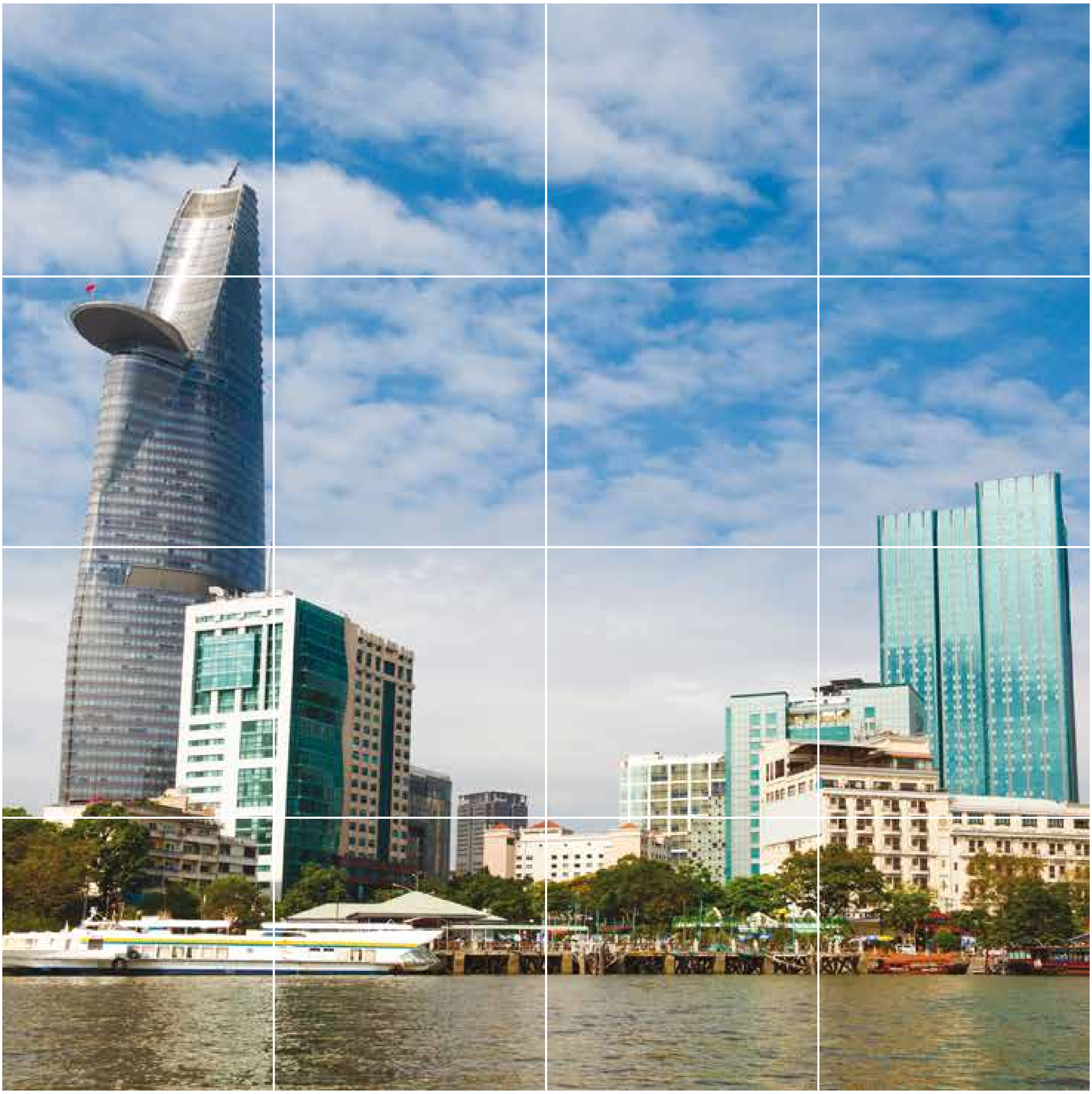
Ho Chi Minh City trip report: The opportunity lies in building homes

Aug 2016



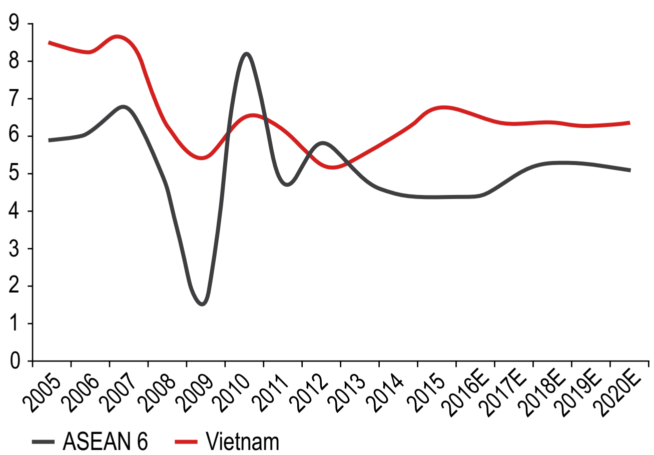
Vietnam is one of the fastest growing countries in Southeast Asia. In 1H16, Vietnam's GDP grew by 5.5%, and is expected to grow 6.0-6.5% in 2016-2020. Ho Chi Minh City GDP growth has been faster than Vietnam, at 7.5% in 1H16.

The strong economic growth is a result of favourable demographics, continued urbanization, industrialization and higher employment in the services sector and a rising middle class.

Demographics and a rising middle class

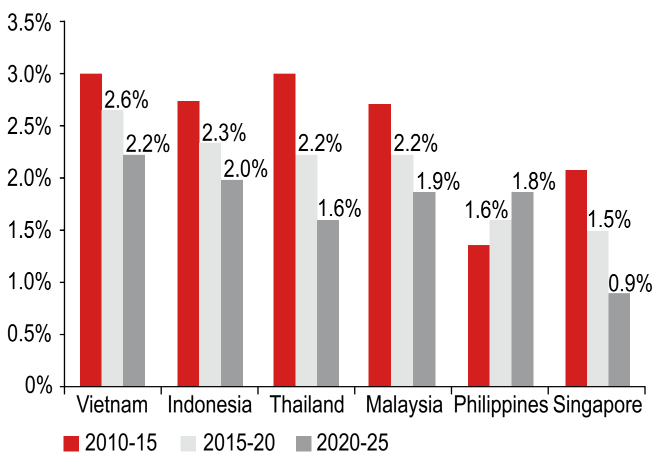
Vietnam's population has grown rapidly from 66 million in 1990 to 91 million in 2016. This makes Vietnam the third populous country in Southeast Asia after Indonesia and Philippines. While the birth rate is low at 2.09, internal migration from the countryside to urban areas will drive urban population growth. The World Bank expects Vietnam's urban population to grow by 2.4% per annum till 2025, the highest in Southeast Asia.

