BUSINESS MONITOR
international

Q3 2010
www.businessmonitor.com

VIETNAM
REAL ESTATE REPORT
INCLUDES 5-YEAR FORECASTS TO 2014

ISSN 2040-770X
Published by Business Monitor International Ltd.

VIETNAM REAL ESTATE REPORT Q3 2010

INCLUDES 5-YEAR FORECASTS TO 2014

Part of BMI's Industry Report & Forecasts Series

Published by: **Business Monitor International**

Copy deadline: May 2010

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Executive Summary

There is a property glut in Vietnam. Rental rates fell by double digit rates through 2009 – in each of the three cities for which we gathered data (Hanoi, Ho Chi Minh City and Da Nang) and across all three sub-sectors. Vacancy rates are generally running at around 30%.

Normally, in an economy that has been growing so quickly – that the authorities are tightening both fiscal and monetary policy in order to curb inflationary pressures – rents and capital values would fall until much of the vacant space is absorbed.

However, this is not the process of adjustment that is under way in Vietnam. The government has intervened to re-regulate the commercial Real Estate sector. Approvals for projects that have been proceeding slowly have been revoked. The aim of this measure may be to prevent/discourage speculation in a country where inflation has been rising. More likely, it is a move to curb supply at a time that rental rates are under downwards pressure.

Our sources – across the three different cities – are adamant that rental rates will stabilise in the coming year and rise in 2011. For the time being, we assume that this is what will happen because the government mandates it. To a certain extent, the government and its agencies will be able to increase the amount of office space (and, perhaps, industrial space) that they are occupying. However, the likely consequence is that vacancy rates will remain high. In essence, it appears that official policy will be to keep rental rates (and probably prices and capital values) above market-clearing levels.

Yields rose in Da Nang over the course of 2009, but fell slightly in Ho Chi Minh City and Hanoi.

Interviews with our in-country sources were conducted in mid-March 2010.

Key Features Of This Report

This is the latest edition of a new series of industry reports published by **BMI** that seeks to identify the key dynamics of the real estate sectors of 44 countries around the world, some of which are developed and some of which are, in every sense, emerging markets. Once again, the questions that we seek to answer for each country remain as follows: What are the main issues that will matter to actors in and around real estate development in the country concerned, both over the long and the short term? What are the main constraints that they face? What are the key insights that one garners when one compares the real estate sector of the country concerned with its peers in other countries?

For Q3 we have introduced a very substantial new improvement to the reports. We have incorporated data and qualitative observations provided to us by commercial real estate agents operating in the countries we survey. As a result we have gained a much clearer picture of the balance between demand and supply in

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each of three main sub-sectors – office, retail and industrial. We have also introduced a new approach to the forecasting of rental yields, which is discussed in the methodology sector of this report.

SWOT Analysis

Vietnam Real Estate/Construction SWOT	
Strengths	▪ The Vietnamese construction sector is expected to grow firmly over the medium term, on the back of high capital investment and strong FDI inflows. With ratings agencies pushing grades higher, foreign direct investment (FDI) in 2008 was estimated at US$62bn, more than triple the US$20.3bn recorded in 2007. ▪ Economic restructuring has led to a labour shift away from farm work to non-farm employment, providing a large and inexpensive labour pool for construction companies.
Weaknesses	▪ Vietnam depends on a large proportion of imports of raw materials for construction, and is therefore largely exposed to volatility in the world markets. ▪ Managerial talent and skilled workers are generally in short supply, which can have the effect of raising the cost of construction projects, particularly those with demanding technical requirements. ▪ Corruption and bribery continue to affect the competition for projects among construction companies and developers. The transparency in awarding contracts is still questionable.
Opportunities	▪ With easing inflation, the government's current focus on growth suggests there could be some intervention to accelerate large-scale infrastructure projects. Also, there are some big projects in the pipeline for Vietnam's infrastructure and real estate, which will likely sustain the momentum in the construction sector. ▪ The lower cost of construction materials could be beneficial to that end. ▪ Government plans for some bigger cities will keep urbanisation steaming ahead.
Threats	▪ Slowdown in growth and the global financial crisis could have resulted in lower demand in the construction sector. Although material prices have retreated from record highs of 2008, sales fell for cement and steel in late 2008. ▪ Tighter lending conditions could impose a financial constraint on construction companies and developers.

Vietnam Economics SWOT	
Strengths	▪ Vietnam has been one of the fastest-growing economies in Asia in recent years, with GDP growth averaging 7.6% annually between 2000 and 2007. ▪ The economic boom has lifted many Vietnamese out of poverty, with the official poverty rate in the country falling from 58% in 1993 to 20% in 2004.
Weaknesses	▪ Vietnam still suffers from substantial trade, current account and fiscal deficits, leaving the economy vulnerable as the global economy enters into recession in 2009. The fiscal picture is clouded by considerable 'off-the-books' spending. ▪ The heavily managed and weak dong, reduces incentives to improve quality of exports, and keeps import costs high, thus contributing to inflationary pressures.
Opportunities	▪ WTO membership has given Vietnam access to both foreign markets and capital, while making Vietnamese enterprises stronger through increased competition. ▪ The government will, in spite of the current macroeconomic woes, continue to move forward with market reforms, including privatisation of state-owned enterprises, and liberalising the banking sector. ▪ Urbanisation will continue to be a long-term growth driver. The UN forecasts the urban population to rise from 29% of the population to more than 50% by the early 2040s.
Threats	▪ Inflation and deficit concerns have caused some investors to re-assess a hitherto upbeat view of Vietnam. If the government focuses too much on stimulating growth and fails to root out inflationary pressure, it risks prolonging macroeconomic instability, which could potentially lead to a crisis. ▪ Prolonged macroeconomic instability could prompt the authorities to put reforms on hold, as they struggle to stabilise the economy.

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Vietnam Business Environment SWOT	
Strengths	▪ Vietnam has a large, skilled and low-cost workforce that has made the country attractive to foreign investors. ▪ Vietnam's location – its proximity to China and South East Asia, and its good sea links – makes it a good base for foreign companies to export to the rest of Asia and beyond.
Weaknesses	▪ Vietnam's infrastructure is still weak. Roads, railways and ports are inadequate to cope with the country's economic growth and links with the outside world. ▪ Vietnam remains one of the world's most corrupt countries. Its score in Transparency International's 2008 'Corruption Perceptions Index' was 2.7, placing it 20th in the Asia-Pacific region.
Opportunities	▪ Vietnam is increasingly attracting investment from key Asian economies, such as Japan, South Korea and Taiwan. This offers the possibility of the transfer of high-tech skills and know-how. ▪ Vietnam is pressing ahead with the privatisation of state-owned enterprises and the liberalisation of the banking sector. This should offer foreign investors new entry points.
Threats	▪ Ongoing trade disputes with the US, and the general threat of American protectionism, which will remain a concern. ▪ Labour unrest remains a lingering threat. A failure by the authorities to boost skills levels could leave Vietnam a second-rate economy for an indefinite period.

Real Estate Investment Trusts

REITs Recovery Stalls

In isolation, 2009 would have been a good year for the world's real estate investment trusts (REITs). The FTSE/EPRA/NAREIT Global Real Estate Index provided a total return of 41.25% in US$ terms, including 34.76% in capital growth and 6.50% in income. Over the course of the year the yield on the index fell from 6.70% to 3.79%. Broadly similar total returns were provided by each of the four regional components of the index – 37.31% in the Americas, 44.91% in Asia Pacific, 40.94% in Europe and 43.30% in the Middle East and Africa.

Of course, this recovery followed a disastrous 2008, when the Global Real Estate Index delivered total returns of -48.90%, and a lacklustre 2007. The quarter-on-quarter (q-o-q) performance of the index on the following page, and its regional components, provides a nuanced picture.

In essence, most – but not all – of the heavy losses in 2008 and in Q109 were recovered in the six months to the end of September 2009. Thereafter, returns from REITs moderated, with prices in all regions dropping in the first three weeks of 2009. In part because of the softness in the share price of Australian property giant **Westfield**, the Asia Pacific component of the index began to lose ground from Q409.

The recovery in Q209 and Q309 was the result of a combination of factors. Investors envisaged a stabilisation in commercial property markets worldwide. REITs and listed companies, particularly in North America, were able to undertake initial public offerings (IPOs), meaning that they had access to capital to shore up their balance sheets.

The latest figures available confirm that the optimism of REIT investors earlier in 2009 has, in the main, been justified. In its Global Market View for Q309, published at the end of last year, **CB Richard Ellis** (CBRE) for instance noted that the aggregate value of commercial real estate transactions had picked up since the beginning of 2009 in each of the three major regions (Americas, Europe, Middle East and Africa and Asia Pacific), although less (in both absolute and percentage terms) in the Americas. Furthermore, although office rents are still declining globally in each of the major regions, the pace of falls has slowed. Major economies have begun to recover, albeit slowly.

Table: REIT Returns – FTSE EPRA/NAREIT Global Real Estate Index And Components, 2007-Q110 (% change)

Global	**2007**	**2008**	**Q109**	**Q209**	**Q309**	**Q409**	**Q110***
Total	-4.65	-48.90	-20.99	37.25	25.28	4.02	-3.72
Price	-7.87	-51.28	-22.14	35.24	24.06	3.16	-3.78
Income	3.21	2.39	1.15	2.01	1.17	0.85	0.05
Yield	na	3.97	na	na	na	na	na
Americas							
Total	-13.98	-42.37	-30.50	33.43	36.05	8.83	-4.75
Price	-17.64	-45.58	-31.71	31.50	34.67	7.75	-4.84
Income	3.66	3.11	1.20	1.93	1.38	1.08	0.09
Yield	na	3.88	na	na	na	na	na
Asia Pacific							
Total	18.60	-53.99	-12.67	45.16	13.95	0.33	-2.87
Price	15.41	-55.81	-13.68	43.69	13.02	-0.52	-2.89
Income	3.19	1.82	1.01	1.47	0.93	0.85	0.02
Yield	na	3.72	na	na	na	na	na
Europe							
Total	-24.46	-51.18	-19.14	26.71	35.02	1.89	-3.64
Price	-26.54	-53.31	-20.17	23.21	33.73	1.51	-3.73
Income	2.08	2.13	1.03	3.49	1.28	0.37	0.08
Yield	na	4.53	na	na	na	na	na
Middle East and Africa							
Total	33.35	-34.48	-5.08	24.37	13.88	6.59	-0.58
Price	26.36	-39.37	-8.49	23.15	10.25	5.72	-0.58
Income	6.99	4.89	3.41	1.22	3.64	0.87	0.00
Yield	na	7.63	na	na	na	na	na

** To January 22 2010; na = not available. Source: FTSE, EPRA, NAREIT*

One reason for the stalling in the rise of REIT prices from the end of Q309 was that a number of companies – in different parts of the world – were tapping capital markets. In its Monthly Market Review for October 2009, for instance, the European Public Real Estate Association (EPRA) noted that **Confinimmo** and **CA Immo**, respectively a Belgian REIT and an Austrian property company, successfully placed EUR100mn and EUR130mn in bonds. In the US, **SL Green**, the largest owner of office properties in New York City, successfully completed a US$215mn refinancing of its property at 100 Park Avenue, which it owns through a joint venture (JV).

In its November 2009 report EPRA noted that **CapitaLand**, the largest property developer in Singapore, raised SGD2.8bn by listing its **CapitaMalls Asia** business on the local stock exchange. This was the largest IPO in that market since the SGD4bn raising undertaken by local telecommunications giant **SingTel** in 1993. In the UK, **Quintain Estates & Development** and **Grainger PLC**, the country's largest residential property company announced large rights issues (of GBP191mn and GBP250mn respectively). In the US, **National Retail Properties** and **Duke Realty Corporation** announced the renewal of substantial credit facilities.

By some measures, valuations look particularly attractive. Vacancy rates in commercial property across the US as a whole, whether in offices, industrial property or retail property, are near historic highs. CBRE notes that although the fall in capital values from peak levels in office properties across Europe varies quite markedly – from 22% or less in most German cities (except Berlin), most Swiss cities and particular Southern European cities such as Rome and Athens to 30% or more in the UK, Ireland and Spain – yields are now nearly everywhere near cyclical highs. In late 2009 European office yields were generally 5-6% in cities where capital values had held up the best and 7-8% elsewhere. EPRA notes that discounts to net asset value (NAV) in Austria, Greece, Germany and Finland are, in each case, more than 20% below the average for the last five years. In only three countries – France, Belgium and the UK – are discounts currently smaller than the long term average for Europe as a whole (11%).

Still, there are a number of causes for concern. As we explain elsewhere in this report, **BMI** is forecasting low credit growth, slow economic growth and muted inflationary pressures in most major economies. Although the details vary from city to city, this is not particularly good news for take-up of office space, or for retailers to be able to sustain significant rental increases. It is also not good news for industrial property, notwithstanding the fact that growth in the amount of newly available space is slowing in the US and that there is a dearth of supply in many European markets. For its part, CBRE notes that its EU15 index of prime industrial rents in Europe fell by only around 5% over the course of 2009. In addition:

- Investor sentiment in Europe remains ambiguous. **DTZ**, for instance, notes that there has since 2007 been a consistent fall in the percentage of commercial real estate investment in Europe that has involved cross-border capital flows. At the peak of the market in 2007, foreign purchases accounted for 52%. The figure slipped to 45% in 2008 to 34% in 2009. The implication is that many investors in the region have become risk averse and are focusing on domestic markets that they feel that they understand best.

- While some REITs were able to tap capital markets in Q2 and Q309, and indeed more recently, there has been a dearth of new funds available to the important European unlisted fund sector. According to the European Association for Investors in Non-listed Real Estate Vehicles (INREV), there were 474 vehicles with a combined gross asset value (GAV) of EUR262bn at the beginning of 2010. To put this into context, it is worth noting that, according to EPRA/NAREIT, there were 108 US REITs with a

combined NAV of US$250bn. Launches of unlisted funds in Europe were running in excess of EUR60bn annually in 2005, 2006 and 2007. In spite of the upheaval in Q408 following the global financial crisis, launches in 2008 as a whole amounted to more than EUR30bn. In 2009, in contrast, funds worth less than EUR10bn were launched.

- Unless this situation changes, European unlisted funds will be substantial net sellers of real estate over coming years. INREV notes that, thanks to planned fund terminations, funds with GAV of EUR14-18bn are due to be liquidated annually over the next six years.

