estate firms, which brings both parties many benefits while at the same time providing a prompt solution to the current capital problem. The long-term solution is real estate securitization, a process applied successfully in many of the world's real estate markets, which offers cheaper and less risky financing to real estate development, and activates the real estate market and balances market supply and demand by allowing more people to actively participate in it.

The property market of Vietnam is young and has much potential for development; resolution of the current problems should lead to strong growth.

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