



Foreign Investment in the Lao Real Estate Market: A Case Study



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The Lao PDR is one of the poorest nations of the world, with 40 percent of the population living below the poverty line. The pressures on the Lao government to alleviate this problem are great, making private and foreign investment a very desirable option for contributing to economic growth. However, for a communist country that only just began its transition towards a market economy in 1986, the use of foreign capital is extremely new (*Signasaith, 1995*). Laos will face many challenges in developing its policy for handling foreign investment in a way that is most optimal for the country. In this paper, I examine a hotel development that is currently under construction in the Lao capital of Vientiane. This project illustrates many of the problems and benefits that foreign investment can bring in an emerging real estate market.

Methodology

Information about the hotel project was gathered primarily through a series of interviews conducted in early January 2004 in Vientiane as part of the Massachusetts Institute of Technology's annual Special Interest Group in Urban Settlement (SIGUS) workshop. Interviews and meetings were held with local residents including the village chief, three Lao government agencies, a French NGO, and the general manager for the development. All research was conducted as a team consisting of members from the Massachusetts Institute of Technology (Cambridge, USA), the National University of Laos (Vientiane, Lao PDR), and Oxford-Brookes University (Oxford, UK). Resident interviews were conducted in Lao and translated for the non Lao-speaking members of my team.



*Harddonechan (or "Don Chan")
Island in the middle of the Mekong.*



PART I: AN UNPRECEDENTED REAL ESTATE DEVELOPMENT PROJECT IN VIENTIANE

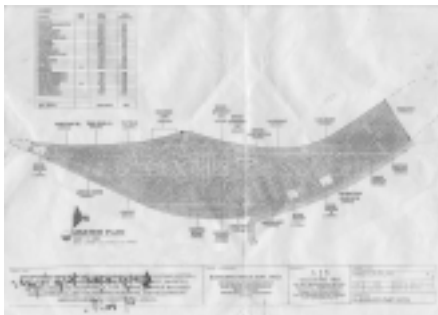
The Setting

The site of the project is Harddonechan Island, which is located in the Mekong River near Vientiane's central business district. The island itself measures six kilometers long and two kilometers wide. 82 households, or about 400 people, currently live on the island. Thatkhao Village includes Harddonechan as well as the community living on the riverbank across from the island. Though located very much in the center of the city, its slight separation allows for a more serene and less polluted atmosphere that the residents value.

Access to the island is via a narrow steel bridge, suitable for motorbikes and pedestrians. Harddonechan is supplied with both electricity and non-potable water through aboveground lines that run alongside the bridge. The bridge and the original water system, the first of its kind in Laos, were constructed during the French Colonial Period between 1905 and 1920. Most of Harddonechan's residents maintain their livelihood by cultivating land on the island as well as the agricultural areas between the island and the bank that are available during the dry season when the Mekong recedes. A few small stores and a noodle shop are located on Harddonechan, serving people from the bank as well as island residents. The residents are primarily middle-class by Lao standards and live in well-constructed (and usually self-constructed) wood and bamboo



Imagine this roofline on top of a 14-story hotel.



Proposed Master Plan for Harddonechan Island.

homes, often utilizing recycled materials. Many homes are accessed informally by crossing through the yards of other neighbors. A few houses on the island were constructed by the French of brick and stucco and continue to be used as the homes of Lao military officers and their families. Due to Harddonechan's location in the Mekong River between Laos and Thailand, a small military presence is necessary if a border control problem arises.

The Project

The Sun Park Hotel and Tourist Complex, currently under construction at the northern end of Harddonechan Island, will contain 246 rooms and a 1,000 seat convention center. The complex, the first five-star hotel in the Lao PDR, will host the 2004 Association of South East Asian Nations (ASEAN) Summit meeting to be held on November 29. The government has expressed a desire to modify the original design presented in the rendering on this page to one that contains elements of Lao architectural style.

The project is part of the largest real estate deal ever to take place in the Lao PDR. At a proposed 14 stories, the hotel will become the tallest building in the country.¹ The deal structure is unprecedented: a Malaysian investor is developing the hotel under a design-build contract and 100-year ground lease, the first of its kind in Laos. Prior to this project, foreign real estate development projects were on a much smaller scale and all previous ground leases were only for a 30-year period. In addition, the developer's general construction contractor, China Yunnan Construction Engineering Group Corporation, plans on bringing a labor force of 800 Chinese workers to Vientiane who will return home once the project is completed, while fewer than 200 Lao workers will be hired. Although the hotel is already behind its very tight construction schedule, the developer has the opportunity to pursue the development of the rest of the island with the Lao government if they are successful with this first project. The preliminary master plan put together by the developer would displace everyone currently living on the island for a complex with tourist-oriented shopping, embassies, gas stations, upper-income housing, and perhaps even a theme park.