- Some office markets remain exposed to the fortunes of the global financial services industry, which has not been flourishing. In its November 2009 Review of Global Office Rents, CBRE noted that many of the cities which had had the sharpest declines in prime office space rents had been those where demand from banks and institutions had been driving rents up sharply in the recent past. For example, office rents in downtown and midtown Manhattan in Q309 were about 30% lower than they had been a year previously. More serious falls took place in Singapore (-53%), Ho Chi Minh City (-46%), Hong Kong (-41% in the centre and -33% across the city as a whole) and Abu Dhabi (-39%)

- In Japan investment activity has remained subdued. DTZ notes that total commercial real estate transactions in that country rose by more than 50% to JPY236bn from Q309 to Q409. However, half of the rise was accounted for by the sale of Pacific Century Place in Tokyo's Marunouchi Ward for JPY140bn.

- Perhaps the greatest challenge for the US commercial real estate sector, and indirectly for real estate owners and developers elsewhere, is the 'debt gap', which has been quantified by the US Mortgage Bankers Association at US$360bn. This is the amount of borrowings that are scheduled to be rolled over through 2010 and 2011. As CBRE notes in its Global Market View for Q309, 'a shortfall for funds for expiring debt has put many properties at risk of default as loans mature and are unable to be refinanced.' The gap arises because the amount of money that property owners can expect to be able to borrow is – thanks to lower real estate values and tighter credit policies at banks – is less than the amount they need to refinance. CBRE notes, however, that commercial property prices have – especially in the class A office market – dropped to levels at which investors are actually buying. In addition, US insurance companies are increasing their allocations to mortgages, while two Wall Street firms have announced that they plan to resume conduit lending programmes.

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Real Estate Market Overview

Key Issues

From the point of view of owners, investors and most other protagonists in Vietnam's commercial Real Estate sector, the general economic outlook is benign. However, a past construction boom has resulted in massive over-supply, which has resulted in slippage in rental rates through 2009 and high vacancy rates.

The government has intervened in the market place. Approvals for projects, which had been progressing too slowly, have been revoked. This may be a measure to limit speculation. More likely, it is a move to control the direction of rents and values. Our in-country sources suggest that rental rates will stabilise this year and start rising again in 2011. We assume that this is the result of official government policy – rather than a true reflection of absorption of excess space. As a consequence, we presume that vacancy rates will remain high for some time.

Comments And Data From In-Country Sources

In a global, if not a regional, context, Vietnam is unusual in that it is at the top of the economic cycle. Thanks to a surge in domestic demand, real GDP growth in 2009 was 5.3%. We are looking for an expansion of 4.4% in the current year – as both fiscal and monetary policy are tightened in order to curb Vietnam's trade deficit and to limit inflationary pressures. The challenges have been made greater by the devaluations of the dong in both November 2009 and February this year. At this stage, we envisage that growth will accelerate again to 5.5% in 2011 and to 6-7% for 2012-2014.

In short, the economic environment is broadly favourable for commercial Real Estate. However, the slippage in rental rates through 2009 – in spite of an economy that was over-heating – and the high vacancy rates that are prevalent in most cities and sub-sectors point to massive over-building.

All our in-country sources emphasised that the central government has intervened to absorb projects where private sector entrepreneurs have not moved fast enough to develop them. This may be a move to discourage speculation. More likely, it is an official measure to control rents and prices. For the time being, we accept at face value our sources' predictions that rents will stabilise in 2010, and increase in 2011. However, we note that, if this is the result of government fiat, the vacancy rates in Ho Chi Minh City, Hanoi and Da Nang will likely remain high.

Table: Vietnam Real Estate Markets – Rentals in m²/month (USD)

	2008		2009		
	Min	Max	Min	Max	% chg y-o-y
Offices					
Hanoi	21.43	57.14	15	40	-30
Da Nang	11	24	10	19	-10-20
Ho Chi Minh City (Saigon)	20	90	15	70	-25-30
Retail					
Hanoi	22.22	62.5	20	50	-10-20
Da Nang	27.75	50	25	40	-10-20
Ho Chi Minh City (Saigon)	67	170	50	120	-25-30
Industrial					
Hanoi	4.44	8.75	4	7	-10-20
Da Nang	5.6	12.5	5	10	-10-20
Ho Chi Minh City (Saigon)	6.5	11	5	8	-25-30

Source: BMI

Table: Vietnam Real Estate Markets – Net Yield (%)

	2008	2009
Offices		
Hanoi	7-9	6-9
Da Nang	6-9	7-8
Ho Chi Minh City (Saigon)	8-9	6-8
Retail		
Hanoi	7-11	8-10
Da Nang	5-8	6-9
Ho Chi Minh City (Saigon)	7-9	8-10
Industrial		
Hanoi	8-9	7-9
Da Nang	6-8	7-9
Ho Chi Minh City (Saigon)	7-9	8-9

Source: BMI

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Vietnam Real Estate Markets – Terms of Contract/Lease

	Terms (yrs)	Rent Free Months
Offices		
Hanoi	2-6	2-3
Da Nang	2-3	None
Ho Chi Minh City (Saigon)	2-5	3
Retail		
Hanoi	2-3	2-3
Da Nang	2-5	None
Ho Chi Minh City (Saigon)	1-2	3
Industrial		
Hanoi	10 and more	5-6
Da Nang	2-8	None
Ho Chi Minh City (Saigon)	1-5	3

Source: BMI

Vietnam Real Estate Markets – Available Space (m²) and Vacant Space (%)

	Available	Vacant
Offices		
Hanoi	500,000	35
Da Nang	n/a	n/a
Ho Chi Minh City (Saigon)	400,000	30
Retail		
Hanoi	100,000	40
Da Nang	n/a	n/a
Ho Chi Minh City (Saigon)	300,000	25-30
Industrial		
Hanoi	100,000	35
Da Nang	n/a	n/a
Ho Chi Minh City (Saigon)	100,000	15-20

Source: BMI

Forecast Scenario

Real Estate Outlook

Supply And Demand

There is clearly an over-supply of commercial property in Vietnam. Our sources in Ho Chi Minh City, Hanoi and Da Nang reported that office and retail rents fell by 10-20% over the course of 2009 (and by more in the case of Hanoi office space). Industrial property rents slipped by 25-30%.

As we discuss in the Real Estate Market Overview, the problem is not that Vietnam is sliding into recession or financial crisis. The **State Bank of Vietnam** is tightening policy to rein in excess demand and to curb inflationary pressures. Like Indonesia, Vietnam has passed through the global financial crisis largely unscathed.

The conclusion, therefore, must be that there has been significant over-building in all sub-sectors and in all three main cities. Vacancy rates are running at 30-40% (except in the industrial sub-sector in Ho Chi Minh City, where they are 15-20%).

Relative to other countries whose real estate sectors are profiled by **BMI**, Vietnam stands out because the government appears to be taking steps to manipulate the market. Our sources report that permits for projects, which have been proceeding slowly have been revoked. The government and its agencies are seen as major sources of demand.

Our sources are surprisingly confident that rents will stabilise over the course of 2010 and will rise quite strongly next year. For the moment, we take the view that this will happen – but only because it is mandated by the central government which, in its own right and through its agencies, is an increasingly important player.

The specific comments from our in-country sources are as follows:

- ‘Rental rates in Ho Chi Minh City were 25-30% lower in 2009 than they had been in 2008. The fall in the property market was because of the government’s intervention. The Ministry of Finance is revoking (sic) from the entrepreneurs [and is giving it back to the government for public usage].

- ‘We expect rental rates in Ho Chi Minh City to rise this year [by 5%] … The rise is expected because demand for commercial real estate exceeds supply. The central government is [resuming] available land and, at the same time, is revoking permits for existing projects.’

- Vacancy rates in Ho Chi Minh City are running at around 30% in the office sub-sector, 25-30% in the retail sub-sector and 15-20% in the industrial sub-sector. ‘We are looking for a 15-20% rise in rental rates in 2011. This is because the rental rates [are at the lowest possible level].

- ‘The Ho Chi Minh City market does not seem promising for new projects. There are no new projects in Ho Chi Minh City. The existing projects are being revoked. We are not expecting any new projects this year.’

- ‘We are expecting rental rates [in Hanoi] to rise by 5% in 2010. Rental rates may increase as the government is revoking (sic) projects from entrepreneurs. This will lead to an increase in demand which will be greater than the supply [of commercial property.]

- Vacancy rates in Hanoi are currently running at 35-40% across all three sub-sectors.

- ‘The launch of three projects – namely Plaschem (Long Bien District), CEO Tower (Tu Liem District) and Handiresco Tower (Ba Dinh District) has lifted Hanoi’s total office space to 500,000 square metres, including 12 Grade A buildings, 30 Grade B buildings and 32 Grace C buildings. These commercial towers have been launched jointly by government agencies and private entrepreneurs.’

- ‘We are expecting a 15% rise in rental rates in Hanoi in 2011.’

- ‘The government is taking over all the new commercial projects that are under construction across Vietnam. Besides these projects, we are unaware of any further projects that are under construction in and around Hanoi.’

- Commercial rents in Da Nang are expected to rise by 5% in 2010. ‘The increase in rental rates should be due to the … programme of the central government, which is trying to develop the available land for public convenience.’

- ‘We expect a 15% rise in rental rates [in Da Nang] in 2011. ‘This is because rental rates are at their lowest possible rates currently.’

Rents And Yields

During 2009, yields rose in Da Nang (in spite of the slump in rental rates). They fell slightly in Ho Chi Minh City and Hanoi. As noted above, the two key characteristics of the commercial Real Estate market as a whole have been over-supply and (apparently) government intervention to stabilise the market. We conclude that (although it was not specially mentioned by our sources in that city), prices and capital

values fell in Da Nang. The government's activities may have prevented a fall in prices and capital values in Ho Chi Minh City and Hanoi.

If the government is successful in generating a rise in rental rates over the next two years, yields should rise somewhat. (We suspect, however, that vacancy rates will remain high). From 2012, though, we would expect yields to slip gradually as market participants see capital growth as being the main source of investment return in a country whose economy is, by most standards, still growing steadily.

Table: Vietnam Real Estate Markets – Rentals in m²/month (USD)

	2009		**2010**		
	Min	Max	Min	Max	% chg y-o-y
Offices					
Hanoi	15	40	15.75	42	5.00
Da Nang	10	19	10.5	20	5.26
Ho Chi Minh City (Saigon)	15	70	15.75	74	5.71
Retail					
Hanoi	20	50	21	52.5	5.00
Da Nang	25	40	26.25	42	5.00
Ho Chi Minh City (Saigon)	50	120	52.5	126	5.00
Industrial					
Hanoi	4	7	4.2	7.35	5.00
Da Nang	5	10	5.25	10.5	5.00
Ho Chi Minh City (Saigon)	5	8	5.25	8.4	5.00

Source: BMI

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Table: Vietnam Real Estate Markets – Forecast Net Yield (%)

	2008	2009	2010	2011	2012	2013	2014
Offices							
Hanoi	7-9	6-9	7.5	7.9	7.5	7.4	7.4
Da Nang	6-9	7-8	7.5	7.9	7.5	7.4	7.4
Ho Chi Minh City (Saigon)	8-9	6-8	7.0	7.4	7.0	6.9	6.9
Retail							
Hanoi	7-11	8-10	9.0	9.5	9.0	8.9	8.8
Da Nang	5-8	6-9	8.0	8.4	8.0	7.9	7.8
Ho Chi Minh City (Saigon)	7-9	8-10	9.0	9.5	9.0	8.9	8.8
Industrial							
Hanoi	8-9	7-9	8.0	8.4	8.0	7.9	7.8
Da Nang	6-8	7-9	8.0	8.4	8.0	7.9	7.8
Ho Chi Minh City (Saigon)	7-9	8-9	8.5	8.9	8.5	8.4	8.3

Source: BMI

Construction Industry Outlook

Table: Construction And Infrastructure Industry Data And Forecasts, 2007-2014

Construction industry	**2007**	**2008**	**2009e**	**2010f**	**2011f**	**2012f**	**2013f**	**2014f**
Value, VNDbn	79,617	95,969	102,800	134,526	169,289	204,177	242,708	284,396
Value, US$bn	4.95	5.84	5.64	7.08	9.15	11.67	14.7	18.3
Real growth, % y-o-y	12.01	0.37	0.12	21.86	19.34	14.61	12.9	11.7
% of GDP	6.96	6.49	5.90	6.90	7.83	8.44	8.9	9.3
Capital investment								
Total, VNDbn	437,702	531,987	610,919	665,518	746,802	833,850	932,415	1,039,643
Total, US$bn	27.2	32.4	33.5	35.0	40.4	47.6	57	67
Total, % of GDP	38.3	36.0	35.0	34.1	34.5	34.4	34.3	34.1
Per capita, US$	318.1	373.0	380.6	392.7	446.5	520.1	609	713
Real growth, % y-o-y	24.2	3.8	2.0	3.0	8.0	7.5	7.5	7.5
Employment								
Construction sector employment, '000	2,268	2,378	2,438	2,529	2,781	3,035	3,309	3,603
– % change y-o-y	6.14	4.87	2.51	3.75	9.93	9.15	9.01	8.89
– % of total labour force	4.99	5.11	5.11	5.18	5.56	5.92	6.30	6.70
Total workforce, '000	45,463	46,563	47,690	48,844	50,026	51,237	52,477	53,746.9
Infrastructure industry								
Value as % of total construction	42.48	45.71	45.79	47.89	49.47	50.51	51.31	51.94
Value, VNDbn	33,825	43,865	47,067	64,429	83,745	103,131	124,543	147,711
Value, US$bn	2.10	2.67	2.58	3.39	4.53	5.89	7.55	9.53
Real growth, %	15.40	6.68	0.30	27.89	23.48	17.15	14.76	13.10
% of GDP	2.96	2.97	2.70	3.31	3.87	4.26	4.58	4.85

e/f = estimate/forecast. Source: Vietnam General Statistics Office, IMF, ILO, BMI

Vietnam's Macroeconomic Outlook

Policy Tightening To Slow Growth

BMI View: *The strong domestic demand-driven recovery in Vietnam brought real GDP growth to 6.9% y-o-y in Q409 and full-year growth to 5.3%. We believe a sharp tightening of fiscal and monetary policy will be needed in 2010 to avoid overheating and to plug a widening trade deficit. We thus maintain our below-consensus forecast of real GDP growth dropping to 4.4% in 2010.*

Our outlook on Vietnam has not changed since early Q409 when it became increasingly clear that the economy was overheating. We thus went from expecting a gradual economic recovery in 2010 to projecting a double-dip scenario, with real GDP expansion dipping to 4.4% in 2010 after a forceful economic recovery in the three last quarters of 2009. This was based on our expectations that fiscal and monetary policy would have to be tightened sharply in H110 in order to rein in the widening trade deficit and halt inflationary pressures. With Vietnam having effected yet another devaluation of the dong in February, less than three months after the last devaluation in late November, our conviction in this view is even stronger

Indeed, the stimulus-driven economic recovery roared on in Q409, with real GDP growth clocking 6.9% y-o-y, the highest outturn since Q108. Q409 saw the manufacturing sector come back in force, with its contribution to real GDP growth rising from 0.6 percentage points (pp) in Q309 to 1.7pp. The industrial output reading of 13.4% y-o-y in December confirmed that momentum was still strong in the industrial sector going into 2010. The construction sector also recovered forcefully in 2009 after a bleak 2008, with growth rising to 13.2% y-o-y in Q409. Meanwhile, the service sector continued to perform well, with growth rising from 6.6% y-o-y in Q309 to 8.7% in Q409.

