

# Building steps for decision making finance essay

[Finance](#)



**ASSIGN  
BUSTER**

3. 1 Introduction Chapter 3 aims to describe the research methodology to collect and analyze data. There are six main sections in this chapter, namely research strategy, research paradigm and design, data collection, framework for data analysis, ethics/ethical issues and limitations. The first section describes the methods used for conducting research and reasons to choose these methods. Next, the research paradigm and design shows the overview of framework for strategies to solve the research problem. The data collection points out sources of data and data analysis presents research tools and framework used to interpret data. Finally, the ethical issues and limitations discuss about ethical principles in this business research and some restrictions of this study.

3. 2 Research strategy There are two main types of research strategy, namely quantitative and qualitative research. Quantitative research can be explained as a research strategy that "emphasizes quantification in the collection and analysis of data" (Bryman and Bell, 2007). It is an approach using number so as to resolve problems of society. Meanwhile, qualitative research known as a research strategy that usually emphasizes words rather than quantification in the analysis of data that have been collected (Bryman and Bell, 2007). Bryman and Bell (2007) also argued that qualitative research is not only concerning with generating theories, but it can also be employed for testing them. Each of these research strategies have advantages and disadvantages. Quantitative methods uses statistical and mathematical concepts to understand the problems, for example what happened or how often an issue occurs whereas qualitative method answers the question why an issue occurs (Dewhurst, 2006, pp. 4- 5). Qualitative research is criticized as too subjective, hardly to replicate, problems of generalization and lack of transparency. Meanwhile,

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

quantitative research also has restriction on in-depth research, such as some areas involved in psychology and psychiatry, because this method only explain the subject of area without explaining clearly insights. Therefore, to take advantages of both research strategies and to avoid the disadvantages of them, the researcher using both quantitative and qualitative research papers in this study. For the research question " Should BIDV be the owner or not owner of real estate assets?", the answer for this subject must be from different angles of view. It would be extremely difficult to use only quantitative or qualitative research to find out the answers for the research problems. Since BIDV has many qualitative criteria for assessing its real estate decisions (such as needs for operational flexibility etc.) and many factors that would have been difficult to measure quantitatively (such as space remodeling, management control...), it would have been impossible to study the CRE decision of BIDV purely quantitatively. Quantitative research method applies in this research for resolving research problems such as financial analysis of CRE decisions (NPV, IRR...) that were appropriate to measure quantitatively.

### 3. 3 Research paradigm and design

This study is an empirical research on the ownership and leasing situation in BIDV and the researcher uses some particular projects of BIDV as case studies to illustrate outstanding phenomena. By doing this way, the researcher points out some indispensable steps to create lease/own decision making process of CRE at BIDV. The detail contents in each step are based on the literature review discussed above and the objectives of the research. The final decision is made by the result of these steps and then, the conclusions for lease/own decision in real estate assets would be drew for BIDV in general. After defining research strategy and design, it is necessary to find appropriate

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

techniques for data collection and data analysis. 3. 4 Data collection In order to answer the question of the research mentioned above, the researcher will use secondary data. They are collected from various resources, including annual reports of bank, IPO document, journals and newspapers... Besides that, the study chooses a situation where a decision needs to be made to own or lease land located in Hung Yen branch – one of big branches of BIDV and to own or lease a part of Duc Long Gia Lai Tower in Gia Lai Branch. Some documents related to land price regulated by People's Committees are valuable resources. In addition, information on websites is collected carefully from official internet sources. 3. 5 Framework for data analysis 3. 5. 1 Building steps for decision making In order to answer the question, this dissertation adopts three steps for analyzing the options of leasing versus buying a real estate space. These three steps are based on the discussion of literature review, namely tactical analysis, financial analysis and real estate market analysis.

### **Step 1: Tactical analysis**

Almost decisions of buy or lease real estate assets happen in the two circumstances: a corporation requires new or additional space (expansion) or a corporation is currently leasing a satisfactory office space and has the opportunity to buy the space. Therefore, in the first step, operational flexibility, management control, initial capital outlay, tax shield are key considerations for firms to evaluate leasing or buying.- Operational flexibility: When it comes to real estate assets, operational flexibility involved in expansion, contraction and relocation. Leasing is normally higher operational flexibility than ownership, because the aspects of strategic reasons to lease

developed by Weatherhead (1997) discussed in the literature review: freedom to move, freedom to reduce the size of the estate if floor space needs to be reduced. However, buying ensures space for expansion and avoids restrictive term clauses of leasing contract. Characteristics of the facility required in the study of O'Mara (1999) such as specialized and customized needs, length of using property are also important factors to analyze. The operational flexibility to relocate and adapt to suitable space requirements is essential in changing business environments.- Management control: these content related to space remodeling and common areas. Ownership brings more management control than leasing, such as safeguarding location for plant, keep away from rent rises, control over management costs... (Weatherhead, 1997)- Initial capital outlay: the cost of purchasing and leasing is an essential factors to be considered. Leasing typically requires a lower initial cost than buying and hence, is preferred by corporations which would like to invest in their core business. Owning needs a significant initial capital outlay, therefore if corporations would like to occupy real estate assets by owning, they have to find sources of financing, for example debt or equity financing.- Tax shield: in terms of lease, occupancy cost are tax deductible and provide a higher tax shield than owning. Operating expenses, depreciation and interest rate are tax deductible in terms of ownership.

## **Step 2: Financial analysis**

This step is an important part of CRE lease/own decision making. The main mission of this step is to find the financial advantage of one choice over the other: the alternative that provides the needed space with the least net cost.

To determine this, corporations should apply the discounted cash flow techniques, such as NPV and IRR because they are taking account of the time value of money and opportunity cost of capital (Arnold, 2008). The cashflow of owning the property is generally generated by the initial cost of purchasing, managing cost of the property, depreciation and tax benefits. Meanwhile, the cash flow of leasing is generated by the monthly rent, leasing cost, operating expense and expected rental growth cost. Then, both cash flows are discounted by the required rate of return. The present value of the after-tax cost and benefits of owning the property is compared with the after-tax cost of leasing the space to determine which alternative is the least net cost and better.

