Financial solutions for residential development in Vietnam

Coordination of Mezzanine finance and Presale system

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**Master of science thesis**

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**Abstract**

Real estate is one of the most important parts of a nation that has significant effect on all economic aspects. The fast growth rate in Vietnam makes this industry more important especially when the imbalance between supply and demand becomes more serious. Seeking the alternative financial sources is one of the most essential purposes in order to develop the healthy real estate market.

This study will mention the potential of using presale system as well as mezzanine finance in developing residential projects. It will review the advantages and disadvantages of using these methods and the combination of them in projects under the opinions of market participators such as developers, households and investors. After all, it will suggest some solutions in order to make the best of this alternative financial source.
Acknowledgement

Firstly, I would like to thank to Royal Institute of Technology (KTH) for giving me the opportunity to receive the advanced education here in Stockholm where I have also experienced one of the best stages in my life.

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Moreover, I am also thankful my opponent who contributes me his supportive ideas and suggestion for my research.

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Stockholm, June 2010

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1 Introduction

1.1 Background

Financial sources are always one of the most concerned issues of investors especially in the real estate sector where projects are usually funded around 70% of total development costs. Seeking reasonable sources is the significant goals for financial controllers.

Vietnamese is a developing country with total population at around 85 million and the population growth rate at 1.5% annually. The improvement of living standard adds to the demand for residential houses that results in sharp increase especially in the big cities. Meanwhile, the supply for this real estate sector is limited by several reasons such as the complicated housing sector’s regulation regime and the lack of invested capital. The significantly high demand raises the imbalance which is one of the reasons for the serious bubble in real estate market. In big cities like Hanoi or Hochiminh, the average property price increases 30%- 40% from the end of 2009 (HIDS, 2009; VIA, 2010). In some new satellite cities, the real estate price is booming (VIA, 2010). In order to equilibrate this situation, the supply should be affected to match the market demand. Consequently, the improvement in legal system of real estate sector and the seeking alternative financial sources must be considered.

Currently, Vietnamese real estate companies depend significantly on the financial sources from banks to strengthen their financial capacity. However, banks tend to cut down their investments due to the present bubble situation in both financial and real estate markets, in these sectors (Shamim Adam, 2010). The Ho Chi Minh Exchange index fell 80 percent from a life high of 1,170.67 points in March 2007 before bottoming out at 234.66 in early February 2009. It has risen since, and on March 2010 the market closed at around 500 (SSC, 2010). Property prices in Vietnam have also experienced unstable boom and bust cycles lately. Besides, though Vietnam is an attractive market, foreign investors face many difficulties in investing in Vietnam real estate sector due to the unexpected and incomprehensive legal framework as well as the lack of investment tolls and the transparent information. Consequently, seeking alternative housing construction finance vehicles and methods to raise funds are most imperative purposes of real estate developers.
1.2 Purpose of the thesis

With the given background, the thesis will examine these problems as follows

✓ Review the recent Vietnamese real estate market mainly focusing on residential sector.

✓ Study the financial sources and raising methods for housing projects.

✓ Evaluate proposals put forward for financing residential real estate projects in the current difficulty in Vietnamese financial market.

1.3 Limitations

The subject of the thesis will mainly focus on how real estate developers should find outside financial source to finance their residential projects in the condition of the current difficulty in Vietnamese financial market. The thesis does not concern about the development in other real estate sectors such as commercial building or hotel. Moreover, the current situation of hidden information in Vietnamese financial and real estate market results in lack of primary information which limits the study from reflecting the reality and seeking most appropriate solutions.

1.4 Methodology

First of all, the study will review literature on previous works related to the subject of thesis. The science articles and thesis about real estate finance and economics will be collected and analyzed. The thesis will also study the data collected from the official sources in Vietnamese financial and real estate markets.

Secondly, the thesis will also be improved by the information gathered from discussions with various financial and real estate experts in Vietnam.

1.5 Organization

The thesis is divided into three parts. The first one introduces an overview about Vietnam economics and real estate market. The second part provides the literature review of the mezzanine finance and presale contract. In this part, general concepts, main characteristics, advantages as well as disadvantages of these raising fund methods will be presented. The third discusses matters of coordinating these two financial
sources in Vietnam residential market including the benefit to market participators and the obstacles of the coordination. Besides, this part also exposes some solutions for the combination in the current condition of Vietnam real estate market.
2 Overview of Vietnamese economics and real estate market

2.1 Current macroeconomics

**GDP growth rate**

Following economic stagnation after reunification from 1975 to 1985, the 1986 Sixth Party Congress approved broad economic reforms (known as "Doi Moi" or Renovation) that introduced market reforms, opened up the country for foreign investment, and dramatically improved Vietnam's business climate. Vietnam became one of the fastest-growing economies in the world, averaging around 8% annual gross domestic product (GDP) growth from 1990 to 1997 and 6.5% from 1998-2003. From 2004 to 2007, GDP grew over 8% annually. However, from the 2008, because of the effect from the global financial crisis and economic recession, Vietnamese economic growth was dramatically slow. The international prices of commodities were on a declining trend since the third quarter of 2008. Orders from overseas for some significant products such as garments and other industrial products collapsed in the fourth quarter of 2008, and a slowdown in manufacturing became noticeable. In the first quarter of 2009, this impact was still on GDP resulted in an increase of only 3.1 percent over last year, or 4 percentage points below the average first-quarter growth for the last few years (Worldbank, 2009).

**Figure 1: GDP growth rate**

![GDP growth rate chart](image-url)

*Source: Reports from World Bank and IMF*
However, positive signs of recovery have been emerging as a result of the government efforts to support economic activity. The government announced its stimulus package which included various measures, from an interest rate subsidy, to tax breaks, and additional capital spending. As a result, GDP grew by 4.5% in the second quarter and 5.8 percent in the third, raising real GDP growth rate to 4.6% year-on-year for January-September. With current recovery and potential up trend of developing economies, the GDP was forecasted to increase to around 7% from 2009 to 2014.

**Foreign direct investment (FDI)**

Figure 2: FDI/GDP

![FDI/GDP graph](image)

Source: Reports from World Bank and IMF

The high growth rate of the emerging economics and the stable politics make Vietnam become one of the most investment attractive countries in South East Asia (ATKearney, 2010). Especially after accessing to WTO in 2007, the foreign direct investment in Vietnam considerably improved from 2.4 billion USD in 2006 to 6.6 billion USD in 2007 (accounting for 9.29% of GDP). This rate continued to rise by 1.5% in 2008 and only decreased to estimated 4.5% in 2009 by the effect of global economics crisis. Nevertheless, the recovery of economics will soon attract foreign investors.