The unexpectedly strong Q409 reading helped bring full-year growth in 2009 to 5.3%, slightly above our 5.1% forecast (largely thanks to an upward revision of Q309 growth). While this is the lowest annual growth rate since the 4.8% reported in 1999, it still compares favourably with Vietnam's emerging markets peers, both in Asia and globally. However, the recovery from the 3.1% y-o-y real GDP growth nadir in Q109 has been largely thanks to the stimulus policies of the government, which has seen M2 money supply growth at 28.7% and credit growth rise to 38% in 2009, at the same time as the budget deficit widened to an estimated 8.9% of GDP.

Policy Tightening Needed To Stabilise Economy

While successful in reviving growth, the strong fiscal and monetary stimuli have aggravated Vietnam's already precarious balance-of-payments position, with the monthly trade deficit widening to US$2.1bn in November. The 3% devaluation of the dong on November 25 only helped the trade deficit correct from US$2.1bn in November to US$1.9bn in December, and we believe the traction from the February devaluation will be equally poor. This is because the devaluations have not been coupled with any serious efforts to quell domestic demand, which continues to expand at a markedly higher pace than the rest of the global economy.

Indeed, the State Bank of Vietnam (SBV) has decided to keep the benchmark base rate on hold at 8% in January and February after having raised it by 100bps on December 1. This was in spite of inflation rising to a nine-month high of 7.6% y-o-y (1.4% m-o-m) in January, with significant upward pressure noticeable in the leading food and foodstuff categories. The authorities have instead opted to ask commercial banks to restrict lending for imports of cars, mobile phones and other high-value consumer goods and to support import-substituting industries in order to keep the trade deficit within the US$14.5bn target set up for 2010. The efficacy of such measures is highly in doubt, however, and we believe that a sharp tightening of fiscal and monetary policy will be needed in 2010 to bring the economy back onto an even keel. We are expecting the SBV to raise the Vietnam base rate by a further 400bps in H110 to 12.00% by mid-year while curbs on fiscal spending are imposed to bring domestic demand into line with external demand (exports grew by 9.8% y-o-y in Q409 compared with a 29.7% expansion in imports) and thus reduce the trade deficit.

Double Dip Still Core Scenario

We expect the fiscal and monetary tightening to lead to a double dip in growth after the tentative rebound seen in the last three quarters of 2009. We are expecting real GDP growth to come in at 4.4% in 2010, as weak growth in G3 markets will weigh on exports and prevent a marked improvement in net exports in spite of the devaluations of the dong. This will mean that the slowdown in domestic demand will be harder felt. With inflation expected to average roughly 9% in 2010, we expect government consumption to decrease by 3.5% in real terms, which will shave 0.3pp off headline growth. A more marked effect will come from a slowdown in private consumption growth as credit conditions are tightened. We expect private consumption growth (in real terms) to slow to 2.3% from an expected 4.9% in 2009 and 9.2% in 2008. This should see the contribution to growth from private consumption decrease to 1.6pp in 2010 from 3.3pp in 2009 and a massive 6.0pp in 2008. This would bring a double dip for Vietnam, with annual real GDP growth dipping again to 4.4% in 2010 after the policy-induced recovery in Q209-Q409, before recovering to 5.5% in 2011.

We are, on the other hand, expecting an increase in the contribution from gross fixed capital formation from 0.4pp to 1.1pp as FDI disbursements, down 12.1% y-o-y to US$8bn in January-October 2009, recover and state-and aid-financed projects gather pace. The precarious state of the property market, however, where activity and prices have been supported by the loan-subsidy programme, is a risk to this forecast. While only a minority of property purchases are financed through bank lending, higher interest rates should still have an impact on the market and on commercial and residential construction.

We expect the slowdown in growth in 2008 to 2010 to make economic policy the main matter of debate during the Communist Party of Vietnam (CPV)'s 11th National Congress scheduled for January 2011. The macroeconomic rollercoaster ride experienced in recent years has raised criticism against Prime Minister Nguyen Tan Dung, the most important proponent of economic reform, from more conservative members in the Politburo. We believe the mainstay of the CPV is still behind Nguyen's reform agenda, meaning that there will be no drastic shift in the socio-economic development strategy for 2011-2016.

We expect measures to be taken to achieve greater macroeconomic stability, however, including a reduction of official growth targets, a shift in monetary policy towards inflation targeting and increased exchange rate flexibility. This is likely to come at a cost to economic growth in the short term, and we are consequently forecasting real GDP growth of 5.5% and 6.0% in 2011 and 2012, respectively, as the global economic environment is expected to be less conducive than in the 2003-2007 boom years. A failure to take a decision on rebalancing economic policy would, on the other hand, mean a high risk of a continuation of macroeconomic volatility as expressed in Vietnam's score of 44 out of 100 in our short-term economic risk ratings.

Risks To Outlook

The key risk to our outlook is policy paralysis ahead of the National Congress in January 2011, in which fears about the political repercussions of an economic slowdown prevents the Politburo’s agreeing on a needed tightening of fiscal and monetary policy. This scenario would see real GDP growth come in higher in 2010 but at the cost of significantly higher levels of inflation and slower growth in succeeding years.

Table: Vietnam – Economic Activity

	2007	2008	2009	2010f	2011f	2012f	2013f	2014f
Nominal GDP, VNDbn [2]	1,144,015	1,478,695	1,645,481	1,843,741	2,074,296	2,312,000	2,589,237	2,885,436
Nominal GDP, US$bn [2]	71.1	89.8	91.8	94.6	106.4	115.6	129.5	144.3
Real GDP growth, % change y-o-y [2]	8.5	6.2	5.3	4.4	5.5	6	6.8	6.9
GDP per capita, US$ [2]	835	1,035	1,043	1,060	1,177	1,262	1,394	1,533
Population, mn [3]	85.6	86.8e	88e	89.2	90.4	91.6	92.8	94.1
Industrial production index, %								
y-o-y, ave [1,4]	16.7	14.6	7.6e	10	12	14	14	14
Unemployment, % of labour force, eop [4]	4.6	5	5.5e	5.5	5	4.5	4	4

e/f = estimate/forecast. [1] at 1994 prices; Sources: [2] IMF (General Statistics Office). [3] IMF; [4] General Statistics Office.

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Business Environment

Real Estate/Construction Business Environment Ratings

Table: Asia Real Estate/Construction Business Environment Ratings

	Limits of potential returns			Risks to realisation of returns				
	Real estate market	Country structure	*Risks*	Market risk	Country risk	*Risks*	Real estate rating	Rank
China	85.0	45.0	*71.0*	86.7	50.0	*73.7*	72.4	1
Australia	65.0	92.0	*74.2*	66.7	75.0	*69.5*	71.9	2
Japan	60.0	75.0	*65.1*	73.3	69.0	*72.0*	68.5	3
South Korea	52.5	71.0	*59.1*	80.0	66.0	*75.2*	67.2	4
Indonesia	77.5	35.0	*62.7*	90.0	35.0	*70.7*	66.7	5
Singapore	47.5	88.0	*61.5*	66.7	81.0	*71.6*	66.6	6
Hong Kong	45.0	88.0	*60.2*	70.0	75.0	*71.6*	65.9	7
India	87.5	31.0	*67.9*	75.0	42.0	*63.6*	65.7	8
Malaysia	50.0	53.0	*51.0*	90.0	59.0	*79.0*	65.0	9
Taiwan	52.5	67.0	*57.6*	70.0	60.0	*66.4*	62.0	10
Pakistan	62.5	29.0	*50.9*	85.00	40.0	*69.3*	60.1	11
Thailand	42.5	43.0	*42.8*	73.3	62.0	*69.3*	56.0	12
Philippines	60.0	41.0	*53.3*	60.0	48.0	*55.7*	54.5	13
Vietnam	**70.0**	**17.0**	***51.3***	**23.3**	**47.0**	***31.8***	**41.5**	**14**

Scores out of 100, with 100 highest. The 'Real rstate rating' is the principal rating. It comprises two sub-ratings: 'Limits of potential returns' and 'Risks to realisation of returns', which each have a 50% weighting. In turn, the 'Limits' rating comprises 'Real estate market' and 'Country structure', which have a 65% and a 35% weighting respectively, and are based on growth/size of construction industry and bank lending (Market) and the broader economic/socio-demographic environment (Country). The 'Risks' rating comprises 'Market risk' and 'Country risk', which also have a 65% and 35% weighting respectively. Scores are based on forecast changes to the ratios of lending growth to nominal GDP growth, loan/deposits and latest annual property price inflation (Market), and the industry's broader country risk exposure (Country), which is based on BMI's Country Risk Ratings. The ratings structure is aligned across all the industries for which BMI provides business environment ratings, and is designed to enable clients to consider each rating individually or as a composite. For a list of the data/indicators used, please see the appendix at the end of the report. Source: BMI

We have developed our proprietary Real Estate/Construction Business Environment Rating (RECBER) for each of the 44 countries whose real estate sectors we survey worldwide. The way in which we construct the RECBER is discussed in the Methodology section at the end of this report. At this point, we note the following:

- The RECBER is a summary of the current situation and the likely prospects for the real estate sector in the country concerned over the next five years. It integrates **BMI**'s forecasts for construction

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activity, **BMI**'s forecasts for relevant aspects of the commercial banking sector and the general business environment within the country.

- The RECBER enables comparisons across countries on a consistent basis.
- Given the actual or potential impact of the global financial crisis on the availability of finance to the real estate sector, the RECBER is arguably more useful and meaningful now than it would have been in early 2008.
- The RECBER is designed so as to capture situations where there is a gross over-supply of housing – which is regarded as a negative factor. It also captures situations where house prices appeared to be rising at an unsustainably high rate during calendar-year 2008.
- The higher the RECBER, the more constructive are the current situation and the likely prospects for the real estate sector of the country concerned.

Vietnam's RECBER

Vietnam's RECBER is 41.5. The ratings for the limits of potential returns – at 51.3 – are higher than the ratings for the risks to the realisation of potential returns – at 31.8.

For the time being, it appears that availability of finance has not been a constraint on the progress of the real estate sector and is not likely to be so. Vietnam's scores for the actual level of and likely growth in lending are among the highest of any countries that are surveyed by **BMI**. We do, however, recognise that Vietnam entered its own financial crisis about six months before the critical phase of the global financial crisis.

Accordingly, we will over the next three months attempt to gain a better understanding of the availability of credit to major players in the country's real estate segment.

For the time being, we are reasonably sanguine about the prospects for the construction segment. We are looking for spending to grow at a compound annual growth rate of about 5%. This garners a score of six out of 10. However, we note that the starting point – which may have been lowered by the financial crisis in Vietnam – is low. This factor scores only two out of 10.

The ratings for the limits of potential returns are also held back by other aspects, which pertain to Vietnam in general, rather than to the real estate sector in particular. Vietnam's financial infrastructure is poor. Its per capita GDP is around US$1,000. Most of the population lives outside the major cities. The respective scores for these three factors are one, one and three out of 10.

In terms of the risks to the realisation of potential returns, we note that domestic lending has been growing in line with nominal GDP. We also expect that the change in the loan/deposit ratio over the forecast period will be benign. For these factors, Vietnam's scores are 10 and seven.

BMI's Long-Term Economic Rating is 54.7, earning a score of 5.5 out of 10. The ratings for the legal framework and bureaucracy are equivalent to scores of 3.9 and 4.9.

In a regional context, Vietnam's RECBER compares favourably with those of other countries in South East Asia – with the exception of Singapore. The ratings for the limits of potential returns are relatively high and those for the risks to the realisation of potential returns, fairly low.

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Asia Pacific Project Finance Ratings

This quarter we have introduced updated oil price scenarios, drawn from **BMI**'s long-term oil price forecasts and also new thresholds and updated historical data for the imports of power as a percentage of total consumption. The latter indicator is used to gauge risks during the operating phase of commercial and non-residential construction projects. It assumes that the higher a country's dependence on power imports, the greater the chances of intermittent power supply, which could affect the commercial viability and payback for projects in the sector.

The net effect of these updates has been negative, as indicated by slightly lower regional averages. Countries with high power import dependency, such as Taiwan and Singapore, have had their scores reduced. Countries with higher dependency on imports than they used to have also had their scores reduced.

Cambodia has been added to our regional table this quarter. The country scores poorly, negatively affected by a lack of adequate legal and regulatory infrastructure.

BMI's project finance ratings (PFR) provides a globally comparative, numerically based assessment of the risks facing the projected cash flows of major infrastructure projects in the energy and utilities, transport and commercial construction sectors. Specifically, it evaluates the degree of uncertainty facing projects generally characterised by the following: long construction period, high construction costs, difficulty in redeploying project assets (eg power stations) to other uses, and earnings generated only after construction completed over a long period of time.

BMI's PFR is best used for evaluating the breadth and depth of risks a major infrastructure project may face during its lifecycle, which will in turn affect the source, availability and cost of finance. Thus, in the current environment, which is characterised by a limited pool of financial resources and growing demand from competing projects coming to market, the PFR provides a leading indicator for the cost of financing major projects and the pace at which infrastructure development will occur in each state.

We have created two different tables aiming to better identify, analyse and assess broad categories of risks that sponsors and/or companies may encounter during the project's lifecycle. The two tables are composed – very broadly – first of the design, engineering and construction phase, and second, of the commissioning and operation phase. The two final scores for each country are then combined to yield the overall PFR.

