Risks in fledgling condotel segment

Despite the lack of a legal framework and phantasmagoric profit commitments, condominium-hotels (condotels) have been one of the most attractive property products among buyers. **Bich Ngoc** reports.

Nguyen Hoang Linh, a 45-year-old man from Ho Chi Minh City, was considering buying a condotel unit at Ocean Vista, a condotel project in the central province of Binh Thuan.

According to the project's developer Rang Dong Group, with 300 days in use every year, the project can have 35-50 per cent room occupancy with the rental rate of $200 per day.

"Apart from reserving 20 days per year for my own use, I can have stable rental income around the year, and this profit rate can return owners' capital in 10 years. I think this is attractive enough for me," Linh said.

Due to their good profit commitments, condotels have been very attractive for buyers in the last three years, with more and more capital being poured into the segment by domestic and foreign investors.

Market observers said the tourism sector has seen rapid growth in recent years, with the number of foreign tourists arriving to Vietnam increasing by 30 per cent per annum in the last three years, leading to the surging supply of resorts, hotels, and condotels.

Another reason for the booming condotel market is the growth of the Vietnamese middle class. With the cost of VND1-3 billion ($43,500-130,500), most middle-class earners can afford a unit as their second-home as these properties double as investment due to their rental yield.

Big investors such as Vingroup, Sun Group, and CEO Group have been investing in condotel projects.

According to figures from the Vietnam Real Estate Association (VNREA), more than 12,500 out of the more than 22,800 available condotels were traded successfully in 2017 in major destinations like Danang, Khanh Hoa, Phu Quoc, and Binh Thuan in the central region, as well as in the northern province of Quang Ninh.

According to the VNREA, Khanh Hoa has the most condotels, with the number of more than 11,800 apartments, followed by Danang (more than 7,000), while newcomer Quang Ninh launched 1,300 condotel apartments as of 2017.

According to the Vietnam Association of Realtors, it is only since 2017 that there has been a boom in the supply of properties and condotel resort transactions.

Outstanding projects include Vinpearl in Nha Trang, Phu Quoc, and Danang, as well as Grand World Phu Quoc, Best Western Premier Sonasea Phu Quoc, Movenpick Resort Waverly Phu Quoc, Coco Ocean Resort Danang, and Ariyana Smart Condotel Nha Trang.

According to Trinh Van Quyet, chairman of the Management Board of FLC Group – a developer building thousands of condotel units nationwide – condotels had a remarkable impact on the market since they added a strong new supply to the hospitality segment which has been in serious shortage.

"This new supply contributed a meaningful resource for tourism development, creating more jobs, attracting foreign currency, and bolstering the state budget," Quyet said.

For developers, according to him, this is an effective channel for capital mobilisation. Developers can sell their condotels and collect the proceeds from the sale but not from leasing. After selling to buyers, developers can represent owners to lease out the units to collect rent and share it with the owners.

"The proceeds from selling condotels come from buyers – which means it comes from the real demand and has less risk, and helps developers reduce their dependence on bank loans, which have become tighter," Quyet said.

Meanwhile, for buyers, condotels are an effective source of stable rental income without the need to manage or lease out the units on their own.

Legal risks

However, Pham Thanh Hung, deputy chairman of CEN Group, warned that even though the condotel segment has developed much during the past years, it remains fraught with legal risks, especially when it comes to the issuance of red books to buyers. "A clear legal framework will reduce risks for all participants, from developers to investors," Hung said.