### **Step 3: Real estate market analysis**

This section analyzes those factors that affect the supply and demand of specific type of space in the real estate market to examine "suspected under valuation of real estate" (Nourse and Kingery, 1987). Conducting this research is a crucial step in deciding own/lease property because corporations could define the real estate market conditions to be undervalued or overvalued at a particular period of time. Undervalued phases supports buying and overvalued phase supports leasing. If a firm purchase property that is undervalued, it is a good real estate investment. Besides that, if rental rates are expected to rise, buying the property is preferred and vice versa. Because these conclusions are vital for analysis, the data used to reach them must be carefully developed. The final decision is influenced by the result of the three steps above and can't be taken only one the basis of any single step. While tactical analysis help firms have initial

screening, financial analysis and real estate market analysis ensure that the best options have been studied in detail. Figure 3. 1: Three steps for CRE decision making3. 5. 2 Framework for data analysisData Collection

### **Secondary Data:**

Annual report of BIDVMagazinesNewspapersFormer researchInternet

### **Literature Review:**

Definition, functions and roles of CRECREM and the own/lease dicussions in previous studiesFactors determining the own/lease decision

### **Analyze current situation of using real estate assets at BIDV**

### **Apply the three steps for own/lease decision making with data collection**

### **Conclusions and Recommendations on using real estate assets at BIDV**

Figure 3. 2: Framework for the research3. 6 Ethical issuesThe author will follow all guideline before conducting a research. Ethical issues arise when conducting research, and gaining access to participants to collect, process and describe data. This research does not harm any participants once the data is presented and does not invade the privacy of organization and individual. 3. 7 LimitationsThe research is a large and complicated topic, so it is hard to cover all of fields in CRE decision making and go into detail. There has been not any significant work on using real estate asset of BIDV before. Moreover, the result of this research depends very much on the quality of data that are collected from official statistics, because all the data is secondary data. The research may not have enough valuable data to answer

some research questions qualitatively. CHAPTER 4: DATA ANALYSIS AND DISCUSSION

#### 4. 1 Introduction of BIDV

##### 4. 1. 1 History and operations of BIDV

Bank for Investment and Development of Vietnam, abbreviated as BIDV, was founded on 26/4/1957, with its head office at BIDV Tower, 35 Hang Voi Street, Hoan Kiem District, Hanoi City. As one of the largest commercial banks in Vietnam, BIDV has various fields of operation in finance, monetary, credit, banking services and non-banking services and products, for example: banking services (finance services, brokerage, loan syndication and advisory, modern, convenient banking products), insurance services (insurance, reinsurance and non-life insurance matched the overall package for customers of BIDV), securities (securities brokerage, investment and investment consulting services , portfolio management...), financial investments (security trading, invest in bonds, stocks ...), capital contribution with the aim to establish investment companies to the project. After 55 years of operating, BIDV has reached many awards in domestic and international. In 2011, BIDV was granted the " Top 20 Vietnam Strong Brand Name" Award 2011 and the " Top 20 Best-known brands of Vietnam". Besides that, in international awards, BIDV also reached " The 2011 International Star Award for Quality by the Business Initiative Directors Group" (BID), which acknowledges BIDV as one of the leading banks in Vietnam. All these awards have received high appreciation and recognition from the business community and the public in domestic and all over the world (<http://bidv.com.vn/>). 2012 marked sustainable development of BIDV by the strategic solution of equitization. As a state owned - commercial bank before, from now BIDV has become Joint Stock Commercial Bank. The Prime Minister issued Decision No. 2124/QD-TTg approved the equitization plan for BIDV on <https://assignbuster.com/building-steps-for-decision-making-finance-essay/>



30/11/2011. After that, on 28/12/2011, BIDV has succeeded in organizing Initial Public Offering auction at Hanoi Stock Exchange. After IPO, the State owned 95.76% of shares, staff and officers owned 0.56% and other shareholders owned 3.68% value of charter capital. The bank is officially converted from state-owned enterprise to joint stock company, changed its name as Joint Stock Commercial Bank for Investment and Development of Vietnam and has planned to begin trading on the Ho Chi Minh City Stock Exchange when the trend in the market will be clearer. (<http://bidv.com.vn/>)

4.1.2 Branch network BIDV is one of the three biggest commercial banks in terms of operation network spreading over 63 cities and provinces nationwide. As at December 31st 2011, BIDV's network consisted of 644 units including 118 branches (among which Ben Thanh and East Hai Phong Branches were launched into operation on January 1st 2012), 376 transaction offices, 150 savings counters and thousands of ATMs and POS transactions (see Figure 4.1). From 2009 to 2011, BIDV focused on network development in big cities and towns (such as Hanoi and Ho Chi Minh city) that having potential for retail banking network to encourage retail banking services. BIDV has gradually developed the network of transaction offices and savings counters. Along with the domestic expansion, BIDV opened the representative in Laos, Lao-Viet Joint Venture Bank's branch in Atapu, the Cambodia-Vietnam Securities Joint Venture Company (CVS); BIDV's branches in Ha Noi and Kampong Cham and the Finance Company in Czech Republic. These units bring the image of BIDV and promote trade, investment and tourism among Indochina countries as well as other countries in the region and all over the world. Figure 4.1: BIDV's traditional network 2009 - 2011 (Source: BIDV's annual reports)

Along with the network expansion, BIDV

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

has incessantly developed and improved its human resource quality. With more than 16. 000 employees at the head office, branches, subsidiaries and representative officers, BIDV always brings its customers the benefit and reliability. All of employees are well-qualified and well-trained with full experience, help them have the ability and capacity to work in a competitive market. Employees with graduate and post graduate of degree accounted for 86. 4% of BIDV's total workforce, an increase of 1. 1% compared to that of 2010. This is young labor, qualified and be defined as the long-term competitive advantage of BIDV. (<http://bidv.com.vn/>)

#### 4. 1. 3 Operational results and business situation in the period 2009-2011

After more than 50 years of development and growth, BIDV has built up total assets that continued growth in scale and improved in quality. In the period 2009-2011, total assets increased 26. 4%, with VND 296, 432 billion in 2009, VND 366, 267 billion in 2010 and VND 405, 755 billion in 2011 - rank 3rd in the banking system. The scale of operations gradually be expanded and the asset structure shifted to hold more liquidity assets. Besides that, credit quality was improved with the non - performing loan ratio has always been controlled under 3%. At the end of 2011, this ratio reached 2. 96%, lower than the industry average (3. 39%). Capital Adequacy Ratio (CAR) in 2011 reached 9. 2% complied with the regulation of the State Bank of Vietnam (when CAR is over 8%, it is considered international safe to the bank).

