KEYS TO... MYANMAR

Developing and Investing in Myanmar's Hotel Industry

In the past three years, Myanmar (or Burma as it is otherwise known), has been enjoying a hotel boom, driven by surging tourist arrivals as the country opens up to economic and political reforms. Tourist arrivals to the Golden Land increased by 160%, from 790,000 in 2010 to 2.04 million in 2013. In Yangon, the limited stock of international-grade hotel rooms has resulted in huge increases in room rates and occupancy levels and international hotel chains such as Best Western, Shangri-La and Hilton are eyeing Myanmar as the next economic frontier in Asia for expansion. As with many emerging markets however, foreign investors and developers need to understand the complexities and realities of Myanmar's real estate and hotel investment arena before jumping on the bandwagon.

COMPLEXITY IN PROCESS FROM LAND ACQUISITION TO HOTEL OPENING

Cushman & Wakefield: Foreign-owned entities are not allowed to own land, condos, apartments or any type of property in Myanmar under the current law. However, they are allowed to lease land from the state or from private land owners for an initial period of 50 years plus two 10 year extensions, depending on the business, industry and the amount invested upon approval from the Myanmar Investment Commission (MIC). When we say that a property or land is foreign owned, it means that the foreign entity has been granted the right to use the land according to a Build, Operate, Transfer (BOT) agreement. In central Yangon, land plots are said to be scarce and expensive, with some reaching US$1000 psf. In its effort to increase the supply of hotel rooms, the Myanmar government is allocating purpose-built hotel zones with roads and infrastructure in areas such as Yangon, Nay Pyi Taw, Mandalay, Bago and others. It is offering land plots for investors to bid for hotel developments, but given the strong bidder interest, prices have also been high. Foreign investors have called for land price regulation and limits; however, to date the regime has yet to come up with a national land use plan and strategy. Developers looking for the greenfield route must be prepared to negotiate, wait and hold or walk away if they perceive land plot values to be unrealistic.

Foreign investors and hotel companies could also consider leasing existing old heritage buildings, particularly in Yangon, to renovate and run as hotels. Some of the 187 vacant colonial-era buildings have been put up for lease, after the government pushed occupants to move to the new capital Nay Pyi Taw. Under the leasing option, a foreign hotel company would need to pay an initial lease fee and then pay annual rent, which would be subject to government adjustments every five years. The real challenge, however, is in the restoration of these old buildings, which are very expensive, time-consuming and require a lot of expertise. Investors could also lease existing small local hotels from private owners and refurbish them to higher-star ones. Opportunities like these, however, are limited and price expectations by owners are often unrealistically high. This is notwithstanding the buyer property tax of 37%, introduced by the government in 2012 as an anti-speculative measure.

DLA Piper: In the course of leasing or acquiring land in Myanmar, investors frequently instruct lawyers to carry out a due diligence exercise on the land. It is not uncommon for foreign developers and operators to run into challenging issues that in other countries might constitute grounds for not proceeding with the proposed transaction. For example, a lease may not be properly registered or evidence of Government approvals relating to the land may be missing. The risk balance then comes into play – if a hotel company really wants to do business in Myanmar, they will often need to modify their due diligence expectations and accept extra risk, especially if the Government or a Government affiliate is an interested party.

However, this is not to say a land due diligence exercise is less necessary in Myanmar; rather, with the intensification of land disputes, it is even more essential. Decades of military rule allowed for the former junta to take ownership of land for the benefit of military-backed conglomerates and cronies, while decades of antiquated technology resulted in various government agencies issuing overlapping title deeds. The current economic and political liberalization has resulted in a willing judicial forum for the claims of those whose land rights may have been affected during these dark decades, and of those who simply want to reap the windfall from Myanmar's skyrocketing land prices. Accordingly, for any developer or operator looking to purchase, lease or operate land and buildings in Myanmar, it is strongly recommended to perform a thorough due diligence to ensure the subject land is not and could not serve as the basis for such a claim.

PROTECTING YOUR HOTEL BRAND

DLA Piper: Myanmar currently lacks legislation giving a proprietary right to a mark upon registration, so hotel owners and operators looking to protect their trademarks must primarily rely on general contract law for protection. In addition, a trademark owner is advised to register a Declaration of Ownership with respect to the trademark and thereafter publish a Cautionary Notice in a local newspaper to put third parties on notice of the trademark's use. However, this registration and publication will only establish the "use" of the trademark and will not itself create a legal or proprietary right to the trademark. Accordingly, if a third party infringes this use, the Myanmar Courts may award damages or an injunction when the relevant mark has been used by the alleged infringer in a way that would confuse or deceive a third party as to the origin of the goods. While this registration and publication will not offer the same comfort to trademark owners as is available in jurisdictions with more developed intellectual property laws, this strategy is advised until a more robust legal alternative – expected soon in the new Myanmar – is enacted.

INFRASTRUCTURE ISSUES, CULTURAL SENSITIVITIES AND FINDING THE RIGHT PARTNERSHIP

Cushman & Wakefield: Myanmar's undeveloped economic infrastructure adds to the hotel development and operational cost uncertainties and risks. Electricity is expensive and in short supply, and power outages are common. The road system is poorly developed, making it difficult and costly for overland transport of construction materials. In addition, the current state of the telecommunications network is undeveloped, adding to the high operating costs. For operations in Myanmar to run properly requires a high level of ground supervision and commitment to personnel on the ground. While the operational obstacles to investment are improving, the infrastructure situation is still challenging and investors may need to work around obstacles by sourcing viable local solutions.

