

LEASE IN INDUSTRIAL PARKS - KEY CONSIDERATIONS TO SUB/LEASE AND RELATED CONTRACTS



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Abbreviations

CLUR: Certificate of Land Use Rights

FDI: Foreign Direct Investment

FTA: Free Trade Agreement

IP: Industrial Park

IRE: Industrial Real Estate

LUR: Land Use Rights

1. General Information about Industrial Land in Vietnam

During 2023, the industrial real estate sector remains a notable highlight in the market, exhibiting favorable absorption rates in both industrial land and pre-constructed factory spaces. The IRE market in Vietnam is closely tied to its ability to attract foreign direct investment. Despite the challenging economic conditions, a significant influx of FDI capital is being observed, resulting in increased demand for leases in industrial parks.

According to the Vietnam Association of Realtors (VARs) report, released in the beginning of 2023, Vietnam has approximately 563 planned industrial parks spread across 61 out of 63 provinces. Among these, 397 IPs have already been established, with 292 of them currently operational and 106 under construction. The top five localities with the highest number of operational industrial parks are Dong Nai, Binh Duong, Ho Chi Minh City (HCMC), Long An, and Bac Ninh.

It is projected that rental prices for IP land will experience an approximate 10% increase compared to the previous period, averaging between USD100 to 120/m²/lease cycle. This upward trend is expected to continue, particularly in the southern market, due to limited supply availability.

During the period, the average rental prices in the southern IP market saw a 4% growth year-on-year to USD172.8 /m², helping the gross growth rate of the past five years to reach 9% a year. Meanwhile, rent for industrial land in the North was up only 2.2% on-year to USD122.9 /m² in the tier-1 market's provinces. Rents in Bac Ninh and Hai Duong provinces rose the most, up 3 - 5% year-on-year, thanks to the new supplies with better rental prices than the general market, according to an industrial report from VietFirst Securities Corporation.

RENTAL PRICE IN INDUSTRIAL PARKS	
<i>*Unit: USD/m²/lease cycle</i>	
The North	90 - 120

The South	
HCMC	180 - 300
Long An	125 - 275
Binh Duong	100 - 250
Dong Nai	100 - 200

Significant transactions from tenants in the plastic, textile, and contact lens manufacturing sectors are being observed across various places, contributing to the market's overall performance. IPs and economic zones have successfully attracted over 10,000 domestic projects and nearly 11,000 FDI projects, with a combined registered investment capital exceeding USD340 billion.

According to a report by CBRE Vietnam, industrial land rental prices in both the northern and southern regions are projected to increase by 6-10% annually over the next two years. With the ongoing upward trajectory of industrial land rental prices and steady demand from the FDI sector, it is anticipated that the business activities of IRE companies will continue to recover in the near future. Particularly, businesses that possess land reserves in strategic locations, particularly in the northern region, stand to benefit from the inflow of FDI capital shifting from China.

As Vietnam continues to enhance its cooperative ties with comprehensive strategic partners such as the United States, South Korea, and China, tenants from these countries are projected to maintain their prominent role in driving supply demand within Vietnam's IRE market in the foreseeable future. In the first nine months of this year, tenants from China, Vietnam, Japan, the United States, and the European Union have actively sought industrial land and warehouses in the Vietnamese market. These countries accounted for approximately 70-80% of rental inquiries received by CBRE in the Southern and Northern regions. Cushman & Wakefield Vietnam said that the market will continue to be vibrant with about 2.5 million m2 of ready-built factories will be brought into the market between the end of 2023 and 2026. Along with the trend of ready-built factories, the field of ready-built warehouses also recorded two

new projects entering the market in Dong Nai and Binh Duong with a scale of about 110,000 m².

REGIONAL DISTRIBUTION OF INDUSTRIAL PARKS¹	
The South	
<i>Average occupancy rate of 85%</i>	
Dong Nai	National highest number of operational IPs 31 IPs – occupancy rate of 84%
Binh Duong	National largest IP total area 31 IPs – 12.721 ha - occupancy rate up to 94%
The North	
<i>Average occupancy rate of 80.6%</i>	
Bac Ninh	Northern highest number of operational IPs 15 IPs
Hai Phong	Northern largest IP total area 14 IPs and industrial clusters
Hung Yen	Largest expected land fund for industrial development

2. Development Motives of Vietnam Industrial Real Estate Market

2.1. Subjective approach

Based on evaluations, Vietnam's IPs are currently more appealing compared to their regional competitors, primarily due to the relatively lower depreciation of the local currency compared to currencies in other countries such as Malaysia, Indonesia, and India over the past 12 months.

