

---

## Legal Updates & News

### Legal Updates

---

#### Further Changes in China's Real Estate Regulations

February 2008



PDF Version

#### Related Practices:

- [Real Estate](#)

The recently-enacted *Property Rights Law* went into effect on October 1, 2007. To ensure its smooth implementation, the Chinese government has amended existing laws and regulations that are inconsistent with its requirements. In this update, we summarize these developments and highlight their significance for foreign investors evaluating an investment in PRC real estate.

*In this issue:*

- [Urban Real Estate Law](#)
- [Property Management Regulations](#)
- [Premises Registration Measures](#)
- [Circular on Further Reinforcing Treatment of Unused Land](#)
- [Amended Construction Land Grant Provisions](#)
- [Real Estate Lending Circular](#)
- [Amendments to Catalogue for Guidance of Foreign Investment in Industry](#)

---

#### Urban Real Estate Law

Article 42 of the Property Rights Law allows for the expropriation of private property in the public interest in accordance with the authorization, and following procedures “provided by law.” The *Regulations for Administration of the Removal of Urban Houses* (城市房屋拆迁管理条例), enacted by the State Council in 2001, previously governed expropriation, but these were made unenforceable upon implementation of the Property Rights Law. Accordingly, there are currently no laws detailing what authority is required and what procedures are to be followed for the expropriation of private property.

To remedy this, on August 30, 2007, the Standing Committee of the National People’s Congress amended the *Law on the Administration of Urban Real Estate* (城市房地产管理法) (“Urban Real Estate Law”) in order to authorize the State Council to promulgate detailed rules concerning expropriations. The amendment also states that the owners of expropriated real estate are entitled to compensation. Where the expropriated real estate is a residence, the amendment guarantees the “residential conditions” of the displaced owners following resettlement. The precise scope of the guaranteed “residential conditions” is unclear.<sup>[1]</sup> The State Council will likely clarify the issue when promulgating the related implementing rules.

Until the implementing rules are implemented, it is difficult to predict what the specific expropriation regime will look like. One likely change over existing rules is an increase in relocation costs that will need to be borne by developers.

---

## Property Management Regulations

The State Council amended the *Regulations on Real Property Management* (物业管理条例) (“Property Management Regulations”) on August 26, 2007, with such amendments taking effect on October 1, 2007. As the name suggests, the Property Management Regulations govern the relationship between property owners, developers, and managers within real estate developments. The new Property Management Regulations expand the rights of owners within those developments in several ways:

First, property owners are given final say on renovation and reconstruction decisions (including parking areas, elevators, storage rooms, and pipes). Previously, developers and property managers had the right to make most of these decisions.

Second, property owners are given more authority concerning owners’ voting rights. Previously owners’ voting rights for the initial owners’ meeting were decided by the local government, by taking into account the construction area, the number of units, and other factors. Pursuant to the new Property Management Regulations, owners themselves determine the distribution of voting rights.

Third, the amendments change the quorum requirements for owners’ meetings. Previously, (i) quorum for an owners’ meeting required the presence of owners who collectively held a majority of the entire voting rights, and (ii) decisions at owners’ meeting were adopted by the affirmative vote of owners representing either a majority or two-thirds of the voting rights, depending on the nature of the matter. Now (x) quorum for an owners’ meeting requires the presence of owners who collectively occupy a majority of the total construction area, and (y) decisions will be adopted only upon the affirmative vote of either a majority or two-thirds of the owners occupying a majority or two-thirds of the total construction area of the entire property, respectively, depending on the nature of the matter.

Fourth, the new Property Management Regulations state that owners are bound by the decisions passed at owners meetings and by owners’ committees. However, should the decision at an owners’ meeting or by an owners’ committee infringe upon an owner’s legal rights, the new Property Management Regulations grant such affected owner recourse through the courts to apply for the rescission of the decision.

---

## Premises Registration Measures

On July 26, 2007, the Ministry of Construction released and solicited public comments on a preliminary draft of the *Measures on Premises Registration* (房屋登记办法) (“Premises Registration Measures”). [2] The Premises Registration Measures the categories of buildings and structures that qualify for real estate title registration. Registration is now permitted so long as the type of building or structure may be used independently and is identifiable. Structures that can be registered include houses, wharves, oil depots, railways, tunnels, bridges, and garages. This expansion will help to protect owner property rights, and will facilitate an owner’s ability to use the real estate asset to obtain financing by title mortgage.

The Premises Registration Measures also allow for the registration of premises that are sold before construction is completed. This is a significant change from the current practice, which allows unscrupulous developers to sell premises prior to completion to multiple purchasers, with the rights of the first purchaser unprotected against subsequent purchasers. The proposed Premises Registration Measures would permit the purchaser of premises under construction to apply for a preliminary announcement of registration of the premises without the cooperation of the developer. Once a preliminary announcement of registration has been made, no further registration for disposition of such property may be made without the original purchaser’s consent. Upon completion of construction, the owner can then apply for an ownership certificate.