Fig 1: GDP growth of Vietnam and Southeast Asia



Source: IMA Asia

Fig 2: Urban population growth



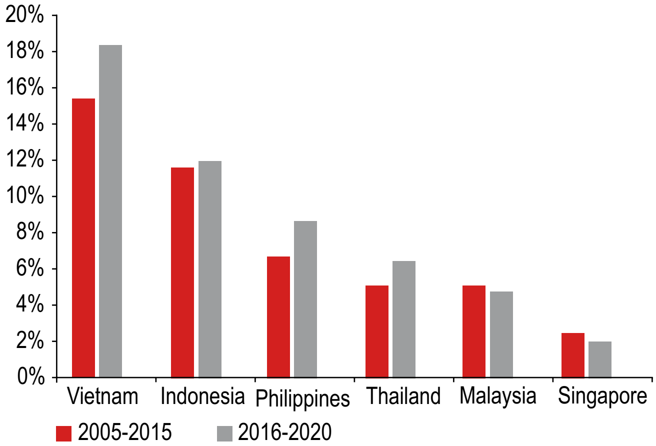
Source: World Bank

Over the next two decades, Vietnam will be in a demographic golden age. Employment in manufacturing and services has increased 25% of the population is aged between 10 and 24; the median age is around 30. According to the Brookings Institute, Vietnam has the fastest-growing middle class in Southeast Asia – 18% per annum over the period 2016-20, accelerating from 15% per annum in 2005-2015.

Employment in the services sector

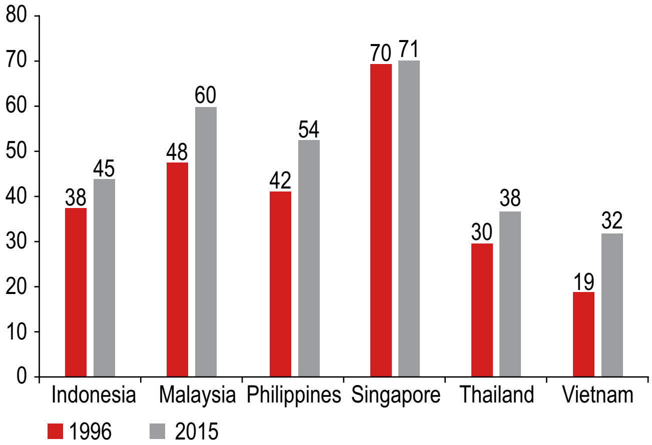
Vietnam's economy is still immature, with about 47% of employed persons still working in the agriculture, fishery and mining sectors, compared to 28% in Southeast Asia. Employment in the manufacturing and services sectors has increased substantially in the last two decades. Employment in the services sector has increased from 19% of the workforce to 32% of the workforce in Vietnam. We expect this to continue to rise in the next 10 years, boosting income growth.

Fig 3: Growth of middle class population



Source: Brookings institute

Fig 4: Percentage of employed persons in the services sector



Source: World Bank

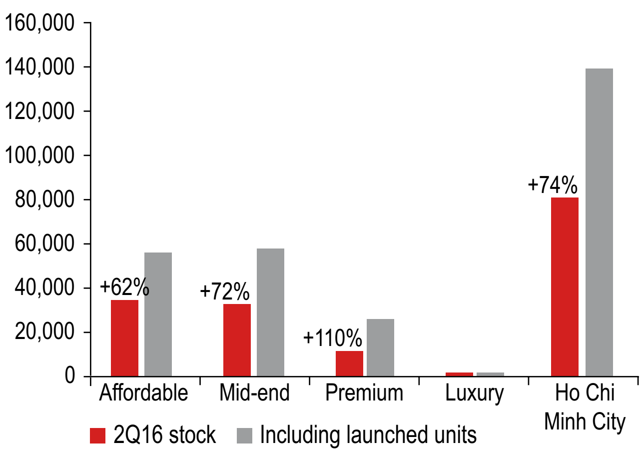
Ho Chi Minh City Residential outlook

Ho Chi Minh City currently has about 80,000 apartment units. Affordable, mid-end and premium apartments make up 43%, 42% and 15% of the stock respectively.

In the next three years, based on the private apartment units that have been launched for sale, the stock could increase by 74%. For premium and luxury apartments above USD2,000 psm, the stock is expected to double.

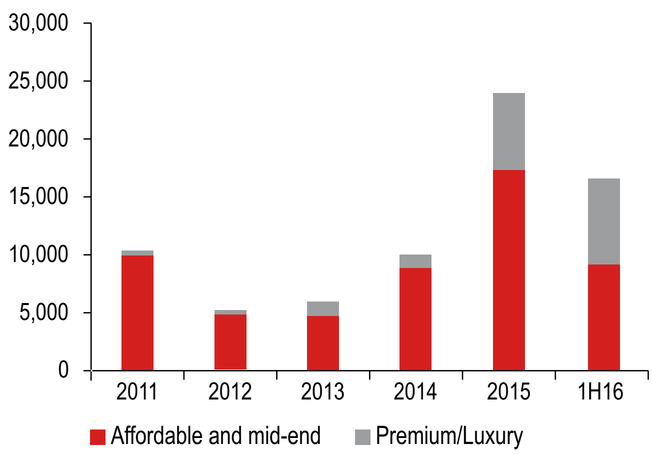
The high supply in the pipeline is a result of strong sales in 2015 and 1H16, where developers sold 24,000 units and 16,800 units respectively, 250% higher than the sales rate in 2011-2014. In 2011-2014, premium and luxury apartments made up just 10% of apartment sales, but in 2015 and 1H16, these made up 27% and 44% of apartment sales respectively.

Fig 5: Apartment units in Ho Chi Minh City



Source: JLL

Fig 6: Apartment sales in Ho Chi Minh City



Source: JLL

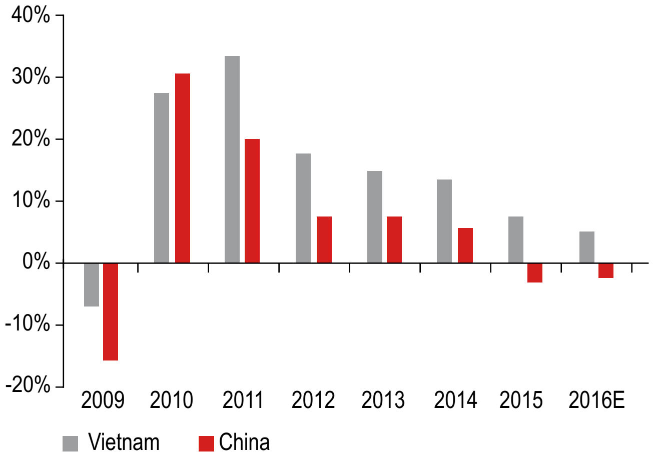
Why are sales so strong?

