Ho Chi Minh City, Vietnam

14 February 2018

Our Take On Frontier Markets

The business hub of Vietnam, Ho Chi Minh City, formerly known as Saigon, has the economic centre and it is the heart and soul of Vietnam's commerce scene. Money is on everyone's mind and the pulse of deal-making and business development is palpable everywhere you go.

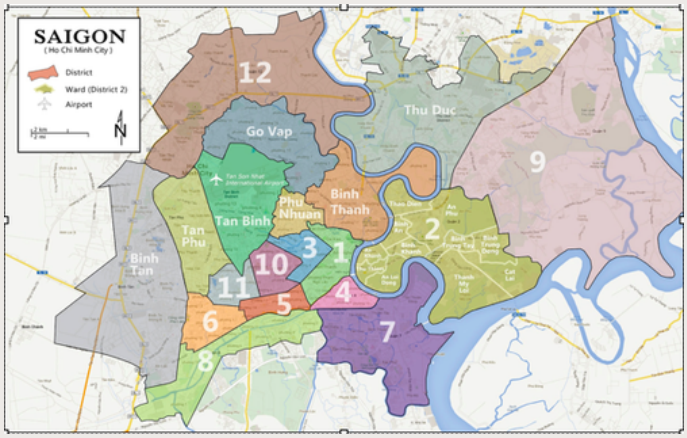
Ho Chi Minh City

Ho Chi Minh City (HCMC) has a population of almost 8.5 million people. The most telling and easy way of identifying the urban districts is from 1 through to 12. District 1 is the Central Business District (CBD) where most of the commercial buildings including the Saigon Trade Centre are located.

District 2 across the Saigon river is increasingly gaining in prominence as the new residential hotspot across the high-end Binh Thanh district. The master-planned area of Thu Thiem within District 2 is touted as the next CBD and is being compared with what Pudong is with the Shanghai CBD.

District 7 is also another district with a prominent master planned community at Phu My Hung and is also seeing increasing importance as a residential suburb.

The best way to experience the booming economy of HCMC is to take a walk in District 1. The many streets and boulevards are teeming with various businesses from retail, cafes, restaurants and even luxury goods. Not only this, many Grade A office buildings tower at District 1 are overlooking the Saigon river. It is a far cry from what it was decades ago.



With such growth, the troubles of infrastructure are widespread. There were times I was trying to cross the road but gave up because the stream of traffic was endless and packed. One learns that the best way to cross a road is to just walk at a constant (and predictable) pace so the motorcycles will avoid you as you walk. Accidents happen when the pedestrian panics and walks erratically or worse, freeze up on the road.

Ho Chi Minh City is an exciting place to be. The vibe is a city in evolution from the third world to the next level. Skyscrapers are now becoming a more common sight.

RUNNING|STREAM

Even more so with a bustling capital city is the need for high-density residence. Across the river from District 1 is District 2 with many established residential estates. Of note to us is the unusually low vacancy rate which can be seen in the form of few unlit apartments in high-density residences.

Having been to other emerging capital cities like Malaysia's Kuala Lumpur, China's Guangzhou and Philippine's Manila, it is a refreshing difference to see an emerging market nation with such high occupancy rates.

Having said that though, the property prices in HCMC, while a fraction of many developed countries, cannot be considered low.

It is even higher than Hanoi by almost 20-25% on average in comparable distance from the city centre. In District 7's Phu My Hung precinct, we looked a project which was priced around USD2000 per square metre. This was considered to be one of the more affordable projects for foreign investors to participate in.

At the other end, the same developer had a project in the Thu Thiem precinct at the south of District 2. This was touted as Ho Chi Minh City's Pudong precinct. (Pudong is a highly successful business district in Shanghai). Prices here started from about USD3500 per square metre. (This is almost similar to the prices of apartment in Brisbane).

But the question is are there are buyers? Jones Lang Lasalle's research for Q3 2017 shows that of the completed 110,000 and 86,000 uncompleted supply for the year, only 10.6% are unsold. For an emerging market economy with significant restrictions on foreign purchasers, this is significant in demonstrating the demand for residential properties in HCMC.

However, there are still some uncertainties with regards to how the locals are able to afford these assets in the absence of a mature banking system with affordable rates mortgage and financing.

Yet, we were told by their sales staff that Stage one of the Thu Thiem project sold out in less than a month with more than 60% being sold the first two days. More than 800 apartments priced slightly above USD3500 PSM and they have buyers on the waiting list for Stage two to be priced from USD4300 PSM.

By official statistics, the average after-tax disposable income of residents in Ho Chi Minh City is higher than Hanoi at less than US$500 per month. Again, being a developing nation, the available data is not reliable and we are reliant on some guesswork to determine the approximate level of disposable income for the average Vietnamese executive.

However, speaking to our contacts on the ground, it is clear that the income levels of Vietnamese professionals are clearly underestimated. Something of note to us is that most Vietnamese executives do not have just one stream of income. Many of them run businesses on the side and much of the income here is not declared to be taxed. The inefficiencies in the tax system is a very common trait in emerging markets.

Furthermore, there is a 30% restriction on foreign purchasers. If that is to be believed, then 70% of the buyers of these properties are local Vietnamese right? Unfortunately, that may not be the case. There is a way of allowing foreign buyers into the market even if the developer has hit the 30% quota.

It is just a simple matter of 'deal structuring.' Instead of the buyer signing a Sales & Purchase Agreement with the developer, what happens is that the buyer will sign a lease agreement with the developer for the same lease period as is allowed for foreigners in the S&P.

A 30 years lease with all the rights associated with a home buyer. Except, the buyer will not get a Pink Book / Title Deed. When the buyer chooses to sell, he will then sell to a local Vietnamese who can then buy with the standard S&P on freehold.

HCMC RESIDENTIAL

Supply and Demand	Apartment	Villas / Townhouses [1]
Completed Supply (units)	110,000	6,000
Uncompleted Supply (units) [2]	86,000	5,800
Unsold Inventory (%) [3]	10.6	12.4

Source: JLL Research

How ingenious! Or is it? Without a title deed, the buyer will be unable to ever secure a mortgage. One of the pull factors for us in investing in Vietnam is comparing what happened to Chinese property after the banking system started opening up to mortgages.

If an investor is looking into investing in Vietnam is unable to secure a mortgage later on because he has no title deed, then he is missing out on being able to do a draw equity from that investment.

Not to mention that the lease with the developer (no matter of reputable) is still an inferior security as compared to a proper title deed. Caveat Emptor!

Interestingly, the comparison with projects in Hanoi shows very high rates of sales as well. But the foreigner quotas are not hit for many projects I looked at which is indicative of a more locally supported market in Hanoi as compared to HCMC

Conclusion

Nonetheless, Ho Chi Minh City is still an exciting place to be and we are hard at work looking for opportunities. There is little doubt in my mind that Ho Chi Minh City's evolution will reward early investors.

But as always, there is more risk in investing in an emerging market. Investors have to be prepared for volatility and uncertainty if they are seeking double-digit returns per annum. This is highly probable in both Ho Chi Minh City and in Hanoi as the market matures.

But a city in it's maturing process is bound to go through periods of volatility and shocks. Global events such as a potential US interest rate rise also affects emerging markets more severely than developed markets.

As such, investors need to be informed about the risk and rewards when venturing into markets such as these. But personally speaking, as far as emerging markets go in the risk versus rewards spectrum, there is no other market that captures my interest as much as Vietnam.

~Colin Chu