2.2 **Population growth and the demand for housing**

Vietnam is a multi-nations country, which is home to the people of about different 54 nations with total population at around 90 million. The majority of the population is
young with around 68.6% of population at the age from 15 to 64 years (GSO Vietnam, 2009). Nowadays, Vietnamese young couples tend to change from consanguineous family to nuclear family which brings them more privacy and consequently require new housing spaces. Moreover, the urban population estimated at about 33% in 2010 along with the urbanization rate at around 3% result in high requirement for housing in centrals (MOC, 2008 and GSO Vietnam, 2009).

Figure 3: Population growth rate and GNI per capita

Source: Reports from World Bank and IMF

On the other hand, with the high and stable GDP growth, the living standard is improved recently. The Gross national income (GNI) per capita has enhanced considerably from USD 1,900 in 2004 to USD 2,700 in 2008 and forecasted to be at USD 4,000 in next 5 years. With the continuously increase in income and the high requirement for housing, the demand in real estate especially residential sector in big cities will be raised.

2.3 Financial market

2.3.1 Overview of Vietnam financial market

Vietnamese financial system officially played an active role in controlling financial resources since the process of economic reforms has been implemented in Vietnam from 1986. Like other economics, there are two main financial systems including formal and informal one.
The informal one is uncountable money lenders, relatives and friends who provide large financial services. This sector is very difficult to exactly measure the size (Pham et al. 2008). Yet its importance is impossible to disclaim in an emerging economy like Vietnam where the administration procedures are very complex. As a result, although it is more expensive to access fund in the informal financial sectors but the cheaper monitoring cost will be compensated. However, without accurate information, this sector will not be discussed in the research.

The formal one is divided into three sectors: banking, equity and debt markets.

**Banking sector**

Vietnamese banking system officially operated from 1951 but only marked the significant “benchmarks” from 1986 when process of banking operational mechanism was reformed. In this period, the four biggest state-owned banks were opened. From the early 1990s, series of joint stock banks and other private financial institutes got the license to open. In 2008, two of the biggest state-owned banks were equitized and the next other two will be equitized soon. Till now, in the banking system, there are:

- Five state – owned banks (SOBs) (two commercial banks and three social banks)
- Forty join stock banks (JSBs)
- Five foreign banks and five joint venture banks
- Thirty three branches of foreign banks

Although there are a great number of joint stock banks, the SOBs still hold a high percentage of deposit market accounting for more than 70% of total market (Pham et al. 2008). The percentage of lending market is around 60-70% (S. Leung 2009). Previously, the market share of JSBs was at around 10% (S. Leung 2009). Recently this rate grows up to 30% especially at the lending field (S. Leung 2009). The reason is that traditional customers of SOBs are mainly State-owned enterprises while which of JSBs are private business and households who raise more demand for financial services lately. In terms of foreign banks, although these banks owning the huge support from abroad mother banks, it is still difficult to compete with domestic banks which possess numbers of branches all over country. Moreover, with very strict international standard in lending, it will be not easy for companies to access their funds.
Equity market

Vietnam has two regulated stock markets (one in Hanoi and other in Hochiminh), in addition to an UpCom market (for unlisted companies). At the beginning, an overall foreign ownership limit of 20% for equities and 40% for bonds were implemented. In July 2003, in a bid to improve liquidity, the government raised the foreign ownership limit for equities to 30% (and now is 49% of the company’s issued share capital in companies listed on the Ho Chi Minh City Stock Trading Center) and totally removed foreign ownership limit of a particular issuer’s bonds (SSC of Vietnam). Till now there are only 453 companies listed in regulated market. A great number of large state-owned companies still did not finish equitization as the previous schedule because of the economic crisis.

From 2006, six years after establishment and work perfunctorily, the stock market began attractive to investors especially foreigners as a very potential investment tool. 2007 is the period of highly speculative nature of the stock market. As at January 2007, the average P/E ratio for the twenty firms that made up the bulk of the market capitalization at the time was around 73, compared with average P/E ratios in other Southeast Asian markets of between 10 and 20 (S. Leung 2009). The burst of market bubble in 2007 and the early of 2008 led to the decrease 70% of VN - Index in one year. However with the recovery trend of the global economics and potential growth of the emerging economic, from 2009, Vietnam stock market has witnessed some rehabilitation. Stock market capitalization reached 38% of GDP by the end of 2009. The value of foreign investor portfolio increased 29% in 2009 after the recovery trend in 2008 (SSC of Vietnam, 2009).

Debt markets

The Vietnam bond market development was boosted when Vietnam entered WTO in 2006. Total market capitalization is at 15% of GDP (S. Leung 2009). However, most of bond issuers are from State sector which owns nearly 80% of market share. From 2009, the improvement in legal framework has enhanced the growth of the corporate bonds market that reached at 20%. But majority of corporate issued bond are state-owned one which are accounting for 64% of total market value (Vuong & Tran 2010).
In terms of bond investors, the bond market tends to domestic although there is no limitation on foreign holding of bonds. The most important reason is low liquidity of bond market. The state-owned bond is mainly invested by the state owned banks or enterprises. The corporate bond market reflects perception of relationship-based and rent-seeking behavior in the financial markets, since only a number of large commercial banks and their securities subsidiaries dominate the total corporate bond primary market (Vuong & Tran 2010).

### 2.3.2 The current unsolved problems of financial market

Not until 2008 when the world experienced the unprecedented economic growth, Vietnam financial system previously revealed many serious problems.

**Not fully-done and unstable regulation system**

One of the most significant difficulties that not only local but also foreign investors have to face is the complicated and unstable regulation system (Weforum, 2009). The document process controlled by administrative agencies may take companies a lot of time then miss their opportunities. It is very common that companies may receive several conflictive feedbacks about the same problems from different organizations. Sometimes, companies are trapped by the unstable policies which are very suddenly effective. Inversely, these ineffective policies take a lot of time to be changed in order to be suitable with the development trend.
Weak organizational capacity

First, there is the management conflict among administrative agencies. In banking sector, there is conflict between SOB and Ministry of Finance (MOF) who are responsible to control the equity of State-owned bank and one of equitization companies relatively. Both organizations want to control these parts of equity which resulted in complicated situation when these banks want to have foreign partners according to their equitization schedule. The weakness is also in the bureaucratic management which presents in creating administrative measures such as the ceiling some credit growth of banks or compel State-owned bank purchase of treasury bills on the monetary sides (S. Leung 2009). It is also the administratively requirement to commercial banks to limit the loan on some sectors like stock and real estate markets when Government cannot smooth the dramatic growth.