We believe investment into the residential market picked up momentum in 2015 due to stronger economic fundamentals as well as regulatory changes. Since 2011, Vietnam has attracted strong foreign direct investment into the manufacturing sector as it became a lower cost alternative to China. Vietnam's exports grew by 16% annually on average in 2011-2016, compared to just 6% for China.

As the trade deficit narrowed after 2011, the Vietnamese dong stabilised at 21,000/USD for an extended period. Inflation declined from 9% in 2012 to an estimated 1.4% in 2016, allowing deposit and borrowing rates to fall to 5.0% and 8.5% respectively in 2016.

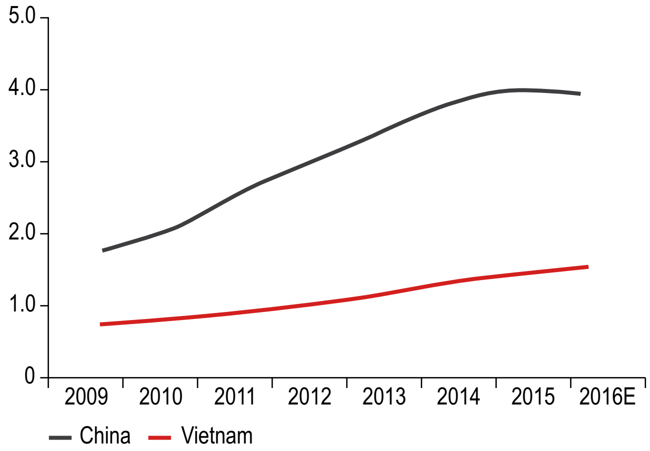
As confidence in the economy grew, interest in property investment was revived. In Nov 2014, regulatory changes were made to allow foreigners to buy up to 30% of any single condominium building or a maximum of 250 houses in any one administrative ward. This was implemented in Jul 2015. Foreigners will be able to own the property for 50 years and enjoy the same rights to lease, transfer or sell the property. Foreigners may extend their home ownership after 50 years, subject to approval. This further stimulated investor interest in Vietnam property.

Fig 7: Export growth on USD basis for Vietnam and China



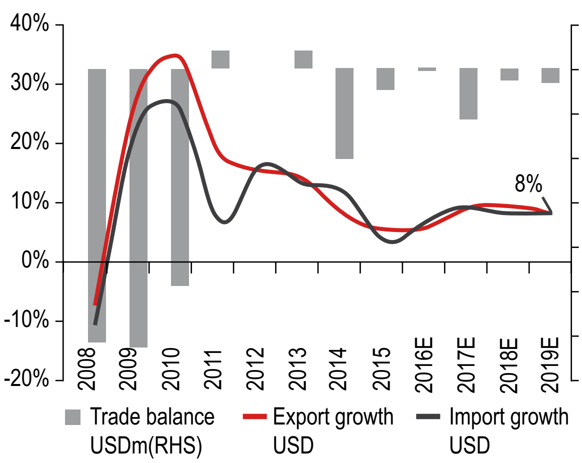
Source: IMA Asia

Fig 8: Manufacturing hourly wage in USD in Vietnam and China



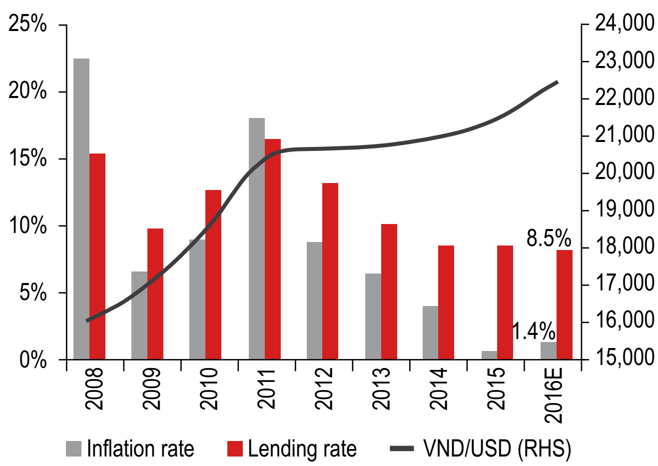
Source: IMA Asia

Fig 9: Trade balance and export growth



Source: IMA Asia

Fig10: Inflation and interest rate



Source: IMA Asia

Is there any oversupply in the residential market?

While the residential supply is expected to grow by 74% over the next three years, we think the market will be able to absorb it.

The current stock of apartments relative to Ho Chi Minh City's population is low compared to other Southeast Asian countries, even after the units that have been launched are developed. The government is seeking ways to encourage developers to undertake more affordable housing projects to meet the housing needs in the city.

However, the supply of premium and luxury apartments seems to be high, especially after the supply in the pipeline is completed. We estimate that Ho Chi Minh City could have close to 3 prime apartments per 1000 persons, close to the average in Bangkok, Kuala Lumpur and Manila, but higher than Jakarta.

Will home prices continue to rise?

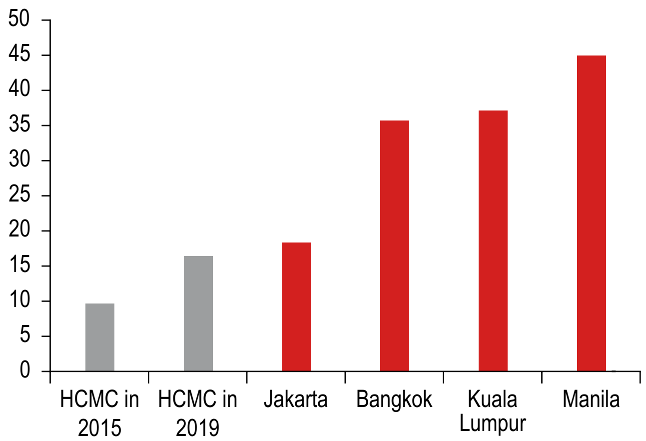
We expect overall apartment prices to rise by 5-7% p.a. in the next three years, supported by strong absorption and affordability levels. Mid-tier and affordable apartment prices could rise by up to 10% p.a.

Despite the strong sales volume in 2015 and 1H16, premium apartment prices have risen by just 9% in the last six quarters. We believe this is due to the range of choices developers have rolled out, creating strong competition. Sales rate has stayed strong at 60-70% in 2015 and 1H16, compared to 30% in 2010-2014.

In contrast, prices rose 106% in 2005-2007 when strong foreign capital flowed into Vietnam in anticipation of a strong recovery in the economy and the property market. During this period, developers sold around 1,500 units per year, achieving a sales rate of 65%. Prices have corrected by 30% over seven years in 2007-2014. Thus, the premium apartment price of USD2,180psm is still 24% below the 2007 peak.