¹*Industrial real estate firms to benefit from land fund shortage* - Ministry of Construction
<https://moc.gov.vn/en/news/76780/industrial-real-estate-firms-to-benefit-from-land-fund-shortage.aspx>

The rental prices for industrial land in Vietnam are currently 25-40% lower than those in other regional countries. Additionally, Vietnam enjoys a strategic geographical location, being in close proximity to crucial supply chains in Asia. As a result, the Vietnamese industrial market is benefiting from the advantages associated with the ongoing process of opening borders and fostering regional integration.

Vietnam is currently in a phase of industrialization and modernization, with a strong focus on developing the industrial sector. As part of this priority, the government has implemented favorable policies such as reducing tariff barriers and simplifying investment licensing procedures. These policies have proven highly effective in attracting foreign investment, making it easier for businesses to choose Vietnam as a location for their factories.

Moreover, Vietnam possesses a youthful population, low labor costs, and increasingly improved workforce. The number of young Vietnamese workers who are proficient in English, Chinese, Japanese and Korean is on the rise, thus meeting the labor requirements of companies. As a result, compared to investing in countries like Thailand and Indonesia, investing in Vietnam offers the advantage of significant personnel cost savings for companies.

2.2. Objective approach

Multinational companies are actively seeking to diversify their operations or relocate from China as a result of the US-China trade war. This situation has a significant impact on the IRE sector in the northern region of Vietnam, which is in close proximity to China and offers convenient options for factory relocation. Consequently, the IRE market in the northern region is expected to become more dynamic and vibrant than before.

Vietnam's participation in various FTAs has created numerous opportunities for the development of the IRE market. These agreements facilitate the elimination of tariffs and provide Vietnam with increased opportunities for technological and scientific exchange with developed nations. As a result, Vietnam can shift its focus from

exporting low-value goods to exporting higher-value goods, leading to a brighter outlook for the external sector.

3. Key Considerations to Sublease and Related Contracts

In general, since the beginning of the lease discussions between developers and lessees, in addition to economic respects of an IP, the parties should always pay regards to the legality and identify associated risks thereof. Legal review (or thorough due diligence) is crucial to the lease and constitute a ground to kick start with the lease and other contracts drafting process.

Solid provisions of the contracts serve as a framework for facilitating smooth and close land leasing activities in IPs between the involved parties, while also serving as a basis for addressing any future issues that may arise. Notable points of the IP sub contract and relevant documents should be considered as follows:

(i) Form

In accordance with regulations, it is mandatory for IP land lease contracts to be documented in writing. As regulated under Decree No. 02/2022/ND-CP, all IP land lease contracts must be made in accordance with the regulatory form, however, other regulations are not required to follow any regulatory form. After a long while of objection by communities in light of the compulsory form usage, Real Estate Business Law 2023 has yet to bring down the requirement, but heralds a more neutral approach².

All parties still have to wait for a concrete answer from the government until the issuance of a guiding decree, hopefully before the effective date of the law.

(ii) Parties Identification

During the drafting process, it is essential to establish a clear legal status for both parties involved in the sublease and relevant contract, namely the lessee (or sublessee)

² Article 44 and Article 45 of Real Estate Business Law 2023

and the lessor (or sublessor). This includes explicitly stating that the lessor possesses a valid legal leasing status. The lessor's status can be demonstrated by providing their enterprise registration certificate issued by the competent Department of Planning and Investment. In addition, the legitimacy of a lease of an IP can be verified through investment registration certificates, investment policy approvals, CLURs and other legal documents issued by the state.

(iii) Purpose of the Lease

The purpose of the lease must be specified under the contract(s) and such purposes must meet the permitted sectors of the IP. More often than not, the business lines of the lessees are not welcomed in the IP, but the parties failed to figure it out or intentionally left it out. As such the legal due diligence or legal review must be carried out in the first place.

(iv) Information about Land and Attached Assets

It is crucial to clearly state that the contract pertains to LUR in the specific IP. Additionally, the responsibilities of both parties in terms of paying taxes, fees, and costs related to obtaining a CLURs should be explicitly defined in accordance with the relevant legal provisions and procedures for amending the certificate if necessary. Any taxes, fees, or costs associated with this process should also be addressed in the contract.

The contract should provide comprehensive descriptions and be supplemented with detailed maps and illustrations.