Deficient formal information system

Another matter existed in not only market but also in the many financial institutes is the unclear information. Till now, there is no domestic rating service in the financial market. Only some huge banks have their owned credit rating systems. Most of join stock banks do not have the credit classification system to allow calculation significant measures that is close to the international financial standard report (S. Leung 2009).

2.4 Real estate industry

2.4.1 The development of residential market

Before 2000, Vietnam real estate market was generally stable and inactive under the government control. Nearly all housing projects were owned by State owned companies that were developed according to the government plans. In big cities, most of people have worked for government organizations then will be distributed houses. Office buildings belonged to State owned companies so reduced the demand for office space. In company with significant change in economics, real estate industry has begun more active and fluctuant. The dramatically inflow FDI has raised the demand for office, commercial as well as industrial space. The continuously improved living standard afforded people to own more comfortable and private house. With the limited supply, the real estate market observed the dramatic development from 2000 to 2003 which
resulted in serious bubble situation. However, in this period, the booming price was mainly observed in land transactions. In Hochiminh, only around 10% of land deals were enclosed with property (HIDS, 2008). The speculation in market was out of control of the government. After two years of booming, Vietnam real estate market became frozen in a long time till 2007. Consequently, the price and quantity of transactions were declined sharply. In 2003, 2004 and 2005 the successful deal decreased 28%, 56% and 78% respectively. Property price dropped 30% - 40% without attracting any interest (SBV, 2007).

Together with the gigantic thriving of stock market from 2007, real estate sector has begun the potential investment field which contributed around 10% to national GDP (MOF, 2010). In real estate industry, residential market has remained the strongest market because of urban growth, shifting family structure, and its role as primary investment option. In recent years, the price in residential sector has changed sharply particularly in the big centrals of Vietnam such as Hanoi and Hochiminh.

❖ **Hanoi – the Vietnam’s capital**

As the capital of Vietnam with the population at around 6.5 million, Hanoi is one of the most crowed and attractive economic central. Hanoi has contributed around 10% to national GDP and attracted 24% of Vietnam total FDI in past 5 years (GSO Vietnam, 2009). Consequently, this city has very fast real estate development growth especially in residential.

**Figure 5: Hanoi residential development.**

<table>
<thead>
<tr>
<th>Year</th>
<th>2008</th>
<th>2009</th>
<th>2010e</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Launched condo units</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Luxury &amp; high-end</td>
<td>2,003</td>
<td>4,511</td>
<td>3,174</td>
</tr>
<tr>
<td>Mid-range</td>
<td>3,323</td>
<td>6,014</td>
<td>5,047</td>
</tr>
<tr>
<td>Affordable</td>
<td>438</td>
<td>2,567</td>
<td>-</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>5,764</strong></td>
<td><strong>13,092</strong></td>
<td><strong>8,221</strong></td>
</tr>
</tbody>
</table>

*Source: CBRE – Vietnam real estate update & market overview 2010*
In 2009, the residential sector became very eventful which marked by the significant change in all over market. The total condo units launched in 2009 were doubled and focused on mid-range units instead of luxury one. Previously, the luxury units were much interested by the developers because of their high profit. However, after 2008, when too much luxury apartments were built and the heavy speculation that led the market overloaded meanwhile the mid-range one are still fewer in comparison with demand. Developers began to change the strategy which involved in mid-range market in order to satisfy the real demand.

❖ Hochiminh – the Vietnam business central

Hochiminh plays the important role as the most active economic central of Vietnam with the city-level GDP average growth rate at 10% which contributes around 30% to national GDP (GSO Vietnam, 2009). With the favorable location in Indochina, Hochiminh is not only the country’s largest economic hub but also the one of Indochina area. Since the Law on Foreign Investment in Vietnam was promulgated, HCM City has become one of Vietnam’s most powerful magnets for foreign direct investment (FDI). Nearly one-third of the total number of FDI projects in Vietnam arrived in HCM City. The strong investment wave in Hochiminh leads to the change in life style which raises the living standard as well as demand for luxury accommodation. Consequently, beside the development in office and retail sectors, the residential market also marks the dramatic thriving.

Figure 6: Hochiminh residential development.

<table>
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<tr>
<th>Year</th>
<th>2008</th>
<th>2009</th>
<th>2010e</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Launched units</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Luxury &amp; high-end</td>
<td>4,005</td>
<td>2,781</td>
<td>12,737</td>
</tr>
<tr>
<td>Mid-range</td>
<td>3,818</td>
<td>4,276</td>
<td>10,380</td>
</tr>
<tr>
<td>Affordable</td>
<td>1,630</td>
<td>3,619</td>
<td>5,130</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>9,453</td>
<td>10,676</td>
<td>28,247</td>
</tr>
</tbody>
</table>

Source: CBRE – Vietnam real estate update & market overview 2010
The most different feature in residential development in Hochiminh is the supply for luxury and high-end apartment much higher than the mid-range one. One of reasons of the high demand for this part is from foreigners working in Hochiminh with the need for renting luxury accommodation. In the first quarter of 2009, the occupancy rate of serviced apartment in Hochiminh was around 97% in grade A units (Savills, 2009). Other demand is from the generation who became rich after economic reform require higher materials condition including housing and from Vietnamese people living abroad send foreign currency to invest in motherland annually.

Figure 7: Capital value 2004 - 2009

Source: CBRE – Vietnam real estate update & market overview 2010

The high demand for luxury and super-deluxe segment has emerged and attracted some serious attention which increased the investment in this part. The capital value has grown considerably from the middle of 2006 at around USD 2000/sm to around USD 4000/sm till now. In 2009, because of the effect from economic crisis, capital value has slightly reduced. However, this increase trend is back currently when economic has recovered.

2.4.2 Financing residential projects

With the immature financial industry, real estate developers confront with many challenges to find the financial support. Currently, there are main six kinds of financial
sources used to develop residential projects including equity, bond, loan from banks or financial institutes, pre-sale, joint venture and REITs.

- **Equity**

Although it is not too difficult for big real estate companies to increase their equity, but in Vietnam, the real estate industry is considered as one of the most potential investment sectors which then augment the expected investment return of investors. As a result, this capital cost is very expensive that will limit the owned financial resource of companies. According to a new real estate regulation, developers only have right to raise money from households when the project is finished the first part that may cost more than 20% of total investment cost. Consequently, the small and medium developers who only have ability to invest in a few projects cannot arrange the cash flow to smooth the construction. The lack of equity is the weakness feature of most of real estate companies.

