

Legal Updates & News

Legal Updates

China Update: Chinese Real Estate

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China's New Property Right Law

The PRC Property Right Law ("Property Law") was promulgated and approved by the National People's Congress ("NPC") on March 16, 2007 and will become effective from October 1, 2007. The Property Law, which covers a wide range of matters affecting both personal and real property, is one of the most important pieces of legislation to be promulgated in the People's Republic of China ("PRC") in recent years. Work on the Property Law started in 1993 and previous drafts underwent a record number of readings by the Standing Committee of the NPC.

The Property Law expands existing provisions regarding property rights and is a major milestone in the development of a more systematic regime for protection of property rights. It, like the PRC Contract Law, promulgated in 1999, is a core constituent part of China's civil law and it confers, for the first time, equal protection for property rights of the state, collectives and individuals.

Below are some of the more significant provisions of the Property Law affecting real estate in China.

Equal Protection for Private Property; Strengthening the Protection of State-Owned Property

Protection of Private Property Rights: The Property Law for the first time places private property rights on the same footing as state and collective property rights in enjoying legal protection. Private real property may only be expropriated for "public interest" and compensation must be given in accordance with laws. There is, however, no clarification on what amounts to public interest or how compensation will be computed. Official commentaries on the Property Law note that in practice, due compensation for expropriation has often not been paid or not been paid in full. It is anticipated that the Property Law will serve as the basis for tightening expropriation procedures and increasing compensation paid. In some cases this will have the effect of increasing the land price a developer pays when it acquires State-owned land use rights in connection with a development project.

Strengthening Protection of State-Owned Property: The Property Law specifies that certain types

of property -- such as urban land and public infrastructure including railroads and public roads -- are owned exclusively by the State and may not be in private hands. It also provides that the State Council exercises ownership of State-owned property on behalf of the State except where otherwise provided by law.

These provisions serve to reaffirm certain key aspects of the Chinese economy, most notably in relation to the real estate sector that urban land is State-owned and that only land use rights but not private ownership is available to developers and other private users.

Real Property Registration

Uniform Real Property Registration System: The Property Law contemplates that China's real property registration system will be unified nationwide and property right holders and interested parties may apply to retrieve the information filed with the registry. Currently, information on land use rights, building ownership and mortgage rights may be separately filed with different local real estate or construction administration authorities. That information is usually not accessible except with the registrant's written consent. The new law therefore ought to facilitate searches on title and related property rights. However, it remains unclear whether any person will be entitled to search the registry or whether applicants must establish some relationship to the property at issue. Implementation of these provisions of the Property Law will need to be monitored closely.

Effect of Real Property Registration: The Property Law provides that a contract relating to real property rights is binding upon conclusion of such contract, unless otherwise provided by law or contract.

At the same time, it states that the creation, alteration and extinguishment of real property rights are "effective" upon registration. Registration of an interest in real property therefore is necessary in order for the interest to be protected against third party claims against the property. The Property Law stipulates that the registration record maintained by the relevant registration authority will be evidence of ownership and other relevant property rights.

It is unclear how far PRC courts will be prepared to look behind the "veil" of registration under the new regime, although the Property Law does provide that if the property right ownership certificate issued to the relevant owner and the real property registration record are inconsistent, the latter will prevail unless the contrary is proven. Furthermore, the new law provides for the first time that the registration authority is liable for losses caused to holders of property rights if it has entered the title registration incorrectly.

A unified property registration system, if implemented properly, should considerably enhance certainty in real estate transactions although implementation throughout the country can be expected to take some time.

Scope of Pre-registration System Expanded: The Property Law has expanded the scope of China's real property pre-registration system. The Property Law provides that parties who enter into a contract for the sale and purchase of real property or other forms of immovable property may, for the purpose of protecting the establishment of relevant property rights, apply for pre-registration with the registration authority. After pre-registration has been completed for a particular property, the registered owner of the property may not sell the property to a third party without consent from the party whose interest in the property has been registered. Note that pre-registration under the Property Law becomes ineffective if the underlying property right is extinguished or a registration application is not made within three months following the pre-registration.

In contrast under current rules, pre-registration is principally available only in connection with sales by a developer of residential property where the developer has obtained a pre-sale permit.

In principle, the pre-registration system under the new law will help protect the interests of buyers of real property during the interim period between contract signing and formal registration of the transfer of property rights.

Exclusive Ownership and Joint Ownership

Significantly, the Property Law clarifies the ownership rights of individual owners in a building. Specifically, an owner of a unit in a building enjoys (i) exclusive ownership over its own unit, and (ii)

joint ownership and right of management along with other owners over the common areas and facilities. Before promulgation of the Property Law, ownership of common areas and facilities in residential and commercial buildings was largely regulated by municipal level regulations, if any, which led to developers to often remain the *de facto* owner.

Easements and Rights of Access

Before promulgation of the Property Law, there were no specific statutory provisions expressly providing for easements over real property. The closest equivalent under prior law are certain provisions and court pronouncements regarding adjacent owners' relations and access rights and easement rights that were contractually created did not generally run with land.