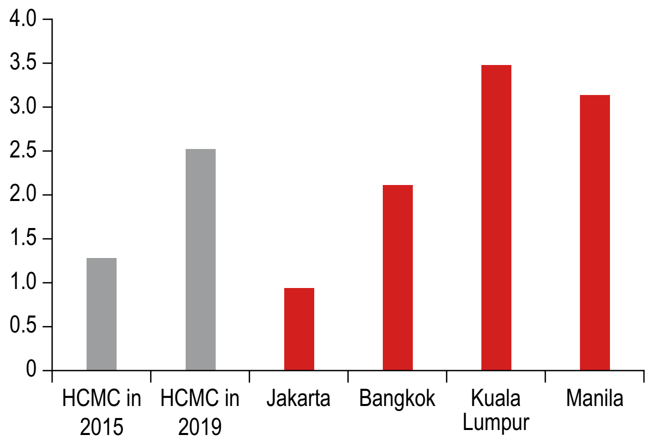
Further, apartment rents rose 4% in the last six quarters, keeping market yields relatively stable at 5.7%. The gap between rental yield and borrowing cost has narrowed from 880bps in 2008 to 280bps in 1H16. As the supply in the pipeline gets completed in the next 3 years, there may be downward pressure on rents and yields. However, given the low inflation experienced in 2015-16, there is scope for interest rates to continue to fall, supporting prices.

Fig 11: Apartment stock per 1000 persons, 4Q2015



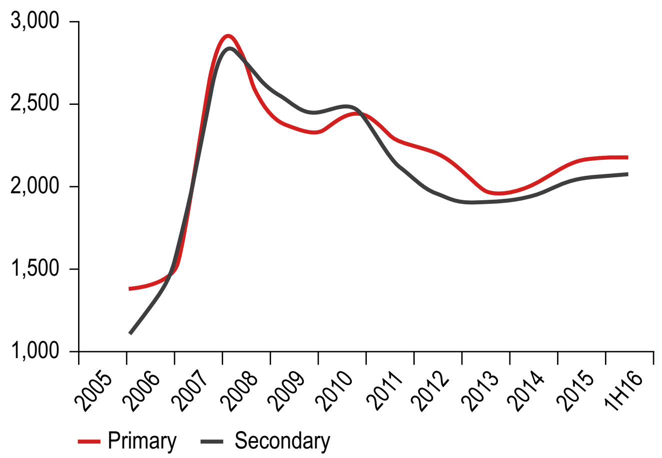
Source: JLL

Fig 12: Prime apartments per 1000 persons, 4Q15



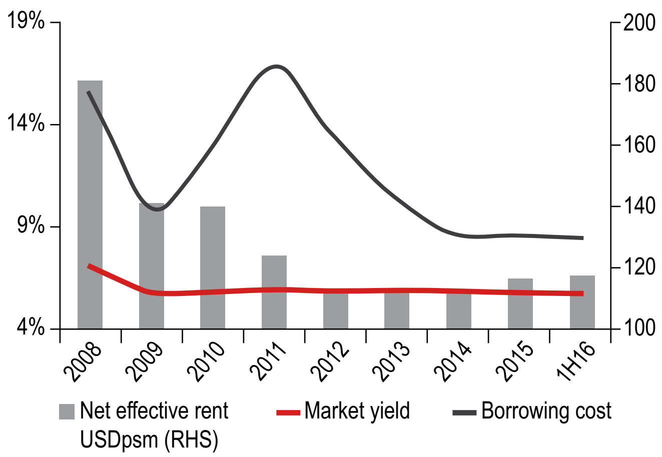
Source: JLL

Fig 13: Ho Chi Minh City premium apartment price USDpsm



Source: JLL

Fig 14: Ho Chi Minh City premium apartment rent and yield



Source: JLL

Are apartments affordable and is the market growth sustainable?

We believe Ho Chi Minh City apartments are still affordable compared to income levels. Based on the top quintile household monthly income of USD1,337, private apartments in the affordable and mid-end range cost about 3.9 to 6.6 years of income, assuming an apartment size of 75 sqm. The entry-level apartment price to income ratio of 3.9 years is 30% lower than the average of 5.7 years amongst other Southeast Asian cities.

Even if prices rose 30% over the next three years, it is likely that the home price to income ratio would be stable given that incomes have been rising at c.10% annually in the last few years. In the last 5 years, home prices in Ho Chi Minh City have declined amid income growth, bringing home price to income ratio from 7.6 years in 2010 to 3.9 years in 2015.

According to the World Bank, urban households in Vietnam have a median monthly income of USD460 while the top quintile household has a monthly income of USD1,340. Based on this, only households in the top 20th percentile can afford mass market apartments built by commercial developers.

For households outside of this income bracket, the government has launched a 30 trillion stimulus package from June 2013 to extend affordability to middle income households by lowering mortgage rates to 5% compared to market rates of 7.5-10.0%. The subsidy is stated to apply to social housing or apartments built by commercial developers that are smaller than 70 sqm and cost less than VND15m psm (or USD673 psm).

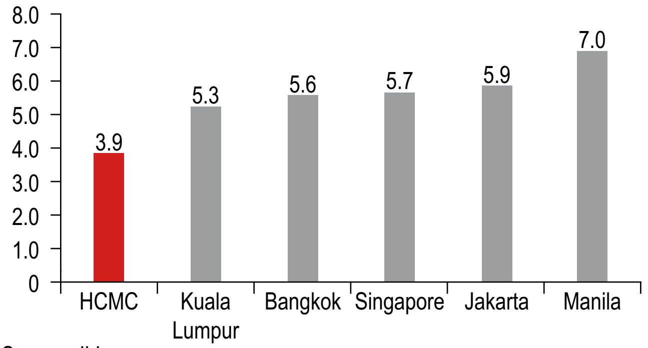
Since the program started, loan growth reached 13% in 2014, 18% in 2015 and is likely to be 18-20% in 2016. Our discussions with developers in Ho Chi Minh City indicated that 50-80% of apartment buyers are taking on a mortgage for 50-65% of the apartment price and loan tenures range from 15 to 20 years. The adoption of home loans is much higher than 2011 where majority of buyers use cash for apartment purchases.