- **Bond**

Vietnam does not have any formal regulations to adjust bond issue in developing real estate projects. Till now, there are only two successful bond issuing cases. However, both of these cases are convertible bond which allows investors buy the house or equity with preferential price. In fact, all the bond issuers dodged the law and attracted investors by the advantage rights when the market was very eventful. If the real estate market is decreased, issuers will be impossible to find the investors. Thus, in comparison with direct investment presently, this investment channel without preferential treatment is not so attractive.

- **Loan from banks and other financial institutes**

Loan from banks is the most important financial source for developing real estate project accounted for around 70% of total investment cost. The total loan in real estate appropriates more than 10% of bank capital (MOF, 2009). However, Vietnam as other emerging economics, the sparing with finance in the bank system will limit this source. Furthermore, the bubble in real estate makes policy makers worried. As a result, State bank requests commercial banks to reduce loan in real estate. Another problem that banks have to face when they provide loan in real estate is the discrepancies in the period between bank capital and loan. Most of loans in property projects are middle and long-term while the middle and long-term deposits in banks only makes up around
30% total bank capital. Consequently, if banks try to extend loan in this sector they will confront with payment risk.

- **Pre-sale**

Pre-sale is one of financial sources for residential projects in Vietnam. With high demand for residential, developers can take advantage to raise money by this way. However, there are still several issues which constrain this method.

First, pre-sale contract requires household paying money according to the construction process which is normally divided into three parts. The money households have to pay every time is very high in comparison with their annual income. Currently, the limit from banks in real estate also cuts down the chance to arrange the money from bank for household. Accordingly, they find more difficult to fulfill the finance requirement.

Second, although the financial source from pre-sale contracts is very attractive to developers but in order to arrange fund from this source, developer must have prestige and economic potential which the small and middle developers are impossible to obtain.

Finally, the government regulations in this sector are very deficient which results in many debates and lawsuits between developers and households recently.

- **Joint venture**

Vietnam real estate market is one of the most attractive and potential investment sectors for foreign investors. Recently, there are a lot of joint venture companies were established in order to take advantage of experience from local investors and financial potentiality as well as knowledge of foreign investors. However the number of successful joint ventures is still minor in comparison with the local one. The reason firstly is the high requirement from foreign partners who often expect high transparent information related to development project. The complicated regulation system and lack of information lead local companies to be impossible to match all requirements from their partners. Secondly, it is very difficult for small and middle companies to find the foreign partners who request the strict relevance in management. The huge local companies often with reputed name prefer raising fund from bank than sharing equity for foreigners.

- **REITs**
The first REIT established in Vietnam in the middle of 2005 has opened the new opportunities for foreign investment in real estate industry in Vietnam. However, in comparison with other economics, the REITs market in Vietnam is still within the infancy stages of development. The reason is that the Government does not have any formal administrative framework for REITs especially the tax incentive for dividend of REITs owners. Additionally, the local investors do not have habit to invest via the intermediaries.

Conclusion, like other emerging countries, Vietnam residential market depends mainly on financial support from banks which limit the development process. Furthermore, the lack of verified financial tools and source from other institutes also reduces the opportunities of developer as well as investors in this potential investment.

2.4.3 The main problems of Vietnam residential market

❖ Non-transparent market

The most widespread problem in residential market in emerging economics like Vietnam is the lack of transparency. Lack of information in real estate makes this industry more complicated and difficult to approach. Most of housing transactions in Vietnam are personal deals. Less than 20% of total real estate transactions are through the official real estate platform (MOC, 2010) which leads to lack of information to establish the official real estate index as well as to charge the tax for government. Besides, in order to reduce the tax charged by the government, the adjusted transaction selling price does the reference wrong. Along with easy transaction without government approval, these matters result to heavy speculation in the market.

This problem is also one of the reasons that FDI reduces in real estate sector although the demand for finance is still very high. Without the transparent information, foreign investors cannot play a major role which requires the local support as driver. Till now in Vietnam, the number of foreign investors who is successful in directly investment in residential is few. Several major real estate funds have to retreat after several years invest in real estate market as well as be impossible to find the suitable investment project.

❖ Inefficient regulation system in real estate
The most difficult initial matter for developers is the management. Land belongs to the government who presented the People (Han & Vu 2008), but government has to pay for land clearance for using. When real estate companies want to develop the project, most of time they have to do the land clearance themselves. In some cases, the inhabitants illegally living in the land still requires the compensation which rises time-consuming and the investment cost accounting for 50% of total investment. Moreover, a lot of land was entrusted to SOEs which then utilize uselessly. The low and limited management ability of government of the land cannot control strictly the land use which was used with different purposes. This issue has answered the phenomenon of a series of real estate companies as well as a mass of projects developed by SOEs who do not have real estate investment function.

Another difficulty for development is the project application process. Although there are several improved policies from government but this process is still very complicated that wastes time and cost to lobby of developers. The ambitious property rights and high administrative cost for official registration and permit applications have discouraged the vast majority of construction project from the going through formally established procedures.

One of other current critical difficulties for developers is tighten financial policy from State bank. The heavy speculation raises the bubble in market that has worried administrative managers. In order to control this situation, State bank requires commercial banks to reduce and limit loan in real estate projects. Consequently, only the large companies who mainly focus on luxury accommodation are able to access this financial source. The smaller companies focusing on the mid-range unit have to confront with difficulty to arrange money and reduce to develop projects which cut the supply and diminish competition. The limit loan from banks also trims down the chance to approach finance of household that frozen the demand for accommodation.
3 The theory of Mezzanine finance and Pre-sale contract

3.1 Mezzanine finance

This section is mostly based on American literature, and therefore reflects the market for mezzanine finance in the United States. However, this literature presents interesting aspects of creative and different financing sources that can be important for the real estate development industry in Vietnam.

3.1.1 Mezzanine finance’s features

Mezzanine finance was first used during the 1980’s. However, because of high demand for investment and low quality of loan assessment in this period, the first mortgage lenders seem easily to increase the loan to the value (LTV) for borrowers. As a result, it limited the need for mezzanine debt. From the early of 1990s, the scarce financial resources raised the requirement for the alternative financial supports. With regulated lenders becoming more conservative, many equity investors are not satisfied with the amount of debt available to finance their properties (Watkins D, Hartzell D and Egerter D 2003). Lenders require the property owner to provide 30-35% of the value of the asset, while many borrowers prefer to limit their equity investments to 10-15% of value. The high investment cost makes owners find it difficult to arrange a large share of equity, and consequently it is risky to invest too much of their own capital in a project. Moreover, the high LTV also allows investors spread their capital over several real estate investments which bring in higher expected return on equity. Therefore, mezzanine debt is applied in order to fill the gap between what the owner wants to borrow and what the first mortgage lender is willing to provide (Watkins D, Hartzell D and Egerter D 2003).