The weightings of each indicator and each group of indicators (inputs, regulatory, market risks etc) are adjusted to reflect the relative importance and thus relative risk they pose for sponsors and equity holders.

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Design And Construction Phase

The design and construction table encompasses factors such as inflation and long-term currency volatility (henceforth referred to as inputs), which at this stage affect primarily the cost of equity and debt, but also the cost of raw materials if they are sourced locally and hence the total cost of the project, as well as legal and regulatory risks the company or sponsors may encounter and which can delay the start of construction and pose regulatory (red tape) issues. Closely related to the legal and regulatory risks are the risk factors within the wider political framework, encompassing political risk factors such as the level to which the rule of law is enforced and respected, and the long-term policy continuity and consistency of government policies over the years. Last but not least, is the financial risk component, comprising domestic economic stability and the international availability of finance.

Broadly speaking, we can distinguish four bands/groups in the table. There are no real surprises in our ratings for the Asia Pacific region with Hong Kong and Singapore at the top of the table with scores above 70 out of 100 as a result of their sound institutional, regulatory and banking environment, as well as proficiency in project finance operations. Singapore's 90-page Public Private Partnership Handbook, published initially in 2004 by the Ministry of Finance, is perhaps the most comprehensive guide to public-private partnership (PPP) regulations and procedures issued by any country in the world, highlighting the government's willingness to create the most conducive environment possible for the successful implementation of PPPs, a goal it has achieved, as Singapore is one of the most stable environments globally. Hong Kong and Singapore's high scores in the PPP legal framework indicator reinforce their position at the top of the this table.

Malaysia, South Korea, Taiwan and China follow the first group closely, but with scores in the 60s. Malaysia's legal and regulatory environment leaves room for improvement, which lowers its score, since a weak institutional and legal framework, especially a poor track record in contract enforceability in Malaysia, is one of the risks facing sponsors and contractors in the initial stages of a project's lifecycle. South Korea's strength lies in low political risk levels and a sound regulatory infrastructure.

Table: Design And Construction Rating

	Inputs	Legal/ regulatory risks	Political environment	Economic/ financial risks	Total
Hong Kong	100.0	86.7	83.6	53.9	77.1
Singapore	84.0	84.3	88.0	55.3	75.0
Malaysia	84.0	60.4	73.8	53.4	66.0
South Korea	54.0	74.0	82.1	53.5	64.8
Taiwan	84.0	61.7	62.3	57.2	64.7
China	86.0	49.0	60.7	56.5	62.0
Thailand	74.0	56.3	58.7	51.5	58.8
Philippines	62.0	39.2	58.9	50.7	52.7
Vietnam	**30.0**	**33.1**	**59.4**	**47.1**	**43.9**
India	70.0	33.4	65.8	52.6	55.6
Cambodia	52.8	18.3	51.4	44.8	42.8
Indonesia	12.0	23.1	60.5	51.5	40.2
Pakistan	12.0	19.9	43.8	44.9	33.1

Scores out of 100, with 100 the highest. Source: BMI

In the third and fourth groups (scores in the 50s and 49 and below) we find four of the most dynamic infrastructure markets in Asia: India, the Philippines, Vietnam and Indonesia. In spite of the impressive infrastructure development course they have embarked on the past half decade, there are still formidable risks, which extend to project finance operations as well. Cambodia is also in this bracket, though the country is not yet as desirable a destination for infrastructure investors as the other four countries above. It is worth noting that the common weakness shared by all states is the legal and regulatory environment, where the scores of all four countries show the closest convergence. Corruption, PPP/concessions legal framework and contract enforceability are the three indicators that make up the group.

Pakistan remains at the bottom of the table owing to low scores in terms of inputs and the political/security environment.

Commissioning And Operating Phase

The table that identifies potential factors influencing the levels of risk during the commissioning and operation of a project has been broken down into three categories: transport, energy and utilities, and commercial construction. The aim is to reflect the different levels of risk a power plant has from a toll road or a stadium, for instance, during the operational phase of the project’s lifecycle. The aim was to add a degree of separation between sub-sectors in infrastructure, and although the sub-categories in the table

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are similar for all three sectors, the scores are different for each country in each sector, which allows us to gauge the different levels of potential risk and potential breadth of the financial impact they may have.

The rising price of oil and **BMI**'s upward revisions for oil price forecasts in coming years, have eroded the score of many countries. This is because a core determinant of the inputs score for energy and utilities is the price of oil. Higher price expectations mean that the cost of operating power generation assets will also increase, jeopardising the projected long-term revenue stream of assets. For this reason, we find that for many countries, the inputs score for energy and utilities has in fallen, dragging down entire scores.

Table: Commissioning And Operating Rating

	Commercial/business construction			Energy and utilities			Transport		
	Inputs	Outputs	Total	Inputs	Outputs	Total	Inputs	Outputs	Total
Hong Kong	85.0	72.4	76.2	90.0	71.2	76.9	100.0	68.4	77.9
Singapore	67.0	67.5	67.3	72.0	67.5	68.8	76.0	65.2	68.4
China	73.0	57.5	62.1	73.0	56.4	61.3	84.0	56.9	65.0
Malaysia	67.0	53.7	57.7	67.0	54.2	58.1	76.0	54.2	60.8
Taiwan	67.0	54.3	58.1	67.0	54.3	58.1	76.0	52.1	59.2
India	55.0	53.1	53.7	70.0	54.3	59.0	70.0	53.7	58.6
Philippines	53.5	54.0	53.9	53.5	55.8	55.1	58.0	55.8	56.4
Thailand	59.5	45.3	49.6	59.5	45.3	49.6	66.0	45.3	51.5
Cambodia	51.4	48.2	49.2	56.4	49.3	51.5	55.2	49.3	51.1
South Korea	37.0	53.7	48.7	42.0	53.1	49.8	36.0	53.7	48.4
Vietnam	**40.0**	**50.9**	**47.7**	**40.0**	**50.9**	**47.7**	**40.0**	**50.9**	**47.7**
Indonesia	16.0	38.0	31.4	16.0	38.6	31.8	8.0	38.6	29.4
Pakistan	11.0	25.1	20.9	28.5	25.6	26.5	8.0	25.1	20.0

Scores out of 100, with 100 the highest. Source: BMI

Overall Project Finance Rating For The Asia Pacific Region

Combining the scores of the two tables we have distilled the overall PFR, which takes into account all of the above sectors and sub-categories. Here we can also categorise the results into four bands of countries, with each group presenting a similar level of risk that may affect the source, availability and cost of finance. In the first group (score of 70 and above) we find Hong Kong and Singapore, whose overall characteristics and market components create the safest environment in the region for project finance operations. Based on both countries' overall scores, Singapore presents fewer risks in the initial development phases, but more uncertainty in the longer term, while Hong Kong presents low risks throughout a project's life cycle.

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The new entry in our regional table, Cambodia, gains points for policy continuity, market orientation and low security risks. However, the country scores very poorly on corruption, contract enforceability and PPP/concessions legal framework indicators.

Table: Overall Project Finance Rating

	Design and construction	Commissioning and operating	Overall
Hong Kong	77.1	77.0	77.0
Singapore	75.0	68.2	71.6
China	62.0	62.8	62.4
Malaysia	66.0	58.8	62.4
Taiwan	64.7	58.5	61.6
South Korea	64.8	48.9	56.9
India	55.6	57.1	56.3
Thailand	58.8	50.2	54.5
Philippines	52.7	55.1	53.9
Cambodia	42.8	50.6	46.7
Vietnam	**43.9**	**47.7**	**45.8**
Indonesia	40.2	30.9	35.5
Pakistan	33.1	22.4	27.7
Regional average	56.7	52.9	54.8

Scores out of 100, with 100 the highest. Source: BMI

Vietnam, Indonesia and Pakistan are at the bottom of our table again this quarter. Although Vietnam's rating presents some upside risk because of declining levels of inflation, the risk rating also encompasses some deep structural problems in the country's overall business environment, such as corruption, overtaxing government intervention in some industries, one of them being the energy and utilities sector. Indonesia's legal and regulatory scores also present upside in light of recent changes in PPP regulations and also the introduction of a state-guarantee agency specifically for the infrastructure sector (January 2010). Pakistan presents a plethora of other structural problems, which combine to give the country the lowest score in the region and the riskiest profile, which indicates significant risks to any project in infrastructure, both in the construction phase and the potential returns on investments over the long term.

Risks And Limitations To BMI's Project Finance Ratings

It should be noted that although we believe the scores are a reliable guide to project finance risks, the PFR assesses broad industry risks, rather than individual projects. This has several implications. First, there will be instances where the risk profile – for example, the supply of inputs – of particular project is

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markedly different from the general risk prevailing in the industry. Second, the PFR will not take into account measures by private sector project participants to mitigate risk when structuring finance – for example, by securing a substantial equity involvement from the sponsoring agency or government.

Vietnam’s Business Environment

BMI View: Vietnam's large and inexpensive workforce remains its largest attraction for foreign investors, although there is an increasing occurrence of foreign direct investment (FDI) projects aimed at tapping the country's growing consumer market. There is still a large degree of state intervention in the economy, but the government has been gradually moving towards a market economy since 1986, with World Trade Organization (WTO) accession in 2007 being the greatest achievement so far. The country's decrepit infrastructure continues to be an impediment for many foreign investors, but we see this as a diminishing problem because the government is investing heavily in new roads, railways and ports.

Latest Developments:

- The Finance Ministry is pushing ahead with a controversial plan to impose price controls on a number of goods, such as petrol, oil, cement, steel and other construction materials, in order to limit consumer price inflation. The plan has been criticised by foreign embassies and business groups arguing that price controls are seldom effective and that the price registration requirements will force companies to disclose their cost structure to competitors and harm their business interests. The price controls currently only apply to state-owned companies and we believe an extension could hamper private sector growth.

- The government of Vietnam is going to test a new build, operate and transfer (BOT) tender model for electricity projects, with the launch of the tender for the Nghi Son 2 coal fired power plant in June 2010. This comes after the nebulous regulatory and legal environment governing Vietnam's power sector has rendered the BOT/Independent Power Plant (IPP) model, for procuring new power generation, almost unworkable. The situation is a product of the tradition of state-owned **EVN**'s monopoly on power distribution and **Vinacomin**'s monopoly over fuel (coal) supply, which has hindered the development of private participation in the power generation sector.

- Vietnam's Ministry of Transport is seeking approval from the prime minister to build a road under the public-private partnership (PPP) format, in what could lead the way for increased private sector participation in much-needed infrastructure investment. The 189km-long road will link the Dau Giay T-junction in Dong Nai Province to Lien Khuong Airport in Lam Dong Province and is anticipated to cost nearly US$1bn. It will be funded by official development assistance loans from South Korea and a group of Korean investors led by **Incheon Urban Development Corporation** (IUDC). In the past the ministry has allowed state-owned **Vietnam Expressway Investment and Development Company** to work in cooperation with South Korea's IUDC to work on the Dau Giay-Lien Khuong road.

- Malaysian water management construction firm **JAKS Resources** has formed a joint venture (JV) with Chinese company **China Huadian** for a power plant project in Hai Duong Province. The joint venture will undertake the project on a build-operate-transfer basis. Work on the project is to start in Q410, with the first MW600 unit scheduled to come online in Q414 and the second unit by Q215.

- The Vietnamese government has announced measures to support small- and -medium sized enterprises (SMEs) amid signs that they are being hampered by a lack of scale, out-dated technology and weak administrative capacity, reports Vietnam News. The directive is to help the SMEs improve competitiveness by reforming administrative procedures and helping them access land and capital. To this aim the government has asked provincial people's committees to allocate more land to SMEs and help them find premises to expand their operations.

- A people's committee in Hanoi has given land developer **Bac Viet** permission to directly negotiate compensation arrangements with local land owners in what could be a landmark case in improving administrative procedures surrounding urban developments. Bac Viet has been given permission to negotiate with landowners in the Tu Liem district on plans to use more than 6,500m^2 for a residential and trading complex.

Table: BMI Business And Operational Risk Ratings

	Infrastructure	Institutions	Market orientation	Overall
Afghanistan	20.73	29.85	40.59	30.39
Australia	86.43	81.44	47.57	71.81
Bangladesh	35.05	25.89	47.74	36.23
Bhutan	20.29	58.26	35.63	38.06
Cambodia	19.69	26.83	63.69	36.74
China	68.01	42.73	46.75	52.50
East Timor	32.47	30.62	59.50	40.86
Hong Kong	75.06	80.76	90.72	82.18
India	**50.37**	**40.21**	**28.77**	**39.79**
Indonesia	32.65	22.48	65.53	40.22
Japan	88.03	81.02	48.74	72.59
Laos	23.90	31.49	50.17	35.18
Malaysia	65.71	59.42	59.29	61.47
Maldives	40.42	54.31	67.17	53.97
Myanmar	21.44	3.06	23.43	15.98
Nepal	42.67	36.69	54.09	44.49
New Zealand	83.41	90.25	63.21	78.96
North Korea	23.63	8.98	1.97	11.53
Pakistan	36.08	29.57	47.50	37.72
Philippines	40.12	37.12	57.64	44.96
Singapore	83.09	88.18	80.16	83.81
South Korea	82.92	67.88	69.35	73.39
Sri Lanka	35.57	48.85	37.49	40.64
Taiwan	69.49	61.38	64.61	65.16
Thailand	59.54	60.06	59.00	59.53
Vietnam	37.23	39.11	49.71	42.01
Global average	*47.39*	*47.46*	*48.65*	*47.73*
Region average	*49.00*	*47.56*	*52.31*	*49.62*

Scores out of 100, with 100 the best. Source: BMI

Legal Framework

Vietnam has a two-tier courts system, with courts of first instances and courts of appeal. The court system consists of the Supreme Court, the provincial People's Courts and the district People's Courts. The Vietnamese legal code is currently in a state of flux, and the authorities are drafting a unified legal framework for the conduct of business.

Most of the legal documents in force relating to business were issued in the early 1990s under market-led reform programmes. However, Vietnam rewrote almost all of its laws and regulations affecting commercial activity and judicial procedures between 2002-2006. Despite some progress in protecting intellectual property rights, the overall legal system in Vietnam is regarded as excessively cumbersome.

Vietnam's judicial system lacks transparency, and there are widespread concerns about the independence of the judiciary. Both local and foreign firms prefer to resort to arbitration or other non-judicial means as a result of weaknesses in the judicial system. There is a general lack of confidence that the judiciary is capable of interpreting and enforcing the law.