The Property Law recognizes an easement as a registrable right of use of the immovable property of another party. An easement is created by written contract between the parties, but is enforceable against third parties only upon registration. Once registered, an easement will generally be binding on the transferee upon the transfer of the land use rights, unless terminated by the owner/user of the land under specific circumstances.

The Property Law also clarifies the scope of "access rights" an owner or user of immovable property has to the property of a neighbor. Specifically if an owner or user of real property requires access to adjacent land or structures for construction or repair of buildings or laying of electrical lines, cables, water pipes, heating and gas pipes, then the adjacent owner must grant the necessary access, subject to compensation for any damage caused by such work. Whether such an access right is recognized will depend on the principles of "facilitating production, convenience, unity and cooperation, fairness and reasonableness," and laws, regulations and local customs will be respected when determining such a right.

Extension/Expiration of Land Use Rights

Grants of use rights in respect of urban land were first made in the 1980s, with applicable use terms of between 40 and 70 years and an open issue has been what would happen to the land and building on the land when the term of use rights expired.

For the first time, the Property Law states that the land use rights to land for residential purposes will be extended automatically upon expiration of its term. The new law leaves unstated what fee, if any, is payable for the extension of land use rights.

No similar provision applies to the commercial or industrial land use rights. The Property Law simply states that ownership of buildings and other related real property rights upon the expiration of the relevant land use rights may be determined by contract.

Mortgage Rights

The Property Law updates existing legislation governing security interests, including mortgage interests in immovable property. In particular, the Property Law permits buildings under construction to be mortgaged, with such mortgage taking effect from the date of registration of the mortgage. The Property Law also provides that the mortgage of construction land does not automatically extend to newly constructed properties on the mortgaged land. These aforementioned provisions serve to clarify and confirm the current judicial practice in these areas.

Shanghai's New Bidding Rules for Land Use Rights

On April 27, 2007, the Shanghai Housing, Land & Resources Administration Bureau (the "SHLRA") published the *No. 1 State-owned Land Use Right Bidding Announcement* (the "2007 No. 1 Announcement"), which further relaxes the restrictions imposed on a foreign investor's ability to bid for land use rights in Shanghai. Pursuant to the 2007 No. 1 Announcement, successful bidders of land use rights now have a choice of paying the land premium deposit either in Renminbi or in 4 other currencies, namely the US dollar, the HK dollar, the Euro and the Japanese yen.

Prior to the promulgation of the *Opinions on Regulating the Entry into and the Administration of Foreign Investment in the Real Estate Market* ("Opinion 171") on July 11, 2006, foreign investors had been allowed to bid for land use rights in Shanghai without having to incorporate a PRC

subsidiary. Thereafter, in response to the restrictions imposed on foreign investment in the real estate market set out in Opinion 171, the SHLRA amended its bidding rules in the *No. 1 State-owned Land Use Right Bidding Announcement* of 2006 published on August 17, 2006 (“2006 No. 1 Announcement”) which prohibited foreign investors who had yet to obtain the approval certificates and business licenses for their PRC subsidiaries, from bidding for land use rights. Pursuant to the 2006 No. 1 Announcement, a foreign investor had to establish a PRC subsidiary and contribute at least half of the project costs as registered capital to the PRC subsidiary before it could bid for, and acquire land use rights. This effectively increased the barriers to entry for many foreign investors looking to invest in the Shanghai property market as it made the implementation of such an investment structure financially unfeasible.

The SHLRA subsequently relaxed its bidding rules on October 23, 2006 with the publication of the *No. 2 State-owned Land Use Right Bidding Announcement* (“2006 No. 2 Announcement”) which re-allowed foreign investors to bid for land use rights without having to set up a PRC subsidiary, but which stipulated that any such land premium deposit had to be paid in Renminbi. Both the aforementioned eligibility requirement and currency limitations were repeated in the subsequent bidding announcements of 2006 in Shanghai. Though technically eligible to bid for land use rights pursuant to the 2006 No. 2 Announcement, in reality, most foreign investors were still constrained by the Renminbi currency limitations.

The new 2007 No. 1 Announcement effectively removes these restrictions on a foreign investor’s ability to bid for land, and gives a foreign investor enhanced flexibility in structuring its investment in the Shanghai real estate market. However, it is worth noting that the 2007 No. 1 Announcement is limited in its scope to Shanghai, and in particular, to the land parcels listed in the 2007 No. 1 Announcement. Eligibility requirements may and do vary in other provinces and cities. For example, only domestic PRC companies holding real estate development qualifications are allowed to bid for land use rights in Beijing. Furthermore, this new eligibility requirement in the 2007 No. 1 Announcement pertains only to land bidding activities. Upon the conclusion of a successful bid, foreign investors are still required to set up PRC subsidiaries to acquire the land, to pay the land premium (less the land premium deposit) and to develop the project in accordance with Opinion 171 and other applicable PRC laws and regulations.