Table 1: Ho Chi Minh City apartment prices

Apartment type	2Q16 price USD psm	Yoy change	Apartment price USD	Home price to income ratio
Affordable	827	7.90%	62,025	3.9
Mid-end	1,414	4.60%	106,050	6.6
Premium	2,192	8.70%		
Luxury	3,925	-3.10%		

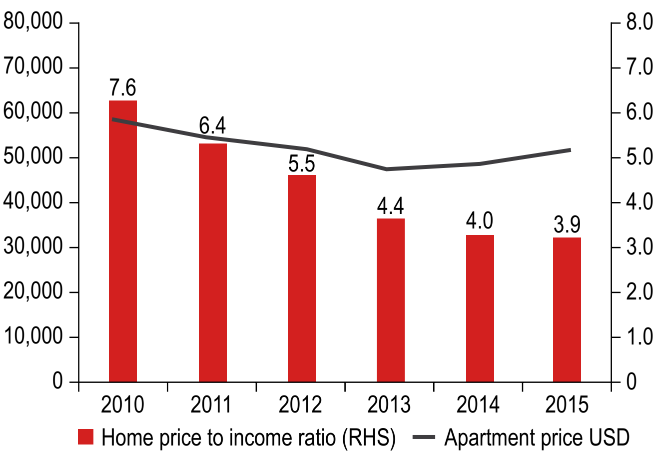
Source: JLL

Fig 15: Home price to income ratio for Southeast Asian cities



Source: JLL

Fig 16: Apartment price USD



Source: JLL

Table 2: Urban incomes in Vietnam by quintile and housing affordability with and without the 30 trillion mortgage program

Income quintile	Monthly income VND '000	Monthly income USD	Loan amount USD	Down payment	Down payment USD	Affordable home price USD	Apt size	USD psm
Q5	29,805	1,337	51,794	30%	22,198	73,992	75	987
Q4	14,272	640	18,601	20%	4,650	23,252	70	332
Q3	10,313	462	10,172	20%	2,543	12,715	70	182
Q2	7,322	328	4,767	0%		4,767	70	68
Q1	3,982	179	1,607	0%		1,607	70	23
With 30 trillion program								
			67,605	30%	28,974	96,578	75	1,288
			24,280	20%	6,070	30,349	70	434
			14,620	20%	3,655	18,275	70	261
			8,305	0%		8,305	70	119
			3,387	0%		3,387	70	48

Source: World Bank, JLL estimates

Is a bubble forming in the residential market?

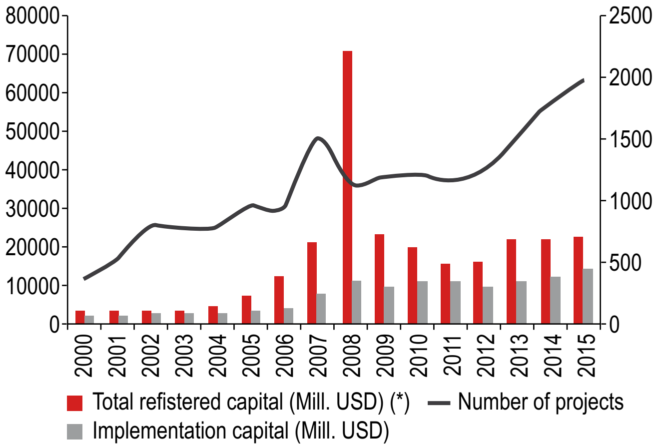
Several developers we spoke to in Ho Chi Minh were conscious of the property and stock market bubble in 2008. However, we find that current conditions are not as effervescent as conditions in 2007-2008.

Foreign direct investment into Vietnam in 2014 and 2015 were stable compared with 2010-2013 and most of the capital inflow was deployed into projects. In contrast, the capital inflow to Vietnam in 2007 was triple that of 2005, and in 2008, capital inflow rose 3 times in a year. Most of the capital was not deployed into projects. While capital inflow in 2008 was 6 times higher than 2005, the number of projects implemented was just 10% higher in 2008 compared to 2005.

The Vietnam stock index has also been stable in 2014-15, rising 15% over two years. In the last 12 months, the index rose 3%.

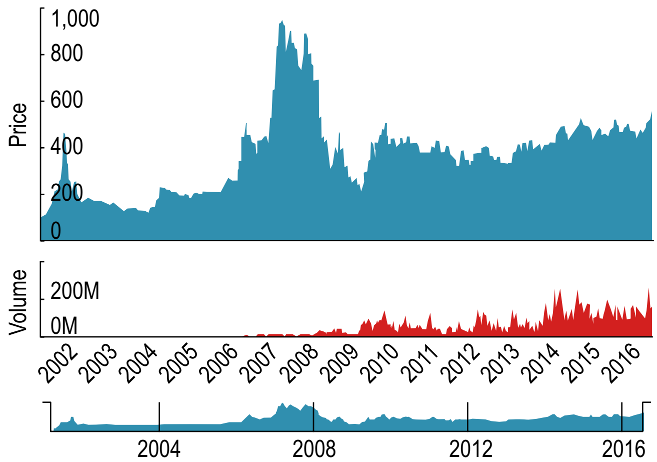
In contrast, the Vietnam stock index rose 144% in 2006 and 56% in 1Q2007 as the market priced in expectations of high GDP growth upon Vietnam's World Trade Organization (WTO) accession, positive operating results from listed companies, and increasing foreign portfolio investments. Rising concern over the risks of an overheating stock market prompted the State Bank of Vietnam to cap securities investments and hike interest rates 3 times from 8.75% to 14% in 1H2008. Subsequently, deposit interest rate rose to 16-18% while loan at 20-21%. In the first 6 months of 2008, the VN-Index fell by 60%.

Fig 17: Foreign Direct Investment into Vietnam



Source: General Statistics Office Vietnam

Fig 18: Vietnam Stock index (July 2000 - July 2016)