Together with the growth in scale, total operating income increased year by year, with profit before tax in 2009: VND 3, 605 billion, 2010: VND 4. 626 billion, 2011: VND 4, 220 billion. The structure of total operating income changed positively and mainly contributed by net interest income, fee and commission income, net gain from trading foreign currencies and other

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

income. Indeed, BIDV's fee and commission income (excluding net gain from trading foreign currencies) ranked top of the banking sector. The operating results of BIDV in the period 2009-2011 can be seen in the table and figure below:(Unit: billion VND)

## **Indicators**

**2009**

**2010**

**2011**

### **TOTAL OPERATING INCOME**

**10, 154**

**11, 488**

**15, 414**

### **TOTAL OPERATING EXPENSES**

**(4, 536)**

**(5, 546)**

**(6, 652)**

Profit before provisions for credit losses 5, 6185, 9428, 762

### **PROFIT BEFORE TAX**

**3, 605**

**4, 626**

**4, 220**

Tax(788)(865)(1, 020)

## **NET PROFIT AFTER TAX ATTRIBUTABLE TO THE EQUITY HOLDERS OF THE BANK**

**2, 817**

**3, 758**

**3, 200**

Table 4. 1: Business performance in the period 2009-2011(Source: BIDV's annual reports)(Unit: billion VND)Figure 4. 2: Business performance in the period 2009-2011(Source: BIDV's annual report)Profitability indicators on this period improved over the years and since 2009 all of them are at standard levels. In 2011, Return on assets (ROA) reached 0. 83%, Return on equity (ROE) reached 13. 16%, Net interest margin (NIM) reached 3%. In two years 2009-2010, ROA has improved over the years and fully achieved the target for 2010, increasing from 1. 04% in 2009 to 1. 13% in 2010. ROE slightly reduced because of the chartered capital injection from the Government. By the end of 2010, the chartered capital reached VND 14, 600 billion, increasing by 39%. NIM has increased year by year, with 3% in 2011 (compared to 2. 61% in 2009 and 2. 9% in 2010) since net interest income higher than total earning assets. BIDV's profitability indicators from 2009 to 2011 are shown in the table and figure below:

## Indicators

**2009**

**2010**

**2011**

ROE18.11%17.95%13.16%ROA1.04%1.13%0.83%NIM2.61%2.

9%3%Table 4. 2: Profitability indicators in the period 2009-2011(Source:

BIDV's Audited consolidated financial statements)Figure 4. 3: Profitability

indicators in the period 2009-2011(Source: BIDV's Audited consolidated

financial statements)To conclude, despite of many challenges in the business environment, BIDV has maintained its sound performance over the years.

This success was contributed not only by the income from operating

activities but also from well-controlled credit quality and the reduction in

provisions for credit losses within the years, therefore help to improve the

bank's profitability. 4. 2 Vietnam's real estate market in banking crisisA few

years ago, Vietnam is one of the world's hottest emerging markets that

attracting many foreign and domestic investors. But now it is facing huge

impacts from financial and banking crisis. Companies that unable to pay

back debts, many of them are inefficient state-owned companies, have

increased non-performing loans of the banking system at a high speed and

left banks weakened. According to the State Bank of Vietnam, non-

performing loans of the banking system could be as high as 10% of all

outstanding loans, considerably higher than reported by individual banks.

Economists think the proportion is much higher and could reach to 15% (Wall

Street Journal, 2012). In addition, the health of the banking system

intensified when Nguyen Duc Kien, one of the most Vietnamese well-known

tycoons, was arrested in August for alleging improperly lending money to real estate projects. The government made efforts to calm down the market and people, but it was unsuccessful. Stocks dropped in the days following the arrest, and the property-related stocks have been selling quickly after state media reports real estate developers are trying to cut prices to push the amount of transactions of apartments. It negatively impacted on the prestigious of large banks. Besides that, Vietnam has tackled many problems from economic exposure. Until 2010, the economy had been growing by around 7% on average, lifting Vietnam to World Bank " middle-income" and is predicted that it would follow countries for example Singapore or Malaysia to become one of the Asian tigers. But growth was just over 4% in the first half of 2012, its most sluggish rate for three years. According to the International Monetary Fund, real GDP growth is expected to slow to 5. 1% in 2012, from 5. 9% in the previous year (Global Property Guide, 2012). With this grow rate, the average incomes are still low, along with the double - digit inflation which outstrips growth and stabilizing its currency, the economy is in a mess. A large number of firms are announcing bankruptcy, and in the spreading urban areas in Hanoi and Ho Chi Minh city, the landscape was covered with litter of delayed construction projects since investors run out of cash or demand for apartments and office spaces dropped off. With such these problems above, the Vietnamese real estate market is in freefall. Piles of bad loans following the financial crisis drew down economic growth and left banks weakened and reluctant to lend. Meanwhile, the capital for real estate projects mainly depended on bank loans and income of people who invest. So when the economic growth down and restricted loans of real estate sector from banking system, the real estate market has got frozen

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

with very few transactions, while investors run away, leaving the market in the oversupply status. Recent statistics show astonishing number of unsold housing units in the two biggest cities of Vietnam: in Hanoi, the number of unsold apartments is about 40, 000 units, and this number is 20, 000 units in Ho Chi Minh City (Global Property Guide, 2012). Many residential projects have stalled in mid-construction and property developers have delayed launching their real estate projects. It was estimated that billions of dollars has been buried under real estate projects. So if production and business are in difficulty, bad debts of business increase, along with the difficulties in the property market, make huge impact on many related industries such as construction, building materials, steel industry... it will also affect the safety of the banking system and the overall economy. Economists concern that Vietnam has entered a downward cycle when banks, responsible with bad debts, are unwilling to lend, making it harder for business and developers invest. That make economy into slower growth, which in turn makes companies, especially real estate companies harder to pay back loans, again cause difficulties for the banks. Moreover, property prices dropped sharply affecting the value of collateral, and contributing to some increase in non-performing loans. In this current situation of real estate market in Vietnam, the banking system, include BIDV, are facing many difficulties and risks in their business operations, especially loans in real estate sector. 4. 3 Overview of using fix assets and real estate assets in BIDV. 3. 1 The fix assets' characteristics of BIDV. BIDV is one of the top commercial banks in Vietnam with operation network spreading over cities and provinces nationwide. Therefore, the assets used for business operations have relatively large-scale and types of them are diversified. Besides that, since <https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

