

# EFFECT OF POLICIES ON THE URBAN PROPERTY PRICE IN VIETNAM

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*The urban property price has a great impact on the purchase of a dwelling house by many people, but the urban property price in Vietnam is beyond the reach of many urbanites. Therefore, identifying precisely factors affecting the urban property price is a challenge for researchers and policy-makers.*

*The study focuses on two primary factors that are supposed to greatly affect the urban property price, that is, changes in calculation of land use fees and high capital cost for investment in housing development projects. After analyzing such influential factors, four suggestions are offered hopefully making the urban land price closer to the ability to pay and improving social welfare.*

Keywords: urban property price, land use fee, capital cost

## 1. The problem

Despite the fact that Vietnam's real estate market is stagnant since 2008, the urban property price has still been beyond the reach of many low-income people, making it difficult for the government to improve social welfares.

According to the actual data, per capita income in Vietnam has shown an onward trend, rising from US\$722 in 2006 to US\$1,024 in 2008 and US\$1,200 in 2010. In 2010 alone, the per capita income reaches US\$1,950 in Hà Nội [7] and US\$2,900 in HCMC [8]. Property prices for low-income people have also risen to VND8-10 million for a square meter of land and VND10-12 million for a square meter of floor in a tenement block [9]. Accordingly, a 50-square-meter flat or floor may cost at least VND500 million. Suppose that the property price and the income fluctuate on the same trend, and low-income persons save a third of their income, they can only pay off their 'dream flat' after 25 years. Once the property market becomes busy again, to own a

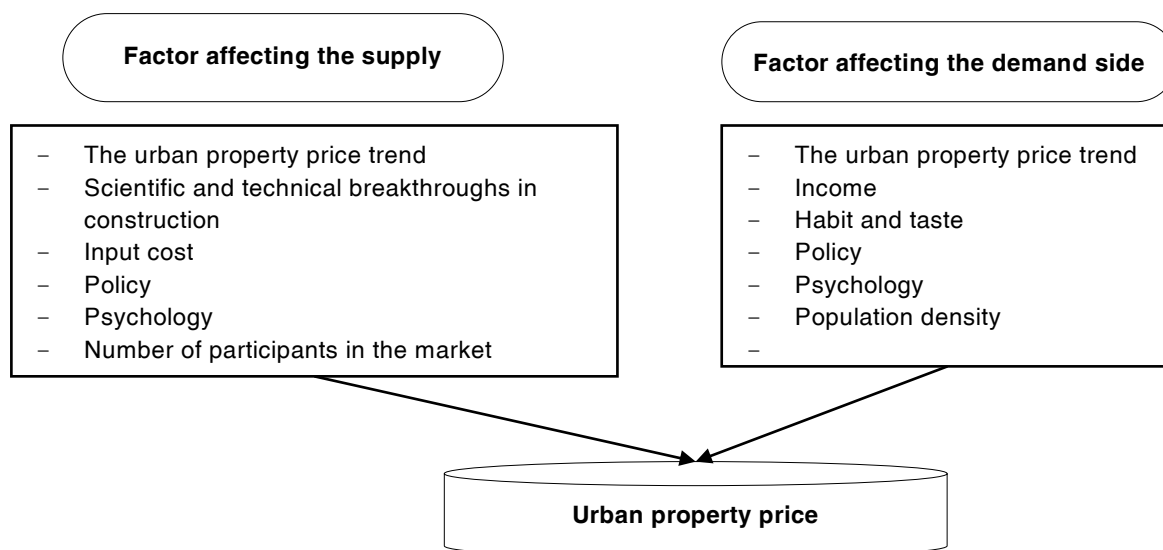
dwelling house may be never in the wildest dream of low-income people. Therefore, it is a challenge for researchers and policy-makers to identify precisely factors affecting the urban property price.

## 2. Theoretical framework

From the economic perspective, the urban land price is driven by the supply-demand relationship, which in turn is greatly affected by the property price trend, macroeconomic policies, psychology, income, prices of factor inputs, number of participants in the market, etc. (Figure 1). At each point in time, the supply and demand in the market will form an equilibrium price, and any change in the supply or demand can result in a new equilibrium price.