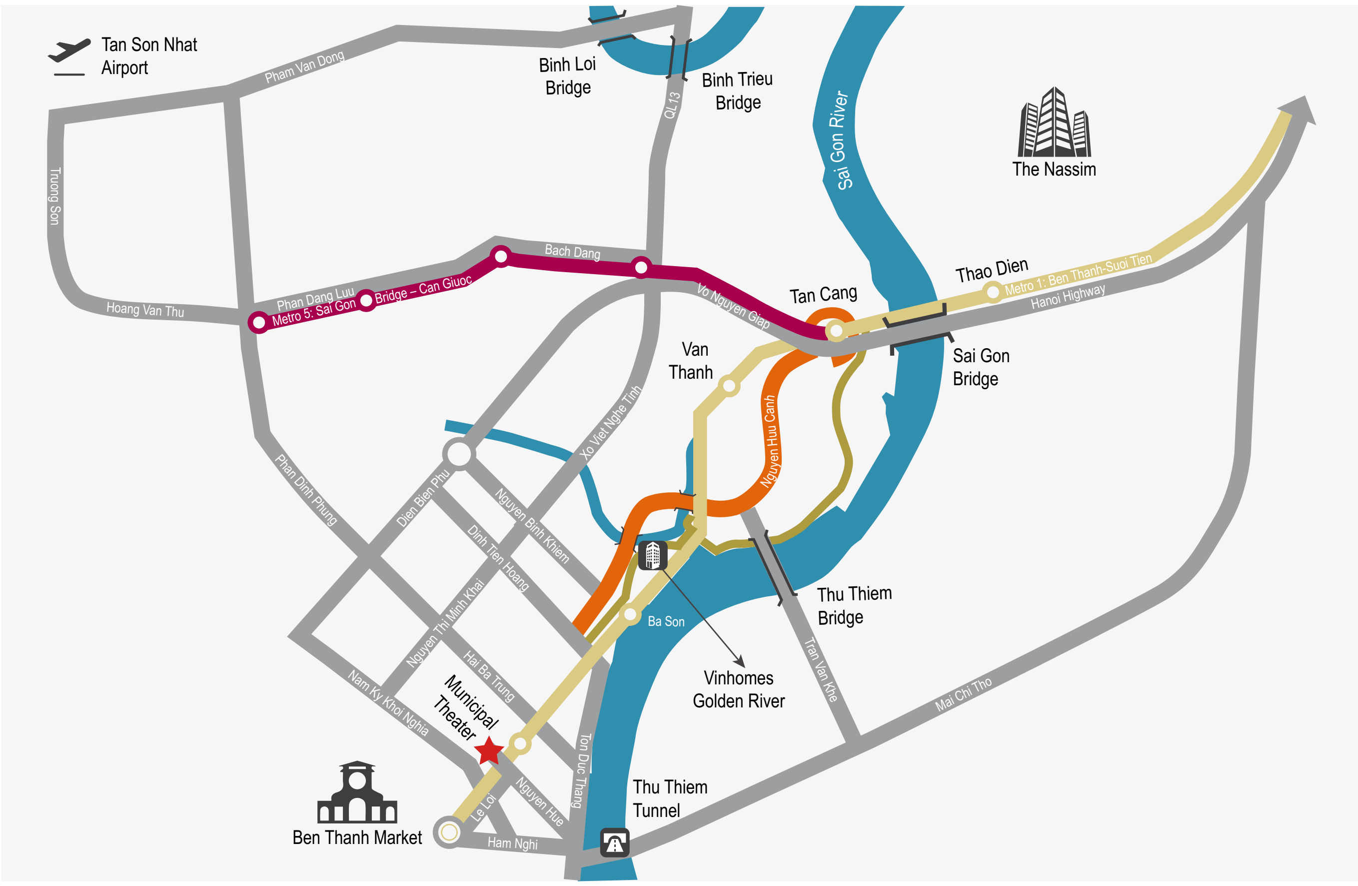
Source: https://www.vndirect.com.vn/portal/cong-cu-phan-tich-chung-khoan/bieu-do-ky-thuat.shtml

Should developers enter the residential market?

Developers we spoke to in Ho Chi Minh City stated that they were making EBITDA margins of 25-30% on prime and mid-end residential projects. Affordable and mid-end residential projects are likely to sell reasonably well given affordability levels. Furthermore, the supply growth in these segments are much lower than premium projects so competition for buyers will be less intense.

However, acquiring good land plots which have been cleared and have clean title deeds at a reasonable price continues to be challenging in Vietnam, as with many other Southeast Asian cities. Foreign developers that are new to the market should consider partnering with local groups on joint ventures. In June 2015, the government eliminated the 49% limit on foreign ownership in many listed companies, a step to spur investment inflows. This provides an opportunity for foreign developers to take on a majority stake in residential projects in partnership with local groups.

We believe the strong office absorption tracks employment growth in the services sector. In the last ten years developers are likely to build more apartments along the new metro line that is scheduled to be completed in 2020. Construction of the first metro line in HCMC commenced on 28 August 2012, connecting Ben Thanh Market to Suoi Tien. The line is expected to consist of 14 stations, covering 19.6km, of which 2.2km will be underground and the rest elevated, running across districts 1, 2, 9, Binh Thanh, and Thu Duc. Set to start operations in 2020, Metro Line 1 will strengthen the accessibility of housing developments located along its route, including Thu Thiem and Thao Dien area.



Ho Chi Minh City office outlook

Based on JLL's data, there were no new Grade A office buildings developed in 2000-2008. In the last six years, the stock of Grade A office buildings increased by 200% with the completion of Kumho Asiana Plaza, Vincom Center, Bitexco Financial Tower, Times Square and Vietcombank Tower. This brought the stock of Grade A net lettable office space to 220,000sm.

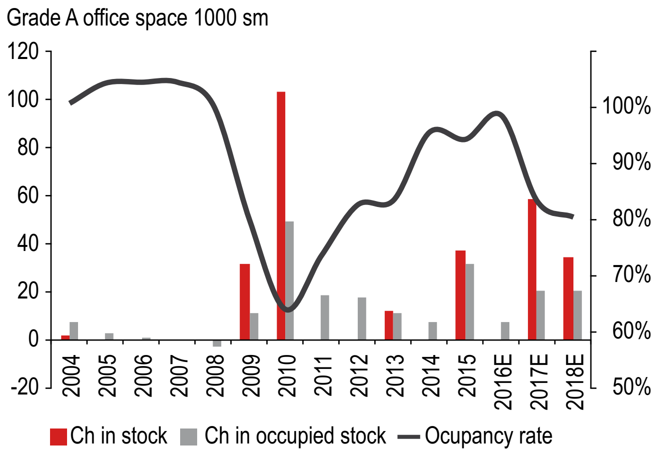
While Grade A office occupancy rate fell to 63% immediately after the completion of Vincom Center and Bitexco Financial Tower in 2010, the space was gradually taken up in 2011-1H2015 and occupancy rate recovered to 93%. The office market has become a landlord's market due to limited supply of office spaces over 1,000 sm until 2H2017 while demand continues to be strong.

In the last ten years, employment in the financial, insurance, real estate and business services sectors in Vietnam has grown by 11% per annum to 3.64 million in 2014, prompting annual occupied office space expansion of 9.6% on average.

Over the next ten years, we expect **demand for office space to continue to grow strongly by 8-10% annually** in Ho Chi Minh City as the economy develops. We expect the proportion of the population employed in services rises from 30% to 40%, and annual GDP growth of 5.5-6.0%.

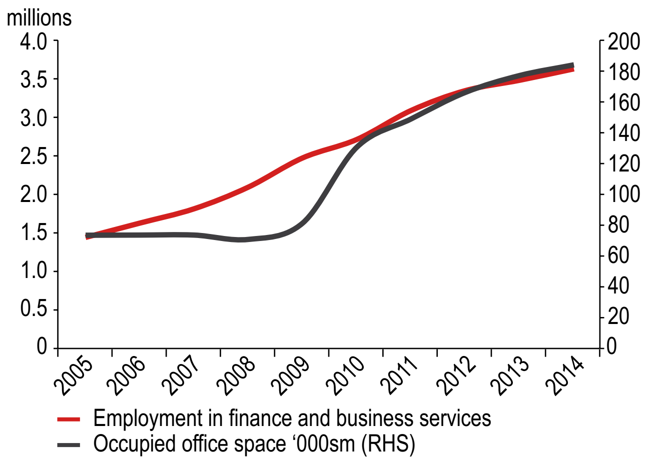
This provides a great opportunity for developers to acquire sites to build more office space to cater to new companies and expansionary demand.