Specific characteristics of the land plot	Construction-related criteria of land plot
<ul style="list-style-type: none"> • Address • Land plot Number • Area • Method of use • Purposes of use • Term of use • Origin of use • Landmarks setup • Restrictions on land use right • Facilities on and below the surface of the area 	<ul style="list-style-type: none"> • Building density • Number of stories of construction work • Maximum height of construction work

(v) Fees and Payment

The parties involved must reach an agreement on various aspects, including determining the unit rental price per square meter (m²), the total rental price, whether the rental price includes taxes or not, infrastructure and management fees, associated operational costs, utility expenses and the method of payment. The lessor has the option to pay the rent to the state either annually or for the entire duration of the lease. Consequently, the lessee will have corresponding legal rights and restrictions based on the LURs and property on land, as stipulated by regulations. It is important for the tenant to be aware of these considerations when signing the contract.

- The rights and obligations of the land lessee depend on the type of land lease contract between the state and the infrastructure investor. In the case where an IP infrastructure investor leases land and pays annual land rent, the sublessee in a sublease contract can only make annual payments. If the land lease is paid in a lump-sum, the sublessee has the option to pay the rent for the entire lease period.³

³ Article 149 of the Land Law 2013

- The rights of the sublessee are more limited if the IP investor leases land with annual payments. In this scenario, the sublessee is not permitted to transfer, contribute capital, or mortgage the rights to use the subleased land. However, they may exercise those rights in relation to the attached assets on land.

In terms of maintenance and repair costs for infrastructure, it is important to establish clear responsibilities for repairing both general and utility infrastructure based on the nature of depreciation resulting from usage. This includes costs related to water treatment, water filtration, electricity, communication lines, and other essential expenses associated with the use of IP land, such as surveying fees and registration fees.

Payment-wise, to safeguard their interests, the lessee can stipulate conditions that they will provide an advance or deposit amount, which will only be treated as the first and/or second installment once both parties have signed the land lease contract and certain issues have been addressed.

Another point at issue is the return/ refund of the rental and other utility fees paid by the lessee where either party violates its obligations before the state.

(vi) Factory Insurance

It is essential to specify the lessee's obligation or lessor's obligations (if the lease is for ready-built factory) to procure insurance coverage for the factory constructed on the leased land. The insurance policies should be maintained continuously throughout the term of the lease contract and be paid for by the responsible party. This insurance coverage should encompass all risks associated with the leased land and any assets on it, as well as operations within the IP and public liability mandated by applicable laws. The responsible party is also required to provide the other party with evidences proving the insurance premium payment or confirmation from the insurers.

(vii) Construction Categories

The involved parties must establish and mutually agree upon the extent, specifications, construction methods, as well as the responsibility to maintain and preserve the factory in satisfactory condition on the leased land.

(viii) Contract Termination

It is required to proactively anticipate and include a comprehensive list of circumstances in which contract termination is allowed or not allowed, along with a well-defined plan and legal consequences in the event of such incidents. The following three key issues should be clearly agreed upon:

Cases for Contract Termination: The contract should specify the situations where termination is permissible, including (i) force majeure events, (ii) mutual agreement between the parties, and (iii) violations of obligations by either party, such as repossession by the government, non-payment or failure to meet production and business requirements.

Consequences of Contract Termination: The contract must outline the subsequent actions that the parties must take following termination. This includes returning land, all assets, machinery, and human resources located within the IP within a specified timeframe upon contract termination or expiration; and the enforceability of the contract.

Liability for Breach of Contract: The parties should agree upon conditions for penalties in case of contract violations and provisions for compensation to safeguard the rights and interests of both parties and ensure proper adherence to the contractual agreement. Additionally, any other rights that are not in conflict with the law or social ethics and are agreed upon by the parties can be included.

The contract should determine the dispute resolution forum. It is advisable for the parties to agree in advance on the preferred methods of negotiation and mediation as the primary means of resolving disputes, followed by options such as court litigation or arbitration if needed.

(ix) Terms and Timings

Concerning the duration of contract implementation, the term of land lease, and the timing of land handover, it is crucial for the parties to reach a specific agreement on the duration of the land lease contract within the IP. This duration should align with the land use period granted by the State. Investment projects that involve constructing and operating infrastructure in IPs must seek permission from the appropriate government authority to extend the land use period, which should not exceed 70 years. Companies implementing such investments are required to pay land use fees or rent for the extended period of land use after obtaining the necessary approvals.