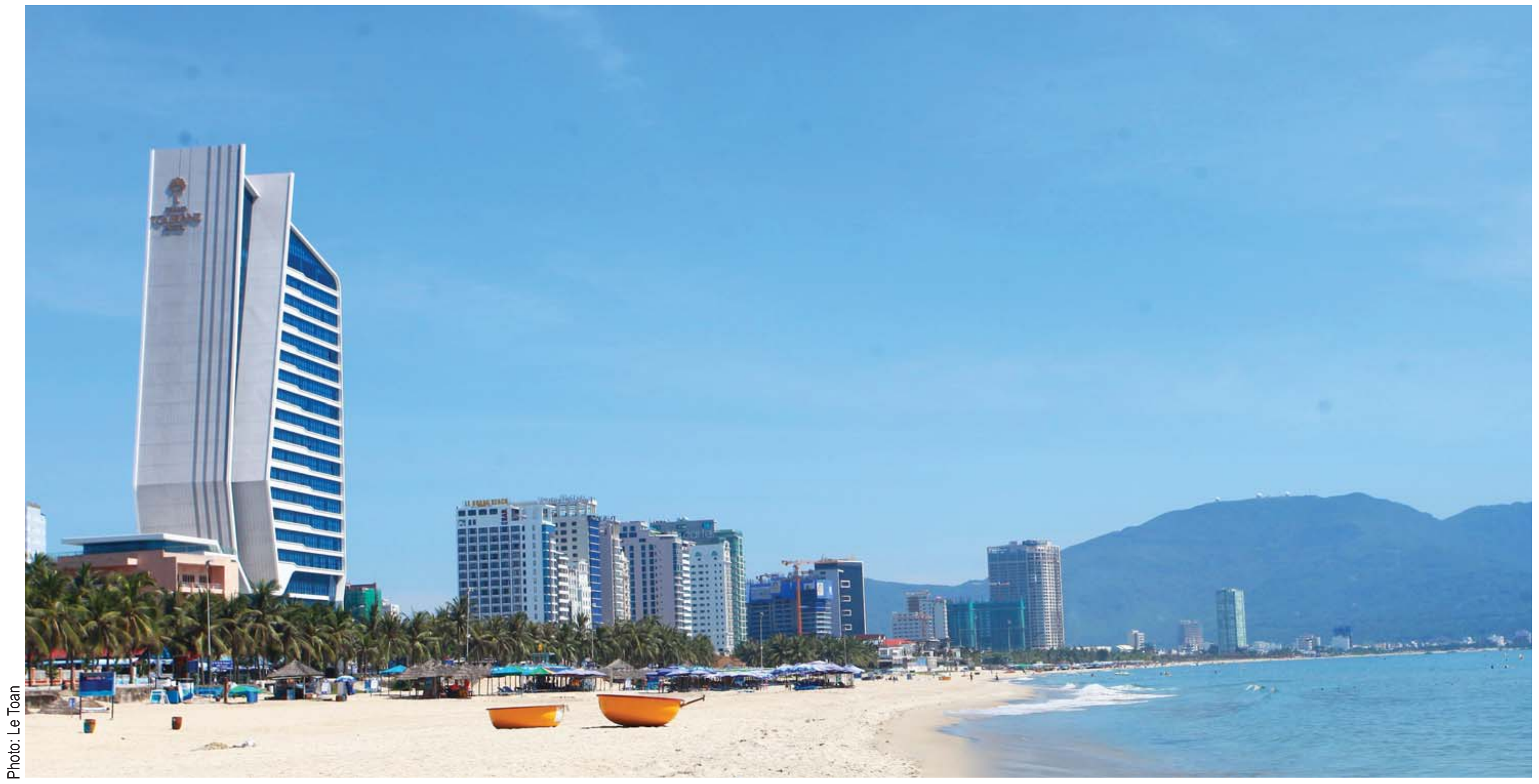

Photo: Le Toan

A relative newcomer to the market, condotels need much clearer regulations to ensure transparency and safety for buyers and developers alike

According to statistics from the Ministry of Construction, in the 2015-2018 period, over 25,000 condotels were launched nationwide.

According to Nguyen Hoai An, director of CBRE Vietnam's Hanoi Branch, condotels are a good economic concept for the sharing of burdens and benefits between buyers and developers. "Unlike with expensive resort villas, condotels are more suitable for small side investors and individuals. Their liquidity, therefore, is also high and they attract many buyers."

Doubtful profit commitments

In order to successfully sell their condotels, many developers have made profit commitments of 10-15 per cent a year to buyers. While lauding the market's potential, industry experts, however, are in doubt about these claims.

Kai Marcus Schröter, general director for Hospitality Tourism Management (HTM), said that the condotel model was popular in the Mediterranean and Europe around 20 years ago, and in Thailand 10 years ago. However, its disadvantages have become apparent in the time since and condotels have been on a downward trend. This was caused by ineffective business results in these countries, which explains why the model is essentially non-existent in the Asia-Pacific region. "I have not seen profit commitments of 10 per cent a year anywhere else in the world," he said.

Schröter believed nowhere can developers commit such a high profit rate because tourism has its high and low seasons, while occupancy and rental fees also cannot be stable.

Meanwhile, Adam Bury, senior vice president, Investment Sales Asia at JLL Hotels & Hospitality Group, said that the 10-15 per cent profit was mostly for advertising.

"Such profit rates are not offered in other countries. In Vietnam, developers are offering such profit because they do not quite understand this type of property. The most important factor for them is to successfully sell condotels to buyers, and they do not worry about how to get such high profit through the lease programme," Bury said.

"Condotels can only reach such high profits when they are located in famous tourist hotspots and receive a strong and steady flow of tourists throughout the year," he added. "The developer may be able to maintain this profit commitment for one or two years, but it is not feasible for the whole 10 years," he said.

Nguyen Manh Ha, deputy chairman of the VNREA, also agreed that profit commitments are too high and can bring many difficulties to developers.

"The profit is attractive to customers, but if it is too high, up to 12-15 per cent, developers will run into difficulties. It is not true that all places have high occupancy, especially as the tourism market is becoming more competitive," Ha said. "Buyers should be warned about this. When they invest, they have to bear the risks. The more profitable the condotel, the higher the risk," he added.