the core business are financial services and banking services, the assets support for business operation of BIDV are mainly means of transportation, information technology software, office equipments and other equipments, apart from land and buildings which represent high proportion in total assets. The proportion of information technology assets have increased gradually since BIDV modernized the banking system in 2003. Currently, BIDV is considered as modern information technology banking system which covered almost business activities, centralized database and transaction online. The other assets are high quality and synchronous. The scale and structure of the main fixed assets of BIDV are shown in the table below:(Unit: billion VND)

## **Types of fixed assets**

**31/12/2009**

**31/12/2010**

**31/12/2011**

Fixed assets costs  
Depreciation to fixed assets ratio  
Proportion  
Fixed assets costs  
Depreciation to fixed assets ratio  
Proportion  
Fixed assets costs  
Depreciation to fixed assets ratio  
Proportion



## **Tangible fixed assets**

**3048**

**0.47**

**78%**

**3664**

**0.47**

**67%**

**4017**

**0.52**

**67%**

Buildings and building improvements 10880. 2328% 13190. 2224% 14060.

2623% Machinery and equipment 15420. 6039% 17390. 6532% 19800.

6833% Means of transportation 3840. 6410% 5680. 4910% 5850.

5910% Others 340. 531% 380. 581% 460. 591%

## **Intangible fixed assets**

**880**

**0. 21**

**22%**

**1780**

**0. 12**

**33%**

**2006**

**0. 16**

**33%**

Land use rights6610. 0317%15320. 0228%17040. 0328%Computer  
softwares2190. 745%2480. 755%3020. 865%

**Total**

**3928**

**0. 41**

**100%**

**5444**

**0. 36**

**100%**

**6023**

**0. 40**

**100%**

Table 4. 3: The scale and structure of the main fixed assets of BIDV in the period 2009-2011(Source: BIDV's Audited consolidated financial statements in 2009-2011)The numbers in the table above represent:- In terms of scale of fixed assets, in recent years BIDV has increased investment in facilities, equipments for banking modernization. Therefore, the scale of fixed assets grew dramatically, total fixed assets in 2009 reached VND 3, 928 billion, 2010: VND 5, 444 billion, 2011: 6, 023 billion - a 53% increase compared to 2009.- In terms of structure of fixed assets, tangible fixed assets represented high proportion in total fixed assets but tended to decrease, for example the tangible fixed assets in 2009 reached VND 3, 048 billion -represented 78%, in 2010 reached VND 3, 664 billion, represented 67% and in 2011 reached VND 4, 017 billion represented 67% in total fixed assets. The real estate assets to total fixed assets ratio would be between 45-52%. The structure of fixed assets shifted to increase investment in intangible fixed assets,

particularly in land use rights. This is appropriate with network development strategy of BIDV to encourage retail banking services in this period. The structure of fixed assets is shown in the figure below: Figure 4. 4: The structure of fixed assets of BIDV in the period 2009-2011(Source: BIDV's Audited consolidated financial statements in 2009-2011)- The depreciation to fixed assets ratio: this ratio is usually calculated as  $\frac{\text{Depreciation}}{\text{Fixed assets costs} - \text{Land}}$ , but in the case of BIDV, some land allocated by the State (belong to BIDV's ownership) in a particular period of time, therefore it has been depreciated like other fixed assets. The depreciation to fixed assets ratio of BIDV decreased over the years, indicated that almost BIDV's current fixed assets have a long useful life and therefore, unnecessary to be replaced quickly. The value range of this ratio is among 0 and 1, and the depreciation to fixed assets ratio of BIDV fluctuated between 0.36-0.41 shows that almost fixed assets are new and BIDV focused on investment in the fixed assets which have less depreciation values (long-life assets), such as land and buildings.

#### 4. 2. 2 Overview of the situation of using real estate assets at BIDV

At the end of the year 2011, total land area is managed and used by BIDV is 420, 833 m<sup>2</sup>. The premises are being used (or under construction for office use) to be office buildings, transactions, public accommodation for head office and branches. They are listed in details:- The area of leased land paid in a lump-sum: 36, 749 m<sup>2</sup>, in 14 locations.- The area of land allocated by the State (BIDV's ownership): 60, 203 m<sup>2</sup>, in 49 locations.- The area of land transferred land use rights (BIDV's ownership): 32, 820 m<sup>2</sup>, in 59 locations.- The area of land lease payment, and other types of land: 291, 061 m<sup>2</sup>, in 171 locations, (Prospectus of IPO BIDV, 2011). Moreover, the land ownership of BIDV has increased dramatically from 2009

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

to 2011 in terms of value, especially in 2010 with VND 1532 billion, or an increase 131% in comparison with that in 2009 (see Table 4. 3). Almost buildings for business operation are constructed by BIDV, and therefore belong to BIDV's ownership. Besides the head office at BIDV Tower, 35 Hang Voi Street, Hoan Kiem District, Hanoi, along with the operation expansion, BIDV has built more and more buildings for branches. At the end of 2011, BIDV's operation network spreading over cities and provinces nationwide with 118 branches. In terms of value, buildings and building improvements increased gradually over 3-year period, from VND 1, 088 billion in 2009 to VND 1, 319 billion in 2010 and VND 1, 406 billion, or a 29. 2% increase in 3 years (see Table 4. 3). Besides that, about 80% of branches currently occupy approximately between 2500-3000m<sup>2</sup> with 5-7 floors of space. Each one is an operational resource, forming the interface of BIDV with customers, providing the place to support the profit generating business activities and advertising the brand. All of them were equipped with technical system, such as air-conditioning system, camera, fire alarm, intrusion alarm, computer network and telephone network. The specification of each unit has to be standardized modern banking and sufficiently high for business activities. The smaller offices are transaction offices, and most of them are between 300-600 m<sup>2</sup> in size. They also were equipped with technical system, for example air-conditioning system, camera, fire alarm, intrusion alarm, computer network and telephone network and all are standard in the transaction offices. However, transaction offices only be constructed and owned by BIDV once they have potential to expand business operations to become branches. Therefore, most of transaction offices are operating lease assets. The office rental (including cost of leased land and buildings) raised