Figure 1 shows that urban property price trend, policy, and psychology affect both the supply and demand sides. Regarding the factor "policy," it includes a variety of policies on tax, credit, town planning and administrative

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**Figure 1: Factors affecting the urban land price**

procedures, and thus its impact on both supply and demand sides of the market is definitely stronger. In this paper, effects of shortcomings in tax and credit policies and administrative procedures on the urban property price will be examined and analyzed.

### **3. Regulations on land use fee, market value, and non-market value**

The land use fee is an amount paid by the land user to the State budget for rights to use and transfer land, or convert it to other purposes.

Article 17 of the 1992 Amended Constitution prescribes that land and other crucial natural resources are under the ownership of the entire people, and the government shall, on the people's behalf and for the people's sake, own and administer such public properties. Then, the 1993 Land Law has acknowledged rights of transferring, inheriting, mortgaging, and leasing immovable properties; awaking the sleeping real estate market of Vietnam. After obtaining the long-term land use right, individuals or organizations should pay the land-use fee when they transfer the land or convert it to other purposes [4]. Theoretically, the land-use fee

comprises two classes: fee for transfer of land-use right and fee for conversion of land-use purpose.

According to Standard 1 in Decision 24/2005 dated April 18, 2005 issued by Ministry of Finance, the market value, when utilized for appraisal, is construed as the price level at which buyers are willing to buy and sellers are willing to sell, provided that the transaction is undertaken objectively and independently in a stable market with transparent and symmetrical information [3].

According to Standard 2 in Decision 77/2005 issued on Nov. 1, 2005 by Ministry of Finance, the non-market value is the price level which is not based on or does not reflect the market value [3].

Therefore, if calculation of the basic land price is based on the market value, such price should be based on data about market transactions that take place objectively and independently in a stable market with transparent and symmetrical information. Otherwise, it is calculated according to the non-market value.

### **3. Inadequacies of implementation of the regulations**

***a. Inadequacies concerning calculation of land use fee:***

Calculating the land use fee for land granted to organizations has been prescribed in many applicable legal documents. Implementation of such legal documents includes two phases regarding methods of calculating the land-use fee according to the official price frame (considered as a non-market value):

In phase 1, the calculation of land use fees is generally the same as set forth in Decree 38/2000/NĐ-CP dated Aug. 23, 2000 concerning the collection of land use fee and Circular 117/2004/TT-BTC dated Dec. 11, 2004 concerning implementation of Decree 198/2000/NĐ-CP. Specifically, Article 2, Section 4 of Decree 38 states that “the land prices for each square meter shall be calculated in VND according to the land price frame set by municipal or provincial people’s committee in light of the government’s land price frame;” and in case the land is allocated for long-term use, “the land price used for calculating the land-use fee shall,” as stated in Part B, Item 2, Section 2.2 of Circular 117, “be the price set by the provincial people’s committee according to Government regulations at the point of allocation.” [10]

In phase 1, to calculate the land-use fee on the basis of the official price frame, the following equation was employed:

$$T_{SDB} = G_D^{QD} \times DT_D^{KD} - G_{DB}^{PD} \times DT_D^{DA} \quad (1)$$

where:

$T_{SDB}$  : Land-use fee

$G_D^{QD}$  : Average land price (per square meter)

set by provincial people’s committee

$DT_D^{KD}$  : Land area for business

$G_{DB}^{PD}$  : Compensation (per square meter of residential land) as approved

$DT_D^{DA}$  : Land area for development project

Phase 2 commences with Decree 17/2006/NĐ-CP dated Jan. 27, 2006 about amending and modifying Decrees on implementation of the Land Law, and culminates with Circular 93/2011/TT-BTC dated June 29, 2011 concerning

amending and modifying Circular 117/2004/TT-BTC. These two documents stipulate provisions on calculation of land-use fee. For example, Article 5, Section 1 of Decree 17/2006; and Points 1.4 and 1.5 of Item 1, Article 1, Circular 93/2011 prescribe that “the land price used for calculating the land-use fee shall be the land price set by provincial people’s committee. In case such prices are not in line with the market price of land-use rights transfer under normal circumstances, the provincial people’s committee shall decide an appropriate land price on the basis of such market price” [10]

The following equation is utilized to calculate the land-use fee in phase 2:

$$T_{SDB} = G_D^{TT} \times DT_D^{KD} - G_{DB}^{PD} \times DT_D^{DA} \quad (2)$$

Where:

$G_D^{TT}$  : The average market price of a square meter of residential land

Accordingly, prior to the effective date of Decree 17/2006 (i.e. Feb. 12, 2006), the land price used for calculating the land-use fee observed provisions of the municipal or provincial people’s committee at the point of allocation. Since phase 2, the land-use fee followed the market value. Several inadequacies have emerged from these new regulations.