Vietnam's legal system remains underdeveloped and, largely, biased against foreign entities. The court system provides inadequate redress for commercial disputes while contracts are difficult to enforce, particularly if a party is non-Vietnamese. Foreigners also see the commercial arbitration system as weak. When disputes arise, foreign investors tend to try to negotiate or include dispute resolution procedures in their contracts; however, even these are far from failsafe.

Foreign and domestic arbitral awards are legally enforceable in Vietnam since it acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards in 1995. Local courts must respect awards rendered by a recognised international arbitration institution. However, this provides no assurance that contracts will be honoured. Non-judicial means are therefore frequently used to enforce debt obligations.

Firms generally avoid the judicial system because the process is lengthy and expensive, decisions are considered arbitrary and enforcement mechanisms are ineffective. Smaller companies rely on personal relationships while larger foreign companies may make use of their access to government to ensure contract enforcement.

Property Rights

The 2006 Uniform Enterprise Law has allowed foreign investors to form any type of company instead of only limited liability companies. In general, foreign companies and the private sector are at a disadvantage compared with state-owned companies in terms of access to land, which is still viewed as the property of 'the people'. Legislation has, however, progressively enhanced the status of private investors in recent years. The 1992 constitution granted stronger land rights to individuals, including

rights over commercial and personal property. Private land use rights (LURs) may now be granted for up to 50 years. Since July 1 2004, the Land Law has allowed local private companies with long-term LURs to lease land to foreign investors.

Intellectual Property Rights

The enforcement of intellectual property rights (IPRs) is wholly inadequate, with widespread pirating of products, particularly software, music and videos. The requirements of WTO accession mean that the government will have to beef up IPR protection substantially. In July 2006, a new Intellectual Property Law came into effect, designed to clarify the responsibility of government agencies charged with protecting IPRs, though doubts remain over the effectiveness of its implementation. The police service is generally slow to act on administrative orders where trademarks have been infringed. Often violators will seek to extract a payoff in compensation for ceasing the infringement. The US State Department has, therefore, despite improvements in the enforcement of IPRs in 2008, kept Vietnam on its 2009 'Special 301 Report' watch-list of countries with inadequate protection of IPRs.

Corruption/Red Tape

Investors see official corruption as one of the biggest hindrances to running a business in Vietnam. Joint ventures with state-owned enterprises are particularly prone to corruption and abuse, though surveys indicate that while corruption affecting businesses is quite prevalent the amounts involved are usually quite small. However, rapid economic growth provides opportunities for graft to grow more quickly than government systems evolve. Vietnam scored 2.7 out of 10 in Transparency International's 2009 ‘Corruption Perceptions Index’, placing it in joint 120th place among the 180 countries surveyed.

One of the best tools in restricting opportunities for corruption has been the expansion of the 'One-Stop Shop' (OSS) network – single agencies that deal with applications for a range of activities, including construction permits, LUR certificates, business registrations and approvals for local and foreign investments.

The Law on Corruption Prevention and Control was passed by the National Assembly in November 2005. A central anti-corruption steering committee was established in 2006, comprising representatives from the government, the National Assembly, state procurator, court and police. The committee is headed by the prime minister, and has the authority to suspend ministers and chairs of people's committees and people's councils if suspected of wrongdoing. The committee discovered 584 cases of alleged corruption, involving close to 1,300 people, in 2007. Among the most noteworthy convictions of corrupt officials was that of former deputy trade minister Mai Van Dau, who was handed a 14-year prison term in March 2007 for accepting bribes in return for export licences.

Japan and Vietnam have established a joint committee for fighting corruption concerning the use of Japan's official development assistance (ODA) in Vietnam, after two Ho Chi Minh City officials were

convicted of accepting bribes from a Japanese firm in September 2009. Japan and Vietnam have also worked on a joint initiative to improve regulations on bidding, purchase and implementation of all ODA projects.

The burden of red tape is amplified by the overlapping of government approvals. Vietnam ranks poorly in the length of time it takes to close a business. It can take about five years to close a business, compared with an average of 3.4 years in East Asia & Pacific, and 1.5 years in OECD states.

Table: BMI Legal Framework Ratings

	Investor protection	Rule of law	Contract enforceability	Corruption
Afghanistan	34.8	0.6	17.4	23.3
Australia	27.9	94.0	89.2	95.3
Bangladesh	61.1	25.1	8.0	3.3
Bhutan	25.6	75.4	57.0	82.0
Cambodia	51.2	13.8	38.9	6.0
China	7.8	50.3	54.7	54.7
East Timor	11.8	12.6	36.3	na
Hong Kong	62.5	89.8	87.5	92.7
India	**38.0**	**62.9**	**8.9**	**54.7**
Indonesia	22.3	25.7	26.5	18.0
Japan	58.3	89.2	90.5	91.3
Laos	44.8	19.8	28.7	28.7
Malaysia	53.8	72.5	47.8	75.3
Maldives	91.8	64.1	46.5	23.7
Myanmar	na	4.8	na	1.3
Nepal	44.3	31.7	43.0	23.3
New Zealand	66.9	97.0	82.4	100.0
North Korea	na	9.0	na	na
Pakistan	56.2	26.9	17.5	8.7
Philippines	56.4	46.1	54.4	23.3
Singapore	64.5	94.6	75.9	98.7
South Korea	31.7	79.0	81.8	76.0
Sri Lanka	57.6	59.9	47.7	48.0
Taiwan	19.7	81.4	53.1	80.7
Thailand	19.5	60.5	60.1	62.0
Vietnam	**22.8**	**49.7**	**45.6**	**28.7**

Table: BMI Legal Framework Ratings

	Investor protection	Rule of law	Contract enforceability	Corruption
Global average	*36.8*	*48.8*	*49.9*	*40.2*
Region average	*43.0*	*51.4*	*50.0*	*50.0*

Scores out of 100, with 100 the best. Source: BMI

Physical Infrastructure

Vietnam's infrastructure rating is 50.8. The country's inadequate infrastructure has become a major grievance for foreign investors and may thus impair future FDI. Our transport infrastructure rating for Vietnam stands at 69.1, but are set to improve as the government, thanks to development assistance from international donors, is investing heavily in constructing new roads, railways, ports and power plants. These projects include the US$33bn 1,600km high-speed railway currently being planned, thanks to Japanese funding, between Hanoi and Ho Chi Minh City, which will cut travel time to less than 10 hours when completed.

As an example of progress already made, more than 90% of rural households now have electricity, compared with just over 50% 10 years ago. Rapid industrialisation of the economy has, however, seen power demand increase by 15-17% per year, outpacing the expansion of capacity. Vietnam is estimated to have produced 69.7 billion kilowatt hours (kWh) of electricity in the first 10 months of 2009, up 12.3% from a year earlier, according to the General Statistics Office. It has been estimated that Vietnam needs to build 124 new power plants between 2006-2010, adding a total capacity of roughly 36,000MW, to satisfy demand. Several ongoing construction projects of power plants have been hit by delays – due to slow land clearance, delayed equipment supplies and poor contractor performance – and power blackouts and brownouts are therefore likely to remain a problem. Our technological infrastructure rating for Vietnam stands at 25.0, placing Vietnam in 85th place in our rankings.

Foreign direct investment has also helped to improve Vietnam's telecommunications system, with foreign groups investing heavily in fanning out 3G telecom and broadband networks over the most populous parts of the country.

Labour Force

Vietnam's large, well-educated and inexpensive labour force remains one of the country's chief attractions to foreign investors. The labour pool is increasing by up to 1.5mn a year, while wage costs are still low compared with other countries in the region, although wage growth has picked up pace in recent years. The General Statistics Office estimated the number of employed at 45.0mn in 2008. The unemployment rate is expected to remain between 5-6% in 2010.

Vietnam's reform-driven economic growth has resulted in a restructuring of the labour market, with a shift away from agricultural employment to non-farm employment. The General Statistics Office estimated that farmers constituted 52% of the workforce in 2008, with close to 21% working in industry and construction, and close to 27% working in the service sector.

Managerial talent and skilled workers are generally in short supply, which has the effect of raising costs. The expanding financial sector is particularly plagued by labour shortages and is said to be in need of tens of thousands of skilled personnel by 2010. Foreign companies are becoming increasingly troubled by an excessive turnover of qualified workers, which is driving up salaries for skilled personnel. Foreign companies have previously been the prime choice of Vietnamese professionals as they pay 14% more than domestic firms on average, according to a 2007 survey by human resources consultancy **Navigos Group**. Working for domestic firms is, however, becoming increasingly popular as they are currently closing the salary gap with foreign firms.

Labour shortages and a sharply progressive income tax system have pushed up the costs for skilled personnel. Vietnam has, on the other hand, maintained its cost advantage in manufacturing wages. The Japan External Trade Organisation (JETRO) found in a survey in November 2006 that monthly salaries for ordinary workers ranged from US$87-198 around Hanoi in northern Vietnam and from US$122-216 in Ho Chi Minh City in the southern Mekong delta region. This can be compared with an average salary for workers in Thailand of US$164 per month and between US$134-446 in China's Guangzhou province, the source of much of Chinese manufacturing output. Although wages are rising – by 19.5% between April 2007 and March 2008, according to Navigos – we believe Vietnamese labour is still very competitively priced, in particular after the imposition of the Chinese Labour Contract Law on January 1 2008, which is estimated to have raised labour costs in China by between 5- 40% and which has prompted many South Korean and Taiwanese firms to consider moving factories to Vietnam.

The regulatory burden in Vietnam's labour market has traditionally been high, but is easing over time. In 2003, legislation was introduced that allowed foreign companies to recruit staff directly, as long as they provide government agencies with a list of recruited workers. However, the requirement to use employment service agencies continues to apply to branches and representative offices of foreign companies.

One of the main regulatory burdens is the social protection system, which imposes a compulsory social insurance contribution scheme in which employers must pay in 15% of the salary, with employees proving 5%. Regulations for hiring workers are significantly more onerous than the East Asia & Pacific average. Whereas the hiring cost is 17% of the salary in Vietnam, it is only 5% in Thailand, for example. The imposition of the Chinese Labour Contract Law on January 1 2008 has, however, made many foreign companies view Vietnamese labour market regulation more favourably.

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Employers are required by law to establish labour unions within six months of setting up, and these must be members of the Vietnam General Confederation of Labour. While most factories have trade unions, many of these do not operate in practice. Trade unions are more active in the public sector, and only one-third of foreign companies have collective agreements with their workforces.

Vietnam does not have a bad industrial relations record. There were about 650 wildcat strikes in 2008, up from 541 in 2007. Most strikes were at foreign-invested firms in the textiles and apparel sector, despite working conditions often being better at these firms than at state-owned enterprises (SOEs). Most strikes have resulted from legal or contractual breaches, including failure to pay wages and benefits, failure to pay social insurance contributions, and failure to pay severance pay at termination.

The sharp uptrend in consumer price inflation, especially of essential goods such as food, fuel and housing, prompted increased labour unrest in late 2007 and early 2008 as workers demanded higher wages. The increasingly pressed economic conditions for labourers prompted tens of thousands of workers to go on strike in Ho Chi Minh City and Dong Nai province in January 2008. Lower inflation and tougher labour market conditions have dampened strike action in 2009. The latest available figures from Vietnam's national trade union showed there were 46 wildcat strikes in Q109, compared with 113 cases in Q108.

The government has raised the monthly minimum wage rate for workers at foreign-invested enterprises from VND920,000-1,200,000 (US$51-67), dependent on economic zone, to VND1,000,000-1,340,000 (US$55-74) from January 1 2010. The 13-15% imposed increases were lower than the 20-38% increase in the minimum wage rate for state- and domestic-employed workers to VND730,000-980,000 (US$40-55). This follows the government's roadmap to introduce a universal minimum pay rate for all enterprises by 2012.

Table: Labour Force Quality

	Literacy rate, %	Labour market rigidity score*	Female labour participation, %
Afghanistan	28.1	20.0	na
Australia	99.0	24.0	45.3
Bangladesh	47.9	28.0	39.8
Bhutan	47.0	7.0	31.7
Cambodia	73.6	36.0	48.8
China	90.9	31.0	45.9
Hong Kong	93.5	na	46.1
India	61.0	30.0	28.3
Indonesia	90.4	40.0	37.0
Japan	99.0	16.0	41.6
Laos	68.7	20.0	50.7
Malaysia	88.7	10.0	35.2
Maldives	96.3	18.0	41.1
Nepal	48.6	46.0	45.0
New Zealand	99.0	7.0	46.1
Pakistan	49.9	43.0	18.7
Philippines	92.6	29.0	38.3
Singapore	92.5	-	41.3
South Korea	97.9	10.0	41.3
Sri Lanka	90.7	20.0	39.8
Taiwan	96.1	46.0	20.9
Thailand	92.6	11.0	46.3
Vietnam	**90.3**	**21.0**	**-**

** Labour market rigidity score from the World Bank's Ease of Doing Business report (1 = highest score); na = not available. Source: World Bank, International Labor Organization, BMI*

Foreign Investment Policy

Increased FDI is an integral part of Vietnam's ambitious economic expansion plans; and, with ratings agencies pushing their grades higher, the country looks like a solid investment destination, especially for manufacturing. Foreign direct investment (FDI) pledges amounted to US$5.6bn in January-April 20, 2010, down 25.7% compared with the same period in 2009. Actual FDI disbursements were estimated at US$4.6bn in the same period.

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The rising levels of official development assistance (ODA) pledged by multilateral donors are also important, but have been outpaced by inflows from foreign private sources over the last five years. But, as the country tries to transform from a centralised to a more market-oriented economy, the investment framework is still poorly developed in many areas, with bureaucracy and a lack of transparency cited among major problems.

Despite ambitious targets for foreign investment as an important source of fuel for economic expansion plans, a number of barriers to investment remain. An opaque legal system, an inflexible financial system, corruption, a lack of regulatory transparency and consistency, a ponderous bureaucracy, and complex land purchase rules are among areas criticised by foreign investors.

The government has been introducing and amending legislation in an effort to remedy these perceived shortcomings.

Key legislation includes:

- The Law on Foreign Investment (1989), which has been amended several times to make FDI more attractive.

- Government decree 24 of 2000, which carries a pledge to avoid expropriation, and guarantees the right to repatriate profits. It also outlines the government's intention to treat private and state sectors equally.

- A revised bankruptcy law and a Law on Competition, both passed by the National Assembly in 2004, in a bid to improve the FDI climate. Fully owned foreign banks are now allowed to compete on an equal footing with domestic banks.