(x) Rights and Obligations

Sublessor/lessor	<ul style="list-style-type: none">• Demanding that the sublessee utilize the land for specific purposes in accordance with the land use master plans, land use plans, investment projects, and contractual agreements.• Requesting the sublessee to make timely rental payments as agreed upon in the contract and according to the agreed method of payment.• Asking the sublessee to cease using the land for improper purposes or activities that could result in the destruction of the land or reduce its value. If the sublessee fails to immediately cease the violation, the sublessor has the right to unilaterally terminate the contract. In such cases, the sublessor can request the return of the leased land and seek compensation for any damages incurred.• Providing comprehensive and accurate information about the LURs.
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	<ul style="list-style-type: none"> • Transferring the land to the sublessee with the agreed-upon area, location, and condition. • Fulfilling all financial obligations to the state and any third parties (such as the lessor) completely, payment of any loans, as well as compensating for any damages caused by errors on the part of the sublessor. • Conducting inspections and promptly notify and remind the sublessee, within a reasonable timeframe, about the necessary measures for protecting and preserving the land, as well as ensuring it is used appropriately and in compliance with the law.
<p>Sublessee/lessee</p>	<ul style="list-style-type: none"> • Receiving information about the leased land and its usage rights. • Utilizing the leased land according to the agreed-upon terms in the contract. • Exploiting and benefiting from the labor and investment outcomes on the leased land. • Requesting compensation for any damages caused by errors on the part of the sublessor. • Demanding that the sublessor transfers the land in the specified area, location, and condition as per the contract. <p>Additionally, when drafting the contract, particular attention should be given to the lessee's rights concerning attached-assets on the land and the ability to conduct business with third parties within the IP.</p> <ul style="list-style-type: none"> • Using the land for its intended purpose, within the designated boundaries, and for the agreed-upon lease term. • Prohibition of any acts that would cause damage or vandalism to the land.

	<ul style="list-style-type: none"> • Making full and timely rental payments as per the agreed-upon schedule and method outlined in the contract, while complying with environmental protection regulations. • Ensuring that the legitimate rights and interests of neighboring land users are not compromised. • Returning the land promptly and in the specified condition as stipulated in the contract. • Accepting liability and compensating for any damages caused by their own fault. • Adhering to other obligations agreed upon by both parties, such as compliance with environmental regulations, fire prevention measures, mandatory insurance requirements, law enforcement, and the maintenance of public order and safety within the IP. • Ensuring that the interests and legitimate rights of adjacent land users are not adversely affected.
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(xi) Property Rights

The contract should clearly outline the rights and obligations of the sublessee in relation to assets constructed and developed on the leased land, in accordance with regulations governing the use of leased land. Specifically, the sublessee is not entitled to claim compensation for:

- Cost of any construction work;
- Property on the land or any structures erected on the land.

The lessor's responsibility lies in transferring property on the land to the Lessee, such as power sources, wastewater treatment and water filtration systems, and warehouses. Furthermore, the contract should also address the responsibilities and costs associated with providing instructions for the installation, utilization, and operation of equipment and assets within the IP. These provisions need to be clearly

specified in the contract to ensure smooth operations that are adaptable and easily accessible to all parties involved.

Another point of note is security interest over the LUR and infrastructure of the IP. As such, the lessee should carefully review the lease conditions outlined in the land sublease contract, ensuring that it explicitly states that the land plot being subleased by the Lessor to the Lessee is free from any mortgages, pledges, third-party guarantees or any encumbrances.

(xii) Entry Right of the Lessor

There are lawful circumstances under which the Lessor is granted the right to access the leased land during the land lease period. This access may be necessary for activities such as arranging, installing, and maintaining utilities like water and electricity, as well as other services along pipes, culverts, ditches, watercourses, trenches, wires, cables, or any other transmission facilities within or adjacent to the leased IP. However, it is crucial to ensure that such installations do not significantly impact the business operations of the lessee and prior notices are served before expected access.

(xiii) Miscellaneous

Firstly, **concerning the sharing of benefits from the lessor as the IP developer with the lessee**, it is important to pay regard to this potential incentives for exemption from or reduction in land rental to the lessor. For example, according to Decision No. 25/2023/QĐ-TTg on land rent reduction in 2023, eligible subjects include organizations, units, enterprises, households, and individuals who directly lease land from the state based on a decision, contract, or CLURs, as well as ownership of houses and other property on land. These leases typically involve annual rental payments. Therefore, the question arises as to whether, during the negotiation of a land lease contract between a developer and the lessee, it would be advantageous to request the lessor to extend the benefit of this preferential period. It is evident that this is a crucial consideration and heavily relies on the negotiation power of the parties and the expertise of the

advisors involved in supporting them throughout the contract preparation and negotiation.

Secondly, **considering the potential consequences that may occur due to the state's reclamation of IP land**, if an enterprise leases land in an IP but fails to utilize it for business, production, or construction purposes, the state may choose to revoke the lease. Land reclamation is performed to ensure fairness, as land resources are limited, and if they are left unused and wasted, the state must reclaim them and allocate them to investors who have a genuine need for their utilization.