---

## Circular on Further Reinforcing Treatment of Unused Land

On September 13, 2007, the Ministry of Land and Resources (“MOLAR”) promulgated the *Circular on Reinforcing Disposition of Unused Land* (关于加大闲置土地处置力度的通知) (“MOLAR Circular”). The MOLAR Circular should help strengthen the enforcement of land laws, particularly those concerning unused construction land and payment of land grant fees.

The MOLAR Circular urges all levels of land authorities to speed up the disposition of unused construction land and to provide status reports on such land to MOLAR before the end of June 2008. It also provides that owners of unused construction land will be charged a fee equal to 20% of the land grant/allocation fee for their land. Finally, the MOLAR Circular emphasizes the enforcement of the current law, [3] which states that land designated for construction that has been unused for more than two years from the construction commencement date stated in the land grant contract will be forfeited without compensation. [4]

Prior to the promulgation of the MOLAR Circular, other national and local rules regulated land vacancy, but these rules were unclear and rarely enforced. The MOLAR Circular is expected to change that. For example, the MOLAR Circular provides specific implementation rules for the *Notice of the Office of the State Council on Adjusting the Residential Housing Supply Structure and Stabilizing the Residential Housing Price* (国务院办公厅关于调整住房供应结构稳定住房价格意见的通知) (“Notice 37”). Article II (7) of Notice 37 contains a provision on the disposition of unused land similar to that found in the MOLAR Circular. However, Notice 37 only pertains to residential real estate, while the MOLAR Circular appears to cover all types of real estate development. It is expected that the clarification and implementation provisions found in the MOLAR Circular will result in more vigorous enforcement of laws concerning unused land.

Investors in real estate development companies in China need to be aware of these regulations, since unused land in a developer’s land bank may be vulnerable to confiscation, depending on the circumstances.

Concerning payment of land grant fees, the MOLAR Circular reiterated that a land use right certificate may not be issued prior to the full payment of these fees. The issuance of land use right certificates in separate phases according to the percentage of paid-in land grant fees is also prohibited (i.e., the issuance of a land use right certificate covering 50% of the granted land for payment of 50% of the total land grant fees).

It should be noted that the MOLAR Circular does not materially change existing law. It does, however, emphasize existing rules and urges land authorities to enforce them. It is unclear at this point how strictly the MOLAR Circular will be implemented, but what is evident, is that MOLAR is concerned about current common practices and is attempting to bring about reform.

---

## Amended Construction Land Grant Provisions

On September 28, 2007, MOLAR amended the *Provisions on Grant of Land Use Right to State Owned Construction Land Through Tendering, Auction and Competitive Bidding* (招标投标挂牌出让国有建设用地使用权规定) (“Amended Construction Land Grant Provisions”). Key amendments include the following:

First, while the grant of land use rights previously conveyed surface rights only, the Amended Construction Land Grant Provisions specify that the land use rights holder also has air and subsurface rights. This change was made to conform to Article 136 of the Property Rights Law, which provides for the first time for air and subsurface real property rights.

Second, industrial land—including land used for warehouses, but excluding land used for mining—will now be granted only through tendering, auction, or competitive bidding. This amendment in effect incorporates existing policy on granting industrial land promulgated September 2006, which has already made completion of industrial land acquisitions more difficult.

Third, foreign individuals and entities are now specifically allowed to bid for land use rights. However, this provision does not prevent the practice of some local authorities of imposing conditions on the eligibility of foreign investors, such as having a certain level of onshore existence (for example, a foreign-invested real estate development enterprise in the PRC).

Fourth, bid invitations for the grant of industrial land shall not include restrictive conditions that affect the fairness and impartiality of the bidding process. This provision will likely restrict practices like directed tendering (定向招标), whereby local authorities set a specific eligibility threshold which effectively only allows pre-selected parties to participate in the bidding process.

Fifth, land use right certificates may no longer be issued prior to the full payment of land grant fees. MOLAR later clarified that this provision is not intended to prohibit payment of land grant fees by installment, but rather to prohibit the issuance of a land use certificate before payment of the last installment.

---

### Real Estate Lending Circular

As part of China's concerted efforts to cool down its real estate market, on September 27, 2007, the People's Bank of China and the China Banking Regulatory Commission jointly released the *Circular on Strengthening the Administration of Commercial Real Estate Lending* (关于加强商业性房地产信贷管理的通知) ("Real Estate Lending Circular"). It purports to restrain soaring real estate prices, and to prevent a significant increase in real estate lending risks by tightening real estate lending practices. The Real Estate Lending Circular is also intended to provide practical measures to effectively carry out the intent of Notice 37.

The Real Estate Lending Circular increases minimum down payments by differing percentages according to the type of real estate involved and continues the policy of using different rates for residential properties and commercial properties. The minimum down-payment for an individual purchasing his first home remains unchanged at 20% for a home smaller than 90 square meters, and 30% for a home larger than 90 square meters. The down-payment for an individual purchasing his second home (if his first home was financed by bank loans) has been raised to 40%, regardless of the size of the home. The minimum down-payment for commercial properties has been increased from 40% to 50%.