Figure 8: Mezzanine debt in capital structure
“Mezzanine real estate investing is a simple concept: investment in debt, equity, or hybrid debt/equity positions subordinate to the first mortgage and senior to the property owners’ equity” (Ballard & Muldavin 2000). With the middle position between debt and equity, mezzanine debt also obtains the middle priority of claims on cash flows. First mortgages have first claim on cash flow, mezzanine providers are next in line, and equity investors receive the residual (McDonald 2007). Accordingly, the risk of mezzanine investment is in the middle of debt and equity investment risk.

Main features of mezzanine debt

With position between the traditional debt and equity, mezzanine financing combines some of the characteristics of both traditional forms of finance.

Figure 9: Comparison the main characteristics of three investment methods

<table>
<thead>
<tr>
<th></th>
<th>Senior Debt</th>
<th>Mezzanine Debt</th>
<th>Private Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Typical Structure</td>
<td>Revolving Debt</td>
<td>Debt with Warrants</td>
<td>Preferred Stock</td>
</tr>
<tr>
<td>Investment Horizon</td>
<td>Short Term</td>
<td>Long Term</td>
<td>Long Term</td>
</tr>
<tr>
<td>Risk Tolerance</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>Return Expectation</td>
<td>&lt; 10%</td>
<td>18-25%</td>
<td>35% ++</td>
</tr>
<tr>
<td>Current Coupon</td>
<td>Floating Rate</td>
<td>Fixed Rate</td>
<td>n/a</td>
</tr>
<tr>
<td>Hidden Costs</td>
<td>Personal Guarantees</td>
<td>None</td>
<td>Loss of Control</td>
</tr>
<tr>
<td>Customization Ability</td>
<td>Rigid Standards</td>
<td>Flexible Standards</td>
<td>Flexible Standards</td>
</tr>
<tr>
<td>Seniority/Security</td>
<td>Senior Lien</td>
<td>Junior Lien</td>
<td>Unsecured</td>
</tr>
<tr>
<td>Equity Dilution</td>
<td>None</td>
<td>Low</td>
<td>High</td>
</tr>
</tbody>
</table>

Like other types of investment, mezzanine debt must be reviewed in terms of risk and return. Regarding return aspect, the expected return of mezzanine investor can be around 18-25% for their loan which is significantly higher than the senior one. The developer using the mezzanine debt instead of equity will be able to reduce the cost of capital as the interest payment is tax-deductible. In other hand, by using mezzanine debt, developer can spread equity across other activities and also reduce the risk to any individual project without diluting the control right of the project.

However, compensation for high return is the low security for mezzanine lenders who have to face risks both at the very beginning of the lender-borrower relationship and later on if the borrower defaults (Berman 2007). In comparison with traditional loan, mezzanine is more subordinated especially when the property value reduces. Risks of mezzanine loan are conditional upon the size of equity, mezzanine finance and senior debt. With a fixed senior debt, if the size of developer’s equity is too small, protection for mezzanine debt will be reduced during the downtrend. Even with a fixed equity, if the size of mezzanine debt increases, the senior lender will still be the last one to bear losses because the downside protection of the mezzanine debt is only the equity while one of senior debt is both of equity and mezzanine debt. Consequently, most mezzanine loans are targeted to be at the bottom of the debt stack and are expected to receive below investment grade shadow ratings (Daniel B. Rubock 2007).

3.1.2 Operation and structure of mezzanine financing

The structure of mezzanine debt can be defined depending on the financial sources or the investment purposes.

- **Financial sources**

The mezzanine debt can be structured as debt or equity, depending on capital structure of the project as well as the needs of the developers for the outside equity.

When the senior lenders do not want to extend the specific LTV, developers will prefer to substitute mezzanine lending for the costly added equity to finance the gap. In this case, in order to reduce the risks, mezzanine lenders often require developer to enter into a joint venture agreement which give mezzanine lenders more control power over the project operation. Moreover, the JV agreement can give the mezzanine provider ability
to take over the property in the event of default and can enable the mezzanine position to keep the first mortgagee from foreclosing and taking control of the property (Watkins D, Hartzell D and Egerter D 2003).

Beside equity form, depending on the needs of the developer, the mezzanine fund can be structured to act like debt for the project. The mezzanine loan is then placed on the property in a second position whereby any cash flow remaining after the first mortgage has been paid will pay down the mezzanine loan. In this case, mezzanine debt will be subordinated compared to the first mortgage but senior to the equity.

Investment purposes

The mezzanine loan can be divided into several types according to the risks and the goals of investment including:

<table>
<thead>
<tr>
<th>Mezzanine investment type</th>
<th>Property characteristics</th>
<th>Typical deal structures</th>
<th>Total return expectation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stabilized</td>
<td>• Existing cash flow</td>
<td>• 70% to 85% LTV piece</td>
<td>• 14% to 18% IRR</td>
</tr>
<tr>
<td></td>
<td>• Limited lease-up risk</td>
<td>• No participation in cash flow or residential value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Minor rehabilitation or repositioning</td>
<td>• 3 to 7 year term</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Exit through refi or mortgage amortization</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Cash flow sweep/lockbox</td>
<td></td>
</tr>
<tr>
<td>Value-added</td>
<td>• Some existing cash flow</td>
<td>• 70% to 95% LTC piece</td>
<td>• 18% to 25% IRR</td>
</tr>
<tr>
<td></td>
<td>• Moderate to substantial leas-up, releasing required</td>
<td>• 10% to 15% interest rate with participation in cash flow and/or residential value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Completed property will represent 75% to 80% loan to value based upon the total capital structure</td>
<td>• 18 month to 3 year term</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Exit through refi or sale</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Value creation should allow return of 100% of capital through refi</td>
<td></td>
</tr>
<tr>
<td>Development</td>
<td>• No exiting cash flow</td>
<td>• 70%-95% LTC piece</td>
<td>• 20% to 30% IRR</td>
</tr>
<tr>
<td></td>
<td>• To-be-built property</td>
<td>• Participation in cash flow and</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Completed property</td>
<td>residential value</td>
<td></td>
</tr>
<tr>
<td></td>
<td>will represent 75%-80% loan to value</td>
<td>• 3 year term</td>
<td></td>
</tr>
<tr>
<td></td>
<td>based upon the total capital structure</td>
<td>• Exit through refi, sale or</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>presale</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Value creation should allow</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>return of 100% of capital</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>through refi</td>
<td></td>
</tr>
</tbody>
</table>

Source: (Ballard & Muldavin 2000)

• Stabilized: Existing property with acceptable current cash flow coverage to the mezzanine investment. Owners of stabilized assets will seek mezzanine financing to leverage their returns or limit their at-risk capital.