DLA Piper: In addition to a relatively undeveloped economic infrastructure, foreign entities may find that a transaction has been delayed for no apparent reason or that they cannot obtain necessary approvals from the local government. Old habits die hard in a country awakening from a nearly half century of economic slumber, and it is inevitable that not all the wheels of government will be turning at the same speed. An investor would be well advised to enlist the services of a reputable local agent (there are several whom we have worked with) who can assist them with matters such as filings with the local government as a means of avoiding unnecessary delays for the various licenses required to operate a hotel.

Cushman & Wakefield: In a country where legal frameworks, planning parameters and infrastructure are still evolving, having a local partner is a recommended way forward. There is no shortage of local developers – the likes of Serge Pun & Associates, Shwe Taung Property, Htoo Group and Max Myanmar are well known – but hotel companies would need to carefully assess the background and credibility of all local partners as well as the local business culture.

LACK OF UNDERSTANDING OF MANAGEMENT CONTRACTS

DLA Piper: With such substantial interest in Myanmar, local owners of real estate frequently have a great deal of leverage in negotiating deal terms with international hotel operators. As a result, many local hotel owners will consider anything other than Myanmar law as the choice of law governing the hotel management agreement as a potential deal breaker. Given the constant revamping of the laws, hotel operators must carefully scrutinize terms in the hotel management agreement for adequate protection that complies with local law requirements. Further, because many owners may want to execute an agreement with an operator even before a local entity has been established, careful, legally compliant contract drafting may allow for the offshore entity to execute the agreement on behalf of its yet-to-be incorporated onshore entity – this may have the added benefit of substantial tax savings.

In addition to this, Myanmar's laws governing foreign-owned condominiums have followed suit behind similar laws which are already in place in other South East Asian jurisdictions such as Thailand and Cambodia. According to an official draft of Myanmar's Condominium Law, published on 10 November 2013, foreigners will be able to own apartments on the 6th floor or above of condominiums. Like neighbouring markets, this kind of development in Myanmar's foreign investment policy is likely to further facilitate the growth of the hospitality industry by whetting the appetite of foreign investment in mixed use developments and other real estate investment opportunities.

MAXIMIZING YOUR REAL ESTATE INVESTMENT

Cushman & Wakefield: Myanmar has come a long way in its banking and foreign exchange system. From the earlier 'black' economy where many services were only available in U.S. dollars and the Euro, the country now has a new, stable official exchange rate system and the local currency (kyat) is accepted everywhere. However, its banking system is still in the early stages of development, dominated mostly by small local banks with low capitalization. Starting from 2014, the authorities plan to allow more foreign banks to operate and offer more banking services but this is unlikely to bring forth many financing options for investors in the short-term. Foreign hoteliers and investors largely have to self-finance their investments and possess a strong cash backing. Repatriation of money out of the country remains controlled, and investors should protect their investments and be able to repatriate back if the need arises.

DLA Piper: The Central Bank is the administrative agency responsible for Myanmar's financial stability, including the governing of its foreign exchange market activities and managing of its foreign exchange reserves. This agency has routinely attempted to limit the outflow of the already low levels of foreign currency reserves, mainly through a requirement that it grant approval prior to any such outward remittance. As Myanmar continues to experience an economic liberalisation, a corresponding relaxation of these limitations is widely expected. Nevertheless, with no timetable given, hotel investors, developers and operators are well advised to keep updated to the existing practices that are current at the time of their remittance request. Be aware that these practices change frequently, usually as a result of the availability of foreign currency and Government policy changes.

YANGON: THE TIDE OF FORTUNE AND A BUBBLE IN THE MAKING?

Cushman & Wakefield: Nowhere is the real estate and hotel boom in Myanmar as pronounced as Yangon, which is the country's main business hub and has seen an influx of MNCs, NGOs and foreign capital. Yangon has seen accommodation occupancy jump from below 40% prior to 2009 to levels between 85% and 100% in 2013.
With too few international-grade hotels rooms (estimated at merely 2,100) and office buildings around, the price of real estate and accommodation space has soared to extraordinary levels. Yangon's international-grade hotels that used to charge US$60-US$80 a night are selling for at least US$250-US$300, while commercial space rents are now US$75-US$90 psm a month. The lack of proper commercial space has led to foreign companies leasing hotel rooms as offices in the city.

Between 2014 and 2017, Yangon could see its accommodation inventory of 10,300 units (including serviced residences) grow by 110% as many hotels are rushed to be built, including international brands like Novotel, Pan Pacific, Hilton and Shangri-La. Will these large pipelines lead to falls in the room rates? On the positive side, authorities are forecasting international visitor arrivals to grow from 2 million last year to 7.5 million in 2020 amidst the continuing reforms. However, there are concerns that the overpriced, lower level of accommodation quality could turn away the non-business traveler. Our prognosis is that the real estate and hotel shortage in Yangon could continue for the next five years, and a leveling off in growth could happen after 2018. However, the international-grade hotel segment would still see high room rates and occupancy, driven by business travelers.

Myanmar's real estate story is sometimes feared to turn into another Vietnam "bubble-bust" scenario, but the differences are significant. Vietnam's construction was funded by low-rate bank loans, but Myanmar's real estate is largely cash-backed. Unlike Vietnam's largely domestic-driven economy, Myanmar's huge wealth of natural resources and its strategic Indochina location all make for a compelling export story. The real risks to the investor remain largely political and reputational. Issues such as ethnic and religious violence and persecution, widespread cronyism and the future role of its military junta regime could pose a threat to stability and run the risk of an investor being associated with an oppressive regime. The Golden Land holds much promise as South East Asia's frontier story, but hotel investors will have to assess their risks and costs before entering.

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