However, since late 2017, there have been signs of oversupply in the condotel segment, with too many developers jumping into the segment, a trend which turned into a lull in 2018 and the first quarter of 2019.■

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> Senior vice president, Investment Sales Asia, JLL Hotels & Hospitality Group

Condotels need to be shored up by legal framework

The lack of a legal framework has been the reason behind recent disputes between buyers and management companies over the ownership and maintenance of condotels.

Three years after the first condotel appeared in Vietnam, the related legal framework has yet to be finished and no one knows when the hole will be filled, especially as the government recently suggested delaying the revision of the Law on Land to 2020 instead of 2019.

The current laws of Vietnam do not have clear regulations regarding the ownership rights and management of condotels, as they are a relatively new type of property in the country.

Under the Law on Land, developers can lease land for a maximum of 50 years. In order to sell condotels, they advertise that this time can be extended, but there is no regulation to this effect.

Meanwhile, under the Law on Tourism, a condotel is merely a hotel project, therefore, it is not eligible to be granted a land-use certificate.

Due to this mismatch, most condotel buyers have not been granted land-use rights and ownership certificates.

According to Nguyen Trong Ninh, director of the Agency for Housing and Real Estate Market Management under the Ministry of Construction (MoC), the term "condotel" has not appeared in the ministry's legal documents before.

Condotels are a combination of condominiums and hotels, so they must be managed and regulated by the tourism authorities and developers doing business in condotels must be authorised by the Vietnam National Administration for Tourism, according to Ninh.

However, other experts argue that as condotels are a new type of property, they must be regulated by the MoC.

For the time being, Ninh said the MoC is setting up standards for condotels which are expected to be included in the revised Law on Land.

Ensuring profitability of Vietnamese condotels

The condotel segment has recently emerged as one of the most attractive investments for investors. *VIR's* **Quynh Chau** talked with **Stephen Wyatt**, director of JLL Vietnam, on his assessment on this new segment of the Vietnamese real estate market.

How do you assess the liquidity of condotels compared to other segments in real estate?

As yet, there have been not any official figures of the liquidity of condotels in the market. Projects that have been put into operation are, so far, very few. We can see that condotels remain attractive for buyers due to the commitment of high profit from developers. However, buyers should note that in many cases, the commitment of profit from 10 to 15 per cent is not guaranteed yet. It's a waiting game to find out if developers can gain this profit or not.

Besides major developers pouring huge capital into condotels, many companies with non-real estate business have also been jumping onto the boat. Can they be successful leaving their core business?

I think condotels attract non-real estate companies for three main reasons. First, it's a new type of investment which has been developing over the last three years, therefore competitiveness remains low compared to many other segments such as apartments for sale, townhouses, villas, and land lots. Apart from this, condotels are favoured by their double functions of condominium and hotel room, offering more choice for users.

Second, like many other segments, condotel owners can see their return investment after a shorter time compared to other segments.

Third, under the Law on Tourism approved in 2017, tourism will be one of the leading economic sectors in the coming time. This causes a great positive impact on the second-home and hospitality segments, and creates a new motivation for those two segments to develop based on government incentives and supportive policies.

For the time being, Phu Quoc Island authorities have offered their own incentives for the tourism sector related to taxation and time for using land. Phu Quoc also opened the first casino to permit Vietnamese people's entry, and the island has become one of the most attractive destinations for tourists.

Many experts say that with the growth increasing at speed, condotels are near to oversupply. What is your view?

According to research from JLL, second-homes and condotels have arisen in almost all the hottest tourism destinations in Vietnam. However, key markets like Danang and Nha Trang can see much room for development.

I think with the high potential of tourism development, we should not worry on oversupply now. However, in order to ensure stable development, one of the most important factors is how to improve the quality of the services, and how to apply a good business strategy. Both developers and buyers must consider very carefully on the profit they intend to gain when putting their condotels up for lease. Both sides must adapt to a more developing market and more demand from buyers.

I think condotel oversupply will depend on the development of the tourism sector in the future. At present, the tourism sector has lots of potential thanks to incentives from the government.

Developers have been racing to launch attractive preferential policies, such as ensuring the profit or the rental yield from 8 to 15 per cent annually. What is your take?

The policy of ensuring profitability is an important factor that makes condotels more attractive and different from other types in the real estate market. Considering if the profit from 8 to 15 per cent is feasible or not, I think again it depends on the development speed of the tourism sector and the capacity of the investor to operate the project effectively. This not only requires investors to have a lot of experience in the field of holiday tourism, but they also must have a long-term view in order to have flexible business plans which are suitable in each phase of the market.■

Cleaning up condotel legislation in Vietnam

Appearing in Vietnam three years ago, condotels have not yet been properly integrated into the country's laws on property buying, selling, and management. The Vietnamese government is considering the issuance of a law to fill in this hole. **Dao Nguyen,** managing partner of DN Legal, draws up four scenarios and solutions to deal with this new property type.