• Value added: Existing asset is underutilized and therefore undervalued or the building has significant vacancy and requires leasing activity and tenant build-out or leasing commissions. The owners will seek mezzanine financing to reposition the property as a higher class and consequently capture greater rents.

• Development: To-be-built property with substantial development, construction, and lease-up risk. Property development is a very risky process. As a result, when mezzanine lender plays a role as construction lenders. They are recommended only in some development situations which are under certain circumstances and must become more conservative.

3.2 Pre-sale residential contract

3.2.1 Definition of presale

Presale is a very popular selling method which happens before the goods or products are completed. In real estate industry, the presale of real estate housing units occurs when the developer receives payment advances towards the purchase of a unit to be delivered
in the future (Fortunato et al. 2008). The property development will be implemented immediately to meet high demand from the market. However, this process often happens in such a long time that makes developers confront with financial and market risks. Some of very common market risks are the increase of construction costs and the decrease in housing demand in the future. Besides, developers also may face the lack of financial source during the construction process due to their main dependence on formal financial institutes. Consequently, developers have to look for the several solutions in order to ensure the success of their projects. On the contrary, in the market with high housing demand, the household is willing to pay higher price or take a long queue for days or weeks to get a chance to buy the residential units. As a result, presale market is active.

Presale is especially popular in Asian countries such as Hong Kong, Taiwan, China etc because of significant high demand for housing and a limit in bank loans (Y. P. B. Leung et al. 2007). The high demand for housing leads to the dramatic increase in price. For this reason, it is not so uncommon for people to buy a flat but have to wait for one, two years or more before seeing it. The presales of uncompleted properties in Hong Kong accounts for a large proportion of the total number of property sold in the first-hand market from 1993 to 2005, ranging from 25% to as high as 78% (Y. P. B. Leung et al. 2007). In Taiwan, presale investment is the most popular real estate selling system for new housing which allows 80% of home occupiers own their home even when there is a lack of a formal financing system (Chang & Ward 1993)

Depending on the government regulations in real estate, the presale will be applied according to the construction process. In some areas, developers can sell their property before building is started to acquire financing for the development process. However, the presale will be only applied after when the specific part of building that was completed at the time of sale (asset in place) (Lai et al. 2004) in order to provide the guarantee for buyers. The good and limited points of presale can be reviewed under the perspective of developers, buyers and the market.

3.2.2 The advantages of presale

- The real estate developers

*Arranges the finance through buyers*
In emerging market, the lack of financial sources makes presale become a very important fund for developers who substantially reduce their cash burden through presale arrangements (Ke et al. 2007). The bubble and speculation in real estate market causes the worry of formal lenders. Therefore, lenders reduce their credit limit and require developers to increase their equity to correspond with external financial sources. Expensive capital cost prevents developers from using too much of their owned capital. In this case, presale will be applied.

In comparison with loan from banks, the financial source from buyers is much cheaper. Property purchasers provide interest-free financing for developers if they can complete the project on time. On the other hand, the payment is often realized according to the construction schedule that also helps to improve the cash flow during the construction and reduce their reliance on bank funding. Besides, the presale will bring developers money before the project completes which can help developers hedge against any possible financial loss on the unsold properties when a price decline is expected by the time the construction is completed (Y. P. B. Leung et al. 2007). Without using too much equity, in the condition of stable real estate market, developers can also use the earning from the presale to invest in other property projects to increase the return.

Reduces risks

The presale system has significant effect on distribution risk between developer and buyer (Chang & Ward 1993). There are two main risks developers have to deal during the construction time which are market risk and financial risk. The real estate project is only implemented based on the future demand which is very unreliable. Only when the construction process is completed can the demand be realized. As a result, if the demand has fallen at the completion time of project developers will be in a very difficult situation which includes holding high vacant building and paying off high construction loans. By using the presale, developers can secure pre-commitments from buyers to reduce risk that the building might remain empty when it is completed. Besides, when developers can arrange the financial source from buyers, they can reduce their own equity in the projects which can diminish risks related to a long investment process of the development by transferring of the equity interests of the uncompleted properties to
The buyers (Y. P. B. Leung et al. 2007). Therefore, it limits inventory costs as well as bankruptcy risk for developers.

Confirms developers’ private belief

Besides being the alternative source for developers as well as reducing the risk of holding completed units, presale is also the tool to gather information to estimate the future demand to make the construction decision today (K. Wang et al. 2000). Commonly, the residential project will be sold in several times. The first part of sold building will be used to gather information relating to the demand in the market. With many phases in the development process, developers have rights to control the speed of the construction. If the demand from market is positive developers can be free to speed up the development plan. Conversely, if the presale result is under expected, the developers can adjust the estimate of future demand and slow down the project development. Generally, through the presale system, developers can still use the trial-sale information to adjust the speed of project. (K. Wang et al. 2000)

The buyers

In developing countries, the high demand for housing makes presale system become very popular. Presale contract gives buyers the right to buy a property at a pre-agreed payment schedule (Lai et al. 2004). Moreover, the unstable market will make the price irregular change. Therefore, presale helps buyers to avoid the risk of price increasing in the market. Besides, housing is generally a valuable asset to most of people. It is not easy for people to afford for houses in one time. The presale system allows people not to pay a large down payment and then arrange their finance appropriately.

The market

Presale system not only helps developers to finance the projects but also creates the house owning opportunities for buyers. Besides, since trades can be made on in progress properties, developers can adjust the housing supply in order to catch the existing demand change and economic outlook (Chau et al. 2007). In this case, developers will consider the presale prices as an indicator of demand for housing which influences their actions and decisions.
Additionally, buyers will try to decline their risk by choosing reputable developers who owned quality projects in the past. Accordingly, developers have more incentive to keep their reputation by providing high quality building meeting with buyer’s expectation. This behavior will make market more transparent.

### 3.2.3 The disadvantages of presale system

#### The real estate developers

The most disadvantage of presale developers have to face is no opportunity to increase price in bull periods. Normally, the selling price will be fixed or adjusted very slightly from the beginning when developers begin to sell flats. When the real estate price increases greatly, developers may not sell so many presale houses because they recognize a loss in opportunity to participate in further increases in house prices. (Chang & Ward 1993). However, the presale system is often divided into several phases that allow developers to adjust the selling price in every selling period to reduce loss from price increase.

Moreover, one of the advantages of presale which is also the disadvantage when developers become over-confident about their estimate ability about the future demands through the presale system. If the presale level improves their belief in the market, they will be over-confident and then speed up the development that then will result in supply increase. Consequently, the vacancy rates and competition are much higher.