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

gradually from 2009 to 2011, with VND 224 billion in 2009, VND 363 billion in 2010, and VND 442 billion in 2011 (BIDV's audited consolidated financial statements). The office rental and land and buildings owned by BIDV as shown in the figure below:(Unit: billion VND)Figure 4. 5: The formation of real estate assets in BIDV in a period 2009-2011(Source: BIDV's Audited consolidated financial statements in 2009-2011, Prospectus of IPO BIDV, 2011)This figure illustrates that land and buildings ownership outstripped the office rental in 3 years, with the book value of land and buildings ownership was VND 3, 110 billion in 2011compare to VND 442 billion of the office rental. Besides that, land and buildings ownership and the office rental increased over 3 years show that BIDV has gradually developed the operation network and the costs for real estate occupation also raised. Therefore, choosing the appropriate real estate assets occupation – own or lease is an important part of real estate asset management and the business strategy of BIDV, because these decisions are not simple financial considerations but involved in many qualitative aspects of real estate decision-making.

#### 4. 3 Overview of the situation of managing some assets related to real estate

As a financial intermediary, besides owning real estate assets by using equity or debt financing like other corporations, BIDV also provides loans, part of them are real estate loans which real estate play as a role of property collateral. In this difficult situation of real estate market, when the price of property dropped out and the real estate companies having troubles since the market has got frozen, such loans to real estate companies have " hidden risks". A decline in the price of real estate will decrease bank capital directly by reducing the value of banks' own real estate assets, and indirectly by reducing the value of loans collateralized by

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

real estate. Furthermore, a decline in real estate prices is likely to reduce the costs of default and increase the perceived risk of real estate lending. As a result, real estate lending will decline, putting even more downward pressure on real estate prices, which in turn feeds back to bank lending, etc. As the banking sector weakens, banking supervision and regulation may reinforce this process by increasing capital requirements and instituting stricter rules for classifying and provisioning against real estate loans, squeezing further lending to real estate investors (Collyns, C. and Senhadji A., 2002). The case of Song Da Thang Long Joint Stock Company is an outstanding example. In 2009, it had loans from BIDV for the real estate project of 13-tower U-Silk City development in Hanoi's suburbs. In this period, the project was at the height of Vietnam's property boom but quickly fell victim to the subsequent property slump and soaring interest rates. In July, it secured an additional loan of 300 billion dong, or around \$14 million, from BIDV to help complete its sprawling. Song Da Thang Long is among the local developers that have struggled with its stock price has fallen about 60% in the past six months, and this additional loans may not enough for the project alive. BIDV, in turn facing with the fear of repayment risks. For the broader view, real estate loans of BIDV in the period 2009-2011 decrease slightly. The loan portfolio at year-end comprises loans to entities in industrial sectors is shown in the figure below: Figure 4. 6: The loan portfolio in industrial sectors in BIDV in the period 2009-2011(Source: BIDV's Audited consolidated financial statements in 2009-2011, Prospectus of IPO BIDV, 2011)In this figure, the proportion of loans in real estate sector decreased significantly from 27% in the total loans in 2010 to 14% in the total loans in 2011. Meanwhile, the proportion of loans in this sector slightly increased from 2009 to 2010 (23% <https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

and 27% in the total loans respectively). This is appropriate for the trend because 2009-2010 is the period of Vietnam's real estate boom. But in the period 2010-2011, credit structure is gradually shifting to the field of high profitability, such as whole sale and retail trade, manufacturing and processing, electricity, petroleum... and restrict lending in high risk areas, for example construction industry. This is due to the difficulties in the real estate market and economic exposure. Some real estate loans has been restructured and limited offering new ones.

4. 5 The case study of own/lease decision in corporate real estate in BIDV In order to bring a clearer view in detail, the researcher would like to present two particular projects of a buy or lease real estate asset analysis in some branches of BIDV. The three steps for CRE decision making stated in Chapter 3 will be applied for analyzing.

4. 5. 1 Case study 1

#### **4. 5. 1. 1 Case study presentation**

For several years, BIDV Hung Yen Branch had been leasing land at Nhu Quynh town, Van Lam, Hung Yen province with 5, 708 m<sup>2</sup> in size. The length of lease term was 50 years, the land payments were VND 3, 600/m<sup>2</sup>/year and the landlord is the State. A part of the land was used as the Van Lam transaction office and BIDV had a plan to build the Central Storage in the rest of the land. Recently, the landlord (the State) showed the willingness to sell the asset, and after the negotiation, a price of VND 13. 7 billion was agreed. However, the BIDV Head Office still had to approve this purchase and therefore, consultants would be appointed to advise on the lease or buy decision. This consideration is analyzed in the three steps, namely tactical analysis, financial analysis and real estate market analysis.



#### **4. 5. 1. 2 Tactical analysis**

In this step, the researcher will consider the qualitative aspects in the lease v buy decision that discussed in the previous chapters.- Operational flexibility: physically, the land was in good and convenient location: it was located at the junction of three roads in the center of Van Lam District, about 200m from National Highway 5, not far from Hanoi (about 17-18km). The site had two broad front, one side borders on the district center with 102. 5m length, the other side borders on the town road with 37. 5m length, which was appropriate for banking offices. Moreover, Van Lam District was a central place in this region and also had crowded people, many enterprises and business households. Therefore, the site was ideal for banking business operation and it was correctly zoned for its current use (used for Van Lam transaction office of BIDV Hung Yen branch). If BIDV continue to use this location by leasing, it only use the land for transaction office and constructing the Central Storage, not have the rights of ownership. In reverse, if this land is owner-occupied by BIDV, apart from using it for transaction office and Central Storage, BIDV could utilize it for joint-venture, mortgage, lease... It is potential for long-term development opportunities, and in the case BIDV sell it to others, the price would be based on the transfer price in the area. Besides that, the land was in unique location: similar land with good location and large space in the market area had low vacancy and it was common cause that this type of land was hard to acquire. The expansion will be also easier if BIDV owns this asset. Clearly, ownership provides more operational flexibility for BIDV because it allows BIDV to adapt to suitable space requirements when business environments change rapidly.- Management control: in the case of ownership, it brings more management