The Vietnamese legal code is currently in a state of flux, and the authorities are drafting a unified legal framework for the conduct of business. A new Common Investment Law and a Unified Enterprise Law came into effect in July 2006, as did a new Intellectual Property Law designed to clarify the responsibility of government agencies charged with protecting IPRs, but doubts remain over the effectiveness of its implementation.

The main forms of foreign investment are:

- Joint venture (JV) agreements, under which foreign and domestic firms share capital and profits.

- Business Cooperation Contracts (BCCs), which allow a foreign company to carry out business in cooperation with a Vietnamese firm through capital investment and revenue sharing, but without gaining right of establishment or ownership.

- Wholly Foreign-Owned Enterprises are becoming more common, especially those involving industrial production for export.

- Build-operate-transfer (BOT) agreements are the least common form of foreign direct investment, and have a reputation among foreign investors of causing regulatory and financing problems.

Foreign portfolio investment is permitted only in small quantities, with aggregate foreign ownership of listed companies capped at 49%. Foreign ownership of banks is capped at 10% per investor, and 30% in aggregate. Moreover, many of the shares listed on the Ho Chi Minh City Stock Exchange (HSCE) are too illiquid to attract foreign investors.

Investments in export processing zones (EPZs), industrial zones (IZs) and high-technology zones (HTZs) attract tax and other incentives, and offer a ready-made operational infrastructure that may be difficult to arrange outside.

EPZ investments carry 10-12% profit tax. The first established was the Tan Thuan zone near Ho Chi Minh City in 1991, where more than 100 manufacturers currently operate. A number of others have since been built, though they have not been as successful as hoped, partly because all produce from EPZs must be exported.

IZs are for use by firms in construction, manufacturing, processing or assembly of industrial products, often food processing and textiles production. IZ firms pay a 10% profit tax and get refunds if profits are reinvested. IZ firms may produce for the domestic market as well as for the export market.

Most FDI into Vietnam comes from North East Asia, notably Taiwan, South Korea, Japan and China/Hong Kong. Canada and the US are the largest non-Asian FDI sources. Leading sectors for FDI are manufacturing, other industry and oil and gas.

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Table: Annual FDI Inflows Into Asia, 2006-2008

	2006		2007		2008	
	US$bn	US$ per capita	US$bn	US$ per capita	US$bn	US$ per capita
Australia	25.74	1,255.4	22.27	1,075.7	46.77	2,227.3
Bangladesh	0.79	5.7	0.67	4.7	1.09	7.6
Cambodia	0.48	34.2	0.87	60.3	0.82	55.8
China	72.72	55.3	83.52	62.5	108.31	80.4
Hong Kong	45.05	6,520.6	59.90	8,602.3	63.00	9,000.4
India	19.66	17.3	22.95	19.9	41.55	36.0
Indonesia	4.91	21.5	6.93	29.9	7.92	33.8
Malaysia	6.05	231.6	8.40	316.2	8.05	298.3
Pakistan	4.27	27.5	5.33	34.0	5.44	33.8
Philippines	2.92	33.9	2.93	33.3	1.52	16.9
Singapore	24.74	5,646.5	24.14	5,441.2	22.72	4,695.1
South Korea	4.88	101.6	2.63	54.6	7.60	156.4
Sri Lanka	0.48	24.0	0.53	26.0	0.75	38.8
Taiwan	7.42	324.0	8.16	354.8	5.43	236.2
Thailand	9.01	142.0	9.58	149.9	10.09	156.9
Vietnam	**2.36**	**27.5**	**6.74**	**77.5**	**8.05**	**92.7**

Source: UNCTAD, BMI

Foreign Trade Regime

Although high tariffs, customs bureaucracy and legal inadequacies have provided significant trade barriers, the opening up of Vietnam's economy has been accompanied by concrete measures to meet the requirements of the WTO and other international trade organisations. Vietnam has committed to bound tariff rates (or legal ceilings) on most products ranging from zero to 35%. Reductions in most bound rates from 17.4% on average in 2007 to 13.6% are to be phased in gradually.

Vietnam became a member of the WTO in January 2007. A bilateral trade agreement with the US in effect since December 2001 has substantially lowered tariffs on US industrial and agricultural products, removed non-tariff barriers on US service providers and eliminated barriers to US exports in key areas such as pharmaceuticals and petroleum products.

The Vietnam-Japan Economic Partnership Agreement (VJEPA) came into effect on July 1 2009 and has already aided an increase in garment exports to Japan. Moreover, the completion of a free trade agreement (FTA) with the EU should help to strengthen Vietnam's share in European markets. The

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Swedish government has, according to Swedish Ambassador to Hanoi Rolf Bergman, set up an FTA with Vietnam as one of its top three priorities during its presidency of the EU in H209, with the negotiation process expected to be completed by October 2010.

Vietnam is a member of the Association of South East Asian Nations (ASEAN) – with Brunei, the Philippines, Indonesia, Laos, Myanmar, Malaysia, Singapore, Thailand and Cambodia – as well as of the linked ASEAN Free Trade Area (AFTA). Vietnam is thus party to negotiations on free trade agreements (FTAs) being conducted by ASEAN, such as talks with the European Union, China, Australia and New Zealand.

Vietnam is, in addition, preparing for talks over FTAs with Chile and Japan.

Import tariffs are high by regional standards, averaging 16.8% in 2007, according to the WTO. Vietnam will continue to dismantle tariffs in a bid to meet its WTO accession goals, although some key sectors remain protected.

Vietnam has agreed to comply with ASEAN's Common Effective Preferential Tariff (CEPT) scheme on manufactured goods within the ASEAN region, which calls for rates to be brought down to the 0-5% range.

The legislation providing the framework for the trade regime is 1998's Law to Amend the Import and Export Tariffs Law. However, given the ASEAN and WTO requirements, the tariff structure is in a constant state of flux. To reduce the rising costs of a range of products, Vietnam in October 2007 cut import tariffs by between 30% and 60% on many food and dairy products.

Table: BMI Trade Ratings

	Protectionism	Bureaucracy
Afghanistan	na	21.6
Australia	70.7	80.3
Bangladesh	0.7	22.9
Bhutan	4.2	18.3
Cambodia	7.5	25.4
China	51.7	52.9
East Timor	na	40.5
Hong Kong	100.0	98.6
India	12.9	23.0
Indonesia	54.4	44.3
Japan	76.9	81.5
Laos	19.7	6.7
Malaysia	64.6	50.9
Maldives	na	55.3
Myanmar	1.4	na
Nepal	13.6	34.1
New Zealand	72.1	76.3
North Korea	4.2	2.3
Pakistan	16.3	42.9
Philippines	76.2	66.9
Singapore	100.0	88.9
South Korea	42.2	69.1
Sri Lanka	48.3	35.6
Taiwan	95.9	64.1
Thailand	55.8	37.6
Vietnam	**11.6**	**44.0**
Global average	*47.1*	*45.2*
Region average	*43.5*	*47.4*

Scores out of 100, with 100 the best; na = not available. Source: BMI

Table: Vietnam Top Export Destinations

	2001	2002	2003	2004	2005	2006	2007	2008
Exports To World	15,025.10	16,707.30	20,144.90	26,485.00	32,447.10	39,826.20	48,561.40	60,816.00
Exports To US	1,065.65	2,453.15	3,939.56	5,024.80	5,924.00	7,845.10	10,089.10	12,594.10
Exports To Japan	2,509.80	2,436.96	2,908.60	3,542.10	4,340.30	5,240.10	6,069.80	8,264.30
Exports To Australia	1,041.80	1,328.33	1,420.86	1,884.70	2,722.80	3,744.70	3,556.90	4,466.29
Exports To China, P.R.: Mainland	1,417.42	1,518.33	1,883.12	2,899.10	3,228.10	3,242.80	3,356.70	4,174.25
Exports To Germany	721.8	729.03	854.71	1,064.70	1,085.50	1,445.30	1,855.10	2,714.70
Sum of Top 5	6,756.47	8,465.80	11,006.85	14,415.40	17,300.70	21,518.00	24,927.60	32,213.64
% of Top 5	44.97	50.67	54.64	54.43	53.32	54.03	51.33	52.97

Source: IMF, Direction of Trade Statistics.

Tax Regime

Since 2003, corporate tax has been charged at a unified rate for both domestic firms and foreign investors. From the start of 2005, a self-assessment regime has been in effect. The previous tax audit system has been superseded by a tax investigation system.

- **Corporate tax:** The main corporate tax rate is 25%, but firms involved in prospecting, exploration and mining of petroleum, gas and other rare and precious natural resources are subject to rates from 32% to 50%. Resident firms are taxed on global income. Non-resident firms are taxed only on Vietnamese-sourced income. A surtax of 10- 25% is charged progressively on income from land use rights.

- **Individual tax:** The National Assembly passed Vietnam's first-ever personal income tax bill on November 20 2007. The bill, which became effective on January 1 2009, replaces a previous system in which expatriates and domestics were taxed at different levels. The new bill provides a common set of rules for individuals resident in Vietnam for 183 days or more in a 12-month period. However, the bill is also applicable to those having a permanent residence in Vietnam, a definition that includes a rented house. How this paragraph will be interpreted is still unclear, but could extend tax liabilities to expatriates and locals who reside in Vietnam for fewer than 183 days per year. The new bill stipulates that personal income is to be taxed at a rate between 5% and 35%, with a personal allowance of VND48mn (US$2,800) and an additional allowance of VND19mn (US$1,120) per dependent. As such, the new bill reduces the highest marginal tax level applicable to expatriates from 40% to 35%. A new feature in the bill compared with

previous legislation is that it covers non-employment income such as interest, dividends, capital gains on real estate and securities investment.

- **Indirect tax:** Main VAT rate is 10%. A 5% rate is charged on some goods, including computers and accessories, construction, machinery, chemicals, coal and metallurgy products. The following attract a zero VAT rate: exported goods and software and services exported to firms in export processing zones. Registration is obligatory for businesses. VAT taxation is also subject to an ongoing revision by the National Assembly.

- **Capital gains:** Usually taxed as income at corporate rate. Gains by foreign investors on the transfer of an interest in a foreign or Vietnamese enterprise attract a 25% tax. Gains by individuals on the transfer of a home or on land-use rights are taxed progressively up to 60%.

Security Risk

Vietnam is generally a very safe country for foreign residents and travellers. Petty street crime is rising in the major cities, but there have been very few serious offences against foreigners reported. Unexploded mines and ordnance are a continuing hazard, particularly in central Vietnam and along the Laos border.

The poor standard of roads and other public infrastructure is also a safety risk, as is the poor level of driving which makes traffic accidents one of the most prominent health risks for both foreigners and nationals.

Company Monitor

Becamex IDC Corp

Company Overview

State-owned Becamex IDC was restructured in 2006 into a parent-subsidiary corporation. It has 30 subsidiaries and engages in infrastructure development of residential and industrial parks; project investment in the form of build-operate-transfer or build-operate; finance, banking and securities; pharmaceutical production; civil construction, industry and transportation; and other operation fields.
Source: www.becamex.com.vn

Becamex IDC is a key player in developing infrastructure for industrial parks, with Vietnam-Singapore IPs, My Phuoc IP and Bau Bang IP worth a combined US$3.8bn. Headquartered in the southern province of Binh Duong, the company is involved in the planning stages for the new city of Binh Duong, Becamex University in Binh Duong and Binh Duong International Hospital.

Company Data

The firm has charter capital of VND2,354bn (US$136mn) and annual turnover of more than VND1,000bn (US$57.8mn).

Dow Jones reported in January 2010 that the company had applied for permission to list its shares on the Hochiminh Stock Exchange. According to the bourse, the company wants approval to list 54.84mn shares and has registered a capital of VND548.39bn.

A Singaporean property developer, Sembcorp Parks Holdings, broke ground in January 2010 at a 1,600ha integrated township in the northern city of Haiphong through the Vietnam Singapore Industrial Park and Township Development Joint Stock Company (VSIP), a joint venture with Becamex IDC Corporation, according to Investment Review.

COTECCONS Group

Company Overview	COTECCONS Group is one of largest private construction companies in Vietnam. It transformed into a joint stock company in 2004, the group now has five subsidiaries, mainly operating in construction, real estate investment and trading of equipment and construction materials. Source: www.coteccons.com.vn
Company Data	COTECCONS has a chartered capital of VND120bn (US$6.9mn) with foreign strategic investors holding a combined 34.3% as of September 2007. COTECCONS is not listed on the formal stock exchange. The company posted a revenue of VND1,344bn (US$77.6mn) in 2007, an increase of 62% from 2006.
Recent Developments	Phu My Hung, RMIT International University (in Ho Chi Minh City), Jotun Paint factory, and The Manor building are examples of its projects. By early 2008, the company had participated in more than 60 construction projects across the country, with 30 large-sized projects each worth at least VND100bn (US$5.8mn) in construction value. In 2006, BTA chose Arata Isozaki, one of the three leading contemporary designers in Japan and Coteccons Group to work on its Diamond Island project, which includes apartments with a sale price of US$3mn each. According to Thanhnien News, construction will be completed by the first quarter of 2011 and the whole project, expected to cost US$350mn, will be finished in 2012.

Housing And Urban Development Corp (HUD)

Company Overview

HUD was established as a state-owned corporation in 2000 and transformed into a parent-subsidiary model in 2006. It has 18 subsidiaries and has implemented 35 projects on a total 4,600 hectares (ha) of land.
Source: www.hud.com.vn

As of January 2010, the corporation became a main subsidiary of the Vietnam Housing and Urban Development Group.

The company claims to be a pioneer in the development of new urban area projects with synchronised infrastructure and adequate social facilities. Most of its projects are in newly developed suburbs of Hanoi and neighbouring provinces. HUD's website states it has participated in building more than 100 apartment projects with a gross floor area of 1.5mn m^2.

Company Data

The company is not publicly listed. It remains state owned and operates under the umbrella of the Vietnam Ministry of Construction.

Recent Developments

Local media reported in January 2010 that the company, in cooperation with VinGroup, will invest US$1bn into a new urban area in Nhon Hoi Economic Zone.

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Nam Cuong

Company Overview

Initially established in 1984 as a waterways transport company, Nam Cuong now engages in residential and industrial construction, hotel management, tourism, as well as trade and finance. Tran Van Cuong was the company's general director and chairman, but he died in January 2010. Source: namcuong.com.vn

The company's headquarters is in northern province of Nam Dinh.

Company Data

The company is privately owned and is not listed.