- Sudden increases in the land-use fee expose investors to financial burdens.

Equations (1) and (2) show that the primary difference in the calculation of land-use fee comes from replacement of the price frame set by provincial or municipal people’s committee ( $G_D^{QD}$ ) in phase 1 with the market price of land ( $G_D^{TT}$ ) in phase 2. Before 2006,  $G_D^{QD}$  often came closer to  $G_{DB}^{PD}$  which was much lower than  $G_D^{TT}$ , and thus investors just had to cover a small amount of land-use fees. However, since 2006, according to new provisions, the land-use fee has made the input cost much higher, causing two problems: (1) enterprises have to include input cost in the product price, making the urban property price soar; (2) many local enterprises have to leave the

market, enabling foreign ones to conquer the local real estate market.

- When compensation is higher than the provided price, no difference is refunded.

When making plan for land clearance and compensation payment, project developers are only provided with a fund for the approved compensation rate ( $G_{DB}^{PD}$ ) which is often equivalent to the official agricultural land price. Meanwhile, other enterprises have to pay land owners an amount equivalent to the market value  $G_{DB}^{TT}$  (referred to as actual compensation for residential land) which is often much higher than  $G_{DB}^{PD}$  if they take responsibility for covering cost of land clearance. However, when calculating the land-use fee, such difference is not refunded by authorities.

Formula for calculating such difference is as follows:

$$\sum T_{CL} = (G_{DB}^{TT} - G_{DB}^{PD})DT_D \quad (3)$$

Where:

$\sum T_{CL}$ : Total difference in compensation payment between old and new calculating formulas

$G_{DB}^{TT}$ : Actual compensation payment for a square meter of residential land

Tax agencies do not accept the actual compensation payment for fear that enterprises inflate the actual compensation payment to require a reduction in land-use fee. In fact, compensation beneficiaries always expect a compensation level equaling the market value and even count for potential values of the plot of land when it is turned into the residential land.

Theoretically, the new formula for calculation of land-use fee is not rational enough because components of the equation 2 are not consistently based on market or non-market values; the land-use fee is calculated according to the market value whereas compensation follows the government's price frame (i.e. non-market value).

Accordingly, enterprises are burdened by the compensation difference which is calculated according to Equation 3 and cannot be offset

against the land-use fee. Whether the difference is low or high depends on the difference between the actually-paid compensation and the approved one and the project size. Indeed, such difference can rise to somewhere between 50% and 90%; that is, for each square meter of project land, enterprises must pay 1.5 to 1.9 times as much as the market value. Once the difference is too high, the urban property price will inevitably rocket up. Thus, many project investors and local authorities may, for their own sake, force expropriated victims to accept a low compensation; and consequently, claims on expropriation become numerous and complicated.

- The total area of project land is charged with land-use fee.

The total area of a housing development project consists of two parts, namely business area and infrastructural area, which can be calculated as follows:

$$DT_D^{DA} = DT_D^{KD} + DT_D^{HT} \quad (4)$$

Where:

$DT_D^{HT}$ : Area used for infrastructure

No legal document clarifies which part of infrastructural area of a housing project is charged for, or exempted from, the land-use fee, and therefore tax agencies usually impose the land-use fee on the whole area used for the project. Because the infrastructural area of a project often represents 40% of the total area, to pay the land-use fee for total infrastructural area will increase the input cost, making the urban property price rise and discouraging enterprises from sparing more area for infrastructure, which may help improve the urban landscape and environment.

- Enterprises lose their autonomy in financial planning.

The market value under normal conditions is the land price frame used for calculating the land-use fees, and it should be assessed exactly. Additionally, constant upheavals in market forces make real estate investors less proactive in planning their financial scheme – a decisive factor in success of the project.