¹ According to government construction rules, the maximum height permitted is seven stories. The new Sun Park Hotel will dwarf Vientiane's Lao Plaza Hotel, built in 1996, which was the country's first international-caliber hotel.

The Players and Their Motivations

Several parties have a stake in the outcome of the project including the Lao government, the Malaysian government, the developer, the Vientiane planning authorities, and the residents of Harddonechan Island. The top-level of the Lao government along with the investor hold nearly exclusive control over the project, while the Vientiane planning authorities and local residents are passively affected. Finally, it is worth considering the target market for the project, the tourists themselves.



*Vientiane Comprehensive
Land Use Plan*

The Lao government was actually the instigator of the hotel complex. Since sufficient conference facilities did not exist in Laos for the ASEAN Summit, the government sought an investor who was willing to provide the funding for and oversee the construction of the project. The schedule for the hotel is extremely tight, with only one year allotted for construction. This meant that one of the government's main priorities was to find a developer who could complete the project on time, above all else. In addition, an agreement took place between the Lao and Malaysian Prime Ministers to allow Malaysian investment in the project. In this sense, the project has support and backing at the very highest level of the Lao government. Besides providing a world-class space for the ASEAN summit, the Lao government is also seeking to provide a model of development that will attract further foreign investment.

The property is owned and developed by a company called Rancang Timur located in Negeri Sembilan, Malaysia. In Vientiane, the developer is represented as Sun Holding Company and employs a general manager and staff to serve as the owner's representative while the project is under construction. Sun Holding Company's objectives are to make money on this project and open the door for further investment in Laos. The fact that their right to develop the rest of the island rests on their successful completion of the hotel in time for the summit is clearly a major motivating factor.

Planning at the national level falls under the jurisdiction of the Ministry of Communication, Transport, Post, and Construction, while the Urban Research Institute and the Vientiane Urban Development Administration Authority (VUDAA) jointly share responsibility for Vientiane at the municipal level. The Urban Research Institute is the organization primarily



Land-locked Laos has no islands for tourists.

involved in future land use planning for Vientiane. Interestingly, one recent five-year plan designated Harddonechan Island as an area for “preservation of green space and nature”. VUDAA’s responsibilities are more administrative and include issuing building permits and managing infrastructure maintenance. I believe these organizations are truly motivated by a desire to make planning decisions that have the best interests of Vientiane’s residents in mind. However, their authority is trumped by any decision made at a higher level of government. Both the Urban Research Institute and VUDAA claimed that they were not involved in the hotel project, and indeed did not seem aware of any details concerning it.

Harddonechan Island’s 400 residents are most directly affected by the hotel complex and yet they have the least influence. The Thatkhao village chief is aware of the proposed redevelopment for the island and has informed the island’s residents. However, the time frame for development is very unclear, and the residents do not know exactly when they might have to move, where they would be sent to, or how much compensation they would receive. Continuation of their agricultural activities is a major concern for most of Harddonechan’s inhabitants. They perceive their island as a clean, healthy, and desirable place to live. The residents consider their home special and unique – a rural enclave in the middle of the city – and want nothing more than to maintain their current lifestyle.

The Sun Park Tourist Complex will be the first five-star hotel in Laos, targeting an obviously up-market clientele. Considering this, the chosen site for the hotel seems a bit strange. It is located in a Lao residential neighborhood with no other hotels or tourist-oriented restaurants or services nearby, about two kilometers from the central business district. Vientiane’s other tourist hotels are located almost exclusively in the central part of the city. I see the hotel as operating more like a gated all-inclusive resort, where guests have no need (and indeed little opportunity) to interact with the surrounding neighborhood. Is this the future of tourism in Laos or just one segment of the market? Until very recently, Laos was one of the least visited countries in the world, making it a particularly unique place to travel. Travel in Laos is inexpensive for Western tourists, making it appealing for backpackers. Since it is landlocked, Laos lacks the beaches and accompanying resorts that Thailand has. Who would choose this city resort over a beach resort in southern Thailand?

PART II: THE DEAL AND ITS IMPLEMENTATION

Decision Making

The planning process for this project was done completely at the highest government level without any public participation. The recommendations of the planning authorities at the Vientiane district level were also ignored. Sengthong Vangkeomany, leader of the national government's Housing Division that falls under the Ministry of Communication, Transport, Post, and Construction, confided that the government selected the site for the hotel despite the Urban Research Institute's opinion that Harddonechan Island should be conserved for agricultural use because of its environmentally sensitive nature. According to Vangkeomany, the planning authorities had no choice but to follow their superiors. In addition, the urgency of the project enabled the developers to avoid submitting environmental impact assessment reports prior to the start of construction.

