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NGUYEN XUAN THANH

NON NUOC SERVICED APARTMENT PROJECT

KQ Investment, a real estate investment fund, just secured a long-term lease from Da Nang City's government from 2009 to 2036 for 3.2 hectares of beach front land in Non Nuoc. A luxury serviced apartment complex was to be developed on the land.

Apartment Mix

The project would construct 175 fully-furnished apartments for lease to long-term stay tourists.

	Number of apartments	Area (m^2)
One-bedroom apartment	60	64
Two-bedroom apartment	93	120
Three-bedroom apartment	22	184

Investment Cost

The total investment cost in nominal term was estimated at VND 547.100 billion, including, building cost, furniture, swimming pool, soft costs, contingencies, and interests during construction..

The unit construction cost was estimated at VND14.4 million per m^2 of construction area (at 2009 prices). The ratio of total construction area to apartment area was 1.2.

Furniture cost (at 2009 prices)

One-bedroom apartment	VND180 mil per apartment
Two-bedroom apartment	VND216 per apartment
Three-bedroom apartment	VND240 per apartment
Common area (based on total construction area)	VND360.000 per m^2

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The project would also construct a swimming pool and surrounding gardens with a total area of 330 m^2 at VND5 million per m^2.

In addition to construction costs, there are soft costs such as design, financing, insurance, permit, marketing, legal fees, and project administration.

Soft cost breakdown as a percentage of 2009-price construction cost	
Design	3,0%
Financing	3,0%
Insurance	1,5%
Permit	2,0%
Marketing	3,6%
Legal and accounting fees	0,4%
Administration	5,0%

The physical contingencies were estimated at 10% of the cost of each item.

Interests during construction were calculated at VND25.882 billion.

The project would be constructed during three years (2009-2011). The following table shows the investment cost breakdown by year (based on 2009 prices):

	2009	2010	2011	Total
Building cost	30%	55%	15%	100%
Furniture	0%	0%	100%	100%
Swimming pool	0%	0%	100%	100%
Other costs				
Design	100%	0%	0%	100%
Financing	100%	0%	0%	100%
Insurance	100%	0%	0%	100%
Permit	50%	0%	50%	100%
Marketing	50%	30%	20%	100%
Legal and accounting fees	35%	30%	35%	100%
Administration	30%	35%	35%	100%

Financing

KQ Investment would invest VND194.149 billion of equity into the project. VND126.318 billion would be disbursed in 2009, accounting for 80 percent of the total investment cost in that year. The

remaining VND67.831 billion of equity would be disbursed in 2010, accounting for 30 percent of the total investment cost of 2010.

The rest of the total investment cost would be financed by a 16-year loan from a commercial bank. The loan would be disbursed in 2009, 2010 and 2011. Interests during construction would be capitalized. The loan would also have a grace period during the first four years of operation (2012-2015). After that, the loan principal would be paid back in equal annual installments from 2016 to 2025. The face value of the loan, including capitalized interests during construction, is VND352.961 billion.

The loan would carry a floating interest rate which is based on the bank's one-year deposit rate plus 350 basis points. At the current deposit rate of 8 percent, the loan's interest rate would be 11.5 percent during the first year since the initial disbursement.

Depreciation

The investment costs would be depreciated by the straight line method as regulated by the Ministry of Finance. The building and furniture would be depreciated over 25 and 5 years respectively..

Of the soft cost items, design, financing, insurance, and interests during construction costs were counted toward the building construction and depreciated over 25 years. Other items such as permit, marketing, legal and accounting fees, and administration costs were to be treated as operating costs and distributed equally during the first three years of operation.

Rental

The current average rent for luxury serviced apartment was US$40 per m^2 per month (2009), including 10% VAT. It was forecasted that the rent would increase by 6 percent per year from 2009 to 2016; 5 percent from 2017 to 2021; 4 percent during 2022-2026; and 3 percent during 2027-2036.

During the first year of operation (2012), the vacancy rate was estimated at 50 percent. It would fall gradually to 20 percent in 2015 and stay at that level till the end of the project life.

Management Contract

KQ Investment was seeking to sign a management contract with a world-class hotel and resort management company. The followings are the cost and income sharing arrangements of the management contract.

The potential gross income (PGI) is equal to the rent per m^2 (excluding VAT) multiplied by the potential apartment area available for rent.

The effective gross income (EGI) is equal PGI minus loss income due to vacancy.

The direct costs include staff salaries, customer costs, booking costs, and utility costs. The total direct cost was estimated at 20 percent of EGI.

The administration costs, including salaries, marketing and sale costs, and office supply costs, were estimated at 6 percent of EGI.

The net operating income (NOI) is equal to EGI minus direct costs and administration costs (including soft costs distributed over the first three years of operation).

The management fee paid to the management company was negotiated at 30 percent of NOI.

The maintenance costs were calculated at 8 percent of NOI.

Net income and corporate income tax

Earning before interest, tax and depreciation (EBITDA) is equal to NOI minus management fee, maintenance cost, and land rental. The land rental, which was to be paid starting from 2012, was VND125,000 per m^2 of land per annum at 2009 prices.

Earning before interest and tax (EBIT) is equal to EBITDA minus depreciation.

Earning before tax (EBT) is equal to EBIT minus interest.

Corporate income tax is equal to EBIT multiplied by the tax rate of 25 percent.

Macroeconomic data

Future VND inflation: 7%

Future USD inflation: 2%

VND/USD exchange rate in 2009: 18,000

The question facing an analyst appraising the project is that given the above financial parameters is the project feasible.