The second disadvantage of presale for developers is the interference from buyer at planning stage. Buyers pay from the beginning of the project development, so they will pay more attention to their assets. As a result the developers will deal with more requirements from their customers.

#### The buyers

“Buying an unbuilt property is an act of faith” (Razzi, E 1995 n.d.). There is a reason of popular presale development in Asia which is an very high demand for housing. This high demand leads people to be easier to accept the risk to prepay for the house. Firstly, it is lack of security for deposit of repayment. People buy the new house which is just in the plan or just completed a very small part. Although they try to limit their risk by choosing the real estate developer who has good reputation and good quality project in
the past, but the matter for buyers is that they cannot differentiate the quality of developers and the properties before it completes, especially when the developers are new entrances (Ong 1999). Consequently, buyers have to face high risk of losing money which was embezzled by bad developers.

Secondly, buyers also have to face the construction risks such as the delay in completion and the lower quality in construction. Developers who get the pre-commitment of purchasing uncompleted properties will be less motivated to complete the project on time. Moreover, when buyers prepay for the house they also have to share the risk of default with developers. The security of prepayment is less than that of bank loan. As a result, if developers are bankrupt, the buyers will face the risk of losing their investment.

The market

It is clear that by using presale system developers can forecast the market more or less. However, the over-confidence of developers could be mistaken about the future demand which leads to overbuild and then over demand in the property market. Furthermore, the payment developers receive from buyers before construction allows them to start more projects especially when the real estate market begins to bottom out. On the other hand, developing the pre-pay projects in increasing trend makes them unable meet the high price after completed. Thus there are more less-profitable projects in the market which then be abandoned or hold when real estate prices start to decline. These cycles are popularly observed in Asian real estate markets (K. Wang et al. 2000)
4 Co-ordination of Mezzanine finance and Pre-sale system in Vietnamese residential market

4.1 The implementation of these financing methods in Vietnam

Both of Presale and Mezzanine are not the new terms in Vietnam real estate market. However, their implementations are much less effective in comparison with formal financial methods.

❖ Presale contract

The Presale contract is not a new method in Vietnam property market. Currently, it is a very important raising fund method for most of residential projects. However, it is very common for developers to sell the flats which are still in planning stage prior to any initial construction. Thanks to very high demand for housing, developers can easily raise fund by this way. They try to take advantage of pre-payment as much as possible in order to minimize their equity invested in projects. In some cases, the corresponding equity in the project is too low to guarantee the safe LTV. Furthermore, developers receive payment before completing the project so their commitment to high quality is very weak. It is very frequent to have problems with the quality and progress of projects. Although the Government has issued new regulations related to the prepayment process but this situation is still common. The accession of buyers in the projects under construction is very limited which lead them to receive low quality flats. Additionally, it is very difficult for the individual buyer to suit developers who own powerful financial and legal support. Therefore, the sole presale system itself exposes to a lot of problems.

❖ Mezzanine lending

In terms of Mezzanine lending, this financial channel is mainly applied in banking system with a moderate size. However, because of the risk associated with bubble situation in real estate market and the control of State bank, it is not so common for banks to increase their credit limit for developers. Besides, a lot of foreign REITs want to access the residential projects, but without local experience, they confront with many challenges from complicated legal system. Consequently, co-ordination with a local investor to develop projects is a sound solution. Nevertheless, the local experienced developers can work well to set up projects but the less transparent in company
management especially in finance and accounting make them unable to meet the international standard requirement from foreign investors. As a result, the opportunities for raising fund of developers and investing of foreign REITs are very difficult to create. Mezzanine lending can be a reasonable solution for this case. With the reference from banks who are the initial investors in the project, foreign REITs will have more confidence in developers. Moreover, by using mezzanine, investors can negotiate to have specific right to access the construction process therefore to follow the project schedule. Additionally, with the high risk in real estate market, investment like mezzanine also helps REITs divert the investment portfolio.

Although it seems very favorable for REITs using Mezzanine method to expand in property market but the role of them is still very limit in this method. Beside the reason related to regulations, the other important reason is that the risk which REITs have to deal with is as high as that of developer whereas the interest they get is relatively low in comparison with dividend developers receive. Therefore, seeking the resolutions to make Mezzanine lending more attractive is raised.

❖ Co-ordination of Presale system and Mezzanine lending

The risk mezzanine investors have to face is more seriously when the value of property declines. In this case, mezzanine debt that is subordinate to senior loan will be significantly affected. Generally, developers try to use the outside financial sources instead of equity. They will extend the mezzanine loan as much as possible in order to save their capital which will add to mezzanine investor’s risk. In the first case of sample, mezzanine loan is only 25% of total property value while equity is 10%. If the property price declines 10% the equity owner will lose all of his capital. Mezzanine lender still keeps the value of his investment fund in the project. In another case when Mezzanine lender increases his fund to 30% of total project value. A decrease of 10% will make him loss 5% of his investment capital. The downside protection for mezzanine lender in this case is the equity which already turns down 5% the result in 5% loss of mezzanine investment. The senior debt which has down-side protection from both of equity and mezzanine will maintain its achievement.

Figure 10: Price decline of 10%
The higher percentage of mezzanine debt in total capital is, the larger mezzanine investors lose. However, by using pre-sales, the downside protection for mezzanine investors can be provided. Presale contract brings out developers the money before completing the projects which may exceed the amount of senior debt. Therefore, the effect of price decline in equity will be less, and it in turn keeps downside protection more solid for mezzanine debt.

In fact, the Vietnam real estate market is very active especially in residential segment. As a result, developers can still take advantage of using presale to raise fund and primarily depend on bank source. However, the restriction from banks, the higher requirement from household and the more competition in the market ask developers to seek the suitable solution to survive. And the co-ordination between Presale system and Mezzanine can be one of the considerable answers.

4.2 The benefit of co-ordination

Households

The quality of properties and the construction progress are the first concern of households who accept the prepayment contract. The limited right as well as the experience to inspect the property worry buyers. However, a project which is partly
financed by Mezzanine loan will be followed frequently by the lender. Generally, when investing in properties, Mezzanine lenders often have the support from real estate experts for decision making as well as keeping track of projects. Consequently, households prepaying for projects that are invested by Mezzanine debt may receive good quality flats. Moreover, prepay households choose developers by their reputation which is sometimes very difficult to realize. Through mezzanine lenders, households will somewhat determine good developers.