The circular also provides that mortgage rates for both second homes and commercial properties must not be less than 1.1 times the benchmark rates (previously, such rates were only required to be equal to the benchmark rates). The Real Estate Lending Circular also sets out the principle that mortgage rates and down-payments for individuals financing subsequent homes must be significantly higher than for loans and down-payments for primary residences. The Real Estate Lending Circular authorizes each bank to determine its requirements and risk management policies accordingly.

The provisions discussed above apply to loans in respect of residential and commercial real estate and ought not to similarly restrict lending in respect of industrial real estate. The Real Estate Lending Circular also includes provisions applicable to real estate loans generally, including a prohibition on loans to developers that are found to be hoarding land without completing related construction (see MOLAR Circular above) or whose equity to debt ratio is lower than 54%. Similarly, loans are prohibited for real estate projects without any of the following: (a) a land use right certificate, (b) a construction land planning permit, (c) a construction project planning permit, and (d) a construction commencement permit. Banks are also prohibited from accepting "commodity houses" that have been vacant for more than 3 years as collateral for bank loans.

We note further that recent media reports suggest that regulators are proposing additional restrictive measures governing real estate loans, including a further 10% increase in interest rates.

---

### Amendments to Catalogue for Guidance of Foreign Investment in Industry

On October 31, 2007, the National Development and Reform Commission (“NDRC”) and the Ministry of Commerce (“MOFCOM”) jointly amended the *Catalogue for Guidance of Foreign Investment in Industry* (外商投资产业指导目录) (the “Foreign Investment Catalogue” or “Catalogue”). The amendments to the Catalogue introduce further restrictions on foreign investment in the real estate sector.

The Chinese government issued the first version of the Foreign Investment Catalogue in 1995. Since then, the Foreign Investment Catalogue has been revised several times, with most significant revisions taking place in 2002 and 2004. The version of the Catalogue previously in effect was promulgated on November 30, 2004 (“2004 Catalogue”). The 2007 Catalogue came into effect on December 1, 2007.

The Foreign Investment Catalogue classifies industries into a number of categories. “Encouraged,” “restricted,” and “prohibited” industries are expressly enumerated in the Catalogue. Industries which are not specified in the Catalogue fall by default under the “permitted” category. Examples of changes in the 2007 Catalogue relevant to the real estate sector include the following:

- construction and development of ordinary residential houses have been removed from the “encouraged” category (meaning they are now in the “permitted” category).
- secondary market real estate transactions, real estate intermediaries, or agent companies have been added to the “restricted” category.
- construction and operation of large scale theme parks have been removed from the “restricted” category (likewise, meaning they are now in the “permitted” category).

Other designations have not changed. Accordingly, “development of large tracts of land” remains in the “restricted” category and requires foreign investors to set up a joint venture with a local partner. “Construction and operation of high-class hotels, villa, high grade office buildings and international conference centers” likewise remain in the “restricted” category.

If particular projects fall under the “encouraged,” “permitted,” or “restricted” category, foreign investors can invest in those projects as long as the appropriate level of government approval can be obtained and applicable restrictions on foreign ownership are complied with. It goes without saying that foreign investment is not allowed for projects under the “prohibited” category.

Investing in a project categorized as “encouraged” for foreign investment has a number of implications. For example, provincial as opposed to central authorities have greater authority over the project. In addition, certain tax benefits may be available, depending on the circumstances. Conversely, categorization of a project as “restricted” for foreign investment does not, at least in principle, mean the project is off-limits to foreign investment. It does, however, mean that the project may be subject to heightened regulatory scrutiny.

Examples of the approval authority of different levels of government over different categories of projects include the following:

- Approval of provincial or equivalent authorities is generally sufficient for projects in the “encouraged” or “permitted” categories if total investment is less than US\$100 million. For “restricted” category projects, provincial approval is sufficient only if the total investment is less than US\$50 million. Projects over these amounts must be approved by MOFCOM and NDRC.
- Provincial authorities may often delegate their approval authority to municipal or other lower level government authorities. However, provincial authority to approve a “restricted” category project may not be delegated.
- State Council approval is required for projects in the “restricted industry” if total investment exceeds US\$100 million, but is generally required for projects in the “encouraged industry” or “permitted industry” only if total investment exceeds US\$500 million.

---

#### Footnotes:

[1] Note that, in addition to compensating families for relocation, a few municipal governments have promulgated rules that require developers to purchase houses for relocated families near their previous location.

**[2]** The official solicitation period ended on August 16, 2007. However, until its promulgation, the Ministry of Construction will continue to accept comments and there may be another solicitation period if a revised draft is released.

**[3]** Specifically, the Measures on the Disposition of Unused Land(闲置土地处置办法) issued by MOLAR in April 1999.

**[4]** The Measures on the Disposition of Unused Land define unused construction land as (i) land designated for construction but whose owners have yet to commence construction within the prescribed date, or within one year after the effectiveness of the appropriate land grant contract or the issuance of the land construction permit; (ii) land designated for construction and on which construction has commenced, but where the area under construction is less than one-third of the total area to be developed, and where construction has been suspended for over one year; or (iii) land designated for construction where the actual investment made is less than 25% of the total planned investment and where construction has been suspended for over one year.