CAPITAL STRUCTURE OF OFFICE BUILDING PROJECTS IN HCMC

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In HCMC the investment capital has increasingly flowed into the office-trading sector since 1992. Most of projects were focused on high-rise buildings for lease including offices, hotel service or apartments. After the financial crisis in 1997, in spite of many difficulties these buildings were still set up mainly in district 1 (Saigon downtown). According to Chesterton Company, office traders had to survive in the fierce price war. Nevertheless, in my opinion, the main cause of investors' disappointment is not wholly price war or financial meltdown in 1997, but it is the feasibility of investment decisions in this sector.

The office buildings can be rated into Class A, B and C in accordance with location, structure, design, construction quality, facilities and management company. The total office space for lease in HCMC up to international standard is about 210,000 m2. According to experts, before the Asian financial crisis, the space of conditional office buildings did not meet the market demand, enterprises had to rent at high costs of US$45/m2/month and up. After 1997, the demand dropped drastically because many investment projects were suspended or revoked. This led to a price war. The rental rates plunged from US$40/m2/month in the second quarter of 1997 to US$18/m2/month in the third quarter of 1998 and US$14.5/m2/month in the last quarter of 1999.

This rate attracted attention of many large corporations including P&G, Mobil...These businesses moved their offices from old villas in the city to high-rise buildings. As a result, the occupancy rate of these buildings increased sharply. In addition, the Government opened the life insurance market to foreign investors, the market also became bustling. The rental rates include Class A from US$20 to 30/m2, Class B US$15-20 and Class C US$10-15. Most of building offices operated in Class B with the rental of US$15-20/m2. This is an acceptable price. The Class B offices accounted for 46%, Class A 42% and Class C 12% of the total space for lease of 254,795 m2.

According to our survey until December 31, 2000, total investment capital in Class A offices with 105,988 m2 reached US$255,678,590, Class B 117,187 m2 and US$141,530,543 and Class C 31,800 m2 and US$112,574,876. The investors' own capital represented 40% and the remaining 60% came from loans in Class A projects, 35% and 65% in Class B and 45% and 55% in Class C. 40% of capital was spent on machinery and equipment and 60% on construction. In joint ventures, Vietnamese party hold 30% stake by the value of their land use right during 40 years or the land rental of US$18/m2/year. The foreign partner pledged to transfer total assets at the end of investment term.

As such, when the joint venture is established with a land area of 18,000 m2, we have:

- Vietnamese party's contribution (30% stake): 18,000 m2 x US$18/m2/year x 40 years = US$12,960,000
- Total investment capital of both parties: US$12,960,000 : 30% = US$43,200,000
- Foreign party's share: 70% x US$43,200,000 = 30,240,000

The costs of capital construction and equipment accounted from 60 to 80% of total investment, the rest was spent on land rental. A property joint venture with total investment capital of US$509 million and investment term of 40 years including 35 operational years will have to depreciate its invested assets in a year as follows:

Capital construction: US$305 million : 35 years = US$8.7 million/year

Equipment: US$203 million : 15 years = US$13.0 million/year

Total depreciation cost: US$21.7 million

With an average sale of US$14/m2/month or US$168/m2/year and operational costs and interest of US$37.8/m2/year; we have the following table:

Table 1: Some financial indicators of an office building project

Total sales 14 x 254,975 x 12 x 90%	US$38,552,220
Operational costs before depriciation and interest 254,975 x US$37.8/m2	US$9,638,055
Average depreciation	US$21,700,000
Total costs before interest	US$31,338,055
Earnings before interest and taxes (EBIT)	US$7,214,165
Interest US$370,000,000 x 5.5%	US$20,350,000
Earnings before taxes (EBT)	US$13,135,835
Return on assets	1.417%
Return on equity	9.45%

The above table reveals the real estate sector in HCMC is now on the early stage and ready for growth. With its low return on assets, the sector cannot meet financial requirements to take loans with an interest rate of 5.5%.

The sector's operational costs remain rather large:

1. Electricity cost accounts for 26% - 35% of total costs.
2. Rental for management company including wages of workers accounts for 49-55% of total costs.
3. Depreciation cost is still huge as analyzed above. Joint ventures are permitted to operate during a term of 40 years only. In theory, businesses have to recover their total invest-

ment capital before transferring their assets to the Vietnamese partner. However, the office building projects are of the capital-intensive industry because it takes 3 to 5 years to complete construction and the construction costs hundreds of US dollars. Therefore, the investors can hardly recover their investment in capital construction within 35-37 years. According to the above calculation, with depreciation cost of US$12.5 million per year, the rental rate must be US$12.5 million : 254,975 m2 = US$ 49/m2.

4. In addition to the above mentioned disadvantages, property investors have applied an inappropriate financial policy. Just in the first step, they sought how to get loans for investment. According to our analysis, no joint ventures plan to use their own capital for investment in planning their feasibility study. The foreign party's capital contribution depends on the land area of Vietnamese partner. Because foreign contractors conduct designing and implementing, most of construction costs are guaranteed by foreign banks. Most of office building projects were under construction in the 1993-1997 period and they began operation later with serious effects of the Asian financial crisis. These businesses had to incur large debts of foreign investors with high interest rates because in these years the FED steadily increased interest rates to attract capital flow into the U.S. This resulted to business bankruptcy or acquisition.■

REFERENCE

1.The market report of Vietnam Chesterton Petty, 2000,

2. *Vietnam Economic Times*

3. *Đầu Tư* Weekly

4.Audited financial statements of Hải Thành – Kotobuki Joint Venture, 1998, 1999 and 2000,

Table 2: Capital structure of HCMC-based office building projects Unit: US$

Building	Combined space (m2)	Investment capital	Capital construction	Equipment
Sunwah Tower	26,000	24,000,000	14,400,000	9,600,000
Central Plaza	6,585	20,560,000	12,336,000	8,224,000
Saigon Metropolitan	20,000	29,900,000	17,940,000	11,960,000
Saigon Tower	14,000	10,000,000	6,000,000	4,000,000
Diamond Plaza	17,700	77,846,590	46,707,954	31,138,636
LandMark	9,900	19,330,000	11,598,000	7,732,000
Saigon Center	11,803	74,042,000	44,425,200	29,616,800
IBC	1,417	-	-	-
Chancellor Court	4,000	18,034,143	10,820,486	7,213,657
PDD	3,500	1,400,000	840,000	560,000
Mê Linh Point	22,000	35,722,000	21,433,200	14,288,800
Riverside Office	14,670	17,000,000	10,200,000	6,800,000
Harbour View	10,600	11,000,000	6,600,000	4,400,000
Saigon Trade Center	47,000	39,380,000	23,628,000	15,752,000
Hannam	6,000	6,794,400	4,076,640	2,717,760
OISC	8,000	12,200,000	7,320,000	4,880,000
City View	1,480	14,000,000	8,400,000	5,600,000
Kim Đồ	2,500	-	-	-
IDC Industrial Center	4,000	-	-	-
Montana	3,000	65,000,000	39,000,000	26,000,000
Hải Thành	4,800	10,008,000	6,004,800	4,003,200
Mondial	1,500	-	-	-
Tecasin	3,800	1,096,876	658,126	438,750
YOCO	6,000	-	-	-
Southern Fortune	2,400	19,490,000	11,694,000	7,796,000
Jardin	2,320	2,980,000	1,788,000	1,192,000
Total	**254,975**	**509,784,009**	**305,870,405**	**203,913,604**