**Investors**

Through Mezzanine finance, investors especially foreigners have another channel to invest in property. In Vietnam, one of the problems prevents foreign investors from involving in real estate projects is opaque information and complicated regulations. By incorporating with local developers who had financed by banks, Mezzanine lenders can have good reference for their investment decisions as well as local knowledge to develop projects. In addition, investing in a presale residential project also reduces the risk of Mezzanine lenders. The payment will partly cover the senior debt then increase the downside protection for Mezzanine debt. The large presale contracts are done, the less risky mezzanine lenders face.

**Property developers**

Beside the benefits that property developers archive from Presale contract and Mezzanine debt separately, the co-ordination of these tools can also bring developers the trust from both Mezzanine lenders and presale households. The advantage which presale buyers and mezzanine lenders receive from projects will create more opportunities for developers. Besides, with financial support from presale system and mezzanine debt, developers can diminish their dependence on loans from banks. The State bank’s strict control over financing in real estate market currently confines commercial banks to provide more loans in this sector. Hence, the combination of these financial methods is a considerable solution for developers.

**Residential market**

The co-ordination of presale system and mezzanine debt firstly enhances the financial fund for developers which will enlarge the supply in the market. Consequently, banks could trim down their credit in property projects then broaden the mortgage for
households which will increase the real demand in the market. Generally, the more active operation of financial sources in residential market results in balance of supply and demand then makes market smoother.

4.3 Difficulties for the coordination

In theory, the coordination of presale system and mezzanine finance can bring out many advantages for market participators. However, in the current condition of Vietnam economic, these advantages are constrained by several reasons such as regulations, information system and by the market participators themselves.

❖ The moral of market participators

“Grab away” is the popular phrase to imply market participators who just try to take advantage of the booming market to benefit themselves but leave a lot of complicated problems for the market. The seriously high demand allows developers presale flats without proving any construction clue. Although Government issued the policy which require developers to complete the base of project before selling it but developers have found many solutions to dodge it. Moreover, many pre-buyers have to receive low quality flats but they will be very difficult to sue developers. The insufficient agency to protect purchaser’s interest and buyers with the worry of losing their flats allow developers still continue to “grab away” in the market.

❖ Complicated and insufficient regulation system

One of the reasons creates condition for developers to “grab away” is the complicated and insufficient regulation system. It is easy to understand that in developing countries like Vietnam the regulation system is generally incomplete. However, the most “dangerous” matter for market participators is the unexpected frequently change of administrative policies. Because of the incompletion, policy makers are trying to review and adjust legal framework to control the market but their weak capacity makes these laws as changeable as a weathercock. Besides, although presale structure is very popular in Vietnam but there is very few articles of law to protect purchaser’s interest. In case of conflict situation, buyers have to lonely deal with developers who have strong financial potential and professional law support. In terms of investment attraction in real estate, there is little incentive for REITs that makes this investment channel unattractive.
Furthermore, the regulations in foreign investment still need to be improved in order to solve many problems related to this kind of investors.

- **Non-transparent information system**

Another most difficult matter that not only foreign investors but also buyers have to confront is the non-transparent information in the market. Without any official grading system, buyers are impossible to differentiate the quality of developers. The completed projects are unable to express the true developer’s capacity. This matter is the same for mezzanine investors. Mezzanine debt is riskier than the senior debt but the mezzanine investors do not have enough information to evaluate the developers. Although there is an agency belonged to the State bank which provides the information related to developers, but most of the information is from the companies which have State-owned capital. Additionally the information is not so updated and lack of many important elements.

### 4.4 Co-ordination implementation suggestions

In order to develop the stable real estate market generally as well as to make the best of combination between presale system and mezzanine financing, there are several suggestions raised.

- **Keep the faithfulness, lucidity and carefulness**

In a booming market under an undeveloped economics, the participators must look after themselves in order to survive in the unstable condition. Developers need to have a long term vision to form their reputation upon good quality projects instead of running after the immediate profit. Buyers must keep their lucidity to avoid buying flats without understanding developers and projects. Investors especially foreigners deciding to take part in projects as mezzanine lenders need to carefully consider the reputation of developers as well as the information of projects. In fact, in a booming condition where people are attractive by the immediate profit, it is not easy for market participators to keep their virtues. However, protecting themselves is the best way to be successful.

- **Create and improve regulation system**

One problem of regulation creation is the overlap of appropriate authorities. Real estate market was controlled by too many regulations from many different organizations. Therefore, it not only wastes the money but also results in troublesome administrative
procedures for market participators. Consequently, the unification in law creation must be applied to minimize the obstacles to create good conditions for investment in property market. In more detail, the purchaser’s interest must be considered by means of creating protection policies and improving the mortgage support from banking system. Relating to developer’s issues, the administrative formalities must be simplified to save the time and cost then reduce the investment cost of projects and increase the supply in the market.

**Establish effective market information providing system**

In order to decline conflicts between market participators and clear up market, the official information system needs to be created. Firstly, administrative formalities of State organizations must be provided clearly and coherently to diminish the cost and time as well as minimize the bureaucracy. The Ministry of Construction must public the information about the developer’s capacity as well as the projects which households and mezzanine investors will refer to before having investment decisions. Government has better to strictly control the purchasing activities to limit the black market then collect the information to set up the real estate index which will be a useful guideline for the investment in the property market.
5 Conclusion

Capital is always the necessary element in the real estate, a very important sector in Vietnam economic. Like other emerging countries, the dramatic development results in significant lack of finance. Therefore, seeking financial solutions is the important task of all market participators. Generally, real estate developers notably depend on the banking system which can provide them up to 80% of total project value. However, the source from banks is cut down due to the high investment risk during the booming period and widespread speculation in the market. Consequently, a cooperation of Presale system and Mezzanine debt may be the suitable financial solution as it can take advantages of each financing method as well as partly limit their weak points.

With the advantage of cheap financial cost and low risk of selling, Presale system not only provides a plentiful cheap fund but also brings out the risk transferring chance for developers. On the contrary, in this system, the most important thing that households can receive is the pre-purchasing opportunities which help them to reduce the risk of rising price and make a financial plan to avoid the down payment. This advantage is very important in the condition of booming market. In terms of Mezzanine finance, this useful method can create an alternatively smooth financial channel for developers to less depend on the banking system. Moreover, it also creates an attractive investment option for investors, especially the medium-size investors and foreign one. The cooperation of these methods not only allows market participators to take the best of their advantages but also minimize of their disadvantages which are the quality of property in presale contracts and the risk of declining asset’s value in mezzanine debts.

The combination of these financing methods has an important role in developing Vietnamese real estate market. However, the weakness in economic administration and the non-transparent information system limit the strong points of these methods. The improvement in organization and operation of both the administrative body and market participators is the key factor to build up this combination then to equilibrium the demand and supply as well as make the real estate market healthier.
Reference

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