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

control for BIDV than leasing. For example, BIDV will have safeguarding location for plant, keep away from rent rises (expected to raise 12% per annum), control over management costs (Weatherhead, 1997). It is more simple for space remodeling if BIDV has a plan to expand business operations of Van Lam transaction office to become branch. Another important factor is the level of occupancy: BIDV had fully occupied the asset and the length of lease term was 50 years – a long time lease so the ownership is preferred.- Initial capital outlay: the lease payment was VND 20. 548 million per annum (calculated as:  $3,600 \times 5,708 = 20,548,000$  VND), whereas the initial capital outlay of buying is VND 13.7 billion – require a much higher initial cost than leasing. For that reason, if BIDV would like to invest in its core business instead of buying this asset, leasing is a favoured choice. However, with the operating network development strategy and improved business performance in the period 2009-2011, BIDV can afford to buy this asset through equity financing.

#### **4.5.1.3 Financial analysis**

In this section, the researcher will find the financial advantage of each choice over the other to find the alternative with the least net cost by discounted cash flow analysis, using NPV method. It was pointed out that this is a long-term project (need for a fifty - year discounted cash flow analysis), therefore it was difficult to forecast in the long term without extensive scenario modeling, which was beyond the scope of the research. However, the cash flow projections were based on a set of fixed escalating variables, with no structural changes and consequently the financial outcome was not depended on the analysis period. The recommendations do not differ if this is

a longer period project. As discussed in the previous chapters, operating expenses, depreciation and interest (in the case of using debt financing) are tax deductible if real estate asset is owner-occupied. Nevertheless, BIDV used equity financing in this project and the subject property is land – a very long life asset, therefore interest and depreciation in this case will not exist and not be calculated in this project. Moreover, operating expense happens in both case of leasing and ownership so the researcher will skip this factor in analyzing to find the alternative with least net cost. For these reasons, only lease payments are tax deductible in the case of leasing. Because BIDV will use equity capital to finance this project, the cost of capital of this case study (the discount rate) is the cost of equity capital. The cost of equity capital is estimated by a return equal to the risk-free rate (usually taken to be that on government securities) and the risk premium, which rises with the degree of systematic risk (Arnold, 2008): Rate of return on shares = Risk-free rate + Risk premium  $K_e = r_f + R_P$  To estimate the relevant risk premium, the researcher will express it as the difference between the average market return,  $r_m$ , and the risk free-rate of return,  $r_f$ , that is  $(r_m - r_f)$  with adjusted average risk level ( $\beta$ ). Therefore, the cost of capital calculation of this case study will be reflected by using Capital Asset Pricing Model (CAPM):  $K_e = r_f + \beta (r_m - r_f)$  For each project, how high the discount rate has to be depends on the measures of risk and return of this project and is based on managerial judgement. In this case study, because in 2012, the return on Vietnam government bonds with a maturity of 2-5 years are about 10%, therefore the risk-free rate is 10% ( $r_f = 10\%$ ). For practical use the researcher will take the average market return of 15% ( $r_m = 15\%$ ). Because the project of leasing land from the State is less sensitivity to general market movements (also <https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

means that it is less risky), the beta for this case study should be 0.8 ( $\beta = 0.8$ ). Therefore, the cost of capital for this case study is:  $K_e = r_f + \beta(r_m - r_f) = 10\% + 0.8(15\% - 10\%) = 14\%$ . This is the discount rate BIDV should use for this project. Assuming rent escalation of 12% per annum ( $k = 12\%$ ), tax rate is 28% ( $t = 28\%$ ), discount rate calculated above is 14% ( $r = 14\%$ ), BIDV had been leasing this asset since 2010 and the land payments hasn't changed in 3 years, were VND 20.548 million ( $m = 20,548,000$ ), the cash flow projections in each case are seen as below: BIDV CONTINUE TO LEASE: (Unit: VND)

**Year**

**Points in time**

**Annual rent escalation factor ( $k = 12\%$ )**

**Cash flow**

**Tax shield ( $t = 28\%$ )**

**Cash flow after tax**

**Discounted factor**

**( $r = 14\%$ )**

**Discounted cash flow after tax**

2010-220,548,000  
20,548,000  
5,753,440  
14,794,560  
 $\times 1.142$

19,227,010  
2011-120,548,000  
20,548,000  
5,753,440  
14,794,560  
 $\times 1.14$

16,865,798  
2012-20,548,000  
20,548,000  
5,753,440  
14,794,560  
 $\times 1.12$

20,548,000  
5,753,440  
14,794,560  
 $\times 1.12$

23,013,760  
6,443,853  
16,569,907  
 $\times 1.14$

16,569,907  
 $\times 1.14$

=0

14, 535, 0062014220, 548, 000\*1. 122(= m(1+k)2)25, 775, 4117, 217,  
11518, 558, 29618, 558, 296/1. 142

=

14, 280, 0062015320, 548, 000\*1. 123(= m(1+k)3)28, 868, 4618, 083,  
16920, 785, 29220, 785, 292/1. 143

=

14, 029, 480

...

...

...

...

...

...

...

...

20604720, 548, 000\*1. 1247(= m(1+k)47)4, 226, 847, 9211, 183, 517,  
4183, 043, 330, 5033, 043, 330, 503/1. 1447

=

6, 439, 040

**Total****20, 548, 000\*2+m****39, 320, 443, 267****11, 009, 724, 115****28, 310, 719, 152****19, 227, 010+16, 865, 798+****m(1-t))****518, 796, 502**

Table 4. 4: Annual after – tax cash flow in the case of leasingAs illustrated in the table, the total cost after tax of leasing the land is 518, 796, 502 VND, discounted to present value at the discount rate 14%. In the case of owning this asset, BIDV have to pay off the amount of 13, 700, 000, 000 VND, larger than the amount of leasing 518, 796, 502 VND. However, the transfer price at the market area is VND 5, 000, 000/m<sup>2</sup>, therefore the total cost BIDV have to pay if buy the asset at the market area is calculated as: 5, 000, 000\*5, 708= 28, 540, 000, 000VND (> 13, 700, 000, 000), greater than 52% compared to buying it from the State. For that reason, if BIDV use the asset for long-term development and see this asset as investment, BIDV should buy this asset because of its potential residual value. In reverse, leasing is the favoured choice.