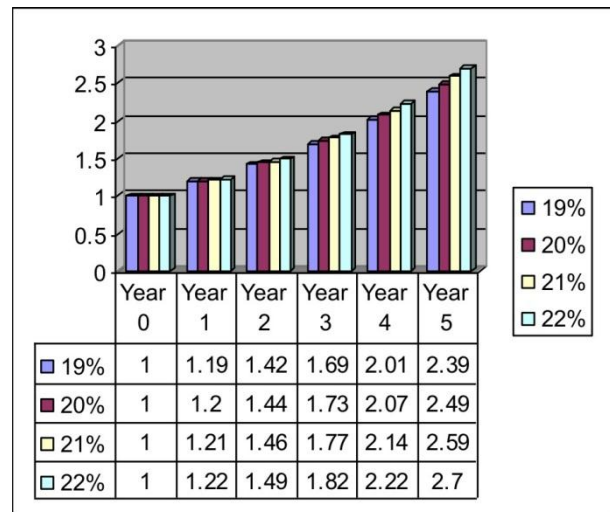
- High capital cost:

Although administrative agencies have implemented the one-door regime, it is not really friendly and effective in dealing with complaints from enterprises. Procedures are still complicated because of poor delegation of rights and duties and a multi-level mechanism, which tends to prolong project – up to three years in many cases [2], increase the cost of capital and reduce profitability of the project. The urban property price will indispensably go up accordingly in order to offset such expenses.

Tight monetary policies have sharp impacts on the real estate market; and the current high interest rate influences not only the urban property price but also the sustainable development of the realty market and investors. Investments in the realty market are mainly supported by the banking system; however, at the present time, this mechanism is not very feasible. Although policies to ensure macroeconomic stability and control the inflation are extremely necessary at current point, it is not wise to reduce bank loans for realty projects because many of them can bring benefit to both investors and local community and help improve the infrastructure, environment and social welfare.

Realty projects usually need long-term capital (i.e. over five years). Meanwhile, for unpaid debts, State banks adjust the interest rate up to 20-23% p.a. for state-owned enterprises and 23-27% p.a. for private ones. As a result, the cost of capital soars and enterprises are obliged to add such expenses to the product price. The urban property price in turn skyrockets.

To illustrate increases in the cost of capital caused by complicated and prolonged administrative procedures, the author makes some calculations for a 1-VND loan at various interest rates (i.e. 19%, 20%, 21% and 22% p.a. respectively). Accordingly, the amount payable by the end of each year in a 5-year period is presented in Figure 2.



Source: The author's calculation according to the function of compound interest

**Figure 2: Amount payable for a 1-VND loan with a 5-year maturity and an interest rate ranging from 19 to 22 percent per annum.**

Figure 2 shows that when the interest rate varies between 19% p.a. and 22% p.a., borrowers will, after three years, pay lenders an interest payment equaling 69 to 82 percent of the principal. This figure can rise to a 101-122 percent bracket after four years, and 139-170 percent after five years. In other words, if a person borrows VND100 billion at the interest rate of 20% p.a., he/ she must pay VND207 billion after four years (i.e. VND100 billion of principal plus VND107 billion of interest) and VND249 billion after five years (i.e. VND100bn of principal plus VND149bn of interest). These figures are worrisome, causing the skyrocketing price of urban property over the past years due to the high interest rate and complicated administrative procedure.

#### 4. Recommendations

It is supposed that the government should employ Equation 1 to calculate the land-use fee (i.e. the price frame set forth annually by municipal or provincial people's committee). This frame should be gradually adjusted to get (around 70 to 80 percent) closer to the market value and then fixed in years. This practice is suitable to the theoretical framework when the non-market



value is used unanimously during the calculation. This will facilitate operation of tax agencies and administrative procedure, minimize malpractices in appraisal and reappraisal of land prices, and help local enterprises reduce input costs and regain their autonomy in their financial planning.

Regulations should clarify which part of infrastructural area of a housing project is charged for, or exempt from, the land-use fee in order to encourage enterprises to expand areas for infrastructure and greenery, which will help improve the surrounding landscape and urban environment.

It is also advised that the government had better stipulate in detail which field of business can access sources of formal loan to ensure financial support for the market development.

Administrative reform should be accelerated to remove obstacles to business, simplify approving procedures for the project and help

investors reduce cost of capital.

In sum, the rocketing price of urban property in Vietnam originates from unreasonable calculation of land-use fee and high cost of capital caused by high interest rate and complicated administrative procedures. These factors are related to the governmental policies. If the policy is not suitable, it should be amended for the interests of enterprises and the community. Accordingly, the realty market can develop stably and sustainably, and the urban property price will be close to the market value instead of being distorted due to unsuitable policies■

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