Condominium hotel (condotel), is generally understood as a residential condominium apartment building that is operated as a hotel. The term, in fact, has no definition under Vietnamese laws and has been used by developers to include both condominiums/apartments and villas, offering buyers a number of ownership structures. Below are the four common scenarios.

Scenario 1: The sale of a residential condominium unit/villa in a real estate development project in which the developer is licensed to build residential premises for sale as well as to operate a hotel/resort. The owner can put the units/villas into the rental pool programme managed by the hotel and receive income from it.

Scenario 2: The sale of membership in a club by the developer. Payment of the membership fee entitles the member to use a certain number of days at a villa or room in the resort. This is similar to a "timeshare" arrangement where there is no ownership of a unit and the buyer simply purchases the right to use a certain number of days at a resort.

Scenario 3: The sale of the right to use a specific condominium or villa with a return on investment paid by the developer if the premises are part of the hotel rental pool and the owner is given a certain number of days to use the same or an equivalent unit at the resort. In most cases in Vietnam, the developer guarantees a minimum rate of return on the investor/owner's investment. There is, however, no ownership right involved. The buyer will never get the red book. This scheme is in fact similar to a loan or investment into a project to finance a developer with the lender or investor receiving monetary benefits in return.

Scenario 4: The long-term lease of a condominium or villa with a guaranteed return if it is put into the rental pool with the owner holding the right to use the unit for a certain number of days. Again, there is no ownership right and no red book.

The laws of Vietnam do not prohibit any of these schemes. The risks of each scenario are laid out below.

Scenario 1, in fact, is the true definition of a condotel. The owner has legal ownership of the unit/villa because the developer is licensed to sell residential premises and the particular land is zoned as residential. Thus, the owner has all the protections under the Law on Housing 2014, which contains clear regulations on construction warranties to be provided by the developer as well as on the management of common areas, and all the protections of an owner such as the right to receive the land use right certificate of the unit/villa and the related land (red book). In this case, the buyer (either foreign or local) shoulders no risk, because this is no different from buying a unit at any residential development project.

The issue, however, is that most buyers in *scenarios 2 and 3* also believe that they are buying real estate and that they have true ownership of the relevant property. In fact, what they have is the contractual right to use a particular room or villa in a resort development project and in certain cases a guaranteed return from the developer. They will not get the red book. They will not enjoy the safeguards provided by the Law on Housing. This does not protect the buyers from the bankruptcy of the developer or even early termination by the developer. In addition, because the guaranteed return is also purely contractual and the buyer may have difficulty in enforcing payments, especially if the developer has no funds to oblige. Forcing it into bankruptcy will not help because the buyer will essentially become an unsecured creditor lining up behind other secured creditors. It is also unclear (unless specifically negotiated) whether these arrangements remain binding if the developer sells the project to a new owner.

In *Scenario 4*, a Vietnamese lessee under long-term lease arrangements does have some means to protect their right to use the leased premises in the event of bankruptcy of the lessor, because the Civil Code and other laws recognise the right of a lessee. However, contractually, the lessee still has to shoulder all the other risks set out above such as enforcement of the guaranteed return, no red book, and no clear laws on the management of common areas. In addition, lessees who are foreign individuals do not have the right to sublease the property. Thus, although the long-term lease by a foreign lessee may be for 50 years and so seem similar to ownership, the rights of a foreign lessee or owner of residential premises are quite different. An owner, for example, will get the red book, can transfer ownership, is guaranteed the right to extend the initial term for another maximum period of 50 years (100 years of total use), and can convert VND into foreign currency from the sale and lease of the premises.

Given the above, buyers in *scenarios 2, 3, and 4* may have difficulties selling these rights to third parties in the future because potential buyers will want something closer to ownership. Thus, buyers may not be able to realise the expected value on the sale of these rights.

The reason the developer in *scenarios 2, 3 and 4* cannot give the buyer ownership is that the developer only has the licence to build and operate a resort/hotel. This is "commercial" land use and therefore it is not possible for the developer to transfer "long-term" use rights or ownership to the buyer. Typically, this is the case for most resort development projects. Thus, in order to raise pre-construction financing, the developer has no choice but to offer these condotel arrangements and in most cases offer a guaranteed return to help buyers mitigate the risks discussed above.

We understand that the government is considering a condotel law to deal with *scenarios 2, 3, and 4*, and perhaps the buyer will receive a certificate of right of use similar to the red book and the law may set out certain protections to the buyers. We are unclear as to the progress on this, but highly support this effort to help developers raise financing and protect the rights of buyers.■

This article is the author's personal and does not constitute legal advice.