**4. 5. 1. 4 Real estate market analysis**

In this section, the researcher will examine the real estate markets to find if they are undervalued or overvalued phase. Undervalued phase supports buying and overvalued phase supports leasing. Recently, the real estate

market in Vietnam has been facing many difficulties. The Governor of the State Bank of Vietnam (SBV) issued an Official Document No 674/NHNN-CSTT dated 13/02/2012 on credit operation in 2012. Indeed, the Governor asked for tightly controlling the outstanding loans of non-manufacturing sector of the total outstanding loans not to exceed 16% for the whole year, applied by all branches of oversea banks and credit institutes. Real estate was one of the three main sectors to control. The inaccessibility of corporations to bank loans had a huge impact on the market. Besides that, the recession of economy was exposing difficulties and challenges to the real estate market. Product stagnation, lowest GDP growth, increasing inventories, especially building materials... all of these factors were worsening in the eyes of domestic and foreign investors. For these reasons, the real estate market of Vietnam has been prolonged recession. The troubles and difficulties of real estate market has been continued to happen. According to Mr Nguyen Trong Ninh, Deputy Director of Housing and Real Estate Market Management Department under the Ministry of Construction, at the Conference on " Real Estate Market 2012 - Opportunity in Crisis" held by the Business Forum Newspaper said: The property market still has six problems to be solved before thinking of a recovery (VCCI news, 2012). The biggest problem is institution, policy and legal documents. Recently, Vietnam's real estate market has about 10 laws, and it developed strongly but not associated with specific strategies and plans, leading to serious imbalance in supply and demand. These troubles and difficulties of this market were clearly reflected by the performance of property market with 350 trading floors were almost unoccupied. This is due to the gridlock between primary investors and buyers, primary investors want to sell as soon as possible whereas buyers

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

keep watching for lower prices. This situation brings the state of freeze to the real estate market. Property prices are somewhere at the bottom, many organizations are restructuring their portfolios and withdrawing from the real estate field. For instance, Hoa Sen group has withdrawn from three big real estate projects to focus on its core tasks of steel manufacturing since 2011, or PetroVietnam, the state's flag on oils and gas sector, also quit investing in many real estate projects to come back to its core fields (CBRE Vietnam, 2012). In addition, secondary investors withdrew step by step and capital shortage (because of inaccessibility to bank loans) enforced many real estate projects to stop or come to delay construction. However, according to many experts, this difficult period is a chance for organizations and investors to restructure business operations, look at business objectives and strategies to approach the market in a more flexible manner (VCCI news, 2012). There are some indicators of economic stimulus measures, and this is the basis of property market recovery. The plan of developing housing development savings fund and housing lending savings fund submitted to the Prime Minister in April is expected to leverage the market. Besides that, to resolve troubles facing the real estate market, the State Bank of Vietnam (SBV) officially lowered deposit rate ceiling twice in a month to 12 percent per annum on April 11. This is the basis for lending rates to fall down, to help firms easily access to bank loans for dealing with capital shortage. Besides, banks have expanded credits for many sectors. Moreover, basing on the development cycle of property market, after 3-4 years of recession (since 2007-2008), the real estate market may begin a new growth cycle.

Macroeconomic performances are improving and stabilizing. This will help the real estate market to develop. With this situation in the real estate

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>



market in Vietnam, the undervalued phase of the market support for buying real estate decision of BIDV, because for a longer-holding period, it may bring many benefits for BIDV in the future, such as residual value when BIDV resale the property. Based on the 3 steps analysis for CRE decision making above, the recommendation for BIDV in this situation is that the bank purchase the property asset at the negotiated price of VND 13.7 billion. After the buying is completed, BIDV will control the asset that is strategically important to its core business operations, no longer consume more money than is necessary and have a chance of residual value when BIDV resale the asset.

#### 4.5.2 The case study 2

### **4.5.2.1 Case study presentation**

For several years, BIDV Gia Lai Branch had been leasing 2 floors of Duc Long Gia Lai Tower at 117-119-121 Tran Phu, Pleiku City, Gia Lai province with 238m<sup>2</sup> in size and the landlord is Duc Long Gia Lai Joint Stock Company. The 2 floors of the building were used for Thanh Cong transaction office of BIDV Gia Lai Branch. Recently, BIDV has a plan of network expansion in Gia Lai province: establish the Southern Gia Lai Branch. BIDV Head Office realized that Duc Long Gia Lai Tower is appropriate for establish new branch in this area and considered the lease or buy decision of this asset. Meanwhile, the landlord (Duc Long Gia Lai Joint Stock Company) showed the willingness to sell a part of Duc Long Gia Lai tower with the negotiated price of VND 180,021 million in 9,246 m<sup>2</sup> in size, consisting of 13 floors and 01 basement. In the case of leasing, the lease payment per annum in the first five years is VND 18,170 million. However, the BIDV Head Office still had to approve this purchase and therefore, consultants would be appointed to advise on the

lease or buy decision. This consideration is analyzed in the three steps, namely tactical analysis, financial analysis and real estate market analysis