Recent Developments

Most of the company's residential and hotel projects are in five northern cities and provinces: Hanoi, Ha Tay, Hai Duong, Hai Phong and Nam Dinh. The company is now selling units in the Hoang Quoc Viet Residential building, currently being built in Hanoi.

Song Da Construction Corporation

Company Overview

The Song Da Construction Corporation is a state-owned company founded in 1960 that undertakes a multitude of construction activities. Its areas of expertise include building hydropower plants, transport engineering, civil and industrial works, installing power transmission lines and substations, producing construction materials such as steel and cement, providing consultancy services in construction, import and export of materials such as steel and cement, and construction technology.

The corporation has a number of power projects under way, including the 342 megawatt (MW) Tuyen Quang Hydropower plant in Na Hang district. Total value of the investment is around US$500mn. The project necessitates the resettling of up to 3,500 households, but benefits should come with the development of new urban areas in the district.

Across the border in Laos, Song Da is heading up the Viet-Lao Power Investment and Development Joint Stock Company consortium to build the XE Kaman Power Plant. The plant will have a capacity of 250MW and is being developed under the BOT model with a 30-year lifespan, including construction time. More than 4,000 Vietnamese workers will be moved to Laos to build the project.

Other ongoing projects include civil works on the south tunnel section of the Haivan Pass Tunnel project. The tunnel, which is more than 6km in length, is part of a project costing over US$130mn.

The Ngang Pass Tunnel in central Quang Binh Province, which was designed and built by the Song Da Construction Corporation, opened to traffic in August 2004, nearly a year ahead of schedule. The use of Austrian construction technology and modern technical equipment boosted labour productivity.

The Song Da Corporation has set up a financial company to manage and enlarge its finances. The financial company will also be responsible for listing the corporation's shares and for issuing corporate bonds.

In August 2006, the company stated plans to issue VND260bn (US$16.25mn) of business bonds. The bonds are to have a duration of five years and a face value of VND100,000 (US$6.23) each with an interest rate of 10.5% in the first year. The idea aims to raise capital investment for a twin towers building in the My Dinh new urban zone in Hanoi.

The construction launch of the Son La Hydroelectricity Plant in northern Vietnam was initiated in 2005. Song Da Construction Corporation is the main contractor for the project. The US$2.6bn, 2,400MW Son La Hydroelectricity plant will be located in the northern mountainous province of Son La and is expected to start generating power in 2015. The plant will be the largest of its type in South East Asia.

In January 2010, local media reported that Vietnam's Prime Minister had approved the experimental establishment of the Vietnam Construction Industrial Group (VCIG). This group operates in the form of holding company – the Song Da Group, which is established on the basis of the reorganisation of the Song Da Corporation, and is the wholly state-owned enterprise. It directly organises production, business operations and investment in its subsidiaries and partnership companies. The VCIG has 25 subsidiaries with over 50% of their charter capital being owned by the Song Da Group, 16 affiliates with less than 50% of charter capital being owned by

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the Song Da Group and four corporations with all of their charter capital being owned by the Song Da Group.

Financial Highlights	The company recorded sales volumes of US$200mn in 2002.
Financial Data	▪ Annual sales volume (2002): US$200mn ▪ No. of employees: 20,000
Operational Indicators	▪ Chairman: Le Van Que ▪ Director: Nguyen Van Binh ▪ Director: Pham Cuong
Contact Details	▪ Song Da Construction Corporation G10 Thanh Xuan Nam Quarter Thanh Xuan District Hanoi Vietnam ▪ Tel: +84 (4) 854 1164 ▪ Fax: +84 (4) 854 1161 ▪ www.songda.com.vn

Vietnam Construction And Import-Export Corporation (Vinaconex)

Company Overview

Vinaconex is one of the largest construction companies in Vietnam. It undertakes works in transportation, power transmission, telecommunications, water supply and drainage, irrigation systems, infrastructure projects, and the design of new and large-scale specialised engineering projects. These projects are executed for civil, public and industrial clients, both domestically and internationally. Overseas, the company has been involved in several projects such as Oran University in Algeria; a subway system and a nuclear power plant in Bulgaria; and a number of factories, hospitals and schools in the former Soviet Union.

Vinaconex is currently involved in two large developments. The US$170mn Cua Dat irrigation project in Thuong Xuan in the Than Hoa province began in 2003 and will provide a hydroelectric power plant with a capacity of 97MW.

Vinaconex's 'Water Supply Project' was launched in April 2004. The biggest ever of its kind in Vietnam in terms of the total investment capital, it will supply clean water to the urban areas of Son Tay, Hoa Lac, Mieu Mon, Hanoi and Ha Dong, taking surface water from the Da River. The project is divided into two stages and will have a total investment capital of VND2.5trn (US$160mn). It will offer a capacity of 600,000m^3/day when completed by 2010.

In September 2006, it was stated that Vinaconex would sell 35% of its chartered capital, equal to 54mn shares, to outside investors. Around 10.8mn shares are to be sold to strategic investors such as BIDV, Vietnam Investment Fund and the Technological and Commercial Bank of Vietnam (Techcombank). Some 28.13% of the shares are to be auctioned at stock exchanges or sold through underwriting at an initial price of VND10,500 (US$0.65) per share.

Through this equalisation plan, Vinaconex will raise its chartered capital to VND1.5trn (US$93.75mn), with the state holding a 64% stake.

The construction firm also plans to issue additional shares worth more than VND500bn (US$31.25mn) to raise its chartered capital to VND2trn (US$125mn) by Q107.

After going public, Vinaconex is to operate under the form of a parent-subsidiary company with the initial 46 affiliates controlled by the parent firm's capital and 16 other associate firms. It is likely to focus on construction, real estate, industrial production and construction materials, along with design and consultancy, trade and services and financial investment.

Vinaconex is also likely to set up new joint stock companies to meet development demand, including Cam Pha Cement Company, Vinaconex Ha Dong Investment and Commerce Company and Song Da Water Supply Company.

Key Statistics

- No. of employees: 26,000
- Year established: 1988
- Viet Nam News reported in February 2010 that the company had beat its earnings target for 2009 by 11.2%, with combined revenue from all units totalling VND13.12tn and net profit grew 41.8% year-on-year to VND460.5bn.

Key Personnel

- Chairman: Nguyen Van Tuan

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Contact Details	▪ Vinaconex Vinaconex Building Trung Hoa Nhan Chinh New Urban Area, Thanh Xuan Hanoi Vietnam ▪ Tel: +(84) 42249292 ▪ Fax: +(84) 42249208 ▪ www.vinaconex.com.vn

Vietnam Construction And Machinery Installation Corporation (Lilama)

Company Overview

The Lilama Corporation is an expansive Vietnamese construction company that undertakes a wide range of activities and has more than 60 affiliates. Lilama includes in its portfolio of activities consultancy, design, manufacture of technological equipment, installation of pressure pipe systems, electrical equipment and machines, shipbuilding and general power generation and infrastructure works.

In August 2007, Lilama, in a consortium with other local companies, invested US$199.2mn to develop a thermal power plant in central Ha Tinh province. The coal powered plant will have a capacity of 1,200MW.

Lilama has been involved in 150 projects throughout Vietnam, including work for the expansion of Quang Ninh province's Uong Bi thermoelectric plant, the Ca Mau power project, the third phase of the Hoang Thach cement project and the Dung Quat refinery in central Vietnam. A Lilama affiliate has also won a US$600,000 contract from Japan's Sumitomo Electric Industries to produce two air-drying systems used in thermoelectric plants.

Ongoing projects include work on three hydroelectric power plants being built in Vietnam's central highlands. Lilama is working alongside other big Vietnamese players such as Song Da Construction Corporation, Vinaconex and the Corporation for Infrastructure Construction and Development to develop these plants, which are designed to produce 2.675bn kWh of power annually. These plants are estimated to cost in the region of US$570mn and will become operational between 2008 and 2010.

Lilama also won a US$305.05mn bid to expand the Uong Bi power plant. It is now planning a stake in eight joint-stock projects worth more than US$37mn to spread its investments in the near future. Lilama's largest VND140bn (US$8.75mn) investment will go into Quang Ninh Electricity, followed by VND54bn (US$3.5mn) in a Laos-based electricity company, VND30bn (US$1.9mn) in Ha Long Cement and VND8.6bn (US$537,000) in Thang Long Cement. Lilama will also spend VND15bn (US$974,000) on a share of Hung Vuong Cement, VND9bn (US$584,000) in Cam Pha Electricity and VND750mn (US$48,700) in Hai Phong Electricity.

In February 2010, International Water Power magazine reported that Cavico Corporation will carry out additional construction work at the Hua Na hydro power plant in Vietnam following the award of a new US$11.9mn contract by Lilama.

Financial Highlights

The company recorded annual sales volumes of US$150mn in 2003.

Key Statistics

- Annual sales volume (2003): US$150mn
- No. Of employees: 20,000
- Year established: 1975

Key Personnel

- President and CEO: Pham Hung

Contact Details

- Lilama Corporation
  124 Minh Khai

Hai Ba Trung
Hanoi
Vietnam

- Tel: +84 (4) 8633067
- Fax: +84 (4) 638104
- www.lilama.com.vn

Vincom

Company Overview	Vincom was established in 2002. It focuses its business in real estate development and also has operations in finance, banking and energy industry. Source: vincom.com.vn as of March 6 2009
Company Data	Vincom is publicly listed, with its share coded VIC. It carried out its IPO in 2007. The company posted profits of more than VND160bn (US$9.2mn) in 2008.
Recent Developments	Vincom started construction of Vincom Park Palace in Hanoi in 2008. By the end of 2008, 70% of apartments in the VPP had been booked. In 2008, the company started construction of the Eden Commercial and Residential Complex in Ho Chi Minh City, which includes an underground car park, and Vincom Plaza in Hai Phong. In January 2010, the company said it will focus on the real estate sector this year while suspending financial investment plans, according to Reuters.

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BMI Forecast Modelling

How We Generate Our Industry Forecasts

New Approach

This round of Real Estate reports incorporates a new approach. In each of the countries surveyed, we have made contact with local sources (typically major commercial real estate agents) and asked them 10 questions in relation to three sub-sectors – office, retail and industrial. We have combined the answers into the data tables and text that form part of the Real Estate Market Overview and the Industry Forecast Scenario.

In taking this 'grass-roots' approach we believe we have ensured that we identify, in a timely fashion, key issues that will likely drive rents and yields over the short, medium and long term. We have developed a framework that facilitates comparisons between cities and sub-sectors in different countries. In developing our long-term forecasts, we have focused on net yields. Our thinking is that, as yields are driven by both rentals and capital values, the movements in yields provide a convenient short-hand for what is and is expected to be happening in markets.

Our forecasts are based largely on qualitative judgements. Given that, in most of the countries that **BMI** surveys, the real estate protagonists are still dealing with the aftermath of the global financial crisis, it is questionable how valuable a quantitative approach would be. In part because of **BMI**'s own macroeconomic research and in part because of the insights gleaned from our in-country sources, we are normally able to comment in an informed way on the likely directions for rentals and capital values. Nevertheless, we recognise that we can and should refine the methodology and incorporate greater quantitative aspects over time as we accumulate more data on each of the various markets that we survey.

Overview

BMI's industry forecasts are generated using the best-practice techniques of time-series modelling and causal/econometric modelling. The precise form of model we use varies from industry to industry, in each case being determined, as per standard practice, by the prevailing features of the industry data being examined. **BMI** mainly uses OLS estimators and in order to avoid relying on subjective views and encourage the use of objective views, uses a 'general-to-specific' method. **BMI** mainly uses a linear model, but simple non-linear models, such as the log-linear model, are used when necessary. During periods of 'industry shock', for example a deep industry recession, dummy variables are used to determine the level of impact.

Effective forecasting depends on appropriately-selected regression models. **BMI** selects the best model according to various different criteria and tests, including, but not exclusive to:

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- R^2 tests explanatory power; Adjusted R^2 takes degree of freedom into account;
- Testing the directional movement and magnitude of co-efficients;
- Hypothesis testing to ensure coefficients are significant (normally t-test and/or P-value);
- All results are assessed to alleviate issues related to auto-correlation and multi-co-linearity.

BMI uses the selected best model to perform forecasting.

It must be remembered that human intervention plays a necessary and desirable role in all of **BMI**'s forecasting. Experience, expertise and knowledge of industry data and trends ensures that analysts spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not. Within the Real Estate industry, this intervention might include, but is not exclusive to, new investments across sectors, or projects getting cancelled; general investment climate and business environment changes; domestic or regional trends changing; macroeconomic indicators; and regulatory changes.

Example Of Construction Value Model:

$(\text{Construction Value})_t = \beta_0 + \beta_1*(\text{GDP})_t + \beta_2*(\text{Inflation})_t + \beta_3*(\text{Lending Rate})_t + \beta_4*(\text{Population})_t + \beta_5*(\text{Government Expenditure})_t + \beta_6*(\text{Construction Value})_{t-1} + \varepsilon_t$

Construction Industry

A number of principal criteria drive our forecasts for each construction and engineering variable:

Construction GDP And Infrastructure Spending

Figures for construction GDP and infrastructure spending are based, where possible, on national accounts as published by the relevant central banks, as well as primary government/ministry sources and official data. Where these are unavailable, construction GDP forecasts are based on a range of variables, including:

- Stated infrastructure and development programmes;
- Likely increases owing to related urban or industrial sector developments;
- Political factors, such as an electorally motivated public works programmes.

Construction as a percentage of GDP is calculated using **BMI**'s macroeconomic and demographic forecasts.

Employment Within The Construction Industry

These figures are forecast based on:

- The growth or otherwise of the construction industry;

- Company results and expansion plans.

Bank Lending

We assume that the growth rate for each of the three variables (assets, loans and deposits) varies over time. The growth rate in 2008 is deemed to be the actual growth rate achieved over the 12 months to the point in time for which the latest data is available. In practice, this is usually a date in late 2008. The growth rate in 2009 is assumed to be a weighted average – 80% of the actual rate achieved in the previous year and 20% of the long-term nominal rate of growth in GDP that BMI projects for the five years to the end of 2013. The growth rate in 2010 is assumed to be a weighted average where the respective ratios are 60% and 40%. In 2011, the ratios are reversed. In 2012, the ratios are 20% and 80%. In 2013, the three variables are assumed to increase at the annual rate of growth in nominal GDP over the five years. In effect, 2013 is the only year of the five where the actual growth of the variables achieved in 2007 has no impact on the projected growth rates.