Saykham Thammanosouth, an architect and town planner at the Urban Research Institute, suggested that the Lao people trust the government and its ability to provide for them. However, the public has little opportunity in Laos to express their concerns about planning decisions that affect them. The right to gather publicly is extremely limited, and many people expressed a fear of negative consequences from the government if they were seen as opposing the project. One group of residents asked our team to protest the development for them because they could not. Although venues for lodging complaints or asking questions about a government policy do not exist for the residents, they may express their concerns through their village chief. VUDAA also mentioned a plan to include the village chiefs in land use decisions. Perhaps this is the beginning of a more participatory system for the future.

Informational Disconnect

The inaccurate communication of information regarding the project was a constant theme I encountered throughout my interviews and discussions. There is a major informational disconnect between the developers of this project, the government, and the residents of the island. I was amazed by how little care was taken by the developer and the government to communicate information to the villagers. Our interviews with island residents demonstrated a variety of perceptions about the hotel's construction schedule and the certainty of relocation. While everyone was concerned about the project, most people continued on with their daily lives.

Above all, the largest misconception is with the actual number of residents on the island. During my interview with the Sun Holding Company's general manager, Eddie Fang, I was surprised by his low estimation of the island's population. In addition, a VUDAA vice president claimed, "The area is not inhabited because it is flooded every year. There are only temporary structures here used to cultivate the fields." Officials told us that the population of Harddonechan is between zero and ten, while the actual number is around 400. How can those responsible for the development of the project consider the needs of the residents if they do not even know who lives there?

The residents were first informed of the project just three months before construction began, in accordance with government policy. In fact, the initial filling of the site began on land that farmers had already planted for the season. The village chief is responsible for informing the residents of the government's plans and has advised them not to make any additions to or large investments in their homes. The residents of Harddonechan remain unaware of the amount of compensation they will receive and are therefore unable to effectively plan for the future.

Land Value, Tenure, and Compensation

Our meetings with officials from the Urban Research Institute and VUDAA implied a lack of clear delineation of responsibility for certain issues, including resettlement. For example, the Urban Research Institute informed us that VUDAA was responsible for all resettlement concerns, while VUDAA claimed that it was not responsible for any

resettlement or compensation issues related to the hotel construction. Despite our efforts, no government official was able (or willing?) to give us any information on the exact amount of compensation residents would receive if they were displaced.



The resettlement village near the airport.

The government's policy towards land ownership is slowly becoming more straightforward. According to Reyes, "While the Constitution provides that land is owned by the "national community", exclusive right of private parties to its use, which may be transferred or inherited, is allowed" (1997). However, the government still retains the right to take over land with very little warning. The people living on Harddonechan Island are not squatters, and according to the village chief, paid the previous landowner for the right to live and cultivate there. A resettlement village has already been established by the government near the airport that will serve several groups of displaced people living in and around Vientiane. The homesites are small and not suitable for agriculture. The government will provide a small plot of land for each household, however no assistance will be given for the construction of a new home. Several villagers expressed concerns about retaining their current ties with their neighbors in the new village.

Those Harddonechan residents with enough money are able to proactively look for a more suitable site than the resettlement village for their new home. However, the vast majority is entirely dependant on what the government will give them. One prominent Harddonechan resident, Pahkdy Phommalyvong, expressed concern for his neighbors who depend strictly on agriculture for their livelihood.

From what little information I was able to gather about the government's compensation plans, the situation looks grim. According to Vangkeomany, Sun Park Holding Company has provided the government with approximately 4,000 kip (\$0.52 USD) per square meter as resident compensation for the portion of the island already under development. The amount that will actually be distributed to the villagers is unclear. Although land values in Laos are difficult to determine since all land is technically owned by the government, VUDAA was able to give an estimate for sites in central Vientiane. The government sets a minimum value of 70,000 kip per square meter that must be used in all land use transactions. While it is reasonable to assume that land values on Harddonechan Island would not be as high as those in the central business district, the compensation estimate is still appallingly low.

What is the land worth? Values per square meter

| | Lao Kip | US Dollars |
|--|----------------|-------------------|
| Compensation provided by the developer | 4,000 | \$ 0.52 |
| Minimum land value in central Vientiane according to VUDAA | 70,000 | \$ 9.17 |

Part III: The Broader Context of Economic Development in the Lao PDR

Foreign Investment Strategies

The Lao PDR's foreign investment policy has been slowly developing since the New Economic Mechanism (NEM) was instigated as the primary reform policy in 1986 (Reyes, 1997). Since 1994, only two types of foreign investment have been allowed in Laos including joint ventures and wholly foreign-owned enterprises.² In recent years, hotels and tourism have accounted for one-fourth of total foreign investments (Saignasith, 1997). Despite the many opportunities for investment in Laos' emerging market economy, foreign involvement remains a risky business. While tax law in Laos is generally favorable for foreign investors³, new decrees changing the fiscal policy are common.