#### **4. 5. 2. 2 Tactical analysis**

In this step, the researcher will consider the qualitative consideration in the lease v buy decision that discussed in the previous chapters.- Operational flexibility: physically, Duc Long Gia Lai Tower was in convenient location: it was located in the commercial center of the Pleiku City, with heavily populated areas and big business, next to the administrative area of the province. The building has three broad front: side borders on Tran Phu, Dinh Tien Hoang, Cu Chinh Lan Street which was the main street of the city and has convenient transportation, appropriate for banking offices. Besides that, Duc Long Gia Lai Tower is the tallest building in Pleiku city and considered as the highlight and outstanding project of the city. If BIDV locates its new branch in this Tower, it is suitable to advertise the image and brand of BIDV in this area. The site was ideal for banking business operation. Therefore, if BIDV use this location by leasing, it may have restrictive term clauses of leasing contract, not have the right of ownership. For particular needs of banking transactions, the tower need renovation and repairs in technological infrastructure and specific facilities, such as constructing vault, elevator loads of money, the fire alarm system... and they will be constructed in the case of BIDV own this asset. Besides that, the tower was in unique location: similar building with good location and large space in the market area had low vacancy. Therefore, it is better to own properties which support for specialized activities and require large investment and special design (O'Mara, 1999), like Southern Gia Lai Branch of BIDV.- Management control:

in the case of ownership, it brings more management control for BIDV than leasing. For example, BIDV will have safeguarding location for plant, keep away from rent rises (expected to raise 5% per five years), control over management costs (Weatherhead, 1997). It is more simple for space remodelling if BIDV has a plan to expand business operations. Another important factor is the level of occupancy: BIDV had fully occupied the asset and the length of lease term was 50 years – a long time lease so the ownership is preferred.- Initial capital outlay: the lease payment was VND 40.832 million per annum for the first five years, whereas the initial capital outlay of buying is VND 180,021 million – require a much higher initial cost than leasing. For that reason, if BIDV would like to invest in its core business instead of buying this asset, leasing is a favoured choice. However, with the operating network development strategy and improved business performance in the period 2009-2011, BIDV can afford to buy this asset through equity financing.

#### **4. 5. 2. 3 Financial analysis**

In this section, the researcher will analyze financing alternatives of each choice over the other to find the alternative with the least net cost by discounted cash flow analysis, using NPV method. It was pointed out that this is a long-term project (need for a fifty - year discounted cash flow analysis), therefore it was difficult to forecast in the long term without extensive scenario modeling, which was beyond the scope of the research. However, the cash flow projections were based on a set of fixed escalating variables, with no structural changes and consequently the financial outcome was not depended on the analysis period. The recommendations do not differ if this is

a longer period project. As discussed in the previous chapters, operating expenses, depreciation and interest (in the case of using debt financing) are tax deductible if real estate asset is owner-occupied. Nevertheless, BIDV used equity financing in this project and operating expense happens in both case of leasing and ownership so the researcher will skip this factor in analyzing to find the alternative with least net cost. For these reasons, in the case of ownership depreciation is tax deductible and lease payments are tax deductible in the case of leasing. In this case study, because BIDV will use equity capital to finance this project, the cost of capital of this case study (the discount rate) is the cost of equity capital. The cost of equity capital is estimated by a return equal to the risk-free rate (usually taken to be that on government securities) and the risk premium, which rises with the degree of systematic risk (Arnold, 2008): Rate of return on shares = Risk-free rate + Risk premium

$$K_e = r_f + \beta(r_m - r_f)$$

To estimate the relevant risk premium, the researcher will express it as the difference between the average market return,  $r_m$ , and the risk free-rate of return,  $r_f$ , that is  $(r_m - r_f)$  with adjusted average risk level ( $\beta$ ). Therefore, the cost of capital calculation of this case study will be reflected by using Capital Asset Pricing Model (CAPM):  $K_e = r_f + \beta(r_m - r_f)$

For each project, how high the discount rate has to be depends on the measures of risk and return of this project and is based on managerial judgement. In this case study, because in 2012, the return on Vietnam government bonds with a maturity of 2-5 years are about 10%, therefore the risk-free rate is 10% ( $r_f = 10\%$ ). For practical use the researcher will take the average market return of 15% ( $r_m = 15\%$ ). Because the project of leasing this building from Duc Long Gia Lai Joint Stock Company is more risky than leasing land from the State in case study 1, the beta for this case study

<https://assignbuster.com/building-steps-for-decision-making-finance-essay/>

should be 2.2 ( $\beta = 2.2$ ). Therefore, the cost of capital for this case study is:  
 $K_e = r_f + \beta(r_m - r_f) = 10\% + 2.2(15\% - 10\%) = 21\%$  This is the discount rate  
 BIDV should use for this project.\* Option 1: BIDV own the asset Based on the  
 pricing email of Duc Long Gia Lai Joint Stock Company, the total cost of  
 owning a part of the Duc Long Gia Lai Tower is VND 180,021 million and has  
 been shown in this table below: (Unit: million VND)

## Size(m<sup>2</sup>)

## Price

## Total cost

Basement 819119,009  
 The first floor 8415042,050  
 Other floors 7,58617128,962

## Total

**9,246**

**180,021**

Assuming straight-line depreciation over 25 years on a building value of VND 100 million (the cost of buying this asset is VND 180,021 million includes the building value of VND 100,000 million and the land value of VND 80,021 million), therefore the depreciation of each year in 25 years is VND 4 million (calculated as  $100,000/25 = 4,000$  million VND). Because depreciation is the tax shield and the researcher do the analysis on after tax basis to eliminate tax implications, the net present value of cost of ownership is calculated as below:  $180,021 - + + + \dots + = 174,733$  (million VND) (Detail of the tax shield of depreciation see Appendix II) It could be concluded that the total cost after tax of ownership is 174,733 million VND, discounted to present

value at the discount rate 21%.\* Option 2: BIDV lease a part of the tower Assuming rent escalation of 5% per five years ( $k=5\%$ ), discount rate is 21% ( $r=21\%$ ), tax rate is 28% ( $t=28\%$ ), BIDV had been leasing this asset since 2013 and the land payments per annum in the first five years is VND 40.832 million ( $m=40.832.000$ ), the cash flow projections in each case are presented in the Appendix III. According to this, the total cost after tax of leasing the land is VND 174,860.28 million, discounted to present value at the discount rate 21%. Compare to the case of owning this asset, BIDV have to pay off the amount of VND 174,733 million, smaller than the amount of leasing VND 174,860.28 million. Moreover, by owning the asset, BIDV has the right to sell it and can gain residual value. For that reason, BIDV should buy this asset.

#### **4.5.2.4 Real estate market analysis**

Analysis in this section is similar in the section of case study 1. Based on the 3 steps analysis for CRE decision making above, the recommendation for BIDV in this situation is that the bank purchase the property asset at the negotiated price of VND 180,021 million. After the buying is completed, BIDV will control the asset that is strategically important to its core business operations, no longer consume more money than is necessary and have a chance of residual value when BIDV resale the asset.