Fig 19: Grade A office demand, supply and occupancy rate



Source: JLL

Fig 20: Employment in finance and business services sector



Source: Vietnam General Statistics Office

Compared to the other Southeast Asian cities, GDP per capita of USD2,100 in Vietnam still lags and as a result, office stock per capita in Ho Chi Minh City is still low. With just 1.7m sqm of office space, Ho Chi Minh City's office stock is less than half of the stock in Jakarta, Kuala Lumpur, Bangkok and Manila.

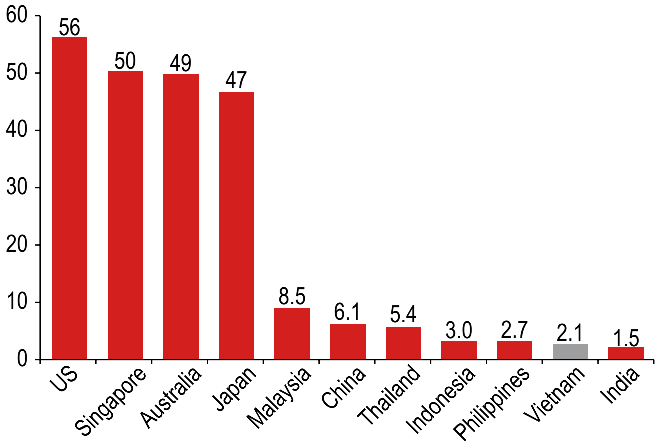
Rents and capital values seem expensive due to lack of significant stock

While office demand is likely to grow faster than the economy, we believe office rents and capital values in Ho Chi Minh City are not low.

Currently, Ho Chi Minh City gross effective prime office rent of USD550psm per annum is 40-160% more expensive than other Southeast Asian cities excluding Singapore. Capital values are similarly high at USD4,900psm, 25-160% higher than these more developed cities. While Ho Chi Minh City prime office market yield at 8.5-9.5% is high, the spread above cost of debt is thin at 150-250bps. In contrast, investment yields in Bangkok, Manila or Kuala Lumpur provide 300-400bps spread over the cost of debt.

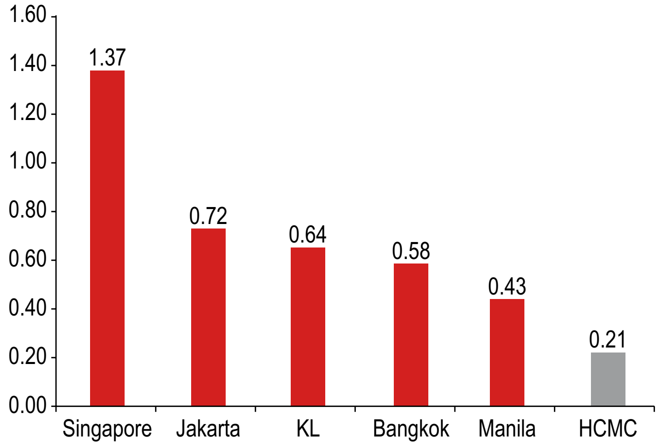
We believe this is symptomatic of a fledging city in the early stages of development. Before the development of sufficient stock of suitable office buildings for international companies, rents and capital values end tend to be expensive and companies may operate out of apartments or standalone buildings until the city gradually builds more office buildings. However, as the city develops and matures, office rents and capital values may moderate. In Ho Chi Minh City's case, the development of the Thu Thiem area across the river from District 1 over the next 10-20 years could prompt the growth of a new CBD that could more than double the office stock and allow rents to moderate.

Fig 21: GDP per capita in USD'000



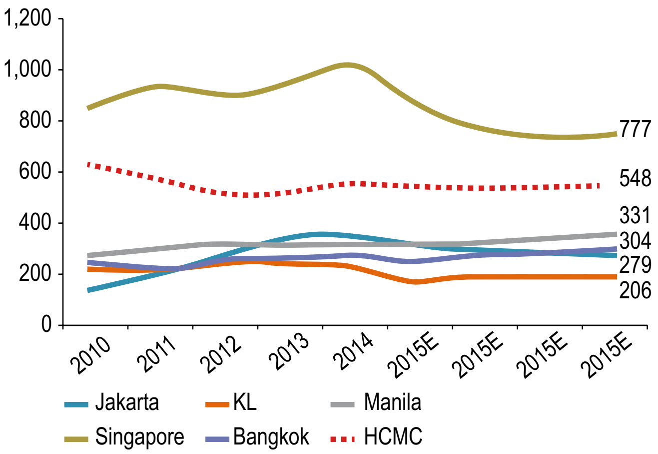
Source: World Bank

Fig 22: Office stock per capita in metro city (sqm)



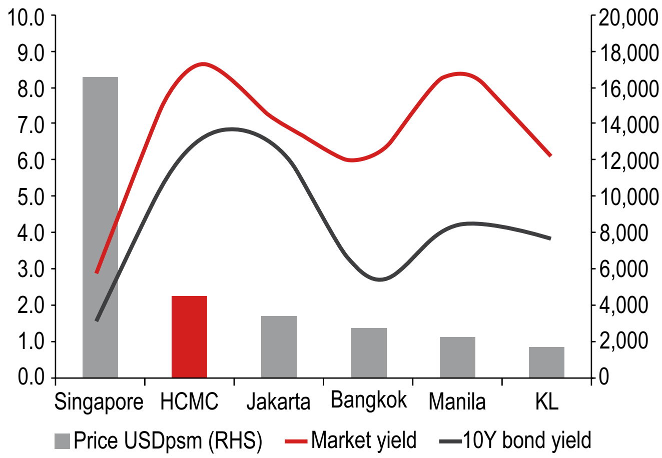
Source: JLL

Fig 23: Prime office rents per annum in Southeast Asian cities



Source: JLL

Fig24: Prime office yields and capital values in Southeast Asian cities

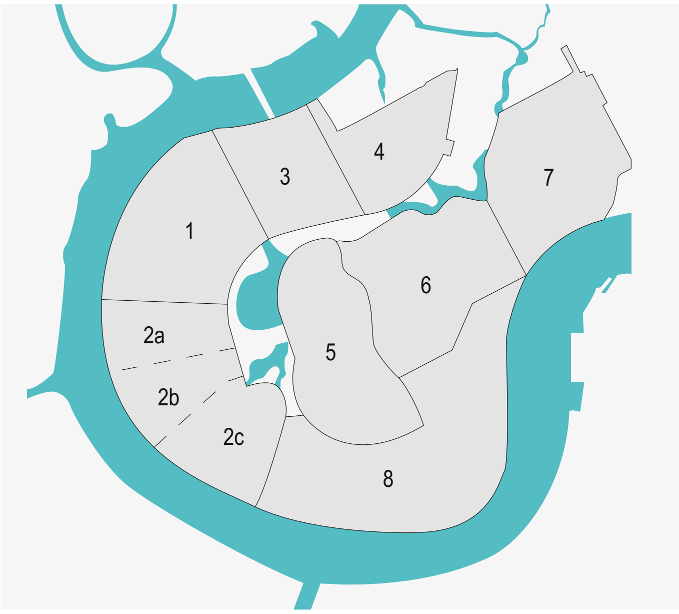


Source: JLL

Thu Thiem New Urban Area

The People's Committee of Ho Chi Minh City announced in 2002 that Thu Thiem will be developed into a new financial and commercial hub of Ho Chi Minh City. Thu Thiem will play a strategic role in the development of the east side of the city, in which several important industrial, social and economic zones have been established. The total land area of the Thu Thiem New Urban Area is 657 ha, out of which 215 ha will be for commercial and residential projects, 159 ha for roads and infrastructures, and 281 ha for public green parks.