In recent years, suggestions have been made that Laos concentrate its efforts to attract the most beneficial type of foreign investment by focusing on a few key areas. Perhaps the most important requirement is the need for a clear and well-defined legal framework, with a complete policy on land ownership. "Failure to adopt and implement more laws in a satisfactory manner could undermine Laos' objective of developing a market-oriented economy and discourage large-scale

² The Sun Park Hotel would fall under the latter category.

³ "The law also guarantees that the capital and other assets of foreign investors will not be nationalized or requisitioned by administrative procedure and guarantees that profits from such investments can be repatriated" (Saignasith, 1995).

(foreign) investments requiring a more secure and transparent legal environment” (Saignasith, 1997). It is significant that this project is the first to allow the use of a 100-year ground lease, as opposed to the 30-year period typical of previous foreign investment deals. This structure gives the investor significantly more control over the project. However, investing in Laos remains an extremely risky business. As the take-over of the island illustrates, the Lao government has the power to make any decision it chooses. Clarifying the legal structure would assuage some of this risk.

In addition, the development of a financial market with a stable banking system and currency is essential to ensure that capital can remain inside the country.⁴ Finally, the investment environment in Laos would benefit from infrastructure improvements and an increase in administrative capacity. These suggestions are taken seriously even at the local level. In one of our meetings, VUDAA noted that the zoning plan, which is being financed by the United Nations Development Programme (UNDP), needs to be completed as soon as possible and must include sufficient infrastructure improvements in order to attract foreign investment.

New Priorities

According to Dessalien’s study for the UNDP, Laos’ policies to encourage outside investment under the NEM have directly affected less than 25% of the population, primarily because the Lao economy remains dependant on subsistence agriculture (Dessalien, 1991). How can the government encourage projects that provide a more far-reaching benefit to the Lao people? What considerations should the government make to determine whom the project is really helping?

As the least densely populated country in South East Asia, Laos remains a nation rich in natural resources but short on human capital. Census data indicates that in 1986, there were only 500 engineers in the entire country (Saignasith, 1997). In November 2003, Lao President Khamtay Siphandone stated, "there are two main problems in the efforts to develop our nation, the first one is capital but the most important is the lack of human resources and we do need qualified people to support the development efforts."

⁴ Although technically illegal since 1990, the use of Thai baht and U.S. dollars for domestic transactions is very widespread.

I propose a new foreign investment criterion for Laos. The government should consider both the short- and long-term benefits of a project that directly affect its residents. Whose homes will have to be moved? Will local jobs be created because of the project? Will the revenues from the project be funneled back into the Lao economy, or return with the foreign investor back into his country's economy? I believe the Sun Park Tourist Complex does not benefit the nation as much as it could. The Lao government is wasting an opportunity to incorporate and train part of its labor force through the construction of the project. The fact that the general construction contractor plans to import 800 laborers from China eliminates these skilled jobs for the Lao workforce. However, due to the tight schedule of the project, foreign workers are essential. A more realistic timeframe could have allowed for more local participation.

Conclusions

Based on my personal observations, image is a major concern to the Lao government. Perhaps there were other solutions to the lack of conference space for the ASEAN summit. Although Vientiane may lack one stylish single facility that can provide accommodation and meeting space for the attendees, a combination of options is possible. For example, the recently constructed \$7.5 million Lao International Trade Exhibition and Convention Center (Lao ITECC) in Vientiane has already served as exhibition space for the Vientiane Expo 2004 and the 2004 ASEAN Tourism Meeting. This facility is more than large enough to host the ASEAN Annual Summit. By viewing this hotel complex primarily as a short-term solution to the lack of world-class conference space, the long-term costs and benefits were overlooked. New markets offer many opportunities, but there is often a sense of urgency that can lead to hasty decisions.



The ultimate question is not whether foreign investment is good for Laos. The question is not even if the construction of an international class hotel and conference center is a good idea. Laos needs such a facility, but at what price? Time constraints lead to rash decisions. Is the construction of an ugly hotel on environmentally sensitive land that will displace hundreds of people worth it? Interestingly, the main objective of the 2004 ASEAN summit is to ratify the Vientiane Action Plan, an economic development roadmap that will outline strategies for all of ASEAN's member countries. Perhaps such a plan can begin to outline strategies for foreign investment that take in a more far-sighted view of the future.

Abbreviations

NEM: New Economic Mechanism

ASEAN: Association of South East Asian Nations

SIGUS: Special Interest Group in Urban Settlements

UNDP: United Nations Development Programme

VUDAA: Vientiane Urban Development Administration Authority

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Internet Resources:

<http://lelaos.free.fr/modules.php?name=News&file=article&sid=2319>

<http://www.asean-tourism.com/aseancountries/laos.shtml>

http://www.aseansec.org/meetings_events.htm

<http://www.cia.gov/cia/publications/factbook/geos/la.html>

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