Real Estate/Construction Business Environment Rating

BMI's Real Estate/Construction Business Environment Rating (RECBER) provides a globally-comparative, numerically-based assessment of the risk/return trade-off for the industry in each state covered by **BMI**'s Real Estate reports. In order to provide clients with a detailed assessment of this trade-off, the overall rating is made up of two distinct sub-ratings.

Limits Of Potential Returns
Evaluates the industry's current size and growth potential, and also assesses broader industry/state characteristics that may enable or inhibit the industry's development.

Risks To Realisation Of Returns
Evaluates issues within (a) the real estate sector, and (b) broader country risk vulnerabilities that increase uncertainty surrounding the stability of anticipated returns on investment into each state.

These ratings themselves comprise sub-ratings.

The 'Limits' rating comprises:

- Real estate market. This evaluates industry growth/size dynamics.
- Country structure. This evaluates the broader economic/socio-demographic environment.

The 'Risks' rating comprises:

- Real estate risks. This covers real estate-specific factors, including finance.

- Country risk. This evaluates the industry's broader country risk exposure.

Weighting

Given the number of indicators/datasets used, it would be inappropriate to give all sub-components equal weight. Consequently, the following weight has been adopted.

Table: Weighting Of Indicators

Component	Weighting
Limits of potential returns	50%, of which
Real estate market	65%
Country structure	35%
Risks to realisation of returns	50%, of which
Real estate risk	65%
Country risk	45%

Source: BMI

In all cases, scores are out of 100, with higher score indicating greater potential returns (Returns), or lower risks (Risks).

Indicators

The following indicators have been used. Overall, the rating uses five subjectively measured indicators, and over 20 separate indicators/datasets.

Limits Of Potential Returns – Real Estate-Specific Factors

The ratings score for limits of potential returns considers four real estate-related factors, each of which is given equal weighting.

- Construction output, US$bn (previous year).
  Absolute size of construction sector used as proxy for size of real estate sector.
- Construction sector real growth, compound annual growth rate (CAGR) (previous year to three years hence).
  Indicates prospects for, and confidence in, the construction sector, and hence a proxy for prospects/confidence for real estate sector.
- Total commercial bank lending, US$bn (end previous year).
  Real estate projects are long term and capital intensive, with most finance obtained from commercial banks. This indicator indicates funding availability.

- Commercial bank lending, CAGR (previous year to three years hence).
  This indicates prospects for the stability of finance and, implicitly, its cost. In times of crisis, this is likely to be the most volatile indicator.

Limits Of Potential Returns – Country Structure

The ratings score for limits of potential returns considers three other factors, each of which is given equal weighting.

- **BMI**'s Business Environment Rating for financial infrastructure.
  This captures the efficiency of the commercial banking sector – and other elements of the financial services industry – in making funding available to the real estate sector.
- Per capita GDP, US$.
  Higher per capita GDP correlates with the expansion of the middle classes, which are the key market for residential real estate, and the users of commercial and retail real estate properties.
- Urbanisation, % of total population living in urban areas.
  Urbanised states tend to be more conducive markets for real estate development, as they have deeper, more mature markets. That said, our scoring methodology views favourably less urban, or even predominantly rural, states that are characterised by persistently strong construction sector growth.

Risks To Realisation Of Returns – Real Estate-Specific Factors

The ratings score considers three factors that are directly relevant to the Real Estate sector. These are each given equal weighting. They are:

- Lending risks, ratio of the growth in nominal lending (i.e. by commercial banks to non-bank customers) to the nominal growth in GDP over a five-year period (last year to current year plus three). It is assumed that lending volumes and nominal GDP should, generally, grow at the same rate. If lending growth substantially exceeds nominal GDP expansion, this would suggest a deterioration in risk standards by lending institutions. Conversely, if nominal GDP rises substantially faster than bank lending, then the cost of finance for real estate ventures is likely to rise (thereby affecting profitability).
- Financial institution confidence, change in the loan to deposit ratio over a five-year period (last year to current year plus three). This is used as a proxy for the stability of finance. Thus, a rapid decline in the ratio (i.e. a lending squeeze) is penalised. Conversely, we are more tolerant of a rise in lending, as in itself, this may be positive for the industry. But high rates of lending growth are penalised as they could indicate an investment bubble unless the state's Country Risk Short-Term Economic Rating – a proxy for vulnerability to an economic shock – is very high.
- Real estate prices, % change y-o-y.
  There are a number of methodological challenges in identifying suitable proxies for real estate prices in each country. Nevertheless, where possible, we have identified a national index (usually for house prices) and assess annual growth. The rating is symmetrical, in that high growth (which indicates a

bubble) is penalised, as is sharp price falls (which indicates that bubbles have been burst). Where no real estate price index is available, this indicator does not affect the overall score for this section.

Risks To Realisation Of Returns – Country Risk Factors

- **BM**I's Long-Term Economic Rating. A measure of long-term economic stability.
- **BMI**'s Business Environment Legal Framework Rating. Denotes the strength of legal institutions in each state – security of investment can be a key risk in some emerging markets.
- **BMI**'s Business Environment Bureaucracy Rating. Denotes the ease of conducting business in the state.

Project Finance Ratings Indicators

Table: Design And Construction Phase

Indicator	Definition	Rationale	Weight-ing
Inputs			**20% (group)**
Domestic – inflation	Average consumer inflation 2002-2009, adjusted for standard deviation	High and uncertain inflation increases risks to input cost projections	60%
International – long-term currency volatility	Standard deviation of the moving average of the past 12 months of data on a monthly basis, plus standard deviation of the moving average	Currency volatility increases risks to cost projections of imported goods	40%
Political environment			**25% (group)**
Market orientation	Measure of government intervention in economy, using data for government expenditure, revenue from state-owned enterprises, average trade tariff rates, tax levels, trade bureaucracy, FDI history	Governments with strong commitment to free markets are likely to refrain from sudden changes to the investment/trade regime	20%
Security risk	Measure of the level of security threat; external and internal, facing a country.	The higher the security risk, the higher risks to infrastructure, in terms of physical security (they can become targets) and levels of insurance premiums, which rise with security risks	20%
Long-term policy continuity	BMI evaluation of level of broad governmental policy consistency over past decade	Strong policy continuity between elites (within or across parties) minimises risks new legislation will alter business operating environment	20%
Characteristics of polity	BMI evaluation of system of government and constitutional framework against ideal	Democratic governments with strong, independent institutions are less prone to sudden policy shifts	20%
Rule of law	Evaluation of breadth/depth of state's ability to protect individuals and property	Strong rule of law reduces direct threats to assets during construction	20%
Legal/regulatory risks			**20% (group)**
Corruption	Subjective measure of level of corruption	Transparency essential to predictable planning of input delivery and cost and predictability of officials' decisions	50%
Contract enforceability	World Bank Index of cost, procedures and time taken to recover a bad debt	Confidence in the legally binding nature of contracts is essential to minimising domestic counterparty risk	50%
Economic/financial risks			**35% (group)**
Domestic – economic stability	BMI's long-term economic rating, incorporating 20 indicators to assess risk of economic crisis	Economic stability reduces risks to projects (eg financial problems at suppliers)	30%
International – availability of finance	US and eurozone average interest rates, adjusted for Chicago BOE VIX index	Project finance is mainly international. Price/availability depend on US/euro-zone interest rates and investor risk appetite (VIX is proxy). Global, indicator	70%

Source: BMI

Table: Commissioning And Operating Phase – Commercial Construction

Indicator	Definition	Rationale	Weight-ing
Inputs			**30% (group)**
Domestic			
Inflation, %	Average inflation 2002-2009 and its standard deviation	High, and uncertain, inflation increases risks to input cost projections	30%
Power, imports as % of consumption	Power used as proxy for all utilities	Supply of utilities essential to function-ing of asset and revenue generation	25%
International			
Long-term currency volatility	The standard deviation of the moving average of the past 12 months of data on a monthly basis, plus standard deviation of the moving average	Currency volatility increases risks to cost projections of imported goods	45%
Sale of outputs			
Regulatory			**20% (group)**
Supply risk	BMI's subjective view of the transparency of government planning policy	Clarity regarding future market supply is essential to forecasting demand	20%
Price risk	BMI's subjective view of the transparency of government policy regarding price of service related to asset	Clarity over policy/regulations covering price essential to projecting income	20%
Contract enforceability	World Bank index of cost, procedures and time taken to recover a bad debt	Confidence in the legally binding nature of contracts is essential to minimising domestic counterparty risk	60%
Market risks			**30% (group)**
Economic stability	BMI's long-term economic rating, which incorporates 20 indicators to assess risk of economic crisis	An economic crisis would cut – potentially substantially – demand	
Long-term currency stability	The standard deviation of the moving average of the past 12 months of data on a monthly basis, plus standard deviation of the moving average	Sharp currency movements introduces risks to value of income in international currency	50%
Political risks			**20% (group)**
Market orientation	Measure of government intervention in economy, using data for government expenditure, revenue from state-owned enterprises, average trade tariff rates, tax levels, trade bureaucracy, FDI history	Governments with strong commitment to free markets are likely to refrain from sudden changes to the investment/trade regime	10%
Security risk	Measure of the level of security threat; external and internal, facing a country	The higher the security risk, the higher the risks to infrastructure, in terms of physical security (can become targets) and potential insurance premiums, which rise along with security risk levels	40%
Policy continuity	BMI evaluation of level of policy consistency over past decade	Strong policy continuity between elites (within or across parties) minimises risks new legislation will alter business operating environment	10%
Rule of law	Evaluation of breadth/depth of state's ability to protect individuals and property	Strong rule of law reduces direct threats to assets	40%

Source: BMI

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Table: Commissioning And Operating Phase – Energy And Utilities

Indicator	Definition	Rationale	Weighting
Inputs*			**30% (group)**
Inflation	Average inflation 2002-2009 and its standard deviation	Volatile inflation will risk unanticipated cost increases that it may not be possible to pass on to asset users	30%
Crude price costs	BMI's Brent crude forecasts for next five years, adjusted for standard deviation of prices over past three years	Gas and other fuel prices correlate closely with oil. Price stability is desirable, as are expected trends. A global, not a country-specific risk	25%
Long-term currency volatility	The standard deviation of the moving average of the past 12 months of data on a monthly basis, plus the standard deviation of the moving average.	Currency volatility raises risks to costs of imported goods or goods bought in US dollars (ie fuel feedstock)	45%
Sale of outputs			
Regulatory			**20% (group)**
Demand risk	BMI's subjective view of government energy policies and their implications for industry demand	Transparency regarding government energy policies is essential for evaluating demand	20%
Price risk	BMI's subjective view of the transparency of government policy regarding power prices	Clarity over policy/regulations covering price are essential to projecting income	20%
Contract enforceability	World Bank Index of cost, procedures and time taken to recover a bad debt	Confidence in the legally binding nature of contracts is essential to minimising domestic counterparty risk	60%
Market risks			**30% (group)**
Economic stability	BMI's long-term economic rating, which incorporates 20 indicators to assess risk of economic crisis	An economic crisis would cut – potentially substantially – projected demand	50%
Long-term currency stability	The standard deviation of the moving average of the past 12 months of data on a monthly basis, plus the standard deviation of the moving average	Sharp currency movements introduces risks to value of income in international currency	50%
Political risks			**20% (group)**
Market orientation	Measure of government intervention in economy, using data for government expenditure, revenue from state-owned enterprises, average trade tariff rates, tax levels, trade bureaucracy, FDI history	Governments with strong commitment to free markets internally and internationally are likely to refrain from sudden changes to the investment/trade regime	10%
Security risk	Measure of the level of security threat; external and internal, facing a country	The higher the security risk, the higher the risks to infrastructure assets, in terms of physical security (can become targets) and potential insurance premiums, which rise with security risk levels	40%
Policy continuity	BMI's evaluation of level of policy consistency over past decade	Strong policy continuity between elites (within or across parties) minimises risks new legislation will alter business operating environment	10%
Rule of law	Evaluation of breadth and depth of state's ability to protect individuals and property	Strong rule of law reduces direct threats to assets	40%

** No distinction between internal and domestic risks. This reflects BMI's view that all projects would have fuel feedstock contracts in place prior to construction. Source: BMI*

Table: Commissioning And Operating Phase – Transport

Indicator	Definition	Rationale	Weight-ing
Inputs			**30% (group)**
Domestic – inflation	Average inflation 2002-2009 and its standard deviation	Volatile inflation will risk unanticipated cost increases that it may not be possible to pass on to asset users	40%
International – long-term currency volatility	Standard deviation of moving average of past 12 months of data on monthly basis, plus standard deviation of moving average	Currency volatility increases risks to cost projections of imported goods	60%
Regulatory			**20% (group)**
Demand risk	BMI's subjective view of government regulation and its record in supporting substitutes etc	Transparency regarding government policy essential for evaluating demand	20%
Price risk	BMI's subjective view of the transparency of government policy regarding price of service related to asset	Clarity over policy/regulations covering price are essential to projecting income	20%
Contract enforceability	World Bank index of cost, procedures and time taken to recover a bad debt	Confidence in the legally binding nature of contracts is essential to minimising domestic counterparty risk	60%
Market risks			**30% (group)**
Economic stability	BMI's long-term economic rating, which incorporates 20 indicators to assess risk of economic crisis	An economic crisis would cut – potentially substantially – projected demand	50%
Long-term currency stability	The standard deviation of the moving average of the past 12 months of data on a monthly basis, plus the standard deviation of the moving average	Sharp currency movements introduces risks to value of income in international currency	50%
Political risks			**20% (group)**
Market orientation	Measure of government intervention in economy, using data for government expenditure, revenue from state-owned enterprises, average trade tariff rates, tax levels, trade bureaucracy, FDI history	Governments with strong commitment to free markets are likely to refrain from sudden changes to the investment/trade regime	10%
Security risk	Measure of the level of security threat; external and internal, facing a country.	The higher the security risk, the higher the risks to infrastructure assets, in terms of physical security (they can become targets) and insurance premiums, which rise along with security risk	40%
Policy continuity	BMI evaluation of level of policy consistency over past decade	Strong policy continuity between elites (within or across parties) minimises risks new legislation will alter business operating environment	10%
Rule of law	Evaluation of breadth and depth of state's ability to protect individuals and property	Strong rule of law reduces direct threats to assets	40%

Source: BMI

Sources

Sources used in Real Estate reports include UN statistics, national accounts, housing and economy ministries, officially released company results and figures, trade bodies and associations and international and national news agencies.

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