The area is now connected to district 1 and other parts of the city via a Thu Thiem tunnel and a new bridge. Four other bridges and a metro line are under planning. Upon completion, these will provide Thu Thiem with a distinct advantage of a seamless connection with the current CBD. The Thu Thiem New Urban Area has been divided into eight main functional areas. According to the Thu Thiem Authority, each area, or so called "neighbourhood" is characterized by a distinct mixed-use program and density range, as well as public spaces and key landmark buildings.



The "Core Area" of Thu Thiem is divided into two neighbourhood known as #1 and #2 (2a, 2b, 2c).

The Northern residential areas consist of #3 and #4

The residential areas along the Mai Chi Tho Boulevard are #5 and #6

#7 includes the Eastern Residential development, Urban Resort Hotel and Marina

#8 encompasses the entire Southern Delta area.

Major approved projects in the area:

- Dai Quang Minh: Lot 5 & 6
- Eco Smart City: Lot 2a
- Empire City: Lot 2b

Major projects in Thu Thiem New Urban Area

Dai Quang Minh

In December 2014, Dai Quang Minh Real Estate Investment JSC entered an agreement with the People's Committee of Ho Chi Minh City, under which the company committed to build four major roads in Thu Thiem New Urban Area with an estimated cost of US$550 million. In exchange, Dai Quang Minh was given the right to develop an 80-ha urban area in Thu Thiem that includes luxurious residential, office, school and hospital. The estimated cost of development is US$85 million.

Eco Smart City

South Korean conglomerate Lotte and its Japanese partners, Mitsubishi and Toshiba, have announced the construction of a US$2.2 billion Eco Smart City project in Thu Thiem to kick off in July 2016.

Covering an area of 16.71 hectares, the complex features a luxury trade centre, office buildings, hotels, serviced apartments, and multifunctional condos, with a highlight of a 50-storey building.

Empire City

Empire City is a 14.5 hectares project located just next to the mouth of Thu Thiem tunnel. It will comprise premium residential apartments, office and retail properties as well as an 86-storey integrated mixed-use tower complex, which upon completion will become the tallest building in Vietnam. The planned GFA is 730,000 square meter with a total investment of US$1.2 billion. The construction commenced in October 2010 and is expected to complete its 4 phases in 2022.

In March 2016, Keppel Land entered into an agreement to subscribe for 40% interest in Empire City Limited Liability Company. The other joint venture partners are Gaw Capital Partners (30%) and Tien Phuoc Joint Stock Company and Tran Thai Real Estate Co. Ltd. (30%).

Details of projects we saw on this trip

	The Nassim	Golden River (Ba Son) Township)
Developer	Hong Kong Land & Son Kim Group	Vinhomes (Vingroup)
Address	No. 30, Street 11, Thao Dien Ward, District 2, Ho Chi Minh City	2 Ton Duc Thang, D1, Ho Chi Minh City
Land Area	6,464 sqm	25,3 ha (2.72 million sq. ft.)
No. of units	4 towers, 29 floors, 238 residential units	13 apartment buildings consisting of 3000 units; and 63 villas with area ranging from 225 to 475sqm
Completion	2Q 2018	December 2017 (Phase 1)
Built Ratio	-	18.6%
Unit Mix	**1BR**: 50 – 52 sqm; **2BR**: 77 sqm **3BR**: 108 – 123 sqm; **4BR**: 140 – 146 sqm **Penthouse**: 408 – 463 sqm	Officetel: **1BR** 42-45 sqm; **2BR** 62– 68 sqm; Apartment: **2BR** 72-85 sqm; **3BR** 92-114 sqm; 4BR 146-150 sqm
Indicative Pricing	Starting from US$3,000 psm - 20% to 30% higher than competition in the area	US$3000 – US$6000 psm US$150,000 – US$700,000 per unit
Payment Scheme	• Refundable registration fee: VND 50 mil • 1st deposit: VND 50 mil; 2nd deposit 7 days after 1st deposit: 10%; 3rd deposit at completion of pile cap: 10% • 1st instalment upon foundation completion: 10%; 2nd and 3rd instalment every 2 months: 20% (10% each) + tax • 4th instalment upon condo handover (2Q 2018): 45%, plus 2% management fees and tax • Upon issue of ownership title: 5% + tax	• Deposit: 200 million VND (~S$12,000), Down payment: 20% / 30% • 1st 6 months: 40% / 30%, 2nd 6 months: 10%, • Handover (Dec-2017 onwards): 25% plus maintenance fee (2%) and tax of 5% of unit value; • Receiving of ownership certificate: 5% For mortgages, LTV could go up to 75% with interest support from the developer for 8-20 months
Buyers Profile	Reached 30% limit on foreign buyers	80% local, 20% foreigners (mostly South Koreans and Chinese)
Facilities	25m lap pool, aqua deck with loungers, feature cabanas, Jacuzzi, kid's pool, aqua fountain, playground, BBQ terrace, fitness alcove, gym & yoga, billiards room, karaoke room, reading room and function room.	Vinschool - system from kindergarten through high school, shophouses, boutiques, supermarkets, restaurants, historical museums, playgrounds, swimming pools, BBQ areas, outdoor gym & fitness, Vinmec Central Park hospital, 1.2 km yacht berth, etc.
Location/ Accessibility	The Nassim is located in Thao Dien, an exclusive area surrounded by low-rise private residences and bungalows. The area has become popular among affluent Vietnamese and the expatriate community. Residents can benefit from all amenities including international schools, Vincom Mega mall, F&B outlets and medical centers. The upcoming metro station (An Phu) will further enhance accessibility of the location.	Existing: Located alongside the Sai Gon River at the heart of district 1, residents have easy access to the CBD by main roads: Ton Duc Thang, etc. Thu Thiem Bridge connecting the old CBD (district 1) and the new CBD Thu Thiem. Future: the 1st metro line scheduled to open in 2020 will run through the development. Ba Son station will be built below ground, making it easier for residents to get to other parts of the city

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